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# GATS and the EU: impacts on labour markets and regulatory capacity

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Gintare Kemekliene and Andrew Watt

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**Report 116**

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# 1. Introduction

This study addresses actual and expected impacts of the General Agreement on Trade in Services on European labour markets and forms of regulation. As such it touches on a number of crucial issues that have been at the centre of debate and controversy in recent years.

## 1.1. The GATS in context

Underpinning the whole set of issues has been the ‘great globalisation debate’. Since the fall of the Iron Curtain almost twenty years ago, the enlargement of the EU in 2004 and the steady rise of large industrialising countries, such as China, India and Brazil, a debate has raged about the benefits and costs of globalisation, and the increasingly global mobility and tradability of goods, services, capital and labour. Initially, globalisation was welcomed by a majority of policymakers, international organisations and social actors as promoting political freedom, raising aggregate incomes and offering new opportunities to deepen the division of labour and thus reap the benefits of increased specialisation, including giving new opportunities to the rural poor in the global South. While a small but vocal minority rejected globalisation, in its current form, outright – a movement that most notably successfully caused the collapse of the WTO trade negotiations at Seattle in 1999 – a number of social movements, including trade unions, academics and policymakers, while accepting the basic idea of increasingly open borders and their aggregate benefits, pointed to the likely social, distributional and ecological consequences of a globalisation untrammelled by conscious policy action designed to maximise benefits and reduce risks, particularly for vulnerable groups in both the ‘North’ and ‘South’. Initially drowned out by uncritical cheerleaders, the concerns raised by this latter group increasingly came to the fore, and distributional issues, in particular, came to dominate also the mainstream debate. The onset of financial crisis in mid-2007, which at the time of completing this study looks likely to develop into a serious global slowdown of unknown duration, has led to questions about the wisdom of blind faith in unregulated markets and issues of the stability of global capitalism.

The World Trade Organisation has been a key actor in the debate on, and implementing and promoting the policies that underpin, globalisation. This has involved not just a continuation of the long-standing policy of reducing tariff and other barriers to trade in goods. The WTO remit has broadened, along with its membership, to take on issues such as services trade, intellec-

tual property rights and – genuinely or merely supposedly conditioned by the demands of globalisation – core domestic policy issues, including indirect effects on labour market reforms, and privatisations and liberalisation of public sectors, etc. This process was driven by the so-called Washington Consensus view of the need for stable macroeconomic problems and market-friendly supply-side reforms. A notable component of the increasing role of the WTO is the General Agreement on Trade in Services (GATS), which came into force in 1995. It is the first agreement on principles and rules for trade in services and incorporates the objective of progressive liberalisation in the succeeding liberalisation rounds. The negotiations in the GATS are thus ongoing as a part of the Doha Development Round. When finalising this report in 2008, negotiations had once again been suspended and it was unclear if and when the outcome in this round would be reached.

Meanwhile, at national level, the debate between policymakers, social partners and scholars focused on the implications of ‘tertiarisation’, in other words, the increasing proportion of economic activity and employment in the advanced capitalist countries consisting of services rather than industrial goods production. In 2007, services in the EU accounted for over 70% of value added and employment (with half of services employment in the public service sector). The share of services in cross-border trade has been increasing faster than trade in goods. This trend has been driven by a number of factors, including technological change, commercialisation and liberalisation, and accelerated by the increased reliance on China and other low-wage countries for the supply of needed manufactured goods. Tertiariation has given rise to a wide range of controversial issues, from job quality to the appropriateness of existing structures of social regulation, social insurance and also collective interest representation.

These questions of the adequate response to globalisation and tertiarisation acquired particular salience in the EU, insofar as the period since the mid-1990s has been characterised by a number of developments that have set Europe apart from the US and some other OECD countries. Arguably, the most important such development was the reunification of the continent under liberal-democratic and market-economic principles, culminating in the enlargement of the European Union in 2004. Both prior to and particularly since enlargement, Europe has experienced far-reaching shifts in the spatial distribution of production and the division of labour (Galgoczi/Keune/Watt 2006) and, especially since 2004, increased labour mobility, particularly the (temporary) migration of workers from central and eastern Europe (the ‘New Member States’ – NMS) to the ‘old’ fifteen EU countries (Galgoczi/Leschke/Watt forthcoming). At the same time, the continent appeared, after decades of successfully catching up with the United States, to be slipping behind. Unemployment was high throughout the period in the EU as a whole, and growth rates were disappointing, especially compared with the US’ ‘roaring nineties’ (to use the title of Stiglitz’s widely read analysis of the period (Stiglitz 2003)). The prevailing conventional wisdom was that Europe, East and West, had to shed ‘old-fashioned’ institutions that were a drag on growth and entrepreneurship and re-establish the primacy of market forms of coordination. The

US and, more latterly Ireland and the UK, were held to be liberal paragons that the ‘sclerotic’ European countries must follow.

Services developments in the EU are affected by the Europeanisation trends, in particular the growing importance of the intra-EU services trade and internal EU initiatives to create a single market in services. This culminated in the implementation of the Services Directive, the key ambition of which is to extend the EU principle of ‘mutual recognition’ in merchandise trade into the services sector.

Such developments engendered, in turn, renewed interest in an old debate about the ‘models of welfare capitalism’ that began with the seminal contribution by Esping-Andersen (1990) who distinguished liberal, Scandinavian/social-democratic, and corporatist/continental European ‘models’. In the subsequent debate a ‘southern’ group was identified, and scholars debated the precise defining features of and country ascriptions to the different models. This led on to a debate about the existence of ‘varieties of capitalism’ (Hall/Sockice 2000) and specifically of a ‘European Social Model’ (ESM), turning on the coherence (or lack of it) of European countries vis-à-vis the US and other non-European advanced capitalist countries (e.g. Jepsen/Serrano 2006; Watt 2004; Sapir 2005)

In the light of these controversial debates around globalisation, tertiarisation, and Europeanisation, it is readily understood why an agreement to fundamentally liberalise services trade, under the auspices of the WTO, exposing previously sheltered sectors (possibly including sections of the public sector) to international competition, and promoting the movement of both capital and labour across borders, would itself become a highly controversial subject. This same background also prompted the authors of this study to seek more information and understanding of the GATS and its impacts.

## **1.2 The debate**

The debate on the GATS encompasses a wide range of views but, by way of introduction, two opposing positions can be set out. On the one hand are the proponents of the Agreement: the WTO, European Commission, OECD, European Service Forum at international level, some national governments. They focus on the static and dynamic efficiency-enhancing implications of services liberalisation. Some of the main arguments brought up by the proponents are as follows. The GATS guarantees to foreign service providers access to markets under stable conditions; the countries would gain in terms of output and employment growth in services and cheaper and better quality services, thereby generating, also, positive welfare effects on the economy as a whole.

On the other hand, there are critics (and in some cases opponents) of the Agreement, consisting of parts of the labour movement, civil society organisations, some academics and some national governments. While not questioning the benefits, they emphasise the threats to national sovereignty and negative

consequences for equity and social development. Critics also fear that the new rounds of services negotiations will force WTO members to open *all* services sectors to foreign competition, including public services. The threats from GATS are seen as particularly serious since GATS commitments are irreversible<sup>1</sup>.

Although, from the start of the GATS negotiations, the division between the opponents and proponents of liberalisation of services has been much more in evidence between different groups *within* countries, a certain tension *between* various blocks of countries has also appeared, mainly since 2000. In relation to some issues the dividing line can be drawn between developed and developing economies. For example the EU has a 'defensive' interest in inclusion of unskilled workers in Mode 4, and an 'offensive' interest in third countries opening up their markets for Mode 3 trade. Developing countries, on the other hand, see scope for generating revenue by 'exporting' some of their lower-skilled workers under Mode 4, and, while keen to attract foreign investment, are concerned about abandoning regulatory capacity if opening up market access under Mode 3.

### 1.3 Aims of the report

While the broad aim of the study is to contribute to knowledge about the GATS and its impacts, and thus to inform the debate amongst both academics and policymakers, including within the labour movement, the amorphous nature of the GATS and its possible effects necessitated a focus on a limited number of themes in order to arrive at a tractable research project. As will be explained in more detail below, during the course of the research project itself, a number of reorientations and some refocusing proved necessary, as a number of interesting issues proved difficult or impossible to research due to a lack of hard data.

This study looks at two modes of service supply under the GATS: commercial presence (Mode 3) and temporary movement of service providers (Mode 4) and attempts to shed some light on two key questions:

1. To what extent has services liberalisation under GATS affected the regulatory capacity of EU member states, and to what extent is this likely to happen in the future?
2. What impacts can be already identified and which additional impacts are to be expected on European labour markets in terms of employment levels prospects and pay?

On this basis we also reflect on possible policy responses by national governments and trade unions and other social actors keen to ensure that the ben-

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1. It is possible to reverse commitments only if compensation is offered to all WTO Members for all actual and potential losses connected with such withdrawal, e.g. the US pulled out of its commitments on gambling, but is required to give compensation for these.

efits of the liberalisation of services trade are maximised and as widely spread as possible, while any risks and costs are minimised and equitably distributed.

The interest in these subjects is derived not least from previous work by the authors in the areas of tertiarisation (Kemekliene *et al.* 2007), European policy responses to globalisation (Kemekliene/Watt 2006), the impacts of capital mobility (Galgoczi/Keune/Watt 2006) and of labour mobility in Europe (Galgoczi/Leschke/Watt forthcoming) and challenges to the European Social Model (Watt 2004, 2006).

In the course of our literature review on the impacts of GATS we discovered that, despite the controversial nature of the GATS debate, there is a lack of systematic and serious attempts to assess the actual and likely implications of GATS-driven liberalisation. Studies supportive of further GATS liberalisation tend to be based on highly abstract general equilibrium models in which increased trade by assumption leads to greater allocative efficiency and thus positive aggregate outcomes. The distributional impacts are seldom discussed, nor is an attempt made to look at realities ‘on the ground’. Meanwhile, critics of the Agreement have developed a largely ‘political’ critique of the GATS provisions, focussing notably on the potentially risky combination of unclear provisions and wording combined with the irreversibility of commitments. There has been little attempt to focus on the impacts of the liberalisation that have actually occurred in practice. Moreover, particularly within the trade union-linked literature, there has been a focus on the impact on the public sector and on Mode 4 that seems unnecessarily restrictive.

For all these reasons a study with the focus on labour market and regulatory impacts of both Mode 3 and 4, as well as an emphasis on national and sectoral differences within Europe, seemed called for.

The research was funded by a grant from the Hans Böckler Foundation. It falls under the ‘Globalisation and its consequences’ research strand in the Hans Böckler Foundation’s Research Support Programme, which addresses issues covered by the study including the issue of controlling and regulating global processes, in regard to its significance for the regulatory capacity of the nation state, labour markets and trade unions.

## **1.4 Structure of the report**

The structure of the report is as follows. Chapter 2 provides the reader with a brief overview of services sector developments in Europe, with a focus on employment, trade and foreign direct investment (FDI), as a necessary background to analysing the GATS and its importance. The focus is on the period since 1995, when the GATS first came into force. The GATS is a highly complex agreement and, in order to be able to assess its reach and importance, and also the scope for further GATS-driven liberalisation in the future, Chapter 3 provides an outline of the Agreement, explains key terms and institutions, and reviews key developments since 1995. Chapter 4 addresses in detail the

two modes of cross border services trade in the GATS framework that are the focus of this research project – commercial presence (Mode 3) and temporary movement of service providers (Mode 4). It considers the scope of these modes within the GATS, the available data, and provides a critical review of available studies on the impacts of service liberalisation under these two Modes.

In Chapter 5 we present the results of our analysis of the EU commitments under the two modes in the two offers submitted by the EU – the initial 1995 offer and the revised conditional offer of 2005. To our knowledge, this is the first attempt to compare GATS commitments by all the EU countries on a sector-by-sector basis for both of the two EU offers.

The next two chapters contain our analyses of GATS' impacts in Europe. In Chapter 6 we use our liberalisation indices to identify correlations at Member States and sectoral level between liberalisation under GATS and a number of indicators of cross-border services flows. We then consider to what extent countries have reduced their regulatory levels in conjunction with GATS liberalisation. In Chapter 7 we turn to the difficult issue of assessing possible labour market effects. Faced with major difficulties relating to data availability and uncertainty about future GATS developments, we provide a framework for assessing possible orders of magnitude for employment and wage effects.

A concluding chapter seeks to draw the findings together and to consider strategic options for policymakers and social actors, especially trade unions, in the light of future GATS negotiations.

## **1.5 Limitations and problems encountered**

In the body of the report we address issues of data availability and some of the methodological problems encountered. For the purposes of this introduction it is sufficient to point out some key limitations. Unfortunately it is much easier to ask interesting questions about the impacts of GATS – and of course also to claim that certain effects are certain to materialise, without providing evidence – than it is to generate and examine quantitative evidence. There are two main types of problem.

The first is a lack of data. This is not an issue of the data being 'dirty' or entries lacking for certain countries or years, although that, too, is a problem in some areas. Most importantly, we lack *any* comparable data on the number of workers crossing international borders to work under the GATS as temporary service providers in EU countries. Only limited data on the cross-border movement of capital to render services is available (and we are often forced to consider total FDI including that within the EU). More fundamentally, we just do not know some quite basic facts about the impacts of GATS more than ten years after the agreement was signed. In some ways, this lack of factual information makes the virulence of the GATS debate hard to understand, although of course our collective lack of knowledge about the facts makes it hard to challenge firmly held views.

The second problem concerns the GATS itself. The only concrete information we have on the extent of commitments relates to those made by the EU in 1995. The offer submitted in 2005 has not come into force yet, due to the repeated failures to reach agreement in the DDA Round of the negotiations (see Chapters 3 and 4). Similar considerations apply to the outcome of discussions on national regulation under the WTO Working Part on Domestic Regulation. While, by construction, GATS outcomes can only ever move in the direction of further liberalisation, it is impossible at the current juncture to predict the likely extent of liberalisation under GATS in one, five, or ten years from now. This is a further factor that feeds the controversial debate, much of which is about possible future developments, the likelihood of which cannot be foretold and thus about which reasonable people can differ.

For all the reasons described above, we have necessarily been cautious in our evaluations and, particularly, in our predictions. The reader's understanding is sought in advance for this. We are convinced that it is very difficult to reach more far-reaching conclusions than these until better and more comprehensive data becomes available and the future of the GATS negotiations clearer. Our view is strengthened by the limited results obtained by other recent work (Mattoo/Stern/Zanini 2008; Panizzon/Pohl/Sauve 2008).

## **1.6 Conclusions**

We encourage the reader to look at the entire study. The main arguments and findings of each chapter are summarised at the end of the chapter in question. A discussion of key findings is to be found in the conclusions. Suffice it to say at this point that we have found support in our work for numerous positions in the debate, for both critics and proponents of the GATS. So far the scope of liberalisation, particularly in the more controversial Mode 4, and the impacts of the GATS on regulatory capacity and labour markets in Europe, appear to be limited. At the same time, more far-reaching and irreversible liberalisation under future GATS rounds would pose challenges in both areas. Policymakers and social actors, including trade unions, should approach the subject dispassionately and carefully consider the pros and cons of further liberalisations under the GATS.



## **2. EU services economy, trade and foreign direct investment**

### **2.1 Introduction**

The debate about the impact of GATS in the EU countries needs to be seen against the background of developments in the services sector more generally. The GATS is, of course, only one of the forces that have been shaping developments in services in Europe. Much more pervasive and of longer duration have been technological changes (such as the increasing penetration of IT technologies); changing consumer demand patterns, demographics and family structures; and broader trends summed up in the word 'globalisation', of which the GATS forms one element. This section provides a brief overview of services sector developments, with a focus on employment, trade and foreign direct investment (FDI), as a necessary background to analysing the GATS and its importance. The focus is on the period since 1995, when the GATS first came into force.

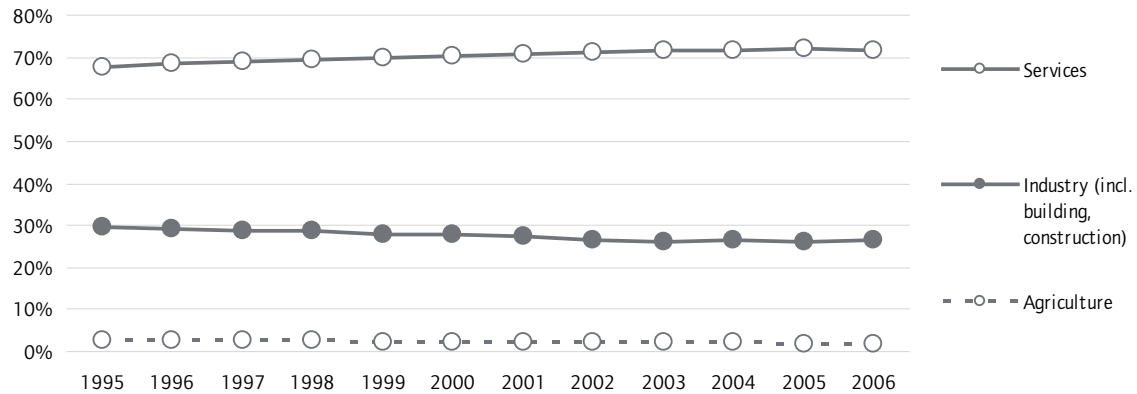
### **2.2 Output and employment in the EU**

Over recent decades there has been a pronounced sectoral shift away from manufacturing and extractive industries in the EU – and in some countries also from agriculture – towards a services-dominated economy. By 2006 services accounted for over 70% of GDP in the EU25 (Figure 2.1), although the EU figure is lower than that for the USA (77%). Of course, the EU25 average conceals considerable differences between the Member States, and in some countries the services share of output is almost as high as in the USA.

The increase in the services-intensity of economies is driven by a number of factors. Standard explanations revolve around both demand- and supply-side factors, including income elasticities of demand for services that exceed one (meaning that consumption of service rises more than proportionately with income), limited scope for labour productivity improvements in the supply of consumer (final product) services, the rise in demand for coordination and intermediation services associated with specialization, structural change and the splitting-up and spatial redistribution of value chains.

Furthermore, advances in information and communication technologies, amongst other factors, are increasingly permitting cross-border – disembodied – trade in services, accelerating the growth of services activities by expanding potential supply and reducing costs.

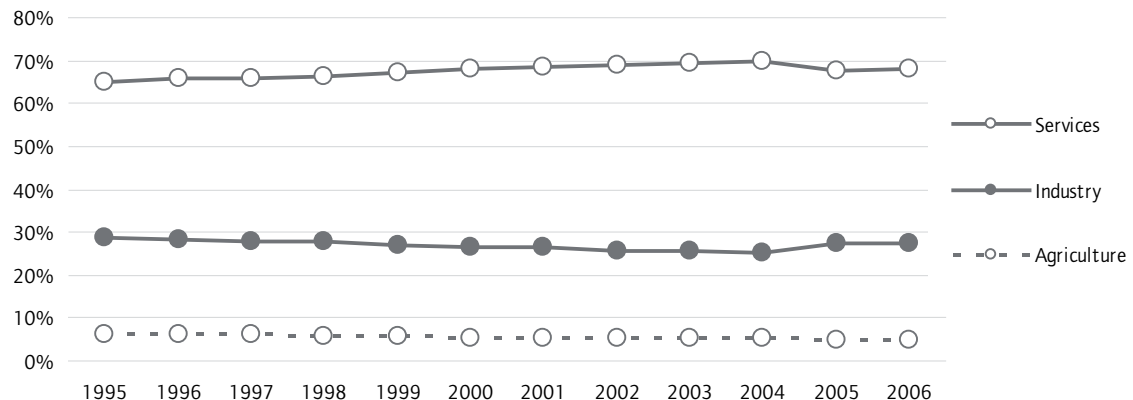
Figure 2.1 Share of services, industry and agriculture in GDP, EU25 (1995–2006)



Data source: Eurostat (2008b)

In general, the size of the services sector is a reflection of the level of economic development, such that, within the EU, Member States with lower GDP/capita have a relatively small services sector, whereas the wealthiest countries are largely ones in which a larger proportion of output comes from services. In line with this, most of the new EU Member states (NMS) have a lower share of services in GDP than EU15 countries; but since 1995 the share of services in GDP in the NMS has grown at a faster rate than in the EU15, implying steady convergence towards (rising) EU15 levels.

Figure 2.2 Employment share in services, industry and agriculture, EU25 (% of total employment, 1995–2006)

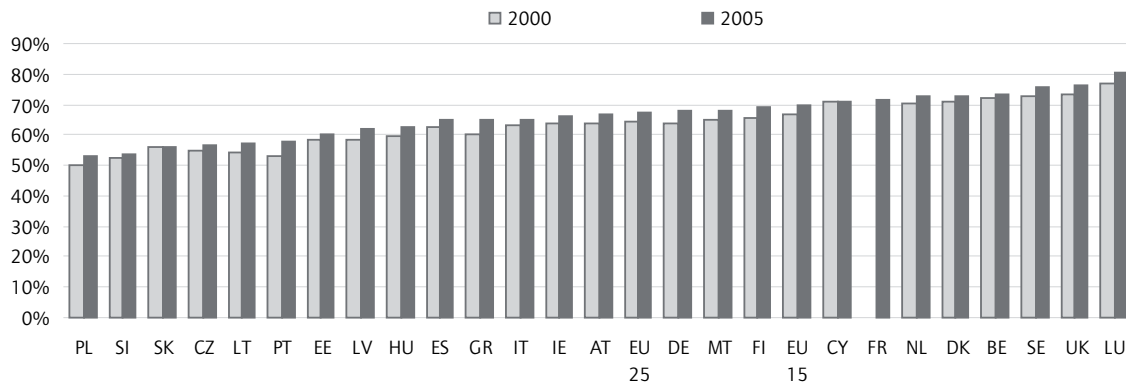


Data source: Eurostat (2008a and 2008c)

Employment trends are rather closely related to output trends, so that a similar picture emerges for the increase in the share of services in total employment. Services increased their employment share by almost 3 percentage points between 1995 and 2006 to 70% (Figure 2.2). Thus services employment now accounts for more than double the share of the employment in industry and agriculture taken together.

Nevertheless, noticeable differences remain at the level of individual EU Member States, with the services share in 2005 ranging from 53% of total employment in Poland and Slovenia to over 75% in Sweden, the UK and Luxembourg. Rising numbers of jobs in services is virtually the only source of net job creation in European economies: in very few cases has non-service employment increased in recent years (Figure 2.3).

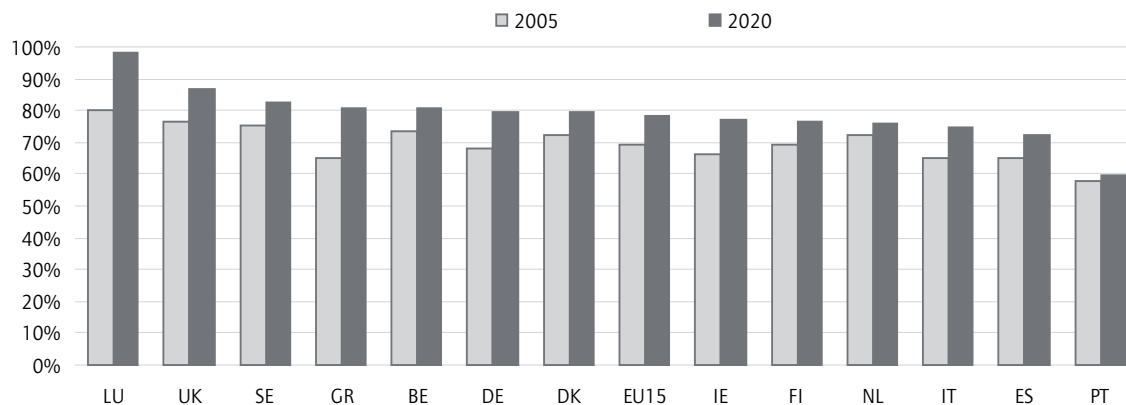
Figure 2.3 Employment in services (% of total employment, 2000–2005)



Data source: Eurostat (2008c)

Simulations conducted by Kemekliene *et al.* (2007) suggest that, on current trends, by 2020 up to 80% of all employment in the EU15 will be in the services sector.

Figure 2.4 Current and projected employment in services in selected EU Member States (% of total employment, 2005 and 2020)



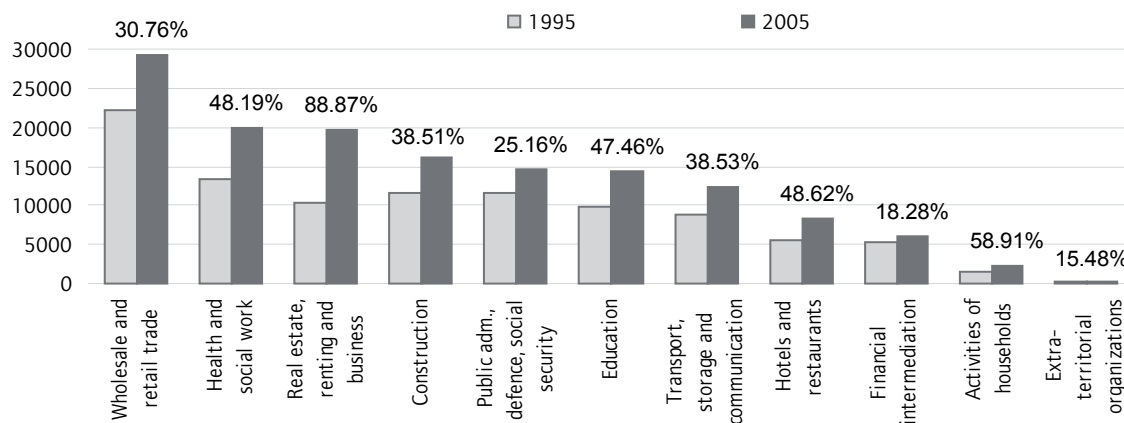
Source: Kemekliene *et al.* (2007): 52

## 2.3 Employment composition by subsector

It is often pointed out that services' importance in economic activity and employment is not reflected in the services trade. These figures are used to justify the argument that 'services are the area of European comparative advantage with the greatest potential for growth in EU exports' (European Commission 2006: 10).

However, it is important to note that the 70% share includes output by and employment in **all** services (private and public, including the armed forces), while employment in private-sector services – the most rapidly growing and most traded services – accounts for around **half** of total services employment.

Figure 2.5 Employment figures and cumulative growth by service subsector, 1995 and 2005, EU25



Data source: Eurostat (2008c) Note: Construction included because counted as a service under GATS

Figure 2.5 and Table 2.1 show that wholesale and retail trade is the economy's largest employer. In 2005 it employed nearly 30 million people or over 20% of the total workforce in the services sector of the EU25. Health care and social work is now the second largest services-sector employer, accounting for nearly 14% of total employment in services. This sector is closely followed by the more amorphous business services sector. One fifth of services employment is taken up by public sector administration, including the armed forces, together with the (largely public) education sector.

The rise of services employment in the EU25 is mainly driven by increases in real estate, renting and business activities (an increase of over 88%). The rise of employment in the business services sector is associated, among other things, with the use of new technology and forms of work organisation. The growth of business services is also closely related to restructuring in the manufacturing sector: first, many service-related occupations in manufacturing moved to the services sector, and secondly, the business and professional

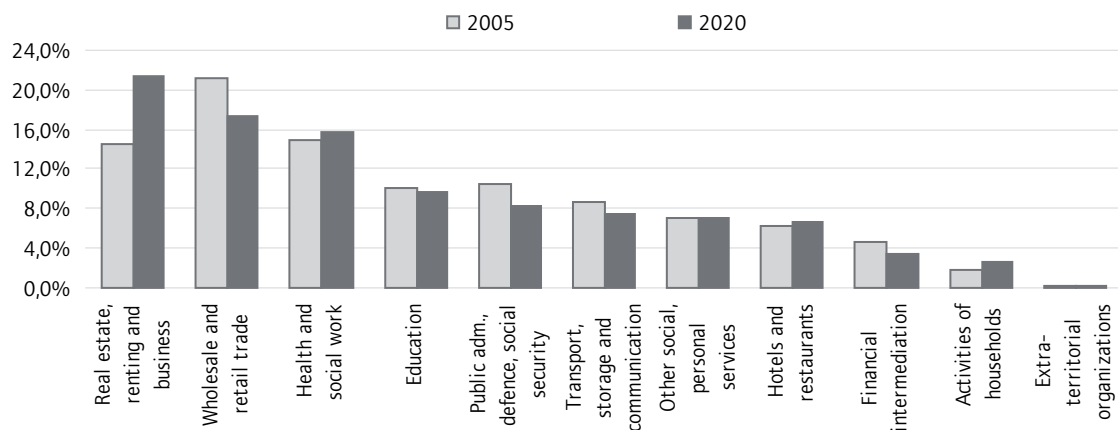
sectors provide services to manufacturing industries as intermediate goods. In the biggest sector (in terms of employment) – wholesale and retail trade – employment on average grew more slowly, by only 10%. Employment growth was, perhaps surprisingly, slowest in financial intermediation, showing that sectors with high growth in value-added are not necessarily the ones with high growth in jobs. This reflects substantial rationalisation and automation in this sector.

Table 2.1 Employment by subsectors in EU25, 1995 and 2005 (share of total service employment)

	1995	2005
Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods	22,19%	20,38%
Health and social work	13,37%	13,92%
Real estate, renting and business activities	10,32%	13,68%
Construction	11,58%	11,27%
Public administration and defence; compulsory social security	11,55%	10,16%
Education	9,73%	10,08%
Transport, storage and communication	8,89%	8,65%
Hotels and restaurants	5,63%	5,88%
Financial intermediation	5,17%	4,30%
Activities of households	1,42%	1,58%
Extra-territorial organizations and bodies	0,13%	0,11%

Data source: Eurostat (2008c)

Figure 2.6 Current and projected employment by service subsectors (% total service employment, 2005 and 2020)



Source: Kemekliene *et al.* (2007): 52

As a result of this situation, the shifts in employment shares between 1995 and 2005 are generally not particularly large. Construction, wholesale and retail trade, public administration, transport storage and communication and financial intermediation experienced marginal losses in their share of total

services employment, while the biggest percentage increase occurred in real estate, renting and business services.

Simulations (Kemekliene *et al.* 2007) suggest that if employment in the different service subsectors continues to grow at the same rates as in the last decade, by 2020 real estate, renting and business activities will become the biggest employer in the services sector (and in the economy in general), overtaking trade, and could account for over 20% of total employment in services (Figure 2.6).

## 2.4 The nature of services sector employment

Given the heterogeneity of both the enlarged EU and the services sector itself, it is not possible here to provide an overview of more qualitative aspects of services sector employment (see for details Kemekliene *et al.* 2007 and Leschke *et al.* 2008). Still a number of generalisations can be made.

Table 2.2 Average annual gross earnings of various service sectors compared to the average for industry (full-time employment, 2004)

	Wholesale, retail, repair	Hotels and restaurants	Transport, storage and communication	Financial intermediation	Real estate, renting, business activities
BE	93,8	61,7	91,8	140	115
DK	97,2	83,2	107,1	118,3	121,6
DE	89,9	64,8	89,6	128,4	107,3
GR	80,3	78,4	130,5	181,1	119,7
ES	86,9	71,3	111,9	188,8	100,7
FR	92,9	73,5	94,1	145,5	111,7
CY	77,6	82,5	115,9	139,4	98,2
LV	87,1	67,6	125,9	246,6	119,4
LU	89,4	67,4	115,7	178,7	116,8
HU	88,4	65,3	116,9	237,3	112,1
MT	63	122,8	148,7	228,7	113
NL	92,1	69,7	100,5	142,1	116,1
PL	92,9	74,3	115,3	174	106,5
PT	111,3	78,1	164,7	241,3	144,9
SK	95,5	68,5	104,1	178,7	114,7
FI	95,8	74,3	93,4	117,5	103,9
SE	98,4	75,8	96,2	137,3	113
UK	88,4	65,4	99,8	170,4	120,2
BG	78,8	63,5	124,1	238,9	97,2
NO	97,6	77,7	98,5	122,7	118,5
CH	89,7	67,9	102,7	137	119,5
Average (not weighted)	89,9	74	111,8	171,1	113,8

Source: Kemekliene *et al.* (2007)

- Gender: Women are more highly represented in services sectors than in the economy as a whole. They represent 56% of total services sector employment. This falls to just under half if public administration is excluded, but even this is much higher than their share in industry (just under one quarter). In hotels and restaurants and retail trade almost

two out of every three workers are female.<sup>2</sup> If anything, this sectoral segregation is becoming more pronounced over time.

- Pay: Table 2.2 shows that there is a strong divergence within the group of services. In particular in hotels and restaurants, but also in wholesale, retail and repairs, earnings are low in comparison to industry. In contrast, in financial intermediation earnings are high, at 71.1% above earnings in industry. Low pay is a serious problem in many service sectors. To some extent this reflects low skill levels, but also difficulties of organising effective worker representation in small-scale enterprises with high turnover and irregular working patterns and more marginal sections of the labour force.
- Non-standard contracts: Both part-time and fixed-term employment contracts are more prevalent in services than in industry. However, these averages conceal a substantial diversity within the services sector. Non-standard employment forms are particularly common in retail trading and in hotels and restaurants. In particular there has been a substantial rise in the use of fixed-term contracts in many service sectors.
- Temporary agency work (TAW): temporary agency work is an increasingly significant form of employment in the services sector. Many EU15 member states experienced strong growth in TAW in the mid- to late 1990s due to economic growth and changes in regulatory systems. In some EU Member States (i.e. Spain, Sweden) in 2005 services sector workers accounted for 60-70% of all TAW and for over 90% in the UK. The extent of TAW in the NMS is much more limited. Nevertheless, strong growth has been reported in recent years (Arrowsmith 2006).

Table 2.3 Employment share of different skill groups, EU15 (1998–2003)

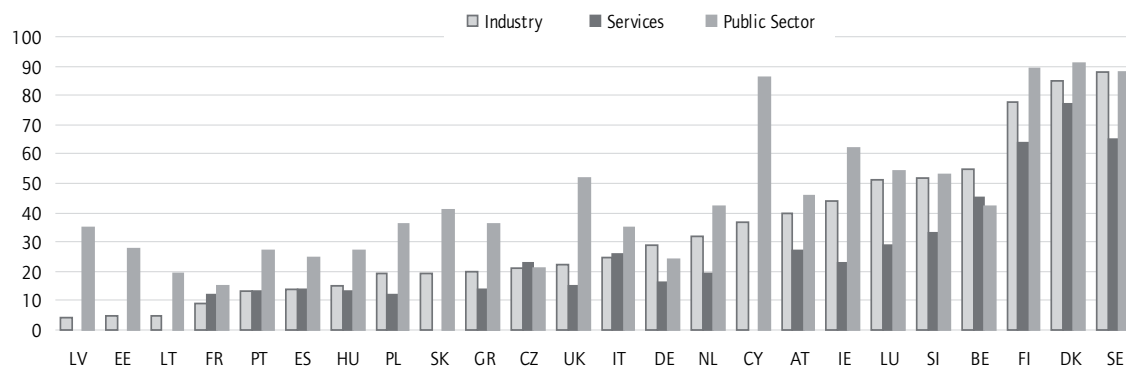
	High skilled			Medium skilled			Low skilled		
	1998	2003	Change (%)	1998	2003	Change (%)	1998	2003	Change (%)
Total economy	20,2	24,7	22,3	37,5	46,1	22,9	42,3	29,2	-31
Industry	10,9	16,3	49,5	37,3	48	28,7	51,8	35,8	-30,9
Services total	26,6	29,7	11,7	39	46,1	18,2	34,4	24,2	-29,7
Wholesale and retail trade	11,1	13,4	20,7	42,6	54,2	27,2	46,2	32,4	-29,9
Hotels and restaurants	6,6	9	36,4	36,3	46,4	27,8	57,1	44,6	-21,9
Transport and communication	12,5	15,8	26,4	44	54,6	24,1	43,4	29,5	-32
Financial intermediation	30,2	33,5	10,9	54,7	57,7	5,5	15,1	8,9	-41,1
Business services	37,6	41	9	37,8	41,8	10,6	24,6	17,3	-29,7

Note: Based on the highest level of education attained – International standard classification of education (ISCED 1997)  
Source: Kemekliene *et al.* (2007)

2. Figures refer to the EU25 in 2005. For further details see Kemekliene *et al.* 2007.

- **Skills:** Table 2.3 shows that the percentage of highly skilled workers employed in the services sector is higher than that for the total economy and for industry, while the percentage of low-skilled employed is lower. But major differences exist between the different service sectors. Financial intermediation and business services emerge as high-skilled services with over one third of those employed being highly skilled, whereas wholesale and retail trade, hotels and restaurants, and transport and communication are far below the average for services. Over time, in services, as in the economy as a whole – but to a slightly lesser degree – there is a trend towards an increasing skill profile for employees, resulting from improved educational levels and changing consumer demands.
- **Unionisation:** As can be seen from Figure 2.7, the services sector needs to be divided up into its public and private-sector components in order to understand developments. Except in those countries where unionisation is universally high, union density tends to be substantially higher in the public sector than in industry, and this is much higher again than in the – for GATS most relevant – private services sector. In most EU countries less than one in five workers in private sector services is a union member: only in the three Nordic countries is the figure above 50%.

Figure 2.7 Trade union membership density by sector and Member State (% of total, 2003)

Source: Kemekliene *et al.* (2007)

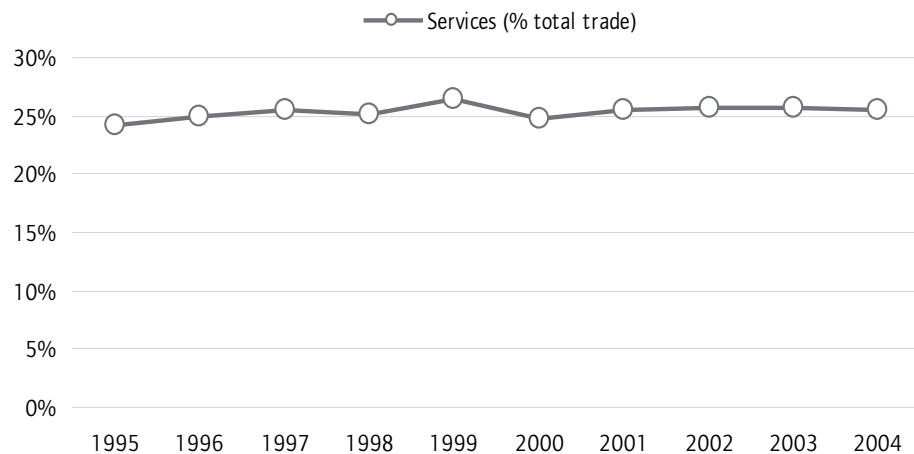
## 2.5 EU trade in services

The growth of the services sector has also been accompanied by the rising share of services in cross-border trade, the key point of departure for discussions about the GATS. Technological developments, reduced transaction costs and separability of business functions are some of the forces that promote the tradability of services and hence the globalization (and Europeanisation) of service provision. This means that services previously considered non-tradable are becoming subject to the same sort of import competition that has long been a driver of structural change, and also social conflict, in European manufacturing.

Our discussion of EU services trade uses EU15 data to describe developments during the GATS-relevant period since 1995, and EU25 or EU27 data, which are only available for recent years, for current ‘snapshots’ of the data.

The EU services trade amounts to about one quarter of the value of total (goods and services) trade of the EU15 (Figure 2.8). However it is rather surprising that, given the rising share of services in output, after more than ten years of increasing services globalisation and the introduction of the multilateral services trade liberalisation mechanism under GATS, the share of services in total trade has not increased; with small fluctuations it has remained flat at around one quarter of trade flows.

Figure 2.8 Trade in services in 1995-2004, EU15 (% of total trade)



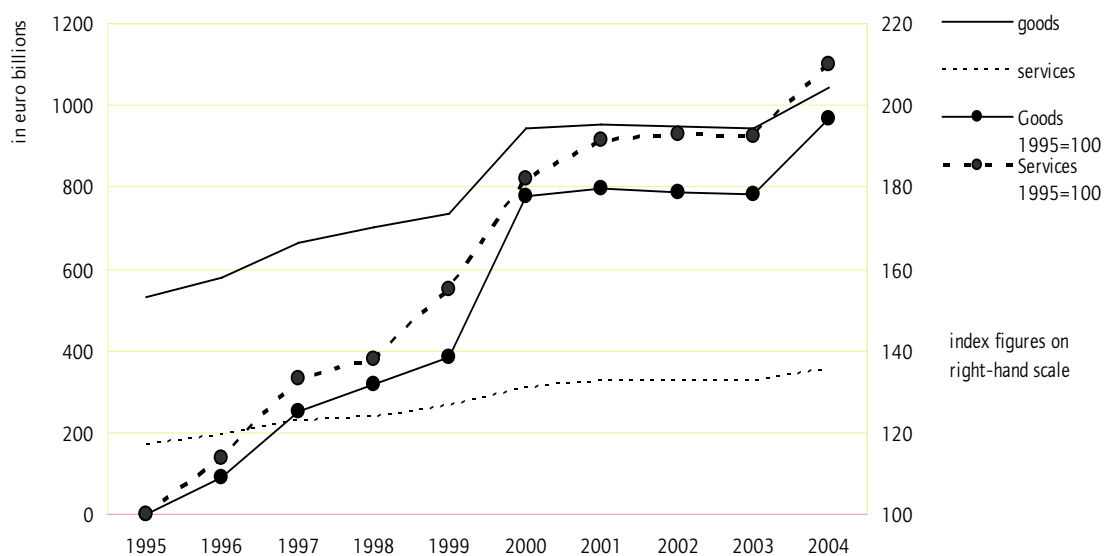
Data source: Eurostat (2007)

Of course this relative lack of change has been against the background of very rapid growth of both types of trade in recent years.

As Figure 2.9 shows, the EU25 is by far the world’s largest exporter and importer of services, with 27% of global exports and 24.4% of imports, almost double the respective figures for the USA (14.7% and 12%). Japan and China follow at a considerable distance.

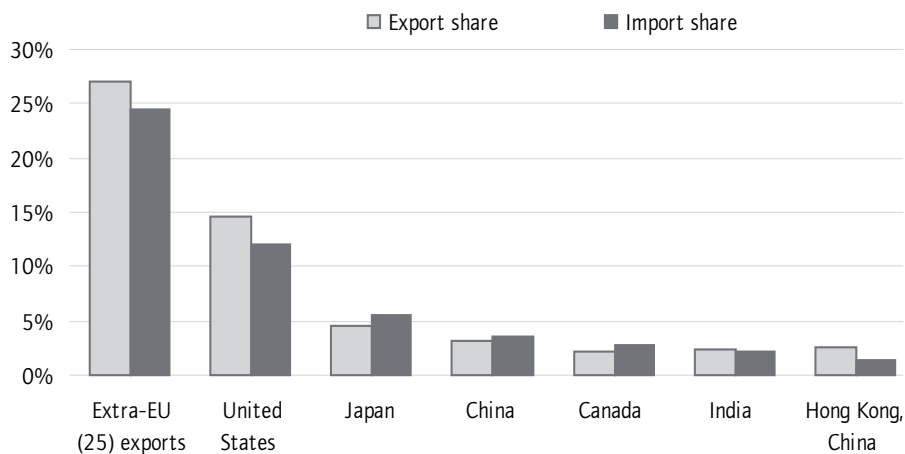
A sectoral breakdown shows that ‘other business services’ that cover research and development, accounting, operational leasing services and miscellaneous business services, accounted for nearly 30% of all services exports and 25% of imports. Transport accounted for 22% of trade flows of services, travel for around 20%. The supposedly ‘residual’ – in trade-statistics terms – category of ‘other services’ is in fact dominant, accounting for substantially more than half of EU25 services exports. Other business services and transportation is also where the EU earns its services trade surplus, more than offsetting a slight deficit in travel.

Figure 2.9 Trade in services and goods in 1995 - 2005, EU 15  
(average imports and exports, EUR bn)



Data source: Eurostat, own calculations

Figure 2.10 Leading exporters and importers in world trade in commercial services  
(excludes intra-EU trade), 2005



Data source: WTO 2006

In 2006, EU27 services trade increased by 9.6% in exports and 6.6% in imports over 2005. Figure 2.10 shows that services net export growth in 2006 was mainly due to an improved balance in insurance services, and also to increased surpluses in financial services and computer and information services; there was also a reduction in the deficit in the travel sector. These numbers

were partially offset by the reduced surplus in transportation services. The significant surplus in 'other business services', remained more or less stable, as did the surplus in construction, and the deficit in royalties and license. On the credit side, insurance services experienced the biggest increase in relative terms (+131.5%) followed by computer and information services, financial services and communication services (up 21.8%, 19.0% and 17.3% respectively). On the import side, double-digit rates of expansion were seen in financial services, communication services, and government services.

Overall, other business services, financial services (including insurance) computer and information services and also construction appear as areas in which the enlarged EU has a comparative advantage in trade with the rest of the world, financing net imports in travel, royalties and licenses and, in some years, in goods trade.

Table 2.4 EU international trade in services with the rest of the world (bn Euro)

	2004		2005		2006	
	Debit	Credit	Debit	Credit	Debit	Credit
Total Services	368,1	321,7	402,9	350	441,6	373,1
Transportation	93,5	79,5	104,4	87,7	109,7	96,2
Travel	62,1	79,5	65,4	83,8	71,1	85,1
Other services	209,6	159,9	230,8	176,2	260,7	191,7
Communications services	6,4	7,1	7,4	8,3	8,7	9,8
Construction services	9,6	5,8	11,2	6,1	12,1	6,6
Insurance services	10,7	8,4	6,1	8,4	14,2	7,2
Financial services	29,6	11,9	35,2	14,4	41,9	17,4
Computer and information services	16,3	8,1	17,3	8,7	21	9,7
Royalties and license fees	20,4	29,4	23,7	32,1	23,4	32,6
Other business services	102,4	77,5	117,1	85,8	126,9	95,7
Personal, cultural and recreational services	5,1	6,3	4,9	6,3	4,6	5,8
Government services	9,1	5,5	7,9	6,1	7,9	6,9
Services not allocated	2,9	2,9	2,3	2,4	0	0

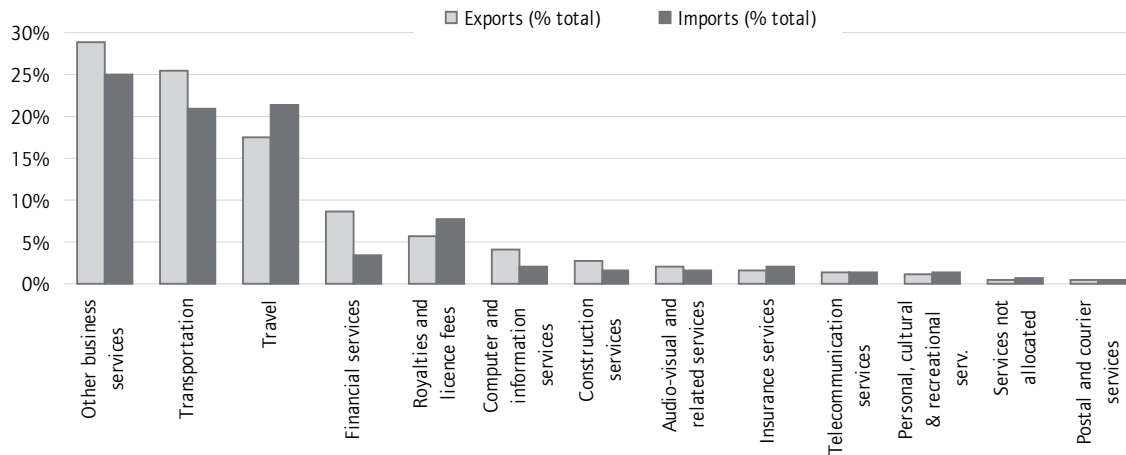
Data source: Eurostat (2007)

An analysis of the breakdown of EU services trade with the rest of the world (extra-EU transactions) shows that the USA (off the scale in Fig. 2.12) continued to be the biggest EU trading partner. In 2006, 30.5% of total exports from the EU27 went to the USA and 32.7% of total imports came from the USA. The highest trade surplus is recorded with Switzerland. Although the EU has considerable surpluses with most of its trading partners, the largest deficits were recorded with Morocco, Croatia, Thailand, Egypt and Turkey, mainly due to deficits recorded under travel.

As Figure 2.12 shows, the United Kingdom was the largest exporter of services in 2006. Almost one quarter of all EU exports to the rest of the world came from the UK, followed by Germany and France. Germany was the biggest importer, accounting for more than 19% of total EU27 imports. It was followed by the UK and France. The small role of the new Member States is noteworthy: in all new EU new Member States, services trade accounted for less than 1% of EU services trade flows. Of course, one should bear in mind that the share

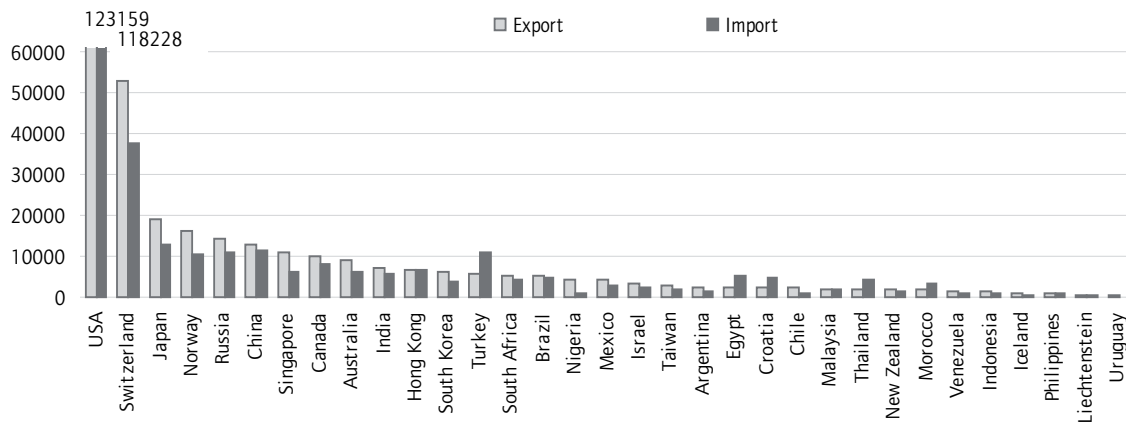
of services trade depends on the size of the country, but Poland is much larger than many EU15 countries which contribute a larger share towards EU services trade.

Figure 2.11 Services trade, extra-EU25, 2005 (share of total services trade)



Source: Eurostat; own calculations

Figure 2.12 EU-27 services trade with its main partners, 2006 (in million Euro)

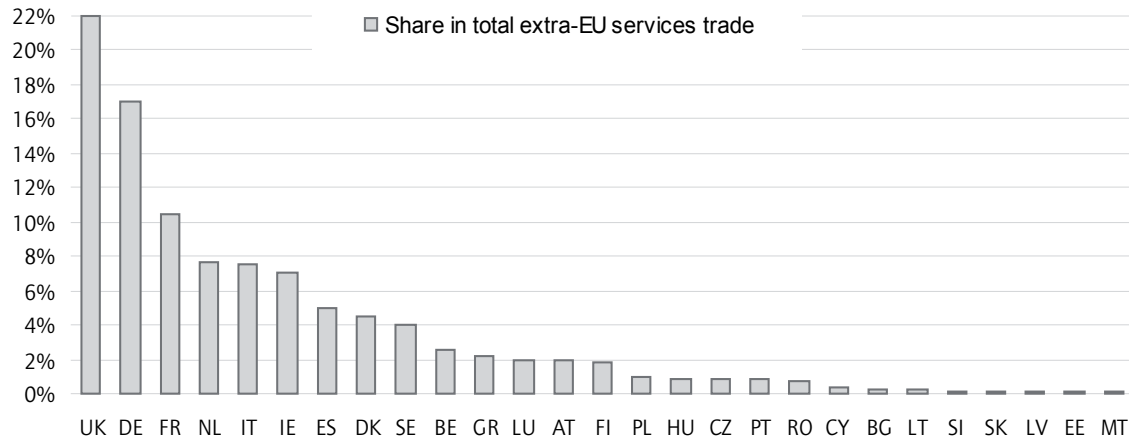


Source: Eurostat  
Note USA is off the scale

Both the volume and the growth of services trade as a share of GDP has been slightly higher between fellow EU15 Member States (intra-EU trade) than that with non-EU countries (extra-EU trade). This is true on both the export and the import side (see Table 2.5). Overall external services trade represents around 80% of internal EU15 trade in services and the figure has declined over time; unsurprisingly it is lower still for the larger trading area of the EU25 (75%). The decrease in proportion over the period implies a slightly greater

degree of ‘Europeanisation’ as opposed to ‘globalisation’. This is relevant to the study, given that GATS applies essentially to EU trade with non-EU members, as internal trade is governed by entirely different EU rules.

Figure 2.13 EU Member States' share in total extra-EU services trade, 2006 (% of total)



Source: Eurostat (2007)

A key point is that while both extra- and intra-EU services trade have been increasing as a share of GDP, it still amounts to less than 5% of GDP (compared with a services share of output above 70%). This emphasises that services are still to a very large extent consumed within the country of production, instead of being traded across borders. In other words, despite the overall importance of services, the size of traded services needs to be seen in proportion. In terms of the relevance of GATS this can of course be taken in one of two ways. On the one hand, services trade is a rather minor part of GDP, and thus associated issues including GATS could be considered of secondary importance. On the other hand, even if services are inherently less tradable than goods, the ‘potential’ for expanded services trade – and thus the importance of liberalising the trading regime, does appear to be significant, implying a key role for GATS, to the extent that trade barriers are what is really holding services trade back.

Table 2.5 Intra/extra EU trade (%) and trade (as % of GDP), 1997 and 2005

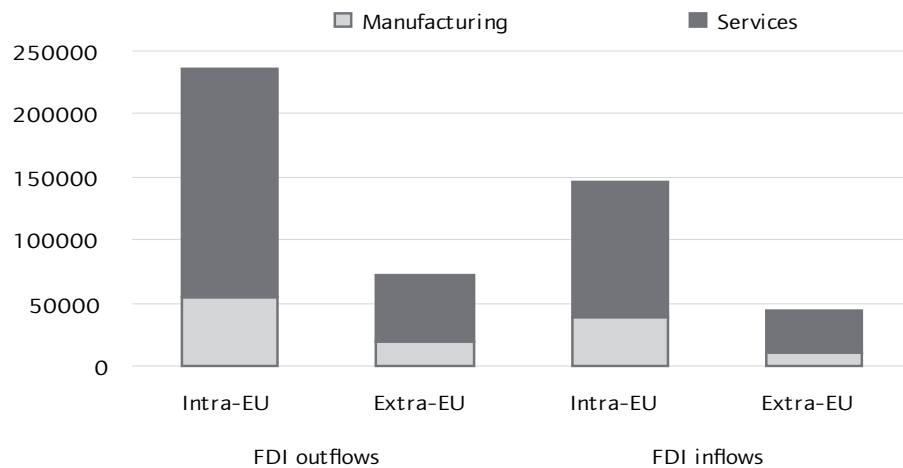
	1997 EU15	2005 EU15	2005 EU25
extra/intra exports	89,7%	86,6%	75,7%
extra/intra imports	83,8%	79,2%	67,1%
extra-EU exports (% GDP)	2,9%	3,5%	3,2%
intra-EU exports (% GDP)	3,5%	4,6%	4,9%
extra- EU imports (% GDP)	3,2%	4,0%	3,7%
intra- EU imports (% GDP)	3,5%	4,5%	4,8%

Source: Authors' calculations based on Eurostat (2007), European Commission (2008)

## 2.6 FDI in services in the EU

Figure 2.14 shows that FDI flows, unlike trade, are concentrated in services. At the same time outflows and inflows of FDI, especially in services, are concentrated within the EU, rather than with trading partners outside the EU.

Figure 2.14 FDI in services and manufacturing in EU25, 2005 (million EUR)



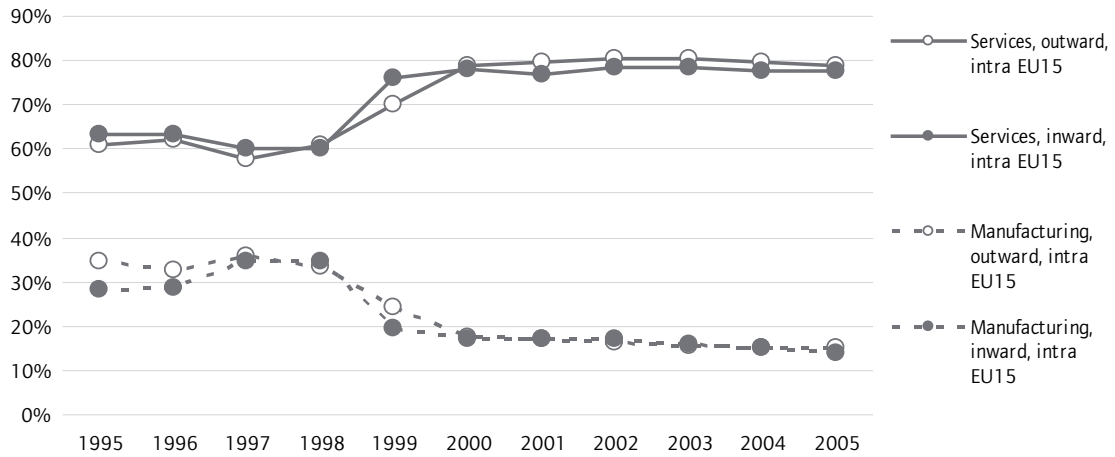
Data source: Eurostat (2008a)

FDI outflows in services are substantially higher than FDI inflows, a finding that applies both to intra- and extra-EU flows. This suggests a limited importance of the GATS (here: Mode 3) compared with the EU rules on freedom of establishment.

Figure 2.15 shows the development of the share of FDI in services and manufacturing over time. It clearly indicates how the structure of FDI has shifted towards services. Whereas in 1995, the services sector accounted for around half of all FDI flows in the EU, by 2005, this share had risen to about 70%. Over the same period, the share of the manufacturing sector in EU FDI flows declined, from about 40% to 20%. This trend is apparently of a global nature and can be expected to continue.

These findings show that, while the services trade figures themselves are rather limited, it seems that increasingly services ‘trade’ takes the form of FDI. A number of studies have been carried out on the relationship between FDI and trade and trade theorists have argued that FDI can be seen as a substitute for actual exporting: vertical FDI splits the production process into segments that are relatively intense in different factors of production. Each segment is located in the country that is abundant in the required factor (see Helpman 1984).

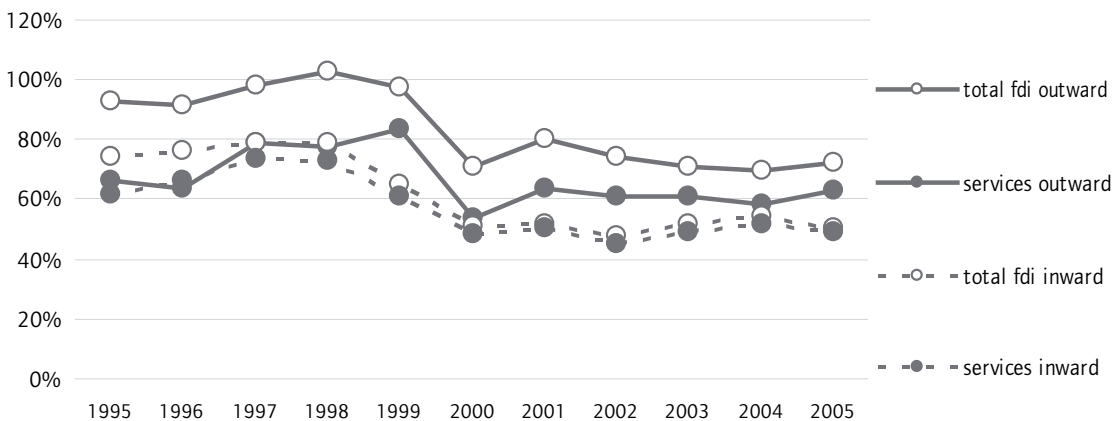
Figure 2.15 Extra-EU15 FDI in services and manufacturing, 1995 – 2005 (share of total FDI)



Data source: Eurostat (2008a)

Figure 2.16 shows that the inward and outward FDI trends are different in services and manufacturing. In terms of inward FDI there is no difference between services and industrial FDI in terms of extra/intra balance, whereas for outward FDI, extra-EU FDI is almost as important overall but much less important than internal FDI for services. The graph also indicates that, over time for all categories, extra-EU FDI is declining as a proportion of internal flows, again suggesting a trend of ‘Europeanisation’.

Figure 2.16 Extra-EU15 FDI flows 1995 - 2005, (% of intra-EU FDI)



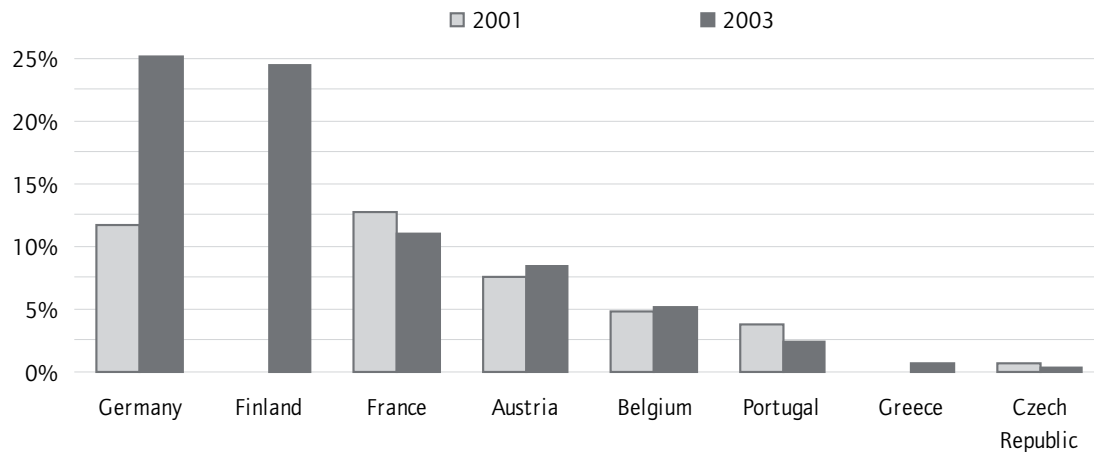
Data source: Eurostat (2008a)

As noted for services trade above, the implication of this for the importance of GATS is ambiguous. It may be that geographical (or cultural/linguistic) proximity is key and Europeanisation is intrinsically more important; however, it can plausibly be argued that the trend in fact reflects the different trade regimes. The much more far-reaching liberalisation of FDI (freedom of capital movements) in the EU compared with the limited international liberalisation brought about under the GATS is one explanation for the Europeanisation trend and is suggestive of the argument that greater GATS liberalisation would encourage services FDI also between EU and non-EU countries.

The sales by foreign affiliates<sup>3</sup> are an interesting overall indicator of the degree of internationalisation and this is of course particularly relevant in the context of the GATS.

Figure 2.17 shows that Germany and Finland have by far the highest share of sales by foreign affiliates in GDP. Furthermore the share in these countries doubled in 2001-2003. For other countries included in the graph, shares range from 0.33% in the Czech Republic to 10% of GDP in France. FATS data are not available for many countries for longer periods.

Figure 2.17 Sales by foreign affiliates in 2001 and 2003 (% of GDP)



Data source: Authors' calculations based on Eurostat (2008a), European Commission (2008)

3. As defined by Eurostat in Foreign Affiliate Trade Statistics (FATS), a foreign affiliate (in the framework of outward FATS) is an enterprise not resident in the compiling country over which an institutional unit resident in the compiling country has control. Control is the ability to determine the general policy of an enterprise by choosing appropriate directors, if necessary. However, control is often difficult to determine and, in practice, the share of ownership is often used as a proxy for control. FATS thus focus on the affiliates that are majority-owned by a single investor or by a group of associated investors acting in concert owning more than 50% of ordinary shares or voting power.

If we consider employment figures by foreign affiliates, in the services sector such employment, as a percentage of total employment in the sector, is higher than in manufacturing in most countries included in Figure 2.17, but there are some important exceptions (namely Germany and France) (OECD 2005). The share of foreign affiliates in service employment ranged from 22% in Ireland to less than 5% in Germany in 2002. The bulk of employment in foreign affiliates is concentrated in four major sectors: wholesale and retail trade, hotels and restaurants, transport and business services. Between 1995 and 2002, in all the countries on which data are available except Belgium, employment by foreign affiliates in services increased, implying an increasing degree of internationalisation and/or Europeanisation. The most important increase was observed in the Czech Republic (accounting for approximately 200,000 employees). Like the FDI figures the employment data for foreign affiliates is suggestive that the official 'trade' figures, which – as we saw above – seemed surprisingly low, rather understate the degree to which service production is internationalised, and emphasise the issue of ownership and cross-border investment by multinational corporations.

Neither service trade flows nor FDI data exactly reflect services trade under the categories of the GATS (the measurement of the GATS modes is described in more detail in chapter 4). Certainly, Mode 3 – as defined by the GATS – is not included in the trade flows but – imperfectly – in the FDI statistics and FATS.

## 2.7 Conclusions

The services sector is the biggest sector in terms of output and employment in the EU and is also the main source of the new jobs in European economies, although with considerable differences between EU Member States and between the different service branches. The services sector, and in particular private services, will continue to grow in terms of both output and employment.

The globalisation of services (in terms of trade and FDI flows) is expected to intensify further. Its impact on service-sector employment, at least at the aggregate level, is not clear. In any case the impact is multidimensional and can have positive and negative effects on both the quality and quantity of employment in different cases and circumstances. Potentially all service sectors are affected by globalisation trends in this sector, but the effects are likely to be stronger in more business-oriented and large-firm sectors, but also commerce.

Having provided necessary background on the services sector in Europe, with a focus on GATS-relevant aspects such as employment, trade and FDI, we now turn to the GATS agreement itself.



### **3. GATS – outline and the review of developments since 1995**

#### **3.1 Introduction**

The General Agreement on Trade in Services (GATS) is the first multilateral trade agreement to cover trade in services. It is a relatively new agreement that was negotiated in the Uruguay Round of global trade talks and came into force on 1 January 1995.

The GATS creates for international trade in services a legal framework that is valid for all WTO members. It aims to increase trade in services by providing transparency in, and the progressive liberalisation of, services markets (WTO 1995).

The function of the GATS is to legally ‘bind’ the liberalisation of the global services economy both by developing common rules for all WTO members and by bilaterally negotiating liberalisation commitments in the services sector. One of the key features of the GATS is that once commitments are scheduled they cannot be reversed unless compensation is negotiated with Members whose trade is affected<sup>4</sup>.

The GATS is the outcome of complex, protracted and difficult negotiations among a large number of countries, both developing and developed. As such, it is a complex and intricate agreement with a potentially broad scope of application. Its extraordinary breadth derives from the diversity of services per se, the architecture of the Agreement, and the expansive and/or ambiguous way in which the GATS defines key terms.

The coverage of GATS extends in principle to all measures by Members affecting trade in services. The only exceptions are air transportation services (which are subject to bilateral agreements), and services provided in the exercise of governmental authority (i.e. services supplied neither on a commercial basis nor in competition with one or more service suppliers). In the latter case, much of the discussion about the scope of GATS focuses on the meaning of ‘commercial’ and ‘competition’ (for more detail see Sinclair 2000; Krajewski, 2003; for a discussion of the concept with regard to the provision of educational services see Scherrer 2005). The Agreement does not define services

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4. Modification or withdrawal is possible under Article XXI, but it requires compensation in other sectors. The US has taken this route in the Gambling case.

with reference to these notions, but specifies only that ‘services supplied in governmental authority’ are beyond the scope of GATS.

The Agreement takes a wide view of what constitutes trade and, in that context, defines four modes of service supply. The distinction between these modes rests essentially on the territorial presence of supplier and user at the time when a service is provided.

For the purposes of the Agreement, trade in services is defined through four modes of services supply:

- *Mode 1* deals with the cross-border flows analogous to international trade in goods (e.g. cross-border routing of telephone calls via call centres);
- *Mode 2* involves consumption of services abroad (e.g. study at a foreign university; use of medical treatment abroad);
- *Mode 3* covers the suppliers’ rights to establish commercial presence abroad to supply services in the relevant Member’s territory, (e.g. establishing a foreign branch; entering into a joint venture);
- *Mode 4* refers to temporary movement of service providers (e.g. employees of transnational companies sent to various group locations).

## **3.2 GATS structure and main principles**

One could characterize GATS as a complex web of rights, obligations, exemptions/exceptions and specific commitments set out in a number of legal documents. First, the agreement contains the general rules, such as most-favoured nation treatment and commitments to transparency that apply to all services. Secondly, the agreement contains specific commitments to market access and national treatment (i.e. treating foreign suppliers like domestic producers) that apply only to those services listed by countries in their schedule to the GATS. Finally, the agreement contains sectoral annexes that set out rules for particular sectors, such as telecommunications and financial services (which have GATS-specific definitions that do not match standard classifications, such as NACE). Last but not least, GATS assumes progressive liberalisation through subsequent rounds of negotiations.

The general commitments relate to non-discrimination as reflected in the most-favoured-nation treatment (MFN) and transparency. MFN is the GATS requirement that its members ‘accord immediately and unconditionally to services and service providers of other members treatment that is no less favourable than that it accords to like services and service suppliers of any other state’ (WTO 1995). Transparency refers to the ‘GATS requirement that its member states publish their regulations affecting trade in services, that they notify the Council for Trade in Services of any relevant changes, and that they respond promptly to requests for information from other members’.

Article VI.4 on domestic regulation is one of the most controversial items in the GATS and raises a number of concerns. Firstly, the Article requires that domestic regulations related to services should not be more burdensome than necessary to ensure service quality. This goes beyond the traditional concerns of the GATT and would impose minimum standards of treatment. However, the ‘necessary disciplines’ have yet to be negotiated. Regulations in the services sector are complex and can relate to core government policy goals. They are often designed to meet ‘non-economic’ goals such as environmental or social objectives. Such regulations vary from country to country and also within countries, where local governments and municipalities are often in charge of implementing regulations. Secondly, negotiations on domestic regulations are ongoing in the Working Party on Domestic Regulations (WPDR). Therefore, there is concern because it is not clear whether any rules developed in the current negotiations in WPDR will apply to sectors where governments have already made specific commitments without being in a position to know the outcome of these negotiations (Joy 2001; Mattoo 2001; OECD 2002; Adlung 2006; Leroux 2006). For example, one of the proposals within this working party is the introduction of a ‘necessity test’. Under this test, a WTO Member which appeals to WTO dispute settlement would have to prove that a particular regulation in another Member is more burdensome than necessary and that there were alternative means of achieving the same objective that would have been less trade-restrictive (for more on this issue see Mattoo/Sauve 2003; Delimatsis 2008). This process might be expected to be both costly and lengthy, especially to the complaining member, so that such complaints will be presented for WTO dispute settlement only in the most significant cases.

The effects of GATS depend predominantly on the extent and nature of the specific commitments on market access (Article XVI) and national treatment (Article XVII) undertaken by WTO Members in individual sectors. Given the structure of the Agreement and scheduling practices, market-access commitments tend to be crucial. The market access rule (Art. XVI) prohibits a whole range of quantitative restrictions on trade. This includes restrictions on the number of employees, the form of the undertaking or the level of participation of foreign interests in the share capital. For example, if a WTO member has opened up a waste disposal sub-sector within the GATS but has restricted foreign participation in domestic incineration facilities to less than 50% (e.g. to maintain public sector influence over such undertakings), this would represent a breach of the GATS and could give rise to a claim before the WTO Dispute Settlement Board (see Palmeter/Mavroidis 2004; Zdouc 1999; Zimmermann 2005). However, there have been only twelve disputes raising GATS issues up to 2008<sup>5</sup>. Of those, seven consultation requests were either settled

5. Consultation requests: The US – the Cuban Liberty and Democratic Solidarity Act (initiated by the EU); Japan – Distribution Services (initiated by the US); Belgium – Telephone Directory Services (initiated by the US); Canada – Film Distribution (initiated by the EU); Nicaragua-Imports from Colombia and Honduras (initiated by Columbia); Turkey- Fresh Fruits (initiated by Ecuador); China- Integrated Circuits (initiated by the US); Panel and Appellate Body cases: Canada- Periodicals (initiated by the US); EC-Bananas (initiated by Ecuador, Guatemala, Honduras, Mexico and the USA); Canada- Autos (initiated by Japan and the EU); Mexico-Telecoms (initiated by the USA); US- Gambling (initiated by Antigua).

or dropped, while only four requests have led to the adoption of Panel and/or Appellate Body reports. The twelfth case submitted by Canada involved invoking GATS as a defence. As such, it is fair to say that, to date, GATS has not figured very prominently in WTO dispute settlement (Davey 2008). Why this is so is not clear. The most likely explanation is that rather than any new market opening commitments being made in the GATS offers, existing liberalisation was merely required to remain bound at the national level. We assess the extent of GATS commitments by EU countries in Chapter 5.

National treatment (Art. XVII) requires equal treatment of domestic and foreign suppliers with the effective aim of establishing the same competition conditions for all undertakings. National treatment under any of the four modes may also be made subject to limitations scheduled by the Members. The national treatment principle makes no distinction between public non-profit undertakings and private companies seeking to maximize their profits. No account is now taken of their legal form (public, private, charitable), their size or social and environmental quality (see WTO 2002b; Ortino 2006).

Regardless of wide scope of the GATS, it is worth pointing out that the (GATS) regime for services is much less ambitious than that for goods (GATT and various other WTO agreements) in that there are many more rules of general application for trade in goods. Most notably, the national treatment rule in GATT is one of general application to all Members and all sectors, while in GATS exceptions and certain national limitations are permitted.

As noted before, liberalisation in the GATS framework is achieved through negotiating rounds (or the accession commitments of new WTO members), in which individual countries or groups of countries offer to make certain commitments, and request particular commitments from others. However, while a liberalisation round is on-going offers may be withdrawn before the round is completed if countries consider that those made by other countries are inadequate. On the other hand, this is a bargaining process, and it could also happen that the other countries were encouraged to increase their offers. At the end of the round, once agreement has been reached, the set of offers that have been accumulated are converted into commitments. Once a liberalisation round is completed, commitments can be withdrawn or modified only after the agreement of compensatory adjustments with affected countries.

### **3.3 Schedules of specific obligations**

The GATS negotiations involve a request and offer system: countries put forward requests representing what WTO Members seek from other trade partners and what they themselves are prepared to put forward in terms of market opening. In this section, we present the main structure and features of the individual country's schedule of commitments.

The commitments can be scheduled for the following 12 services areas, which can be further subdivided into some 155 sub-sectors as referred in the WTO services' classification list (1991)<sup>6</sup>:

- business (including professional and computer) services
- communication services
- construction and related engineering services
- distribution services
- educational services
- environmental services
- financial (insurance and banking) services
- health-related and social services
- tourism and travel-related services
- recreational, cultural and sporting services
- transport services
- other services not included elsewhere.

The national schedules of commitments by WTO members conform to a standard format and are subdivided into two parts, one horizontal and one sector-specific section (as presented in Table 3.1). Horizontal limitations, which are likely to reflect policy constraints of a general, economy-wide nature (i.e. restriction for temporary movement of service providers, limitation to foreign land ownership), apply across all sectors listed in the schedule.

Table 3.1 Example of the GATS commitments structure and limitations

Commitment type and mode of supply	Conditions and limitations on market access	Conditions and qualifications to national treatment	Additional commitments
<b>Horizontal commitments (apply across all sectors)</b>			
1. Cross-border	None	None	
2. Consumption abroad	Unbound	Unbound	
3. Commercial presence	Maximum foreign equity stake is 49 per cent	Unbound for subsidies	
4. Temporary movement of service providers	Unbound except for intra-corporate transferees.	Unbound except for categories listed in the market access column.	
<b>Specific commitments (for a particular sector or sub-sector)</b>			
1. Cross-border	None	None	
2. Consumption abroad	Unbound	Unbound	
3. Commercial presence	Maximum foreign equity stake is 49 per cent	Unbound for subsidies	Establishment of an independent regulator
4. Temporary movement of service providers	Unbound except as indicated in the horizontal commitments.	Unbound except as indicated in the horizontal commitments.	

Source: Illustrative example combining findings from the GATS offers of various WTO Members

For each service sector or sub-sector for which an offer is made, the schedule must indicate, with respect to each of the four modes of supply, any limitations on market access or national treatment which the country intends to maintain. Furthermore, when making a commitment, a government binds the specified level of market access and national treatment and undertakes

6. The full list can be found on the WTO website [http://www.wto.org/english/tratop\\_e/serv\\_e/mtn\\_gns\\_w\\_120\\_e.doc](http://www.wto.org/english/tratop_e/serv_e/mtn_gns_w_120_e.doc)

not to impose any new measures that would restrict entry into the market or the operation of the service (WTO 2002c). Specific commitments thus have a binding effect similar to a tariff: they are a guarantee to economic operators in other countries that the conditions of entry and operation in the market will not be changed to their disadvantage (see Barlow 2001; Sinclair/Grieshaber-Otto 2002).

If a government enters the word 'Unbound' in its schedule, it wishes to remain free in that given sector and mode of supply. This essentially means that a country can introduce or maintain measures inconsistent with market access or national treatment in that sub-sector. To determine the specific domestic restrictions applicable in an unbound sector, each piece of legislation relevant to that sector in the country concerned needs to be examined. Clearly this becomes an extremely complex matter, depending on each case. If a service sector is omitted from a schedule, it implies that the country has no obligations on market access and national treatment in that specific sector. Therefore, the sector is also 'unbound' in GATS terms.

### **3.4 History of negotiations – from 1995 to 2008**

The GATS, the first multilateral agreement on services, was one of the major innovations to emerge from the Uruguay Round of WTO negotiations. Given the novelty of the subject, most of the efforts during the Uruguay Round negotiations on services centered on conceptual and 'architectural' issues of the GATS (i.e. how to define trade, what rules and principles should apply to measures affecting this trade, and devising mechanisms to determine the coverage of the Agreement). Therefore, no actual liberalisation of trade in services occurred during the Uruguay Round and only standstill commitments were made, thus binding the present level of liberalisation or mostly offering less (WTO 2001). What emerged instead was a framework under which liberalisation could be pursued in the future, with explicit commitments to engage in further negotiations to liberalise trade in services five years after the entry into force of the GATS, and periodically thereafter.

By far the biggest sectoral liberalisation achievements were made just after the Uruguay Round had finished. These were the negotiations on telecommunications conducted until 1997 and which resulted in a Basic Telecommunications Agreement and triggered actual liberalisation process in many countries, including the EU, and the negotiations on financial services conducted until 1999 that also led to a high level of commitments (Marko 1998; Mattoo 1998; OECD 1999; Ying 2000; Sauve/Steifatt 2001).

In 2000, a new round of GATS negotiations started as part of the so-called 'built-in-agenda', despite the failure to start a 'Millennium Round' of trade negotiations at the Ministerial Conference in Seattle 1999. By 2001, WTO members had agreed on highly sophisticated 'negotiation guidelines', which included a bilateral request-offer process to negotiate individual country schedules of commitments. Hopes were high for a further round of negotia-

tions. Especially the EU endeavoured to open up global markets for its now strengthened services companies after some infrastructure services had been liberalised in the wake of the Internal Market Programme. However, while several WTO members did submit revised requests and offers in the GATS negotiations, the willingness to make commitments to open up Member States' own services sectors was rather low. Some argue that the EU itself, in its revised conditional offer of 2003, did not make any offers that went beyond the *status quo* of the existing liberalisation levels (Deckwirth 2007).

In the run up to the Hong Kong Ministerial Conference in 2005, developed countries, including the EU, expressed serious concern about what they perceived as the failure of bilateral negotiations to result in meaningful and high quality offers from Membership of the WTO. It was argued that the bilateral request/offer process had failed to generate an ambitious result but had led to a 'low-level equilibrium trap', where little is expected and less is offered, resulting in a crisis in the services negotiations. The bilateral Request/Offer process was also viewed as highly resource-intensive since it involved sector-by-sector and country-by-country bartering of commitments. The request/offer process was also criticised for lack of seriousness since some of the requests were overly ambitious, seeking – in some cases – elimination of all limitations (Kategekwa 2006).

In response, the proponents of the expansion of the Agreement, including the EU, began to push for so-called 'benchmarks' and plurilateral negotiations to ensure ambitious results in the GATS negotiations. Benchmarks refer to various targets set to ensure that the GATS negotiations result in ambitious levels of increased coverage. In plain language, benchmarks are negotiating techniques designed to coerce reluctant governments into making GATS commitments that they do not want to make (Sinclair 2006). In the run-up to Hong Kong, a number of benchmarking proposals were tabled by the proponents of GATS expansion. These proposals all set targets that were meant to spur, and in certain cases compel, more far-reaching GATS commitments. They have taken a variety of forms: numerical (i.e. a country must commit a minimum number of sectors or sub-sectors); qualitative (i.e. governments must, for example, eliminate certain types of measures such as foreign ownership limits or economics needs tests); horizontal (i.e. governments must bind existing levels of liberalisation across sectors or in certain modes of delivery); sectoral (i.e. model schedules or checklists that define 'high-quality' commitments by sector) (Khor 2005; South Center 2005). Even if the benchmark approach was not ultimately taken up further in the Hong Kong Ministerial it is possible that this issue will come up in future GATS negotiations.

The most significant outcome of the Hong Kong ministerial was the mandate to proceed with plurilateral request-offer negotiations. It was proposed that plurilaterals would provide more optimal use of time and human resources through meeting in larger groups to discuss liberalisation potentials and dynamics in particular sectors. Indeed, it was argued, by some, that if developing countries were able to act collectively with other similar countries sharing common interests their positions in negotiations would be strengthened.

However, this approach was criticised by many, including the labour movement (ETUC 2005; ICFTU 2005). Plurilaterals would damage the flexibilities GATS offered countries, by forcing on them higher levels of liberalisation commitments in specific sectors, notwithstanding development needs.

Despite reluctance on the part of many Members, Ministers agreed, in Annex C to the Hong Kong Declaration, that the request/offer process would be complemented by a plurilateral approach. During spring and early summer 2006, more than 20 plurilateral requests were submitted. Some of the key sectors and modes in which requests were tabled include: energy, environmental, construction, telecom, financial, maritime, education, logistics, computer and related, express delivery, postal, maritime, architectural and engineering, audiovisual, legal, logistics, services related to agriculture, cross-border supply (Mode 1 and Mode 2) computer-related services, and Mode 4. Members engaged in three rounds of plurilateral negotiations.

However, in July 2006, the negotiations on GATS once again reached a standstill at the General Council Meeting in Geneva when Pascal Lamy, WTO General Director, suspended the Doha negotiations after the big trading powers—America, the EU, Japan, Australia, Brazil, and India—failed to produce agreement on the contentious issue of cutting agricultural protections. The suspension also meant that all work in all negotiating groups, including trade in services, was suspended and the deadlines for revised offers and requests cancelled. Since then, WTO Members have been in a process of drafting a set of general guidelines and schedules for further negotiations. However, the development of a draft services text contained many disagreements as many countries were unsure what the scope or purpose of the draft services text would be. Members agreed on the need for a new date for the submission of revised GATS offers, but disagreed concerning the extent of the new commitments in the revised offers. Another important disagreement regarding the text is that developed countries argue that services should be given the same priority as agriculture and non-agricultural market access negotiations. Developing countries, on the other hand, argue that there should be no comparability of negotiation in these different fields and that services negotiations should proceed more cautiously. In January 2008, a group of countries led by the EU, the United States, Japan, and Canada presented an outline of what they would like to see in the draft text. Subsequently the group has claimed that talks to date have been disappointing and slow (Robinson 2008).

While Pascal Lamy, Director General of the WTO, has outlined a schedule for the completion of talks by the end of 2008, many trade officials were then saying the timeline was far too optimistic. The most recent round of negotiations that took place in Geneva on 23-29 July 2008 broke down after failing to reach a compromise on agricultural import rules. It is important to note that during these negotiations, both the EU and the USA offered to increase their commitments for Mode 4. The talks in Geneva were considered a 'last chance' for a deal before the US Presidential elections in November 2008. Now, it appears the Doha Round will be put in the freezer until January 2009 at the very earliest or even until after European Parliament elections and the nomination

of a new European Commission in November 2009. While some speculate that, with new faces around the table, the chances for a deal would increase, others say that, by then, there will be no chance of reviving what will then be the nine-year negotiating mandate of the Doha Round (Euractiv 2008). At the moment of writing this report, it was therefore not clear if and when a breakthrough in the Doha Round negotiations will be reached and how work on services negotiations will continue.

Separately from the bilateral and plurilateral sectoral negotiations, negotiations on certain GATS rules that could not be agreed upon during the Uruguay Round are on-going. These include: (1) emergency safeguards; (2) subsidies; (3) government procurement; and (4) domestic regulation. Table 3.2 summarizes the progress in negotiations of these aspects (for more see Sauve 2002; Mattoo/Stern/Zanini 2008, Pannizon/Pohl/Sauve 2008). To summarise, emergency safeguards – which are designed to allow Members to temporarily suspend their liberalisation commitments during or in response to a threat of an import surge that would result in serious injury to domestic industry and hence national growth and development – had been earmarked for completion three years after the entry into force of the WTO Agreement, in January 1998. However, due to an inability to agree on the very need for – and substantive provisions of – a possible emergency safeguard mechanism, the Working Party on GATS Rules (WPGR) – a subsidiary body to the Council for Trade in Services – postponed the deadline for completing negotiations on such an instrument for the third time to March 2004 (Sauve 2002). After the March 2004 deadline passed, no specific date for completing negotiations was set. Negotiations on the other two components of the unfinished agenda (subsidies and government procurement) have produced no significant results to date.

More developments have taken place in the negotiations on domestic regulations. Since the start of work in 1995, apart from some ‘Disciplines on Domestic Regulations’ in the accountancy sector, the working group on domestic regulation had made no further substantial progress before the Hong Kong ministerial conference. However, the Hong Kong ministerial in 2005 jump-started the critical GATS issue of negotiation of new rules restricting ‘domestic regulation’. The proposed new rules could potentially restrict laws and regulations, at all levels of government, even when they do not discriminate against or between foreign investors. The Hong Kong declaration mandated that these controversial negotiations be concluded and a legal text developed by the end of 2006. Significantly, the ministerial decree made domestic regulation negotiations part of the Doha Development Agenda’s ‘single undertaking’, meaning that they must be concluded as part of the current round (Sinclair 2006). After some delay, the text was issued in April 2007 and in early 2008 the revised text on GATS restrictions on domestic regulation was circulated to Members. In particular, the latest draft retains the controversial requirement that Members ensure that certain regulations they adopt are objective and do not constitute ‘disguised barriers’ to trade. If adopted, this would apply new restrictions on regulations governing qualification requirements and procedures, licensing requirements and procedures, and technical standards (Robinson 2008).

Table 3.2 Summary of the ongoing GATS negotiations

	What?	How?	By when?
Progressive liberalisation	New specific commitments by WTO Member states	During successive rounds of negotiations	Negotiations must start by January 2000 Doha mandate: Initial requests by 30 June 2002 Initial offers by 31 March 2003 Improved offers by 2009?
GATS Rules	Emergency safeguard measures	Development of GATS Agreement on Emergency Safeguard Measures based on the principle of non-discrimination	An agreement must be in force by: January 1998 (postponed) December 2000 (postponed) March 2002 (postponed) March 2004 (postponed) To date, no specific deadline was set
	Government Procurement	Negotiations on Government Procurement under the GATS	Negotiations must start by Jan. 1996 Progress report by GATS Council Chairman in 2003 Negotiation ongoing
	Subsidies	Development of GATS subsidy discipline to avoid the subsidies' trade-distortive effects while addressing the appropriateness of countervailing procedures	Open ended
	Domestic regulations	Development of regulatory GATS disciplines	Open ended

Source: author's interpretation, based on literature review

### 3.5 Conclusions

Analysis in this chapter has shown why the GATS is inevitably a controversial agreement. It is broad in scope; it contains a number of unclear terms and rules; in addition negotiations on different (and very important) aspects are ongoing and it is not clear when and what outcome will be reached. The GATS implications on the services sector in the EU, therefore, must be seen in the context of its evolving structure.

On the other hand, the GATS implications in the EU must be seen in light of the history of DDA Round and what has been achieved so far. The DDA negotiations have been ongoing since 2000. They had been suspended a number of times, the last being in July 2008. The proponents of the Agreement consider the progress in these negotiations small, especially in services. In general, the focus of the Doha Round has mostly been on agriculture, and, to a more limited extent, trade in manufactured goods but not services. Many WTO Members submitted very limited GATS offers. And the best market-access offers do not reflect the liberalisation that has already taken place at the national level. In general, trade commentators suggest that the negotiating process seems to have resulted in a low-level equilibrium trap where little is expected and less offered.

It is difficult to judge if the current round might achieve a breakthrough in the near future. This raises a difficult issue – to which we will return repeatedly – namely that, because of the widespread failure of negotiations, the current practical relevance of GATS is limited, while at the same time its potential scope, were a breakthrough in negotiations to be achieved, could be very far-

reaching indeed. It is worth noting that progress in the GATT from its creation in 1947 was similarly chequered, particularly in regard to the abolition of quantitative restrictions, such as those used for balance-of-payments reasons. In the end, however, enormous progress was made towards liberalisation.

The cross-cutting GATS issues described in this chapter apply to each of the four modes of services supply. Two of them – Mode 3 and Mode 4 – are the focus of this report and are described in detail in the next chapter.



## 4. Mode 3 and Mode 4: scope, trade flows and possible impacts

### 4.1 Introduction

This chapter addresses in detail the two modes of cross-border services trade in the GATS framework that are the focus of this research project – commercial presence (Mode 3) and temporary movement of service providers (Mode 4). The aim of the section is to show in general terms the relationship between GATS and cross-border investment and GATS and temporary migration of workers, and to elaborate on some key aspects within the debate on these issues. In this chapter we consider the scope of these modes within the GATS, the available data, and provide a critical review of the existing studies that discuss the impacts of service liberalisation under these two Modes.

Mode 3 – commercial presence – is the main mode for trading services. It is estimated that it accounts for approximately 50% of services trade. At the same time it is the most open mode of services trade within the GATS. In contrast, temporary movement of services providers under Mode 4 accounts for a small share of international trade in services and a small share of cross-border movement of labour. Notwithstanding, GATS Mode 4 emerged as one of the major topics in the Doha Development Round negotiations. The debate on the temporary movement of services providers has taken place within the general context of increasing labour migration and the growing importance of the services sector and international trade in services. From the EU perspective, Mode 4 debates are also intertwined with the debates on EU enlargement and increased labour mobility from the new Member States, the relocation of capital and the EU services directive. More generally, the background has been characterised by slow growth and high unemployment in some Member States.

### 4.2 Definition and scope

#### 4.2.1 Mode 3 definition and scope

GATS Article I.2 defines Mode 3 as ‘the supply of a service by a service supplier of one Member, through commercial presence in the territory of any other Member.’ The ‘commercial presence’ is defined in the Art. XXVIII(d) as: *Any type of business or professional establishment, including through (i) the constitution, acquisition or maintenance of a juridical person, or (ii) the creation or maintenance of a branch or a representative office, within the territory of a Member for the purpose of supplying a service.* (WTO 1995)

The notion of investment adopted by the GATS differs from broader, asset-based definitions used, for example, in bilateral investment treaties or other instruments devoted specifically to investment. It applies only to foreign direct investment, leaving out of its reach portfolio investment and other types of assets, such as intangible assets.

Commercial presence in the GATS focuses on enterprise-oriented investments. Therefore, it aims to cover any juridical person devoted to the supply of a service, i.e., involved with the production, distribution, marketing, sale and delivery of a service. All forms of legal organisation relating to establishment in the host country fall under the scope of the agreement, so long as they relate to a juridical person, subsidiary local branch, or representative office of the investor.

The Agreement does not govern individual investment decisions, but rather the conduct of its signatories, namely States. No ‘rights’ are thus conferred directly upon individuals (i.e. juridical or natural persons)<sup>7</sup>. Furthermore, the GATS focuses on a commercial presence as a modality of trade in services, and does not provide for the kind of rules on the treatment and protection of foreign investment typically contained in international investment agreements. For example, the GATS does not address matters such as expropriation and compensation.

What GATS does, from the standpoint of an investor, is to provide security regarding establishment to the extent that it can report host country violations of their GATS commitments to its own national authorities in order to obtain enforcement of the Agreement.

The commitments for Mode 3 are scheduled in the same way as for other modes of service supply, described in Chapter 3. WTO Members list horizontal commitments that apply across all sectors and sectoral commitments that apply to certain sectors. Mode 3 limitations are possible in relation to:

- the number of service suppliers or operations allowed
- the total value of service transactions or assets allowed
- the total quantity of service output allowed
- the number of persons employed
- the specific type of legal entities allowed
- the percentage of foreign ownership (WTO 1995).

Members can qualify these limitations by putting an appropriate entry in the column. They could also extend these limitations by entering something in the ‘additional commitments’ column (for example, it has been noted that there is no mention of temporal limitations in the default commitments). In addition, any type of national treatment limitation – conditions applying only to foreign suppliers – can be scheduled.

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7. It is conceivable that some WTO Members might have domestic rules that confer such rights because of their GATS treaty obligations. Under the rules developed by the European Court of Justice that is unlikely to be the case in the EU.

## 4.2.2 Mode 4 definition and scope

The GATS describes trade in services under Mode 4 as ‘the supply of a service... by a service supplier of one Member, through presence of natural persons of a Member in the territory of any another Member’. Mode 4 covers temporary entry by the following four main categories of natural person:

- intra-corporate transferees (managers, specialists, trainees);
- business visitors and services sales persons, who enter into another Member’s territory for the purpose of setting up a commercial presence or negotiating the sales of services;
- independent professionals (self-employed workers who enter into another Member’s territory for the purpose of temporary supplying a service);
- contractual service suppliers, who enter the territory of another WTO Member on a contract between their employer and service consumers in the territory of the other Member.

In general, the GATS covers all international temporary movements of service providers, whether developing to developed countries, developed to developing, or between developed or developing countries, and potentially includes liberalisation of movement of highly skilled, medium skilled or unskilled services providers. Furthermore, Mode 4 applies to nationals and, in certain circumstances, also to permanent residents of WTO Members seeking to supply services abroad (WTO 2002a).

However, the precise limits of the scope of Mode 4 are very ill-defined. Firstly, the GATS Annex<sup>8</sup> states that Mode 4 does not cover natural persons seeking access to the receiving country’s employment market; does not apply to the measures regarding citizenship, residence or employment on a permanent basis; and does not affect national governments’ rights to regulate entry and temporary stay, provided these measures do not nullify or impair the commitments. However, Mode 4 covers movement of independent services providers, i.e. self-employed persons, who seek employment in a foreign country on temporary basis. One can argue that independent service providers are indeed natural persons seeking employment in the receiving country. This poses a number of general and more specific challenges in defining the scope of Mode 4 (Sussex 2005).

Another problem of definition arises from the fact that while the GATS Mode 4 covers service providers who move only temporarily, there is no definition in the Agreement of what is ‘temporary’. In effect, the length of stay allowed by GATS Mode 4 is identified in the offers made by Members and varies from a few months to a few years (in some cases the periods are renewable) depending on the type of work and usually skills level.

8. [www.wto.org/english/docs\\_e/legal\\_e/26-gats\\_02\\_e.htm#annmov](http://www.wto.org/english/docs_e/legal_e/26-gats_02_e.htm#annmov)

On the other hand, it can be argued that some flexibility of definition and classification might be needed, because the GATS commitments are binding, while services economies are very dynamic, services become more tradable due to technological developments, and the new types of services evolve over time.

### **4.3 Interests in Mode 3 and Mode 4 liberalisation**

#### **4.3.1 Interests in Mode 3 liberalisation**

Our analysis of the EU GATS offer (presented in detail in chapter 5) shows that commitments in Mode 3 are the most extensive if compared to other modes of service supplies. The EU opened up most of the services sectors for Mode 3 trade to a very high extent already in 1995.

While Mode 3 is not perceived as very controversial when it comes to the opening of the EU services sectors, it is more important in relation to the market access for the EU investors to third countries' markets (especially developing ones). Many other WTO Members, especially developing ones, place much greater limitations on foreign investors than is the case in the EU and the removal of such limitations is of great interest for EU companies. In this regard, the European Commission is often criticised for asking developing countries to remove FDI barriers in their sectors. The debate here is ongoing about the link between FDI, development, jobs and growth and the importance of maintaining policy space in order to protect local industries in developing countries (see Joy 2003; Whaley 2004). We return to this issue in Chapter 7.

Nevertheless, some interest groups within the EU can be identified. The proponents of the Agreement (such as the European Commission, business representatives, some national governments) argue that the Mode 3 is not a risk, as it guarantees a predetermined set of conditions that provide policy stability for potential investors. Supporters of the agreement emphasise that it offers investors access to an investor-state dispute settlement mechanism, allowing them to take their disputes directly to international arbitration. On the contrary, European trade unions and NGOs, while not questioning the importance of foreign investment for the local economies, are concerned that GATS gives access to third-country investors without any protection of labour standards or wages of local workers. These concerns are shared by GATS critics worldwide (see Chanda 2002, Hardstaff 2003). Furthermore, one of the main arguments is that GATS might endanger a number of national regulations, thereby causing negative social and labour market impacts.

#### **4.3.2 Interests in Mode 4 liberalisation**

There are various interests at play in the negotiation of temporary movement of service providers under Mode 4. The interest groups that represent large international services companies in the EU call for more commitments under Mode 4, especially regarding highly skilled workers. They also emphasise

a strategic interest in further liberalisation of categories of persons linked to commercial presence (intra-corporate transferees and business visitors) (European Services Forum 2005). Among other reasons, this is seen as important for underpinning existing and future Mode 3 specific commitments – i.e. if a foreign service company seeks to establish commercial presence in a third country, temporary workers would move under Mode 4 before, during and after the investment process. Mode 4 is also perceived as facilitating access to a more qualified and more productive labour force and as a way to smoothing fluctuations in demands for services. From the business perspective, global corporations should be able to move personnel around as needed and may be more inclined to invest in countries that facilitate this (OECD 2003a, OECD 2003b). The business lobbies are interested in further liberalisation under Mode 4 and the introduction of a ‘GATS visa’ that would apply for both horizontal and sectoral commitments and include separate sets of conditions for each category of workers (European Services Forum 2001a, European Services Forum 2001b, European Services Network 1999).

However, many governments, social partners and some NGOs in the EU are reluctant to engage in further liberalisation of Mode 4 because of broader policy concerns relating to migration in general. Mode 4 is located at an overlap between migration and international trade and therefore raises a number of important and complex issues that go beyond the sphere of trade policy. Many fear that national laws and regulations concerning entry, stay, work and social security measures, including regulations concerning minimum wages agreements, could be challenged by further liberalisation of trade in services at the WTO. While trade unions in the EU are in favour of the free movement of labour within Europe, they argue that further Mode 4 liberalisation has the potential to open the door to unregulated migration, with negative impacts on local employment, wages and social standards as established in collective agreements (Raza 2003, ETUC 2005, Uni-Europa 2002). Mode 4 concerns mostly relate to the movement of independent and contractual services providers and possible flows of medium- and low-skilled service providers following further liberalisation. With regard to Mode 4 trade unions emphasise that negotiations should ensure protection of migrant workers against all forms of discrimination, observance of core international labour standards and national labour law; respect for existing collective agreements covering the sectors concerned; and the full involvement of the ILO (ETUC 2005).

Although the division between the opponents and proponents of Mode 4 liberalisation has been much more evident between various interests groups *across* countries, a certain tension *between* various blocks of countries has also appeared. In relation to Mode 4, the dividing line can be drawn between developed and developing economies (especially regarding the inclusion of medium- and low-skilled workers). So while the EU has a mainly defensive interest in Mode 4, many developing countries put particular emphasis on further Mode 4 liberalisation, and consider it to be a key element in the GATS negotiations within the DDA round (see Chanda 1999, OECD 2003b, Winters 2005, Dey 2006, Katetegwa 2006). Countries like India have competitive exporters in computer and engineering services and are interested in liberalisation of movement of

services providers in this category. But most developing countries are interested in liberalisation of Mode 4 due to their comparative advantage in low- and medium-skill labour-intensive services such as transport, construction and tourism, care professions and cleaning services (European Commission 2004).

## **4.4 Magnitudes of Mode 3 and Mode 4 trade**

### **4.4.1 Measuring Mode 3 and Mode 4 services supply**

Commercial presence is covered by two kinds of statistics: (i) information on flows and stocks of foreign investment which make commercial presence possible, and are currently recorded in FDI statistics, and (ii) information on the activity of foreign companies in domestic markets (such as turnover), which is to be recorded under the Foreign Affiliates Trade in Services (FATS) statistics.

While providing some estimates of Mode 3 flows, both data sets have significant limitations and do not exactly reflect trade flows under Mode 3. The FDI definition does not match the definition of commercial presence in the GATS. In the FDI statistics, the concept of ownership underlying statistical practices in FDI is based on 10 per cent of shares or voting power, while in the GATS, commercial presence definitions is based on 'ownership' of more than 50 per cent of the equity interest or 'control'. Moreover, in this dataset, variables such as output and sales are generally not included in existing questionnaires. Thirdly, the sectoral breakdown is limited. Lastly, FATS statistics would be the most useful for measuring Mode 3. However, this database is very new and has very limited geographical coverage (see OECD 2005; Lipsey 2006).

Measuring Mode 4 trade presents real challenges. A general problem arises from Mode 4's interconnection with commercial presence (Mode 3). The strong links between Mode 3 and Mode 4 make it difficult to separate out the value of trade that is due to the presence of the service provider in the country where the service is provided from the value of trade that is due to the service firm established abroad.

Furthermore, since the GATS entry into force in 1995, no comprehensive statistical framework for the measurement of the movement of service providers has been developed, and no systematic data has been collected by regional or international organisations.

Trade in services is usually measured by reference to balance of payments (BOP) statistics. As to Mode 4, BOP statistics capture labour-related flows in the three categories:

- wages, salaries and other compensation received by individuals working abroad for less than one year;
- worker remittances from workers who stay abroad for a year or longer;
- migrants' transfers, i.e. flow of goods and changes in financial assets associated with international migration (OECD 2003c).

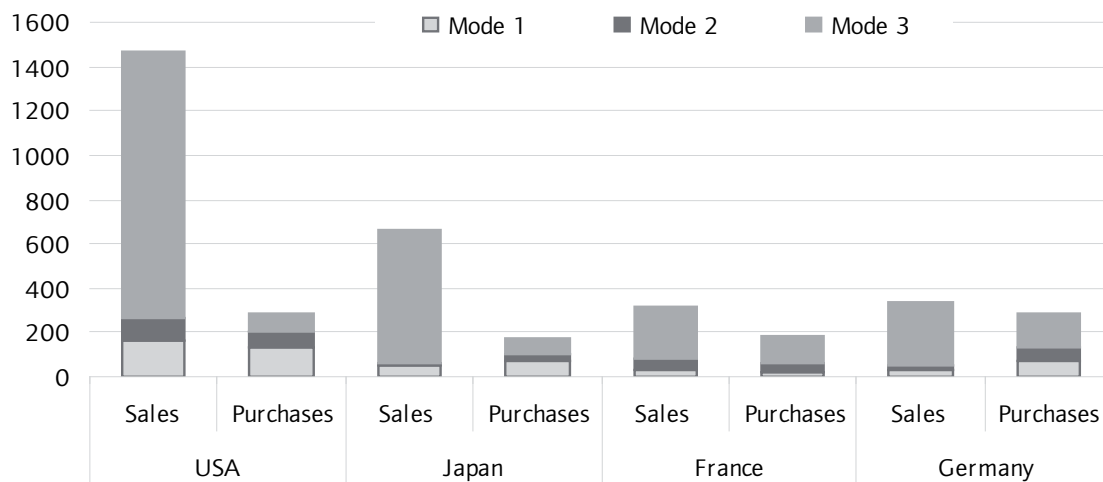
Unfortunately none of these categories in the BOP corresponds exactly to the definition of Mode 4. For instance, data on workers' compensation includes all temporary workers employed in any economic sector (not only services), which would lead to an overestimation of Mode 4. At the same time, this indicator only includes workers staying abroad for less than one year, while in some offers Mode 4 covers temporary stay of up to five years, which leads to an underestimation of Mode 4. Therefore, empirical estimates on Mode 4 need to refer to both trade in services, and labour market and migration statistics (i.e. share of temporary foreign workers in receiving country, etc.). This entails the danger of conflicting evidence and estimations that do nothing to facilitate an evidence-based debate on these issues within academia and between policy-makers and concerned civil society.

#### 4.4.2 Relative importance of Mode 3 and Mode 4

In this section we briefly review the main studies that attempt to shed some light on the size of Mode 3 and Mode 4 services trade flows.

A few studies try to assess global Mode 3 trade flows relative to other modes of service supply. Karsenty (2000) estimates that Mode 3 worldwide accounts for 57% of cross-border sales of services, versus 29% for Mode 1, 14% for Mode 2 and 1.4% for Mode 4. OECD (2008a) looks at the size of the Mode 3 trade for four countries: Japan, USA, France and Germany. It finds that Mode 3 trade is higher for the selected countries than the average figure in the Karsenty study: roughly 80% for the United States and Japan, 73% for France and 67% for Germany (figure 4.1).

Figure 4.1 Trade in services by mode of supply (in billion USD, average of 2000 and 2001)



Data source: OECD (2008a).

Next comes Mode 1 (cross-border supply), except for France, in which case Mode 2 (consumption abroad, essentially through tourism) figures significantly (17%). In the case of Japan, and to a lesser extent Germany, Mode 3's domination of trade in services stems from a very high proportion of this mode of supply in sales abroad (91% for Japan; 79% for Germany), whereas the proportion for purchases from abroad is only 40% for Japan and 53% for Germany. It is assumed that Mode 4 is included under Mode 1 or is insignificant.

Both studies clearly show that Mode 3 is the most important mode for supplying services across borders. Unfortunately there are no studies that show how Mode 3 trade increased over the years. For the analysis on FDI in services in the EU, see chapter 1. The lack of reliable and comparable international statistics makes it extremely difficult to assess the extent of trade in services that occurs via the movement of natural persons. But notwithstanding the difficulties discussed above, a few studies have attempted to capture the value of Mode 4 trade.

The studies that use compensation for temporary foreign workers as a proxy for Mode 4 trade, estimated this service trade at USD 30 billion in 1997, which accounted for around 1.4% of trade in services, while Modes 1 and 3 together accounted for about 80% of trade in services (Karsenty 2000). More recent measurements by the WTO Secretariat have also found Mode 4 to account for just over 1% of world services trade (WTO 2006).

The studies that use remittances as a proxy to measure global Mode 4 trade flows show that officially recorded workers' remittances amounted to USD 72.3 billion in 2001 (International Organisation for Migration 2003). In 1997, based on remittances figures, the OECD estimated the value of Mode 4 at USD 30 billion (OECD 2003b).

Labour market and migration statistics could also be used to get a general idea of the possible size of Mode 4 flows. For instance, estimates in the UK based on work permits granted to non-EU workers show that in 2000 services imports through the movement of non-EU temporary workforce amounted to nearly USD 2.5 billion, equivalent to 0.2 % of the UK's GDP. The table below shows that a number of temporary permits granted in services in the UK, increased by half between 1995 and 2000; and most permits were issued in health, computer, business and financial services sectors. However, the reliability of this data to measure Mode 4 trade is also undermined by the fact that this data also includes temporary movements of workers under the bilateral schemes, and self-employed temporary workers are not included in this category of work permits.

Table 4.1 UK: temporary work permits granted in services industry in 1995 and 2005

	1995	Share in total (%)	2005	Share in total (%)
Health and medical services	1.774	7,34	22477	2608
Computer services	1.827	7,56	15616	18,12
Administration, business and management services	4.041	16,73	10129	11,75
Financial services	3.194	13,22	6526	7,57
Hospitality, hotels, catering and other services	320	1,32	6494	7,53
Education and cultural activities	1.901	7,87	6404	7,43
Entertainment and leisure services	2.919	12,08	4260	4,94
Manufacturing	1.987	8,22	2970	3,45
Construction and land services	182	0,75	2037	2,36
Sporting activities	544	2,25	1945	2,26
Retail and related services	2.826	11,7	1276	1,48
Extraction industries	424	1,75	1086	1,26
Law related services	258	1,07	987	1,15
Transport	333	1,38	961	1,11
Telecommunications	458	1,9	858	1
Government	46	0,19	672	0,78
Utilities: gas, electricity, water	168	0,7	492	0,57
Agriculture activities	952	3,94	382	0,44
Real estate and property services	5	0,02	201	0,23
Security and protective services	2	0,01	99	0,11
Unconfirmed			319	0,37
<b>Total</b>	<b>24.161</b>		<b>86.191</b>	

Source: Salt/Miller (2006)

While available statistics are not sufficient to draw firm conclusions, the existing data suggest that temporary labour migration is increasing. Labour mobility for skilled workers, often facilitated by special programmes, is also increasing and seems to be concentrated in the services sectors. Unfortunately, existing data does not enable us to answer questions such as what is the size of flows of Mode 4 service providers and what are their skill levels and occupations. We return to this issue in Chapter 6 where, as we will see, it complicates the discussion of the labour market impacts of Mode 4 movement of service providers and renders estimates of such impacts extremely uncertain.

## 4.5 The debate on the possible consequences of Mode 3 and Mode 4 liberalisation

This section provides an overview of the debate on GATS impacts, with a focus on Modes 3 and 4, and lists some of the *types* of effect that can be expected. In chapters 6 and 7 we attempt our own quantitative evaluation of the effects on trade, regulatory capacity and the labour market.

The impacts are presented in such a way as to follow the ‘logic’ of the GATS process. The idea behind the GATS is to increase cross-border services flows (as described in Chapter 2, these flows involve trade, FDI and movement of service providers). Therefore, we first consider studies that address this link between the Agreement and trade. The GATS is supposed to increase trade by opening up additional services to foreign competition at the national lev-

el, gradually removing existing limitations and locking in permanent commitments to remove impediments to trade at the multilateral level. Trade expansion requires changes in and the liberalisation or removal of existing government regulations. By this means, the GATS has direct and indirect implications for regulations at the Member State level. Secondly, therefore, we detail the debate and address the state of knowledge of the GATS' impacts on regulations in and the regulatory capacity of the Member States in relation to Mode 3 and Mode 4.

How GATS affects the services economy and labour markets depends on its regulatory impact. If GATS is 'successful' in removing limitations, then the ensuing increase in trade will have effects on economic welfare (aggregate welfare, widely expected to increase, but also distributional effects) and on labour markets (employment opportunities, working conditions and wages). At the same time, the liberalisation of key regulations will itself have an impact on the way that labour markets function and thus on a wide range of social and economic outcomes. If GATS does not affect regulations – then any increase of trade flows is due not to the GATS, but to the increasing tradability of services in general, bilateral agreements, etc. The last two sub-sections therefore consider these two aspects and present the main findings of the studies that have sought to assess and sometimes quantify GATS affects on economic welfare and on labour markets.

#### 4.5.1 Possible impacts on trade

The idea behind the GATS is to liberalise services trade so as to increase cross-border flows. However, from a research point of view, we cannot determine from the trade flow statistics how much of the trade/FDI/movement of service providers is due to the GATS. We cannot really determine for certain whether over the past ten years GATS has succeeded in increasing services trade or not, although conclusions can be drawn between the pattern of countries and sectors opening up under GATS and trade flows (a method we employ in Chapter 6).

A substantial number of studies are concerned with the relationship between foreign direct investment and trade. While some studies have concluded that there is a substitution effect between inward direct investment and trade (see Gopinath *et al.* 1999; Svensson 1996; Chanda 2006), others have concluded that there is a complementary effect and higher FDI inflows are linked with larger trade flows (see Bayoumi/Lipworth 1997; Eaton/Tamura 1994; Marchant/Manukyan/Koo 2002; Mekki 2005).

A few studies look at the relationship between Mode 4 and trade and suggest that the liberalisation of temporary movement of services providers under Mode 4 has implications for trade in services through other modes of supply and trade flows in general (International Organisation for Migration 2004, Jansen/Piermartini 2004, Chanda 2006). The extent of impacts depends on whether Mode 4 is a substitute for or a complement to other modes of supply, or if it is simply the only mode available to deliver the service (OECD 2003c).

Empirical research on a link between immigration and trade shows that a 10% increase in migrant population increases exports by 0.1 - 2.5 %, while the effect on imports ranges from 0.1 - 3.1 % (see Dunlevy/Hutchinson 1999; Rauch/Trindade 2002). We look at the Mode 3/Mode 4 interaction ourselves in Chapter 5.

The indirect link between migration and trade has been discussed in the migration and trade literature. These studies suggest that migrants may start building networks which could be used for new business opportunities, during and after their stay in the receiving country (Adlung/Roy 2005). Furthermore, temporary workers in host country consume a portion of their income in the host country and make use of that country's services, therefore contributing to the increased demand for certain services. Lastly, the stay of services providers in a foreign country may also enhance merchandise trade through increased demand for foreign products.

For both Mode 3 and Mode 4, as in the case of imports of goods, increased imports of services are likely to lower domestic prices of the relevant services which will be of advantage to consumers and producers that use the services as an input.

#### 4.5.2 Possible impacts on regulatory capacity

Due to the intangible nature of services it is not normally possible for countries to apply tariffs – as in the case of goods – as a means of restricting imports. Barriers to services trade instead take the form of government regulations. Domestic regulations that serve as a barrier to trade come in two basic types. Some discriminate directly – and usually quite deliberately – against foreign service providers (e.g. restrictions on the number of foreign service providers allowed in a given sector). Others do not discriminate formally between domestic and foreign producers but nonetheless act as a barrier to services trade because they are more burdensome for foreign than for domestic suppliers to fulfil (e.g. licensing requirements). Both types of *regulation* need to be addressed when discussing current and possible future GATS impacts in the receiving country economy and the ability of governments to regulate their national economies.

The first type of regulation relates specifically to third-country service suppliers. If a WTO Member opens a given sector under GATS Mode 3 and Mode 4, all national regulations applying to third-country producers need to be removed, unless otherwise explicitly stated ('limitation') in the horizontal and sectoral section in the EU offer, either by the EU as a whole or by individual Member States. If a sector is closed under the GATS, restrictive regulations can remain, but it is to be expected that they will be targeted in the upcoming GATS negotiation rounds. Examples of these restrictions concern residency and nationality requirements, economic 'needs tests' for foreign suppliers to provide activities in a given sector, etc.

The second category consists of a very much broader range of domestic regulations that are directly or indirectly related to the services economy and could potentially have an effect on cross-border services supply. These regulations are wide ranging, covering domestic laws, guidelines, unwritten practices, subsidies and grants, licensing standards and qualifications, and technical norms. In relation to Mode 3, these include shop-opening hours in distribution services; interconnection fees and the bundling of services by national telecom operators; limitations on the number of hotels in a tourist resort; foreign ownership limitations in insurance; limitations on telephone or electronic media marketing; limitations on the purchase or rental of real estate; or fees or taxes on licensing payments requirements for academic standards and accreditation rules in the education sector, etc. (Sussex 2005). In fact the list of such regulations is virtually endless. (Some work on the extent of EU regulations of services have been carried out by the Commission (European Commission 2001 and 2002), however this is not linked to the GATS liberalisation.)

The problem is that such requirements can have the (unintended) effect of disadvantaging foreign producers. For instance, the requirement to hold a particular qualification certificate, obtainable only in the home country, while not overtly discriminatory (provided the country's education system is open to foreigners) clearly makes it harder for foreign producers, who have their own qualification systems, to offer services on that market.

The extent to which GATS affects these regulations depends on the outcome of the negotiations in the Working Party on Domestic Regulations. As described in Chapter 3, these negotiations are currently on-going with no set deadline and the outcome is unclear. Until a decision is taken in the WPDR, national regulations that are clearly non-discriminatory cannot be challenged before the WTO, even if foreign suppliers claim that in fact they impose an unfair burden on them. Even if GATS does not affect these regulations at this stage, implications could, potentially, be extremely far-reaching, especially if a 'necessity test' is applied to all regulations in the services sector as is suggested in the proposals of the WPDR. A necessity test implies that all regulations affecting the services sector could be potentially challenged in the WTO Dispute Settlement Panel if a foreign service provider considers them an unnecessary barrier to competition. The burden of proof however would fall on the 'complaining' Member – it would have to prove to the WTO that a given regulation in their trading partner country was unnecessary to achieve a certain public policy objective and also that other means were available that would impinge less on cross-border trade. In regard to Mode 4, critics fear that national laws and regulations concerning entry, stay, work and social security measures, including regulations concerning minimum wages agreements, could be challenged by foreign governments representing their (potential) exporters. Domestic regulations are also supposed to be 'transparent'. Some authors have concluded that foreign governments and (large) producers should be informed in advance of changes in national regulations and have their views canvassed in advance of legislation (Scherrer 2005). These issues are all the more a cause for concern in that they would be decided by mechanisms within

the WTO. Thus a body with a mandate on expertise in trade and an explicit commitment to promoting free trade, would decide on sensitive matters of public regulation in areas characterised by national political traditions and compromises in which the WTO has little expertise and, it is argued, little interest (Scherrer 2005).

Since negotiations in the WPDR are ongoing, any disciplines which are finally agreed would apply to all sectors scheduled up to that date<sup>9</sup>. Therefore, in a sense, governments make ‘permanent’ commitments under GATS not knowing what sort of regulatory implications might be entailed by them in the future.

As discussed in Chapter 3, so far there only 14 cases have been brought to the Panel and only two of these were ‘real’ GATS cases, reflecting the fact that the negotiations in the WPDR have not yet been concluded. To date GATS clearly influences only those regulations included in the first category as discussed above.

An important part of the debate on impacts on regulations and also research in this area concern the ambiguity of the GATS rules and applications. This concerns both current and future implications and raises especial concerns in the case of public services. As noted in the previous chapter, there are many disagreements about whether public services are excluded from the GATS. This aspect is of particular relevance to Mode 3. Article 1.3 specifies that the GATS applies to any service in any sector except services supplied in the exercise of governmental authority, which means any service supplied neither on a commercial basis, nor in competition with one or more services suppliers (WTO 1995). The meaning of the provision has been considered rather ambiguous by many. For example, Sauvé (2002) notes that ‘public services’ were understood very broadly by GATS negotiators, but the status of public services in the GATS is inevitably questionable in all those sectors in which public and private providers exist side by side within that service sector (Larsen/Martin/Morris 2002); increasingly in Europe and elsewhere ‘public’ services have become hybrid systems of public and private companies, (see Keune/Leschke/Watt 2008). This suggests a major potential conflict in WTO rulings, challenges from foreign governments and a potential threat to public service provisions unless governments explicitly impose limitations in these areas. A government could unintentionally liberalise a sector if it thought it were protected as being part of the public sector if this status were successfully challenged.

Under this view GATS might be seen as adding to other forces that push for a greater role of the private sector in offering such services, among them EU single market (most recently: the services directive) and broader globalisation trends (Keune/Leschke/Watt 2008).

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9. There is a long experience of using ‘grandfather’ clauses in GATT/WTO which provide a way of avoiding this result. Furthermore, it would be quite practical to confine the scope of new obligations to particular sectors.

Scholars and commentators are divided on how great the threat to regulation really is. Some studies argue that WTO Members are not obliged to grant market access to foreign investors and that they can maintain existing discriminatory or quantitative restrictions (Sauve 2002). In addition, some studies even suggest that GATS disciplines could have positive implications on national regulations (Mattoo/Sauve 2003) in the sense that they help to promote reform at the national level (Mattoo 2001). However, other studies point out that the lack of clarity within the GATS as to what sort of limitations on ‘market access’ and ‘national treatment’ are permissible, poses many difficulties, notably how to demonstrate that domestic regulation is not an impediment to competition (Sinclair 2000). A number of authors argue that the GATS directly challenges the crucial role of local and national governments in regulating services (Joy 2003; Broude 2007; with a focus on education service Scherrer 2005). Furthermore, Sinclair concluded that the broadly worded legal obligations in the GATS will be interpreted forcefully and that the Agreement can be used to challenge an almost unlimited range of government measures regulating services and investment that, even indirectly, affect the conditions of competition of international service suppliers (Sinclair 2000). Krajewski (2001) provides evidence that, due to restrictions for policy choices and a broad scope of GATS, social and environmental policies are endangered.

As we will also see in other areas, the main finding seems to be that, for the moment, the current pressure on regulation is limited. It relates almost exclusively to discriminatory regulation. Countries scheduling commitments have in most cases already removed such provisions and, at least in the case of strong GATS players like the EU, probably feel that they can dispense with them. From our interviews with European Commission, national governments, industries, it seems that the EU is very much open to foreign service providers through Mode 3, and all national regulations are in line with the GATS commitments. However, the *potential* impacts on regulations might be significant. A combination of pressure to open up new sectors, challenges to public sector status and an agreement within the WPDR could potentially pitch a whole swathe of domestically oriented, non-discriminatory legislation and regulation, designed to achieve legitimate social, environmental and economic goals, into global competition.

### 4.5.3 Model-based estimates of net economic welfare impacts

Economic theory suggests that cross-border movement of labour and capital tends to be beneficial for allocative reasons, at least for the economy as a whole: migrant labour and capital are assumed to move from a place where they are less productive to one where they are more productive. Furthermore, foreign workers add to the labour force, increase the amount of available labour inputs in the economy, and thereby raise potential output. Exactly the same logic applies to movement of capital (Mode 3). This is offset by losses in the countries of origin, but they are smaller in size because factor productivity is lower; if it were not, so the assumption, there would be no incentive to move.

Most model-based studies that attempt to measure the impacts of the liberalisation of trade in services, and therefore impacts of Mode 3 and Mode 4, focus upon the expected global net welfare gains.

In the studies that consider Mode 4 liberalisation, gains are estimated to accrue both for developed and developing countries. The gains mainly come from liberalisation of movement of less skilled workers from the developing countries (where they are in oversupply) to developed countries (which are relatively undersupplied), rather than liberalisation of the movement of high-skilled workers. Estimates of the economic impacts of trade liberalisation suggest that the global annual gains from full Mode 4 liberalisation could be as high as USD 200-300 billion (see OECD 2001, Winters 2001; Rodrik 2004).

The most well known and most widely cited research on GATS Mode 4 by Winters, Walmsley and Wang (2003) estimates that if developed countries allowed temporary workers from developing countries to increase by 3% (approx 8 million skilled and 8.4 million unskilled workers) world net welfare could increase by over USD 150 billion a year (Winters 2003). Simulations from subsequent models based on bilateral migration flows (as opposed to from a global migrant pool) show that a similar lifting of quotas would produce approximately double these gains (Walmsley/Minters/Parsons/Ahmed, 2005; van der Mensbrugghe 2005). Furthermore, these studies also argue that the gains here represent lower bound estimates since they fail to account for any dynamic effects, those associated with 'brain circulation', or the spillover and indirect effects of increased service provision.

The estimations show large aggregate gains for several reasons. Firstly, since estimates of service prices and wage differentials between developed and developing countries exceed a ratio of ten, whereas for merchandise trade this ratio is equal to two, the gains from liberalisation of service trade and, therefore, of temporary movement of service providers are, in general, expected to be greater than those from further liberalisation of trade in goods (Rodrik 2004). Secondly, the protection levels linked to the Mode 4 trade are higher in the services sector than for goods markets, and services make up a large and growing share of world trade. Therefore, the removal of restrictions to the movement of services providers is expected to create significant net welfare gains.

A few studies address welfare gains from the Mode 3 services liberalisation. Petri (1997) is the first to measure the net welfare impact of investment liberalisation in the services sector. He considers impacts for the 21 APEC (Asia-Pacific economic cooperation) region countries. In his study, barriers to FDI are taken from Hoekman (1995) and are modelled as a tax on FDI profits. According to this study, when barriers to trade in goods and services (i.e. reduction of barriers to foreign investment in services sectors) are reduced by 50 percent in all APEC member economies, global welfare gains of about USD 260 billion annually are expected.

Dee and Hanslow (2000) project the gains from eliminating barriers to trade in services, agriculture and manufacturing in WTO negotiations context. They

incorporate FDI flows in their model. The authors find welfare gains of about USD 130 billion (or 0.46 percent of world real income) out of USD 260 billion total from liberalising trade in services. Almost all economies are projected to gain. Nevertheless, the impacts differ significantly across countries. While economies such as China, Hong Kong, Indonesia and Chile are projected to gain significantly, the opposite is true for New Zealand, Japan, the EU, Canada and the United States. In this study, for the EU, Canada, the US and Taiwan the impact of multilateral services liberalisation is projected to be negative, due to the loss of rents.

Verikios and Zhang (2000) consider impacts of services liberalisation in communication and financial services. Simulating complete multilateral liberalisation of trade in communication services and financial services in a post-Uruguay Round, the study finds positive global welfare effects for both sectors. When liberalising trade in communication services, global gain are projected at about USD 13 billion or 0.05 % in terms of real income, and when liberalising trade in finance, insurance and business services, the expected gains are about USD 3.5 billion or a 0.01 % rise in real income. However, as in the previous study, the distribution of liberalisation effects differs significantly across countries. Most regions are expected to gain from liberalisation, the major winners being China, Japan and Indonesia. As in Dee and Hanslow, some economies, such as the US, the European Union and Hong Kong, are expected to be worse off in terms of real income. The EU, meanwhile, would experience a gain from allocative effects on output, but this gain is not great enough to offset the loss from a smaller capital stock.

Brown and Stern (1999) employ an approach which draws on the model structure developed by Petri and extended by Dee and Hanslow to simulate liberalisation of trade in services. The authors find large aggregate welfare gains but also a rather high dispersion of welfare results under all scenarios and parameter specifications. The far more pronounced welfare effects than in previous applied general equilibrium analysis of trade liberalisation are a consequence of allowing capital reallocation effects to be captured. The capital inflow is correlated with an expansion in output by most or all sectors of the economy. The authors find that the less mobile the capital, the smaller the welfare effects of liberalisation in terms of absolute levels and dispersion.

Studies that model welfare gains accruing from trade liberalisation are widely quoted by those advocating rapid and extensive liberalisation of the services trade at the WTO. However, the models and the results of such studies have been subject to much criticism and need to be used with caution (see Taylor/Armin 2006; Stiglitz/Charlton 2005). Firstly, the results of models are sensitive to their assumptions. In the case of computed general equilibrium (CGE) models, these are restrictive. The analysis relies on a particular model of the economy, namely, the neo-classical model which assumes full employment, perfect information, quick adjustment, etc. Such assumptions are questionable for any country, and especially for developing ones. Furthermore, analysis based on CGE models tends to gloss over the fact that different countries are likely to be affected differently, and different groups within countries will

be affected in different ways. These studies also fail to take into consideration the cost that arises due to the implementation of GATS provisions. The limitations briefly discussed here are even more valid for the studies that model welfare gains arising from Mode 4 liberalisation, as the mobility of workers does not lend itself to an easy cost-and-benefit analysis in part because of many immeasurable aspects of migration.

Essentially the idea is that social regulations are efficiency-reducing. They are often modelled as a sort of ‘tax’ on production. Consequently, downward pressure on regulatory intervention by way of GATS-driven liberalisation is almost by definition welfare-creating. However, it is well known – see for instance the above discussion about regulatory impacts – that in the face of pervasive market imperfections, regulation does not only have distributional effects (that can be considered, depending on ethical positions, to be positive or negative) but also efficiency-enhancing and thus welfare-improving effects. Any genuine study of GATS impacts would have to take into account the costs imposed by the abolition of welfare-enhancing regulations. The problem, of course, is that these are not readily measurable. This does not make it legitimate, however, simply to ignore them.

#### 4.5.4 Possible labour market impacts

Regarding Mode 4 impacts, it is recalled that Mode 4 covers only temporary movement of service providers. On one hand, the temporary nature of the movement of workers under the GATS might make it easier to react to labour market shortages in receiving countries. On the other hand, GATS negotiations are structured so as to grant progressive and continuous liberalisation; and the commitments made by Members are binding. Normally countries’ migration policy measures are such that they can be adapted in response to changing circumstances (such as an economic downturn). Given that GATS commitments are irreversible, countries that have made Mode 4 commitments may find it more difficult to respond to fluctuating labour market needs.

The key issue in evaluating impacts of increased flows of temporary service providers on EU labour markets is whether foreign service providers are substitutes for or complements to local workers. Proponents of Mode 4 liberalisation argue that temporary foreign workers are generally more complements than substitutes for local labour, and temporary workers are only brought to the sectors where there is a shortage of workers. Therefore, further liberalisation under Mode 4 could have positive effects on the labour market by relieving labour shortages in certain sectors. Yet equally services providers that move temporarily under Mode 4 could provide direct competition for services providers in the host country, for whom the occupation in question is permanent, opening up the possibility of employment displacement (job losses among existing workers in the sector) and/or downward pressure on wages and working conditions. Although in theory ‘temporary’, the growing number of such temporary stays and the resulting continuous inflows of service providers could create significant ‘permanent’ competition for local workers. Un-

clear provisions of the GATS that fail to prevent the use of Mode 4 workers on a rotating basis contribute to such fears.

The impacts on wages depend, apart from on the magnitudes of flows against the background of the existing balance of supply and demand in the sector concerned, on the relative composition of skills of foreign and native service providers. Studies that measure Mode 4 liberalisation impacts on the wages of local workers have yet to be made (see our own simulation attempts in Chapter 7). However, the potential negative implications that arise from labour migration in general – i.e. not specifically to Mode 4 – on wages in host countries have received a lot of attention in the academic and policy debates. A growing number of studies seek to measure the impacts of migrant inflows on wages, but the evidence remains inconclusive. A review of such studies will be found in Chapter 7 but two examples can be given already here. Borjas' research on impacts of labour migration on wages in the US shows that a 10% increase in immigration reduced the earning of local workers by 3-4% between 1980 and 2000. He estimated the effect to be greater (approximately 7.4%) for local workers without a high-school education, while he also found that immigrants' main competitors on the labour market are other immigrants (Borjas 1987). Longhi *et al.* in their research on the implications of migration on wages in the US, Germany, The Netherlands and Austria find that a 1% point increase in the proportion of immigrants in the labour force reduces wages by 0.119% (Longhi *et al.* 2004). Thus, if flows are substantial, at least some negative wage effects – holding other factors constant – do appear likely.

The availability of temporary foreign workers for hire could also undermine pressures to address labour shortages through increased training of nationals or improvement in pay and working conditions. For example, temporary employment of foreign nurses could undermine efforts to improve conditions and wages in this sector and prevent receiving country governments from having to address the root cause of their nursing shortages (International Organisation for Migration 2003).

In the EU offer it is emphasised that in all cases of Mode 4 service supply, EU and Member States' laws and regulations regarding entry, stay, work and social security measures shall apply, including regulations concerning period of stay, minimum wages as well as collective wage agreements. However, many labour unions voiced their concerns that Mode 4 liberalisation could become a vehicle for social dumping and the weakening of hard-won social standards in the EU. One reason is that labour legislation or collective agreements do not cover or not fully cover certain categories of workers in the EU offer, notably trainees and self-employed workers (UNI-Europa 2005).

The concerns relating to working conditions and pay raised by critics of the Agreement are further strengthened by the latest developments of the European Court of Justice (ECJ) rulings on *Laval un partneri* and *Viking line* cases (for more see ETUI-REHS 2008). In December 2007, the Court decided that trade union rights to take collective action or to make foreign service providers respect certain minimum working conditions are limited by the EU's prin-

ciples of freedom of movement and establishment. The Court stressed that the Posting of Workers Directive does not impose an obligation on foreign service providers to respect any working standards beyond the minimum standards as set in the directive. It also pointed out that collective action such as that taken by Swedish trade unions to force Laval into a collective agreement constituted a restriction on the freedom to provide services. Many fear that these developments could weaken workers' rights in relation to the internal EU directives on movement of services providers: (i) the posting of workers directive which lays down minimum standards on issues such as pay rates, holidays, working hours, health and safety and gender equality for workers posted abroad for a limited period of time, and (ii) the Services Directive which requires states to ensure free access to and free exercise of a service activity within their territory but allows them to continue applying their own rules on conditions of employment, including those laid down through collective agreements. However, one could also argue that these developments could have a significant impact in relation to trade in services under GATS – in the future, foreign suppliers could use the WTO Dispute Settlement Panel to push down standards and undermine national treatment.

Furthermore, potential regulatory and enforcement implications of the GATS arise in relation to wage parity. Some developing countries argue that any insistence on wage parity between domestic and foreign workers – for instance via national/sectoral collective agreements or national minimum wages – undermines their comparative advantage and that, from an economic point of view, wage gaps can be justified in some cases by differing levels of productivity, skills and education. However, trade unions in receiving countries insist on parity of wages and conditions for foreign and national workers, fearing a negative pressure on wages and conditions of domestic workers (see Waghorne 2003).

Even where wage parity laws are enforced, it may in practice be difficult to control wages paid to foreign workers. In line with this, many concerns are raised with regard to enforcement of labour standards as the GATS neither defines nor protects the rights of employees concerned. Temporary service providers are more likely to be exposed to poorer working conditions than regular workers and might well be more willing to accept these conditions due to the fact that their stay in the receiving country is only temporary (Raza 2003).

Moreover, trade union representation of temporary foreign service providers is more difficult than with permanent workers given the short-term nature of the stay abroad and the pressure frequently exerted by the employer not to join trade unions. Increased Mode 4 liberalisation and, thus possible usage of Mode 4 workers as substitutes for local workers, could have a fundamental impact on collective bargaining in the EU given that the negotiating power during labour disputes and wage negotiations would shift more in favour of the employer (Raza 2003).

Last but not least, an important element in the debate over Mode 4 liberalisation relates to the implications on public finances. In general, temporary

movement under GATS Mode 4 is expected to exert less pressure on the welfare state in receiving countries than permanent migration (i.e. smaller social cost of integration of foreign workers and social assurance costs). Temporary service providers are more likely than are permanent migrants to leave their families behind in the home countries, thereby entailing a lower demand on a number of social welfare provisions.

However, in relation to temporary movement under Mode 4, a number of specific issues arise, namely from the differences in social security systems and contributions in receiving and sending countries. For example, where work is subcontracted to a foreign company, wages and social security contributions for project workers are often paid according to the provisions of the foreign company's home country, possibly thereby entailing a negative effect on employment and labour standards in the host country (Winters *et al.* 2003).

As long as the flows of temporary services providers remain not too large, negative impacts on local labour markets are likely to remain rather limited. However, overall labour market impacts of GATS-induced migration combined with more general trends towards international outsourcing and use of contract labour could be greater and may pose new and different challenges (for more see Galgoczi/Keune/Watt 2006). Of course, in practice it is difficult to separate these causal chains, which may lead to 'blame' being wrongly assigned.

GATS Mode 3 is about services trade through the establishment of commercial presence in the host country and therefore applies to foreign direct investment in services originating from third countries. While the impacts of Mode 4 relate to implications of immigration, discussion on impacts of Mode 3 on the EU labour market are similar to the general discussion on impacts of FDI on employment (see Jansen/Lee 2007). Having said that, many of the considerations enumerated above also apply: incoming foreign suppliers, although also hiring domestic labour, may well bring in staff from their countries of origin under Mode 4, especially small-scale operators. To this extent, the concerns raised above are common also to Mode 3. In what follows, however, we focus on specifically capital-related issues.

The supporters of liberalisation under GATS tend to emphasise the benefits that FDI can offer to host economies such as supply of capital, technology, management know-how and therefore better jobs (see OECD 2008a).

Existing studies, however, show mixed results. In general, it is perceived that multinational enterprises (MNEs) are able to provide higher wages and, possibly, better working conditions because of their higher productivity which, in turn, is explained by greater technological know-how and modern management practices that allow them to compete effectively in foreign markets. This transfer of technological and managerial know-how across affiliates of MNEs may give rise to direct and indirect benefits by increasing the productivity of domestic firms (Malchow Moller *et al.* 2007, OECD 2008a). However, the technological and other competitive advantages inherent within FDI are likely

to increase the productivity only of skilled workers in the domestic sector and, in the course of this process, to increase the demand for skilled workers (and hence their wages). This would be at the expense of unskilled workers (Driffield and Taylor 2000). For example, estimates suggest that the MNE wage premium in the UK ranged between 3.4% and 7% (Driffield 1996; Girma *et al.* 2001, Driffield/Girma 2003), whilst the productivity advantage over domestic companies approximated to 20% (Davies and Lyons 1991). According to Fignini and Görg (1999) and Driffield and Taylor (2000), this is likely to increase the industry-level skilled wage share. On the contrary, Martins (2006) shows for Portugal that the foreign wage premium disappears after controlling for worker selection and may even reduce individual wages by 3% for workers in foreign firms relative to their counterparts in domestic firms. Heyman *et al.* (2007) present similar findings for Sweden. By contrast, Andrews *et al.* (2007) for Germany, Malchow-Moller *et al.* (2007) for Denmark and Balsvik (2006) for Norway find small positive effects (1% - 3%). Relatively few studies exploit worker mobility to analyse the role of foreign ownership, two exceptions being Andrews *et al.* (2007) and Balsvik (2006), who show that workers moving from a domestic to a foreign firm experience a 6% increase in wages in Germany and 8% in Norway. These findings may indicate that the short-term effects of foreign ownership may be more important for newly hired workers in foreign firms than for those who stay in firms that change ownership.

Very little is known about the impact of foreign ownership on non-wage working conditions and only a few studies have attempted to characterise employment conditions in MNEs and analyse their determinants. This literature appears to suggest that MNEs have a relatively low tendency to export labour practices to their foreign affiliates, tending instead to adapt to local practices (e.g. Almond/Ferner 2006). Bloom *et al.* (2008) use survey data on management and work-life balance practices for over 700 medium-sized firms in the US, UK, Germany and France to analyse to what extent US multinationals export certain practices to their affiliates in Europe. Evidence indicates that US multinationals based in Europe appear to bring over their management practices with them to Europe but then adopt more worker-friendly European work-life balance practices. The fact that US firms internationalise their management practices but localise their work-life balance practices appears to be attributable to a combination of regulations and social norms.

These results suggest that fears that incoming FDI, under GATS Mode 3, would not be likely to lead to major changes in industrial relations and human resource management systems in most European countries.

## 4.6 Conclusions

This concludes our review of the debate in the academic and policy-oriented literature concerning the possible effects of both Mode 3 and Mode 4 liberalisation in the key areas of the labour market and regulatory capacity from the perspective of the receiving country. Two important elements of this debate can be noted. Firstly, there is a great deal of disagreement and controversy

about the current and possible future impacts. Secondly, much of the debate has been driven by considerations of the likely direction of impact according to more or less theoretically driven speculation. This reflects the lack of a clear empirical understanding of the actual extent of liberalisation and of capital and labour movements under the GATS. Yet clearly the size and to some extent also the nature of any impacts cannot be decided in the abstract. We need to look more closely at the scope of actual and possible future liberalisation for the EU countries under the GATS. Building on the analysis in the first part of this chapter, therefore, we turn in the next chapter to an empirical analysis of the extent of trade liberalisation in the EU under the GATS.

## 5. Assessing GATS commitments

### 5.1 Introduction

In this chapter we analyse the EU offer relating to Mode 3 and Mode 4 of services supply. The chapter starts with a brief overview of some of the main qualitative aspects. We then carry out our own quantitative analysis of the two offers submitted by the EU for the two Modes – the initial 1995 offer (for the 12 Member States that belonged to the EU in 1995) and the revised conditional offer of 2005 (for the by then 25 EU Member States). To our knowledge this is the first attempt by researchers to quantify and compare the extent of both the 1995 and 2005 offers for all the EU Member States.

Before embarking on this analysis, it is important to emphasise several basic features of the commitments listed in the offer. Firstly, from the GATS offers alone it is difficult to ascertain the exact extent of the current liberalisation, vis-à-vis the regulations currently applying in practice, within a given sector in a given country. It has been suggested by numerous commentators that the EU offer represents, for the most part, a ‘standstill’ exercise in the sense that the commitments reflect the existing (or even lower) liberalisation levels prevailing at the national Member State level. Thus, in terms of concrete policies, no new opportunities are being offered to third countries under the GATS; this is true not only of Europe, but applies also to other WTO Members (see Francois/Wooton 2000; Langhammer 2005; Hoekman/Mattoo/Sapir 2008).

If a sector is listed in the EU schedule of commitments, this does not imply that the provisions indicated there represent, now or in the future, the actual liberalisation level. It means that this is the level of liberalisation concerning which Member States are prepared to make a binding and permanent commitment, within the GATS framework, to all WTO members. In parallel, a Member State can offer, and may already have offered, additional opportunities to third country service providers outside the GATS framework – i.e. within bilateral or regional agreements with countries outside the EU.

Equally, if a certain sector or sub-sector is excluded from the offer, this does not necessarily imply that major restrictions for cross-border trade apply – although this is likely to be the case – but simply signifies that governments retain discretion regarding the use of policies within that sector.

From a research perspective, this means that the GATS schedules do not offer a clear baseline from which to measure changes caused by liberalisation under the GATS. Nevertheless, as we do not have detailed information on the actual opening of the services sectors at the national level, and its links with GATS commitments, we must rely on, and draw our conclusions from, the existing commitments listed in the EU GATS offer. We do, of course, expect there to be a strong link in practice between a willingness to commit to open trade under Mode 3 and Mode 4 and actual practice and, at the level of Member States, but not sectors, we analyse this empirically in Chapter 6.

## **5.2 Qualitative analysis of the EU offers in 1995 and in 2005**

### **5.2.1 General remarks**

The basic structure of GATS offers was explained in Chapter 3. To summarise, a single GATS schedule of commitments is presented by the EU because, under European law, the European Community has exclusive competence in the area of external trade. Within this offer there is (i) a horizontal section that concerns cross-sectoral issues and/or sets the rules/limitations for certain modes of services supply and that applies to all service sectors included in the offer (unless otherwise stated) and (ii) sector-specific commitments for each of the four modes of service supply. In both *horizontal* and *sectoral* sections, some indicated limitations apply to all EU Member States, while others apply only to particular Member States.

There are however important differences between Mode 3 and Mode 4 in the EU offer – in terms of both the overall extent of liberalisation and the general approach to scheduling the commitments within these two modes. As regards the extent of liberalisation, the EU offers a substantially higher degree of openness in Mode 3. On the contrary, Mode 4 commitments are very limited and in the current EU offer include four narrowly defined categories of high-skilled services suppliers. Secondly, the commitments in the EU offer for these two modes are scheduled in a different way. For Mode 3, in a sectoral section the EU lists a maximum level of opening in a given sector to which it is prepared to commit under the GATS, including EU-wide or Member-State-specific sectoral limitations if deemed necessary. This serves as a starting point. The EU or individual Member States also impose limitations in the horizontal section of the GATS offer, whether for political, economic or social policy reasons. These limitations then apply to all listed sectors, unless otherwise stated.

For Mode 4, by contrast, the horizontal section sets a maximum possible opening level in the given GATS offer. This section defines the specific groups of persons (e.g., senior executives or specialists not available at the national level), specific types of movement (e.g., intra-corporate transfers or business visitors), and durations of stay (e.g., up to three years or up to six months in a three-year period), for service providers who can potentially work under Mode 4 in the EU services market. In the sector-specific sections of the offer,

Member States or the EU as a whole then choose to open the sector in line with conditions set in the horizontal section (and list limitations if deemed necessary) or to close the sector completely under the GATS.<sup>10</sup>

Put simply, to obtain the actual commitment for a Member State in a given sector under Mode 3 one has to ‘subtract’ any EU or country-specific restriction in the horizontal schedule from the commitments in the sector-specific section. In Mode 4 one must ‘subtract’ sector-specific limitations by the Member State or the EU as a whole (up to and including total exclusion) from the EU-wide horizontal commitment.

### 5.2.2 Qualitative analysis - Mode 3 horizontal and sectoral commitments

In 1995 and 2005, in the horizontal section certain limitations were listed that applied to Mode 3. In both the 1995 and 2005 offers, limitations/requirements were set on (i) *public utilities*, specific requirements as regards (ii) *legal entities*, (iii) *investment*, (iv) *real estate purchases*, and (v) *subsidies*. However, the limitations within these five categories differ across the two offers.

Both the 1995 and 2005 offers indicate that services considered as *public utilities*, such as infrastructure, environmental services or health services, may be subject to government monopolies or to exclusive rights granted to private operators. It further clarifies that public utilities exist in sectors such as related scientific and technical consulting services, Research & Development services in the social sciences and humanities, technical testing and analysis services, environmental services, health services, transport services and services auxiliary to all modes of transport. Given that public utilities often also exist at the sub-national level, detailed and exhaustive sector-specific scheduling is seen as being impractical.

As regards *legal entities*, the offer in 1995 indicates that less favourable treatment may be accorded to subsidiaries of companies originating from outside the EU, unless they ‘possess an effective and continuous link with the economy of one of the Member States’. In 2005 this ‘safety clause’ remained. In addition, Finland, Hungary, Poland, Slovakia, Slovenia and Sweden introduced country-related limitations such as specific requirements concerning the nationality of persons on the board of directors and forms of legal entities.

For *investment regime*, no EU-wide, but country-related limitations are scheduled in the horizontal section. In 1995 several Member States – France, Italy, Spain and Portugal – have indicated their country-specific requirements.<sup>11</sup> In 2005, these limitations remained. In addition, Austria, Hungary,

<sup>10</sup> Only in the case of duration of stay, and the requirements for the economic needs test, can Member States go beyond the EU horizontal offer, and very few have actually done so.

<sup>11</sup> In Spain, foreign governments and foreign public entities are required to acquire specific authorisations for investment. In Portugal, Italy and France authorisations are required for foreign investment in newly privatised companies.

Finland, Slovenia and Malta set national treatment and/or market access limitations that require authorisations for Mode 3 services trade if it involves investing in state-owned properties.

A number of very specific limitations in the horizontal section relate to the *acquisition of real estate property*. Here once again, no EU-wide limitations have been imposed but only those that relate to a specific Member State. In 1995, the specific limitations concerning real estate property are listed by Denmark, Greece, Germany, Ireland and Italy. They range from obtaining authorisation to buy land near borders in Greece to completely restricting the purchase of real estate for setting up a commercial presence under GATS Mode 3 in Denmark. Except for Germany, in 2005 Member States maintained the limitations listed in 1995. In addition, limitations were scheduled by most of the fifteen Member States that joined the EU in 1995 and 2004.<sup>12</sup>

In both the 1995 and 2005 offers, the ability of the EU to provide *subsidies* in services sectors in pursuance of legitimate objectives is maintained. However, no reference is contained in the GATS offer text or anywhere else to the meaning of 'legitimate object', which raises questions as to how this rule could be applied and, more importantly, possibly contested in the WTO.

In the sectoral section of the GATS Mode 3 offer, already in 1995 the EU offered extensive commitments in most sectors. There were very few 'non-bindings' under this Mode (with the exception of postal and courier services and most transport services). Where limitations were listed, they usually concerned nationality requirements for managerial staff, authorisation requirements for certain activities and limitations to invest in state-owned enterprises. In 2005, Mode 3 commitments have increased overall and additional sectors were opened up such as postal and courier services. However, a number of country-specific or in some cases EU-wide limitations remain. For instance, one Member State-specific measure in professional services, applied by many countries, is a nationality condition. Another measure, which is applied by a number of Member States, is a residence criterion which holds for natural persons as well as for companies. Economic needs tests are applied by several Member States (e.g. Belgium, Denmark, France, Italy and Portugal in wholesale and retail service trade). In certain cases, authorisation from relevant government bodies is required to set up a commercial presence, while in some sectors limitations are set on activities in areas of particular historic interest.

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12. Cyprus, Latvia and Slovakia scheduled 'unbound' (i.e. make no commitments) for acquisition of real estate property; Austria, Czech Republic, Malta and Slovenia indicated that certain authorisation procedures (e.g. regional authorities may consider whether important economic, social or cultural interests are affected before issuing permission to buy or rent land in Austria; if land is 10km from the border in Slovenia, special permission is required) are required for opening a commercial presence; Hungary and Poland introduced requirements for acquisition of state-owned properties by foreign investors; lastly, in Finland limitations on the purchase of land apply in certain regions.

Overall, the EU offer in Mode 3 is quite far-reaching, although there are important restrictions at sectoral level and some considerable variation (in 2005) between Member States.

### 5.2.3 Qualitative analysis – Mode 4 horizontal and sectoral commitments

The horizontal section of the EU offer sets the conditions for the maximum possible liberalisation level for Mode 4 service supply. It defines categories of temporary service providers that can move under the GATS and describes the conditions under which they may stay in the EU. Therefore, to understand what is offered for Mode 4 we need to address the horizontal section in detail, highlighting the main similarities and changes between the 1995 and 2005 offers.

In 1995, the horizontal commitments for Mode 4 applied to the following categories of workers:

1. Temporary presence of service providers as intra-corporate transferees who had to be employed in the company for at least one year before the transfer:
  - a. Persons working in a senior position, who primarily direct the management of the establishment;
  - b. Persons who possess specialist knowledge essential to the establishment's service, research equipment, techniques or management.
2. Temporary presence of service providers in the following categories:
  - a. Representatives seeking temporary entry for the purpose of negotiating the sale of services;
  - b. Persons working in senior positions, who primarily manage the establishment, when the service provider has its principal place of business outside the EU and has no other representative, office, branch or subsidiary in the Member State (WTO 1994).

The length of stay for any of these categories of workers was not specified in 1995.

In contrast to Mode 3, in the horizontal section no country specific limitations were listed in 1995, except for France, where managing directors were required to obtain specific authorisation if they were not residents of the EU, and for Italy, where access to industrial, commercial and artisanal activities was subject to a residence permit and specific authorisation.

In the 2005 offer, the horizontal Mode 4 section contained a number of changes. Firstly, the categories of service providers that existed in 1995 were re-named. Two main categories of the 1995 offer, as described above, are called

*intra-corporate transferees* (ICT) and *business visitors* (BV) in 2005. No other changes were introduced in these categories, except that the BV category was expanded to include the temporary movement of graduate trainees.

More importantly, the 2005 EU offer broadened possibilities for temporary movement of services providers by introducing two additional categories of service provider who can move under the GATS in the EU – *contractual service suppliers* (CSS) and *independent professionals* (IP). CSS were described as service providers who have no commercial presence in the EU. They are allowed to provide services in 21 services sectors<sup>13</sup>, and have to comply ‘with laws, regulations and requirements of the European Communities and the Member States where the contract is executed’. The IP category includes self-employed service providers who can only provide legal, architectural, engineering, computer, management, consulting, and translation services in the EU. It is set out in the EU GATS offer that the CSS and IP categories must possess a university degree or technical qualifications demonstrating knowledge at the equivalent level; professional qualifications and at least three years’ experience in the sector for the CSSs and six years in the sector for the IPs. Furthermore, commitments for both CSS and IP categories are subject to numerical ceilings, except in Denmark, the Netherlands, Sweden and the UK (in Poland, IP and in Italy, CSS categories are also not subject to numerical ceilings). The conditions as to how numerical ceilings are set and applied are not defined further. The horizontal commitments in Mode 4 apply to all listed sectors and all EU Member States, unless otherwise indicated in the sectoral sections. In addition, even if not specifically listed, the central and east European new Member States reserved a right not to make commitments for CSS and IP service categories until 2011.

The EU Mode 4 offer in 2005, contrary to 1995, specifies the maximum length of stay for different categories of worker. The duration of stay for the managers and specialists under *intra-corporate transferees* is limited to a maximum of three years (five years in Latvia); trainees can be transferred to affiliated companies in the EU for up to one year. *Business visitors* are allowed to enter and stay in the EU for up to 90 days within a one-year period (half a year in Estonia). *Contractual service suppliers* are allowed to provide services in the EU for up to six months within one year. Finally, *independent professionals* may offer services in the EU for up to one year. The GATS offer does not specify whether or not service providers in any of these categories can re-enter the EU as Mode 4 workers within a certain time.

It is important to note that both the 1995 and 2005 offers explicitly stipulate that ‘all other requirements of Community and Member States’ laws and reg-

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13. Legal, accounting and bookkeeping, taxation advisory, architectural, engineering, computer, research and development, advertising, management consulting, services related to management consulting, technical testing and analysis, related scientific and technical consulting, maintenance and repair of equipment after-sales or after-lease, translation, construction, site investigation worker, higher education services, environment services, travel agencies, entertainment services and services related to the sale of equipment.

ulations regarding entry, stay, work and social security measures shall continue to apply, including regulations concerning period of stay, minimum wages as well as collective wage agreements'. In the 2005 offer it is further specified that 'commitments on movement of persons do not apply in cases where the intent or effect of such movement is to interfere with or otherwise affect the outcome of any labour/management dispute or negotiation.'

In the sector-specific commitments in the 2005 offer the main scheduled limitations are residency and nationality requirements, and economic needs tests. In general the idea of economic needs test is that those entering the EU must provide evidence that there is an 'economic need' for their service which is not being met from domestic suppliers. However, in most cases Member States do not specify the criteria, and how the tests in question are to be conducted remains to be determined.

As regards the two new categories of workers (CSS and IP) introduced in 2005 offer, it is important to note that, in the sectoral schedules, commitments were made in only a few services sectors (i.e. CSS in construction, travel agencies, entertainment services, certain sub-sectors in business services, IP in certain sub-sectors of business services). Despite the opening at the horizontal level, most EU Member States in most sectors have not opened up to these new categories in 2005.

Overall, it is to be noted that Mode 4 remains very much less open than Mode 3. Even in the 2005 conditional offer – which has not yet come into force – the EU Mode 4 commitments relate exclusively to highly skilled individuals and specialists. In most cases this affects managers and technicians in large multinational companies. The inclusion of two additional categories in 2005 did, in principle, mark a substantial opening – although still restricted to highly qualified persons – although access in fact remained restricted due to sectoral-level restrictions by Member States.

We now proceed beyond this qualitative assessment of the horizontal and sectoral section of the EU GATS offer and calculate, on the basis of the horizontal and sectoral limitations described in the section, GATS commitment indices for 1995 and 2005.

## **5.3 Quantitative analysis of the EU offers**

### **5.3.1 General remarks**

In the next section, we calculate Mode 3 and Mode 4 commitment indices in order to assess the current formal degree of service sector openness in the EU under the GATS, as reflected in the commitments made by EU Member States in 1995 and 2005. With the help of these indices we can compare the extent of opening offered in different sectors and also differences across EU Member States. We begin by briefly reviewing previous research efforts in this area.

### 5.3.2 Review of the previous efforts to quantify GATS offer

This sub-section presents a brief survey of the empirical studies that have sought to establish quantitative indices for the GATS commitments or restrictiveness of services trade in general. We focus on the methodology applied in these studies and discuss the findings only where the EU is concerned.

There are very few studies that quantify GATS commitments across all service sectors and all WTO Member countries. The most widely quoted is the study by Hoekman (1995), which classifies GATS commitments for all WTO Members (the EU treated as one) into three categories, and assigns a numerical score to each:

- 1 if no restrictions are applied for a given mode of supply in a given sector;
- 0 if no commitments are made for a given mode of supply in a given sector;
- 0.5 if the sector is scheduled in the offer but certain restrictions apply. These limitations range from shop-opening hours in a certain sub-sector to economic needs tests that apply across all listed services. Any limitation is given a score of 0.5 regardless of its importance.

Since, as noted above, there are 155 non-overlapping service sectors in the GATS classification list, and for each sector there are four possible modes of services supply, a total of 620 such openness/binding factors exist for each WTO member.

Hoekman calculates different sectoral indicators to show the number of sectoral commitments made (regardless of how meaningful they are) by a WTO Member in its GATS schedules out of maximum of 620 sectoral commitments possible, and also the average degree of opening within a sector using weighting for each Mode of service supply. The simplicity of the Hoekman approach – which ignores the varying significance of limitations – makes it relatively easy to calculate indices for all 155 GATS sectors using one unified weighting/scoring system. Hoekman finds that in 1995, among the highly industrialised countries, the EU is second, following Japan, in terms of the number of open sectors. The number of open sub-sectors is higher than that of the USA. For the highly industrialised country group, Hoekman finds that business services are by far the most open sector, followed by financial and value-added telecom services. On the contrary, postal services, motor vehicle repairs and hotels/restaurants were largely kept closed under the GATS.

Langhammer (2005) applies a modified Hoekman approach and quantifies the 2003 EU offer for each EU15 Member State. Besides extending the three-scale category, the author also introduces different weights for each mode of service supply in the EU15 Member States. For each possible pair of Member States, a so-called overlap or similarity index is calculated. The findings of the study show that most of the EU Member States are very similar in their offers under the GATS (the similarity index varies between 90% and 100%).

A study by the WTO measures GATS commitments using a more simplified approach (Adlung/Roy 2005). The 160 services sub-sectors are aggregated to 14 main services groups. Whenever a Member has scheduled at least one of the sub-sectors within these 14 sectors, this commitment is counted, without further weighing, for the whole of the sector. This gives an idea of the most open/closed sectors within the GATS. However, some services sector groups are subdivided into more categories than others: the possibility that at least one sub-sector is scheduled are higher if there are more sub-sectoral categories. Such a simplified methodology might be useful if one were seeking to gain an overview of the diversity of all WTO Members and their commitments. However, for comparing industrialised countries such as the EU Member States, such a methodology is too simplistic as very few sub-sectors are kept completely closed in the EU offer. To provide an overview of the depth of commitments, the authors also use the same three scores for quantifying commitments as in Hoekmann study. In addition, this study groups scheduled limitations into several categories and analyses how frequently certain limitations are used. Again, in this study the EU is considered as one member of the WTO. Furthermore, the results per country are not presented, but lumped into two categories of developed and developing plus transitional countries. To summarise, the authors find that in 2005 developed countries mostly schedule commitments in financial, business and telecommunication services. In general, a similar share of commitments is scheduled for all services categories, except for the lower commitments in health and 'other communication' service categories.

A few sectoral studies have analysed GATS commitments in given sectors. For instance, Mattoo (1998) develops a frequency measure to gauge the commitments made by developing and transitional countries in the GATS on financial services. His approach is similar to that of Hoekman (1995) but has two important differences. First, Mattoo attaches different weights to different modes of supply. Mode 4 is, however, excluded from his analysis due to the predicted small size of Mode 4 and also data unavailability. In particular, commercial presence is given a dominant weight because it is currently the most important mode of supplying financial services. Secondly, while using Hoekman's three-value scoring system for commitments on Modes 1 and 2, Mattoo devises a more elaborate scoring system for commitments on Mode 3.

The liberalisation index, as Mattoo calls it, is then the weighted average of these scores given to a country's commitments. Mattoo's analysis produces rather surprising results. The CEE countries included in the analysis are less open for financial services trade (both in terms of number of sub-sectors open and whether the liberalisation index is concerned) than African countries, but offer a higher overall liberalisation under the GATS than Asian countries.

Other sectoral studies use similar approaches. Marko (1998) for telecommunication services, Kalirajan (2000) for distribution services, McGuire and Schuele (2001) for banking services, and McGuire *et al.* (2001) for maritime transport services, compile a list of restrictions from a number of sources including the GATS schedules. These restrictions are given scores and then

grouped into a number of categories, each of which is assigned a weight. Restrictions considered to impose a greater cost on economic efficiency are given a greater weight. These weights and scores are then used to calculate sectoral restrictiveness indices.

### 5.3.3 Methodology

For the purpose of this report, we want to obtain information on questions such as the following: to what extent is there *one* EU offer in the GATS? to what extent do the levels of commitments of the EU Member States differ? and how has the EU offer evolved in the past ten years since the GATS came into force? We cannot draw on the existing studies to answer these questions. None of the studies described in the literature review provides a detailed overview of the schedules of commitments by each of the 25 EU Member States and none of them addresses the changes in the WTO Membership over the time.

In this chapter we seek to close these gaps in the research and to quantify the EU GATS offers in 1995 and 2005 by creating our own commitment indices for each EU Member State and for each of the 12 main services categories. We look at the EU offer in the two modes of services supply – Mode 3 and Mode 4 – which are the focus of this report. Using the approach described below we will be able to assess the current formal degree of service sector openness reflected in the commitments made by EU Member States. It will also allow us to rank EU Member States and sectors in terms of openness level within the GATS and to find out how GATS commitments have evolved since GATS came into force in 1995.

In our analysis we use a mix of the approaches that were applied in the studies described in the literature review in the previous sub-section. Along with others, we broadly follow the pioneering Hoekman model. However, four main modifications are added to his approach. Firstly, Hoekman's three-value scoring system for commitments is extended with a more elaborate scoring system for commitments (we use five categories for Mode 3 and seven categories for Mode 4). This will allow us an in-depth cross-sectoral and cross-country comparison. Our scoring system is based on our own assessment of how important (i.e. trade-restricting) the scheduled limitations are. Secondly, the analysis is conducted separately for each EU Member State and not only for the EU offer as a whole. Thirdly, we apply sectoral weighting, which allows us to roughly compare 'national' liberalization commitments between EU Member States. Finally, we quantify two EU GATS offers, the first EU offer of 1995 which applies to 12 Member States and which was signed when the GATS came into force and the revised conditional offer of 2005 which applies to 25 EU Member States.

The EU Member States' specific commitments for Mode 3 and for Mode 4 in 1995 and 2005 were entered into a spreadsheet for all 155 service sectors as defined by the GATS. For every EU Member State and every sector, a score was given depending on a level of opening and the limitations listed, sepa-

rately for Mode 3 and Mode 4. We take into account cross-sectoral limitations listed in the horizontal and sectoral sections. In our analysis, we do not give different weightings for national treatment and market access limitations; they are entered in one column and treated together. Tables 5.1-5.3 indicate how the qualitative information in the EU GATS schedules is translated into index scores.

In order to make the results tractable and readily presentable, we calculated simple averages of the scores for 155 service sub-sectors and created indices for each of the twelve main aggregated services sectors. We thus obtain one index value for each of the 12 main sectors and for each of the 12 EU Member States in 1995 and for 25 EU Member States in 2005. To recall, the 12 main service categories in WTO classification are as follows:

- business (including professional and computer) services
- communication services
- construction and related engineering services
- distribution services
- educational services
- environmental services
- financial (insurance and banking) services
- health-related and social services
- tourism and travel-related services
- recreational, cultural and sporting services
- transport services
- other services not included elsewhere

For the purpose of this report, ideally weighted averages, based on employment, for instance, of the sub-sectors should be used to calculate the sectoral indices. However, the WTO classifications are not congruent with national or international sectoral classifications (such as NACE) that would enable us to derive employment figures needed for weighting the sub-sectors. Thus simple averages were used. This is crude, but it is not obvious why it should systematically bias the results. It is possible that, for instance, smaller sub-sectors are more likely to be unbound than larger ones. However, if this is true across all the main sectors and countries, then the sectoral and country rankings will not be affected.

In principle, the same problem of a lack of congruence with NACE categories applies also at the level of the 12 main sectors: we cannot simply look up employment (or value added) numbers for these sectors (neither at national nor EU level) and use them to weight the 12 sectors in a precise way. On the other hand, there could be a huge risk of distorting the Member State indices if we were to treat, say, the tiny ‘recreation services’ category on the same footing as the amorphous ‘business services’ group. This forced us to estimate crude weights for these 12 WTO main sectors. As far as possible, reference was made to analogous NACE classifications. The weightings are provided in Table 5.1. They are crude but certainly far superior to the alternative of using simple averages to calculate the national indices.

Table 5.1 Sectoral weightings

Business services	0,2
Communication services	0,03
Construction and related engineering services	0,1
Distribution services	0,2
Educational services	0,1
Environmental services	0,025
Financial services	0,1
Health related and social services	0,1
Tourism and travel related services	0,1
Recreational, cultural and sporting services (other than audiovisual services)	0,01
Transport services	0,03
Other services not included elsewhere	0,005

Source: Authors' calculations based on Eurostat (2008a and 2008b)

In order to determine the average sectoral commitment index for the EU as a whole and therefore to arrive at one EU index for each of the 12 services sectors, we weight the commitment indices based on total employment in each Member State in the relevant year. This weighting is unproblematic and precise as national employment data are readily available (from Eurostat).

In general terms, the methodology described above applies to both Mode 3 and Mode 4. However, a number of specific adjustments had to be made for each Mode to reflect the different characteristics of the schedules. This is explained in the box: the most important implication to note is that the scales used for Mode 3 and for Mode 4 commitments are not comparable.

#### Explanation of scales:

It is impossible to arrive at one common scale for Mode 3 and Mode 4 indices. An index score of 1 for Mode 3 implies that a given sector is fully opened to foreign investors and that there are no limitations for third countries' investors to open commercial presence in a given service sector. In order to have comparable Mode 3 and Mode 4 scales, '1' for Mode 4 would also have to be full opening of the sector for Mode 4 trade, meaning no limitations for temporary movement of service providers in any skill category. However, while full opening of sector under Mode 3 is possible and this is what negotiations under the GATS will try to achieve in upcoming liberalisation rounds, the full opening of the sector for Mode 4 trade is simply inconceivable. Currently the EU offer defines four narrow categories of workers who can move under Mode 4. Full liberalisation is not on anyone's political agenda. Even if we were to ignore this fact and still use 'full liberalisation' as the top of the scale, we would create insurmountable problems in assessing current commitments. It would be impossible to put any sort of realistic numbers on the EU offers measured against this benchmark, simply because the degree of liberalisation is so comparatively limited, even at the level of the 2005 horizontal offer. The scale would be so comparatively large that it would be impossible to distinguish between different Member States and sectoral commitments that, in terms of current policy, are rather important. If for example business visitors are allowed to work in the telecommunication sector for a certain period of time, one cannot sensibly interpret what that measure means in terms of a – completely implausible – full opening of the sector. For these reasons, the Mode 4 scale is defined differently (see below).

As noted above, for Mode 3 the value ‘1’ implies the maximum amount of liberalisation that is at all possible in a give sector, i.e. treatment on a par with domestic service providers. To allow calculation of the sectoral coverage of commitments for Mode 3, numerical indicators allocated to each of the ‘cells’ of a Member’s schedule are as follows:

Table 5.2 Classification of GATS Mode 3 commitments

1	None (sector is completely opened)
0,75	Sector is opened in the GATS offer but certain limitations are scheduled
0,5	Sector is opened in the GATS offer. The level of limitations is higher or unknown
0,25	Sector is opened in the GATS offer but significant limitations set, i.e. economic needs test
0	Unbound (sectors is completely closed or excluded from GATS offer)

Source: Authors’ classification referring to EU GATS offers in 1995 and 2005 (WTO (1994) and European Commission (2005))

In general terms, the methodology described above applies to both Mode 3 and Mode 4. However, a number of specific adjustments had to be made for each Mode to reflect the different characteristics of the schedules. This is explained in the box: the most important implication to note is that the scales used for Mode 3 and for Mode 4 commitments are not comparable.

For Mode 4, a value of 1 is assigned to the sector if the level of liberalisation is in line with the horizontal section of the 2005 offer.<sup>14</sup> (None of the sectors, however, reaches this level of openness). A value of 0 is given if a sector is completely closed for Mode 4 service supply (table 5.3).

In the 1995 offer, the horizontal section contained only two categories of workers that can move under Mode 4. In the 2005 offer, these two categories of workers remain and two additional ones were added. Therefore, if sectoral commitments made, in 1995 but also in 2005, are in line with 1995 horizontal section, a value of 0.5 is given.

The commitments are given the score of 0.25 if they are in line with the horizontal section of 1995 but additional limitations are scheduled. On the other side of the scale, the value of 0.875 is given if commitments in 2005 go beyond 1995 horizontal section and additional commitments are made for *both* new categories of service providers (contractual service providers and independent professionals), but with limitations. A similar logic leads to scores of 0.75 and 0.675 where just one of the two new categories is included (with and without limitations). The numerical indicators allocated to each of the ‘cells’ of a Member’s schedule for Mode 4 are summarised in Table 5.3.

<sup>14</sup>. The horizontal section stipulates four categories of workers that can move under Mode 4 and defines their skill levels and duration of stay. This is the maximum liberalisation possible for Mode 4 in the EU.

Table 5.3 Classification of GATS Mode 4 commitments

1	Opened in line with the horizontal commitments in 2005 - commitments made in all 4 categories and no additional limitations scheduled
0,875	Opened in line with the horizontal commitments in 2005 - commitments made in all 4 categories but additional limitations scheduled
0,75	Opened in line with the horizontal commitments in 2005 but only for three categories of workers
0,625	Opened in line with the horizontal commitments in 2005, but only for 3 categories of workers plus other limitations listed
0,5	Opened in line with the horizontal commitments of 1995 offer - Commitments in two categories
0,25	Opened in line with the horizontal commitments of 1995 offer - Commitments in two categories, plus other limitations listed
0	Unbound (sector is completely closed or excluded from GATS offer)

Source: Authors' classification referring to EU GATS offers in 1995 and 2005 (WTO (1994) and European Commission (2005))

While the methodology applied in this study does not allow comparison of Mode 3 and Mode 4 commitments in terms of their actual importance, it allows cross-country and cross-sectoral comparisons for each Mode of service supply over time. In the remainder of this section, we present the results of our quantification exercise.

### 5.3.4 Quantitative analysis – Mode 3 offer

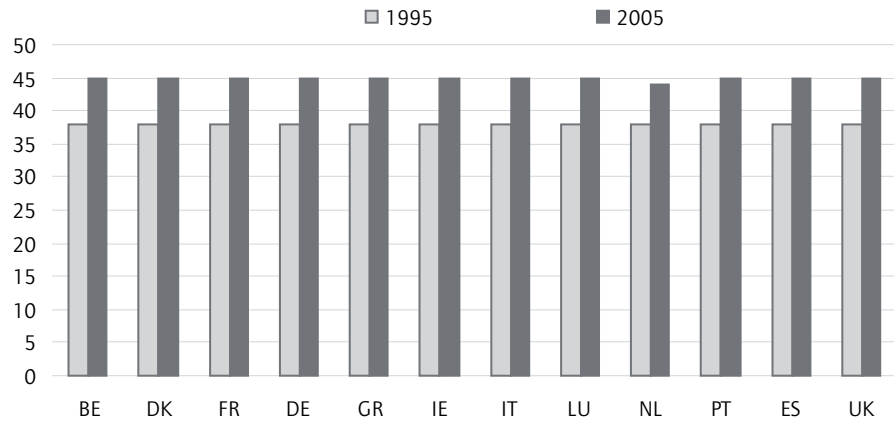
#### The breadth of commitments

The commitments may be viewed and analysed from different perspectives. A first, most basic, approach is simply to look at the number of sectors and sub-sectors opened by EU Member States in a given Mode of service supply.

Both in 1995 and 2005, all twelve main service categories were opened in the GATS to a varying degree. Thus, in order to see any variation among EU Member States, it is necessary to consider the breadth of the EU GATS offer at the sub-sectoral level.

It is interesting to note (Fig. 5.1) that in 1995 all 12 EU Member States had opened 90 or 91 out of 155 sub-sectors and in 2005 the same 12 Member States had made commitments in an additional 35-37 sub-sectors (Figure 5.1). At this level, it can be argued that a single EU offer for the 12 'old' Member States exists. However, the degree of commitment *within* the sub-sectors varies to a major extent. This shows the importance of the more in-depth analysis we provide below.

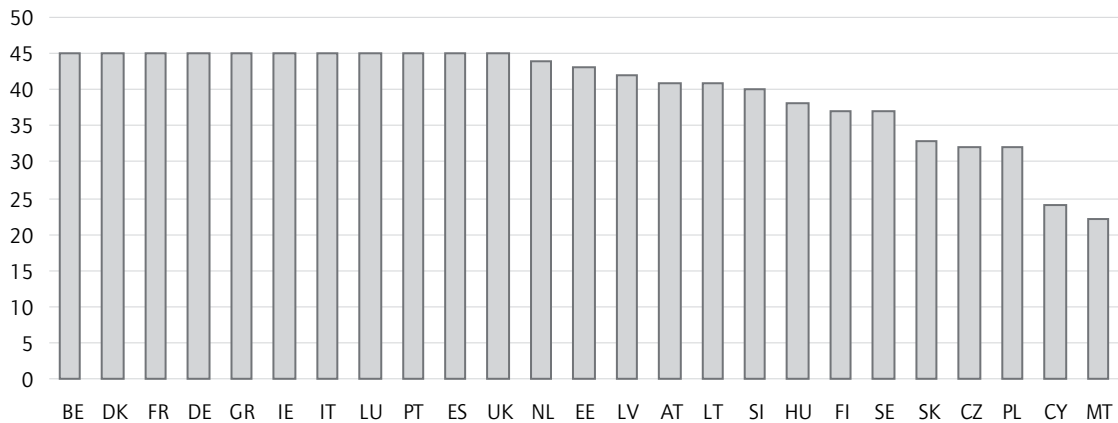
Figure 5.1 Number of open sectors in 12 EU Member States for Mode 3, 1995 and 2005



Source: Authors' calculations based on EU GATS offers in 1995 and 2005 (WTO (1994) and European Commission (2005))

Figure 5.2 presents the pattern of Mode 3 commitments by the 25 EU Member States and shows the number of sub-sectors open. In the ranking, groups of countries can be identified. Firstly there are the 12 EU Member States that were covered by the 1995 offer. In all these countries, 126-128 sub-sectors were scheduled in the GATS offer. In other Member States, the Mode 3 commitments are smaller.

Figure 5.2 Number of open sectors in EU25 for Mode 3, 2005



Source: Authors' calculations based on EU GATS offer in 2005

The 12 EU Member States are followed by the Baltic countries and Austria. The third group is Slovenia, Hungary, Finland and Sweden. Lastly, the rest of the new Member States follow. Cyprus and Malta have more than half of all sub-sectors completely unbound, that is make no commitments under GATS.

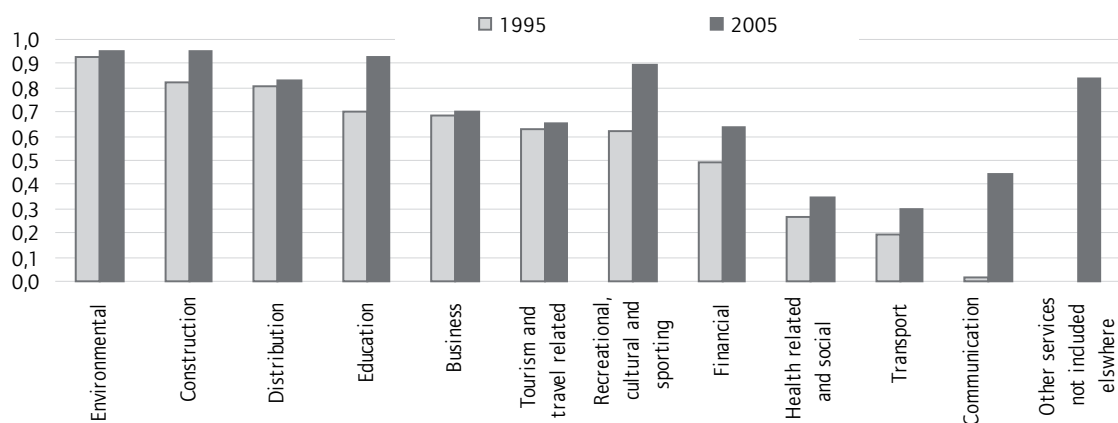
This clearly suggests that EU GATS offer in 1995 was discussed and agreed collectively. In 2005, Member States were less constrained in this manner and the new members, led by the Baltic countries, have been, to differing extents, 'catching up', since joining the EU, with the Member States that were part of 1995 GATS offer, which remain a coherent block at a higher level of liberalisation. Thus enlargement has led to greater intra-EU diversity with respect to GATS negotiations.

### The depth of commitments

The next step in the analysis goes beyond the mere 'counting' of open sectors, and, using the methodology described earlier, makes a quantitative assessment of the extent to which commitments have actually been made in the service sectors by the EU Member States in 1995 and 2005. This analysis is presented in the graphs below. First, we address the 1995 offer; then we consider the changes between 1995 and 2005 for the 12 EU Member States; and finally look at the 2005 offer for the EU25 Member States.

As Figure 5.3 shows, there is a lot of variation in the commitments across sectors in the EU offer in 1995 and in 2005. In 1995, in some services sectors, such as environment services, construction and related engineering services, and distribution services, EU Member States have scheduled extensive commitments. In these sectors, the commitment index is close to 1, representing the maximum opening level. For other sectors, however, more or less significant limitations are set. For example, in health, transport, communication and other services sectors, low levels of commitments were made in the 1995 offer. It is difficult to ascertain any sectoral pattern here, for example regarding the extent of public sector involvement.

Figure 5.3 Mode 3 commitment index, 1995 and 2005, average of 12 EU Member States, by sector



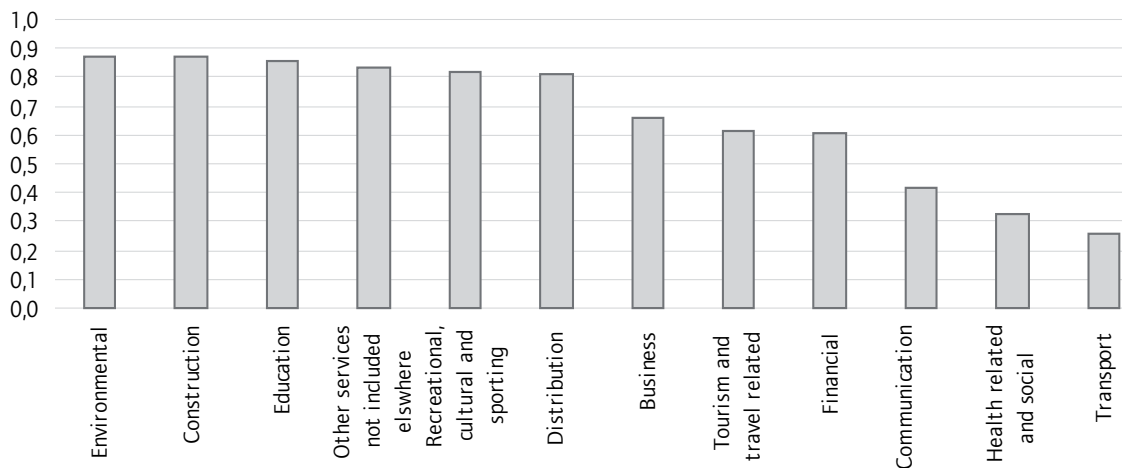
Source: Authors' calculations based on EU GATS offers in 1995 and 2005

In 2005, the commitment index for the 12 EU Member States increased for all sectors, in accordance with the GATS philosophy of progressive liberalisation. However, the increase was only marginal in environmental services, distribution, business and tourism, although all of them already exhibited a high degree of opening in 1995. The highest increase is noted in recreation, communication and ‘other services’. More commitments were also offered in the construction and related engineering services sector, financial and educational services.

There was little change in the sectoral ranking between 1995 and 2005, although the (rather small) education and recreational services ‘overtook’ a number of (larger) sectors. Overall, there has been some convergence, as generally more additional commitments were made in the previously more closed sectors (such as communication and ‘other services’<sup>15</sup>).

Figure 5.4 presents GATS commitment index per sector. Environmental, construction and educational services are the most open sectors in the EU for Mode 3 trade, while communication, health and transport are the least committed sectors; despite the general openness of Mode 3, transport scores below 0.3 on this measure. On the other hand, half (6) of the broad sectors are in a rather high and narrow range between 0.8 and 0.9.

Figure 5.4 Mode 3 commitment index, EU25, 2005, by sector



Source: Authors' calculations based on EU GATS offer in 2005

What interpretation can be offered of the sectoral pattern of GATS commitments? If we refer back to the services-sector employment data presented in

<sup>15</sup> Although in the graph it appears to be a very dramatic opening, developments in the ‘other services’ sector are difficult to interpret because it is a residual category and it is not specified what activities are actually covered.

chapter 2, it seems that overall the more far-reaching Mode 3 commitments tend to be in larger sectors in terms of employment. For example, in wholesale and retail trade, which employs over 22 million people in the EU25, Mode 3 commitments are high. At the other extreme, the financial intermediation sector is comparatively small in terms of employment and has relatively low Mode 3 commitments. Examining the issue more formally – although the precise figures should be treated with caution, because, as we have already mentioned, the standard employment data by sector are not directly comparable with the WTO sectoral classifications – we see that this positive link between Mode 3 commitments and size of employment in a given sector appears to hold across the whole sample of 12 sectors in both 1995 and 2005. However, the correlation is weak: 0.4 in 1995 and only 0.1 in 2005.

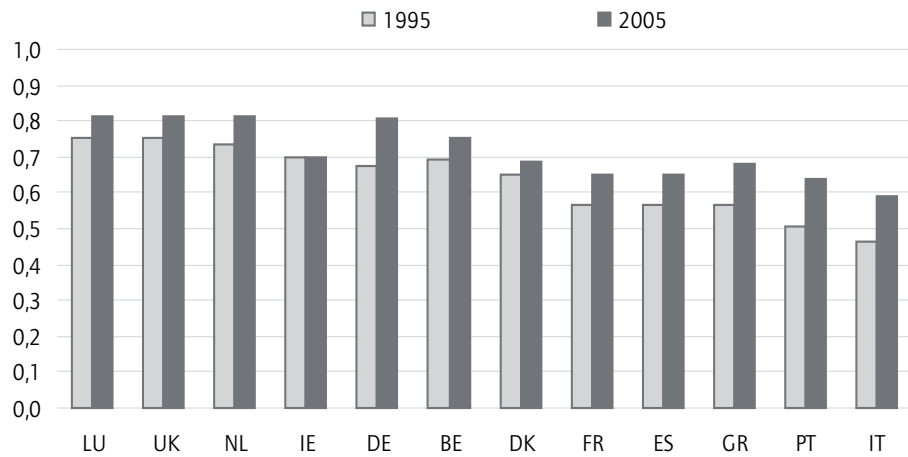
We would also have liked to run correlations between the indices of sectoral openness and the size of trade flows. Unfortunately, in addition to the problem of delineating sectors, trade flow data for the EU25 are only available for a limited number of sectors. We were able to identify roughly comparable sectors for eight of the 12 main sector categories. These figures are also broadly suggestive of the idea that the most open sectors are also those in which services imports are largest. Partly, this reflects sector size, but it seems that a high degree of sectoral de facto trade openness goes hand in hand with a willingness to make commitments on the part of EU countries. Unfortunately, the data are too imprecise for us to even speculate on whether the causality runs (more) from higher trade volumes to Mode 3 liberalisation or the reverse.

Cross-country comparison between the 12 EU Member States (Figure 5.5), which are based on a rough weighting of the importance of the 12 broad sectors as explained above, shows that in 1995, Luxembourg, UK and the Netherlands had the highest commitment index, ranging between 0.7 and 0.8, while Portugal and Italy were below 0.5; the bunching of ‘southern’ countries in the lower half of the rankings is noteworthy. The analysis shows that there are fewer differences between EU Member States when scheduling Mode 3 commitments compared with the differences between sectoral commitments for the EU as a whole. Nevertheless, the apparent equality of commitment between Member States suggested by the simplistic analysis of the number of sectors scheduled disappears under our more sophisticated analysis.

In 2005 the commitment index increased for all 12 EU Member States with the exception of Ireland, for which no change was recorded. The highest increases are recorded for Germany, Italy and Portugal. Increases are broadly in parallel, so there is little change in ranking, but, as with the sectoral comparison, we see a slight convergence across countries over the ten-year period, the southern countries moving closer to the average.

In 2005, the three countries with the highest commitment index remain the same as in 1995 – Luxembourg, the UK, and the Netherlands. In addition, Germany caught up with these Member States. Portugal and Italy remained the countries with the smallest degree of commitments in Mode 3.

Figure 5.5 Mode 3 commitment index, 1995 and 2005, 12 EU Member States



Source: Authors' calculations based on the EU GATS offers in 1995 and 2005

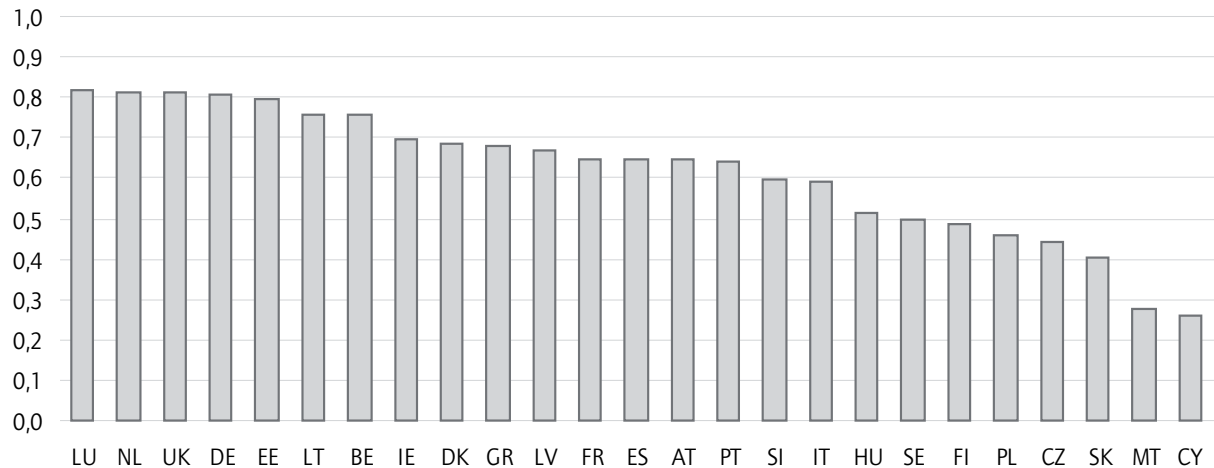
To what extent does the level of Mode 3 commitments by the 12 EU Member States over these years converge to a single 'EU offer'? Here we look at the Mode 3 commitments index in 1995 and compare them with the change in the index between 1995 and 2005. The correlation results are quite strongly negative (-0.6), confirming that countries that had a lower degree of commitments in 1995 tend to open more sectors, or to accept a higher degree of opening, for Mode 3 services trade in 2005 than those countries with the higher initial commitment.

The same analysis was carried out for convergence for commitments across the sectors. The correlation is almost -0.7, suggesting an even slightly stronger link between low commitments in 1995 and a higher increase in 2005.

Lastly we analyse the level of Mode 3 commitments for all EU25 countries in the 2005 offer. The graph below shows that Estonia, Luxembourg, the Netherlands and the UK offered the highest degree of commitment in Mode 3. Their liberalisation index is at around 0.8. For Cyprus, Malta and Slovakia, which made the smallest number of commitments, the index is below 0.4.

Some signs of regional clustering emerge from the graph, but the picture is far from clear. The bottom 5 countries are all new Member States, with the two small Mediterranean islands, Malta and Cyprus, clearly lagging behind the main group; however the Baltic countries have rather high commitment indices. The 'Nordic' countries are rather split, with Sweden and Finland very similar, but Denmark showing a substantially higher degree of openness. The 'Southern' countries are grouped around the centre of the distribution, with the continental/corporatist countries mostly in the upper third (but with the notable exceptions of Austria and France). The UK is one of the most liberal countries under GATS, but this is less true of Ireland. These findings seem to suggest that 'varieties of capitalism' or welfare-state models within Europe have some relevance in terms of predicting countries' choice of Mode 3 commitments.

Figure 5.6 Mode 3 commitment index, EU25, 2005



Source: Authors' calculations based on EU GATS offer in 2005

Using data presented in Chapter 2, we conducted a correlation analysis to see whether the level of commitments in each Member State is linked to the relative size of services sector employment. Strong positive results are obtained for 1995, suggesting that among the 12 EU Member States, those where services account for the largest shares of employment tended to schedule more GATS commitments (correlations for 0.78 for 1995). The correlation is also positive, albeit much weaker, for the EU25 in 2005. There are a number of outliers, notably the Baltic States, which are open, although the share of services employment is low, and Sweden, where the reverse is true.

We also examined the pace of employment growth in services and looked for a possible correlation with the commitment level in 2003. Here a positive but weak correlation was found (0.23).

Altogether these results do not amount to a 'model' explaining GATS openness under Mode 3. We have, however, seen that there is a tendency for openness to be higher in countries with the following features: being an EU member prior to 1995, having a high share of services in total employment, and experiencing rapid growth in services employment.

The analysis of the Mode 3 indices for different sectors and for each Member State shows that none of the services sectors in the EU is completely excluded from the GATS. Nor is any of the services categories opened up 100%. In all services sectors limitations are listed in the horizontal and/or sectoral sections. It is clear that there is 'scope' for further liberalisation of this Mode in Europe and, if GATS moves forward, attempts to achieve this may take place in the upcoming liberalisation rounds in the WTO.

Our analysis shows clearly that there is no one single EU offer for Mode 3. While there were signs of a single EU offer in 1995, commitments are much

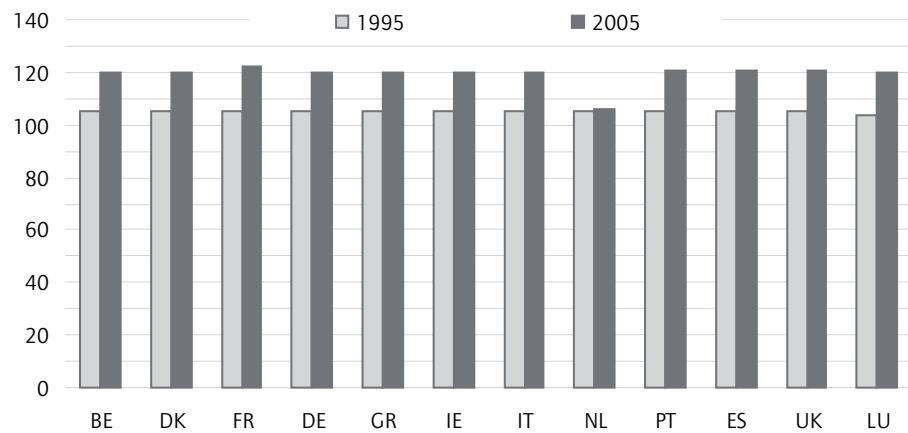
more diverse in 2005. Furthermore, the number of opened sectors can be deceptive, as it is not always matched by the same level of commitment by Member States. As for sectoral commitments, the diversity of commitments in the EU is clear in 1995 and in 2005. There are some faint signs of regional groupings of the EU Member States in these rankings, but the only clear conclusion that can be reached is that the 12 EU Member States are the most liberalised and the new EU Member States tend to be the least liberalised, although even here the three Baltic states do not fit the pattern.

### 5.3.5 Quantitative analysis – Mode 4 offer

#### The breadth of commitments

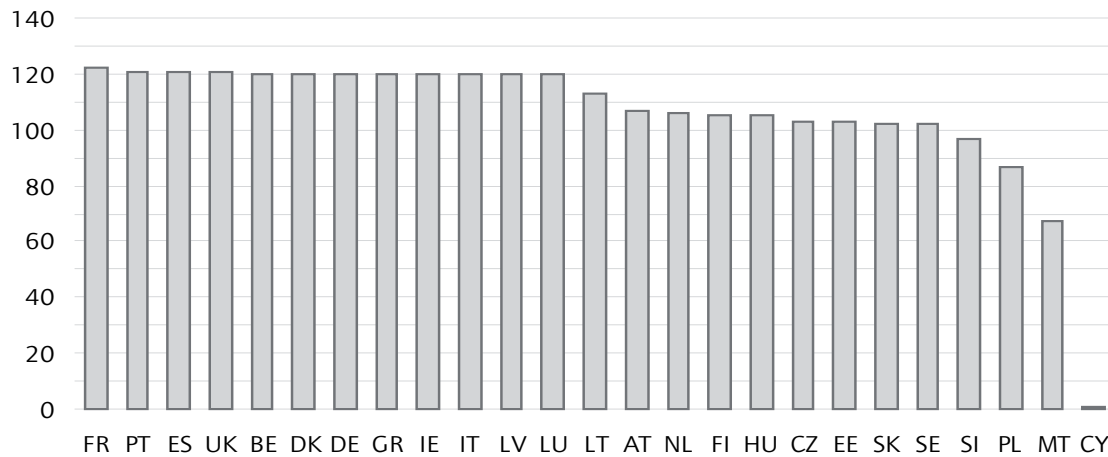
This section repeats the above analysis for Mode 4. The graph below presents the number of sub-sectors open for Mode 4, regardless of their economic importance and the ‘depth’ of commitments. It provides a cursory indication of Members’ propensity to bind offers of access conditions under the GATS, and gives an idea of the overall breadth of commitments. In 1995, as with Mode 3, the 12 EU Member States offers are virtually identical in terms of numbers of sectors where a commitment is made: 109 out of 155 sub-sectors (Figure 5.7). Furthermore, as in Mode 3, the further opening of sectors in the 2005 Mode 4 offer is also highly uniform among the 12 Member States.

Figure 5.7 Number of sectors opened for Mode 4, 12 EU Member States, 1995 and 2005



Source: Authors' calculations based on EU GATS offers in 1995 and 2005

Figure 5.8 suggests more variation in 2005; however, 12 EU Member States commitments remain uniform. Austria, Finland and Sweden and new EU Member States on average scheduled fewer sectors than 12 EU Member States. As in Mode 3, the Baltic countries open more sub-sectors than other NMS and Malta and Cyprus keep the highest number of sub-sectors closed.

Figure 5.8 **Number of open sub-sectors in Mode 4, EU25, 2005**

Source: Authors' calculations based on EU GATS offer in 2005

Compared to Mode 3, the number of sub-sectors opened in Mode 4 is lower; although one cannot argue from this type of analysis that Mode 4 is closed. Nevertheless, as the analysis in the next section will demonstrate, while a considerable number of sectors are scheduled under the Mode 4, the level of liberalisation offered within that sector is very low.

#### **Depth of commitments**

Figures 5.9-5.12 present the assessment of the Mode 4 commitments in 1995 and in 2005 based on our calculations using the methodology described above. Firstly, we consider the 1995 offer. Then we look at how the offer evolved for 12 EU Member States between 1995 and 2005. Lastly, we discuss Mode 4 commitment indices for EU25.

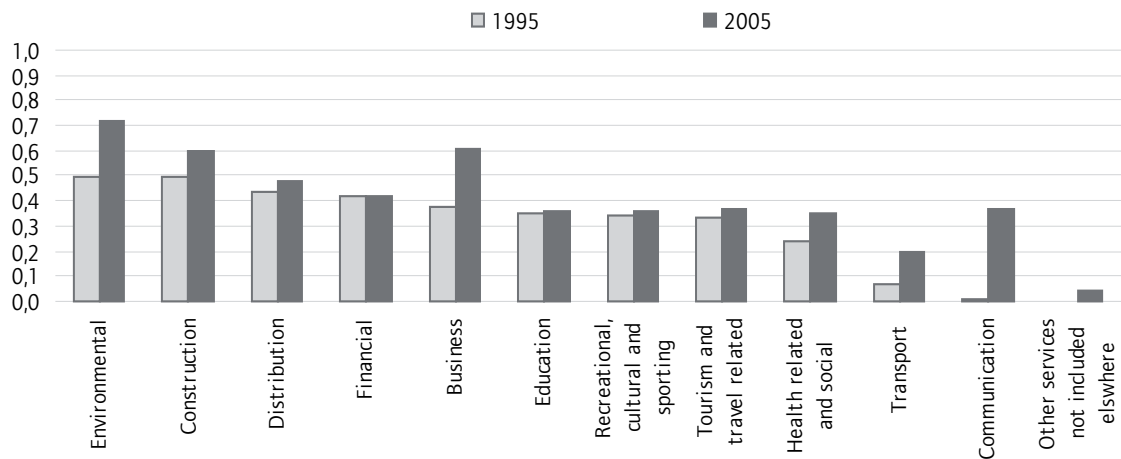
The sectoral distribution for the 12 EU Member States as a whole is presented in Figure 10. It shows that the highest levels of commitments in the 1995 offer were made in environmental services and construction and related engineering services. In these sectors, the liberalisation index has a value of 0.5, meaning that the 12 EU Member States level of commitment made was to roughly the same degree as in the horizontal section. For other sectors, however, a number of additional limitations are set. The most limitations (fewest commitments) were listed for communication, transport and other services sectors.

How did the EU offer change between 1995 and 2005? In 2005, the sectoral focus of EU Member State offers in Mode 4 was on environmental, business

and construction services, and to a lesser extent, health and transport services. The most significant increase in the level of liberalisation is recorded in business and communication services. In contrast, there were basically no additional commitments in distribution, financial and education services.

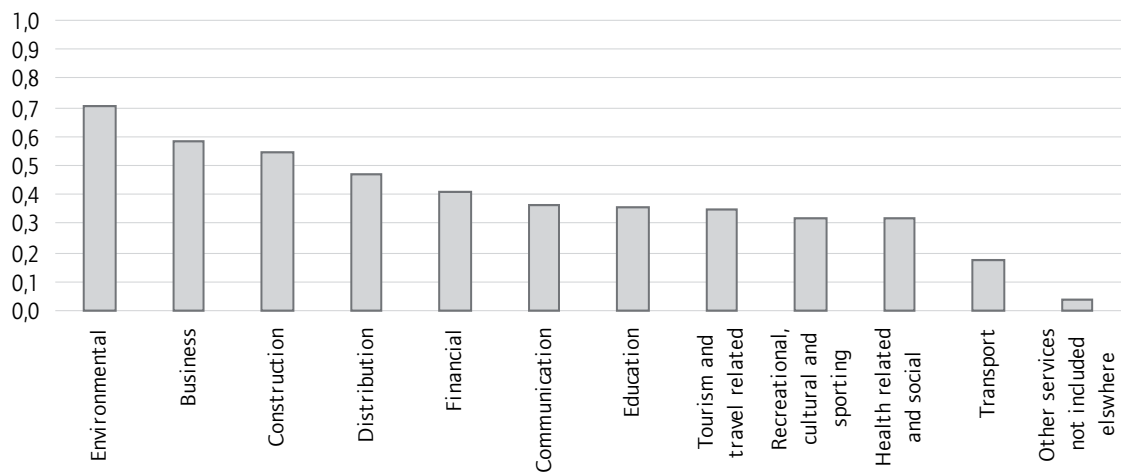
The analysis shows that, as for Mode 3, environmental, construction and distribution services are the most open sectors. However, financial services are, relatively speaking, more opened up for Mode 4 trade than for Mode 3.

Figure 5.9 Mode 4 sectoral commitments in 12 EU Member States, 1995 and 2005



Source: Authors' calculations based on EU GATS offers in 1995 and 2005

Figure 5.10 Mode 4 level of commitment, EU25, 2005, by sector



Source: Authors' calculations based on EU GATS offers in 1995 and 2005

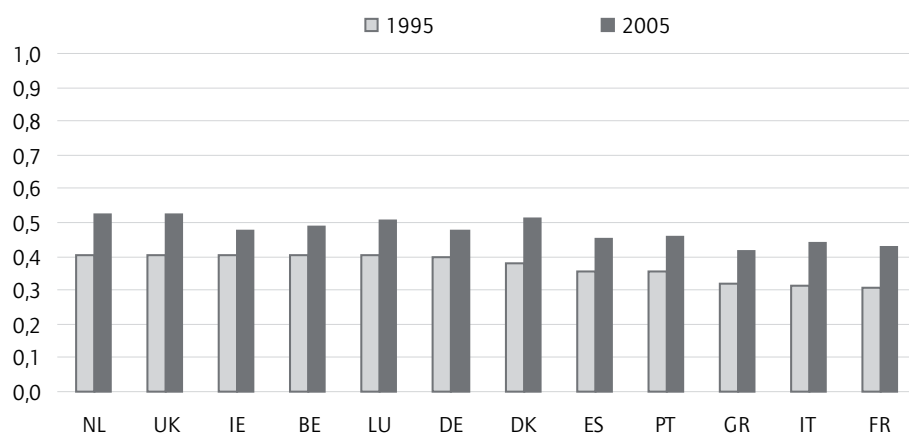
Cross-sectoral analysis for the EU25 as a group shows that environmental, business and construction services have the highest degree of commitments in Mode 4, above 0.5, and thus more liberal than the 'maximum', the horizontal offer, in 1995. The level of commitments is lower for distribution and financial services, and somewhat lower and very similar for education, tourism and travel-related, cultural and sporting and health services (between 0.3 and 0.4). Very few commitments are made in transport and other services.

Cross-country comparison (Figure 5.11) shows that in 1995 most of the 12 EU Member States offered openings in line with the horizontal section. Therefore, country indices for most EU Member States do not deviate much (at around 0.5). In fact, half of the EU Member States included in this graph have the same Mode 4 commitment index. However, Greece, Italy and France record rather lower commitments in 1995, indicating that they made restrictions in sectors that are relatively important in employment terms.

How has the offer in 2005 changed compared to 1995 for the 12 EU Member States? Commitments have increased for all countries and to approximately the same extent. The Netherlands, the UK, Denmark, Italy and France saw the highest increase in their Mode 4 commitments, while Ireland and Germany increased their commitments to a lesser extent.

In 2005, the Netherlands and the UK remained the Member States with the highest degree of commitments in Mode 4, followed by Denmark, Luxembourg and Belgium. In contrast, France, Italy and Greece made the fewest commitments, just as they had brought up the rear in 1995.

Figure 5.11 **Mode 4 commitments in 12 EU Member States, 1995 and 2005**



Source: Authors' calculations based on EU GATS offers in 1995 and 2005

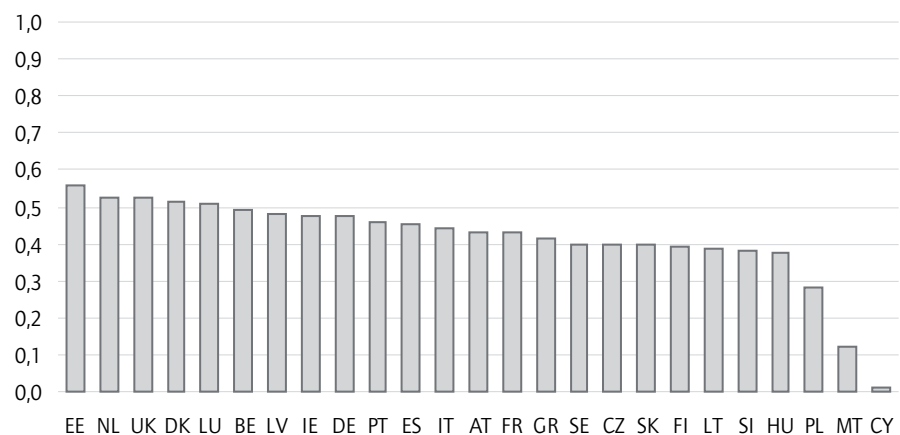
Do EU Member States' Mode 4 commitments converge over time? Marginally: the correlation test shows that the link between the level of commitments in

1995 and change between 1995 and 2005 is negative but rather weak (correlation equals -0.38). The link is much weaker than for Mode 3, where the analysis showed quite strong convergence over time.

Lastly, the analysis is carried out focusing on EU25 Member States in the 2005 offer. Here we look at the commitments scheduled by individual Member States. Figure 5.12 shows that EU Member States constitute rather a heterogeneous group in terms of scheduled commitments for Mode 4 (again based on weighted sectoral averages). Estonia offers the highest degree of commitments in Mode 4, followed by the Netherlands, the UK and Denmark. Poland, Malta and Cyprus are the least open Member States for Mode 4 workers in the GATS framework. In fact, Cyprus opened very few sub-sectors and is virtually closed to the temporary movement of service providers.

In 2005, the Mode 4 commitment index ranges from 0.01 for Cyprus to 0.56 for Estonia. Only five countries have opened up to a greater extent than in the EU horizontal section back in 1995, and even these to only a very limited extent. The regional pattern that emerges from the graph is rather similar to that for Mode 3 and discussed above. The three Nordic countries are even more widely dispersed than for Mode 3. The southern Nordic countries have changed places, but still occupy the middle ground in terms of liberalisation. The UK and Ireland occupy similar places as with Mode 3. The continental European countries occupy the middle and upper half of the distribution. Apart from Estonia and Latvia all other new Member States have a lower commitment index than the EU15. Thus again there is some – albeit not particularly strong – support for the idea that intra-European ‘models of capitalism’ are a good predictor of a willingness to open up national labour markets under Mode 4.

Figure 5.12 **Mode 4 liberalisation index, EU 25, 2005 (sectoral weighting)**



Source: Authors' calculations based on EU GATS offers in 1995 and 2005

We carried out the same tests as for Mode 3 to see what factors might be behind Member States' willingness to liberalise certain sectors, linking up with our service sector analysis in Chapter 2. Again, the results are suggestive but rather inconclusive.

In terms of sectoral indices, as in Mode 3, we find that commitments in Mode 4 are biased towards bigger sectors. However, contrary to Mode 3 findings, the correlation in 2005 is much stronger than in 1995.

In terms of Member States' commitment indices, there is a strong positive link between share of services employment and level of Mode 4 commitments for 1995 but a much weaker link for 2005 (as for Mode 3). In addition, we find a negative but very weak link between cumulative employment growth in a sector and the size of Mode 4 commitments in 2005. As we concluded for Mode 3, the results are not strong enough to be a reliable basis for conclusions regarding how commitments might evolve in the future.

### 5.3.6 Link between Mode 3 and Mode 4 commitments

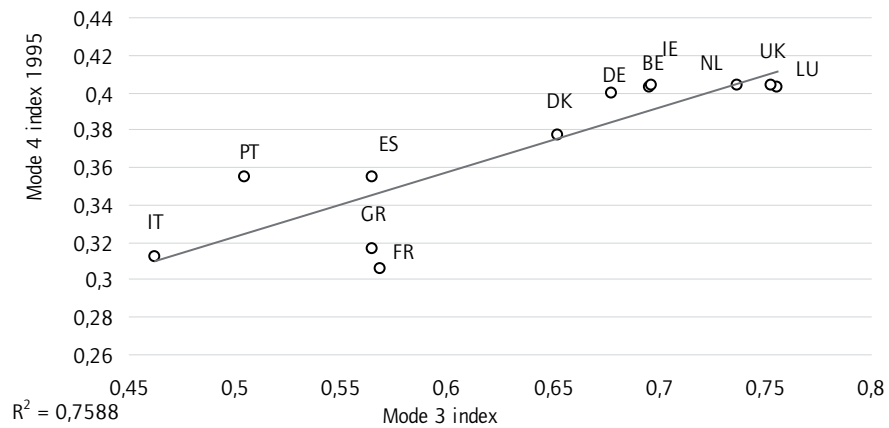
It is often argued that in economic reality movements under Mode 4 are related to those under Mode 3: high-skilled senior staff move under Mode 4 to open company branches abroad, which is Mode 3 services trade in the GATS context. Against this background, it might be expected that the level of Mode 3 and Mode 4 commitments within a given sector will be linked.

We have already made a number of qualitative remarks for the link between Mode 3 and Mode 4 in the previous section. Here we run a number of correlation tests to establish whether the link exists between the two Modes. We find a very strong correlation for 1995 (for the 12 EU Member States), suggesting that this link does indeed exist. The graph shows all points rather close to the best-fit line, which is almost a 1 to 1 relationship (although it should be recalled that the Mode 3 and Mode 4 scales are not comparable). However, the correlation is weaker in 2005. This indicates that there is no strong correlation between the sectors in terms of the additional commitments made between 1995 and 2005. For example, commitments in Mode 4 for education services were virtually unchanged, whereas for Mode 3 substantial additional commitments were made; for business services the reverse was true. As a result, the sectoral link between Mode 3 and Mode 4 commitments was strong when a first offer was made but has weakened in the revised conditional offer.

Is there a link between the extent of Mode 3 and Mode 4 commitments within a given country? This might be expected on the basis of the idea that countries take a basically more or less 'liberal' view of services trade and in view of the substantive link between the two forms of service provision referred to above. For both 1995 and for 2005, figures 5.13 and 5.14 shows the same level of

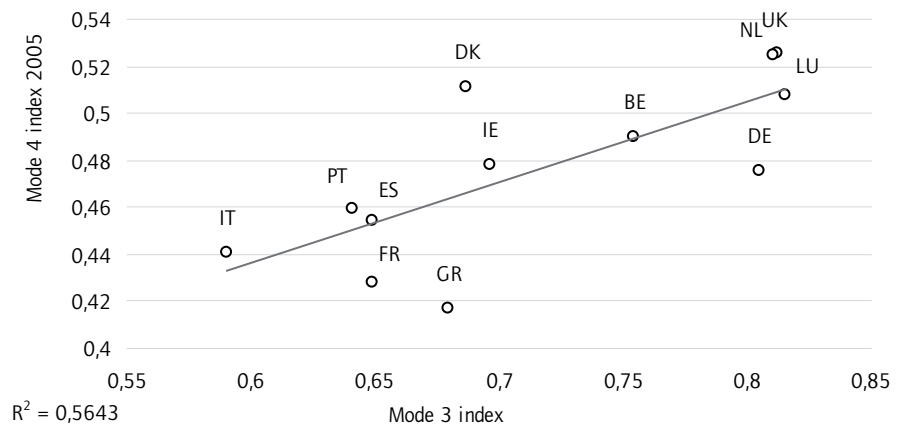
correlation (around 0.8) suggesting a strong link between the level of commitment for Mode 3 and Mode 4: those countries that made a higher commitments in Mode 3 tended to do also for Mode 4. Nor has this changed during the 10-year period. This explains the similarity between the country rankings of Mode 3 and Mode 4 commitments already noted above.

Figure 5.13 **Correlation between Mode 3 and Mode 4 commitments in 12 EU Member States, 1995**



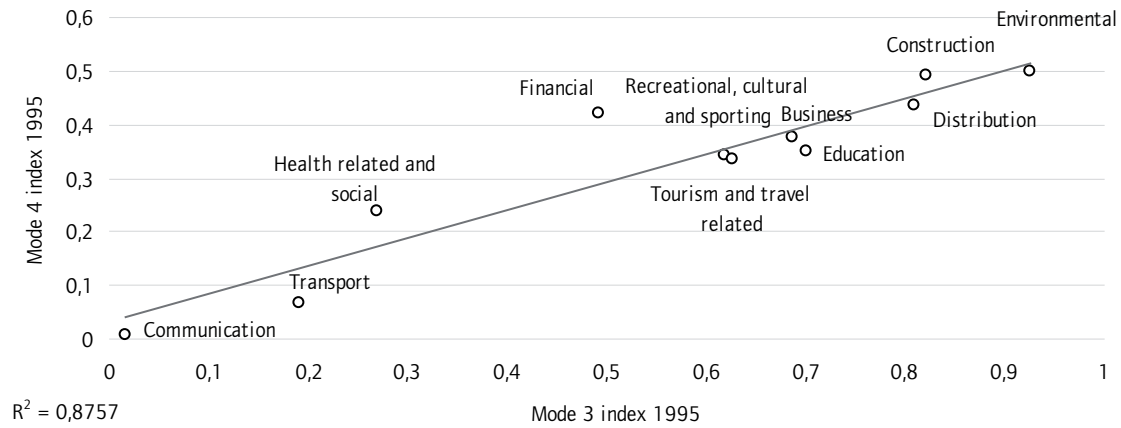
Source: Authors' calculations based on EU GATS offers in 1995 and 2005

Figure 5.14 **Correlation between Mode 3 and Mode 4 commitments in EU25 Member States, 2005**



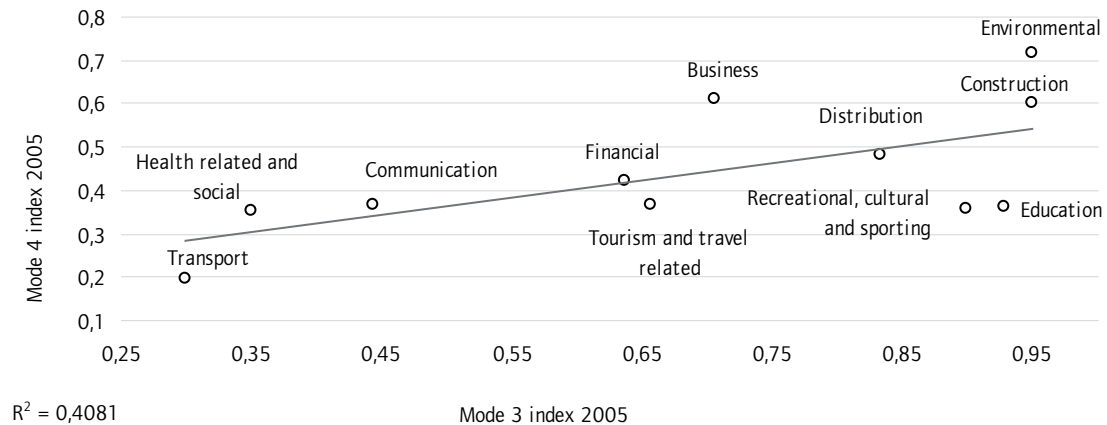
Source: Authors' calculations based on EU GATS offers in 1995 and 2005

Figure 5.15 Correlation between Mode 3 and Mode 4 commitments in sectors, in 12 EU Member States, 1995



Source: Authors' calculations based on EU GATS offers in 1995 and 2005

Figure 5.16 Correlation between Mode 3 and Mode 4 commitments in sectors, EU25, 2005



Source: Authors' calculations based on EU GATS offers in 1995 and 2005

## 5.4 Outlook for future commitments in the EU GATS offer in Mode 3 and Mode 4

European Member States' commitments under GATS depend on a whole range of factors, to name just a few of them: further developments in the DDA Round (and not only services but also in agriculture, Non-Agricultural Market Access, etc.); the willingness on the part of Member States to make commitments at the multilateral level in general; EC pressure on the Member States to converge to a 'single EU level'. Commitments also depend partly, of course, on the requests by other WTO Members to open certain services or remove

certain limitations under the GATS, as this is key to persuading other countries to grant freer market access. Countries are also influenced by current and expected future economic and employment trends, including demographic developments in services at the national and global level.

Earlier in this chapter, we attempted to identify some explanations for the size of existing EU commitments under the GATS at sectoral and Member State level. While the results did not amount to a ‘model’ explaining GATS openness under Mode 3 and Mode 4, we did see that there is a tendency for openness to be higher in countries with the following features: being an EU member prior to 1995, having a high share of services in total employment, and experiencing rapid growth in services employment. The results are not strong enough for us to be confident in asserting that such features will continue to have predictive force in the future, however. In particular, as part of a convergence process, higher additional commitments would be expected from the NMS, especially Cyprus and Malta which in 2005 had very low commitment indices, mirroring what we identified as happening between the 12 EU Member States between 1995 and 2005. Whether this will be to such an extent as to ‘overtake’ 12 EU Member States, as the Baltic States have done on some measures at least, remains to be seen. There is likely to be convergence between EU Member States in terms of their structural features, which, to the extent that these are drivers, implies convergence also in their GATS commitments. At the same time, there will be a convergence pressure emanating from the strong role of the European Commission in representing the EU Member States in GATS negotiations. Thus there are two different logics – one ‘economic’ and the other political – promoting convergence.

In the case of Mode 3, it should be recognized that the EU, and especially the 12 EU Member States, already offered relatively high commitments in 1995 and 2005. Nevertheless, our GATS commitment indices suggest that there is still scope for further opening in the future in a number of sectors, such as the health and transport sectors. One might expect the level of commitments in these sectors to increase.

On the other hand, the DDA Round negotiations were suspended once again in 2008. There is a growing perception that the multilateral system does not work and bilateral and/or regional cooperation is increasingly being seen by actors as a good substitute for the WTO. An increasing number of countries are pursuing or have signed bilateral or regional trade agreements that include service-sector commitments for all modes of services supply. To date, however, there are no agreements between the large players in the WTO – the EU, USA, Brazil, China, and India. Most regional agreements are between industrialised countries, especially the USA and EU countries, and developing economies. The most controversial mode of service supply – Mode 4 – has also been the subject of a number of bilateral agreements, for example, agreements between the UK and South Africa and Ghana. In general, countries seem to prefer to address Mode 4 movement of service suppliers on a country-by-country basis, rather than through the multilateral approach in the GATS. To a large extent, this reflects a need to keep regulatory autonomy to control

and manage the movement of service providers – and withdraw commitments if and when necessary. If bilateral/regional agreements are a priority for services liberalisation, one could expect smaller additional commitments – or even a freeze – under the GATS in the coming years.

Another issue that could affect the size of the EU GATS commitments is the ongoing negotiations on domestic regulations in the Working Party on Domestic Regulations. The lack of any clear outcomes of these negotiations is surely a factor preventing countries from making commitments, especially in more sensitive sectors (i.e. as is now the case in the EU offer for transport and health). Thus a breakthrough in such negotiations, which makes it clearer what countries are letting themselves in for in terms of their future regulatory capacity, might lead to a greater willingness to make additional commitments. However, past experience suggests that such a breakthrough is unlikely under present conditions and would require a more fundamental shift in the WTO's way of working and/or the interest perceptions of the large players.

Requests by other WTO Members are also likely to influence EU Mode 3 and Mode 4 commitments. These requests are not publicly available and so it is not possible to conduct systematic research on them. However, some information is available from the DG Trade website for requests submitted by 2003. It is difficult to summarise the requests, but they concern all parts of the EU offer: horizontal aspects such as public utilities and real estate and also sectoral sections (i.e. requests to make additional commitments in audiovisual, construction and related engineering services, and energy specific services).

A number of requests concern additional commitments for Mode 4. This is not surprising as Mode 4 is the main offensive interest for many WTO Members (mainly developing countries) in the GATS. To exemplify, a number of requests were received asking to expand sectoral coverage of the CSS category; extend the permitted length of stay; create a new category of ICT for training purposes. Several requests were submitted asking to make commitments on lower skill levels and even to remove all restrictions, allowing free movement of persons who provide services (two countries have requested this for all categories of service supplier, one country for ICTs only and one country for certain job types only) (European Commission 2003). There seems, however, to be little inclination at present on the part of the EU Member States to open up to low-skill workers.

GATS negotiations are reciprocal and the extent of the offers also depends on what other WTO Members are prepared to commit in services but also in other areas of the Doha negotiations. Therefore, it is difficult to judge which of these requests will be taken on board in the EU GATS offer.

## 5.5 Conclusions

This chapter has described the EU GATS offer under Modes 3 and 4 for 1995 and 2005. Building on earlier methodological work and an initial qualitative

assessment, we developed and presented a methodology for assessing in a quantitative way the extent of the offer made by the EU Member States and the EU as a whole for each of the 12 broad service sectors. A number of interesting results were obtained from this analysis, enabling a more accurate picture to be painted of the nature of national offers in both years than previous research has provided, and enabling cross-country and cross-sectoral comparisons to be made. This also enabled us to refer back to our statistical descriptions of the services sector in the EU and the Member States in Chapter 2, with a view to identifying structural features that might serve as predictors of sectors that have been and possibly will in the future be opened up under Modes 3 and 4.

All in all, we can make some predictions based on past experience for the sort of areas (countries, sectors) in which further liberalisation is most likely. However, the huge political uncertainty surrounding the WTO negotiations makes it all but impossible to forecast what the overall degree of liberalisation will be in the next five or ten years. It is dependent on a whole range of political and economic factors, from the outcome of the presidential election in the US and the depth of the coming economic downturn, in the short run, to longer-run issues of the balance of economic and political power between the trading nations and the impact that has on decision-making processes within international organizations such as the WTO. One plausible scenario is that further liberalisation will indeed take place, but on a piecemeal, bilateral basis, rather than under the GATS.

The main purpose of this work, however, was to derive measures for the actual degree of opening under Mode 3 and Mode 4 that can be used to shed light on the debate, described in Chapter 4, on the actual and likely possible impacts of GATS-driven liberalisation on European labour markets and countries' regulatory capacity. This is the task of the next chapter.



## 6. GATS implications for cross-border services flows and regulatory capacity in the EU

### 6.1 Introduction – possible causal links

In this chapter we derive a set of possible causal links between (i) GATS and globalisation of services in the EU (specifically EU services imports from non-EU countries, FDI inflows and temporary movement of service providers) and (ii) GATS and Member States' regulatory capacity. These are expressed in the form of testable hypotheses that can be set against the factual evidence available since the GATS came into force in 1995. The hypotheses are based on the GATS debate and literature review presented in chapter 4. They are formulated so as to reflect our main research interest, namely as the impacts of GATS Mode 3 and Mode 4 liberalisation in the EU Member States, and so that we can bring to bear on them the quantitative indices of Mode 3 and Mode 4 commitments that we calculated in chapter 5.

Two main types of causal link between GATS commitments and regulatory capacity can be hypothesised. One, a more indirect and 'economic' one, runs from GATS commitments to an actual liberalisation in services trade which, via an increase in actual services trade, FDI and movement of workers, exerts downward pressure on domestic regulation. Domestic regulation may simply become incompatible with the growth in imports, FDI and movement of workers and/or the increasing number of active trading partners will lead to pressures, via WTO mechanisms, to remove regulations. Secondly, a more direct and 'political' channel may run between GATS commitments and changes in domestic regulation, irrespective of any changes in trade flows. This channel can work through direct 'spillovers' between the trade negotiating and domestic policy arms of national government. It is then *ex ante* an open question whether it is the trade negotiators that lead, forcing domestic policy to follow, or whether it is only when domestic policy has been liberalised (perhaps due to some other pressures), or at least when it is clear that liberalisation will happen, that a 'green light' is given to make lasting commitments in that sector under the GATS.

In line with all the above considerations, we have formulated four testable hypotheses, as follows.

1. EU Member States that are more open under the GATS have more intense services trade flows (services imports and inflows of FDI and temporary service providers);

2. EU Member States that have scheduled more GATS commitments between 1995 and 2005 experience a higher increase in their services trade flows;
3. EU Member States that are more open under the GATS have lower levels of domestic regulations;
4. EU Member States that have experienced higher increase in GATS commitments have seen bigger falls in their domestic regulation indices.

In the remainder of this chapter we run a number of correlation tests and regressions to see to what extent these statements are valid. At the end of the chapter we shall examine issues of causality. In the first section we listed some plausible reasons why trade liberalisation under GATS might be expected to be linked causally to increased trade and lower regulation, although causality may also run the other way. In any case, it is first necessary to test for the existence of strong correlations, in the absence of which any discussion of causality is superfluous. We expect positive correlations in the case of hypotheses 1 and 2 and negative correlations for hypotheses 3 and 4.

## **6.2 Correlation analyses of GATS impacts – data and empirical tests**

As a measure of liberalisation under the GATS we use our indices of GATS commitments from the previous chapter. Some limitations of these indices were noted in Chapter 5. In the present context the most important caveat is that, while the 1995 indices relate to concrete and irreversible trade liberalisation commitments made by the, at that time, 12 EU Member States, the 2005 indices relate to the EU25 conditional offer, which is still under negotiation at the WTO DDA Round. We do not therefore know the extent to which these commitments reflect existing practices of services trade liberalisation at the national level. It may be that corresponding liberalisation measures regarding domestic regulations are still in the pipeline. This is not a problem for hypotheses 1 and 3 ('levels') for the 1995 data, but it makes interpretation of the results for Hypothesis 2 and 4 'changes' more difficult. All the results for 2005 are open to the potential 'explanation' that the commitments are as yet non-binding and any effects on actual levels of regulation are not yet felt. On the other hand, it is widely believed that the EU GATS offer is a 'standstill' and does not go beyond actual liberalisation levels at the national level (see Chapter 4). If this is the case, then liberalisation levels of both the 1995 offer, which already applies in 12 EU Member States, and the 2005 offer, which has not yet come into force, are equally applicable across the EU. Unfortunately, we cannot support such a view by comprehensive empirical data, and it relies on secondary assessments (authors' interviews with DG Trade officials in September – October 2007, statements by industry associations (European Services Forum 2005) and findings of Francois/Wooton (2000), Langhammer (2005) and Hoekman/Mattoo/Sapir (2008)). Of course, such an interpre-

tation also suggests that GATS commitments ‘follow’ rather than ‘lead’ the liberalisation of domestic regimes, or at least that the interaction between them is complex.

Because the Mode 3 and Mode 4 scales are not comparable, they cannot be readily combined. Following on from the approach in the previous chapter, then, the correlation tests have to be run separately for the two Modes. Inevitably this leads to some repetition in the presentation of the results.

Tables 6.1 and 6.2 summarise the GATS commitment indices calculated by the authors and presented in detail in chapter 5.

Table 6.1 Mode 3 and Mode 4 commitment indices, 12 EU MS in 1995 and EU25 in 2005

	Mode 3		Mode 4	
	1995	2005	1995	2005
Austria		0,65		0,43
Belgium	0,7	0,75	0,4	0,49
Cyprus		0,26		0,01
Czech Republic		0,44		0,4
Denmark	0,65	0,69	0,38	0,51
Estonia		0,8		0,56
Finland		0,49		0,39
France	0,57	0,65	0,31	0,43
Germany	0,68	0,8	0,4	0,48
Greece	0,57	0,68	0,32	0,42
Hungary		0,52		0,38
Ireland	0,7	0,7	0,4	0,48
Italy	0,46	0,59	0,31	0,44
Latvia		0,67		0,48
Lithuania		0,76		0,39
Luxembourg	0,76	0,82	0,4	0,51
Malta		0,28		0,12
Netherlands	0,74	0,81	0,4	0,53
Poland		0,46		0,28
Portugal	0,5	0,64	0,35	0,46
Slovakia		0,4		0,4
Slovenia		0,6		0,38
Spain	0,57	0,65	0,35	0,45
Sweden		0,5		0,4
United Kingdom	0,75	0,81	0,4	0,52

Note: Mode 3 and Mode 4 scales are not comparable, for more details see chapter 4.

Source: Authors' calculations based on EU GATS offers in 1995 and 2005

As the services trade indicator we take as a starting point data on extra-EU imports of services from Eurostat database by each Member State in 1995 and 2005. Data in 1995 presents extra-EU15 services imports (data available for 8 EU MS only) and data in 2005 extra-EU25 services imports (data available for all 25 countries). As already noted in chapter 4, cross-border services flows recorded in the trade statistics mainly cover GATS Mode 1 (cross-border trade) and Mode 2 (consumption abroad), and only part of Mode 3 (commercial presence) trade. A first attempt to ‘normalise’ these data is made by dividing them by national GDP, i.e. expressing service imports as a share of GDP. For the bivariate correlations this leaves an unresolved problem that country

size is an important determinant of trade to GDP ratios (i.e. smaller countries have higher trade to GDP ratios); we subsequently allow for this by means of multivariate regression analysis.

Table 6.2 Mode 3 and Mode 4 sectoral commitment indices, 12 EU MS in 1995 and EU25 in 2005

	1995	Mode 3 2005	1995	Mode 4 2005
Business services	0,69	0,71	0,38	0,61
Communication services	0,02	0,44	0,01	0,37
Construction and related engineering services	0,82	0,95	0,49	0,6
Distribution services	0,81	0,83	0,44	0,48
Education services	0,7	0,93	0,35	0,36
Environmental services	0,93	0,95	0,5	0,72
Financial services	0,49	0,64	0,42	0,42
Health related and social services	0,27	0,35	0,24	0,35
Recreational, cultural and sporting services (other than audiovisual services)	0,62	0,9	0,34	0,36
Tourism and travel related services	0,63	0,66	0,33	0,37
Transport services	0,19	0,3	0,07	0,2

Note: Mode 3 and Mode 4 scales are not comparable, for more details see chapter 4.

Source: Authors' calculations based on EU GATS offers in 1995 and 2005

As Mode 3 trade indicator we use the EU FDI inflows data from the UNCTAD database for the World Investment Report (WIR) (UNCTAD 2004). Thanks to a special issue of the WIR in 2004, dedicated to services FDI, we have data for services FDI (which is normally lumped together with that in industry) by Member State. Disaggregation into intra- and extra-EU FDI services inflows is unavailable, however, so that we have to rely on data for total EU FDI inflows in the services sector.<sup>16</sup> Unfortunately, the UNCTAD FDI data is not available for the same years as the EU GATS offers. We use the closest available years – averages for 1996-1999 and for 2000-2003. The use of averages has the advantage of smoothing out the results which, in the case of FDI, can fluctuate rather strongly from year to year (for a description of the data see UNCTAD 2004). However, the latter period precedes the EU GATS offer of 2005, making the findings hard to interpret.

As has already been noted in this report, there is scarcely any data available on flows of temporary movement of service providers under Mode 4, neither by Member State nor by sector. In order to not totally exclude this key question, we make use of the best available proxy data. To our knowledge, this is the data provided by the UK on the number of temporary permits granted per industry in 1995 and 2005. Unfortunately, the sectoral classification used in the UK statistics differs from the WTO services classification, but the two are

<sup>16</sup> Eurostat FDI data, by contrast, does distinguish between intra and extra-EU flows. However, it is only available for some countries and only net flows are given.

sufficiently close to carry out some rough tests (Salt/Miller 2006). One point to note is that the UK data covers all registrations as temporary workers. In 1995 this included the eastern European countries, which were not, at that time, EU members. In 2005 new EU Member States are not included in the dataset as they do not require permits to work in the UK. One problem with the data is that it does not relate directly to the number of people working in the UK at any one time but to actual registrations, the labour market impact of which will vary depending on the average length of stay, and also on the number of return registrations.

Finally, for domestic regulation we have a very detailed and comparable data set compiled by the OECD (see OECD Indicators of Product Market Regulation Homepage<sup>17</sup> for a detailed data description). It is a composite indicator of product market regulation that ranks countries along a whole series of indicators. The overall PMR indicator is also divided into an externally (trade) and an internally (domestic regulation) oriented section. The OECD PMR data has two small limitations: it is not available for all the EU25 countries (as not all are OECD members). And, as for FDI data, the indices are available only for years that do not coincide with GATS offers, namely, 1998 and 2003. The latter date, especially, is not ideal as it precedes the EU offer of 2005 (which in any case is not yet binding).

Overall, the data situation is unsatisfactory but, as we are not interested in point estimates of coefficients but merely in identifying orders of magnitude and the orientation of correlations, they can be considered adequate, provided the results are interpreted cautiously.

### **6.3 GATS impacts on inflows of services trade, FDI, and movement of service providers**

#### **6.3.1 Hypothesis 1**

**Hypothesis 1: EU countries' GATS commitments are positively correlated with extra-EU services imports, FDI inflows and inflows of temporary movement of service providers**

In order to test Hypothesis 1 we correlate our Mode 3 and Mode 4 indices with (i) services imports as a share of GDP, (ii) inflows of FDI in services as a share of GDP and (iii) inflows of foreign temporary service providers (into different UK sectors). If GATS is 'effective' as a mean of liberalising services trade, one could expect to see a positive correlation between EU GATS commitments and these three indicators of cross-border services flows. Such a correlation – and the same applies in all the following cases – is to be seen as a necessary condition for GATS to be exerting such an impact. It is not a sufficient condition (i.e. proof of a causal relationship of GATS). However, notably because the

17. [www.oecd.org/document/1/0,3343,en\\_2649\\_34323\\_2367297\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/1/0,3343,en_2649_34323_2367297_1_1_1_1,00.html)

direction of causality might run the opposite way, we discuss this possibility where relevant below.

### **Correlation with imports**

Correlation tests show a positive link between levels of the GATS commitments and services imports from outside the EU in 1995 and 2005.

In 1995, we find a quite strong and positive link between GATS commitments and extra-EU imports as a share of GDP. The link between imports and GATS indices is stronger for Mode 3 than for Mode 4 (the correlation is 0.73 for Mode 3 and 0.63 for Mode 4, the  $R^2$  of these simple bivariate correlations are just above half for Mode 3 and 0.4 for Mode 4).

The scatter plots (Figures 6.1-6.4) show, however, that for both modes of service supply there are two groups of countries. For a substantial group of countries (i.e. Italy, Greece and Spain), quite large differences in the degree of openness of Mode 3 and Mode 4 commitments are consistent with rather similar services trade scores. For another smaller group of countries higher Mode 3 and Mode 4 indices are linked with higher imports (i.e. Netherlands and UK).

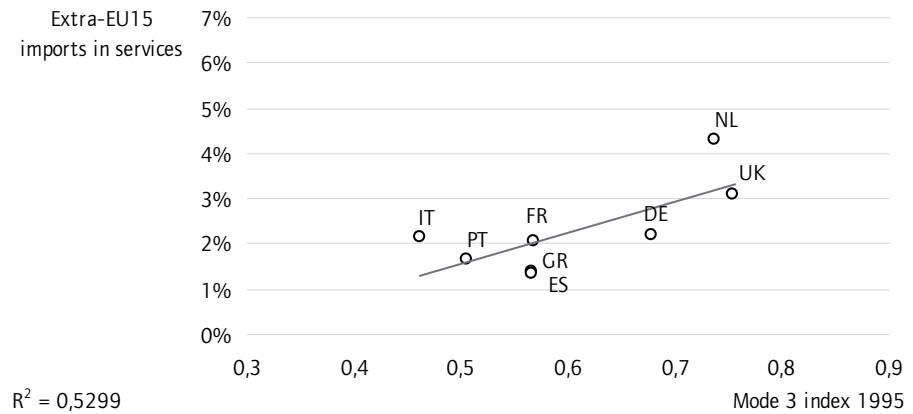
The positive correlation also holds in 2005 (Mode 3 correlation 0.57, Mode 4 correlation 0.53)<sup>18</sup>, again with a similar pattern for the two modes, but only if a number of small outliers (Luxembourg, Ireland, Cyprus and Malta) are excluded. For both years and for both Modes of analysis, there are no Member States with high trade openness but low GATS commitment indices. However, two Member States – Germany and Denmark – have high levels of GATS commitments but lower trade openness compared to other Member States.

Overall the figures provide evidence of a link between GATS commitments and levels of services imports. The link is somewhat stronger for Mode 3 – which one could expect, since Mode 3 trade accounts for most of services trade flows, while Mode 4 services flows are very small and commitments are limited to very narrowly defined categories of high-skilled service providers. Furthermore, the 1995 correlation is stronger than for 2005. Weaker results in 2005 may simply be the result of ‘adding’ the new Member States to the calculations. It may also be that the convergences in commitments in the 2005 offer (which is not yet binding) between even the old Member States has weakened the statistical link; in Chapter 4 we showed that the change in Mode 3 index between 1995 and 2005 was negatively correlated with the existing levels in 1995.

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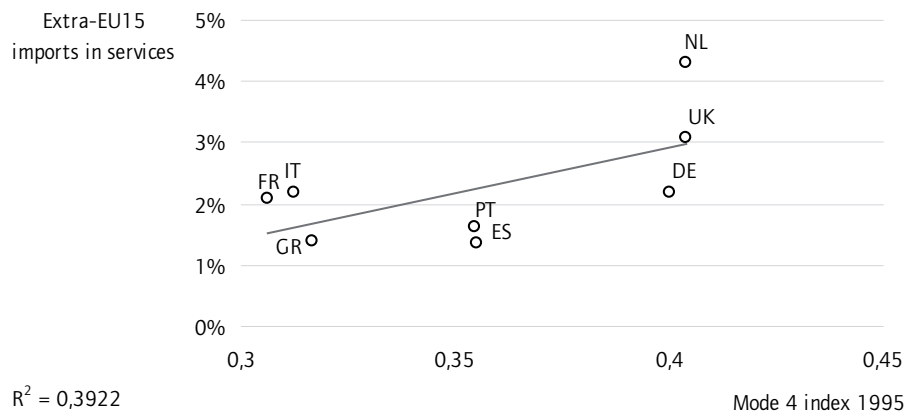
<sup>18</sup> Note that the y-axis scale is different in the 1995 and 2005 graphs. This is due to EU enlargement which has the statistical effect of reducing the size of extra-EU services imports. This does not affect the overall pattern of the scatter plots, although it will have a slight effect on the results for countries that trade a lot with central and eastern Europe (e.g. Germany) compared with those trading relatively more with third countries (e.g. UK).

Figure 6.1 Correlation between Mode 3 index and extra-EU15 imports in services (share GDP), 1995



Source: Authors' calculations based on EU GATS offer in 1995 and Eurostat (2007)

Figure 6.2 Correlation between Mode 4 index and extra-EU15 imports in services (share of GDP), 1995

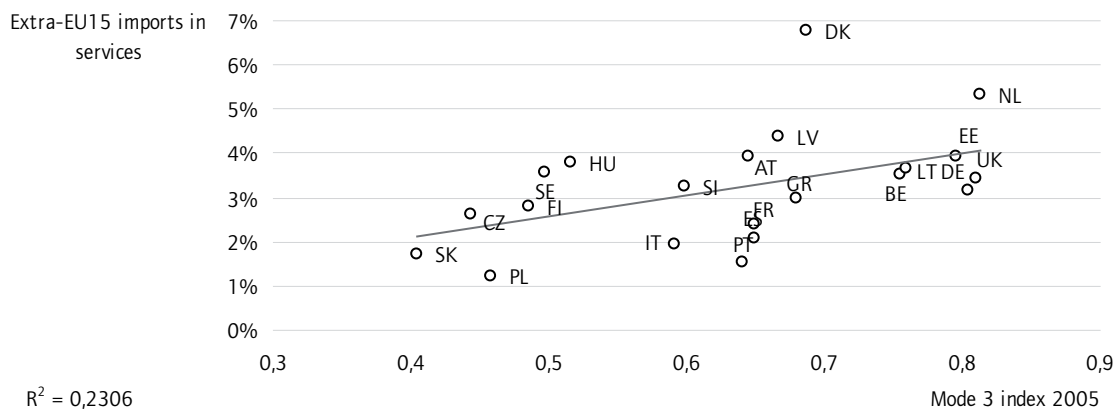


Source: Authors' calculations based on EU GATS offer in 1995 and Eurostat (2007)

But clearly other factors besides GATS are important determinants for the size of extra-EU imports. One obvious candidate is simply country size. Smaller countries tend to have high trade shares generally simply because they tend to be more specialised. This almost certainly explains the 'outliers' Luxembourg, Ireland and Cyprus and Malta. The latter two, notably, are rather closed under the GATS, but rely heavily on tourism services. We consider this more formally in the regression analysis below. Furthermore, the likely influence of country size disappears when we consider the changes in the GATS indices and the changes in service flows (Hypothesis 2), which, to that extent, is a more telling test.

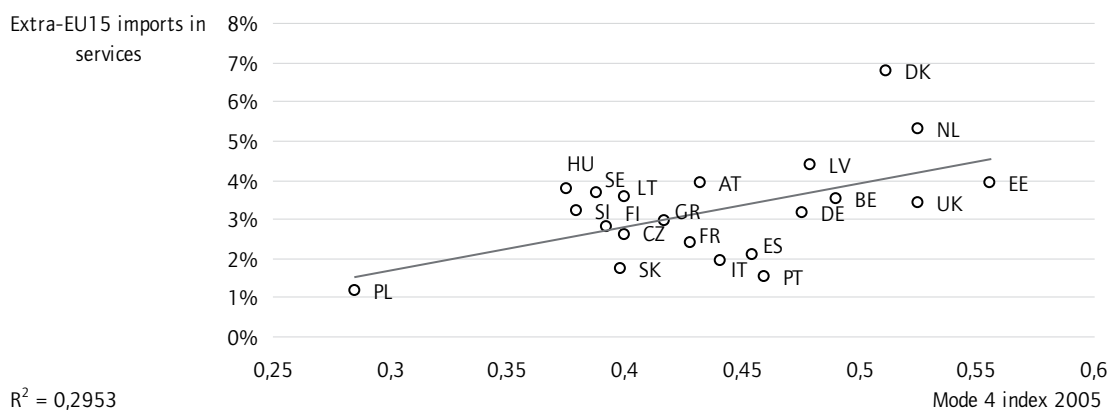
It is far from clear whether it is GATS commitments that have driven services trade levels, or – perhaps more plausibly – the fact that countries more open to trade saw fewer problems in making GATS commitments. Nevertheless, the key finding is that EU Member States’ GATS liberalisation commitments under Modes 3 and 4 tend to be associated positively with the relative (to GDP) size of services imports.

Figure 6.3 Correlation between Mode 3 and extra-EU25 imports in services (share of GDP, excludes LU, IE, CY and MT), 2005



Source: Authors' calculations based on EU GATS offer in 2005 and Eurostat (2007)

Figure 6.4 Correlation between Mode 4 and extra-EU25 imports in services (share of GDP, excludes LU, IE, CY and MT), 2005



Source: Authors' calculations based on EU GATS offer in 2005 and Eurostat (2007)

### Correlation with FDI

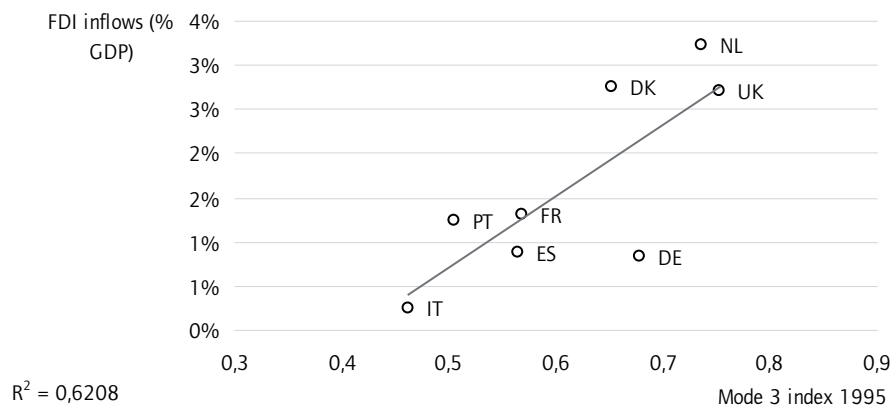
In the second step, we consider the link between Mode 3 and Mode 4 commitments and total EU FDI inflows in services in 1995 and 2005. Ideally we would like to test whether GATS commitments are linked to *extra-EU* FDI services inflows. Unfortunately, as already indicated, this data is not readily available and we can only consider services FDI numbers that include those from other EU countries. Since Mode 3 (but also Mode 4) are directly linked to services FDI, one could expect strong positive correlation between levels of GATS commitments and levels of services FDI coming from outside the EU.

In Figures 6.5-6.8, the Mode 3 and Mode 4 indices are plotted against the FDI inflows in services (as a share of GDP). In 1995, it is apparent that most of the Member States with higher Mode 3 and Mode 4 indices also had more FDI inflows in services. Overall, the correlations are strongly positive: 0.79 for Mode 3 and 0.65 for Mode 4. This strongly suggests the existence of the GATS-FDI link in 1995 and, as expected, that it is stronger than for services imports.

As for the correlation with trade openness, the results for 2005 are less conclusive than in 1995. Indeed, the correlation for both modes is actually negative, although very weakly so (Mode 3 correlation -0.2 and Mode 4 correlation -0.05). If outliers (Cyprus and Slovakia) are excluded, correlation is positive but rather weak (correlation of 0.42 for Mode 3 and 0.27 for Mode 4). These figures suggest that, in 2005, GATS commitment indices do not contribute much to the explanation of EU FDI inflows in services: several Member States, such as Hungary, Finland and Slovakia, have lower Mode 3 commitment indices and relatively high FDI inflows measured as a share of GDP, while others, such as Denmark, UK and Lithuania, have higher Mode 3 and Mode 4 commitment index but lower inflows of FDI in services. A plausible interpretation here is that a generally positive GATS effect on FDI inflows is being 'drowned out' by a much more substantial 'EU enlargement effect'; note the bunching of NMS on the left (low commitments) of the 2005 Mode 4 graph, but with widely differing FDI penetration. The fact that the relationship is positive for the homogenous group of seven old Member States lends credence to the idea of a positive effect, but its overall weight is probably rather minor. The accession of the new Member States to the EU, and subsequent attraction of inward FDI, is clearly much more important than GATS in 2005.

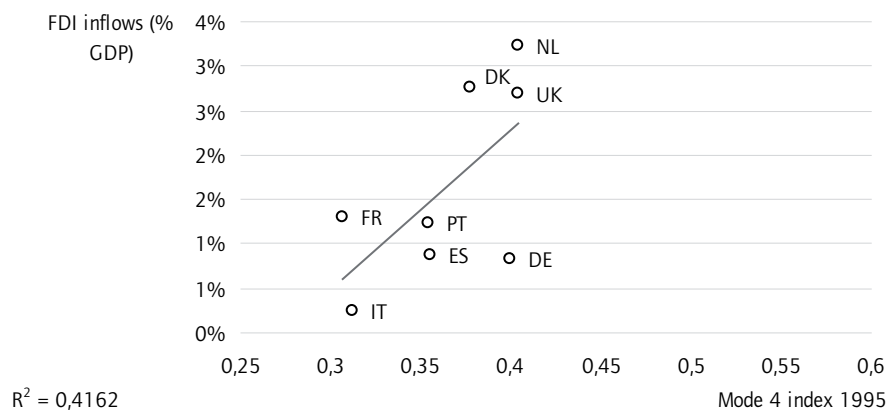
As one could expect, the correlation between Mode 3 and FDI is somewhat stronger than with Mode 4 for both years of analysis. Overall, the findings suggest that GATS has a positive link with FDI inflows in services within a relatively small and homogeneous group of western European countries, but that this relationship largely breaks down after enlargement, as a number of rather closed CEE countries exhibit high inward FDI-to-GDP ratios. It can be argued that this reflects an enlargement effect trumping a GATS effect.

Figure 6.5 Correlation between Mode 3 index and FDI inflows in services (share of GDP), 1995



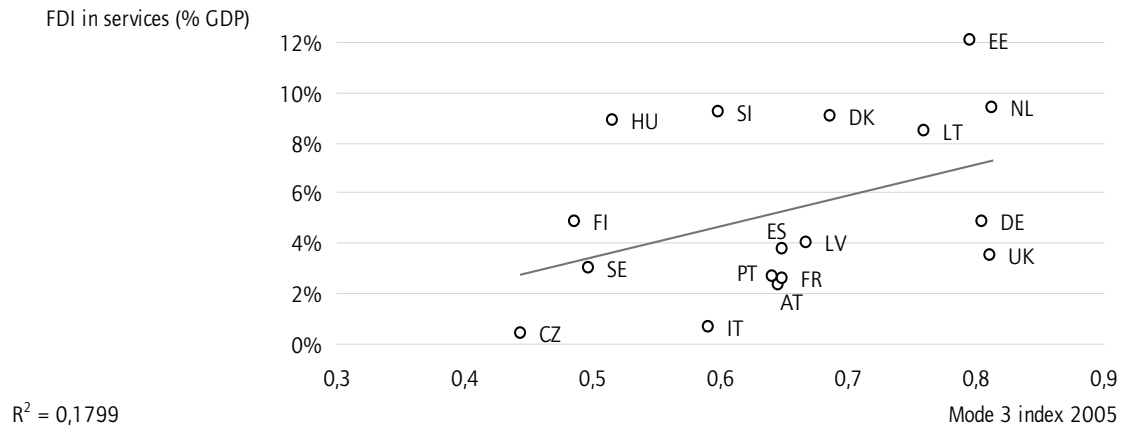
Source: Authors' calculations based on EU GATS offer in 1995 and UNCTAD (2004)

Figure 6.6 Correlation between Mode 4 index and services FDI inflows in services (share of GDP), 1995



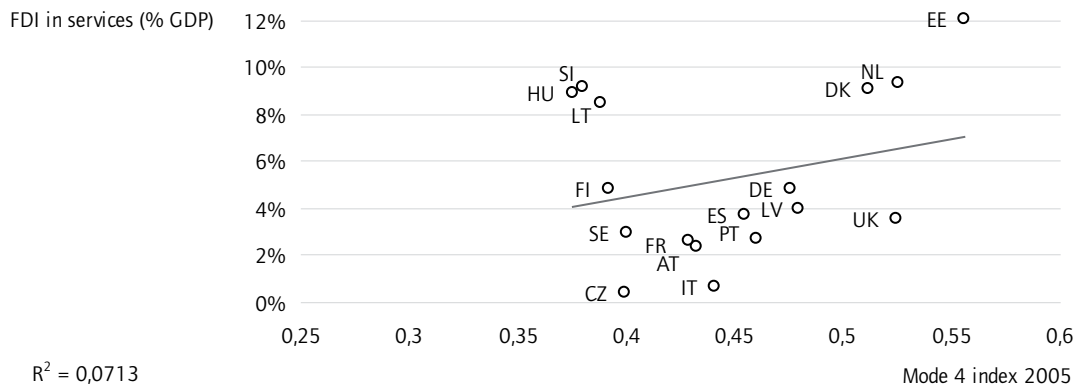
Source: Authors' calculations based on EU GATS offer in 1995 and UNCTAD (2004)

Figure 6.7 Correlation between Mode 3 and FDI inflows in services (share of GDP, excludes Cyprus and Slovenia), 2005



Source: Authors' calculations based on EU GATS offer in 2005 and UNCTAD (2004); FDI data not available for Poland.

Figure 6.8 Correlation between Mode 4 and FDI inflows in services (share of GDP, excludes Cyprus and Slovenia), 2005



Source: Authors' calculations based on EU GATS offer in 2005 and UNCTAD (2004); FDI data not available for Poland.

### **Multivariate regression analysis of GATS impacts on imports and FDI inflows in services**

As noted above, a simple but important factor likely to be affecting the correlations is country size. Smaller countries tend to have larger shares of goods and services that are imported and exported; cross-border capital investments (FDI) are also likely to be relatively more important. To take extremes, the global economy as a whole has zero imports/exports of goods and services, whereas a country such as Liechtenstein relies on the rest of the world for a large share of the goods and services it consumes (all its cars and computers, for instance) and exports relatively large amounts of, in particular, services in which it has specialised (financial services, tourism).

To take account of this we have run simple multivariate OLS regressions in which the dependent variables (service imports as a share of GDP and inward FDI as a share of GDP) are regressed on our Mode 3 and Mode 4 indices and on population.

As the simple correlation analysis, which showed weaker results for 2005 compared with 1995, had pointed to a possible ‘enlargement effect’ overriding a ‘GATS effect’, we also tested for this possibility using country dummies for the NMS. The main results of these two sets of regression analyses are summarised in Table 3 and discussed below.

It should be emphasised that we are in no way attempting here to build a ‘model’ – a parameterised set of explanatory variables – to ‘explain’ services trade variables in terms of our GATS variables and other ‘control’ variables. The data are far too unsatisfactory and the causal relations far too complex for that. For this reason, we do not report the size of the estimated coefficients, merely their sign and their significance level. We also ran regressions in which both Mode 3 and Mode 4 indices were included as explanatory variables. However, they tended to suffer from multicollinearity (as exhibited by large standard errors and low t-values), reflecting the known fact that countries with liberal Mode 3 commitments tend also to be more open also under Mode 4 (see also Chapter 5). These results are not reported.

As expected, in all the regressions population size was consistently negatively correlated with country results for services imports and FDI as shares of GDP: big countries import less, relatively speaking. This confirms the above intuition, and controlling for this simple factor increases confidence in the findings for those cases in which significant positive coefficients are found on the GATS variables.

The results controlling for population size broadly confirm the findings of the correlation analyses above. The key overall finding of the basic regressions can be stated as follows: our GATS indices of openness under Mode 3 and Mode 4 are consistently (one exception) positively correlated with two relevant measures of openness to actual services trade (extra-EU services imports and FDI, both as a % of GDP), in both 1995 and 2005, but in most cases the correlations are rather weak and not statistically significant.

Table 6.3 Regression results service trade variables and GATS indices

	1995	1995	2005	2005
Without NMS dummy	Mode 3	Mode 4	Mode 3	Mode 4
Service imports % GDP	+	+	+	+
t-stats	2.45*	1,81	1,69	0,88
FDI % GDP	+	+	-	+
t-stats	5.30***	2.76**	-0,19	0,14
With NMS dummy, 2005 only	Mode 3	NMS dummy	Mode 4	NMS dummy
Service imports % GDP	+	-	+	-
t-stats	0,1	-1,17	0,08	-1,53
FDI % GDP	-	+	+	+
t-stats	-0,08	1,01	0,46	1,13

Note: For details see text. + = positive coefficient, - = negative coefficient. \*, \*\*, \*\*\* = significant at the 10%, 5% and 1% levels respectively. Population size is used as a control in all regressions and its coefficient is consistently negative.

Source: Authors' calculations based on EU GATS offers in 1995 and 2005, UNCTAD (2004) and Eurostat (2007)

More specific findings are as follows:

- The correlations are consistently stronger and more significant in 1995 than in 2005. In the latter year, results were not statistically significant and in one case the coefficient did not have the expected sign.
- The correlations for Mode 3 are generally rather stronger than for Mode 4.
- In 1995 the significance level is much higher for FDI than for services trade.

These findings can be explained relatively easily and are consistent with our previous analysis. The 1995 commitments are already binding, whereas those for 2005 are not. Mode 3 is generally more important for services trade and our calculated indices are more telling when it comes to identifying meaningful differences between countries than is the case for the Mode 4 index. Finally, FDI (as a share of GDP) is a much more clearly defined outcome, and very obviously related to Mode 3, in particular, than services trade, which is affected by a number of non-GATS related issues, such as countries' specialisation in tourism or financial services.

In the second panel of the table we report the results of introducing, in the 2005 regressions, a dummy variable to test for an 'enlargement effect'. In the case of service imports the coefficient is negative: the NMS have, for given population size and GATS commitments, lower import shares of GDP. This reflects their more generally less developed service sectors compared with the EU15 countries (see Chapter 2). The reverse is true in the case of FDI: other things being equal, the NMS attract more extra-EU inward FDI as a percentage of GDP. Again this is in line with what we know about post-enlargement FDI trends (Galgoczi/Keune/Watt 2006)<sup>19</sup>.

<sup>19</sup> The reader is reminded that, unfortunately, separate FDI figures for services are not available at the level of individual countries, so the figures reflect total inward FDI from outside the EU.

While the NMS dummy coefficients are not statistically significant, they do add to the explanation for the 2005 results. There indeed seems to be a systematic enlargement effect that overlays any GATS effect (the GATS coefficients and t-values are smaller when the NMS dummies are added). At the same time, it is not the case that the enlargement effect resolves the problem of the weak (or negative) correlations in the 2005 results. It seems likely that the effects discussed earlier in the context of the bivariate correlations (the fact that the 2005 offer has not been implemented and/or a catch-up effect in terms of commitments that is not (yet) reflect in a change in the trade variables) are an important part of the explanation for the weak correlations.

Summing up, the fact that the coefficients are often not statistically significant means that, technically, we cannot reject the null Hypothesis that the GATS indices have no effect on outcomes. However, as emphasised above, we are not proposing here a full model (a range of explanatory factors). Even if the data situation were better, this would in any case probably be impossible. Thus the fact that, repeatedly, the results point in the 'right direction', i.e. the coefficients have the expected sign, can taken as suggestive evidence of a GATS effect, albeit a limited one.

Moreover, the results are strong and statistically significant where we would intuitively most expect this to be the case. This is particularly true of the very strong and highly significant results for Mode 3 and FDI in 1995. Here, within a reasonably homogeneous set of countries (reducing the likelihood of unobserved heterogeneity), the set of Mode 3 binding commitments actually made by EU15 countries correlates very strongly with the outcome that one would expect to be influenced, namely inward service FDI flows. Indeed, if it had been possible to exclude intra-EU FDI, even stronger results might have been expected, possibly also in 2005.

As far as Mode 4 is concerned, it should be recalled that we do not have measures for GATS outcomes in terms of Mode 4, i.e. figures on the temporary movement of persons (except for the UK figures discussed in the next section). Here stronger correlations would be expected with our Mode 4 indices, but this Hypothesis must remain speculative as we are unable to test it.

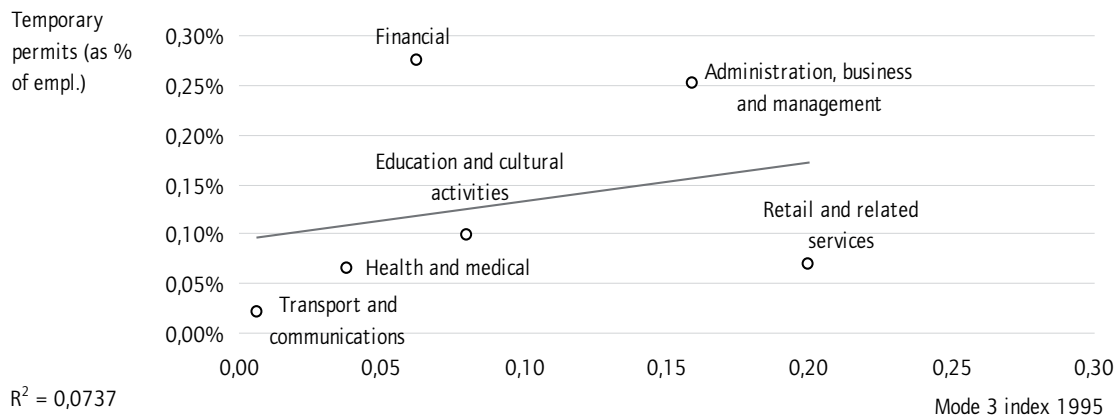
#### **Correlation with inflows of temporary service providers**

In this section we consider whether inflows of temporary service providers are linked with the sectoral levels of Mode 3 and Mode 4 commitments. Here we have to rely on rather unsatisfactory data for the UK only, and the analysis is therefore based on a sectoral comparison. The small number of sectors urges caution in interpreting the results.

Figure 6.9 shows the correlation between the UK Mode 3 and Mode 4 indices and the number of temporary work permits granted in the UK, expressed as a share of total employment within the sector, for 10 service categories that approximate to definitions under the GATS: Business; Communication; Construction and related engineering; Distribution; Education; Financial; Health related and social; Tourism and travel-related; Recreational, cultural and sporting (other than audiovisual); Transport.

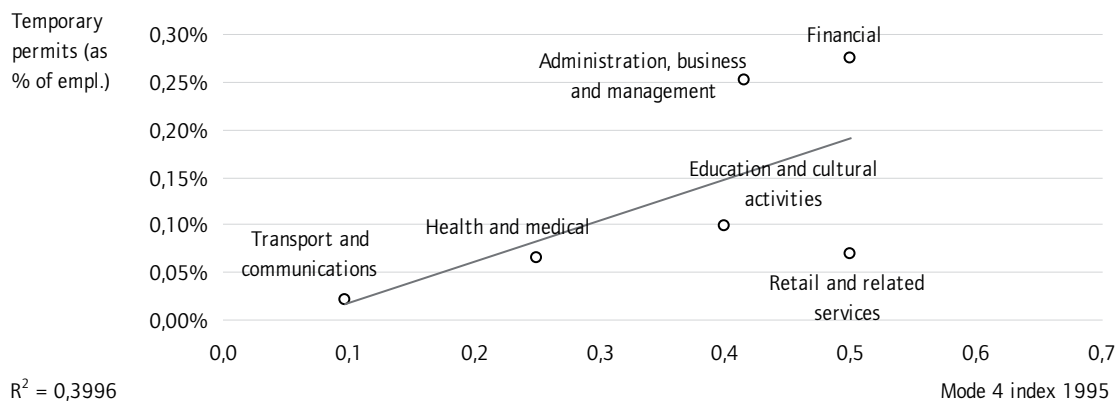
We find that in 1995 and in 2005, the inflows of temporary workers in the UK and GATS commitments were positively correlated. The link between Mode 4 commitments and temporary permits is especially apparent in health and business services, and in transport services at the other end of the graph. As might be expected, the link between Mode 4 and inflows of workers is much stronger than for Mode 3. (In 2005 there is no correlation for Mode 3). Two at first sight equally plausible explanations for the observed correlations are, in the case of Mode 4, that either the UK offered higher commitments in the sectors where participation of foreign workers is more important or higher GATS commitments caused higher inflows of temporary workers in a given sector.

Figure 6.9 **Correlation between sectoral commitments under Mode 3 and inflows of temporary service providers (share of total employment in a given sector) in UK, 1995**



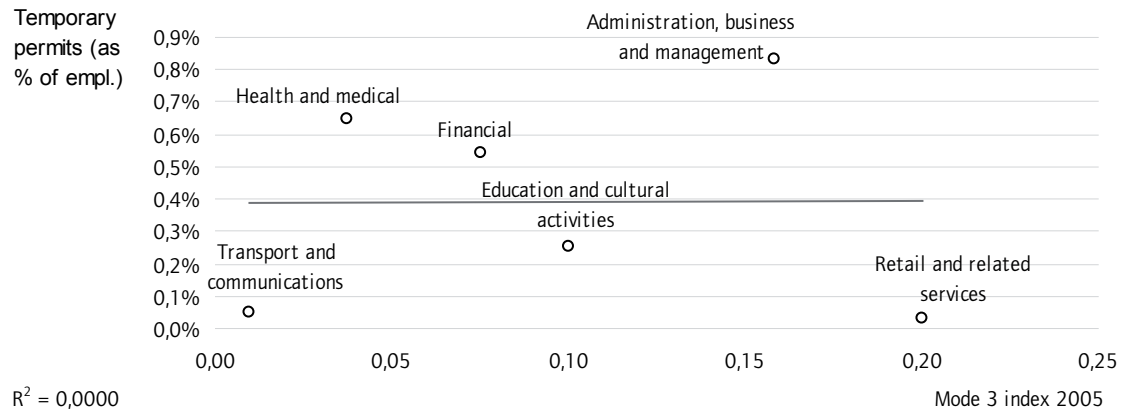
Source: Authors' calculations based on EU GATS offer in 1995 and Salt/Miller (2006)

Figure 6.10 **Correlation between sectoral commitments under Mode 4 and inflows of temporary service providers (share of total employment in a given sector) in UK, 1995**



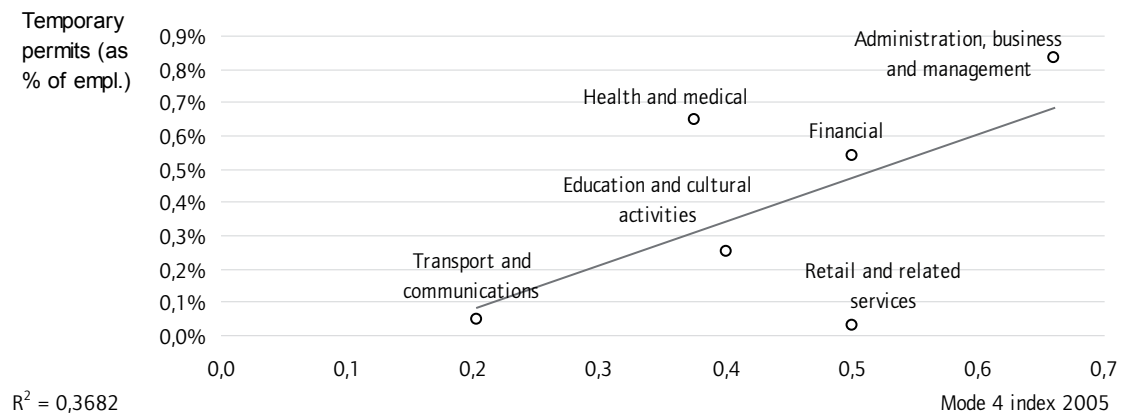
Source: Authors' calculations based on EU GATS offer in 1995 and Salt/Miller (2006)

Figure 6.11 **Correlation between sectoral commitments under Mode 3 and inflows of temporary service providers (share of total employment in a given sector) in UK, 2005**



Source: Authors' calculations based on EU GATS offer in 2005 and Salt/Miller (2006)

Figure 6.12 **Correlation between sectoral commitments under Mode 4 and inflows of temporary service providers (share of total employment in a given sector) in UK, 2005**



Source: Authors' calculations based on EU GATS offer in 2005 and Salt/Miller (2006)

We can sum up the considerable number of findings relating to Hypothesis 1 as follows. The correlation tests and regression analyses for the link between flows of services and GATS commitment indices provide some evidence to support Hypothesis 1. But the results are not uniform and vary noticeably between the two years. For all the indicators – imports, FDI inflows, migration – we find stronger links for 1995 than in 2005. There are also variations between the Modes but they seem largely to conform to expectations (great relevance of Mode 3 for services trade and FDI, greater impact of Mode 4 in temporary foreign employment).

### 6.3.2 Hypothesis 2

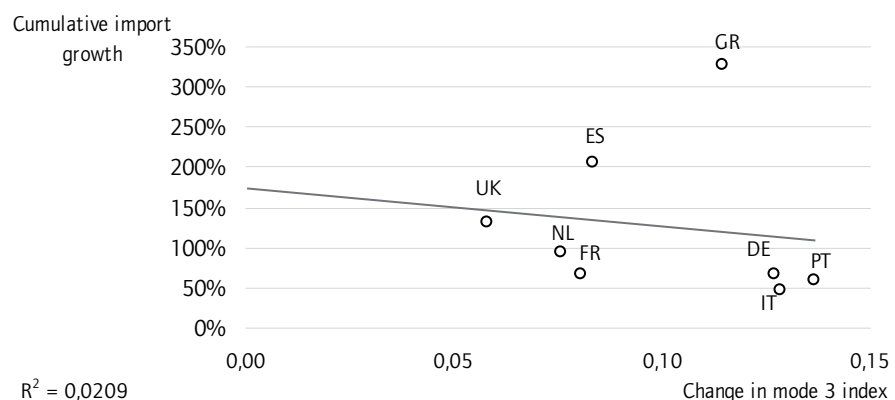
**Hypothesis 2: there is a positive correlation between the additional commitments scheduled by countries between 1995 and 2005, the size of the increases in services imports, FDI and movement of services providers**

An advantage of the approach in this Hypothesis is that it automatically controls for the influence of country size. It also focuses on the 12 EU Member States that were the EU Members in 1995 and, to this extent, removes the ‘enlargement effect’. On the other hand, there may well be problems with lagged effects that depend on an unobservable, namely the extent to which the 1995 and 2005 offers reflect any actual change in countries’ level of regulation or merely lag behind. For example, if a country makes a big commitment, accompanied by actual deregulation, in 1995 and this serves to boost services trade with a lag, this may result in a negative correlation emerging in our analyses, especially if in 2005 few additional commitments are made. Similarly commitments made in 2005 may not have had time to show up in the trade data (all the more so as we have to rely on FDI data for years prior to 2005). Missing import and FDI data also limits the sample size to eight countries.

#### Correlation with imports

We test the second Hypothesis by looking at the correlation between the *change* in the GATS commitments between 1995 and 2005 and the *growth* of extra-EU services imports over the same period.

Figure 6.13 Correlation between change in Mode 3 index and cumulative growth of extra-EU imports, 1995-2005

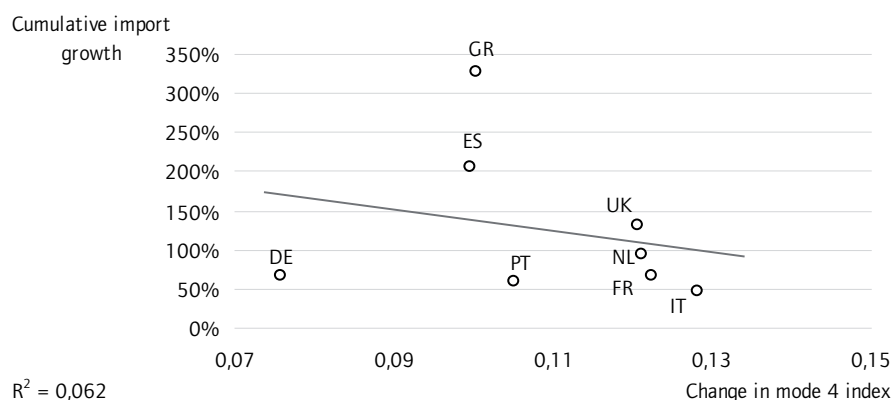


Source: Authors' calculations based on EU GATS offers in 1995 and 2005 and Eurostat (2007)

The results presented in Figures 6.13-6.14 are at first sight quite surprising. We find slightly negative links, but generally extremely weak correlations between the size of the increase in GATS commitments and the growth of extra-EU

services imports in the same group of Member States. For example, Portugal had the biggest increase of commitments in Mode 3 but among the smallest cumulative increase in imports, while in the UK and Netherlands commitments increased less and imports increased at a higher rate. Finally, for Spain, France, Mode 3 commitments increased at a similar rate, but service imports grew to a very different extent. The picture for Mode 4 is very similar; but the overall correlation appears negative, but in fact the minimal R-squared indicates that there is virtually no statistical link.

Figure 6.14 Correlation between change in Mode 4 index and cumulative growth of extra-EU imports, 1995-2005



Source: Authors' calculations based on EU GATS offers in 1995 and 2005 and Eurostat (2007)

### Correlation with FDI

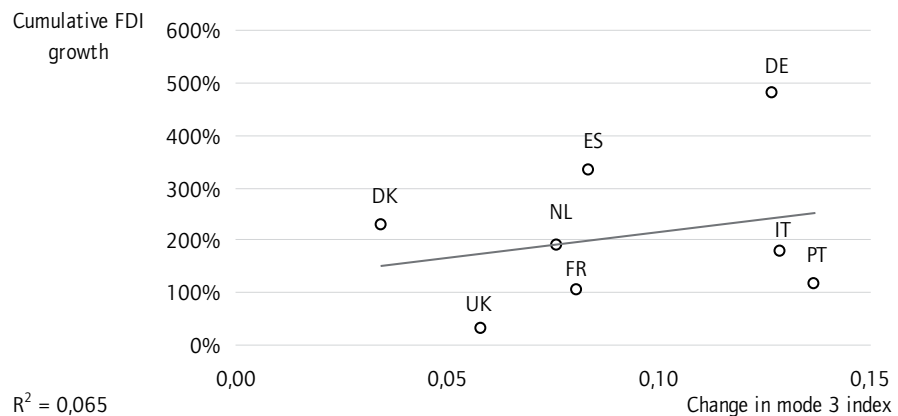
The link between change in Mode 3 commitments and increases of service FDI in 1995-2005 is positive, albeit weak (correlation 0.19). Germany and the UK are the only cases where high (low) increases in Mode 3 commitments are associated with high (low) increases in FDI inflows. But for other Member States, the results are mixed, with Portugal and Denmark, in particular, weakening the overall correlation.

However, the link between the change in Mode 4 commitments and FDI inflows is strongly *negative* (correlation -0.71,  $R^2$  at 0.5). Across the eight countries included in the graph, higher increase in Mode 4 index is matched by lower increase in FDI. This is especially true for Germany and for the UK (on the other end of the graph).

The available data do not provide confirmations of Hypothesis 2 – an increase of GATS commitments for certain sectors and for certain Member States is not reflected in bigger increases in cross-border flows of services (imports and FDI). It is not immediately apparent what could be driving these results. It may be that changes in commitments take time to make their effects felt. The more fundamental problem may be that, as mentioned already, the 2005 commitments, as a conditional offer, are not yet matched by concrete liberalisation measures at

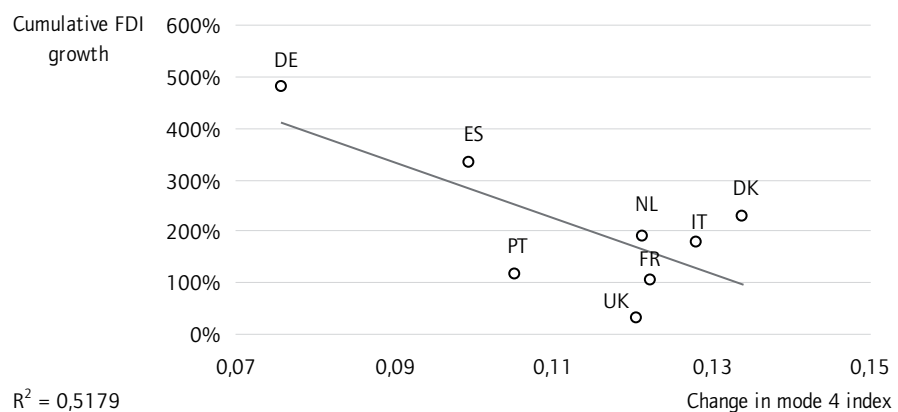
the national EU Member States level. As we noted in the previous chapter, there was a tendency for 'laggards' in 1995 to catch up in terms of commitments with the leading group of countries in 2005. If the effect of such commitments has not yet made itself felt, then this would be consistent with the positive correlations that we identified in the context of Hypothesis 1 breaking down. Indeed, at the extreme, such an effect would turn the correlation negative. Alternatively, an additional factor might be driving the results, overwhelming a GATS effect, although from the distribution of the countries it is not immediately apparent what such an effect could be. At face value, these data, counter-intuitively, cast doubt on the idea of a clear link between higher Mode 3 and Mode 4 commitments and faster growth of cross-border supply of services.

Figure 6.15 Correlation between change in Mode 3 commitments and cumulative growth of FDI in services, 1995-2005



Source: Authors' calculations based on EU GATS offers in 1995 and 2005 and UNCTAD (2004)

Figure 6.16 Correlation between change in Mode 4 commitments and cumulative growth of FDI in services, 1995-2005



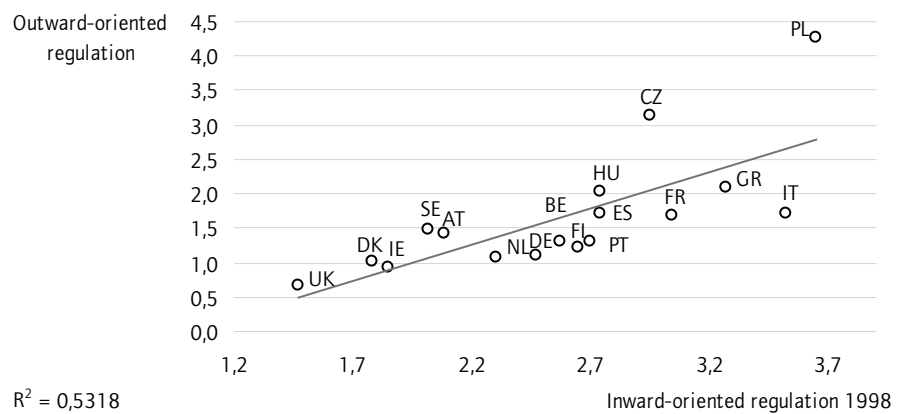
Source: Authors' calculations based on EU GATS offers in 1995 and 2005 and UNCTAD (2004)

## 6.4 GATS impacts on regulations in the EU

In this section we test Hypotheses 3 and 4 to see if there is a link between GATS commitments and regulation levels at the EU Member States.

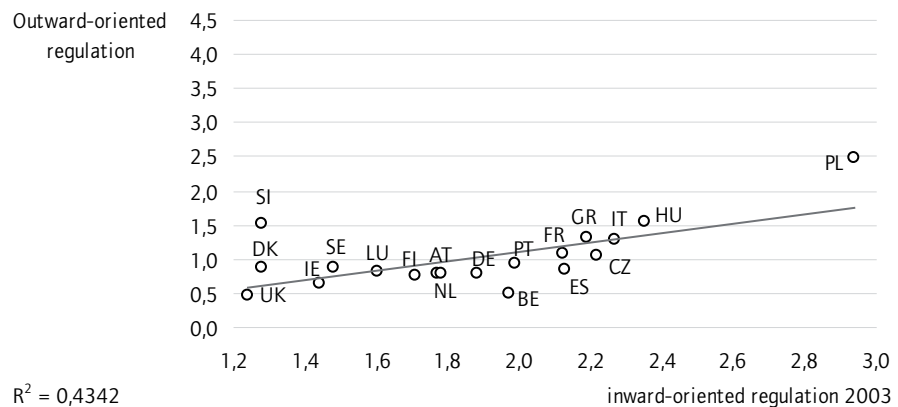
As a first step we examine whether there is a link between outward- and inward-oriented regulations in the OECD's PMR index. As explained earlier, only two years are available for the PMR indicators, 1998 and 2003. From Figures 6.17-6.18 below, a rather strong correlation emerges: as might be expected, countries with higher inward-oriented regulations also have higher levels of the outward-oriented regulations, and vice versa. This applies for both years.

Figure 6.17 Correlation between outward- and inward-oriented regulations, 1998



Data source: OECD (2008b)

Figure 6.18 Correlation between outward- and inward-oriented regulations, 2003



Data source: OECD (2008b)

This establishes a basic plausibility for hypotheses 3 and 4 that there are spillovers between trade regulation and liberalisation and domestically oriented regulations, while of course not telling us anything about the nature of the spillover, for instance whether light regulation in both areas in some countries is driven by a common 'liberal' ideology, or whether there is an actual causal chain in one direction or the other.

### 6.4.1 Hypothesis 3

#### **Hypothesis 3: GATS commitments are negatively correlated with levels of domestic regulation**

Because the PMR indicator has low values for light regulations and high values for heavily regulated economies, where there is a positive relationship between openness under GATS and a liberal regulatory regime we will see a statistically negative correlation (in the graphs visible as a downward-sloping regression line) between commitments and the PMR.

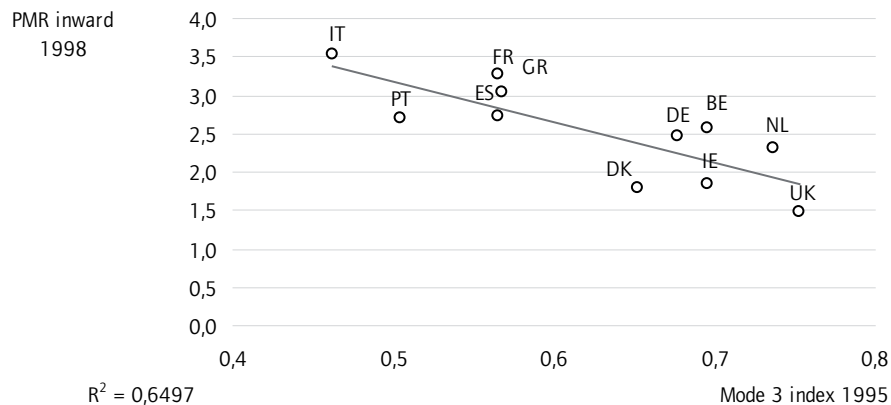
In Figures 6.19-6.22 the EU GATS commitment indices for Mode 3 and Mode 4 in 1995 and 2005 are plotted against the OECD PMR indicators for inward-oriented policies for 1998 and 2003.

For 1995, it is apparent that MS with a lower internal PMR indicator generally had higher GATS commitment indices and vice versa (correlation in 1995 is at around -0.8 for both Modes of service supply). The correlation coefficients indicate a good 'fit' for both modes and suggest that there is a strong statistical link between levels of regulations and GATS commitments in the expected direction.

For 2005, Mode 4 index is still linked to lower levels of PMR in broadly the same way as in 1995 (correlation -0.6). However in the case of Mode 3 commitments, the PMR indicator does not contribute much to the explanation: some lightly regulated economies such as Slovenia, Slovakia and Finland have lower Mode 3 indices, while some more regulated economies such as Greece, Spain and France have higher indices. This is reflected in the flatter line and the lower value of the  $R^2$  (0.08). This could be interpreted as a catching up process – meaning that countries with the higher regulation levels offer higher commitments under GATS to catch up with Member States 1995 offer. As discussed above, for FDI a problem may also be that the second measurement year for PMR (2003) precedes the 2005 conditional offer. This is likely to affect the results unless that offer reflected the actual regulatory situation in 2003, which is possible but unobservable.

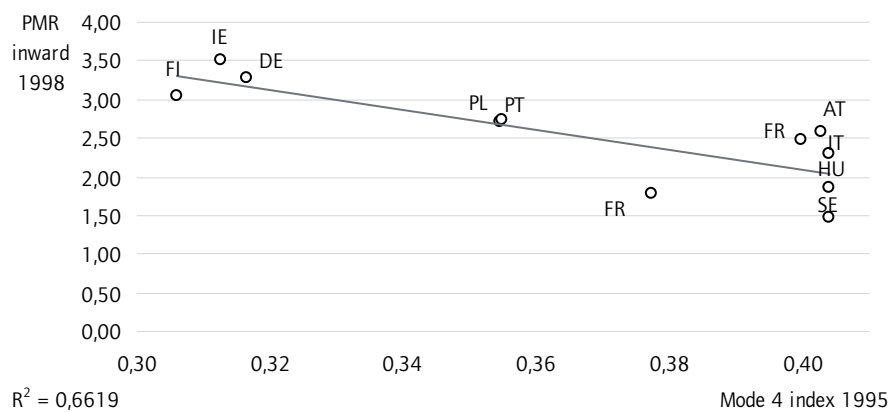
Overall, for both modes and years we see relatively strong evidence (except for Mode 3 in 2005: very weak evidence) of the expected link between opening under GATS and levels of domestic regulation. Overall, the statistical evidence is highly supportive of Hypothesis 3: liberal GATS commitments go hand in hand with lower levels of domestic regulation, once again leaving the question of the direction of causality open.

Figure 6.19 Correlation between Mode 3 index, 1995 and domestic regulations, 1998



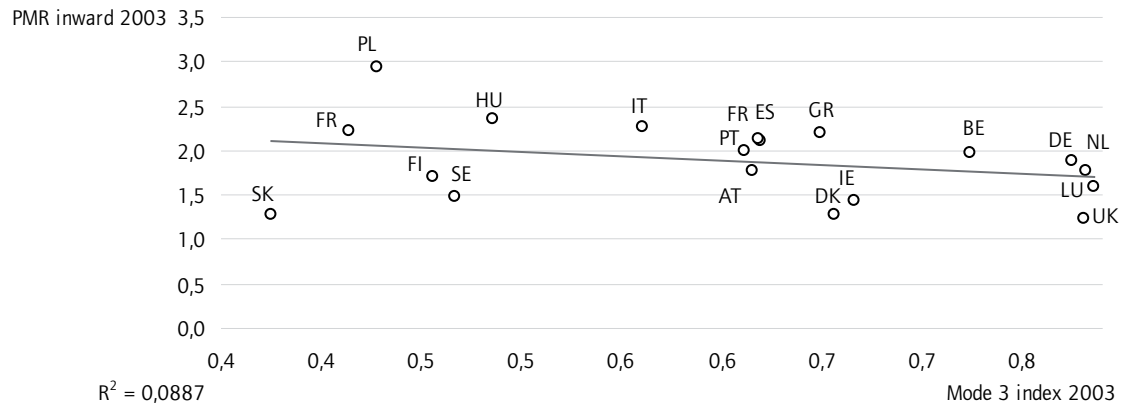
Source: Authors' calculations based on EU GATS offer in 1995 and OECD (2008b)

Figure 6.20 Correlation between Mode 4 index, 1995 and domestic regulations, 1998



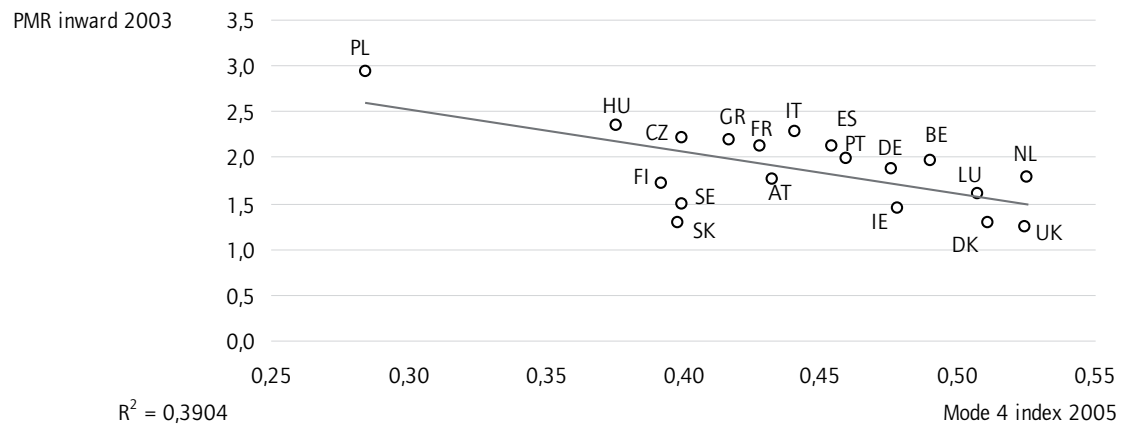
Source: Authors' calculations based on EU GATS offer in 1995 and OECD (2008b)

Figure 6.21 Correlation between Mode 3 index, 2005 and domestic regulations, 2003



Source: Authors' calculations based on EU GATS offer in 2005 and OECD (2008b)

Figure 6.22 Correlation between Mode 4 index, 2005 and domestic regulations, 2003



Source: Authors' calculations based on EU GATS offer in 2005 and OECD (2008b)

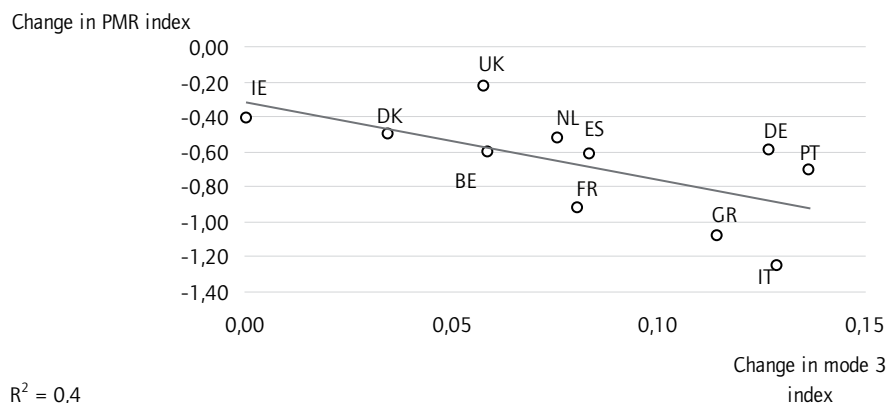
## 6.4.2 Hypothesis 4

### **Hypothesis 4: increase in GATS commitments is linked to decrease in domestic regulations**

For testing Hypothesis 4 we consider whether the change in the GATS Mode 3 and Mode 4 commitments over the ten years between 1995 and 2005 is linked with changes in regulation levels. Rather like the analysis of Hypothesis 2 above, the results are inconclusive. For Mode 4 we find no relationship between the increase of commitments between 1995 and 2005 and a decrease in regulations. However, we find a reasonably strong correlation for Mode 3, suggesting that deregulation by Member States is indeed associated with increases in their respective Mode 3 commitments. At least for Mode 3, it suggests that those Member States that are more willing to liberalise their national markets internally or at the EU level are also more willing to make commitment in the GATS framework and open up for the third-country service providers.

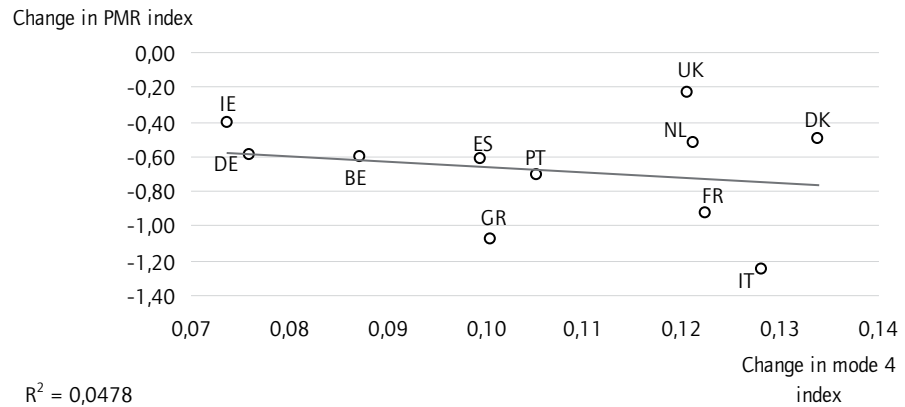
This result fits the pattern identified earlier for Hypothesis 2: intuitively plausible results for changes in Mode 3 commitment, but no clear relationship in the case of Mode 4. This may simply reflect the simple fact that Mode 4 still accounts for such a small proportion of services trade that results here are likely to be somewhat arbitrary. Moreover, the degree of liberalisation is so limited that even rather large shifts in the Mode 4 index do not actually have much impact ‘on the ground’ as they still affect only very marginal categories of workers in quantitative terms. On top of this, the points made earlier in the context of Hypothesis 2 about time lags are also pertinent.

Figure 6.23 Correlation between changes in Mode 3 and PMR indices



Source: Authors' calculations based on EU GATS offers in 1995 and 2005 and OECD (2008b)

Figure 6.24 Correlation between changes in Mode 4 and PMR indices



Source: Authors' calculations based on EU GATS offers in 1995 and 2005 and OECD (2008b)

## 6.5 Conclusions from the correlation analysis

The findings on the relationship between GATS commitments, trade, FDI, migration and regulations can be summarised as follows:

We find quite strong positive correlations between the level of GATS commitments and both various measures of services trade and the degree of openness of domestic regulation. The correlations tend to be strongest for Mode 3 and for 1995. Strong relationships between Mode 3 and FDI and Mode 4 and temporary employment are as would be predicted from the nature of these two modes. The weaker correlations for 2005 probably reflect the fact that the commitments made then remain a conditional offer that does not yet bind the Member States and/or the fact that a 'GATS effect' is being drowned out by an 'enlargement effect'. Our regression analyses showed that an enlargement effect does indeed exist, although it is not so strong as to be driving the results. What is clear is that the move from 12 to 25 Member States increases the unobserved heterogeneity of the groups. In the case of simple bivariate correlations and simple regressions, this will tend to weaken the fit. The stronger correlations for Mode 3 than Mode 4 can be interpreted in terms of the former's greater quantitative importance for trade and the different scales used to measure commitments in the two modes: in Mode 3 small movements along the scale represent bigger effects than in Mode 4.

The evidence regarding links between changes in commitments and changes in services trade measures and regulation measures is generally weaker, especially for Mode 4. This may reflect the same factors pertaining to the commitments in 2005 mentioned in the previous paragraph, which of course affect the validity of our measure of the change in commitments. There may also be issues about the timing of effects. Countries that have sought to 'catch up' in 2005, by opening up their markets to a greater extent than those countries which were already more open, clearly have the highest measures of the

change in commitments. If there are lags in this, finding expression in trade flows and regulation indices (and the latter were from 2003), then the correlations are likely to be distorted.

More generally we should note that, *faute de mieux*, the analysis in this chapter was based on data that are far from ideal in a number of respects. The aim is in no way to provide estimates of the size of effects, but merely to shed light on whether the claims and predictions made by the various actors in the GATS debate can, in terms of the direction of effects and linkages, be substantiated by the – limited and imperfect – statistical evidence we have on the period since 1995. On the whole, our analyses are supportive of the idea that greater trade openness under the GATS, particularly Mode 3, goes in hand in hand with both increased cross-border services trade and reduced regulatory levels.

What can we conclude regarding the debate on regulatory capacity? It certainly seems to be the case that a greater degree of openness by EU Member States under GATS goes hand in hand with a lighter regulatory touch. However, using purely statistical methods we cannot resolve the issue of whether one is driving the other or both respond to, for instance, the ideological orientation of the government. There has certainly been a secular decline in levels of domestic regulation across the OECD countries since the 1990s. While this has been accompanied by liberalisation under GATS, the country matches are not so close as to suggest that any GATS effect in this process is particularly strong compared with other factors. Nor have we, or *can* we in this form of analysis, take any position on the desirability of regulation, or discuss what types of regulation it is that are primarily affected.

## 7. GATS impacts on EU labour markets

### 7.1 Introduction

In this chapter we attempt to analyse the existing and likely future impact of Mode 3 and Mode 4 of the GATS on European labour markets. To this end we bring together the evidence we have collated in earlier chapters on GATS' impacts, in terms of establishing commercial presence abroad and the movement of service providers, with estimates of the quantitative effect on labour markets of movements of capital and labour of a given size. In principle this allows us to estimate the overall labour market effects of existing and possible future liberalisation under the GATS.

We do this separately for Mode 3 and Mode 4. As will become apparent, it is possible in the case of Mode 4, on the basis of a number of assumptions, to gain at least some idea of the likely order of magnitude of GATS effects on wages and employment. However, this is scarcely possible in the case of Mode 3, notably because the decisive link between the volume of capital movements and the employment and wage effects is so uncertain. However, some qualitative statements are possible based on broader research into capital movements and relocation. Mode 4 is also more controversial in terms of labour market effects and this also justifies a greater focus in this section on the temporary movement of labour

### 7.2 Impacts of Mode 3: The impossibility of quantitative evaluation

As indicated, a causal and quantitative analysis of GATS' labour market effects requires two major steps. In the case of Mode 3, the first is to assess the impact of existing or possible future GATS commitments on the number of firms setting up foreign dependencies (or the amount of capital involved) under the GATS in the EU. The second is to assess the impacts that a specific volume of such cross-border transactions typically has on labour market outcomes (such as wages and employment) in both 'sending' and 'receiving' countries.

If we knew, for example, that:

- the effect of GATS Mode 3 has been, over a given period, to increase FDI from country A to country B by €X bn; and that

- a net figure of € 1 bn of FDI from a high-wage country to a low-wage country tended to involve the creation of, say, 1000 jobs and to push up wages in the receiving region by 2%, while, because of substitution effects, costing, say, 500 jobs in the country of origin and affecting local wages negatively by 1%

we could provide an estimate of the Mode 3 labour market effect for this country pair by multiplying the specific impact figures by the amount X. By extension it would be possible to estimate effects for all the EU countries and also an aggregate effect. Of course, such a calculation would be purely mechanical and would, notably, ignore the likely knock-on effects of increases or falls in employment and wages resulting directly from the Mode 3-driven changes.

But, much more fundamentally, we do not have reliable figures for either of the two necessary steps.

In Chapter 4 we looked at the challenges involved in the attempt to measure commercial presence under GATS. It was noted that neither of the readily available statistics, foreign direct investment (FDI) and Foreign Affiliates Trade in Services (FATS), gives an accurate picture of GATS-induced increases in ‘commercial presence’; the former is not strictly relevant as it represents the one-off investment effect of establishing a commercial presence, while the latter is not yet available for an extended period or with a reasonable coverage of countries. In Chapter 2 we saw that extra-EU25 FDI inflows and outflows in services represent of the order of €50 bn in 2005. Yet we cannot be sure what proportion of this is due to GATS. Moreover, the gap between the in- and outflows is rather small, only some €10 bn for the EU25 as a whole. Accordingly, even if this were ascribed in its entirety to Mode 3, this figure is so small in comparison with aggregate GDP that, even if the specific FDI effects are thought to be large, it seems hard to make a case that, at the level of the EU as a whole, the employment or wage effects of Mode 3 in its existing form could be anything but insignificant.

In the future, improved FATS coverage might make such analyses more feasible. Moreover, even without such data it would be possible to assume – as we subsequently will attempt for Mode 4 below – by way of future scenarios certain figures for the amount of cross-border services trade resulting from possible future liberalisations under Mode 3. This clearly makes sense, however, only if we have plausible estimates (or ranges) for the specific labour market effects of a unit volume of FDI/FATS.

This is the crucial weakness, however. There has been considerable research into the effects of FDI, and specifically studies of capital movement (delocalisation or production relocation within Europe (cf. Galgoczi/Keune/Watt 2006 and the other articles in that volume, especially that by Hunya; see also Galgoczi/Keune/Watt 2008). The tenor of that research – which has focussed on manufacturing but also covers some services, notably banking and IT services – is that corporate decisions on production location and relocation are highly complex and can be understood only within the context of their specific

production strategies and market opportunities and challenges. One company may seek to close production facilities in high-cost countries, effectively transferring production to low-cost locations and re-exporting products (and possibly services); such corporate strategies have been prominent within Europe in the white goods sector, for example (cf. Telljohann 2008). The impacts of such strategies on jobs and wages and conditions in the two sets of countries will differ markedly from a strategy to serve local markets, for instance by opening up production facilities to serve local markets; even within this latter category, impact will vary depending on the existing structures. For instance, in central and eastern Europe the provision of new, previously unavailable, banking services, primarily by western banks, created substantial employment there, and also in western headquarters, whereas the expansion of large retailers in the same countries has had an ambiguous effect, creating new jobs but also driving out competition from existing smaller-scale retailers.

In short, we have no basis for assessing the specific labour market effects of unit quantities of measurable outcomes (particularly increased FDI) which is a precondition for making even rough estimates of aggregate impacts. All we can do is fall back on the qualitative analyses of the direction of effects discussed in an earlier chapter. As noted above, the GATS controversy regarding labour market effects focuses in any case more on Mode 4, which is more obviously relevant. Mode 3 is widely seen as more benign in these terms, and the emphasis in the debate has been on the impact on regulatory capacity, which we addressed in some detail in the previous chapter.

### **7.3 Impacts of Mode 4: attempts at a speculative quantitative evaluation**

#### **7.3.1 General remarks**

We now consider the effect on the wages of competing ‘native’ workers, and perhaps on their employment opportunities, of temporary labour migration under Mode 4. Analogously to the above discussion of Mode 3 impacts, in order to make such calculations we need to know two – and preferably three – main things. Firstly, we need to know how many Mode 4 workers are working in the EU at a given time, together with some information on their characteristics (especially skills). Secondly, we require some estimate of the average impact that a given increase in the labour supply has on the wages (and employment chances) of comparable native workers. Thirdly, it would be good, if not absolutely essential, to know how the workers in question are distributed between countries and sectors.

Unfortunately, neither of the two necessary and apparently simple conditions is met. Even with the ‘nice-to-know’ information regarding distribution according to region and sector, we draw a blank. As we have shown in Chapter 4, no country – not to mention the EU or the WTO as a whole – keeps data on numbers of ‘Mode 4 workers’. (From a single country we could at least hazard a guess by extrapolating to the EU level.) We did use some figures on tempo-

rary employment in the UK in the previous chapter. However, the aim there was to look at the sectoral distribution. As pointed out, these figures include large numbers of temporary migrants who have entered the UK in ways other than under GATS Mode 4. As such, those numbers cannot be used to provide an estimate of total numbers from which we could extrapolate. Thus we know neither the quantity of such workers nor the key qualitative characteristics. This contrasts with the situation in relation to Mode 3, though we *do* have some estimates of the specific effects of given increases in the labour supply on the wages of competing workers. Indeed, the problem with assessing the magnitude of the effect of an increase in the labour supply is that we have too many estimates, with huge variations between different studies. The end result is that we cannot be confident about the size of the impact of a given upward shift in the labour supply.

Lacking these simple but essential ingredients, it might appear that it is a hopeless exercise to say anything about the effects of current or potential future temporary movement of service providers under Mode 4. This would be unduly pessimistic, however. Provided one is clear about the very provisional nature of such estimates, it is legitimate for the researcher to try his or her best to arrive at a 'ballpark number', a figure that gives a reasonable estimate of likely orders of magnitude. This section attempts to do this for temporary migration under Mode 4.

We proceed in three stages. First we select, from a review of existing studies from different countries of the labour market impact of inward labour migration – that is, general migration, not specific to GATS Mode 4 – a high and a low value, representing plausible estimates of the likely maximum and minimum effect, respectively, for a given increase in labour supply.

Secondly we try to estimate, on the basis of the indirect evidence available, plausible high and low values for the number of Mode 4 workers currently active in the EU.

Thirdly – and much more tentatively – we consider what might be the effects of considerably larger flows of temporary migrants under Mode 4 if, as critics fear and proponents hope, Mode 4 service delivery in the European Union were to be substantially liberalised. To this end, we refer back to our discussions in previous chapters of the future of GATS negotiations and the factors driving countries to open up Mode 4 access.

Of course, even such a tentative analysis relies on the assumption that the impact of a given shift in labour supply is the same whether it comes from (past) inward migration or from (temporary) migration under Mode 4. The section concludes with some reflections on whether Mode 4 migration might in fact be very different in its effects from 'classical' migration; to the extent that this is the case, the results obtained from our approach here would be subject to considerable uncertainty. However, if we have plausible reasons for thinking that we can identify the direction, if not the magnitude, of the difference between the effects of the two forms of migration – i.e. Mode 4 migration had

either lesser or greater effects than ‘normal’ migration – the exercise would still have value in delineating maximum or minimum values, respectively, for the anticipated effects.

### 7.3.2 Estimates of the specific effects of an increase in the labour supply

We have conducted a review of academic studies of the impact of inward migration on the wages (and in some cases the employment) of competing native workers. The key results of these studies, together with some explanatory notes, are summarised in the table below.

Table 7.1 Review of academic studies of the impact of inward migration on wages

Study	Increase in labour supply	Impact on wages	Impact on employment	Notes on methodology, context
Barrell, R, J. Fitzgerald and R. Riley 2007	0.7% and 2.2% increase in working age population (WAP) in UK and IE, respectively	Inflation slightly lower. Downward pressure on wages and productivity (not quantified, but transitory). In long run GDP per capita rises due to WAP increasing as a share of total population	0.25 and 1 p.p. increase in unemployment, respectively but only for transition period (2yrs)	But the model is such that almost any shock has no effect (per capita) in the longer run, so how realistic? And what if the migration flow keeps on, or even accelerates
Borjas 2003	10% increase in supply	3-4% fall in wages, especially low-skilled almost three times as high for least skilled	3-4% fall in employment	In the US. In the longer run capital stock may adjust. Plus high-skill migration may boost technological change. Methodology: see text.
Borjas 2005	10% increase in high-skill (phd) migration	3% fall in doctoral wages in the same field		US, high skill
Friedberg and Hunt 1995	Increase in migration (unquantified)	Small effects		Review of studies comparing high and low-migration studies
Gilpin et al 2006	Overall assessment of actual CEE immigration to UK		No statistical effect on claimant unemployment	Measured CEE workers' impact on UK overall: 'modest, but broadly positive'
Manacorda et al 2006	Overall assessment of immigration effects			Immigration affects the wages not of natives but of other immigrants (as natives and immigrants are imperfect substitutes)
Smith and Edmonston 1997	Increase in migration (unquantified)	Small effects		
Steinhardt (forthcoming)	Diverse increases in labour supply through migration	Mixed results, mostly showing small effects, but one recent study shows a wage elasticity of around -0.1) and an early study a more substantial effect of -0.35.		Review of seven German studies using different methodologies (incl. Borjas-type). Findings rather diverse. Some show negative effects for other immigrants (rather than native German workers). The effects tend to be concentrated on the low-skilled

Before proceeding, a number of remarks concerning the methodology and findings of these studies are in order. The first point is that, along with many other social science and economic questions, a fundamental problem of studies that try to measure empirically the impact of inward migration is that of the lack of a counterfactual: in other words, one can measure the situation before and after a period of inward migration, but ultimately it is not possible

to hold all other possible intervening factors constant, nor to allow for all the ways that the employment system adjusts. In short, as we can never know what the situation would be without the migration ('the counterfactual'), any study contains a degree of speculation. One of the key challenges, therefore, is to minimise the likelihood of intervening factors and adjustment effects colouring the results.

In the case of a rising supply of labour due to inward migration, the predictions of economic *theory* are, by contrast, unambiguous: in the absence of countervailing developments, an increase in the supply of labour (of a certain category in a certain sector or region) will lead to a reduction in price of labour (i.e. in the wage) for that type of labour. Moreover, this reduction will make the employment in question less attractive, causing the native workers to supply less labour in that sector. The result, then, is a path to a new equilibrium in which the wage is initially driven down, native employment falls in consequence (upon which the wage may rise once more but to less than the initial level). This can have ripple effects throughout the economy. In the short and medium run this tends to disadvantage workers with the same set of skills (competing native workers); capital owners and those workers whose skills are complementary (put most simply: high-skill workers in the case of low-skill migrants and vice versa) benefit. Most models assume that in the long run – but this can take a decade or more – the capital stock adjusts and the overall capital-labour shift returns to its initial relationship.

Given this, it is surprising that, as can be seen from the table, many studies came to the conclusion that the impact of inward migration on wages is very small. Both the Friedberg and Hunt (1995) and Smith and Edmonston (1997) studies – the former being a review of other analyses – reached the conclusion that the impact of inward migration on earnings and employment was marginal. Indeed, this was the prevailing view until the pioneering studies by Borjas (among them Borjas 2003 and 2005) in the USA. He reasserted the standard theory-driven view – when supply rises price falls – by way of a critique of the methodology of prior research, which often relied on comparing regions or cities that had been subject to migration with those that had not.

Borjas pointed out that this ignored other factors, notably immigrants' attraction to high-wage, growing local economies and also natives' responding by leaving the areas affected: thus migration has wider knock-on effects throughout the economy. So the appropriate level of analysis is the entire economy. He made use of various survey and other evidence to compare the overall wage performance of various groups of American workers (some of them highly skilled) subject to competition from immigrants with comparable groups or relevant national averages. He arrived at a specific effect (or elasticity) of around -0.3, i.e. a 1% increase in labour supply depresses the wage of competing workers, compared to what it would have been, by one third of 1% (and also reduces native employment by a similar amount). Two studies of Germany using a similar methodology (reported in Steinhardt, forthcoming) arrived at rather different figures, with elasticities of around -0.1 and -0.06, although one older study

found an effect comparable to that of Borjas. More recent studies in the UK in the context of EU enlargement again found only very limited effects, although here the focus was on employment and unemployment (Gilpin *et al.* 2006). The Barrell *et al.* (2007) study relies on a macroeconometric model in which, by construction, ‘shocks’, such as an increase in labour supply, work their way through the economic system, with a short-to-medium-run impact on key variables. But in the end the economy returns to an equilibrium. In the case of migration this is such as to leave most variables the same in per capita terms. There are small increases in unemployment but these are temporary. There is a small wage effect due to the only sluggish adjustment of the capital stock, but this, too, reverses in time. Manacorda *et al.* (2006) address primarily the question of who the competitor workers are: in the UK context it is argued that this is less native ‘British’ workers, for whom the incoming Poles and Balts are only imperfect substitutes in the eyes of employers, than those immigrants that arrived prior to the eastern Europeans. Some of the German studies discussed by Steinhardt (forthcoming) also suggest that the adjustment burden falls on former immigrants rather than native workers, who are not seen as substitutes.

On the basis of this review of such studies we assume a high elasticity of wages to migration (measured with respect to the wages of ‘comparable workers’ among the existing workforce) of 0.33 (one third) and a low effect of 0.05 (one twentieth). The former figure is the highest found in the literature and in many cases referred to the US, where wage competition is arguably stronger than in Europe, with its greater prevalence of collective agreements and statutory minimum wages. If there is an important trade-off between ‘wage flexibility’ and ‘employment flexibility’ in reacting to such shocks, with the US stronger in the former and Europe in the latter, then the ‘price’ of this resistance to greater wage pressure may be higher unemployment. The existence of such a trade-off is disputed however. It is harder to justify the latter number: for the following calculations a small positive number is needed, and the figure chosen merely reflects the frequent – but hotly disputed – finding in the literature that wage effects are ‘very small’.

### 7.3.3 Size of Mode 4-related migration – current situation

Here we use a simple technique to estimate orders of magnitude for Mode 4 temporary migration in the EU25. To make the analysis as simple as possible, we abstract from the fact that under Mode 4 some EU service providers would also be working under Mode 4 outside the EU, offsetting the impact of non-EU citizens working under Mode 4 within the EU.

We start by making a high and low estimate for the current state of affairs. As we saw in Chapter 4, although there are no data reporting the magnitude of Mode 4 migration directly, there is some indirect evidence on which we can fall back.

The WTO (2005) estimates that in the early years of this century Mode 4 accounts for 1% of world services trade, i.e. of the order of USD 30 bn, the same

figure as estimated by Karsenty (2000). Basing itself on an estimated share of total workers' remittances, the OECD (2007) also arrives at a similar number for the value of Mode 4 'production'.

The global figure for the value of trade can be converted into employment numbers by dividing by the estimated value of the product produced by a Mode 4 worker in a year. While this is unknown, a minimum figure of at least USD 75,000 would seem plausible for Mode 4 workers in high-wage countries.<sup>20</sup> It would imply gross wage income, allowing for profits, of, say, USD 5,000 a month. This must be regarded as a conservative estimate given that, currently, the two groups that have been liberalised under Mode 4, both consist of highly paid professionals and managers. That would convert into a global figure of not more than 400,000 persons. If the largest conceivable figure of 400,000 is set in proportion not to the overall global or even OECD working population, but – rather absurdly in order to arrive at an absolute maximum figure – to total employment in the EU25, which is in excess of 200 million persons, it represents around 0.2% of employment.

Thus the absolute maximum conceivable employment effect of the current degree of liberalisation under Mode 4 would appear to represent 0.2% of EU25 employment. This assumes that the entire world's Mode 4 workers (as estimated) come to the EU25, and no Europeans work outside the EU25 under the GATS regime. It is not easy to make an allowance for the net effect within Europe alone. We have simply divided the highest possible global figure by 2 to arrive at 0.1% of EU25 employment. This would appear to be a very generous estimate of the greatest possible current employment effect. It is hard to come up with a plausible minimum figure; it could be very small indeed and even negative if more Europeans work outside Europe under GATS than come to Europe from the rest of the world. For the sake of having a small round positive number for our subsequent calculations, we will simply take one tenth of the maximum, i.e. 0.01% of EU25 employment.

#### 7.3.4 A corridor of estimates for current wage effects

If we multiply these maximum and minimum employment values by our high and low estimates of the specific wage effect of a given increased labour supply, the highest possible combination (0.33% and 0.1%) yields a downward impact on wages of 0.033%. The lowest estimate (0.05% times 0.01%) would, mathematically, be a scarcely measurable 0.0005%. Even the highest conceivable figure – which in view of the above assumptions is almost certainly a major overestimate – yields a very small, although not entirely negligible, overall wage effect for the 'mathematical' impact of inward migration under Mode 4 in the EU25. Even this effect, would, on most economic models (cf. Barrell *et al.* 2007) not be permanent and would apply to a limited set of workers.

<sup>20</sup> GDP per working hour in the EU25 is approximately EUR 33 (2006). At 1800 hours per year average GDP per fulltime worker is approximately EUR 60,000. This is of the order of USD 75,000 at equilibrium exchange rates.

On the basis of these – admittedly very rough – calculations, it seems reasonable to conclude that, in aggregate, the current impact of Mode 4 liberalisation on the wages of comparable existing workers in Europe countries is imperceptible. The number of people involved is simply too small. It is certainly completely drowned out by non-GATS related migration, particularly intra-EU migration since enlargement in 2004.

One unresolved issue is the notion of ‘comparable existing workers’. Mode 4 migration is concentrated either regionally or by sector and also by skill group. The UK temporary permit figures reported in Chapter 6, for instance, show that the incoming labour was highly concentrated in health and medical services and computing (accounting for around one quarter each). The studies we used as the basis for calculating the specific wage effects from inward migration are often not very clear on the extent of size of the group of workers affected by the estimated wage effect, talking about low-skilled natives or competing workers. What seems clear is that, at the aggregate level, even these small wage effects will be substantially diluted. At the same time in specific regions and sectors where the relative size of the increase in labour supply is greater, the wage effects could increase to such an extent that they become perceptible.

We lack reliable and comprehensive data on the characteristics of those working abroad under Mode 4. We do know from the GATS schedules, however, that to date liberalisation under Mode 4 has been essentially limited to the highly skilled. Given that Mode 4 migration is virtually exclusively limited to highly paid professionals, it is important to note that any wage-reducing effects would tend to be equality-enhancing: it is the salaries of managers and technical experts that would be reduced, not necessarily absolutely, but relative to a situation without temporary migration under Mode 4. We also know (Chapter 5) that the actual flow of Mode 4 workers by sector is driven by a whole range of factors among which the sectoral commitments made by countries is only one.

It is important to note in this context that the rise in non-EU temporary migration (much of which may not be under Mode 4 at all) needs to be seen in the context of immigration from within the EU. There is no doubt that the numbers of EU immigrants are much greater, particularly since enlargement in 2004, if not earlier. More than 800,000 workers from the ten new member states (especially from Poland and the Baltic countries) successfully registered to work in the UK alone between 2004 and 2007, along with countless numbers that came to work without registering (for details see Barrell *et al.* 2007 and McKay forthcoming). It is true that most EU15 countries initially imposed transitory arrangements, and partly for this reason the UK and Ireland, which opened up their labour markets fully in 2004, have attracted a disproportionately high share of EU migrants. Yet, even those countries, like Germany, which have retained such measures have taken large numbers of EU migrant workers under quota and other systems. Moreover, these transitory measures have been progressively liberalised in a number of EU15 countries and will have to be terminated in all countries by 2011 (all these issues are discussed

at length in Galgoczi/Leschke/Watt forthcoming). Even if the wage elasticity is at the high end, therefore, we can be confident that any effects of Mode 4, even to the extent that it is perceptible at sectoral level, are almost certainly swamped by the much more important effects of inward migration from within the EU, which, moreover, is not restricted to certain categories of highly skilled workers.

We can summarise the above analysis by stating that the wage effects of current temporary migration under the GATS are almost certainly extremely small in aggregate, although it is possible that they affect workers in some sectors at local level. Moreover, from the perspective of social groups – such as trade unions – concerned about social justice and distributional issues (and their members' incomes), it seems that not only is the impact of current inward migration under Mode 4 under any plausible (and even some implausible) assumptions very small, it may well be – in this normative view – 'positive'. It pales into insignificance compared with intra-EU migration since enlargement in 2004, and probably also compared with import competition more generally. It is not that 'globalisation' is not having an effect, merely that Mode 4 – in its current state – is not an important channel.

This does not necessarily mean, however, that concerns about temporary movement under Mode 4 are misplaced. For, as we have repeatedly emphasised, the GATS is an ongoing and irreversible process and the extent of future commitments is hard to forecast. We take a look into the crystal ball in the next section.

### 7.3.5 The labour market effects of possible future Mode 4 liberalisation

It is possible to extrapolate from the above analysis to allow for various *assumed* increases in migration as a result of future liberalisations under GATS, about the magnitude of which one can only speculate; see the concluding section of Chapter 5. In this simple exercise, the specific wage effect is assumed to remain constant, so that the size of the overall wage effect rises, in linear fashion, with the assumed increase in labour supply. This is a purely 'mechanical' exercise therefore. It must be emphasised that such calculations are in no way predictions. At best they permit very rough 'if-then' statements to be made about the orders of magnitude. In the long run there will be offsetting mechanisms, for instance from demand-side policy (which will be more expansionary than it otherwise would have been if labour supply increases while wage growth is moderated) and, related also to this, from the capital stock. Because of the likelihood of such offsetting mechanisms at the macro level, the wage effects should be seen as reflecting the impact on the relevant sectors and/or skill groups.

The results of such calculations are presented by way of illustration in the table. The first column (A) suggests possible scenarios for the future in which

Mode 4 is further liberalised. The second column (B) indicates a ‘guestimate’ of the factor by which Mode 4 migration might expand compared with its current estimated levels thanks to such developments: so, in the first scenario, migration would be anticipated to be 10 times what it currently is under Mode 4. Column C merely reiterates our high and low estimates of the specific effect (elasticity) of a rise in labour supply equal to the estimated current Mode 4 impact. Columns D and E calculate the mathematical maximum and minimum wage effect respectively.

Table 7.2 Labour market affects under three GATS liberalisation scenarios

Assumed political development in GATS and change in the EU offer (A)	Assumed extent to which migration is affected (B)	Wage impact of current Mode 4 migration (hi/lo) (C)	Maximum wage effect = hiC*B (D)	Minimum wage effect = loC*B (E)
Scenario 1: The two existing Mode 4 categories, currently closed (IPs and CSSs) are opened but absolute quotas are imposed.	X 10	0.033/0.0005	0,33%	0,01%
Scenario 2: As scenario 1 but the absolute quotas are removed.	X 20	0.033/0.0005	0,67%	0,01%
Scenario 3: As scenario 2 but the definition of CSSs is changed to remove skill requirements (complete liberalisation, also to the lower skilled)	X 100	0.033/0.0005	3,30%	0,05%

Source: Authors' calculations

A short description of and rationale for choosing the three scenarios is as follows:

#### Scenario 1:

Steps toward liberalisation of temporary flows of service providers in the contractual services supplier (CSS) and independent professional (IP) categories are already taken in the 2005 EU offer – these categories are included in the EU horizontal Mode 4 section. However, at the sectoral level and for most Member States, these categories remain closed. One could expect that in the ongoing and upcoming liberalisation rounds at the WTO, EU commitments in these categories could be extended. These two categories of service provider are perceived as the most controversial in Mode 4 trade. Therefore, in scenario 1 we consider that the opening in these categories would be subject to numerical quotas and economic need tests at the EU or national level. In terms of employment the impact in this scenario would be 200,000 on the low and 2 million on the high estimate.

#### Scenario 2:

In the second scenario we consider that further commitments in these two categories could be made by the EU. Due for example to pressure from other WTO Members, it is assumed in this scenario that the quotas for these categories of workers would be removed. However, their existing definitions, restricting them to skilled workers, are retained. In terms of employment, the impact in this scenario would be 400,000 on the low and 4 million on the high estimate.

**Scenario 3:**

Lastly, we consider a scenario of the full liberalisation of Mode 4 services supply in the EU. Many (developing) WTO Members have an offensive interest in Mode 4 and they would like to see more access for their service suppliers to developed country services markets, and not only in the high-skilled categories. In the current negotiations, developing countries argue that the opening of their markets for developed countries depends on the concessions industrialised countries are ready to make in terms of Mode 4 offer. While it currently seems extremely unlikely, we wanted to consider what impacts a full liberalisation of the four types of service provider Mode 4, with the removal of all references to skill requirements, might have on EU labour markets. In terms of employment the impact in this scenario would be 2 million on the low and 20 million (10% of the current labour force) on the high estimate.

In sum, the two first scenarios represent possible developments of the GATS regime over coming decades, although, not least in the wake of the recent renewed failure of the Doha Development Round of negotiations, even they do not seem likely in the foreseeable future. The third scenario would amount to a virtually complete opening of the EU25 to temporary labour migration, comparable in many ways to the ‘enlargement’ of the EU, but involving the whole global economy.

Orders of magnitude have been ascribed for the estimated quantitative impact of such liberalisation on actual migration flows that would appear to be more or less in accordance with these scenarios. Given the mistakes made at predicting migration flows following EU enlargement in 2004 (Galgcozi/Leschke/Watt forthcoming), it should be clear that these are merely ‘round numbers’ and essentially illustrative in character.

The exercise is instructive, nonetheless. The table suggests that, if the low estimate of the impact on wages of the current volume of Mode 4 migration is correct, then even very substantial liberalisation of Mode 4 migration, up to and including a scenario of virtually complete liberalisation (assuming that led to a 100-fold increase in the numbers of temporary service providers), would have an imperceptible aggregate wage effect.

However, if the current wage impact is higher, i.e. the wage elasticity is around one third, and the current numbers of Mode 4 migrants in the EU are – we think implausibly – high, at 200,000, then the aggregate effects of further liberalisation could be significant. A ten-fold increase in migration resulting, say, from the opening up of two additional categories of workers, subject to quotas, would – mathematically – still be barely perceptible against the background of general wage developments. Removing quotas, however, i.e. permitting entry to the EU of independent professions and contractual service providers, subject only to the existing rather high skill limits, might perceptibly affect the pace of wage growth for competing workers. Our mechanical calculation, which implies an increase in the labour supply of 4 million workers, suggests an effect of 2/3 of a percentage point and competing workers might even see their wages dragged down absolutely. As the workers involved would be most-

ly high (IPs) or at least medium-skilled (CSSs) the impact would, in theory, not be such as to exacerbate wage inequalities. As noted, however, there are questions as to whether the formal qualification requirements, even now, are actually effective in practice. Clearly, if large numbers of low-skilled workers were in fact to come under such a liberalisation scenario, growing wage pressure on lower-skilled workers would result.

This would very obviously be the case in the – at present seemingly highly unlikely event – of a very far-reaching liberalisation, such that migration flows increase 100-fold and include large numbers of unskilled workers. Migration of this order of magnitude – 20 million workers, adding 10% to the EU25 labour force – would consist in large part of low- and medium-skill workers, resulting, as assumed in the scenarios, from a liberalisation reflecting, not least, the demands of lower-income countries for labour market access for their citizens. The distributional impact would in this case be ‘negative’ (i.e. widen income differentials), and is thus not just quantitatively but also qualitatively different from the current situation. The overall wage effect would certainly be felt – it would be of an order of magnitude comparable to the impact of Mexican immigrants on low-skill wages in the US, as estimated by Borjas. For those representing the interests of low-skill and low-wage workers in the EU, and those concerned about distributional and inequality issues, such orders of magnitude – as speculative as they are – give pause for thought regarding a more fundamental opening up of EU labour markets under Mode 4.

One important caveat to the above analysis is that Mode 4 workers may not be comparable to ‘traditional’ migrants, to the extent that their focus remains in their country of origin. It might be argued that they would be prepared or obliged to work at wages not just slightly below those of natives but very substantially, as they only face the higher cost of living to a limited extent. While this may be the case it should be noted that the same is true of much short-term migration currently in the EU15 countries from Eastern Europe. The limited number of studies so far conducted of the wage effects of intra-EU migration since enlargement suggest that they have been rather limited; see the discussion in Galgoczi/Leschke/Watt forthcoming.

## **7.4 Conclusions**

Overall, the analysis presented here, while highly speculative, provides some support to both positions in the debate: at the moment there is almost certainly simply no Mode 4 effect on wages in the EU25 countries, certainly at any sort of aggregate level. However, a more fundamental liberalisation of migration under Mode 4 could be expected to have important effects. Given the changed skill mix, these effects would also be expected to be qualitatively different and, from perspective of social equity, more pernicious.



## 8. Conclusion

This study was conducted in order to shed light on three main questions:

1. To what extent have EU Member States liberalised their economies under the GATS and what changes have taken place since 1995?
2. To what extent has services liberalisation under the GATS affected the regulatory capacity of EU member states, and to what extent is it likely to do so in the future?
3. What impacts can already be identified and what others are to be expected on European labour markets in terms of employment levels and pay?

The detailed findings on these three questions are set out in Chapters 4-7. As necessary preparation for these analyses, earlier chapters describe the dimensions and expansion of the services sector in the EU and the nature and institutional characteristics of the GATS. The main findings relevant to the three guiding questions for the study can be summed up succinctly.

The overview of services sector developments in the EU noted the growing importance of trade and FDI in services, though the actual increase lagged behind their weight in domestic output and employment in Europe. It seems likely, however, that this gap reflects the intrinsic nature of services and technological constraints rather than regulatory barriers to trade. The complexity of the GATS, and the difficulty of assessing even the current extent of actual commitments by EU Member States to open their services markets, emerged clearly from Chapter 3. A key point to be emphasised is that the GATS negotiations have to date *not* led to large-scale commitments by WTO member countries, including the EU Member States, in terms of opening up their labour markets to workers under GATS Mode 4. At the same time, the outcome of future negotiations seems all but impossible to predict: further substantial liberalisation under GATS seems unlikely in the near term, but a substantial breakthrough can never be excluded as the GATS forms only part of a wider trade agenda and, beyond that, of a geo-political ‘game’ between the leading world economic powers. The new emerging trend, however, is the growth of bilateral agreements outside the scope of the WTO, which also cover GATS-related issues, including movement of temporary service providers.

The debate on Mode 3 and, especially, Mode 4 of the GATS is characterised by a great deal of disagreement and controversy regarding their actual and pos-

sible future impacts. Much of the debate has been driven by considerations of the likely direction of impact according to more or less theoretically driven speculation. This reflects a number of factors including: the simple fact of the existence of different interests; the lack of a clear empirical understanding of the actual extent of liberalisation under the GATS; the contrast between the limited actual extent of current and the substantial scope for future liberalisation; the difficulties of disentangling GATS from other simultaneous processes such as Europeanisation; and, not least, a lack of data on outcomes of interest.

The study has sought to shed light on these issues by making a thorough and original quantitative assessment of the extent of the EU Mode 3 and Mode 4 offers in both 1995 and 2005. This analysis generated a large number of new insights into the extent of liberalisation by individual Member States and also by economic sectors. Particularly noteworthy is the big discrepancy between the relatively open trade under Mode 3 and the still highly restrictive nature of Mode 4 trade, important differences in the degree of openness between sectors, the relatively coherent position of the 12 EU Member states of 1995 and the subsequent greater diversity, as reflected in the 2005 offer that includes 25 EU Member States, against the background of an overall liberalisation trend over the ten-year period. Interesting in themselves, these findings are indispensable for the analytical work that has sought direct answers to our two main questions regarding the *impacts* of GATS.

Regarding the impact on regulatory capacity, our key findings can be summarised as follows:

- There is considerable evidence that, controlling for size, countries that are relatively open under the GATS, especially in Mode 3, are also more open to actual services trade, including FDI. In Mode 4 this also seemed broadly true at the sectoral level, although this could be tested only for the UK.
- A greater degree of openness by EU Member States under GATS goes hand in hand with a lighter regulatory touch. However, using purely statistical methods we cannot resolve the issue of whether one is driving the other or both respond to other factors, such as the ideological orientation of the government.
- There has been a secular decline in levels of domestic regulation across the OECD countries since the 1990s. While this has been accompanied by liberalisation under the GATS, the country matches are not so close as to suggest that any GATS effect in this process is particularly strong compared with other factors.
- One plausible causal chain between GATS commitments and deregulation, namely challenges under WTO rules, to Member States that have made commitments on behalf of foreign suppliers that believe they have been prevented by *de jure* non-discriminatory but *de facto* discriminatory legislation, does not seem to have been quantitatively relevant at all to date.

- That the effects so far appear limited reflects not least the limited progress made to date in the GATS negotiations. Concerns remain regarding future developments, particularly in view of the unresolved negotiations in the Working Party on Domestic Regulation. A ‘breakthrough’ in these negotiations – although this appears unlikely in the foreseeable future – could potentially pose a much more serious threat to regulatory capacity, as vast swathes of domestic regulation could be challenged as being unnecessary barriers to trade, with rulings on this matter made by an organisation, the WTO, whose mandate is to increase trade, and that has limited competence, and arguably interest, in the social and economic goals of domestic regulation. However, it would be up to the WTO Member which appeals to WTO dispute settlement to prove that a given regulation in another Member is more burdensome than necessary and that alternative measures were available to achieve the same objective and prove less trade-restrictive. This process might be expected to be both lengthy and costly, especially to the complaining Member, so that such complaints are likely to be brought to WTO dispute settlement only in extremely significant cases.
- Interviewed policymakers seemed to be rather unconcerned about threats to regulatory capacity, at least those emanating from existing commitments. Lists of potentially affected regulations had not, it seems, been drawn up by national policymakers.

Regarding the impact on European labour markets our key findings can be summarised as follows:

- A lack of even basic data makes it extremely difficult to assess the impacts of existing Mode 3 and Mode 4 commitments on labour market and employment outcomes. Generally Mode 3 is held to be unproblematic in employment terms. A quantitative analysis was attempted for Mode 4 based on estimates of the specific effects of inward migration drawn from broader migration studies and the limited evidence on the existing extent of temporary service providers in the EU.
- On plausible estimates of the current incidence of Mode 4 workers, the aggregate impact on wages and employment appears *at the present time* to be negligible. Given that Mode 4 currently deals solely with high-skill personnel, the distributive impacts of any effects that might be felt at sectoral or regional level are also unlikely to be of concern. Again, this finding is primarily due simply to the limited numbers of workers that have crossed European borders under Mode 4 rules because of the limited commitments made.
- The impact on wage-earners in Europe, especially at the bottom end of the labour market, deriving from globalisation and also Europeanisation is not in dispute; however the role of GATS Mode 4 within this is almost certainly extremely limited at present. It is important in both academic

analyses and policy discussions to distinguish between GATS and other causal factors.

- On the other hand, plausible scenarios of further liberalisation of Mode 4 do generate more substantial wage effects. In particular a ‘full liberalisation’, in which the four categories of Mode 4 workers to EU labour markets are given unlimited access, without any skill limitations, would have a major impact. Assuming that such a liberalisation increases migration flows 100-fold, up to 20 million workers might enter, adding 10% to the EU25 labour force. In large part they would consist of low and medium skill workers. This would exert substantial downward pressure on wages, particularly for already vulnerable groups of workers, and might well, at least for a transitional period, displace indigenous labour. The distributional impact would in this case be ‘negative’ (i.e. widen income differentials), and would thus be not just quantitatively but also qualitatively different from the current situation. The overall wage effect would certainly be felt – it would be of an order of magnitude comparable to the impact of Mexican immigrants on low-skill wages in the US. However, it should be emphasised that this scenario appears unlikely at present.

If we were to summarise in one phrase the findings of the entire study it would be to say that both sides of the GATS debate have a point. Any current negative impacts on labour markets or regulatory capacity, to be set against any economic efficiency gains – which were not the focus of this study – are certainly small. However, the potential impacts of further liberalisation, against the background of the irreversibility of commitments and the uncertainty about the outcome of future negotiation rounds, do give cause for concern. Policy-makers and social actors should approach the subject with a cool head and carefully consider the pros and cons of further liberalisation under the GATS. The impact of other processes, such as increased services trade as a result of liberalisation within the EU, which has provoked substantial controversy, does suggest that more extensive GATS liberalisation would have substantial impacts in the areas considered.

What is certain is that it is vital that the ‘knowledge base’ in this area be improved. The WTO the EU and national governments are called upon to improve the statistical coverage of all the GATS-relevant economic and social variables mentioned in this report which, at the time of writing, is extremely patchy and, in some areas, nonexistent. It is totally unsatisfactory that the current impact of existing commitments is not being seriously monitored by public authorities. Only on the basis of analyses and research founded on reliable data is it possible to draw robust conclusions on which forward-looking policy can be based.

For the social actors keen to ensure that the benefits of the liberalisation of services trade are maximised and as widely spread as possible, while any risks and costs are minimised and equitably distributed, particularly within the la-

bour movement, in addition to the points just mentioned, we would emphasise the following:

- GATS is a relatively small part of a bigger picture. It is important to maintain a critical analysis of ongoing developments in this area, and to retain the capacity to do so within the labour movement.
- In the framework of such work, however, the limited relative importance of the GATS – compared, in Europe, with intra-European developments such as enlargement and the freedom of movement of workers, for instance, – must be borne in mind.
- GATS critics have been right to draw attention to the potential dangers inherent in the way that GATS commitments are negotiated and in how the WTO works. The limited effects recorded to date primarily reflect the limited market opening that GATS has brought about. The ongoing negotiation process within the GATS (and also in bilateral trade agreements) calls for ongoing monitoring by concerned civil society groups.

In such a European-level study it was necessary to focus on the ‘big picture’, on effects at the aggregate level. Even if the macro effects are small, at local and/or sectoral level specific concerns about ‘unfair’ competition and deteriorating labour standards may still arise and call for policy interventions.



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**European  
Trade Union Institute**

Bd du Roi Albert II, 5  
1210 Brussels  
Belgium

Tel.: +32 (0)2 224 04 70  
Fax: +32 (0)2 224 05 02  
etui@etui.org  
www.etui.org

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