GATT and GATS Approaches to Trade in Goods and Services

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Abstract

The economics of international trade agreements enjoys an established literature which has illuminated many features of trade agreements from real-world scenarios. However, most of the insight has been developed in the context of international trade in goods until recently. The importance of trade in services has increased in recent years as a response to the historical unimportance it has received. Consequently, researchers and practitioners have started addressing the literature gap in trade-in-service agreements at the international level. The purpose of this assignment is to catalogue the differences between the goods trade and trade in services at the international level in the context of the trade agreements provided by the World Trade Organization.

The terms-of-trade theory has been incorporated in this research work as an attempt to find answers with the purpose of filling the research gap while spreading the normative message that the shallow-integration technique of the General Agreement on Tariffs and Trade can be aligned with the General Agreement on Trade in Services if the data is present. There is an increasing call for data on trade-in services. The efforts to develop and collect such data by the World Trade Organization and other agencies are underway. Successful efforts in this regard will provide valuable input in the process of deep integration into the current structure of the General Agreement of Trade in Services.

Introduction

The World Trade Organization is a global international organization that deals with the rules of trade between nations. Thus, it operates a system of trade rules. At large, the organization is aimed at facilitating the importers, exporters, and producers of goods and services to conduct their businesses at the international level. Overall, it opens trade for the benefit of all. The organization provides governments with a forum for the negotiation of trade agreements and gives them the place to address the conflicts arising between them during the process of trading goods and services. Thus, it is the platform for them to address any problems arising between them over the international trade agreements. The organization is run by its member states. The membership makes all decisions as a whole, either through the ministers, their delegates, or ambassadors. As a matter of fact, the agreements of the World Trade Organization are complex and lengthy because they include legal

texts that cover a collection of various areas relevant to the subject matter. However, the documents are made under a number of simple, fundamental principles that form the foundation of the multilateral trading system.

The terms-of-trade theory has been incorporated into this research work as an attempt to find answers to the research gap. It is a theory that accounts for several features of the General Agreement on Tariffs and Trade (Bagwell & Staiger). This theory is motivated by salient features of service trade, augmented with a set of restrictions on the trade data and policy instruments available to the governments. The General Agreement on Tariffs and Trade is the central World Trade Organization agreement that covers goods trade. On the other hand, the General Agreement on Trade in Services is the central agreement that covers trade in services. As the agreements are operated by the global organization, they work at the international level. Despite the fact that both of the agreements result in a contract of sale, they operate strikingly differently from each other at various levels. The General Agreement on Tariffs and Trade has been successful in liberalizing the trade of goods among its members. The General Agreement on Trade in Services, on the other hand, has been unsuccessful in achieving its target in this regard (Francois and Hoekman). Thus, there is a difference in the level of success achieved by each type of international agreement.

The purpose of this assignment is to catalogue the differences between the goods trade and trade in services at the international level in the context of the trade agreements provided by the World Trade Organization. The categories include structural differences, differences in basic approaches, different types of integration, different types of challenges, and the application of international agreements and the terms-of-trade theory. The terms-of-trade theory has been incorporated in this research work as an attempt to find answers with the purpose of filling the research gap while spreading the normative message that the shallow-integration technique of the General Agreement on Tariffs and Trade can be aligned with the General Agreement on Trade in Services.

Structural Differences

The first General Agreement on Tariffs and Trade was negotiated in 1947. Its disciplines were elaborated by several subsequent treaties within the system of the World Trade Organization. The agreement itself was further refined, and its commitments were deepened by numerous subsequent negotiating rounds. The General Agreement of Trade in Services, on the other hand, is a result of more recent developments. It dates back to 1994. Thus, its disciplines are much more elaborate and complete than those of the agreement of goods trade and the ones in the service sectors. Nevertheless, the legal structure of the agreement of trade of services is much more dramatic than that of the agreement of goods trade. It also contains the most modern disciplines of the World Trade Organization as well.

Moreover, the General Agreement on Tariffs and Trade came as a response to the high tariff policies of post-World War II. They followed the Smoot-Hawley Tariff Act of 1930 in the United States and

emerged globally. A product-to-product basis pursuant to the General Agreement on Tariffs and Trade Article II was adopted to negotiate the tariff ceiling or bindings. Under this, the member countries are under no pressure to reduce their tariff rates, nor are the tariffs prohibited. Moreover, the member countries are given the freedom to choose the strategy of reciprocal tariff reductions with the purpose of opening their markets. Concurrently, the substitution of other forms of alternatives is prevented by the General Agreement on Tariffs and Trade.

However, there are prohibitions on quantitative restrictions, regulations discriminating against imported goods, and domestic taxation. The discrimination is targeted by the 'most favourite nation' obligation of the international agreement. The final factor creating incompleteness of the international agreement concerning goods trade was recognized by the inclusion of the provision allowing member countries to seek redress if the domestic policy has been changed in some way by the importing government. Although it is not particularly prohibited by the General Agreement on Tariffs and Trade, it curtails the trade. It upsets the expectation associated with tariff commitments in the context of reasonable market access. It is a non-violent doctrine.

The General Agreement of Trade in Services, on the other hand, maintains a profoundly different structure. It defines four modes of trade. Firstly, there is Mode 1 trade, which includes a cross-border transaction of a service by the exporting countries to the consumers in the importing countries. For instance, a Swiss national buys an insurance policy from an American and receives the insurance policy by wire transfer or mail. These cross-border transactions are the closest replicas of traditional trade-in services. However, there is a difference between the two, i.e., the transactions often remain unobserved by the importing government due to the fact that they do not come to the attention of the customs inspectors and do not pass through port facilities. Therefore, Mode 1 trade transactions are not taxed or regulated otherwise.

Mode 2 trade in services includes the consumption of a service by a national of another importing country residing or living in the exporting country. For example, a tourist in France gets a haircut. Mode 2 trades are also not taxed or regulated by the governments. Therefore, both of the first two modes of trade in services are de facto free trade. They are not much affected by the General Agreement of Trade in Services. There are no formal commitments on these two modes by the governments either, and if there are, they are no more than just promises not to interfere with such trade transactions. Therefore, the free trade policy is preserved, which had been practised for the most part before the General Agreement of Trade in Services.

Mode 3 trade-in services includes the establishment of a commercial presence by a foreign service provider in the importing nation. For instance, a domestic branch is opened by a foreign law firm or bank. The importing governments are in charge of these situations. They can largely regulate services or restrict trade, especially in the scenario of foreign businesses or organizations establishing domestic offices. Such restrictions are commonplace. Mode 4 trade includes employment of foreign nationals in the domestic offices of foreign businesses after the establishment of a commercial presence in the importing nations. For example, foreign law firms or banks not only open local

branches in the importing country but also hire nationals from their home countries. The importing countries regulate these transactions extensively because they touch immigration policy.

Differences In Basic Approaches

The basic approach of the General Agreement on Tariffs and Trade is termed tariffication. It reduces tariffs and precludes using other policy instruments for protectionist objectives. In doing so, tariffication channels all remaining trade protection into tariffs published and imposed at the borders. Thus, the protection becomes more transparent. Eventually, the number of instruments in play is reduced, reducing the cost of trade negotiations (Bagwell and Sykes, 2004). They also minimize the deadweight cost of production (Schwartz and Sykes, 1996).

It may also be termed as shallow integration, which indicates detailed product-by-product negotiations on tariff – the single border instrument. It also means that the integration is limited in its scope and does not expand beyond the border transactions and measures such as domestic regulations and taxation, which are subject to cross-border rules. These rules are applied in all goods markets. Also, these rules are applied without differentiating the goods subject to tariff binding from the ones that are not. There are several additional treaty instruments, such as problems concerning technical or regulatory barriers to trade, the use of government subsidies, and countervailing duties and antidumping practices, that have evolved the obligations of the goods market.

Nevertheless, shallow integration remains at the heart of the general approach of the General Agreement on Tariffs and Trade in the goods market. For instance, the Agreement on Sanitary and Phytosanitary Measures by the World Trade Organization requires that the measures limiting the application of domestic regulations be based on scientific risk assessment. Another example in this regard is that of the Agreement on Technical Barriers to Trade by the World Trade Organization, which requires obedience to some principles by the product regulations, such as keeping the regulations trade restrictive only to the limit where they are efficient in achieving the legitimate regulatory objectives. Moreover, the anti-dumping and subsidy agreements of the international organization require certain procedural and substantive rules to be satisfied; they must be satisfied before the imposition of countervailing duties and antidumping practices by a member on any imported product.

The General Agreement of Trade in Services, on the other hand, maintains a profoundly different approach. The barriers in international agreements of trade in services largely arise from the restrictions on the Mode 3 and Mode 4 trade. Thus, the focal point of the General Agreement of Trade in Services primarily remains on such transactions with a special focus on sectoral commitments on the Mode 3 services. Based on this discussion, it can be argued that the dimension of the General Agreement of Trade in Services remains different from that of tariffication. By definition, tariffs are taxes imposed on cross-border transactions. Thus, they play a negligible role in the services sector. For this reason, in contrast to the General Agreement of Trade in Tariffs and Trade, tariffs are

unavailable by definition for the Mode 3 trade. The same applies to Mode 4 trade transactions as well.

Moreover, the General Agreement of Trade in Services does not support any particular policy instrument and, thus, does not channel trade protection. Thus, there is no applicable analogue between the international agreements concerning services and the General Agreement of Trade and Tariffs Article IX and Article III. The former prohibits quantitative measures, whereas the latter deals with domestic regulations and taxation. Instead, members of the General Agreement of Trade in Services can use any of these instruments to negotiate tariff bindings under the General Agreement on Trade and Tariffs Article II. Thus, the member governments are given the capacity to make or not make any commitments. The members must recognize the restrictive policies if the commitments are made. These commitments are divided into schedules of national treatment exceptions and schedules of market access restrictions. Any commitment that is not memorized in the schedules is waived off and cannot be employed on the transactions in the future.

A national treatment obligation is imposed for the sectors under the General Agreement of Trade in Services, where market access commitments are made between countries. These obligations are subject to sector-by-sector negotiation. Therefore, the complete freedom of action is retained by the members of the General Agreement of Trade in Services except for the principle of the most favourite nations. Transparency is the fundamental obligation in the service sectors where the commitments are made. Thus, the members have to face a wide array of regulatory policy instruments and tax and quantitative restrictions for protective purposes. Over time, further changes may be made through negotiations.

Different Types Of Integrations

The difference in the level of success achieved by each type of agreement raises the question of which factors are playing a role in this context. First of all, both of the agreements have attempted different types of integrations despite the fact that both of them seek to expand market access. The agreement on goods trade has been designed with shallow integration in the minds of researchers and practitioners, whereas the design of the agreement on trade in services was developed with an orientation towards deep integration. The former achieves market expansion through negotiating reductions in the amounts of tariffs, whereas the latter seeks expansion through negotiating removal or change of domestic regulation in the service sector of the countries involved in the agreement.

Different Types Of Challenges

Due to the difference in orientation of the two international agreements, the agreement on trade in services faces challenges for negotiations, which the other agreement does not have to face. Literature has shown that tariff and non-tariff barriers are distinguished from trade (Copeland and Mattoo). Tariffs are discriminatory taxes on trade; they are very transparent and tend to be measured

easily. Thus, making agreements aimed at liberalization of tariffs in order to ease the process of transactions is very commonly found in the context of international trade. The only limitation arises from the government, which, at times, would not be open towards the policy of liberalizing their tariffs for one reason or another (Copeland and Mattoo).

The non-tariff barriers, on the other end of the discussion, are complex. They are pervasive, which indicates that negotiations in this sector are not easy. One of the many reasons for the pervasiveness in the sector is the presence of market imperfections. Most of these barriers come into existence as a side-effect of the domestic regulations. For instance, insurance companies are regulated to ensure their solvency; engineers are certified to ensure that the bridges they build will not collapse, and doctors are certified to ensure the safety of the patient, all because of the issues in asymmetric information. However, the local suppliers can be given an edge by the authorities as they can manipulate these rules. For example, if a regulation requires that an engineer has to be certified by a domestic university instead of attaining education at an international university, it will ensure the strength of the bridge made by that engineer, but it will prevent consumers from enjoying the work of an engineer qualified from a high-class foreign university. Therefore, the trade policy must be able to differentiate between the beneficial effects and protective effects of regulation and suggest rules for liberalization while achieving the other legitimate policy objectives (Copeland and Mattoo, p 104).

The International Agreements And The Terms-Of-Trade Theory

The terms-of-trade theory will help interpret the deep-integration focus of the General Agreement on Trade in Services as well as clarify the underlying problems in such international trade. Solving these problems will help researchers and practitioners in considering alternative design approaches for international agreements. It raises the question of whether the shallow integration technique of the General Agreement on Tariffs and Trade can be aligned with the agreements in services.

To answer this question, the logic of shallow integration must first be reviewed. It stems from the interaction between the General Agreement on Tariffs and Trade and the terms-of-trade theory. An international inefficiency existing under non-cooperative policy choices (Nash equilibrium) must be addressed through a trade agreement. It is later noted that Nash equilibrium does not provide a solution. International inefficiencies arise because of the terms-of-trade manipulations that result from trade taxes, i.e., import and export tariffs. Thus, the Nash Equilibrium is distorted in this context. It results in high Nash equilibrium trade taxes. Consequently, the trade values are made low. However, it consequently eliminates the policy distortions from an international perspective. Thus, the overall focus of international trade revolves around expanding trade values and market access to efficient levels by lowering the tariffs. This logic fits nicely with the shallow integration approach of the General Agreement on Tariffs and Trade.

However, the application of this logic to the agreements of trade in services raises several issues

concerning the kinds of services that remain the focal point of the General Agreement of Trade in Services, the establishment of the foreign service providers of the importing countries, and the specific topic of this discussion, i.e., to catalogue the differences between the goods trade and trade in services at the international level in the context of the trade agreements provided by the World Trade Organization. These are the Mode 3 services for which the tariffs and border taxes are not available because the import of these services does not cross the international border. However, the effects of trade taxes can, in principle, be replicated by other policy instruments, but these alternatives are unavailable to the governments.

Such unavailability has two implications. Firstly, many of the Nash policies of the importing countries are contaminated with internationally inefficient terms-of-trade motives if an import tariff to manipulate the service's terms of trade is lacking, due to which protective distortions for wielding in the service sector are spread by the importing governments. Secondly, a potentially new international inefficiency in the Nash equilibrium is introduced in the absence of an export tax or subsidy due to the fact that this absence makes the exporting country rely, as it wishes to increase the income of the service-sector exporters, on the policy adjustments by the importing government. These two implications can go a long way in accounting for the broad structural differences between the General Agreement on Tariffs and Trade and the General Agreement on Trade in Services.

Applying The Shallow Integration Approach On The General Agreement Of Trade And Tariffs

The two agreements are different in their structures, basic approaches, integrations, challenges, and application of terms-of-trade theory. The discussion on the normative message that the shallow-integration technique of the General Agreement on Tariffs and Trade can be aligned with the General Agreement on Trade in Services is important. Shallow integration means that the integration is limited in its scope and does not expand beyond the border transactions and measures such as domestic regulations and taxation, which are subject to cross-border rules. Although it remains at the heart of the general approach of the General Agreement on Tariffs and Trade in the goods market, the focal point of the General Agreement of Trade in Services primarily remains on such transactions with a special focus on sectoral commitments on the Mode 3 services.

Maurer et al. explain that there is an increasing call for data on trade-in services. The efforts to develop and collect such data by the World Trade Organization and other agencies are underway. Successful efforts in this regard will provide valuable input in the process of deep integration into the current structure of the General Agreement of Trade in Services. However, it has been found from the discussion that the approach of shallow integration for liberalizing services trade is significantly road-blocked by the Mode 3 service trade flows, which include the establishment of a commercial presence by a foreign service provider in the importing nation. It occurs beyond the challenges faced by the goods trade. The difference in the approach is primarily defined by the differences in the basic

approaches of the General Agreement of Trade and Tariffs and the General Agreement of Trade in Services.

Conclusion

The General Agreement on Tariffs and Trade came as a response to the post-World War II high tariff policies in 1947. By definition, tariffs are taxes imposed on cross-border transactions. Thus, they play a negligible role in the services sector. A product-to-product basis pursuant to the General Agreement on Tariffs and Trade Article II was adopted to negotiate the tariff ceiling or bindings. They also include prohibitions on quantitative restrictions, regulations discriminating against imported goods, and domestic taxation. The General Agreement of Trade in Services, on the other hand, has four modes of trade and was recently developed in 1992. Both of the first two modes of trade in services are de facto free trade. They are not much affected by the General Agreement of Trade in Services, and there are no formal commitments from the governments on these two modes either. Mode 3 trade-in services includes the establishment of a commercial presence by a foreign service provider in the importing nation, whereas Mode 4 trade includes the employment of foreign nationals in the domestic offices of foreign businesses after the establishment of a commercial presence in the importing nations. Therefore, the importing countries regulate these transactions extensively because they touch immigration policy.

This assignment has been focused on cataloguing the differences between the goods trade and trade in services at the international level in the context of the trade agreements provided by the World Trade Organization. The two agreements are different in their structures, basic approaches, integrations, challenges, and application of terms-of-trade theory. The discussion is carried out while spreading the normative message that the shallow-integration technique of the General Agreement on Tariffs and Trade can be aligned with the General Agreement on Trade in Services. It has been found from the discussion that the approach of shallow integration for liberalizing services trade is significantly road-blocked by the Mode 3 service trade flows. It occurs beyond the challenges faced by the goods trade. The difference in the approach is primarily defined by the differences in the basic approaches of the General Agreement of Trade and Tariffs and the General Agreement of Trade in Services. Moreover, complete and comprehensive data is required for the successful application of the shallow integration approach on international agreements. Successful efforts in this regard will provide valuable input in the process of deep integration into the current structure of the General Agreement of Trade in Services.