

Regulatory Implications of Multilateral Trade Liberalisation for the Global Services Market: The Case of the Trade in Services Agreement (TiSA)

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I. Summary

Bilateral commitments on the liberalisation of services markets typically build upon those made by individual countries in the World Trade Organization (WTO) under the General Agreement of Trade in Services (GATS). These commitments usually guarantee a noodle bowl of preferential market access, but not much in the way of regulatory harmonisation for globalised services industries. This study aims to investigate the normative and economic implications of multilateral market openings and regulatory harmonisation of the global services sectors beyond the bilateral and WTO/GATS frameworks. The mobile communications industry serves as the initial benchmark analysis in order to empirically assess whether the multilateral liberalisation of the global services market can potentially respond more effectively to the growing transnational competition in production inputs, consumption outputs, and capital attraction in a broader pool of service-oriented economies. Ultimately, this study argues that the multilateral opening of the global services market is on balance beneficial to the domestic services industries, and as such the WTO/GATS

framework can be superseded by further economic integration and regulatory harmonisation in future multilateral trade agreements currently under negotiation, such as the Trade in Services Agreement (TiSA).

II. Introduction¹

As the WTO member states have not agreed on an exhaustive list of sectors to be covered under the General Agreement on Trade in Services (GATS), economic integration in the emerging services sectors lags behind the global needs of corporate supply chains. Unsurprisingly, service-oriented economies in the global markets are moving away from the sluggish WTO system to seek further avenues of trade liberalisation at the mega-regional level, in particular through the Trade in Services Agreement (TiSA) proposed by the European Union (EU). However, adding yet another regulatory layer to the intricate frame-

¹ This introductory section is adapted from Di Lieto, G. "Asia-Pacific services trade needs more harmonized regulation," *Asia Times* (October 10, 2017) Available at <http://www.atimes.com/asia-pacific-services-trade-needs-harmonized-regulation/> (accessed November 19, 2018).

work of global trade in services may have the unintended consequence of encumbering the economic integration process of service-oriented markets. In order to assess the costs and benefits of the TiSA and formulate priorities and objectives in negotiations, this study addresses the normative and economic implications of the regulatory adjustment of multilateral trade in services for the economies involved in the TiSA negotiations. The purpose of this evaluation is to analyse whether these countries should either embrace the EU-inspired framework of trade in services, insist on the existing WTO-GATS system, or circumscribe their services trade regulation efforts within legal environments of regional economic integration. Using evidence-based analysis, this study presents an empirical model of the mobile telecommunication industry situation within the potential TiSA environment. This is as an initial benchmark analysis to establish that it is in the best interest of services trade partners to access the largest possible regulatory framework and from within it raise the standards of membership. This outcome entails further domestic regulation harmonisation as a necessary step for the future liberalisation of global services markets.

III. The Regulatory Adjustment of Multilateral Trade in Services

The global development of digital technologies and the rise of liberalisation policies in the public services sector is increasingly blurring the boundaries between public/private and local/foreign services. This dynamic surely complicates the interpretation and application of international trading rules. Throughout history, international trade has occurred mainly as a sale and purchase of raw materials and

commodities, agricultural products, and manufactured goods derived from crafts materials. As for the services, in the pre-industrial era merchants sent off their ships across the seas, using archaic modes of freight, port services, and payment letters. However, only in recent decades have other service activities found a quantitative growth and qualitative characterisation such as to become an item of primary interest in the trade balance of nations. Broadly, the expression “international services trade” refers to all transactions relating to service industries that pass through state borders, and are registered as such by the customs and/or monetary authorities of the countries involved. Under the term “services” we find intangible assets that are classified as such internationally. This is an extensive sector which is relentlessly growing and often difficult to define and interpret. It may indeed include a mix of goods and activities that are arduous to be clearly identified as either secondary or tertiary, so as to create many problems for statisticians, regulators, and tax and customs authorities. The two greatest phenomena of the contemporary economy are the globalization and de-materialisation of production and trade.² The further deconstruction of commerce into cross-border services is thus contributing to the creation of a world-economic structure that makes the clear distinction between economic sectors often difficult, despite being kept quite distinct from the so-called traditional economy.³ In the historical curve

² Baldwin, R. 2016. *The Great Convergence: Information Technology and the New Globalization*. Harvard University Press.

³ Di Lieto, G. 2018. “The Worrying Rise of Covert Trade Protectionism,” Brink News. (February 28, 2018) Available at <https://www.brinknews.com/the-worrying-rise-of-covert-trade-protectionism/> (accessed November 19, 2018).

of economic development, services assumed macro-economic relevance only in the latter part of the twentieth century, progressively taking a leading role in production and employment. In the so-called post-industrial society and particularly in the advanced economies, services tend to be the most important sector of the economy, both in terms of employment and contribution to the domestic product. Nowadays, according to the World Bank Database, trade in services accounts for about one fifth of global trade; as the fastest growing sector of the global economy, it generates two thirds of global output and one third of global employment. The relevant question thus is whether the TiSA initiative is better suited than the existing WTO-GATS framework to regulate this ever increasingly complex economic environment at the multilateral level.

IV. Regulatory Interplay of GATS and TiSA

In 2013, the European Commission took the momentous initiative to propose in a formal submission to the European Council the opening of negotiations for a new international agreement on trade in services. Initially, this proposed multilateral treaty was named the International Services Agreement (ISA) and involved a co-opted grouping of 23 WTO members, the so-called “Really Good Friends of Services” (RGFS), counting most of the top global trading economies.⁴ Subsequently, the ISA then evolved as the Trade in Services

Agreement (TiSA) in view of harmonisation with WTO rules, which means that it could become a multilateral instrument at a later stage. Controversially, only limited information on the procedures and substance of the TiSA negotiations have entered the public realm to date. Hence, it can only be speculated that, while TiSA presents significant promise as a far-reaching preferential services trade agreement in application of Article V GATS (on Economic Integration), the prospects for its later incorporation into the WTO framework seem very uncertain. In fact, despite the declared goal of compatibility with the GATS, the early TiSA negotiations point to clear departures from GATS practice, in particular where it seeks to deal with national treatment measures through a negative list approach, while sticking to a positive list approach for market access schedules as it occurs in the WTO negotiations. Remember that a positive list allows parties to an agreement to specifically choose the sectors in which to schedule commitments. Conversely, a negative list approach means that parties to an agreement commit to certain measures in all sectors, except those specifically reserved. It has been argued that the hybrid listing rationale of TiSA “lie in the fact that governments often find it easier to progressively liberalize discriminatory regulation [...] than to dismantle quantitative restrictions limiting competition in services markets”⁵. Compared to the current GATS provisions that only apply if and when a specific commitment on national treatment and market access is scheduled, the segmented approach of TiSA to market opening is likely to lead to complex legal interpretation issues of compatibility with existing GATS sched-

⁴ Di Lieto, G. 2016. “Wikileaks Reveals the TiSA Agreement Could Cost Australian Services,” *The Conversation*. (August 4, 2016). Available at <https://theconversation.com/wikileaks-reveals-the-tisa-agreement-could-cost-australian-services-63199> (accessed November 19, 2018).

⁵ Sauv , P. and A. Shingal. 2014. *The Preferential Liberalization of Trade in Services*. Edward Elgar Publishing, pp. 420.

ules. This is evident if we consider that GATS disciplines such as payments and transfers would automatically apply to all measures affecting trade in services that escape the TiSA negative list of measures violating national treatment. However, these same GATS disciplines would only be applicable in sectors and modes of supply where positively listed market access commitments were scheduled. This situation would thus create a variable geometry to multilateral liberalisation of services trade that may take the rule-making environment of international trade into uncharted territories. A split system of services trade liberalisation would indeed further unsettle the WTO system at a time when it is struggling to keep relevant to emerging service sectors, particularly those with network properties, such as resources distribution, waste disposal and telecommunications.⁶

V. Economic Analysis of the Potential TiSA Framework

To evaluate the regulatory issue identified above, this section provides an economic analysis of the possible legal environments of multilateral trade in services, as modelled on the mobile telecommunication industry situation within the potential TiSA framework. The model utilised in this paper seeks to investigate the connection between the profits of mobile telecommunications services firms and the restrictiveness of trade in services. In particular, the model is designed to jointly capture: 1. the restrictiveness effects to trade in terms of market access for the importation of services; and 2. the domestic regulation of imported services after national jurisdictional boundaries have been crossed. Relevant literature

recognises these issues as the two mainstays of restrictiveness in terms of services trade.⁷ Mobile telecommunications services (also referred to in the study as wireless telecommunications excluding satellite) form the analytical basis as they naturally provide a homogeneous service capable of cross-country analysis and convergence in terms of market liberalisation. As such, for the purposes of this study the mobile telecommunications market constitutes an initial benchmark and proxy analysis of the flows of natural persons providing services. Together, the parameters in this study allow for an empirical investigation of whether trade restrictiveness, broadly defined, positively contributes to the profitability of domestic firms. Limited literature exists in terms of telecommunications services, with some notable studies investigating market power as a function of the profit effect of trade barriers in telecommunications.⁸ This analysis on the profit-cost margin of emerging market telecommunications firms finds that restrictions to trade positively contribute to market power only when regional trade agreements and most favoured nation clauses are controlled. Other relevant literature looking at the effect of trade barriers on the profit margins of telecommunications companies has found that barriers to entry inflate the profits of incumbent companies.⁹

The empirical purpose of the model used in

⁶ Di Lieto, G. above n 1.

⁷ Pauwelyn, J. 2005. "Rien Ne Va Plus? Distinguishing Domestic Regulation from Market Access in GATT and GATS," *World Trade Review*, Vol. 4, No. 2, pp. 131-170.

⁸ Fontagné, L. and C. Mitaritonna. 2013. "Assessing Barriers to Trade in the Distribution and Telecom Sectors in Emerging Countries," *World Trade Review*, Vol. 12, No. 1, pp. 57-78.

⁹ Khachaturian, T. 2015. "Services Trade Restrictions and Company Profits: Telecommunications." US International Trade Commission. Working Paper, No. 042.

this study is to identify whether domestic market regulation and/or market access influence the profits of telecommunications services firms operating within the jurisdictions covered by TISA. As mentioned above, this model selects firms classified as wireless telecommunications services (excluding satellite - NACE Code 6190). Based on this classification, the model identifies a list of companies and their accompanying profitability measures through the Bureau van Dijk's *ORBIS* database from 2014 to 2015, which is the time period that matches the available measures on the restrictiveness of services trade published by the OECD under its *Regulatory Database for Services Trade Restrictiveness*. The end result is a dataset capable of panel analysis and comprised of 70 companies (n=70) resident in TISA related jurisdictions over two successive annual periods (t=2). In terms of profits of mobile telecommunications services firms (the dependent variable), the analysis captures the earnings before interest, tax, depreciation and amortization (EBITDA) margin. EBITDA margins are measures of profitability from operations that are free from tax and accounting related distortions. Similarly, as the model is cross-country and cross-company, the use of a percentage margin prevented potential distortions created by national currency units or the size of firms operating within the same sector.

The *Regulatory Database for Services Trade Restrictiveness* provide six measures of restrictiveness of services trade for different sectors. These include one composite Services Trade Restrictiveness Index (STRI) which is formed through a linear combination of the other five indices in the same sector that assess: foreign entry; movement of people; other discriminatory measures and standards; competition; regulatory transparency. Given the purpose of the model, the independent varia-

bles include the indices of "Other discriminatory measures and international standards" (referred to in the empirical analysis as domestic regulation) and "Restrictions on foreign ownership and other market entry conditions" (referred to in the empirical analysis as market access). All variables included in the study underwent a logarithmic transformation, as summarised in the table below.¹⁰

¹⁰ Table 1 provides summary statistics and a simple correlation matrix of the data used in the analysis. As indicated on Table 1, only domestic regulation maintains a positive correlation with EBITDA margins. A priori, positive correlation between profits and the restrictiveness measures fits within the theoretical understanding that barriers to trade can advantage domestic producers. In order to investigate this finding empirically, equation 1 was estimated: $\ln [EBITDA]_{it} = \alpha + \beta_1 \ln [DomesticRegulation]_{it} + \beta_2 \ln [MarketAccess]_{it} + u_{it}(1)$ where $i = 1, \dots, N$ denotes States (countries), $t = 1, \dots, N$ and denotes time and μ_i denotes the unobservable individual effect.

Table 1. Results

Variable	Descriptive Statistics				Correlation Matrix		
	Mean	Median	Std. Dev.	Total Obs.	Log of EBITDA	Log of Domestic Regulation	Log of Market Access
Log of EBITDA	0.177924	0.190041	0.120018	140	--	--	--
Log of Domestic Regulation	0.015596	0.017166	0.007595	140	0.167950	--	--
Log of Market Access	0.060872	0.045454	0.037067	140	-0.213230	-0.087427	--

Results of Panel Regression and Diagnostic Tests

Variable/Details	Pooled OLS	Variable/Details	Pooled OLS	Variable/Details	Pooled OLS
Log of Domestic Regulation	2.377474*** (1.817133)	Breusch-Pagan LM Test Statistic: Cross-Section	54.73693*	R-squared	0.067932
		Breusch-Pagan LM Test Statistic: Time	0.907118	Adj. R-Squared	0.054325
Log of Market Access	-0.64782** (2.416374)	Hausman Chi-squared Test Statistic	na	S.E. Regression	0.116713
		Redundant FE: F Test Statistic: Time	0.105774	F-Statistic	4.99246*
Constant	0.180278* (6.226739)	Redundant FE: Chi-squared Test Statistic: Time	0.108843		
		Jarque Bera	3.817428		

Notes: Data period under analysis: 2014-2105; Logs refer to natural logarithm unless otherwise stated. Absolute value of t-statistic in parenthesis; * (**) *** indicates statistical significance at the 10%, 5% and 1% levels respectively; Reported RE statistics are weighted results; Breusch-Pagan LM Test: compares random effects to pooled estimates under null hypothesis of no heteroskedasticity; Hausman Chi-squared Test: compares fixed effects with random effects under the null of individual effects are uncorrelated with the other regressors in the model; Redundant Fixed Effects: compares fixed effects with pooled estimates under the null of no fixed effects in cross section; Jarque-Bera is a conditional normality test under the null of a normal distribution; regression undertaken using EViews 9; In accordance with an established procedure for panel analysis (Brooks 2008), the model results in a series of diagnostic tests. The Breusch-Pagan Lagrange Multiplier (LM) test indicated significance at the 1 percent level for effects in the cross section, implying that random effects (RE) was preferred to pooled ordinary least squares (OLS). The redundant fixed effects (FE) test could only be specified for period fixed effects and indicated no significance, implying that pooled OLS is preferred to FE. The Hausman test could not be undertaken as the estimated effects in the RE and FE regressions are dissimilar. Ultimately, the diagnostic tests imply that RE be the choice of estimation. However, under RE estimation, the F-test does not reject the null hypothesis at the 5 percent level. Implying that the RE model does not offer any statistical insight into the relationship under investigation. This is not the case in terms of the pooled OLS. Several robustness and misspecification procedures

were undertaken using the existent data and limited alternate measures of restrictiveness in services trade. None provided an improved or alternate means of analysis. On this basis, the remainder of the analysis proceeded using the pooled OLS regression.

The results indicate that domestic regulation and market access are statistically significant at the 10 and 5 percent levels respectively. This implies that there is statistical evidence that restrictiveness in terms of domestic regulation and market access contributes to profits of mobile telecommunication services firms. However, domestic regulation maintains a positive coefficient. Whereas market access maintains a negative coefficient.¹¹ Together this implies that the lower the restriction on market access the greater the profits, while the greater the domestic regulation the greater the profits.

It would appear that the empirical findings of the economic model adopted in this study are at odds with the theoretical understanding of trade restrictiveness and profits. However, this can be resolved if three additional factors are considered: 1. Homogeneity of services, 2. Trade creation and 3. Regulatory harmonisation. TiSA is a proposed agreement aimed at liberalising trade in services between its member jurisdictions, and the companies included in the analysis undertake a homogenous type of service. This implies that intra-industry trade will be a feature in mobile telecommunications. On this basis, the formation of a regional trading area under the TiSA is expected to produce scale effects and, in turn, be trade creating. The scale and trade creating outcomes of TiSA, together with the homogeneity of the service, explain why the lower the restriction on market access the greater the profits are in mobile telecommunications i.e.

the larger the market for the same service, the larger the profit. However, once the border has been crossed or membership achieved, and given the homogeneity of the service, further gains can be achieved through creation of common higher standards. This, in turn, simultaneously explains why the empirical evidence suggests that the greater the domestic regulation the greater the profits in mobile telecommunications.

Conclusion

In essence, for services trade partners with operations in global markets it is more profitable to enter the largest possible services trade 'club' (be it GATS, TiSA or a regional partnership) and, once they are in, it is in the new members' interests (i.e. more profitable) to raise the standards of membership in terms of domestic regulation harmonisation, provided that the normative crossover with other trade instruments does not offset the economic gains with increased transaction costs of participating in a larger regulatory environment.¹² KIEP

¹¹ Di Lieto, G. above n 1.

¹² Di Lieto, G. above n 1.

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