



**Australian Services
Roundtable**

The Importance of Domestic Regulatory Transparency

**Attachment 3
Submission to the Mortimer Review**

**Export Policies
and
Programs**

June 2008

Relevance of Regulatory Regimes to International Trade in Services

The history of many services industries (apart for example from the professions, which tend to be self-regulated) has tended to be one of a high degree of government intervention, including government ownership and control. This is in direct response to a widespread perception of market failure in many services activities. Some services activities have typically been seen as constituting “public goods” justifying government service delivery, for example health, education, urban bus transport or water supply (which in most countries are still seen as legitimate public services) or banking (which in most countries is now in the realm of the private sector). Other large infra-structural services, like telecommunications, energy distribution, airlines or shipping, have similarly tended historically to be seen as “natural monopolies” with capital resource requirements beyond the means of the domestic private sector.

Typically all these services activities have consequently been highly regulated, usually to specify an appropriate standard of public service delivery and to ensure that the various public policy objectives are met. For example, banking and insurance are everywhere subject to stringent prudential controls, telecommunications is typically subject to “universal service” requirements etc.

In much of both the developed and developing world, over the past two decades, many of these services activities have been reformed; many have been privatised or at least opened up to private investment and competition, allowing a huge range of new services activities to enter the realm of the market place, including potentially the global market place. Sometimes the regulatory regimes governing these activities have not kept up with the rapid pace of change in the global business environment. Very often the regulatory regimes continue to restrict foreign access to domestic services activities. Sometimes this is intentional and sometimes accidental. Sometimes it is an appropriate step in the sequencing of competition policy reforms. Sometimes the regulatory regime is perceived by foreign services providers as a discriminatory obstacle to market penetration. And hence a target for inter-governmental trade and investment negotiations. Sometimes the regulatory regime is perceived by domestic entrepreneurs as an obstacle to domestic competitiveness and hence to export opportunity. And hence a target for domestic regulatory reform.

In essence, therefore, it is chiefly the nature and structure of these various domestic regulations which determine – and limit – the extent of foreign access to services markets. For this reason, the barriers to trade in services are often described as domestic regulatory barriers which exist ‘beyond’ or ‘behind’ the border’. Behind the border regulatory barriers are typically less transparent and less obvious than barriers at the border.

Handling regulatory issues in the context of trade negotiations

The rules for international trade in services are set by members of the WTO and are contained in the General Agreement on Trade in Services (GATS).

Under the Agreement, individual WTO members make specific undertakings on the degree of access foreign service providers will enjoy in their market, and whether they are treated differently from local service providers. The GATS is different to other WTO Agreements, in that there is no one rule to which all Members must adhere. Under GATS, each WTO member makes their own individual offers of commitments on opening up their markets to competition from foreign service suppliers.

Most importantly, there is nothing in the GATS which forces governments to deregulate. Indeed the GATS explicitly recognizes the right of governments to regulate and to fund all public services such as water supply, public health and public education. The nature and extent of GATS commitments are strictly a matter of choice for WTO member governments.

In the case of bilateral negotiations, most trading partners are seeking to achieve new commitments in Market Access and National Treatment which go beyond existing GATS schedules. The box below illustrates some relevant sorts of constraints.

Market Access

- (1) Limitations on the number of service suppliers (e.g., numerical quotas, monopolies, exclusive service suppliers)
- (2) Limitations on the total value of services transactions or assets in the form of numerical quotas or the requirement of an Economic Needs Test
- (3) Limitations on the total number of service operations or on the total quantity of service output
- (4) Sector specific Economic Needs Tests or limitations on the number of persons that can be employed
- (5) Measures that restrict or require specific types of legal entity or joint venture through which a service may be provided
- (6) Limitations on the participation of foreign capital in terms of a maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment.

National Treatment

- (7) Measures which affect nationals differently from foreigners (eg taxation/incentive measures, local content requirements, other performance requirements?)
- (8) Measures which affect established foreign companies differently from established nationally-owned companies

The Importance of Ensuring Best Practice Regulation

Whether or not trading partners are requesting domestic regulatory reforms in local services sectors, it is important to realise that overly restrictive or inefficient domestic regulation is not only a barrier to imports but can also act as a key constraint to the export of local services. For any domestic services industry to be internationally competitive, domestic regulation of that sector needs to be world's best practice. Where domestic regulation is unduly burdensome and costly, potential local services exporters will be prejudiced vis-à-vis foreign suppliers, as will local exporters of all goods in which services are increasingly heavily embedded.

Regulatory reform in the services sector therefore tends to improve the business environment for both domestic firms and foreigners. Interestingly, services trade liberalisation tends to be win – win rather than win – lose. The evidence is that domestic services sector tends to grow, rather than decline, when the sector is opened up to increased competition. This is unlike the situation in goods markets, where trade liberalisation may lead to a decline in former heavily protected industries.

Principles for best practice in services trade regulatory regimes

Every services industry is affected by government decisions on who can do business and how business must be conducted. If a country's regulatory house is not in order, domestic competition will be impaired and export potential will be prejudiced. In such cases, international services negotiations could result in easier access by foreigners to markets in which domestic suppliers remained restricted in their terms of entry or operations. The trade liberalisation challenge, therefore, is to remove barriers to doing business facing all entrants, domestic and foreign, not just to foreign suppliers. Domestic reform – and sometimes reregulation - is often an essential prerequisite to the removal of discrimination against foreign services suppliers.

There is strong international evidence of links between regulatory reform and productivity growth. Productivity is boosted by a focus on reforming those regulations that are overly prescriptive, poorly targeted, mutually inconsistent, duplicative, difficult to enforce or unduly costly or resource intensive for business to comply with. Industry self regulation similarly needs ongoing critical evaluation and assessment. Governments need also to try to introduce a degree of separation between policy-maker, regulator and compliance enforcer. It is important to ensure also that there is a degree of harmonisation of regulatory practice between central, provincial and local administrative levels and wherever possible among close regional trading neighbours.

The policy issues associated with services trade regulation are often among the hardest issues on the domestic political agenda. Competition policy, foreign investment policy, immigration policy, the recognition of standards and qualifications in other countries, and the management of public funding in sectors like health, education and transport infrastructure are some of the key issues. All countries have a strong economic interest in getting these regulatory issues right. Getting it right ultimately requires benchmarking the domestic regulatory system with relevant international practice. The first step in the reform process is to increase the transparency of the regulatory regimes.

Benefits of Reforming Regulatory Restrictions to Services Trade

Relative to the goods sectors, the services sector is by far the most heavily protected sector globally, burdened with the highest degrees of entrenched politically sensitive government intervention. While tariffs have come down in goods trade, a wide range of opaque impediments to international business continues to distort world trade and investment in services. It follows that the global benefits to liberalisation in services will far exceed the gains from liberalisation in other sectors.

A recent estimate in a study commissioned by the United States Coalition of Services industries (USCSI) suggests that full services sector liberalization could result in global welfare gains equalling \$1.7 trillion. This is more than double the potential gains from liberalization of trade in industrial goods, and 31 times the projected gains from liberalisation of agriculture. These modelling results make sense given that a strong services sector enables financial, technological, and infrastructure development economy-wide, which in turn facilitates greater investment and trade also in the agricultural and manufacturing sectors.