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What Would a Development-Friendly WTO Architecture Really Look Like?

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Abstract

This paper elaborates on a number of key principles that need to underpin a coherent and development-friendly architecture for the WTO. The key principles include enlarging the scope of WTO bargaining to include labor flows as well as capital flows; creating a structure that would provide a balance between furthering liberalization and providing some discretion or policy space to accommodate the inevitable political constraints; and minimizing the extent of regulatory harmonization. These principles, while applicable to all countries, may have less immediate relevance in addressing the problems of the least developed countries.

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I. Introduction

Much of the discussion in the run-up to the opening of the Doha round of multilateral trade negotiations and since has centered on the need to integrate fully the needs and concerns of developing countries into the trading system. Hence the call to arms for a so-called development round or development agenda. A large body of literature has identified the elements of what might constitute such an agenda, including changes in specific World Trade Organization (WTO) rules.[2] Less attention has been paid, however, to the design of a *coherent WTO architecture* that would foster development. This paper makes a proposal for such an architecture that serves primarily to bring together a number of specific suggestions that have been made by others.

There are two key issues. The first relates to the scope of bargaining and how it can be expanded to facilitate and maximize the mutually beneficial bargains that can be struck between countries. The second relates to the nature of rules that provide a balance between furthering liberalization and providing some discretion or policy space to accommodate inevitable political constraints.

Constraints, stemming in large part from political realities, will inevitably limit the scope and depth of the integration that can be targeted. Consider two examples. Labor mobility, which is likely to yield the largest increases in global welfare, is nevertheless restricted, especially, by developed countries, because of the large social dislocations that it could give rise to. In contrast, developing countries have traditionally been more protectionist based on their desire to industrialize and their dependence on trade taxes for revenue generation.

If integration among a disparate membership—encompassing the United States and the European Union, on the one hand, and India and China, on the other—is to advance, flexibility is the principle that ensures that the best does not become the enemy of the good. But flexibility is a mixed blessing: if there is too little, the implied rapid pace of integration may be politically unacceptable. But if there is too much, it can unduly compromise the other principles that need to inform the legal architecture. In other words, given that we are not in the first-best world of an exclusive concern with efficiency, how can there be method in the messy middle ground that the WTO, with its disparate membership, inevitably has to apply? This is a particularly opportune time to revisit the legal architecture of the WTO, given that the Doha round anticipates key changes in it, most notably through the inclusion of foreign direct investment.

We would note at the outset that the proposed architecture, while relevant to all developing countries, may less directly and immediately address the problems of the least

[2] See, for example, Finger and Schuler, 2000; Winters, 2000; Rodrik, 2001; and Hoekman and others, 2003.

developed countries (LDCs).[3] The really important agenda for these countries is to strengthen their "supply capacities" so that they can more effectively reap the benefits of the international division of labor. This strengthening will, of course, require technical and financial assistance, but these cannot be addressed by the WTO; in this regard, the World Bank and other international organizations have a key role to play. Further, the core activity of the WTO—multilateral liberalization—has a mixed or even adverse impact on the LDCs: most-favored nation (MFN) tariff cuts in agriculture and textiles will hurt LDCs, because their preferential margins will be eroded; and agricultural liberalization will tend to raise prices of foodstuffs, which would again hurt the LDCs as net food importers.

II. The Principles for the World Trade Organization Legal Order and their Rationale

The proposed architecture would be founded on the following five principles:

- Comprehensive coverage, encompassing goods and services and all factors of production, not just capital but also labor;
- An obligation not to discriminate—de jure and de facto—between domestic and foreign products and suppliers (national treatment) once the latter have entered the domestic market (post-entry);
- Restrictions on the entry of foreign products and suppliers could be maintained, but these would be negotiated, bound at prevailing levels and there would be a presumption in favor of using the least inefficient instrument, e.g., a tariff rather than a quota;
- Regulatory harmonization only in a narrow range of situations where there are negative externalities, economic (e.g., terms-of-trade losses through export cartels) or non-economic (pollution), with reliance on compensation rather than sanctions as the means to secure changes.
- Freedom to pursue deeper integration amongst a sub-set of members subject to safeguards that protect the interests of nonmembers.

Principle 1: Comprehensiveness

Until the Uruguay round, the multilateral system only covered cross-border trade in goods. With the institution of the WTO and the General Agreement on Trade in Services (GATS), a significant additional step was taken in bringing within the purview of the system, all international transactions, and crucially, the different modes of delivering services. (See Table 1).

[3] We use the term least developed countries to cover those countries to whom the arguments made in this paragraph apply.

Table 1. Coverage of WTO Agreements

Sector Mode of Delivery	Goods	Services
Cross-border trade	Covered	Covered
Consumption abroad [4]	Covered	Covered
Commercial presence (Foreign direct investment)	Not covered but on the Doha Agenda	Covered
Temporary presence of natural persons	Not covered and not on the Doha Agenda	Covered

Thus GATS included not just cross-border trade in services, but also capital movement—on the insistence of developed countries—and temporary labor flows to deliver a service—on the insistence of developing countries. Significantly, the Doha declaration, in calling for rules on investment, anticipates the possibility that in the future, one additional method of conducting international transactions in goods will be brought within multilateral rules. Even after the Doha round, the one omission would be the temporary movement of persons to help in the production of goods. It would seem natural for developing countries to argue for a symmetric treatment of factors of production: if capital movements to produce goods are to be included, so should the temporary movement of labor.

This call to enlarge the scope of the WTO to encompass labor mobility will face stiff resistance especially with the recent concerns about security. But there are a number of good arguments that we elaborate below that make this proposal worthy of consideration, if not immediately, at least as a desirable long-run goal. One way to move towards this in a meaningful way, while accommodating the political and social concerns, may be to focus in the short term on temporary mobility of skilled labor.

A. The Case for Comprehensiveness

Why should WTO rules encompass not only cross-border trade in goods and services but also the supporting factor movements? In the current context, the question more specifically is why the rules should include labor mobility. The main economic argument for factor mobility is that even fully liberal cross-border trade in goods and services will leave significant global efficiency gains unrealized. A political argument is that the inclusion of labor mobility will enlarge the negotiating space in the WTO increasing the possibility of mutually beneficial bargains being struck. Finally, from a development perspective, the gains

[4] This arises most frequently in services when the consumer rather than the provider travels abroad. Obtaining medical treatment abroad or traveling for tourism are two common examples of such a mode of service delivery.

to developing countries from greater freedom to move their workers abroad are likely to dwarf the benefits from improved market access in goods.

Labor mobility may indeed confer benefits because cross-border trade in goods and services is unlikely to lead to factor price equalization (FPE). If FPE were to hold, trade in goods and the movement of factors of production would be substitutes: as trade was freed, the incentives for labor migration and capital movement would disappear. Intuitively, one can think of goods as bundles of their constituent factors: then trade in goods and the migration of factors are two means to the same end.[5]

FPE may not obtain in reality, first of all, because many barriers to trade persist, only some of which are attributable to policy. Other barriers are natural, such as cultural and physical distance and geographical impediments. Second, the productivity of factors varies systematically between countries because of location-specific differences in the set of complementary inputs that are available or the environment in which they operate. Third, economies of scale may allow larger economies to pay higher wages.[6]

B. The Gains from Labor Mobility

From a global welfare perspective, the greatest gains to be realized are those where divergences in prices between industrial and developing countries are the greatest. As Rodrik (2001) has noted, the income gains that derive from international trade rise with the square of the price differentials across national markets. For commodities and financial assets, these price wedges rarely exceed a ratio of 2 to 1. However, wages of similarly qualified individuals in the advanced and low-income countries differ by a factor of 10 or more. In the extreme case in which workers from different countries are identical and productivity is purely a function of location-specific characteristics, the increment in output when a worker moves is equal to the difference in wages between the two countries involved. In an early model of this case, Hamilton and Whalley (1984) suggest that if labor were able to move between regions sufficiently to equalize wages around the world, world income could increase by 150 percent or more! Varying the assumptions—e.g., to reflect higher dependency ratios in developing countries, different costs of living in different countries, or incomplete wage equalization—would still allow huge gains, far in excess of anything observed elsewhere in the trade liberalization literature.

Winters (2000) has an alternative, perhaps more realistic, estimate of the gains from labor mobility. Suppose, very conservatively, that when a worker moves from a low to a high

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[5] This section draws on Winters et al. (2002). More technically, the result arises because under suitable assumptions factor prices are uniquely determined by goods prices; free costless trade equalizes goods prices and, through that mechanism, factor prices.

[6] At a more theoretical level, FPE may fail because there are more factors than goods (this is particularly likely if some factors are specific to particular industries, i.e., not inter-sectorally mobile, which is true of almost all in the short-run); because not all countries produce all goods (so-called complete specialization), or because technology is such that the same goods prices are consistent with different factor prices (the case of so-called factor intensity reversals).

income country, she could make up only one-quarter of the productivity or wage gap between the two countries. (That is, assume that three-quarters of observed wage gaps are due to differences in individual characteristics such as health, education or culture, and hence that they would persist even after developing country workers started to work in the rich countries). Suppose also that fifty million additional developing country workers worked abroad in any year, equivalent to an increase of about 5 percent in industrial countries' populations. With a wage gap of, say $24,000 per year, the gains would be $300 billion per year![7] These estimates have been corroborated by Winters et al. (2002) using a computable general equilibrium model. They find that an increase in developed countries' quotas on the inward movements of both skilled and unskilled temporary workers equivalent to 3 percent of their workforces would generate an estimated increase in world welfare of over 150 billion per annum. Both developed and developing countries share in these gains, and they are largest if low-skilled mobility as well as high-skilled mobility is permitted.

These estimates dwarf the estimated gains from complete liberalization of trade in goods and any of the initiatives currently contemplated under the Doha agenda. Moreover, a large part of the gains from labor mobility would accrue to developing country workers and directly so, obviating reliance on trickle-down. Finally, these estimates also understate the economy-wide benefits to developing countries from temporary labor movement that can be instrumental in creating trade and investment links and contribute to the transfer of technology and skills.

In addition to helping reap the gains from the international division of labor, the inclusion of labor would rectify an anomaly in the current architecture. Suppose, under a future more liberal GATS, a computer programmer from India could move to the United States. However, he would only have the right to work for an accountancy firm or a computer software firm in the United States, but not the right to work in a U.S. manufacturing firm. Given that the underlying skill of the labor is quite sector-blind, and that the gains to international efficiency relate to that skill, nevertheless international rules could render them—artificially—sector-sensitive.

Comprehensiveness also expands the scope of the bargaining space (see Levy, 2000). Mattoo, Sauve, and Subramanian (2000) argue that multilateral bargaining may become less efficient over time because the very process of liberalization reduces the bargaining space. Countries have less to offer in a reciprocity framework. The inclusion of labor mobility rectifies this to some extent. Our call for enlarging the scope of the WTO to encompass labor mobility may seem unrealistic given the experience of the GATS and the recent concerns about security. But it is important to recognize that while this makes a wider range of bargains possible, there is no guarantee that these bargains will be struck. As the GATS experience has shown, the fact that labor mobility is part of the negotiating framework is no guarantee that there will be actual liberalization.

[7] Labor costs per manufacturing worker, which are an indicator of productivity, were about $32,000 in the United States in 1990–94, compared with $1,192 in India, $1,442 in Lesotho, $5,822 in China, and $6,138 in Mexico; high-income countries' population was 927 million in 1997 (World Bank, 1999).

In any case, apart from economic efficiency and bargaining arguments, the inclusion of labor mobility in the WTO cannot but enhance its legitimacy: it would address the perception that the WTO system is currently rigged against developing countries by placing out of bounds the very factor that is the source of their comparative advantage. Given the sharp division in the world between countries in terms of the relative endowments of factors, with developed countries having an abundance of capital and developing countries of skilled and unskilled labor, a system that only favors the mobility of capital can be seen as being unfair. This is indeed a common, and justified, refrain of developing countries.

Principle 2: Post-entry National Treatment

National treatment is the counterpart in trade law of the biblical injunction to treat thy neighbor as thyself and requires a country to treat foreign products and providers no less favorably than its own. In an ideal world where efficiency is the sole objective, there should be unconditional national treatment—regardless of modes of delivery and the point of delivery, i.e., pre- or post-entry. This would, however, be a demanding requirement that many WTO members, developing (particularly in the case of capital mobility) and developed (in the case of labor mobility) would be unwilling to countenance. Can we, nevertheless, propose a general principle that promotes good policy while respecting the desire for policy flexibility?

In the General Agreement on Tariffs and Trade (GATT), national treatment is defined as a general obligation that applies post-entry; it applies across the board, covering all sectors and measures, but only kicks in once foreign products cross the border. Countries do have the flexibility to impose restrictions at the border, but according to a hierarchy that favors less inefficient measures like tariffs over quantitative restrictions.

In the GATS, national treatment applies both pre- and post-entry but is not a general obligation; countries chose the sectors, modes, and measures to which national treatment will apply. There is also no hierarchy restricting the choice of measures affecting market access. In fact, quotas are not prohibited, and countries are merely required to specify any that they wish to maintain, and that too, only in sectors where they chose to grant market access.

The key issue is how GATS rules can be strengthened in a way that will also lend itself to application in the new areas. Two approaches are possible. The first would be to follow the GATT goods model based on the distinction between pre- and post-entry treatment. No discrimination would be allowed post-entry between imported and domestically produced goods and factors, but countries would have the freedom to impose pre-entry restrictions subject to a certain hierarchy of instruments. Alternatively, rules could focus on the nature of the instrument, with flexibility being conferred on the use of economically efficient instruments regardless of whether they are imposed pre- or post-entry. Thus, fiscal means of discriminating against imports (such as a discriminatory domestic tax) would be treated more liberally than quantitative restrictions and treated on par with tariffs and other duties and charges levied exclusively on imports.

In our view, while both approaches have merit, the latter approach may on balance be preferable for three reasons. First, on economic grounds, the pre-/post-border distinction matters particularly when we are dealing with factor flows and not just cross-border trade.[8] In order to establish presence in a market, foreign firms have to incur sunk costs. As a consequence, any restrictive action taken by governments has a different impact whether it is applied pre-or post-entry. If governments have the discretion to take discriminatory measures post-entry, they could impose huge costs on firms that could really amount to expropriation. The resulting uncertainty could have a chilling impact on entry ex ante. There is thus a case for stronger rules post-entry than pre-entry.[9]

Second, and possibly in recognition of this destructive power of discretion, many countries around the world have voluntarily renounced—through constitutional and other provisions—the freedom to take restrictive actions against foreign firms once they have established a commercial presence. In practice, countries exercise the greatest flexibility at the point of entry, retaining the right to allow goods, services, or factors into their jurisdictions.

A post-entry national treatment obligation would merely codify the status quo in most countries.

A final merit of this approach would be transparency. All restrictive measures would be at the point of entry, ideally taking the form of a single fiscal measure analogous to a tariff. This measure could be made much more transparent than a multiplicity of internal and external discriminatory measures. Not only would there be benefits for traders and investors, but such a measure could become the focus of, and hence enhance the efficiency of, negotiations.

C. The Dilemma of Domestic Subsidies

Subsidies provided to domestically produced goods or to domestic firms may have a protectionist effect. But they are often the best instrument to remedy domestic distortions, and as instruments of protection they are superior to tariffs on two grounds: first, tariffs impose a larger welfare cost because in addition to protecting domestic producers they also tax domestic consumers; subsidies avoid the latter. Further, the cost imposed by subsidies are more transparent than the costs of tariffs because the former involve budgetary outlays that are visible, while the latter remain obscured.

Reflecting the superiority of subsidies as instruments of protection, GATT rules permit them to be granted under the exception embodied in Article III: 8A of the GATT. In order to prevent this exemption from damaging the interests of trading partners, GATT rules

[8] Of course, this is not to deny that there are sunk costs even in cross-border trade, but they are arguably lower than for factor flows.

[9] Strictly speaking, the presence of sunk costs requires limiting the discretion to impose restrictive measures after a foreign provider has incurred sunk costs, and not necessarily to eliminating all discrimination through a post-entry national treatment rule.

provide for safeguards (including countervailing actions) that allow partner countries to take action ex post where such damage can be demonstrated. These safeguards are embodied in the Agreement on Subsidies and Countervailing Measures. It would appear therefore reasonable to extend this treatment of subsidies to foreign direct investment (FDI) flows in services and goods.

In practice, of course, developing countries have paid a heavy price for the trading system's permissiveness toward subsidies. In agriculture, industrial country subsidies—estimated at over 300 billion a year - impose large welfare costs on developing country exporters of agriculture (World Bank, 2002). Notifications to the WTO suggest that as much as 90 percent of all domestic support to agriculture was granted by 23 industrial countries and less than 10 percent by 111 developing countries.[10] In another important instance, many countries use investment subsidies to lure capital away from their natural destinations but few developing countries have the fiscal strength to match the subsidy-giving ability of industrial countries.[11] From a development perspective, it would seem desirable to trade away the notional gains that developing countries might derive from being able to grant subsidies for the tangible practical costs that arise from industrial countries being able to do so. For this reason, it may be in the interest of developing countries to support a strong post-entry national treatment principle.[12] While this is not a prohibition on subsidies (unlike in the European Union for example), it would require any subsidies granted to domestic firms also to be extended to foreign firms located in a country's jurisdiction. In practice, the fiscal costs of having to comply with national treatment should act as a deterrent against the widespread use of subsidies.

D. What Kind of National Treatment?

The national treatment obligation would encompass both de jure and de facto elements, which are already incorporated in the GATT and GATS (reference to GATT cases and GATS Article). Establishing de jure departures from national treatment is relatively straightforward. But establishing whether measures are de facto discriminatory is proving fiendishly difficult. The WTO has seen a spate of disputes—beef hormones, genetically modified organisms, asbestos, environmental standards—that pertained to measures which were apparently origin-neutral but in practice disadvantaged foreign products and providers. The problem is more acute in services because of the pervasiveness of regulations—ranging

[10] Hoekman, Ng, and Olarreaga (2002).

[11] There is little systematic evidence of such incentives, but World Bank (2002), argues that such incentives are far larger in industrial countries. For example, in 1996, Mercedes-Benz received a subsidy of $300 million, which amounts to a subsidy of $200,000 per employee from the U.S. state of Alabama for establishing an auto plant (Moran, 1998). Similarly, following its reunification, Germany paid a subsidy of $6.8 billion to Dow Chemical, which amounts to $3.4 million per employee (Moran, 1998).

[12] It should be noted that the subsidies in relation to cross-border movement of goods would continue to be treated as they are currently. In view of the broadly appropriate nature of these rules, a case could be made for extending them to cross-border movement in services.

from qualification and licensing requirements in professional and financial services, to technical regulations in telecommunications and transport—that are almost always consistent with de jure national treatment.

Several examples, of particular relevance to developing countries, illustrate how difficult it has been and will continue to be to distinguish between regulations that incidentally impede trade in the pursuit of legitimate objectives and regulations that deliberately discriminate against foreign provision for the sake of protection. Professional service providers from developing countries are today obliged to jump through numerous qualifying hoops before they can sell their services abroad. Such requirements to requalify and undergo long periods of internships are typically justified on the grounds that all providers, national and foreign, are subject to the same conditions. This apparently origin-neutral requirement could in practice be extremely onerous on foreign providers who have fulfilled similar requirements in their home countries. While it would be wrong to deprive regulators of the right to establish that service providers are adequately trained, it makes a mockery of market access commitments to allow national regulators unlimited freedom to determine the conditions of access.

Another issue is privacy, which could have a profound effect on electronic commerce. In late 1998, the European Union issued a wide-ranging directive that aims to safeguard the privacy of personal data of EU citizens and prevent its misuse worldwide. It is backed by the power to cut off data flows to countries that the European Union judges not to have adequate data protection rules and enforcement. The issue could have an impact on developing countries' surging exports of data processing services, and poses a difficult choice for these countries. If they choose not to enact laws deemed adequate, they could be shut off from participation in this growing market. If they do enact stringent laws, it is unlikely that they could be made specific to trade with particular jurisdictions, and so the result could be an economy-wide increase in the costs of doing business.[13] This is not to suggest that there might not be good reasons to protect privacy. However, the desired level of such protection may differ across countries, and if trade is made conditional on the existence of "comparable" laws, then there might be a socially costly "race to the top."

Current rules need to be improved to address these situations. In the area of goods, the Technical Barriers to Trade (TBT) and Sanitary and Phytosanitary Measures (SPS) agreements have gone some way in incorporating principles that can help identify cases of de facto discrimination. But analogous rules for domestic regulation are still being negotiated in services with only limited progress. We would suggest three requirements.

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[13] For instance, if private sector estimates generated in the United States are to be believed, information sharing saves the customers of 90 financial institutions (accounting for 30 percent of industry revenues), $17 billion a year ($195 per average customer household) and 320 million hours annually (4 hours per average customer household) (Glassman, 2000).

The first, is to create a presumption in favor of international standards.[14] The problem is twofold. The high degree of regulatory diversity in services has meant that not many international standards exist. Where they do, for example the Basle Committee on Banking Supervision's standards pertaining to prudential regulation and the safety standards of the International Maritime Organization, compliance is seen as a minimum condition rather than sufficient to ensure access. Furthermore, even if there were international standards, countries should retain the right to depart from them. The question is how. We would suggest that countries should be required to choose the most economically efficient instrument for achieving the economic or social objective motivating the standard. However, there may be situations where countries could plausibly argue that the first-best economic instrument is not feasible, and it would be overly intrusive if WTO rules did not grant countries the freedom to make the case. In such situations, WTO rules could embody a second line of defense against protectionist abuse by requiring a consistency check to ensure that governments are using similar instruments to attain similar policy objectives in other contexts.[15]

Consider the following example that involved the imposition of certain taxes by the United States on automobiles on environmental grounds. The first-best instrument would have been taxes relating to the carbon content of fuels, the source of the environmental problem. The United States argued that this was not feasible and the WTO dispute-resolution panel found it difficult to question this judgment. However, the United States did not apply the taxes to all automobiles, exempting sports utility vehicles. It could reasonably have been argued that if the professed objective was environmental protection, the appropriate measure would be environmental taxes on all automobiles: the exclusion of certain categories would be decidedly inferior, and created a presumption that the choice of instrument was protectionist.

Principle 3: Pre-entry Restrictions: Hierarchy and Binding[16]

The flip side of the strong post-entry national treatment would be the flexibility accorded to governments to restrict entry—the market access arena.[17] Thus, governments could choose, as part of the negotiated commitments, to decide into which sectors (goods and services) to allow FDI and the temporary presence of foreign labor.

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[14] Of course, international standards themselves have to be legitimate and be derived from genuinely participatory processes.

[15] In practice, it may not be easy to apply this check in all instances, but at least the most egregious cases of inconsistency can be identified.

[16] The implications of principles 2 and 3 are summarized in Table 2.

[17] The notion of market access here is different from that in the GATS, which includes several measures—e.g., quantitative restrictions on output—that could be applied post-entry. We would suggest freedom only with respect to strictly pre-entry measures.

Table 2. Implications of Proposed Principles 2 and 3

Sector **Mode of Delivery**	**Goods**	**Services**
Cross-border trade	No quotas, national treatment, only tariffs	No quotas, full national treatment, i.e., no tariffs
Consumption abroad [18]	No quotas, national treatment, only tariffs	No quotas, full national treatment, i.e., no tariffs
Commercial presence (Foreign direct investment)	Post-establishment national treatment; presumption in favor of price-based border measures	Post-establishment national treatment; presumption in favor of price-based border measures
Temporary presence of natural persons	Post-entry national treatment; progressive liberalization.	Post-entry national treatment; progressive liberalization.

However, this freedom would be circumscribed by another principle inspired by the GATT. This freedom to limit market access would not be unlimited. In line with the hierarchy of instruments, governments would need to choose less-inefficient ways of restricting market access. In other words, there would be a presumption in favor of price-based or fiscal measures over quantity of regulatory measures.[19] The GATS, on the other hand, does not really set up a similar hierarchy, reflected in the fact that all restrictions/commitments are negotiated. There is no preference for price-based measures over others as a general principle.

It would seem that the superiority of fiscal over quantitative measures of protection is even more clearly established in services. First, many of the instruments of protection in services, like requalification requirements for foreign professionals and excess reserve requirements for foreign financial institutions, which have a tariff-like effect in terms of increasing costs of foreign providers, are not however tariff-like in generating revenue. Therefore, part of the loss in consumer surplus is not offset by increase in tariff revenue. So the resultant loss in welfare is much greater. Similarly, when quotas are imposed, their welfare consequences could be alleviated if the rents generated accrue domestically (to importers or government) rather than to foreign exporters. But the difficulties of intermediation in services suggest that quota-rents are more likely to be appropriated by exporters. And, as in the case of goods, even where quota rents could have accrued to domestic agents, they are often dissipated in unproductive rent-grabbing activities.

[18] This arises most frequently in services when the consumer rather than the provider travels abroad. Obtaining medical treatment abroad or traveling for tourism are two common examples of such a mode of service delivery.

[19] See Deardoff (1994, 2000).

It has, however, been suggested that the difficulty of imposing tariffs on services implies that the substitution of a more desirable policy instrument for a less desirable may not always be feasible. But the difficulty of switching to fiscal instruments of protection in services has probably been exaggerated. As far as cross-border trade is concerned, the imposition of duties is probably most difficult—perhaps impossible, given the current state of technology—when a service is delivered electronically. But in this case, other explicit barriers to trade are also likely to be currently infeasible. Where quotas are feasible and maintained, as on cross-border trade in transport services, it is easy to conceive of tariff-type instruments: e.g., a tax per passenger or unit of cargo carried by a foreign company. Moreover, the auction of a quota is analogous in economic effect to the imposition of a tariff in competitive markets. In the case of commercial presence, a number of fiscal instruments are possible, including entry taxes (or auctions of entry licenses).[20]

E. Binding Pre-entry Restrictions at Prevailing Levels

All international agreements involve legally binding commitments. The problem today is that large gaps between actual policy and WTO bindings are pervasive, rendering the latter virtually meaningless in terms of constraining reversals of liberalization.[21] For example, Chile's average bound tariff is over 30 percent while the average applied tariff is less than 10 percent. Similarly, in the area of services, India has committed itself in the WTO to allow foreign ownership in basic telecommunications up to 25 percent when in practice up to 49 percent is allowed. The key question is whether the level at which countries bind their policies can be left to negotiations or be subject to a generic rule.[22] In the context of our proposal, the question of bindings will be relevant only with regard to pre-entry measures.

We would propose a general rule that actual policy be bound across the board. This would have the obvious advantage of providing guarantees against reversal of policies and create a more secure trading environment for partner countries.[23] For instance, a number of developing countries have reversed their trade liberalization, which could have been prevented by more meaningful bindings. The requirement to bind at prevailing levels would

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[20] See Mattoo (2003).

[21] In practice, a number of countries, particularly developing, have not bound all their industrial tariffs in the GATT. In the GATS, a similar degree of freedom is introduced by the possibility of not scheduling a sector or specifying that a particular mode is "unbound"—which also implies that a member can introduce new restrictive measures.

[22] There is another issue relating to whether commitments should be specified ("scheduled) as a "positive list" or "negative list." In principle, these approaches do not determine the degree of liberalization, because either approach can be used to specify a desired level of openness.

[23] In practical terms, of course, the gap can widen again as markets become more open, unless an undertaking exists, as in the NAFTA, automatically to ratchet up scheduled commitments to reflect any liberalizing policy changes.

have the advantage of preventing the introduction of restrictions on currently liberal cross-border trade in services.[24]

While our proposal would ensure that there is no wedge between a country's actual policy and its GATS commitments, it could lead to a potentially serious problem that would affect in particular the willingness of developing countries to pursue sound liberalizing policies. A development perspective would require that this disincentive to liberalize be addressed.

Consider how the problem might arise. A negotiated commitment in the WTO to say reduce tariffs or open up to foreign service providers comprises two elements, which might be called the first and second moment benefits. The former stems from the lowering of barriers—the pure liberalization element. The latter emanates from the commitment not to reverse the liberalization—the binding element. Partner countries derive gains from both these elements and how much they offer in return is conditioned by the sum of these benefits.

Suppose that in a round of trade negotiations, a developing country bound its tariff at the applied rate of 20 percent. What would be the incentive for this country to unilaterally liberalize its tariff after the round? If it reduced its tariff further to 10 percent, then in the next round of trade negotiations, it would have lost some of its negotiating coinage. In particular, because partner countries would not pay for the liberalization from 20 percent to 10 percent, the developing country would have lost the bargaining chip arising from the liberalization element. It would be left with the chip relating to the commitment not to raise tariffs beyond 10 percent.

The proposal we have made, namely that all bindings should be at prevailing levels, would compound this problem. The country would have to bind its tariffs unilaterally at 10 percent in the WTO pursuant to our proposal. In the future round, partner countries, seeing that tariffs had been unilaterally reduced from 20 percent to 10 percent and bound at that level can comfortably pocket this guarantee of access and not have to pay for it. Of course, this would be anticipated by the country contemplating liberalization, rendering it less willing to unilaterally liberalize for fear of losing all its negotiating coinage in a future multilateral trade round.

The way to remedy this is through a credit rule, whereby all countries would agree ex ante before the start of any round that countries would get credit for any unilateral liberalization undertaken between rounds of trade negotiations. Going back to the example, in the second round of trade negotiations, partner countries would have to "pay" for the unilateral liberalization: when entering the trade negotiations, it is as if partner countries had to assume that the developing country's tariffs were still bound at 20 percent. The impulse to liberalize unilaterally then need not be inhibited by the fear of loss of negotiating coinage. The proposed rule is different from the demands for credit which are typically made at the beginning of a new round of negotiations in that it does not rely on altruism to be generally

[24] Transport services are an exception.

acceptable.[25] The feasibility of any such credit rule would be enhanced if market access negotiations were based on multilaterally agreed liberalizing formulae rather than bilateral request-and-offer approaches.

One final point relates to whether pre-entry restrictions on movement of natural persons should take the form of price- or quantity-based measures. We would take the view that the strict hierarchy in favor of price-based measures could be relaxed in the case of labor mobility for distributional reasons. Currently, the rents from the quantitative restrictions on labor mobility accrue to the foreign provider due to a combination of wage-parity legislation—requiring that foreigners are paid close to the prevailing domestic wage—and the difficulty of intermediation in many services, which means that domestic importers are less likely to obtain the quota rent. Moving to purely price-based measures with equivalent restrictive effects could have the effect of redistributing at least some part of these rents away from developing country providers to developed country governments. These equity consideration must be set against the obvious efficiency benefits of pure price-based restrictions.

Principle 4: Regulatory Harmonization

Consider now whether national treatment is a sufficient rule, or whether there is a case for deeper harmonization of domestic regulation. Two questions arise: where is it desirable? And, how is it best achieved?

Our answer to these two questions is: first, regulatory harmonization in the WTO can only be attempted if it leads to an increase in global welfare; and second, where it is globally welfare enhancing, the means to achieve it must be through compensation rather than through the threat of retaliation. Three examples where action or inaction by one country imposes a externality on another will serve to clarify our proposals. Consider the incorporation of Trade-Related Aspects of Intellectual Property Rights (TRIP)s, which involved regulatory harmonization, in the WTO. Requiring some countries to raise their levels of IP protection involved some positive externalities in the form of the boost to global research and development. However, harmonization also imposed short-run costs on countries raising their IP standards. Empirically, the strong presumption was that the latter costs outweighed the potential positive externalities (see Watal, 2000; and Maskus, 2000). For this reason, TRIPs was not a good candidate for inclusion in the WTO.

There is a stronger presumption that regulatory cooperation would be global welfare-enhancing in two other situations. These involve externalities arising from pollution and terms-of-trade losses through export cartels. In principle, the "offending" country can be

[25] GATS Article XIX:3 requires that in each future round "modalities shall be established" for the treatment of liberalization undertaken autonomously by members since previous negotiations. In principle, this is precisely the type of ex ante assurance of credit that would be desirable. But the nebulousness of the provision and the postponement of the establishment of modalities suggest that in practice the provision may provide little more than a basis for ex post demands for credit.

induced to change its policies either through rewards or sanctions, and this choice depends on the structure of prevailing multilateral rules. For example, if the "offending" country has the right to "pollute," then it must be rewarded for refraining from doing so; on the other hand, if the "suffering" country has the right to an unpolluted environment, then it can impose sanctions on the "polluting" country.

Where non-economic externalities are the issue, WTO rules are already appropriate by prohibiting the use of trade measures to induce a change in another country's policies. However, certain recent dispute settlement rulings (for example, the verdict in the shrimp turtle case) have called into question such an interpretation. Some clarification is necessary to restore the law to its status prior to the shrimp turtle dispute. A good model to follow in the case of externalities is the Montreal Protocol that provided incentives to countries (in the form of financial assistance) to adhere to the limits on emission of the polluting substance.[26]

Currently, WTO rules do not address, i.e., they implicitly condone, certain kinds of negative economic externalities. For instance, the exemption of export cartels from domestic competition laws are permitted under current rules. These cartels, of course, have economic effects very similar to export taxes or import tariffs imposed by large countries in that they create welfare losses for other countries. World Bank (2002) estimates that cartel practices among companies based in high-income countries may have over-charged customers in developing countries by up to $7 billion in the 1990s.[27]

It would, of course, be desirable from a global welfare perspective for countries to end such exemptions unilaterally but they have little incentive to do so. However, the standard mechanism of reciprocity-based trade negotiations could help reduce these distortions. More precisely, a country or a group of countries that are potential victims of export cartels could offer improved market access in return for the end of exemptions from national competition law; for example, developing countries could offer to liberalize their maritime transport regimes if the European Union and the United States end the exemptions from their competition law for collusive agreements (like the Conference system).

Where there are no externalities, there would be no basis for harmonization. Regulatory differences across countries reflect different national trade-offs between economic and non-economic objectives. In general, and to avoid the problem of overreach, these national trade-offs should be respected. If Europe wishes to maintain higher safety standards for beef that choice should be respected. Similarly if developing countries opted for lower levels of environmental standards that too should be respected.

From a development perspective, the threat of trade measures against developing countries for their alleged "low" labor and environmental standards has been a Damocles

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[26] The trade sanctions in the Protocol were merely a device to help secure adherence to the cooperative agreement on emission standards not a substitute for compensation.

[27] See also Evenett and Ferrarini (2002).

sword, endangering conditions of existing market access, and vitiating the general climate for trade negotiations. Although, labor standards are not on the agenda of the Doha round, and the scope of discussions on environmental issues is carefully circumscribed, there is nevertheless a need to address the issue of regulatory differences generically and decisively on the multilateral front. This would also ensure that such issues are not the basis for unilateral actions.

Principle 5. Facilitating "Deep Integration"

Having argued that regulatory harmonization should not be forced upon countries, we acknowledge that small groups of countries that voluntarily seek deeper integration should not be prevented from doing so. For example, countries could either chose to harmonize or mutually recognize standards. The key issue here is how to be permissive with regard to regulatory convergence within subsets of countries while safeguarding the interests of those excluded from them.

The problem for outsiders arises because mutual recognition agreements (MRAs) are like sector-specific preferential agreements. Selective recognition can have discriminatory effects and lead to trade diversion away from countries that are excluded. Since developing countries are not natural candidates for MRAs-one can readily observe Organization for Economic Cooperation and Development (OECD) countries making progress (albeit limited) toward MRAs in professional services, but avoiding such agreements with countries such as India, Egypt or the Philippines—they could be potential victims of trade diversion. The result may well be to create trade according to a pattern of mutual trust rather than on the basis of the forces of comparative advantage. How can this problem be minimized?

A possible approach is exemplified in GATS Article VII. This provision allows countries to harmonize or mutually recognize standards provided such arrangements are not used as a means of discrimination and outsiders with substantially similar standards are afforded an opportunity to negotiate similar agreements. This provision creates a desirable openness vis-à-vis third countries that the WTO provisions governing regional integration do not. It is, therefore, important that the current fashion of notifying MRAs as part of regional agreements be curtailed, and it be affirmed that GATS Article VII is an independent obligation with regard to regulatory measures that even parties to a regional agreement must respect.

III. Conclusions

This paper has sought to elaborate a coherent architecture for the WTO that could foster development. Such an architecture would serve two purposes. First, it would enlarge the scope of bargaining between industrial and developing countries, thereby facilitating mutually beneficial bargains. Second, it would create a structure of rules that would provide a balance between furthering liberalization and providing some discretion or policy space to accommodate the inevitable political constraints. These principles, while applicable to all countries, may have less immediate relevance in addressing the problems of the least developed countries.

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