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## Services, development and trade: The regulatory and institutional dimension

Note by the UNCTAD secretariat

### *Executive summary*

Services sectors are essential to the efficient functioning of all economies and to strengthened productive capacity with the potential to induce structural transformation in support of the 2030 Agenda for Sustainable Development. The quality of policies, regulations and institutional frameworks is a key determinant of services performance. Services are increasingly subject to liberalization under multilateral, plurilateral and regional trade agreements. This makes it critically important to secure coherent approaches to domestic regulation and trade liberalization in the services sector, such as by instituting effective coordination mechanisms between trade negotiators, policymakers and regulators. It would be important to work towards “best-fit regulations” while recognizing risks and trade-offs that such a reform agenda may entail for national regulatory autonomy, policy space and development imperatives.



## Introduction

1. Services sectors are essential to the efficient functioning of all economies and to strengthened productive capacity.<sup>1</sup> Services are key to achieving structural transformation in line with developing countries' aspirations towards economic upgrading and diversification, and greater competitiveness. The quality of policies, regulations and institutional frameworks is a main determinant of services performance and is decisive in harnessing the pro-development benefits of services sector development. A dynamic service economy can contribute significantly towards the Sustainable Development Goals, as their achievement presumes efficient and equitable functioning of the services sector and universal access to infrastructure and essential services, whether they be telecommunications, energy, financial services, health care, sanitation or education.

2. Regulations are important in harnessing the development benefits of the services economy and trade, particularly infrastructure services, as the latter are subject to network externalities and information asymmetry, and prone to market failure. Adequate policy interventions are instrumental for sectoral and economy-wide development. Services are increasingly subject to trade liberalization initiatives under multilateral, plurilateral and regional processes, in which developing countries increasingly take part. Most significantly, the new generation of regional trade agreements (RTAs), particularly the emerging "mega RTAs", have extended the frontiers of liberalization and international rule-making to services, essentially addressing national regulatory measures as they apply to foreign services and services providers. These agreements not only define market access and entry conditions but also provide disciplines on qualification, technical and licensing requirements. This has raised a thorny policy question: How to balance commercial benefits that could arise from effective market opening with the prerogatives of national governments to implement necessary regulatory measures in support of public policy objectives? This issue underscores the importance of coherent approaches to trade liberalization and regulation of services.

3. The strong regulatory focus of recent RTA that seeks to achieve regulatory coherence and convergence in order to address what exporters see as trade-restrictive effects of domestic regulatory measures, including those arising from regulatory divergence across jurisdictions, has pointed to the importance of working towards "smart" regulations that are best fit to national circumstances and development needs. This is necessary to minimize the inadvertent trade-restrictive effect of regulations and introduce effective, efficient and equitable regulatory practices. While the elements of such best-fit regulations would differ across countries, some useful lessons could be learned from national experiences and international initiatives. Establishing policy coherence between domestic regulation and liberalization approaches should be seen in this broader context of striving towards a best-fit regulatory and institutional framework in an increasingly open trade environment. At the same time, it would be important to attend to risks, costs and trade-offs that such a reform agenda may entail with respect to national regulatory autonomy and policy space.

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<sup>1</sup> UNCTAD, 2010, *Services, Development and Trade: The Regulatory and Institutional Dimension of Infrastructure Services* (New York and Geneva, United Nations publication).

## I. Trends in the services economy and trade

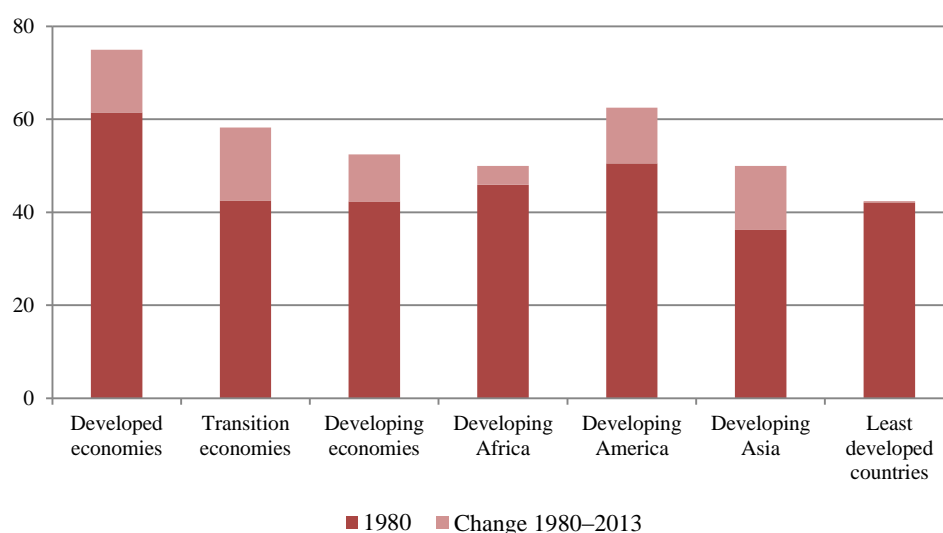
### A. Services sector growth

4. The “servicification” of economies characterizes the long-term trends in many countries. Between 1980 and 2013, the share of services in gross domestic product (GDP) increased for all income categories, from 61 per cent to 75 per cent in developed economies and from 42 per cent to 52 per cent in developing economies (figure 1). Among developing regions in 2013, services have the highest contribution to output in Latin America and the Caribbean – 63 per cent – but they are also predominant in Africa and developing Asia, with 50 per cent shares. Although with the lowest and more stable contribution at 42 per cent, services also have the largest share of the output of least developed countries (LDCs).

Figure 1

#### Contribution of services to gross domestic product by region and income level, 1980 and 2013

(Percentage)



Source: UNCTADStat.

5. While the increased share of services between 1980 and 2013 is generally associated with a declining industrial share in developed economies – minus 23 per cent – it mainly corresponds to a decrease of minus 7 per cent in the agricultural contribution to GDP in developing countries (figure 2). The predominance and growth of services implies the need for countries to devise best-fit and coherent regulatory and institutional frameworks, which are determinants of services performance and therefore central to harnessing their potential for development goals.

Figure 2  
**Contribution of services to gross domestic product by income level and economic sector, change between 1980 and 2013**  
 (Percentage)



Source: UNCTADStat.

## B. Impact on employment

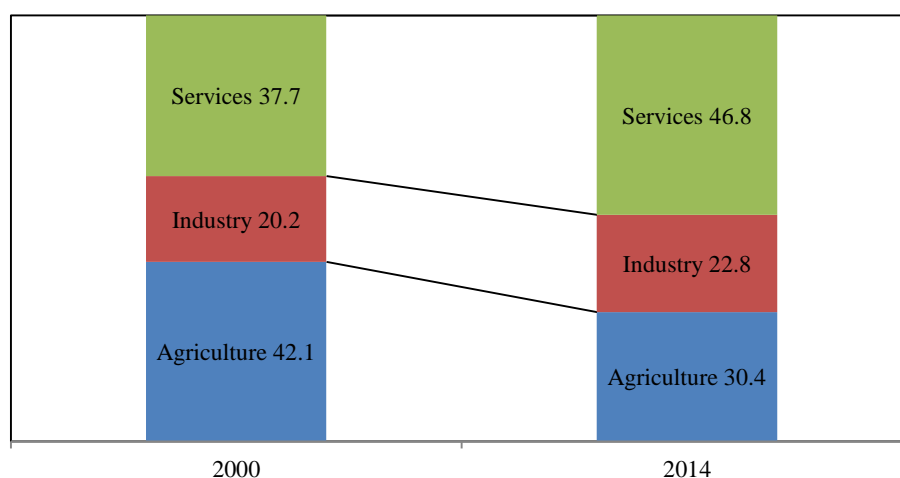
6. The trend towards servicification is also reflected in employment levels. Since the mid-2000s, services have been the primary source of employment, even during the 2008-2009 global economic crisis. The broad services sector remained the main job provider, contributing 47 per cent to global employment in 2014 (figure 3) and is projected to employ about 1.5 billion people by 2016. The bulk of new jobs is likely to be created in the services sector. Although they play an important role in structural transformation, industrial activities are not projected to contribute strongly to job recovery.<sup>2</sup>

7. Services are increasingly important for the creation of jobs related to global value chains. Between 2000 and 2013, services accounted for the greatest part of new jobs in advanced economies and were the second largest contributor, after manufacturing, to new jobs in emerging economies. Between 2000 and 2011, some services sectors revealed more potential to create trade-related jobs, namely business services, transport and communication in developed economies, and business services, hotels and restaurants in emerging economies. Data from 2014 revealed that although women account for large shares of employment in several services sectors, they represent a small share of employment in the sectors that create the most jobs linked to global value chains. The indirect effects of services exports were stronger in some sectors, with one job in tourism creating three jobs elsewhere and in India one job in information technology creating four jobs elsewhere.<sup>3</sup> Infrastructure services in particular are a key factor in creating supply and export capacity and taking advantage of employment benefits from trade.

<sup>2</sup> International Labour Office (ILO), 2015, *World Employment and Social Outlook: Trends 2015* (Geneva).

<sup>3</sup> UNCTAD, 2014, *Exploiting the Potential of the Trade in Services for Development 2* (New York and Geneva, United Nations publication).

Figure 3  
**Global employment by economic sector, 2000 and 2014**  
 (Percentage)



Source: UNCTAD calculations based on ILO database available at [www.ilo.org/legacy/english/weso/2015/WESO\\_jan2015.xlsx](http://www.ilo.org/legacy/english/weso/2015/WESO_jan2015.xlsx). All websites cited in this paper were accessed on 7 March 2016.

Note: Values for 2014 are estimates.

### C. Exports, migration and the services sector

8. In 2014, the world's five largest exporters of commercial services were the United States of America (14 per cent of the global exports of commercial services), the United Kingdom of Great Britain and Northern Ireland (6.9 per cent), France (5.5 per cent), Germany (5.4 per cent) and China (4.7 per cent). These countries were also the leading services importers in the same year. Although underrepresented in the leading positions, developing economies expanded services exports faster than developed economies between 2005 and 2014, and their share in global services exports increased from 24 per cent to 29 per cent.

9. The sectoral composition of commercial services exports in 2014 reveals a contrast between developed and developing economies. While transport, travel and other business services are the largest categories for both types of economies, the relative importance of transport and travel is more pronounced for developing economies: 57 per cent of their total commercial services exports. Conversely, the share of financial and insurance services and charges for the use of intellectual property in total commercial services exports is higher in developed economies. This suggests that developed economies are more specialized in such high value added services, while developing economies, particularly Africa and LDCs, are more reliant on traditional services activities, such as transport and travel services (table 1).

Table 1  
**Commercial services exports by region, income level and category, 2014**  
 (Percentage)

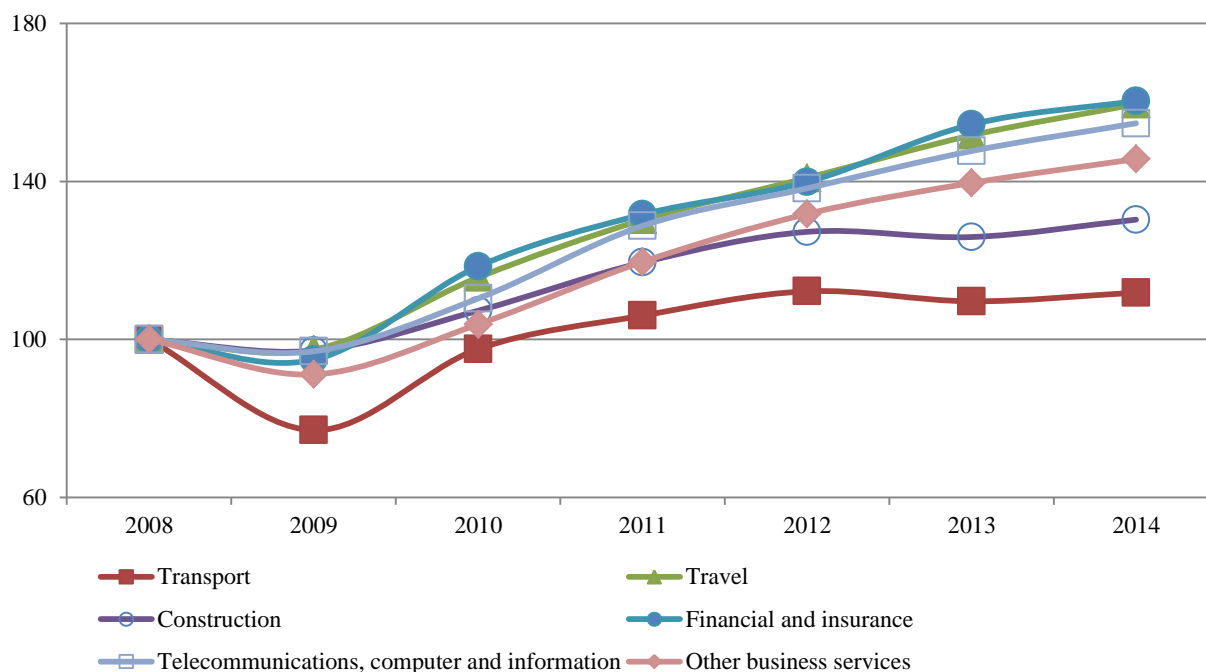
<i>Services categories</i>	<i>Developed economies</i>	<i>Developing economies</i>	<i>Developing Africa</i>	<i>Developing America</i>	<i>Developing Asia</i>	<i>Least developed countries</i>
Goods-related services	3.2	3.0	2.1	2.5	3.2	1.5
Transport	17.9	21.4	30.7	19.0	20.9	25.9
Travel	20.9	35.3	44.4	44.8	33.2	57.7
Construction	1.6	3.2	1.7	0.3	3.7	1.1
Financial and insurance	13.6	6.0	3.0	5.1	6.4	1.7
Intellectual property	8.4	0.9	0.2	0.5	1.0	0.1
Telecommunications, computer and information	9.7	8.3	5.2	5.1	9.0	4.5
Other business services	23.5	21.3	12.3	21.7	22.0	7.2
Personal, cultural, and recreational	1.0	0.6	0.5	1.0	0.6	0.3
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

*Source:* UNCTADStat.

*Note:* The category “other business services” covers research and development, professional and management consulting and technical, trade-related and other business services.

10. The evolution of exports of commercial services in developing economies between 2008 and 2014 is indicative of the dynamism of financial and insurance services, telecommunications, computer and information services, some of which are heavily regulated services sectors (figure 4). This trend confirms that some high value added services categories are the most dynamic in developing economies and contribute to their economic upgrading. Charges for the use of intellectual property represent the most dynamic commercial services exports in developing economies in the same period, which is largely a result of increased foreign direct investment (FDI), yet it still contributed to less than 1 per cent of these exports in 2014 (table 1).

Figure 4  
**Exports of selected commercial services from developing countries by category,**  
**2008-2014**  
 (2008 = 100)



Source: UNCTADStat.

11. Between 2005 and 2015, the share of services in total exports of goods and services hovered around 25 per cent in developed economies and 15 per cent in developing economies. However, cross-border services trade data captures only a part of services trade, as services trade increasingly occurs with commercial presence through FDI and the temporary movement of natural persons – mode 4. Commercial presence is the major mode of supply in services. UNCTAD estimated the value of all sales by affiliates at \$36 trillion in 2014. If half of this is assumed to be in services, trade through foreign affiliates could be of the order of \$18 trillion, nearly four times the global cross-border services exports.<sup>4</sup> In 2014, services accounted for 49 per cent of the global value of announced greenfield FDI projects, \$341 billion. Of these, 47 per cent were for infrastructure services. Between 2005 and 2014, services FDI increased most in electricity, gas and water, construction, and health and social services.<sup>5</sup>

12. The temporary movement of people supplying services is particularly important in professional and business services, as well as in services related to agriculture, manufacturing and mining. Given the continued growth of remittances, it would appear that trade through mode 4 is on an upward trend. In 2015, worldwide remittance flows are estimated to have exceeded \$601 billion, with about \$441 billion going to developing countries.<sup>6</sup> The relevance of migration for the services sector is also underscored by the

<sup>4</sup> A/70/277.

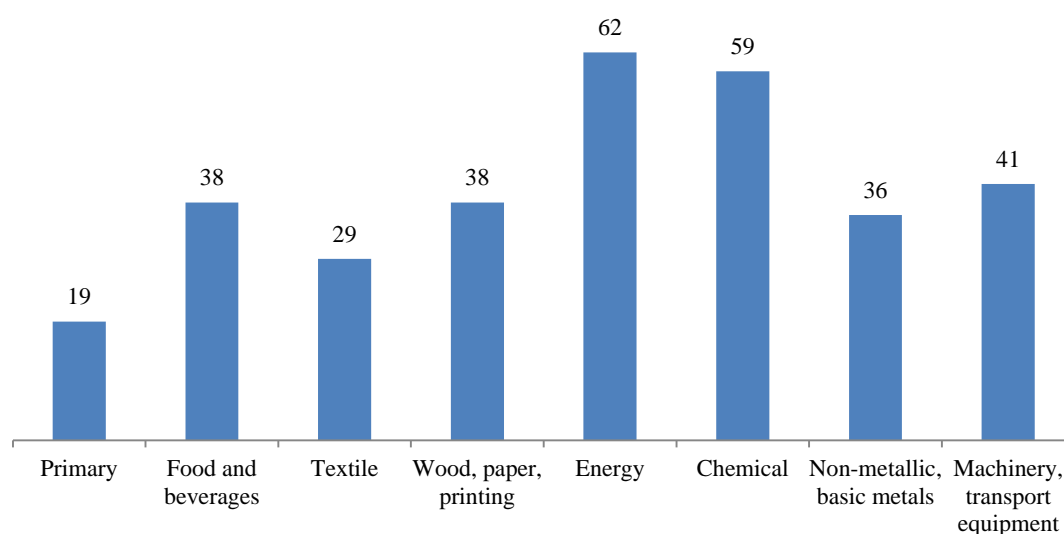
<sup>5</sup> UNCTAD, 2015, *World Investment Report 2015: Reforming International Investment Governance* (New York and Geneva, Sales No. E.15.II.D.5, United Nations publication).

<sup>6</sup> World Bank, 2016, *Migration and Remittances Factbook 2016* (Washington, D.C.).

proportion of migrant workers in services – 71 per cent. Migrant workers accounted for 150 million of the 232 million migrants in 2013.<sup>7</sup>

13. Furthermore, services are intrinsically embedded in goods exports. In 2011, services value added accounted for 59 per cent of the gross value of merchandise exports in developed economies and 43 per cent in others, much above the shares of services in the total exports of goods and services for both developed and developing economies. The value of services embedded in goods tends to be higher in sectors such as energy, chemicals, machinery and transport equipment (figure 5).

Figure 5  
**Value added of services embedded in exports by sector**  
(Percentage)



*Source:* L Cernat, JM Rueda-Cantuche and N Sousa, presentation entitled “How important are mode 5 services for export-related jobs in Europe?” Council on Economic Policies, Geneva, Switzerland, November 2015.

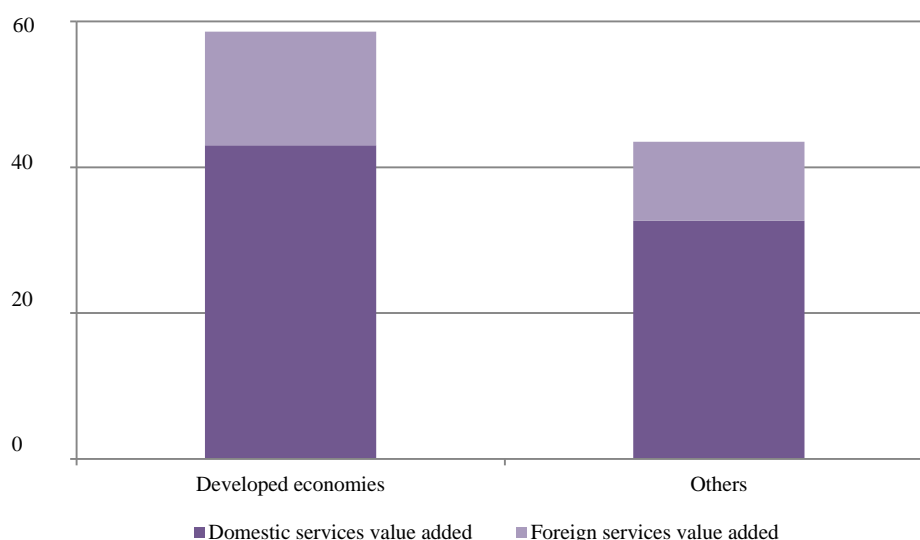
*Note:* “Primary” refers to agricultural raw materials, hunting, forestry, fishing, mining and quarrying.

14. The sizeable shares of foreign services value added in gross exports – 16 per cent in developed economies and 11 per cent in others – confirm the increased tradability of services and their enabling role for participation in global value chains (figure 6). The international fragmentation of production requires efficient professional, business and infrastructure services, as well as research and development, product design and marketing services. The services sector, including infrastructure services, is therefore an important option for export diversification.

<sup>7</sup> ILO, 2015, *ILO Global Estimates on Migrant Workers: Results and Methodology* (Geneva).



Figure 6  
**Domestic and foreign services value added share of gross exports, 2011**  
 (Percentage)



Source: UNCTAD calculations based on data from the Trade in Value Added database, Organization for Economic Cooperation and Development (OECD).

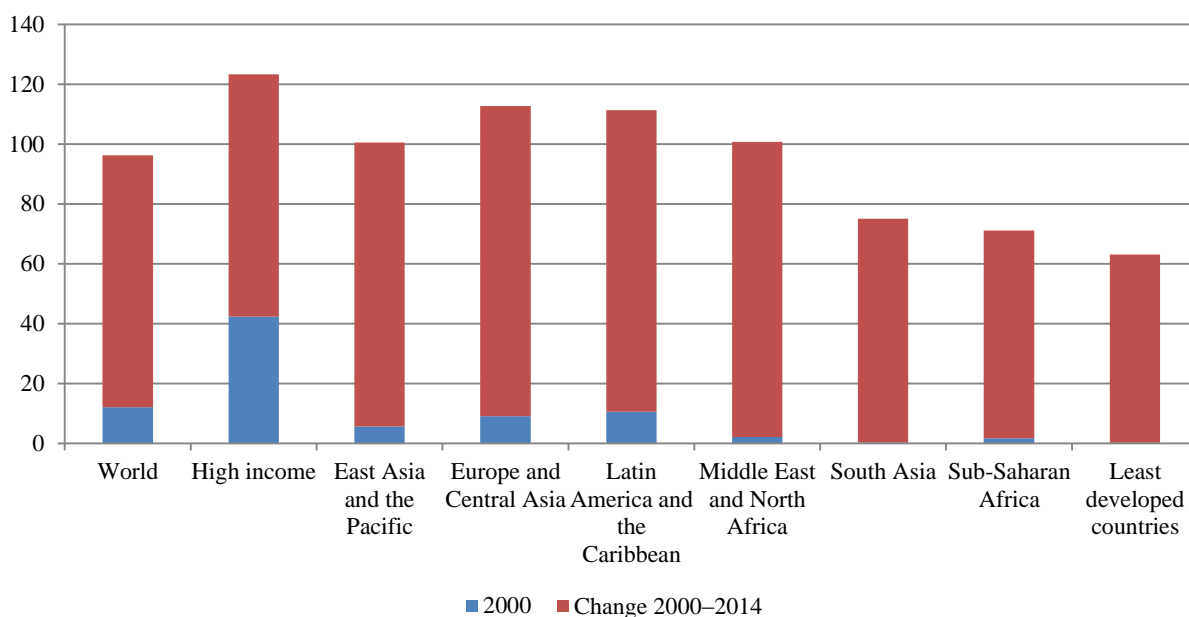
#### D. Telecommunications, computer and information services

15. The dynamism of telecommunications, computer and information services in developing economies is important, as these services enable modern economic and social activities, contributing to increased productivity and competitiveness. A 10 per cent increase in Internet use in an exporting country increases the number of products traded between two countries by 0.4 per cent and the average bilateral trade value per product, by 0.6 per cent.<sup>8</sup> These services, mentioned in the Sustainable Development Goals, can help achieve the 2030 Agenda for Sustainable Development.

16. The digital divide among developed and developing countries has narrowed somewhat, as revealed by the number of mobile cellular subscriptions per 100 people. The difference in these subscriptions between high-income countries and the world average was 30 in 2000 and 27 in 2014. This also confirms that progress remains insufficient. Four developing regions have higher penetration than the world average, whereas South Asia, sub-Saharan Africa and LDCs still have a lower-than-average number of subscriptions, despite robust uptake between 2000 and 2014 (figure 7). Moreover, other indicators, such as the number of Internet users and broadband subscriptions, confirm that developing countries are still lagging behind.

<sup>8</sup> World Bank, 2016, *World Development Report 2016: Digital Dividends* (Washington, D.C.).

Figure 7  
**Mobile cellular subscriptions by region and income level, 2000 and 2014**  
 (Per 100 people)



Source: UNCTAD calculations based on the World Bank World Development Indicators.

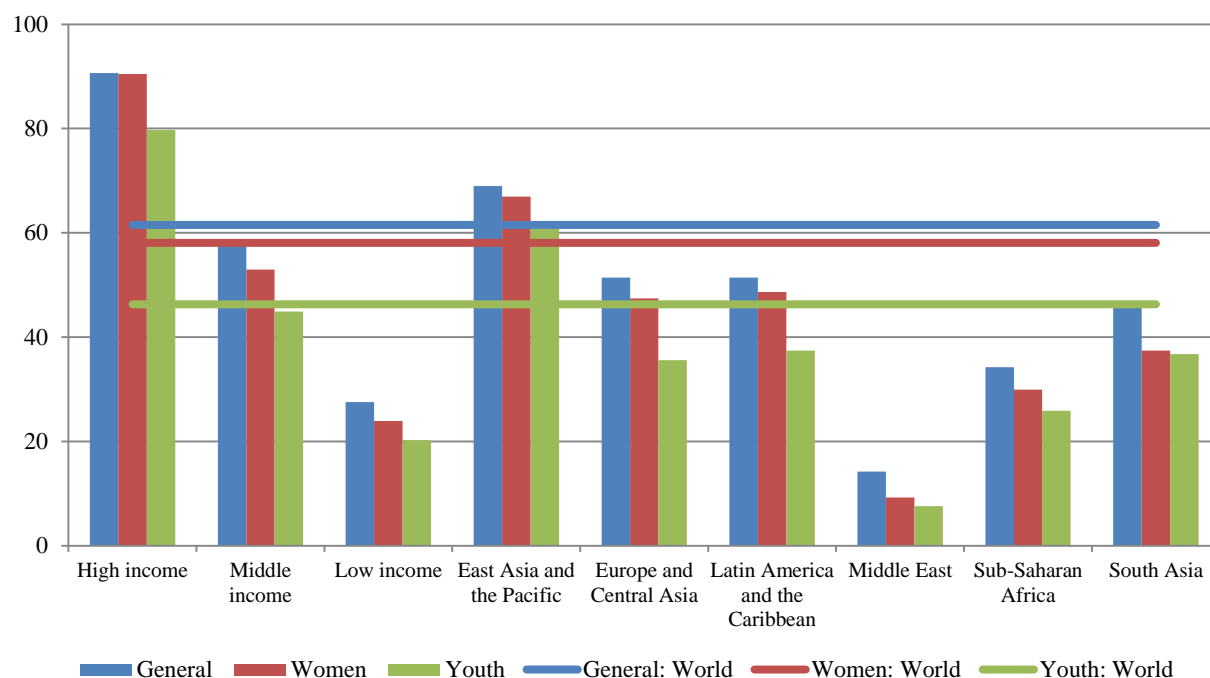
Note: Based on World Bank classification; high-income economies are those in which 2014 gross national income per capita was \$12,736 or more.

17. The importance of financial services is manifold, providing valuable inputs for the economy at large, facilitating domestic and international transactions, mobilizing and channelling savings, and allowing for the provision of credit for productive investment in the real economy. Access to financial services is a key element in the implementation of the 2030 Agenda for Sustainable Development. Lack of access to financial services can be a major impediment to income opportunities of individuals, particularly the poor, women and youth, rural populations, migrants and those in the informal economy, as well as for firms, particularly micro, small and medium enterprises.<sup>9</sup> In 2014, 62 per cent of people over 15 years of age had a bank account. Women (58 per cent) and youth (46 per cent) are worse off (figure 8). Although this is a great improvement over 2011, it is necessary to go much further. Digital financial services, including mobile money schemes, reduce physical and economic barriers of access, and contributed to improved access between 2011 and 2014.

18. Cross-border exports of financial and insurance services reached \$548 billion in 2014. Developing economies account for only 16 per cent of these exports. Yet financial and insurance services exports have been growing faster in developing economies than in developed economies. Developing Asia was responsible for 87 per cent of developing economies' exports of financial and insurance services in 2014. The 10 largest developing exporters make up for 89 per cent of the same exports. Except for Mexico and Brazil, these leading exporters are all from Asia.

<sup>9</sup> TD/B/C.I/EM.6/2.

Figure 8  
**People with a bank account by region and income level, 2014**  
 (Percentage)



Source: UNCTAD calculations based on data from the World Bank Global Findex database.

Note: Based on World Bank classification. High-income economies are those in which 2014 gross national income per capita was \$12,736 or more; middle-income economies, between \$1,046 and \$12,735; and low-income economies, \$1,045 or less. "General" includes people over 15 years of age and "youth", those between 15 and 24.

## II. Trends in services policies and regulations

### A. Overview

19. The quality of policies, regulations and institutional frameworks is a key determinant of services performance. Market failures arising from externalities, information asymmetries and monopolistic market structure characteristic of certain infrastructure services justify economic regulation. Unbundling of vertically integrated network industries and the privatization of many State-owned monopolies that provided essential infrastructure have introduced competition, transforming the role of the States from that of provider to regulator. Governments pursue multiple public policy objectives through regulation. They exercise regulatory power by setting conditions for market access and entry, including through licensing and qualifications. They set prices at a level that is fair and reasonable, both for providers and consumers. They determine the condition of enterprise ownership, and thus the level of private participation and competition. They also control the quality and operation of services, address anticompetitive behaviour of dominant firms and secure universal access, including through universal services obligations.

20. Trade-offs among the four regulatory objectives listed below and the need to strike a coherent balance among them are at the heart of the problem of economic regulations:

- (a) Sustainability in generating sufficient revenues to cover costs;
- (b) Allocative efficiency in ensuring that production costs send the appropriate signals for consumption and investment;
- (c) Productive efficiency to provide incentives for firms to minimize production costs;
- (d) Equity in ensuring universal access to essential services.

21. The way Governments exercise such regulatory power has evolved over time and differs across sectors. Further, regulators face the challenge of constantly adapting regulatory instruments and approaches to evolving market conditions and public policy needs. These regulatory measures have also come under closer scrutiny in terms of their trade and investment effect under trade liberalization processes.

## **B. Telecommunications services**

22. The telecommunications sector is a good example of multiple regulatory needs being addressed in a context of exponential technological change, proliferation of new business models and evolving market structure. It has witnessed a growing broadband-centric environment, a movement from distinct infrastructure platforms to a cloud ecosystem and the phenomenon of big data from the increased ability to gather and store data. The sector also has an increasingly important international dimension, tradability and high foreign investment activity. This complex environment has led to fourth-generation regulation, where regulators have a broader scope, overseeing the digital ecosystem formed by an increased range of converged information and communications technology (ICT) and telecommunications services, delivered over multiple networks and channels. Growth in these services was faster where the latest technologies and innovations were leveraged by a consistent, forward-looking and well-enforced fourth-generation regulatory framework.<sup>10</sup>

23. In fixed segments, network expansion has been supported by ex-ante regulations, mandates and requirements, including on unbundling of the local loop, publishing a reference interconnection offer, setting minimum quality-of-service norms and promoting technology neutrality, interoperability and non-discrimination. In mobile segments, which have evolved from premium services to near-utility perception, ex-post regulation reliant on competition laws and regulations and on market approaches with lower barriers to entry are often found. New licences have been granted, and the scope of existing licences has been increased. Single-service individual licences are not as common as before, sometimes giving way to technology neutral licensing and global authorization regimes.

24. Market expansion and the rapid growth of broadband mobile technologies, such as fourth- and fifth-generation and long-term evolution applications, services and providers, have increased the demand for mobile data traffic and spectrum bandwidth. This has made spectrum management a key regulatory issue, which may have an impact on competition, cost and roll-out speed. New models of spectrum regulation focus on the evaluation of alternative uses of spectrum along the frequency, time and geographic dimensions, re-use, re-farming, and a renewed scrutiny of the efficiency of current spectrum use. An important part of implementing a spectrum plan is ensuring that licensing can take place in a timely

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<sup>10</sup> International Telecommunication Union, 2015, *Trends in Telecommunication Reform: Getting Ready for the Digital Economy* (Geneva); TD/B/C.I/MEM.4/8.

way, while ensuring that frequencies are put to their most efficient and highest-valued use over the longer term.

25. Universal access remains a major regulatory concern. Public policies and regulations endeavour to encourage operators to render their services available, affordable and convenient to the population. This may comprise financial incentives or other funding mechanisms for infrastructure development and service uptake, provision of grants on a competitive basis and licence-based obligations. Encouraging innovation and infrastructure sharing can also be in line with expanding access to networks and services. Increasing demand for telecommunications services, for example by extending digital literacy among the population, can also provide incentives for operators to expand coverage.

26. Competition is a central part of promoting availability, affordability, convenience and quality of telecommunications services. A pro-competitive environment includes, for instance, more open market entry and facilitated licensing measures, encouraging or mandating obligations related to sharing access, promoting number portability, enabling band migration, allowing or mandating infrastructure sharing, addressing high mobile termination rates and securing net neutrality – the principle that all electronic communications passing through a network should be treated equally. Owing to the convergence of services, increased Internet usage, the Internet of things and the prevalence of business models driven by advertising and the collection of user data, consumer protection is more important today than ever before. New concerns revolve around cybersecurity and data protection.<sup>11</sup> Many countries are adopting regulations specifically designed for ICT customers that are to be enforced by the ICT sector regulator or a designated consumer protection agency.

### C. Financial services

27. The need to reduce the probability of future crises – and mitigate their costs, should they occur – has required a shift of the regulatory focus of the entire financial system towards macroprudential objectives. This shift aims to internalize negative externalities created by individual financial institutions, address systemic risks and ensure comprehensive coverage. New national regulatory frameworks try to adopt bank capital and liquidity standards, for instance under Basel III, to improve the ability of banks to cover losses. According to the Basel Committee, the implementation of capital and liquidity requirements has generally been timely and consistent with the agreed Basel standard. Non-Basel Committee jurisdictions have made progress in adopting Basel III standards.<sup>12</sup> Several markets have begun to impose requirements that are more stringent than those set out in Basel III, including setting minimum leverage ratios at above 3 per cent and pursuing stricter liquidity standards.

28. Universal access to financial services remains a key regulatory agenda for developing countries. Innovative business models are deployed to address financial inclusion barriers. State-owned, cooperative, development and community banks have proved to be particularly amenable in extending access to finance to a broader range of untapped population. New payment technologies and the use of banking correspondents enable the combined use of banking, postal and retail networks to expand coverage and reduce costs in the provision of financial services. Technology also allows for new payment systems, including mobile money schemes that capitalize on mobile telephony uptake to offer a variety of financial services with lower infrastructural costs. The regulation of

<sup>11</sup> See, for example, TD/B/C.II/EM.5/2.

<sup>12</sup> Bank for International Settlements, 2015, *Implementation of Basel Standards*. Several developing countries such as Brazil, China and India, are members of the Basel Committee.

digital financial services has focused on promoting network interoperability, enabling innovation, licensing to ensure a level playing field and addressing information security risks.

29. The financial inclusion strategy in Kenya, for instance, focuses on mobile phone financial services, microfinance banks, agent banking and the improvement of support services.<sup>13</sup> Digital financial services contribute substantially to financial inclusion, with mobile phone payment platforms integrating with financial institutions to provide financial services such as transfers, payments, savings and credit. The Safaricom mobile money system, M-Pesa, is an example of how regulations need to be coherent across different regulatory objectives, in this case universal access and competition goals. Regulators allowed Safaricom to maintain a dominant position for seven years through exclusivity agreements that took into consideration the high costs incurred in developing the system. This allowed for quick growth and economies of scale. In 2014, the competition authority opened the system to competition, reducing transaction costs from \$4.91 to \$0.43. Given Kenya's close economic ties with its neighbouring countries, regional regulatory cooperation is considered necessary in detecting cross-border and cross-sector risks to preempt financial crises.

30. According to the International Telecommunication Union Focus Group on Digital Financial Services,<sup>14</sup> financial inclusion has benefited from digital financial services. Of the 2 billion unbanked people, some 1.6 billion have a mobile phone in the household, enabling the development of mobile money services. In sub-Saharan Africa, 81 per cent of the market is covered by such services.<sup>15</sup> The Focus Group also underlined the importance of coherence and collaboration between telecommunications and financial services regulators.

### III. Domestic regulations and trade liberalization on services

#### A. Overview

31. Trade liberalization under regional and multilateral trade agreements increasingly covers infrastructure services. Regulatory reform and competition are the forces behind recent liberalization in this sector. Trade liberalization in services essentially addresses regulatory measures, because whether, to what extent and how to allow international competition in domestic markets is essentially a regulatory decision. Trade liberalization processes therefore intrinsically influence the design and functioning of domestic regulatory and institutional frameworks, and hence the ability of Governments to regulate. The key challenge is to ensure adequate content, pace and sequencing of liberalization-cum-regulatory processes, so that effective regulatory and institutional frameworks, and domestic capacity be built before privatization and liberalization, while retaining the possibility to adapt to new challenges, including those stemming from liberalized markets.

32. Progressive liberalization of services has been pursued at the multilateral level under the Doha Round of the World Trade Organization (WTO). Services negotiations were not

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<sup>13</sup> UNCTAD, 2015, Access to financial services as a driver for the post-2015 development agenda, Policy Brief No. 35 and *Economic Development in Africa Report 2015: Unlocking the Potential of Africa's Services Trade for Growth and Development* (New York and Geneva, Sales No. E.15.II.D.2, United Nations publication).

<sup>14</sup> The Focus Group, to which UNCTAD belongs, is a multi-stakeholder platform on financial inclusion and digital finance.

<sup>15</sup> GSMA, 2014, *2014 State of the Industry: Mobile Financial Services for the Unbanked*, available at [http://www.gsma.com/mobilefordevelopment/wp-content/uploads/2015/03/SOTIR\\_2014.pdf](http://www.gsma.com/mobilefordevelopment/wp-content/uploads/2015/03/SOTIR_2014.pdf).

given priority attention, although services were a built-in agenda item mandated by the Uruguay Round. The tenth WTO Ministerial Conference, held in Nairobi in December 2015, resulted in six ministerial decisions. One dealt with preferential treatment of LDC services under an LDC services waiver that extended the waiver and services preferences an additional four years to 31 December 2030. The prospects of the Doha Round services negotiations became uncertain, as the Nairobi Ministerial Declaration recognized that “[M]embers have different views on how to address the negotiations.” Since then, plurilateral and regional initiatives have abounded. Twenty-three WTO members, representing 70 per cent of global services trade, have been engaged in negotiations for the plurilateral Trade in Services Agreement since 2012.<sup>16</sup> The agreement is intended to promote the multilateralization and participation of new members.

33. Services are a major feature of new-generation RTAs that are oriented towards deeper and comprehensive integration with a strong regulatory focus, addressing behind-the-border regulatory measures affecting services, investment and competition. As of 1 February 2016, 625 such agreements were notified to WTO; of these, 419 are in force and 153 consist of services agreements. While only six services RTAs had been notified to WTO before 2000, over 130 additional agreements have been notified since then. Particularly notable is the emergence of two mega RTAs – the recently concluded Trans-Pacific Partnership Agreement and the Transatlantic Trade and Investment Partnership. Apart from creating large markets and inducing deep market opening, these agreements would introduce disciplines to induce regulatory coherence and reduce divergence in national regulatory standards. Developing countries have also embarked on regional services liberalization in the context of RTAs. The Association of Southeast Asian Nations is setting up its own economic community, providing the free movement of skilled labour, goods, services and investment. African countries have launched negotiations on a number of issues, including services, to establish a pan-African continental free trade area by 2017.

## **B. Regulatory barriers, divergence and convergence**

34. The interface between trade agreements and the right of States to regulate is a matter of long debate. In the services sectors, regulators typically develop regulation for legitimate public policy purposes. While regulation may act as a de jure or de facto barrier to trade, trade liberalization and commitments addressing the design of national regulatory frameworks could affect national regulatory autonomy. This issue is likely to become even more important as regulation increasingly takes centre stage, given that products today are more integrated with value added services and connected to each other. The nature of these products, which are connected to the Internet or cloud and embody a variety of value added services that involve cross-border data flows, requires new regulation to address security, privacy, intellectual property, consumer protection and industrial policy concerns. These policies, which limit or raise the cost of digital trade and data flows, are rapidly becoming more important.<sup>17</sup>

35. A series of regulatory measures applied to services can potentially have trade restrictive effects from an exporter’s perspective, even though regulators may not have trade restrictive or discriminatory objectives. Research suggests that public ownership and price controls are less trade restrictive than discriminatory measures related to ownership

<sup>16</sup> Australia, Canada, Chile, Colombia, Costa Rica, the European Union, Hong Kong (China), Iceland, Israel, Japan, the Republic of Korea, Liechtenstein, Mauritius, Mexico, New Zealand, Norway, Pakistan, Panama, Peru, Switzerland, Taiwan Province of China, Turkey and the United States.

<sup>17</sup> B Hoekman and P Mavroidis, 2015, *Regulatory Spillovers and the Trading System: From Coherence to Cooperation* (Geneva, International Centre for Trade and Sustainable Development and World Economic Forum).

limits, nationality and residency requirement for board members, barriers to competition and transparency in licensing regimes.<sup>18</sup> That the authority of the regulator is limited to the national territory may contribute to the development of trade-restrictive regulation, as the regulator does not have the capacity to interfere in another jurisdiction and could hence have preference on domestic suppliers. Moreover, since in many services sectors, for example professional services, regulation is developed by several authorities and/or services associations, some of these players could have a preference for domestic suppliers. This is supported by studies on market-entry licensing, which show that while licensing criteria are usually made public, licences tend to be delivered in a discretionary manner.<sup>19</sup>

36. Obstacles to international trade in services can also stem from diversity in national regulatory systems. Service providers supplying several markets bear the costs of adjusting to different regulatory requirements. In such a case, the emphasis of trade agreements is not on eliminating regulations per se, but on the management of regulatory diversity. Where regulatory divergence stems mainly from pursuing similar objectives through different regulations, countries have engaged in regulatory cooperation such as regulatory harmonization, mutual recognition or equivalence. Regulatory cooperation is more feasible among countries with similar levels of development and regulatory preferences. RTAs typically seek to reduce regulatory discretion by requiring that such measures not be more trade restrictive than necessary. When regulatory divergence results from fundamental differences in objectives and approaches, cooperation may not be feasible.

### **C. Domestic regulation rule-making**

37. Barriers to services trade are not tariffs, but domestic regulations. The General Agreement on Trade in Services (GATS) recognizes the right of Governments to regulate in numerous parts of the Agreement, including the preamble and article XIX (progressive liberalization). They both stress the need of developing countries to exercise this right. However, while seeking to ensure that licensing, qualification and other requirements do not burden foreign providers excessively or that monopolies do not abuse their position to impede entry and competition, GATS does not impose many constraints on domestic regulation beyond non-discrimination and transparency obligations. For example, article VI.1 states that in sectors where WTO Members have made commitments, all measures be administered in a “reasonable, objective and impartial manner”. Also, according to the prudential carve-out of the Financial Services Annex, WTO Members shall not be prevented from taking measures for prudential reasons, but prudential measures violating the Agreement shall not be used to avoid Member States’ commitments or obligations under the Agreement. The Telecommunications Services Reference Paper affirms that Members have the “right to define the kind of universal service obligation it wishes to maintain,” but requires that universal services obligations be administered in a “transparent, non-discriminatory and competitively neutral manner” and not be “more burdensome than necessary...”, a condition which in practice may hamper countries’ ability to use this right.

38. GATS also seeks to guarantee a balance between key policy objectives and trade liberalization commitments through the general and security exceptions clauses of articles XIV and XIV bis, which cover measures necessary to protect public morals or to maintain public order and those necessary to protect human, animal or plant life or health.

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<sup>18</sup> <http://www.oecd.org/trade/services-trade/43080529.pdf>.

<sup>19</sup> A Mattoo, 2015, *Services Trade and Regulatory Cooperation* (Geneva, International Centre for Trade and Sustainable Development and World Economic Forum).



39. WTO Members are engaged in negotiations to develop multilateral disciplines on domestic regulations on licensing, qualification and technical standards, so that these instruments do not act as unjustifiable trade barriers.<sup>20</sup> A major aspect of the proposed disciplines is the necessity test, a requirement that such measures should not be discriminatory or more trade restrictive than necessary. There is concern that this could limit regulators' ability to formulate and modify regulations to address legitimate public policy objectives. For instance, the imposition of user fees on services suppliers to finance universal access might fall afoul of this test. Research suggests that the proposed requirement that domestic regulations such as licensing requirements be "pre-established" might imply that a regulatory change that upsets foreign services suppliers' "reliance on existing law" could be found incompatible with the GATS' requirement to maintain a "stable and predictable" framework.<sup>21</sup> The Trade in Services Agreement also seeks to enhance disciplines in this area. The draft article on transparency and draft annex on domestic regulation are of particular relevance to the interface between trade agreements and regulation. The draft article on transparency reportedly addresses the publishing of measures, the opportunity to comment and the requirement for Governments to communicate the rationale for a measure adopted. The draft annex on domestic regulation covers the scope similar to the WTO draft disciplines on domestic regulations.

40. The new generation RTAs and mega-RTAs have emphasized achieving regulatory coherence among the parties. With respect to domestic regulation, the Trans-Pacific Partnership Agreement, similar to the draft text of the Trade in Services Agreement, maintains the principle upheld in the GATS preamble of the right of Members to regulate, and to introduce new regulations, on the supply of services. However, the Trans-Pacific Partnership Agreement goes beyond GATS in a number of respects and imposes additional obligations relating to the following factors:

- (a) Time frame for application processing;
- (b) Provision of information to a rejected applicant;
- (c) Applicant's possibility to correct minor errors in the application;
- (d) Acceptance of authenticated copies of documents in place of original documents;
- (e) Imposition of authorization fees that are reasonable and transparent;
- (f) Granting a reasonable period of time for the submission of an application;
- (g) Assurances that there are domestic procedures in place to assess the competency of professionals of another party.<sup>22</sup>

41. The particular relevance of national regulatory regimes for market access and entry conditions has increased the attention of trade negotiations on certain infrastructure services, particularly telecommunications and financial services. RTA regulatory disciplines with regard to telecommunications services are often based on the GATS reference paper on basic telecommunications, providing commitments on non-discriminatory access to basic telecommunications networks and communication platforms for value added services. These disciplines may extend the Reference Paper to add new definitions and disciplines. As regards financial services, RTAs tend to deepen regulatory

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<sup>20</sup> M Mashayekhi and E Tuerk, 2008, GATS negotiations on domestic regulation: A developing country perspective (chapter 7), in K Alexander and M Andenas, eds., *The World Trade Organization and Trade in Services* (Leiden, Brill).

<sup>21</sup> TD/B/C.I/MEM.3/8.

<sup>22</sup> The full text of the Agreement is available at <https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpp-full-text>.

disciplines, often building upon the GATS Understanding on Commitments in Financial Services, and addresses such issues as prudential carve-out, standstill, new financial services and anticompetitive practices.

**Box 1. Regulatory disciplines on telecommunications and financial services under the Trans-Pacific Partnership Agreement**

In many dimensions, the Trans-Pacific Partnership Agreement goes further than GATS or other RTAs. As regards telecommunications services, the Agreement's wording on universal service acknowledges the right to define universal services obligations but instructs for these not to be more burdensome than necessary for the kind of universal service that it has defined. The Agreement stipulates that service suppliers of another party shall have access and use to public telecommunications services offered in its territory and must be afforded access to telephone numbers on a non-discriminatory basis. Suppliers of public telecommunications services in the territory of a party have to provide an interconnection with suppliers of such services of another party and number portability. The Agreement includes provisions for major suppliers of public telecommunications services, covering issues such as competitive safeguards, resale of services, unbundling of network elements and interconnection. As regards financial services, the Agreement goes beyond GATS by eliminating, inter alia, nationality or residence requirements for senior management of financial institutions. Similarly to GATS, the Agreement does not prevent parties from taking measures for prudential reasons. Unlike GATS, however, it makes such prudential measures subject to its other provisions on national treatment and market access. For both sectors, parties are to publish in advance proposed regulations, allow for prior comments from interested persons and other Parties and address substantive comments. These obligations may require important efforts that can imply costly endeavours for some developing countries.

*Source:* UNCTAD.

42. International disciplining of national regulatory processes and frameworks under RTAs has prompted concern over the possible adverse effect on national regulatory autonomy. For instance, the Trans-Pacific Partnership Agreement includes provisions on regulatory coherence, whereby each member will be required to have a mechanism to facilitate central coordination and review new "covered regulatory measures" so as to promote convergence towards good regulatory practice, including impact assessments of a regulatory measure. The investor-State dispute settlement mechanism has attracted much concern. While providing foreign investors with legal certainty, the mechanism might confer greater rights to foreign investors and lead to regulatory chill, as regulators might refrain from taking certain regulatory actions for fear of a legal challenge under investor-State dispute mechanisms, given that many disputes have dealt with services such as telecommunications or energy. Among the concerns expressed by WTO Members are the constraints potentially imposed on regulators, including those from developing countries with limited institutional, financial and human resources and capabilities.<sup>23</sup>

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<sup>23</sup> See <https://www.uschamber.com/sites/default/files/legacy/grc/TPPRegulatoryCoherenceWorkingGroupPaper.pdf>.

## **IV. Towards a coherent approach to trade and regulation of services**

### **A. Overview**

43. Devising a sound regulatory and institutional framework is as important as it is challenging. There is no one-size-fits-all solution, with priorities subject to many variables, including the level of development, productive capacities, interlinkages with other sectors, openness, and quality of infrastructure services. International trade adds layers of complexity to regulatory and institutional frameworks. The trade dimension requires Governments, in their pursuit of legitimate public policy objectives, to address regulatory measures that could have undue trade restrictive effects. This may represent a constraint on national regulatory autonomy. The concern is particularly acute for developing countries, given the asymmetries concerning the degree of development of their services regulations. A series of institutional limitations – in terms of regulatory capacity, accountability, political commitment and fiscal capabilities – often inhibit their ability to institute sound regulatory and institutional frameworks, thereby running the risk of their regulatory regime having inadvertent trade-distorting effects.

44. Such a close trade–regulation–development nexus highlights the importance of policy coherence, simultaneously addressing the trade dimension of services regulations, and the regulatory dimension of trade liberalization initiatives, so that adequate design, pacing and sequencing can be established between domestic reform and trade liberalization processes. While recognizing the potential risks that may arise from liberalization initiatives over national regulatory autonomy and capabilities, engagement in trade agreements can create an opportunity to induce positive regulatory reforms and capacity-building in the services sector. There is a case for striving towards a sound regulatory and institutional framework and smart and best-fit regulations so as to minimize their inadvertent trade-restrictive effect and introduce effective, efficient and equitable regulatory practices. While the elements of best-fit regulations differ across countries, some useful lessons could be learned from national experiences and international initiatives.

### **B. National and international experiences**

45. Australia pioneered in utilizing the best-practice regulation process as a tool to deliver regulation where it provides greatest benefits to the society.<sup>24</sup> This tool seeks to promote good policymaking and to guarantee the coherence between individual initiatives by various regulatory agencies and the Government's overall objective. For example, Australia's regulatory impact analysis requirements aim to ensure that public policy achieves a desired objective in a cost-effective manner and are based on the idea that regulation should be imposed only when it can be shown to offer an overall net benefit. In the United States, the President issued a series of executive orders laying out regulatory principles regulatory agencies should follow, and the Office of Information and Regulatory Affairs, part of the Office of Management and Budget, reviews agency regulations to ensure that they comply with the principles and that they do not conflict with regulations by other agencies.<sup>25</sup>

46. The Asia–Pacific Economic Cooperation (APEC) group on services developed a services cooperation framework of which the coherence in regulatory frameworks is

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<sup>24</sup> [www.dPMC.gov.au/office-best-practice-regulation](http://www.dPMC.gov.au/office-best-practice-regulation).

<sup>25</sup> [https://www.whitehouse.gov/sites/default/files/omb/inforeg/eo12866/eo13563\\_01182011.pdf](https://www.whitehouse.gov/sites/default/files/omb/inforeg/eo12866/eo13563_01182011.pdf).

highlighted as one of the main outcomes. A multiple forum and multi-stakeholder agenda will contribute to pursuing this objective.<sup>26</sup> Various regional regulatory institutions, such as the Eastern Caribbean Telecommunications Authority and the African Forum for Utility Regulators, have identified key principles of sound regulatory and institutional frameworks. The World Bank developed a toolkit for assessing regulation on services trade and investment that suggests a set of general principles of what may be considered sound regulation.<sup>27</sup> The OECD Council on Regulatory Policy and Governance issued a recommendation establishing principles for regulatory quality and reform, which include the promotion of regulatory coherence through coordination mechanisms between the supranational, national and subnational levels of Government.<sup>28</sup> UNCTAD services policy reviews serve as a toolkit to assist countries in assessing and devising an appropriate policy mix to improve services sector performance and provide regulatory mapping.<sup>29</sup>

### C. Towards best-fit regulations

47. From such national and international experiences, some common principles underpinning best-fit regulations could be distilled. Regulations must be adopted only upon a reasoned determination that there is a net benefit to the society, going beyond particular interest groups. They must be set to the minimum level necessary to achieve the objective and avoid unnecessary restrictions, consistent with obtaining regulatory objectives and in line with the level of development of the country concerned. Regulations should also be integrated and consistent with others policies, laws and international obligations. They should be performance-based and not unduly prescriptive; they should be accessible, transparent and accountable; clear, stable and concise, and communicated effectively. They should be enforceable, mindful of the compliance burden imposed, and should be the embodiment of minimum incentives needed for reasonable compliance.

48. Policymakers and regulators also have a role to play. They need to select regulatory approaches that maximize net benefits. They should identify and assess available alternative to direct regulations, including economic incentives. They need to consult in a genuine and timely way with affected businesses, civil society organizations and individuals, including those at the subnational levels. They should consult with each other, including competition authorities, to avoid creating cumulative or overlapping regulatory burdens, and they should implement regulation with common sense, empathy and respect.

49. The establishment of regulatory and institutional frameworks and capabilities need to precede privatization and liberalization; public policy goals need to be factored in trade agreements, and all regulations need to be periodically reviewed to test its continuing relevance.

50. Efforts in promoting best-fit regulations start with ensuring an enabling institutional framework. The bodies participating in the regulatory process need to be independent from political influence and accountable.<sup>30</sup> Regulatory institutions should work towards national and subnational cooperation and promote coordinated approaches throughout the regulatory cycle: regulatory design, implementation and evaluation. Different mechanisms can be used, including a standing coordination mechanism that can promote multi-stakeholder

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<sup>26</sup> APEC Services Cooperation Framework (2015).

<sup>27</sup> World Bank, 2014, *Regulatory Assessment Toolkit: A Practical Methodology for Assessing Regulation on Trade and Investment in Services* (Washington, D.C.).

<sup>28</sup> OECD, 2012, *Recommendation of the Council on Regulatory Policy and Governance* (Paris).

<sup>29</sup> UNCTAD, 2014, *Services Policy Reviews: A Detailed Methodology for Reviewing Policy, Regulatory and Institutional Frameworks for Services* (New York and Geneva, United Nations publication).

<sup>30</sup> World Bank, 2006, *Handbook for Evaluating Infrastructure Regulatory Systems* (Washington, D.C.).

consultations.<sup>31</sup> Regulatory design is a major component of ensuring coherence. Policymakers can usefully consider drawing on elements of good practices as outlined above, and international standards, including those developed under International Organization for Standardization, while recognizing the costs this may represent to developing countries and the need to ensure their effective participation in standard-setting bodies.<sup>32</sup> Evaluation through regulatory impact assessments will enable continuous adaptation of the regulatory measures. Applying these principles requires a high-level political commitment as well as resources.

51. To ensure a coherent approach to services trade and regulations, effective and constant communication, information flows and consultative processes are essential between government entities in charge of sectoral services regulations and the trade ministry. For regulatory coherence in trade, information should be constantly communicated in two directions between the trade ministry and the regulatory agencies. In this approach, regulatory agencies inform the trade ministry of the status of existing regulations as they regulate to specific sectors, such as relevant legislation, regulations, policy objectives and any regulatory initiatives. The trade ministry would then be in a position to assess and formulate trade policy on services, including identifying trade-negotiating objectives, positions and strategy. The resulting services-related trade policy commitments and initiatives could be implemented through necessary regulatory measures that fall within the competence of each regulatory body. Both the trade ministry and regulatory bodies need to maintain a constant dialogue, allowing access to proposed new regulations or trade initiatives at an early stage of their preparations.

52. In the United States, for example, the Office of the United States Trade Representative maintains a well-established interagency structure to coordinate trade policy, resolve policy differences with federal regulators and develop and implement United States trade policy. The Office confers with federal agencies through the Trade Policy Review Group and the Trade Policy Staff Committee, which are the primary means at subcabinet level for directing United States positions on international trade. Both groups have members from 19 federal agencies and offices, including departments and agencies in charge of commerce, energy, transportation, treasury, environmental protection and international development. The Committee has over 90 subcommittees covering specialized trade areas, including regional and functional issues, such as services, energy issues, basic telecommunications, international finance and investment. Additionally, the Office holds hearings and issues Federal Register notices through which the public may provide input. The private sector advisory system, set up by Congress, is designed to ensure that United States trade policy is in line with the country's business and economic interests.

53. In China, close policy coordination was utilized in determining its commitments in its accession to WTO in the banking sector. The People's Bank of China, the central bank, was responsible for banking regulations and defined China's accession commitments in close consultation with the Ministry of Commerce. To oversee the implementation of accession commitments, China established the China Banking Regulatory Commission in 2003 to strengthen banking regulation in line with international standards such as the Basel standards. In the Republic of Korea, an across-the-board coherent approach linking trade liberalization and regulatory frameworks has contributed to the enhanced competitiveness of its telecommunications sector. It established policies supporting ICT master plans and developed an enabling institutional framework with a ministry dedicated to ICT services, which closely coordinated with the trade ministry. The Government provided and

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<sup>31</sup> OECD, 2015, *Regulatory Policy Outlook 2015*, (Paris, OECD Publishing).

<sup>32</sup> National Centre for APEC, 2012, *Strategic Framework for Regulatory Coherence in APEC: An Impact Assessment for the Dairy, Electronics, and Off-Highway Vehicle Industries* (Seattle).

stimulated necessary investments, created an ICT information fund and developed public–private partnerships. The broadband Internet service market was opened without licensing and pricing controls. This relaxed approach has encouraged facility-based competition among service providers. Adaptation of the domestic regulations was ensured before and after major trade negotiations, including the free trade agreement between the Republic of Korea and the United States.

**Box 2. Lessons from UNCTAD services policy reviews**

Experiences of UNCTAD services policy reviews highlighted the importance of policy coherence and coordination; sound institutions and good governance; evidence-based policymaking; an enabling productive, technology and business environment and labour skills development. The horizontal and vertical coordination of sectoral policy initiatives is important in formulating a coherent overall national strategy for services sector development, consistent with other complementary policies, particularly trade policies, while taking into account the different economic attributes of individual services sectors. In Bangladesh where the Government sought to develop the ICT services sector to diversify its economy away from the garment industry, the review highlighted the importance of addressing persisting bottlenecks in a coherent fashion, such as foreign exchange regulations, obstacles to licensing, work permits and bandwidth prices. In Rwanda and Uganda, the reviews highlighted the need for better coordination of telecommunications and financial services regulation and broad universal services objectives in the case of mobile money initiatives.

*Source:* TD/B/C.I/MEM.4/8.

*Note:* See UNCTAD, 2013, *Services Policy Review: Nicaragua* ; UNCTAD, 2015, *Services Policy Review of Peru*; *Services Policy Review of Bangladesh* (forthcoming).

**D. Conclusion**

54. A pro-development approach to trade liberalization requires coherence between regulatory and trade agendas, and effective coordination between regulatory authorities, sectoral ministries and trade ministries. Regional and international coordination also plays a key role in ensuring such coherence. Lessons can be learned from practices and experiences in building coordination and coherence towards mutually supportive regulatory and trade strategies. This includes lessons from UNCTAD services policy reviews that have assisted countries in devising an appropriate policy mix and securing coherence to improve services sector regulation and performance, export diversification and structural transformation. Experts may wish to address some of the following issues:

- (a) How do policies, regulations and trade liberalization strategies affect services performance and their development role, including in attaining the Sustainable Development Goals?
- (b) What is the potential impact of regulatory frameworks on international trade?
- (c) How can trade strategies affect regulatory frameworks?
- (d) What are the specific constraints affecting developing countries in building effective coherence between regulation and trade liberalization?
- (e) What principles, institutional frameworks and coordination mechanisms can contribute to coherence between regulation and trade liberalization in order to address regulatory divergence, ensure the adequate adoption of international standards and limit constraints on regulatory options?