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BASED NEGOTIATION

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**ABSTRACT**

This paper argues that the pursuit of special and differential treatments (SDT) by developing countries has hampered the liberalization of global service trade, which is one of the causes of the only slowing improving of service efficiency globally. We use value added per worker as a proxy of production efficiency, and show the growth rate of service efficiency is much lower than agriculture and industry. Despite the progress in world commodity market integration in past half century, the world service market remains highly segmented, which can be seen clearly from the World Bank's STRD index and CHB index. We argue that the SDT negotiation contributes to the service market segment, and give three reasons on why it is difficult for developing countries to be granted SDT in service. In the last part we present some suggestions on trade negotiations in the future.

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# **Global Service Efficiency and the Search for Special and Differential Treatment**

## **1. Introduction**

The past three decades have witnessed a transition in the global economy from an industry to a service economy. In terms of value added at current prices and exchange rates, the service sector was already dominant in 1970, accounting for 52 percent of world production and 68 percent in 2005. The respective shares of agriculture were 10 percent in 1970 and 3.6 percent in 2005, and those of industry 38 and 29 percent (Memedovic, 2009). These proportions have been stable since 2005.

But global service efficiency does not improve much. As a report by the World Bank (2009) stated: “As incomes continue to rise, people’s needs become less “material” and they begin to demand more services—in health, education, entertainment, and many other areas. Meanwhile, labor productivity in services does not grow as fast as it does in agriculture and industry because most service jobs cannot be filled by machines. The lower mechanization of the service sector also explains why employment in the service sector continues to grow while employment in agriculture and industry declines because of technological progress that increases labor productivity and eliminates jobs.”

In this paper we argue that, in addition to the reasons mentioned by the World Bank, the segmentation of global service market contributes to the slow improving of service efficiency. Services may be more labor-intensive than agriculture and industry, but this does not mean that there are no economies of scale in services, and an integrated service market will increase the service efficiency, especially in core business services such as banking, insurance, transportation and telecommunications.

Why is the service market segmented? Traditionally, service products are classified as non-tradable goods and the market will be confined to local suppliers, for example in the case of hair-cutting, and also in retailing and government services. But this cannot explain most of modern services, such as the Call-Center industries in India. According to trade theory the difference between tradable and non-tradable lies in the trade cost, which mainly depends on technology. As science and technology advanced in the past decades, many services are now not only tradable, but also can be traded more quickly than goods, such as online banking services. There must be some institutional elements which impede the integration of world services.

In this paper we argue that the pursuing of special and differential treatment (SDT) by developing countries has hampered the liberalization of global service trade. As

the rounds of negotiations in the GATT made tariffs on goods very low, from the GATS and Doha Round in the WTO countries are busy on negotiations for service liberalization. The developing economies are eager to be granted SDT from developed countries, but this is far more complex than the SDT in goods trade in 1960s. The Doha Round has been an impasse and some members are resorting to regional agreements such as the TPP. There are substantial benefits in terms of per capita income for developing nations if they are included in the world service market.

## **2. Evaluation on Global Service Efficiency in Past Decades**

In economics, production efficiency implies that an economy is producing as much as possible without wasting precious resources. Theoretically, production efficiency will include all of the points along the production possibility frontier, but this is difficult to measure in practice. Data envelopment analysis (DEA) is a nonparametric method often used in productive efficiency, and there are also parametric approaches which can be used for the estimation of production frontiers. These frontier analysis methods may be more suitable for estimating efficiency in industry sectors, since there are more difficulties to applying them to service sector. Service products are not material and sometimes even difficult to specify, for example whether loans are output of banks or the input of them.

Although fixed assets can be critical inputs in several service sectors, such as transportation and telecommunications, most service sectors rely heavily on human capital rather than material capital, for example business services and professional services. The data availability on other inputs is another problem, because at the aggregate level of country or world service data, it can hardly give a clear definition on capital input in service. Therefore, many literatures on service efficiency use labour as the sole input in analyzing service efficiency. As Bjurek, Hjalmarsson and Forsund (1990) pointed out, in service sector capital in the form of office space and computer terminals is almost proportional to labour input. We will follow this tradition, and use the ratio of service value-added to employment in services as a proxy for service efficiency<sup>1</sup>.

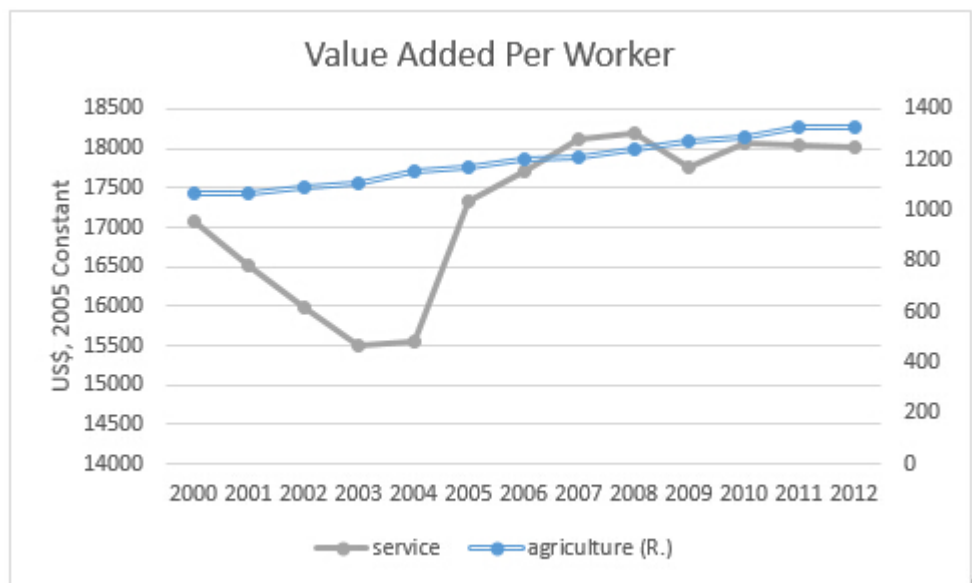


Figure 1: The Value-added per Worker in World Service and Agriculture

Source: Author computed based on WDI data.

<sup>1</sup> In theory it would be difficult to compute value-added in a service sector, for example the value-added of a bank. We omit this problem and take the service value-added data from the WDI database.

Figure 1 depicts the trend of efficiency (proxy by value-added per worker) in service and agriculture of the world. We can see that efficiency in world services is about ten times higher than agriculture efficiency, and also more fluctuated than it. Although absent detailed sector data, we can expect the efficiencies of different service sectors should be very diverse, higher in modern services and lower in traditional services. As to the growth rate of efficiency, service efficiency growth in an average annual rate of merely 0.44%, while that of agriculture growth more quickly, with average annual rate of 1.85%.

It is impossible to study the world service efficiency over a long time horizon, since there are no service employment data for the world before 2000. We then turn to country data to see how service efficiency changes relative to agriculture and industry efficiencies. We use China and South Korea, two most successful developing economies in the past decades. The data period is 1980-2010.

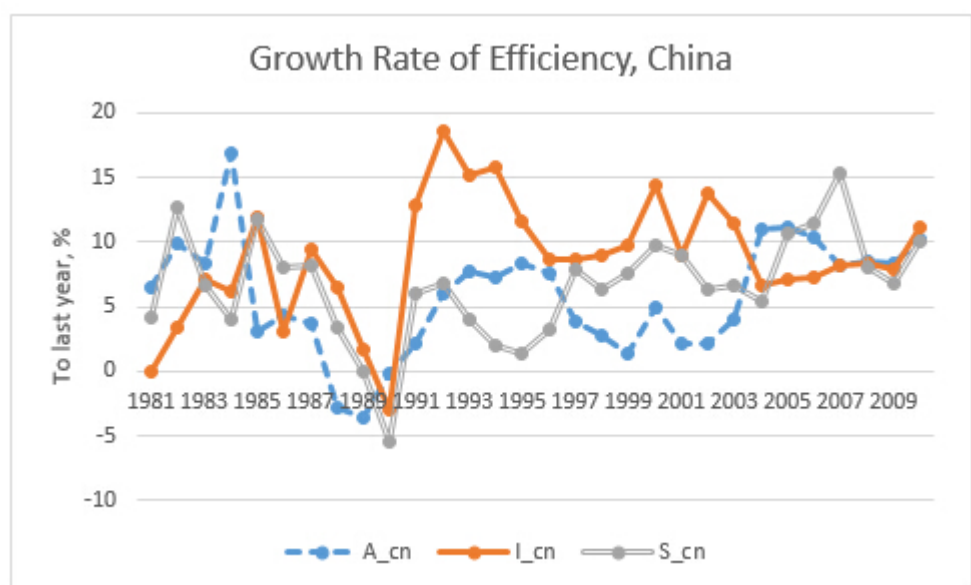


Figure 2: China's Growth Rate of Efficiency in Three Sectors

Source: Author computed based on WDI data.

Figure 2 is the annual growth rate in China's three sectors, agriculture, industry and services in three decades since its reform and opening up. We can see in the early 1980s, agriculture efficiency growth was higher than service, and service growth higher than industry. This may be due to the fact that industry is more capital intensive, and thus need more time to update its fixed capital to acquire higher efficiency. In contrasts agriculture and service are more labour intensive in China and the institutional change from central planning to market economy bring efficiency improvement more quickly. But since 1987 China's industry efficiency growth has been higher than that of service in most years, and agriculture efficiency growth at a similar speed as service. From 1980 to 2010, China's agriculture efficiency increased 429.7%, industry efficiency increased 1096%, and service efficiency increased 568.3%, with the average annual growth rate 5.7%, 8.6% and 6.5% respectively.



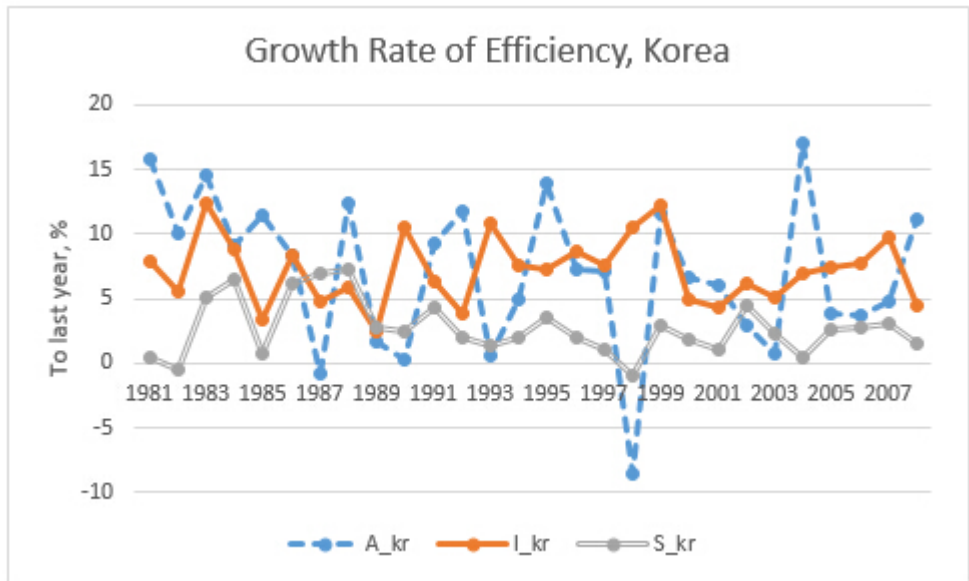


Figure 3: Korea’s Growth Rate of Efficiency in Three Sectors

Source: Author computed based on WDI data.

The lower growth rate in service efficiency is more significant in the case of South Korea, as Figure 3 shows. During the three decades the increase rate of service efficiency nearly never higher than industry efficiency. Korea’s agriculture efficiency, although more fluctuated than service, is also higher than it in most years. During this period, Korea’s agriculture efficiency increased 601.5%, industry efficiency increased 1040%, and service efficiency increased 99.9%, with the average annual growth rate 6.7%, 8.4% and 2.3% respectively.

It seems in the past decades service efficiency does not compete that of agriculture and industry in growth rate, especially in the economies enduring higher increasing. The developed economies might encounter such situation earlier. In a report by US Department of Commerce in 1996, it concluded that “Since the

1960s, most G-7 countries have experienced a gradual slowing in average output growth, coupled with steady expansion in the services share of economic activity and, especially in the United States, a sharp decline in service-industry productivity growth.<sup>1</sup> Table 1 is taken from this report.

Table 1: Service Sector Productivity Growth Rates

(Output per employee)

	Canada	Germany	France	Italy	UK	Japan	USA
1971-80	1.5	2.6	2.6	0.6	1.7	2.3	0.2
1981-90	1.0	2.0	1.9	1.4	0.8	1.9	0.1

Source: U.S. Department of Commerce (1996)

This cast some shades on the prospect of world economy, of which service sector comprise two thirds in output and one half in employment. If service efficiency is doomed to be lower to growth, this would become another kind of Limits to Growth, not by environment and resource. Why is it?

### 3. Service Efficiency and Market Segmentation

- a) Literature on low service efficiency

<sup>1</sup> U.S. Department of Commerce, Service Industries and Economic Performance, 1996.

Economists have attributed the sluggishness of service sector productivity growth to a range of influences, for example workers' skill levels, capital-labor ratios, unproductive IT investments, sub-optimal scale, and government policies. Here we discuss several elements before we present our own explanation.

Some blame that as an accounting category, "the service sector" may be an impediment to understanding, and the service economy is at least two economies, one characterized by high rates and the second by low rates of (measured) productivity growth. High-productivity-growth service industries including transportation, communication and business services, which are exploited more from advances in information technology. Service industries with consistently slow productivity growth tend to be very labour intensive, for example health services. Mukherjee (2013) classified service sector into three groups based on their productivity growth: traditional services such as retail and wholesale trade; hybrid of traditional and modern services, for example education; and modern services (financial, computer services, etc.). If take all the service industries together, the efficiency growth tends to be lower.

Another stream of thought is under-estimation of service productivity growth due to measurement biases, which mainly include three areas. The first component of measurement bias relates to the choice of inputs. The actual hours worked per employee in service sector usually more dispersed than in industry sector, for

example a barber may not have many consumers in a small community. The second measurement component relates to the choice of outputs. In some service industries there is not even a well-acceptable definition of output, e.g. financial services, and the quality changes of service are difficult to isolate from price changes. The third component of potential measurement bias relates to the estimation of aggregate productivity growth, e.g. the role of specific services as intermediate inputs for other industries<sup>1</sup>.

Although the above explanations for the slow growth of service efficiency are illuminating, in this paper we emphasize the effect of market structure. The basic rationale of international trade is that market integration can bring each country concentrated on the sectors it has most advantages, and thus improve the efficiency and welfare of the whole world. From Adam Smith's famous example of pin-making in England in 18<sup>th</sup> century, there have been volumes of theory and empirical literature on this field. It is the underlying philosophy of the World Trade Organization, as well as the GATT that preceded it, that open markets, transparency and nondiscriminatory trade policies are conducive to the national welfare of all countries.

Despite the progress in world commodity market integration in past half century, the world service market remains highly segmented. We will first make an

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<sup>1</sup> Maroto-Sanchez (2010)

evaluation of world service segment, and then discuss how such market segment contributes to the low efficiency growth rate in service sector.

b) How the world service market is segmented?

We first use aggregate data to show there is a kind of “home bias” in service sector. If world service market were as integrated as world commodity market, we should expect the share of service trade in total trade equals the share of service value-added in GDP, and thus the ratio of them should be near one. The smaller this ratio is, the less service trade relative to service value-added, and thus the more home bias. Table 2 reports the service trade relative share thus computed of seven main economies, two country groups and the world as a total.

Table 2: Service Trade Relative Ratio in Selected Economies

	(%)				
	2005	2007	2009	2011	2013
China	29.3	29.5	31.0	26.1	28.0
France	32.0	32.1	35.3	33.7	37.3
Germany	26.2	25.1	27.3	25.0	27.2
India	54.3	53.5	51.2	53.8	54.0
Japan	27.4	26.9	30.2	23.7	24.4
LDC	44.7	45.5	48.5	49.2	44.0
OECD	30.5	31.6	34.3	30.3	31.4
UK	40.6	42.5	43.8	38.4	40.2
US	26.4	27.7	32.0	28.4	29.3
World	30.0	30.9	32.8	28.6	29.6

Notes: Computed as the ratio of service trade to total trade of a given economy, as a percent of the ratio of the ratio of service value-added to GDP.

LDC is the least developed countries as UN classification; OECD represent all OECD members.

Source: Authors' Computation based on the data from World Bank's WDI database.

In Table 2 we can see the world average ratio is about 30%, which means the share of service trade in total trade is only one third of service's share in GDP. As to the seven main economies selected, the ratio of US is very close to the world average as well as the ratio of OECD countries. The ratio of India, UK and France are higher than world average, and the ratio of Japan, Germany and China are lower than it. This supports the argument that manufacturing countries (China, Germany and Japan) are relative lower in service trade ratio, while service countries (UK, India) have higher service trade ratio. The abnormally high ratio of LDC countries in service is due to their low share of service sector in GDP, rather than a higher share of service trade. Although the ratio less than one is understandable considering some service industries are really "untradeable", e.g. construction, it is still strange that there is not even a slight trend of increasing of this ratio in the decade. In fact, the world ratio is slightly lower in 2013 as compare to that of 2005.

Table 2 provides an indirect evidence that world service market is segmented as compared to the commodity market. A direct method to prove it is study the restriction on service trade, as done by the development economics research group of the World Bank. They collected information on applied services trade policies across 103 countries, 18 service sectors (covering telecommunications, finance,

transportation, retail and professional services) and three modes of delivery (cross-border, commercial presence, presence of natural persons) to set a database on services trade restrictions (STRD).

Table 3: Service Trade Restriction Index, Selected Economies (2008-2011)

Country	Overall	Financial	Telecom.	Retail	Transportation.	Professional
China	36.6	34.8	50	25	19.3	66
France	26.4	1.3	12.5	25	43.9	46
Germany	17.5	1.3	0	0	24.4	59
India	65.7	48.1	50	75	62.4	87.5
Japan	23.4	1.9	25	25	15.6	56
UK	14.3	0.6	0	0	23.1	45
US	17.7	21.4	0	0	7.9	54
EU-20	26.1	4.2	0	25	37.1	54
Ethiopia	88.2	89.7	100	100	72.9	84
Ghana	18.4	24.6	25	0	5.8	44

Notes: this index use a 5-point scale, with “Completed closed” scaled as 100 and “Open without restrictions” as 0. The data are averaged in different sectors.

Source: The World Bank’s STRD database.  
<http://data.worldbank.org/data-catalog/services-trade-restrictions>

In Table 3 we list the Service Trade Restriction Index of selected economies. Generally speaking, advanced economies tend to have a lower restriction index in service trade, while developing economics have more restriction. Some least developed countries have the highest restriction in service trade, for example Ethiopia. But service trade restriction index does not always negative related to economic development, e.g. Ghana is among the lowest restriction economies. Among the five service sectors, trade in financial, telecommunications and retail services are relatively open, while trade in transportation and professional services

are restricted more strictly. From Table 3 we can see the world service trade market is far from integrated.

A more technical method to access the market segment in service trade is used in Barattieri (2014). Based on Anderson and Yotov (2010), Barattieri (2014) computed a Constructed Home Bias Index (CHB) to quantify the extent of service market segment. The CHB index is the ratio of the realized internal trade in a given sector relative to the internal trade that would prevail in a frictionless world. Since this index is a pure number, it can be compared across different sectors, and by appropriately weighted average in all service sectors it can capture the liberalization of world service market across times.

The CHB index of country  $i$  in sector  $k$  is defined as:

$$CHB_{ik} = \left( \frac{t_{ii}^k}{P_i \Pi_i} \right)^{1-\theta_k}$$

where  $t_{ij}^k$  represents the bilateral trade cost of shipping a unit of sector  $k$  goods from country  $i$  to country  $j$ ,  $P_i$  and  $\Pi_i$  represent the inward and outward multilateral resistance terms<sup>1</sup> as defined in Anderson and van Wincoop (2003).

Table 4: CHB Index, Selected Economies

Country	Manuf. 1995	Manuf. 2008	%Change	Service 2001	Service 2008	%Change
US	3.68	4.37	0.19	2.40	3.05	0.27

<sup>1</sup> "Multilateral resistance" refer to the average trade barrier of a country with all of its trade partners. It not only includes the "remoteness" between two countries such as distance, but also includes border barriers and other obstacles to trade.



China	14.31	4.34	-0.70	21.90	10.85	-0.50
Japan	4.41	8.33	0.89	7.10	12.07	0.70
Germany	9.45	10.23	0.08	15.42	14.60	-0.05
UK	20.53	21.86	0.06	17.02	14.63	-0.14
France	15.31	14.73	-0.04	20.07	16.41	-0.18
India	44.69	23.79	-0.47	62.82	38.34	-0.39
Korea	26.45	21.47	-0.19	66.48	61.15	-0.08
Greece	194.63	139.88	-0.28	237.89	153.82	-0.35
Finland	126.36	94.44	-0.25	246.34	183.12	-0.26

Source: Barattieri (2014)

We do not discuss more on the computation details, and list selected economies' CHB index in manufacturing and service sectors as Table 4. We can see that the US is the most open country with the lowest CHB index in both sectors, and also the only one whose service sector is more open than manufacturing sector. The world average CHB index in service sector fluctuated between 30 and 32 during this period, about one half higher than that of manufacturing sector, and had no trend to decrease. Therefore, the service sector shows more home bias than manufacturing sector, and thus world service market is more segmented than manufacturing market.

c) How a segmented service market contributes to low efficiency growth?

We then discuss how the service market segment contribute to low growth rate of service efficiency, or in other words how service market integration leads to higher efficiency improvement. The rationales are similar to that of commodity markets and we just list several here.

Firstly, an integrated world service market can lead to better exploitation of comparative advantage of each country. Rather than “untradeable” in traditional views, some categories of service industry are traded with a much lower trade cost than commodities. One example is the contact centers flourishing in India. A contact center is referred to as a customer interaction center from where all customer contacts are managed. It includes online call centers and other types of customer contact such as email newsletters, website inquiries, chats and the collection of information from customers. Thanks to the development of information and communication technology, such contact service can be provided by contact centers thousands miles away from the actual consumers. This magnifies India’s comparative advantage of low labour cost and high language skills, and brings Indian contact market one of the fastest growing and competitive markets in the world with a compound annual growth rate of 45% over the past five years.

Secondly an integrated service market exploits economies of scale. Some service industries are characterized with high fixed cost and low variable cost, for example hotel and banking services. An empty hotel does not consume much less than another hotel without a single room being available. Similarly, a bank branch with few customers all day costs almost the same as another branch with a long queue.

The third reason is network effect. Many service industries have network effects, for example computer software industry. If every country had a unique kind of software system, maybe most software engineers were busy translating one software into another system rather than designing new software. Service market integration makes most countries use the same software system, and thus a Word document compiled in China can readily be read in America.

There are many other reasons that can explain why service market integration contributes to higher efficiency growth, e.g. knowledge diffusion through learning- by-doing mechanism, competition effects among service providers, etc. We do not discuss further on this, and now turn to the next part: why world service market is more segmented than commodity market?

#### **4. Service Market Segment and SDT Negotiations**

Among the four modes of service trade defined by the WTO, only Mode 1 (services that are traded internationally across borders) shares some similarity with commodity trade, and the other three modes are distinct from traditional concept of “trade” in that they require the movement of consumer or supplier, instead of the “service” itself. Therefore, the Mode 2 (services that require the consumer to be in the location of the producer), Mode 3 (services that require commercial presence in the form of foreign direct investment), and Mode 4

(services that require the temporary cross-border movement of worker) of service trade are highly related on the cross-border movement of human or capital, and thus under stricter supervision by governments. This is the fundamental reason that world service market is more segmented than commodity market.

There have been negotiations on service trade liberalization since the period of the GATT, and these negotiations continued in the frame of WTO. But the progress in service trade cannot be compared to that in commodity trade. We briefly document the history of service trade negotiation before explaining the effect of special and differential treatment (SDT) on this.

#### a) Service Trade Negotiations

From the creation of the GATT in 1947, trade negotiations had focused on tariffs issues in commodity trade. But as service sector accounts for 70 percent or more of economic activity in high-income countries, services become essential inputs into the production of all industries, as well as new technologies emerge that allowed competition emerge in markets that were traditionally regarded as natural monopolies, it turns out to be a necessary for advanced economies to begin undertake regulatory reforms to increase the contestability of service markets.

It was the United States, who perceived it had a comparative advantage in services,

launched the initiative to consider rules for trade in services in the early 1980s. The US made an initial attempt to put services on the GATT negotiating agenda during the 1982 GATT ministerial meeting, but only met with vigorous resistance from many contracting parties and even an agreement on negotiating in this field could not be reached. However, the meeting did result in establishing a GATT work program on services to undertake studies on service sectors.

The US and other developed economies continued their efforts during the 1986 ministerial meeting in Punta del Este, Uruguay to put service on the GATT agenda. This was defended most vigorously by the so called G10, a group of ten developing countries including Argentina, Brazil, India, Nigeria and others, which rejected launching talks on services. At last both made some concession: the services negotiations would proceed as a part of the Uruguay Round, but on a parallel track from talks on goods.

Since there does not exist a common set of border barriers such as tariffs in service trade, it is quite difficult for the negotiators to agree on what field of service barriers they should negotiate about. It seems a GATT-type approach of exchanging equivalent “amounts” of trade liberalization simply impossible to emulate in service negotiations. As a result, subjective notions of sectoral reciprocity became the focal point of negotiations.

After 15 years of discussion in service liberalization, a major result of the Uruguay Round was the creation of the General Agreement on Trade in Services (GATS), which entered into force on January 1, 1995, established rules and disciplines on policies affecting access to service markets, and greatly extended the coverage of the multilateral trading system. The GATS rules can be seen as operating on two levels. First there is a set of general rules that apply across the board to measures affecting trade in services, of which the most important are transparency and the most-favored nation (MFN) principle. Then there are sector-specific commitments made by members on market access and national treatment that are the core of the GATS, and determine the liberalizing impact of the agreement<sup>1</sup>.

Article XIX of GATS required members to launch new negotiations on services no later than 2000, and periodically thereafter. These talks became part of the 2001 Doha Development Agenda and conducted in Special Sessions of the Council for Trade in Services. But the negotiations proved fruitless. The Doha dilemma has brought countries like the US turn to regional trade agreement such as the TPP, rather than negotiating in the WTO. As a result, the world service market is far from integrated after 20 years' practice of the GATS.

#### b) Special and Differential Treatment in Negotiations in Services

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<sup>1</sup> See Hoekman and Kostecki (2009), p.337.

One of the reasons for the little progress in services negotiations in GATS is the pursuing of Special and Differential Treatment (SDT) by the developing countries, which have taken the SDT in goods trade as granted. The initial premise underlying GATT 1947 was essentially parity of obligations, which make no distinction between rich and poor trading nations. In the mid-1950s, with a large number of colonies approaching independence, the concept of giving SDT to developing countries arose on the justification that this would help them protect infant industries to foster development, and have preferential access to their export markets to realize economies of scale. In 1965, developing countries' demand for special status in the multilateral trading system lead to a new Part IV of the GATT, which formalized the concept of SDT as the developing countries were not expected to grant reciprocal tariff concessions and bind tariffs. This led to the so called Enabling Clause in the Tokyo Round Framework Agreement, which provided for departures from MFN and other GATT rules. The following Uruguay Round was a single undertaking in the means that all agreements were to apply to all members, and all members were to submit schedules of concessions and commitments, but it also included the SDT for developing countries with various transition periods for the different agreements and the more limited extent of tariff cuts they needed to make.

Since service topic entered the Uruguay Round talks, developing countries also try

to be granted SDT in service trade. In 1995 the preamble to the GATS states that the Agreement aims “to facilitate the increasing participation of developing countries in trade in services”. GATS Article IV takes this further by requiring WTO members to negotiate specific commitments relating to (1) strengthening the domestic services capacity of developing countries; (2) improving their access to distribution channels and information networks; and (3) liberalizing market access in areas of export interest to these countries, giving “special priority” to least-developed countries (LDCs). It states that these objectives are to be implemented through a process of progressive liberalization, and developing countries are given flexibility to (1) open “fewer sectors” than those opened by developed countries; (2) liberalize fewer types of transactions; and (3) extend market access in line with their development situation. It also requires members to establish for each round of services negotiations how they will provide special treatment for LDCs, which are known as “modalities”. The modalities for the special treatment of LDCs in the service negotiations was adopted in September 2003, which require members to provide “effective market access” in sectors and modes of supply of export interest to LDCs when making specific commitments. At the Hong Kong Ministerial Conference in 2005, members recognized the economic difficulties LDCs face and acknowledged that they are not expected to undertake new commitments in trade in services in the Doha Development Agenda.



Despite all these principles from advanced members to provide SDT to developing countries, especially to the LDCs, the developing countries have in reality acquired nothing more than some goodwill to show for their efforts. And the service negotiation itself has become a problem for negotiators spending years on it without even an agreement on what to negotiate. Negotiations to liberalize market conditions for trade in services are conducted mainly through a “request-offer” procedure. Members send requests directly to each other indicating what improvements they are seeking for their services and service suppliers; members specify in their initial offers how and to what extent they are willing to take binding commitments in response to these requests.

The timelines for this “request-offer” procedure had been postponed again and again. The Doha Declaration in 2001 introduced target dates for the circulation of initial requests on 30 June 2002, and initial offers on 31 March 2003, and a single undertaking was to be concluded not later than 1 January 2005. But as the Cancun Ministerial Meeting in September 2003 failed to make any progress, it was not until mid-2004 that the so called July 2004 Package set a new target date of May 2005 for the submission of revised offers. This was again postponed. The Hong Kong Ministerial Declaration of December 2005 only reaffirmed key principles and objectives of the services negotiations, and set out a new timeline of 31 July 2006 for the submission of offers. Just one week earlier than this date, all negotiations under the Doha Development Agenda were suspended, due mostly to

a stalemate over agricultural and non-agricultural market access. When these negotiations were resumed in 2007, there was at last a conclusion that no timelines should be made.

It was until December 2011 that a progress in SDT was made, when the WTO Ministerial Conference adopted a waiver which allows WTO members to deviate from their most-favoured nation obligation of non-discrimination in order to provide preferential treatment to services and service suppliers from LDCs. Of the 155 WTO members, 32 are LDCs who stand to benefit from preferential treatment designed to promote their trade in those sectors and modes of supply that are of particular export interest to them. This could be a good news to these LDCs. Unfortunately, there was no member made use of the LDC services waiver between 2001 and the Bali Ministerial Conference in December 2013. The LDCs submitted a collective request on 21 July 2014, and over 25 developed and developing countries indicated sectors and modes of supply where they intend to provide preferential treatment to LDC services and service suppliers in a high-level meeting took place on 5 February 2015. When will these LDCs get the actual SDT in services? Maybe there is still a long way to go.

c) SDT negotiation contributes to service market segment and service inefficiency

From above analysis we can see that the negotiation approach of SDT has contributed to service market segment. In principle the developed economies agree to provide SDT to developing countries, as the GATS Article IV stated, but in practice there are lots of disparities among them on what to grant, how to grant and to whom to grant such SDT. Why the SDT negotiation in service so difficult? We analyze this in the next part.

## **5. The Opportunities in global SDT Negotiations**

The pursues of SDT by developing countries is one of the reasons which make the WTO negotiations in the Doha Round to go nowhere. Why it is so difficult for the developing countries to be granted SDT in service? Here we give three reasons.

a) Is there a car to free-ride on?

Firstly, the mechanism of SDT may not suit for today's trade. From its original design in 1960s the SDT is a mechanism for free-riding, which aims at granting developing countries special entrance to the market of developed countries without a reciprocal opening of their own. These may some of the reasons in the early period of SDT when a lion's share of world trade is goods trade among developed countries, which were eager to abate tariffs between each other to form

a world market. But in the current service negotiations, there is a large difference among developed countries that there is simply no car for developing countries to free-ride on.

For example, Chapter Fourteen of the NAFTA Agreement lists rules on financial service liberalization among the US, Canada and Mexico, including National Treatment, Most-Favored-Nation Treatment, as well as the permit on new financial services and data processing, forbidden of requirement on senior management and boards of directors, among others. Given the geographic, historical, cultural and linguistic similarities between the US and Canada, it would seem natural for their financial markets to be integrated together after two decades of NAFTA. But there are only a few banks and bank branches from the US which operate in Canada.

According to official Canada statistics, there are 24 foreign banks and 29 foreign bank branches in 2015, of which only 3 banks and 5 bank branches are from the US. They can hardly compete with the 29 domestic banks with thousands of branches all over the country.<sup>1</sup> As the Canadian Bankers Association note, most international banks in Canada specialize in corporate and investment banking business and only have one or two offices or branches. The only exception is HSBC Bank China, which has a strong retail presence with branches across

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<sup>1</sup> <http://www.osfi-bsif.gc.ca/Eng/wt-ow/Pages/wwr-er.aspx?sc=1&gc=1#WWRLink11>

Canada.<sup>1</sup>

b) Is the space enough for new free-riders?

SDT as designed in 1960s was aimed to provide special market access to developing countries which were characterized with trade problems such as poor export ability and huge balance of payments deficit. After half a century's development, the role of developing countries in world service trade now is not similar with what it was in goods trade in the 1960s. In 2013 the four BRIC countries export 473 billion US\$ in service, account for 9.7% of the world's total. China and India are among the top 10 service exporters in the world. In 2013 China was the fifth, only behind the US, UK, Germany and France, and India was the sixth largest exporter. Granting SDT to so large developing countries would bring large impact on developed countries.

Detailed world service trade data is not available, so we take the US service imports as an example. In 2014 the US service import is 477.4 billion US\$, of which import from advanced economies (Canada, Europe, Japan, Australia, New Zealand) is 272.3 billion, the others from developing economies<sup>2</sup>. If all the developing economies were granted SDT in US service imports, it would be a problem to the developed exporters.

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<sup>1</sup> <http://www.cba.ca/en/component/content/category/61-banks-operating-in-canada>

<sup>2</sup> <http://www.bea.gov/iTable/iTable.cfm?reqid=62&step=1#reqid=62&step=9&isuri=1&6210=4>

c) Are the free riders belonging to the same coalition?

The group of “developing countries” are so diversified that it is difficult for them to agree on what SDT they should pursue from the developed countries. As Whalley (1990) pointed out, over the years the differences between developing countries have grown to the point that in the Uruguay Round a grand coalition of all developing countries did not exist in any active sense. The current divergence of so called developing countries in service trade is no less obvious as it was three decades ago in goods trade.

Since there are more than a hundred developing countries in the world, it is difficult to make a complete analysis on their difference in services. We list several main indicators of five largest developing countries (Brazil, China, India, Mexico, and Russia), and the group of LDCs in Table 6. There are obvious differences between these indicators. The service sector has different importance to different countries. Service value-added accounts for nearly two thirds in GDP in Mexico, while it only accounts for 43% in China. Service trade as a share of GDP is almost 15% in India, while it is only 4.14% in Mexico. India has service trade surplus, while other economies have service trade deficits. If we compare the four service industries, the country difference is more distinct. For example, computer and communication exports accounts for 70% of India’s service export,

while it only accounts 12.8% in Mexico. In the travel industry, the picture is just mirrored, which accounts 70% in Mexico's service export but only 12.4% for India.

Table 6: Service Trades in Selected Developing Economies, 2013

Country	Brazil	China	India	Mexico	Russia	LDCs
% of GDP						
Serv. value	53.8	43	55.4	62.6	54	46.3
Serv. trade	5.24	5.76	14.77	4.14	9.55	13.37
Serv. surplus	-1.9	-1.2	1.2	-0.7	-2.7	-4.6
% of s. export						
Computer	58.5	54.9	70.4	12.8	49.4	22.8
Financial	9.0	3.4	5.7	13.9	3.2	0.0
Transport	14.6	17.6	11.4	4.0	30.0	14.1
Travel	17.9	24.2	12.4	69.3	17.3	62.6
% of s. import						
Computer	47.7	24.7	35.7	8.3	39.8	26.9
Financial	4.0	7.8	9.4	17.3	3.8	7.3
Transport	18.3	28.6	45.6	43.3	13.9	51.9
Travel	30.0	38.9	9.2	31.1	42.5	14.0

Source: Author's computation based on WDI data

Service imports are also diversified. Computer and communication imports account nearly one half of Brazil's service imports, while in Mexico these are only 8.3%. More than a half of LDCs' service imports are transportation, but for Russia they only account for 13.9%. It seems impossible for so different economies to agree on what kind of SDT they should ask for in the service negotiations. Confined the coalition to the 48 LDCs may not help much, because although those LDCs share a similarity of low GDP per capita, they are quite different in many

other characters e.g. comparative advantages, resources, etc.

## 6. Does SDT really help?

We have thus far shown that the pursuing of SDT in service trade by developing countries contributes to the delay of Doha Round negotiations and the segmentation of world service markets, which then leads to the slow efficiency growth of service sector. Is it rational for the developing economies to ask for SDT despite the price of market segmentation? Since there is currently no SDT in service, we will use the SDT in goods trade as a reference and show it actually had no remarkable benefit to the developing countries granted it.

The rationale of SDT in trade is based on a fundamental fallacy that opening one's market to others involved "concessions" that needed to be "paid" for. The OECD countries can open markets to each other because each wish to gain better access to the markets of the others. By SDT developing countries were excused from the need to pay for new export opportunities to developed economies. For example, the Generalized System of Preferences (GSP) scheme in 1968 allowed all developed countries voluntarily grant tariff preferences to developing countries. But as successive rounds brought down tariffs among developed economies, the margin of preference to developing countries was diminishing. Such preference was also becoming less secure since it was tied to the level of economic development with a "graduation" clause. A number of products most important to



developing countries were excluded from GSP, such as agriculture and textiles products. Therefore, the gain from SDT was not large.

But the price from SDT was larger than the gain. The developing countries did not open their markets to more competition, which may be politically attractive, but also hampered their protected industries to increase efficiency. A notorious example was the so called infant industry protection. Pursuit of SDT by developing countries also contributed to their status as second-rank players in trade negotiations with little influence, and becoming potential targets of other discriminatory policies such as “voluntary” export restraints and “orderly” marketing arrangements. Powerful entities such as the US and the EU could convince smaller countries to restrain exports of politically troublesome low-cost, standard-technology exports.

SDT policy could also be circumvented in a globalized economy without helping those countries it aimed to. This can be seen clearly in the experience of the African Growth and Opportunity Act (AGOA) countries. Began in 2001, the AGOA enabled some less developed African countries to export hundreds of apparel products quota-free and duty-free to the United States, which was a kind of SDT to specific developing countries. As pointed out by Rotunno (2013), a key feature of the AGOA preference was the absence of rules of origin (ROOs), which are usually imposed under regional trade agreements to avoid transshipment.

Therefore, the easiest way for these underdeveloped countries to export to the US is to import directly from other countries and transship them. Take Botswana, Namibia and Uganda as an example, as in Figure 4. Their export to the US jumped significantly when they entered the AGOA, but fall sharply following the expiration of the MFA quota system in 2005. Since a country's industry structure and export ability cannot fluctuate so dramatically, a reasonable explanation for this pattern change is that these countries largely transshipped other countries' exports to the US, and their own production and export ability was not strengthened by the SDT.

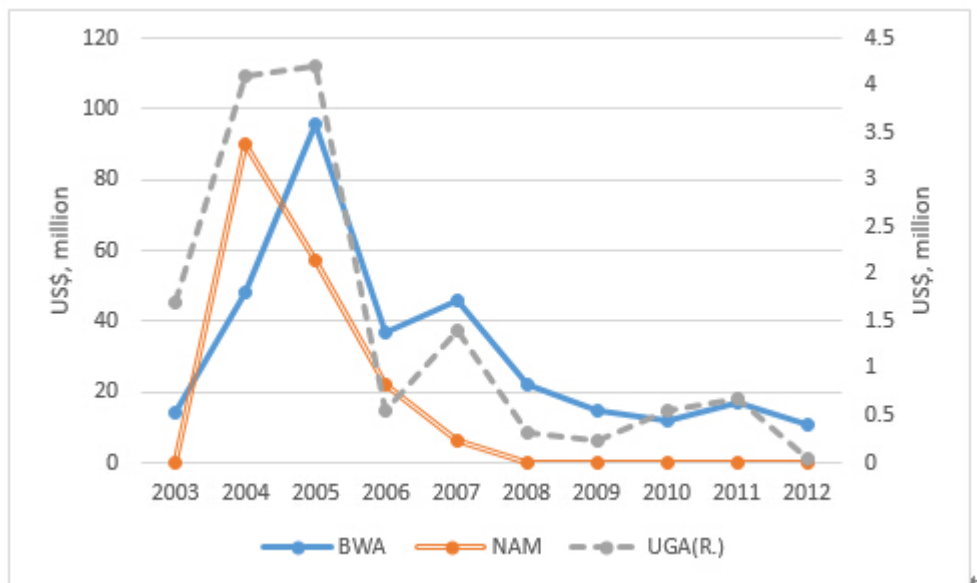


Figure 4. Clothing Exports to USA, Selected AGOA Countries

Source: UN's Comtrade Database

From above analysis we can see negotiations on SDT in service has trapped Doha Round into an impasse and continued put world service market segmented as ever.

If an integrated service market is the goal, what can we do in the future of world service negotiation? "There are several policies that might be considered going forward. They include making SDT and exception, grouping developing nations, and developing a tiered negotiation system. We leave these to the future studies.

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