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“The role of WTO in the regulation of international market of services”

BY

Kazimov Mir Khalig Ilham

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**Major:** 060401 – World Economy

**Specialization:** International Economic Relations

**Supervisor:**

I.R. Rzayeva, Ph.D.

**Head of Master Programme:**

A.H. Ismayilov, Ph.D.

**Head of the Department of International Economics:**

A.H. Ismayilov, Ph.D.

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## **GLOSSARY**

ASA	Air Service Agreement
ASAP	Air Service Agreements Projector
AZSTAT	State Statistical Committee of the Republic of Azerbaijan
BOP	Balance of Payments
BRICS	Brazil, Russia, India, China, South Africa
CBAR	Central Bank of the Republic of Azerbaijan
CIS	Commonwealth of Independent States
CJSC	Closed Joint-Stock Company
DDA	Doha Development Agenda
DSB	Dispute Settlement Body
DSU	Dispute Settlement Understanding
EBOPS	Extended Balance of Payments Services Classification
EEA	European Environment Agency
ENT	Economic Needs Test
EU	European Union
FDI	Foreign Direct Investment
FIMSA	Financial Market Supervisory Authority
FTA	Free Trade Agreement
FTZ	Free Trade Zone
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
IATA	International Air Transport Association
ICAO	International Civil Aviation Organization
ICC	International Chamber of Commerce
ICT	Information and Communication Technology
ILO	International Labour Organization
IMF	International Monetary Fund
IRU	International Road Transport Union

ISO	International Organization for Standardization
ITC	International Trade Centre
ITU	International Telecommunications Union
LDC	Least Developed Country
MFN	Most Favored Nation
NAMA	Non-Agricultural Market Access
NT	National Treatment
NTB	Non-Tariff Barrier
OECD	Organization for Economic Co-operation and Development
PTA	Preferential Trade Agreement
QUASAR	Quantitative Air Services Agreements Review
R&D	Research and Development
SME	Small and Medium Enterprise
STRI	Services Trade Restrictiveness Index
TANAP	Trans-Anatolian Natural Gas Pipeline
TBT	Technical Barriers to Trade
TiSA	Trade in Services Agreement
TNC	Trade Negotiations Committee
TRIMs	Agreement on Trade Related Investment Measures
TRIPS	Trade-Related Aspects of Intellectual Property Rights
UN	United Nations
UN IATF	United Nations Inter-Agency Task Force on Financing for Development
UNCTAD	United Nations Conference on Trade and Development
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNSC (UNSD)	United Nations Statistical Commission (Division)
UNWTO	United Nations World Tourism Organization
VG	Voorburg Group on Service Statistics
WTO	World Trade Organization

## INTRODUCTION

**Relevance of the topic.** Service sector plays an increasingly important role in determining patterns of world trade. Nowadays, services compose a major share of output, employment and investment. They expand faster and with more resilience compared to goods. Notably, service sector reforms constitute a basis for concurrent strategies on economic development and growth.

The World Trade Organization (WTO) has an immense role in fostering service trade on multinational level by developing pertinent rules and guidelines on various sectors of the former. Elucidating its activities will assist in grasping the extent of present regulation, alongside with ensuing its advantages and shortcomings.

**Research objectives.** The object of the thesis is international market of services and its regulation by the WTO. The subject of the thesis is benefits offered and flaws emerged by virtue of such regulations, as well as plausible application of theirs to service industry of Azerbaijan. All in all, the thesis attempts to:

1. Review the origins and substantiate the development of international market of services;
2. Evaluate services from the perspective of conventional theories of international trade;
3. Estimate the impact of trade barriers on the international trade in services;
4. Scrutinize the role of WTO in the regulation of global service market, breaking down its constituent Agreement on Trade in Services (GATS);
5. Define pros and cons of WTO regulations on services;
6. Project such regulations on local service market of Azerbaijan.

**Theoretical and methodological framework of the research.** Studies carried out by both local and foreign authors, as well as statistical publications and issues serve as a theoretical basis of the thesis. When it comes to the methodological framework, the paper utilizes qualitative methods of research, follows an emergent design, interprets available data (both primary and secondary) on the matter through deductive process, and provides tentative conclusions.

**Structure of the research.** The thesis consists of introduction, 3 chapters (with each divided into respective paragraphs), conclusions, and list of references. Additionally, it interprets data by means of 43 exhibits (charts, tables, and diagrams). The first chapter reviews historical emergence of service industry and verifies the reasons of its development. It also tests the applicability of theories of international trade to trade in services, exemplifying each notion, as well as sheds light on barriers to service trade. The second chapter provides brief information on the World Trade Organization – its history, structure, procedures, and activities. The breakdown of General Agreement on Trade in Services (GATS) follows afterwards – not only it interprets clauses of the Agreement, but also studies its effect on different service realms. The chapter concludes with detailed analysis of problems of future trade liberalization posed by the Agreement. The final chapter describes current state of affairs in the WTO accession process of Azerbaijan, and examines possible pros and cons of service trade liberalization of Azerbaijan, to be undertaken in accordance with the WTO/GATS regulations.

**Key words:** *services, trade in services, services and World Trade Organization, General Agreement on Trade in Services, regulation of service trade, liberalization of service trade*

## Chapter 1. INTERNATIONAL MARKET OF SERVICES

### 1.1 Historical review: rise of service industry

Likewise primary and secondary sectors of the economy, service sector (also known as tertiary sector) plays an essential role for the economic development of a country. Nowadays, services are widely recognized as a realm making up the majority of global economy: in 2016, in terms of world GDP composition by sector, services have accounted for 68.9% from total (World Bank, 2018), and have been employing 64.3% of global labor force (ILO, 2018).

According to historical data on value added by sector (as % of global GDP), presented by the World Bank (2018), services is the only area which demonstrates positive growth year-over-year, with industry and agriculture receding (Exhibit 1).

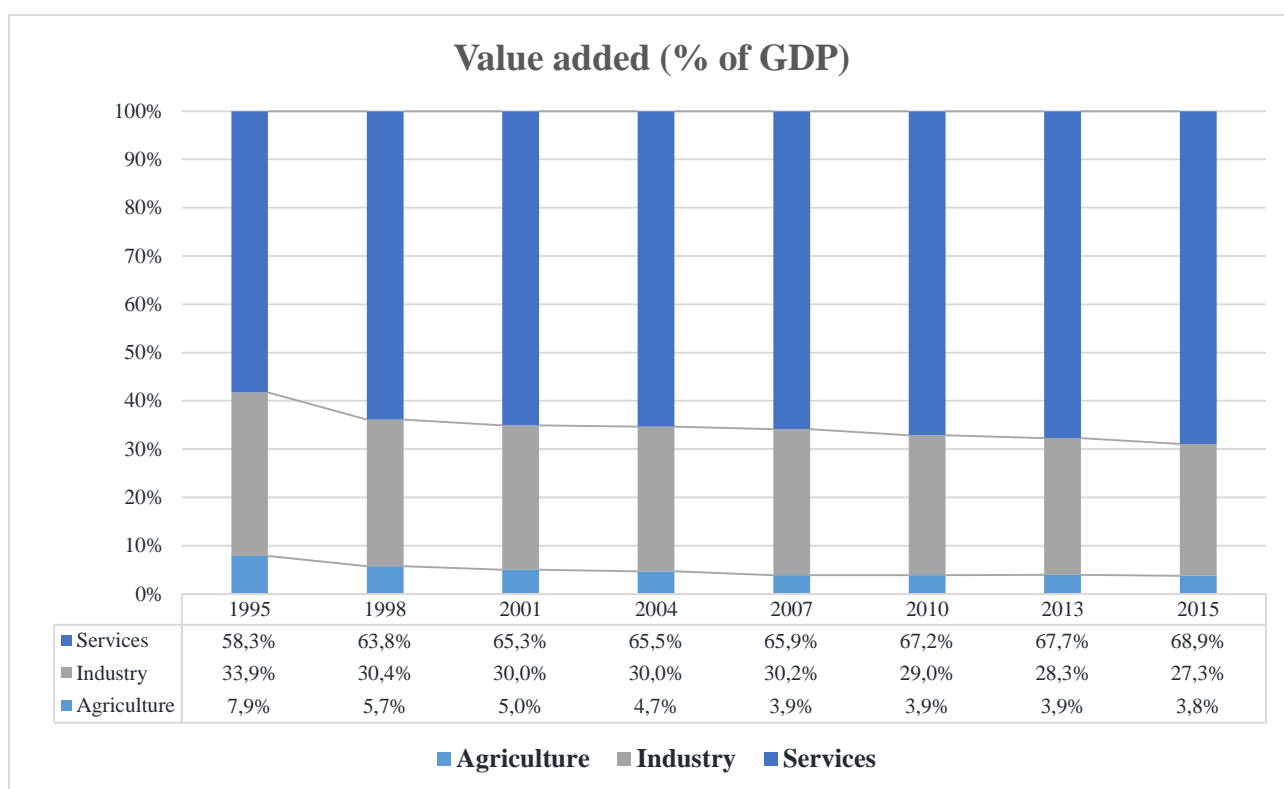
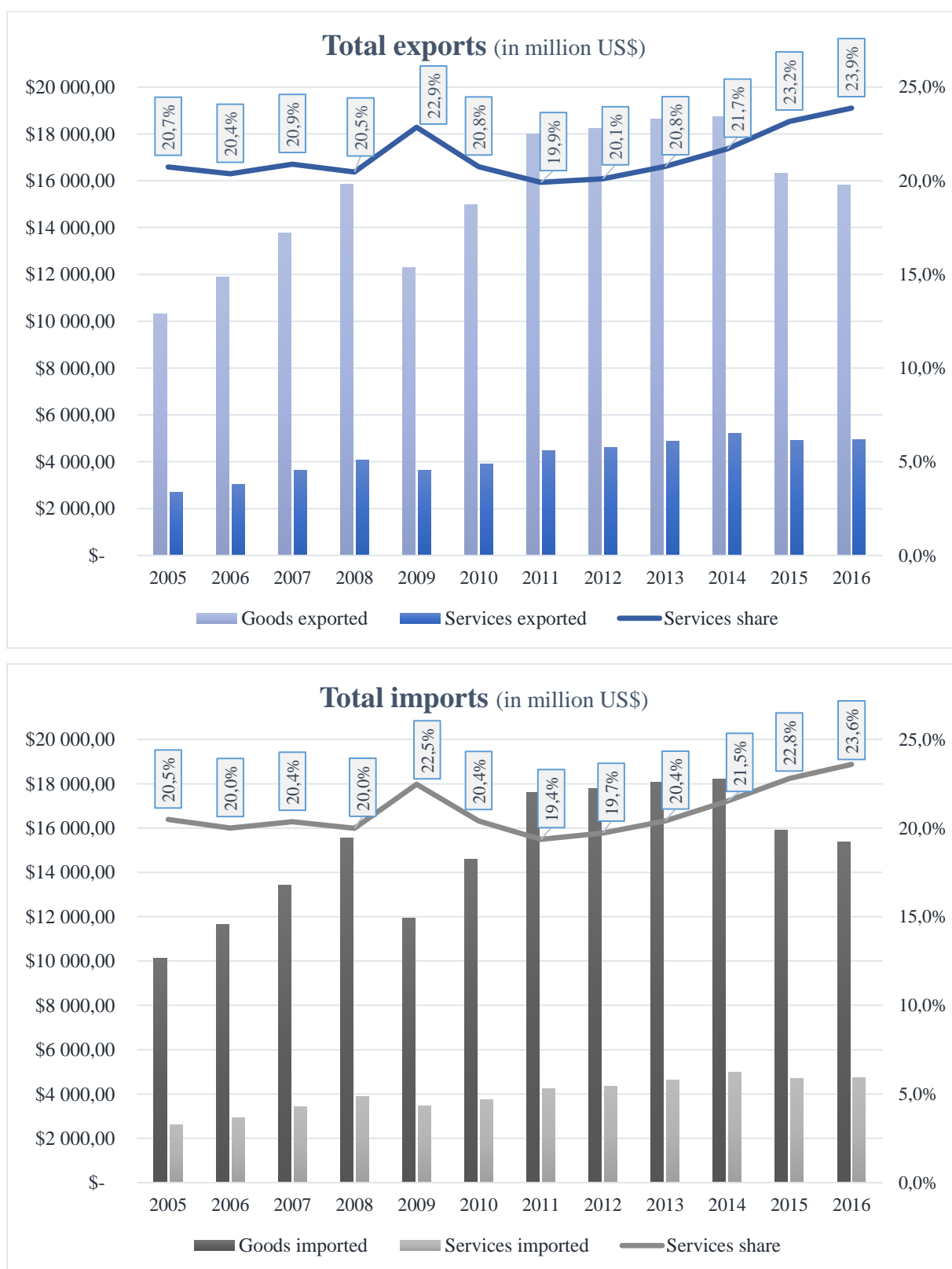


Exhibit 1. Value added per economy sector (as % of global GDP). Gross domestic product (GDP) represents the sum of value added by all its producers. Value added is the value of the gross output of producers less the value of intermediate goods and services consumed in production, before accounting for consumption of fixed capital in production. The UN System of National Accounts calls for value added to be valued at either basic prices (excluding net taxes on products) or producer prices (including net taxes on products paid by producers but excluding sales or value added taxes). Both valuations exclude transport charges that are invoiced separately by producers. Total GDP is measured at purchaser prices. Value added by industry is normally measured at basic prices. (World Bank, 2018).

By the same token, the role of services in international trade (in terms of both exports and imports) is rising, too (see: Exhibit 2.1; 2.2), with trade in services steadily reaching almost a quarter of world trade:



Exhibits 2.1-2.2. Global exports and imports of goods and services during 2005-2016 (BOP, current US\$) (World Bank, 2018).



<sup>1</sup>As presented above, world trade in services totaled US\$ 4.8 trillion in 2016, up from US\$ 3.0 trillion in 2006 (BOP, current US\$<sup>2</sup>; World Bank, 2018), which reaffirms the fact that trade in services raises indubitable prospects for international trade growth.

Per WTO (2015), trade in services has become the most dynamic segment of world trade over the past 20 years, growing up more quickly than conventional trade in merchandise. Developing countries and transition economies have played an important role in this area, increasing their share in exports of world services from a quarter to one-third over this period (WTO, 2015). It comes to the meaning that, tertiary sector steadily casts down primary and secondary ones from being the leading domains of economy not only in developed (where it has come to dominate the economy already), but also in developing states (Cali, Ellis, and Te Velde, 2008).

According to the United Nations (2018), trade in services has also exhibited higher resilience compared to trade in goods – which is evidenced by the fact that, in 2016, global service exports appeared to show a growth following a decline in 2015. In contrast, goods exports continued to drop in value terms (Exhibit 2.1). Such

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<sup>1</sup> In theory, when looking at bilateral statistics, imports reported by a country from a partner country should equal the corresponding reported exports of this partner (“mirror imports”). In practice, this is only exceptionally the case: the discrepancy observed between two countries’ respective imports and exports are referred to as **bilateral asymmetries (BOP asymmetries)**. Asymmetries concern also trade flows between more than two countries, and are often monitored at the level of specific economic zones or at the global level (aggregate exports of all countries of the world should equal corresponding aggregate imports). In its 2009 report, the IMF Committee on BOP presented the situation of global imbalances (world asymmetries) covering the period of 2002 to 2008. As regards total services (i.e. including government services), the report shows that credits (exports) have been higher than debits (imports) since 2002. Many factors contribute to the occurrence of such asymmetries: misallocation, implementation of different thresholds for recording transactions, different times of recording, difficult geographical identification of the counterpart, etc. (WTO, 2010). For the sake of this, both export and import datum are presented in Exhibits 2.1-2.2.

<sup>2</sup> BOP figures underestimate the importance of services for world trade. “Trade in services” encompasses not just the transactions recorded in the BOP but also the sales of services by local companies that establish a presence abroad – the so-called **foreign affiliates trade**. According to the World Trade Organization (WTO) Secretariat, these global sales are approximately one and a half times larger than conventional cross-border trade flows measured through the BOP. The increase in services sales through the presence of companies abroad is driven by increasing flows of foreign investment in services activities. In fact, services represented almost two-thirds (61%) of the global FDI stock in 2005, compared to 49% in 1990. Services remain the dominant sector in cross-border merger and acquisition (M&A) deals, too (Marchetti and Roy, 2008; WTO, 2015).

a tendency in the latest financial and economic crises (lower magnitude of decline, less synchronicity across countries and earlier recovery) has led many countries to incorporate services trade into the post-crisis national trade and growth strategies of theirs (UNCTAD, 2014).

Nonetheless, studies on tertiary sector of economy have never been as solid and sophisticated, as they happen to be now. There was minor understanding of service sector, and little appreciation for the sector's role in world economy for long. As Colin Clark threw out the challenge in "The Conditions of Economic Progress" (1940), *"the economics of tertiary industry remains to be written. Many as yet feel uncomfortable about even admitting their existence"*.

Examining reasons of negligence over the service sector, one would be that for decades, **manufacturing has been regarded as the most important sector of the economy** – as stated by Jensen (2011), when economists in the early 20<sup>th</sup> century began studying the relationship between economic structure and economic growth, the share of employment in manufacturing was observed to be positively correlated with per capita income across countries. The concept of a "close relationship" between manufacturing and economic development became entrenched to the point where policymakers consistently utilized the terms "industrialized countries" and "developed economies" interchangeably – in this view, manufacturing was deemed to be "good" and associated with "higher living standards" and "good jobs", while service jobs were regarded as "low-skill and low-paying" (or, as ironically referred by the author, *"burger-flipper"* jobs) (Jensen, 2011).

Yet, this tenet continued to exist till mid-20<sup>th</sup> century, when most of the world's developed countries and majority of the developing ones witnessed a secular and structural change from industrial to service society (Barth, 1999). The process of tertiarization happened to become most advanced in the United States: the service sector accounted for 60% of value-added already in 1950 (Ventura-Dias, 2011) and virtually, all of the net growth of employment in the post-war period occurred in services sector (Fuchs, 1965). Growth in college-educated labor, skill premium, the relative size of skill-intensive services, and the share of service sector all accelerated

around 1950s (Buera and Kaboski, 2012). Moreover, Fuchs (1965) admits that the surge towards tertiarization of American economy was evidenced well ahead of war – this thought is supported by Fisher in 1935 and Clark in 1940 as well (both proposed the so-called “three-sector hypothesis” independently of each other, pursuant to which, in the course of economic progress employment will first shift from agriculture to manufacturing, and then, to services (Schettkat and Yocarini, 2013) ).

Besides, Melvin (1995) suggests that, 1930-1970s marked the development of national income statistics, when national accounts were divided into three subgroups: primary, secondary (industrial) and for the first time – tertiary (service) activities. Therefore, the indicated period serves as an important milestone in the history of development of service sector.

Obscurity over the services has also been caused by an **equivocal definition of “services”**, or, as put by Melvin (1995), “*difficulty in deciding exactly what services are and how they differ from goods*”. Ordinary language renders the separation between goods and services quite problematic because the demand for material goods derives from the services these goods deliver, which represents their utility, or value-in-use (Ventura-Dias, 2011). For instance, the utility of a vehicle is transportation services it provides.

Hoekman and Mattoo (2008) identify a set of features distinguishing services from goods. It includes *intangibility* of services<sup>3</sup> (which stems from the fact that, unlike goods, no one can “see” or “touch” a service. A service is rendered on spot and hence, cannot be monitored, measured, and assessed by quality as easily as a tangible product (good) can be) and their *non-storability* (i.e., production and

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<sup>3</sup> Intangibility of services has implications for their tradability. One important consequence is that it is more difficult to assess the quality of a service before purchase than it is for goods. With a service, its quality may not become clear until during, or after, its consumption, resulting in problems of asymmetric information between the producer and the consumer, and related moral hazard and adverse selection problems. This asymmetric information may lead to a more frequent use of reputation to signal quality and habit persistence in consumption. Consequently, there may be considerable non-price competition in service markets, although prices can of course be used to signal quality (van Welsum, 2003).

consumption of services occur at the same time). Hill (1999) considers that, services also demand *prior agreement*, cooperation or participation of the consuming unit in the production; in contrast to goods, no service can be made if the consuming unit does not consent.

When it comes to the very definition of “services”, there have been way many interpretations of the concept. Apparently, services are the result of labor process which does not produce a tangible good. A service is defined as a product which, in A. Smith's words, “*perishes in the very instant of its production*”, or which, as J.B. Say put it, is “*immaterial*” (in this context, the final output of economic activity is deemed to be material if it takes the form of tangible things, whilst as noted earlier, services are characterized by their intangible nature) (Gadrey, 2000). One longstanding definition of a service is “*a change in the condition of a person, or of a good belonging to some economic unit, which is brought as the result of the activity of some other economic unit, with the prior agreement of the former person or economic unit*” (Hill, 1977). Gadrey (2000) asserts that, this definition stands afar from the concept of immateriality – in his point of view, what Hill depicts is a conventional service situation that revolves around a procedure leading to a “change of condition” (i.e., “change of state”) that is desired or asked for (following “prior agreement”, representative of services) by an economic agent (consumer).

Hill (1999) claims that it is wrong to stress “immateriality” alone when defining services; he adds that the definition of a service ought to depend on “*whether consumption occurs after production or simultaneously*”, too. Simply put, goods have to be produced before they are consumed and hence exist at least momentarily as inventories; services, on the other hand, cannot be put into inventories (i.e., are non-storable, as noted earlier) because their production and consumption happen simultaneously (Reinsdorf and Slaughter, 2009).

Overall, because of the difficulty of finding a satisfactory definition of services, some economists have backed away from the problem, arguing that services are so vague and heterogeneous as to be incapable of being defined satisfactorily. They therefore define services rather inherently, as “*consisting of all products that are not*

goods” (Hill, n.d.). For instance, S. Kuznets (1966) in his book of “Modern Economic Growth” writes: *“The services sector comprises a variety of economic activities... They have one basic feature in common: none of the activities represents in any significant way the production of commodities; each renders a product that is intangible and not easily embodied in a lasting and measurable form. For this reason, and despite the magnitude of the services sector, the measurement of its output is most subject to error, and data and knowledge are far too scanty to permit adequate analysis”*.

As Ventura-Dias (2011) suggests, at the first stage of its development, academic research struggled to conceptualize services as a special case, an exotic entity with unique attributes such as intangibility, heterogeneity, inseparability and perishability that differentiated them from goods; while it matured, the literature became more focused on the interrelationships between goods and services. Hence, there are enough reasons not to become lost in thought over the definition of services. Within the frameworks of this thesis, any definition of “services” beholds true unless it overlooks their intangible nature.

Many of us are used to think of trade solely as trade in goods, without giving its due to trade in services. For example, one can evidence merchandize trade at any border crossing station, or by visiting a shopping mall where all sorts of goods bear the label “Made in ...”, with the blank referring to virtually any country of the world. Thus, once speaking of trade in goods, it is simple to ideate a clear image (thanks to their tangibility). Yet, trade in services is harder to conceptualize, as by and large, services are intangible. Additionally, services have long been thought of as non-tradeable, as it was believed that a typical service requires a face-to-face interaction of buyer and seller (Jensen, 2011). However, ever-increasing share of services in the world trade as well as advances in ICTs and wide spread of e-commerce (which defies boundaries of time and space) proved that, this way of thinking has been a pure misconception and is highly inapt today. For instance, consultancy services can be traded electronically and do not require the movement of either a producer or consumer of a service.

In so doing, trade in services would refer to the action of buying/selling of services occurring between a producer and a consumer. Financially, it records the value of services exchanged between residents and non-residents of an economy, including services provided through foreign affiliates established abroad (OECD, 2018). Cross-border purchase/sale of services will internationalize the concept – i.e., trade in services taking place between a producer and a consumer, given that one of them is, in legal terms, situated in a different economy, will define international trade in services. Likewise, Stern and Hoekman (1987) define international trade in services as “*occurring when domestic factors receive income from non-residents in exchange for their services*”. The advantage of this definition is that it is not conditioned by the location where the service is produced<sup>4</sup>.

Still, most researchers in the area quite properly see their goal not as defining services but rather as making progress in the measure of their output and productivity (Melvin, 1995).

**Lack of statistical data on services and difficulties in their measurement** raises another reason why tertiary sector has gone unnoticed for so long.

In “The Growing Importance of Service Industries”, Fuchs (1965) first warned that aggregate measures of economic output (as GDP) would become less useful for studies of productivity and economic growth without refined measurement of services output. Pursuant to Greenspan (2001), output per hour was a “*meaningful and relatively robust statistic*” in an economy dominated by goods, for which a common unit of output was rather clear (roughly speaking, tons of steel per work hour in a rolling mill yielded rough approximations of underlying productivity for most purposes); however, in a knowledge-based economy, output begins to reflect ideas, hence creating challenges to existing statistical systems.

Yet, this inconsistency has been interrupted by the establishment of the World Trade Organization in 1995. With its foundation, trade in services became part of the world trade order. Now it covers the core agreement, GATS, as well as the

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<sup>4</sup> It should be noted that, the WTO/GATS defines trade in services in four modes of supply, based on physical proximity of both producer and consumer. These modes are to be discussed further in the thesis (see: paragraph 2.2).

additional instruments, which have been adopted later on to govern the liberalization in specific sectors of international service trade. WTO regulations, issues, handbooks and statistics contribute to the realm of services and serve as a valuable reference tool for the world community as a whole, as well as for professionals and researchers who deal with one of the sectors concerned (Wolfrum, Stoll, and Feinäugle, 2008).

Hereby, pursuant to the WTO (2010), balance of payments (BOP) statistics on service transactions between residents and non-residents provides a sound basis for the measurement of trade in services in conventional sense. It takes into account residence of transactors, market prices, time at which services are deemed to be rendered, and valuation in a common unit of account.

Extended BOP services classification (EBOPS 2010)<sup>5,6</sup> includes 12 main components presented below, and is largely regarded as a product-based taxonomy (WTO, 2010):

1. ***Manufacturing services on physical inputs owned by others;***
2. ***Maintenance and repair services not included elsewhere (n.i.e.);***
3. ***Transport;***
4. ***Travel;***
5. ***Construction;***
6. ***Insurance and pension services;***
7. ***Financial services;***
8. ***Charges for the use of intellectual property n.i.e.;***
9. ***Telecommunications, computer and information services;***
10. ***Other business services*** (embrace R&D, consulting, technical, trade-related and other business services);

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<sup>5</sup> EBOPS 2010 provides for the production of statistical information that, among others, meets needs for information in the framework of General Agreement on Trade in Services (GATS) (WTO, 2010).

<sup>6</sup> Additionally, conventional balance of payments statistics do not fully reflect the importance of services trade to an economy. Services can provide intermediate inputs in the production process and are often bundled into the final value of goods produced. This implies that there is a services element included in the value-added of output in all sectors (UN, 2018). Here's why value added by services (as % of global GDP) has been presented earlier.

11. *Personal, cultural, and recreational services* (including audio-visual and related services);

12. *Government goods and services* cover all government and international organizations' transactions not contained in other EBOPS 2010 items.

Among listed components, travel and other business services represent the largest domains, with each having accounted for more than US\$ 1 trillion in 2015 (Exhibit 3). Other important components encompass transport, telecommunications, and financial services (ITC, 2018).

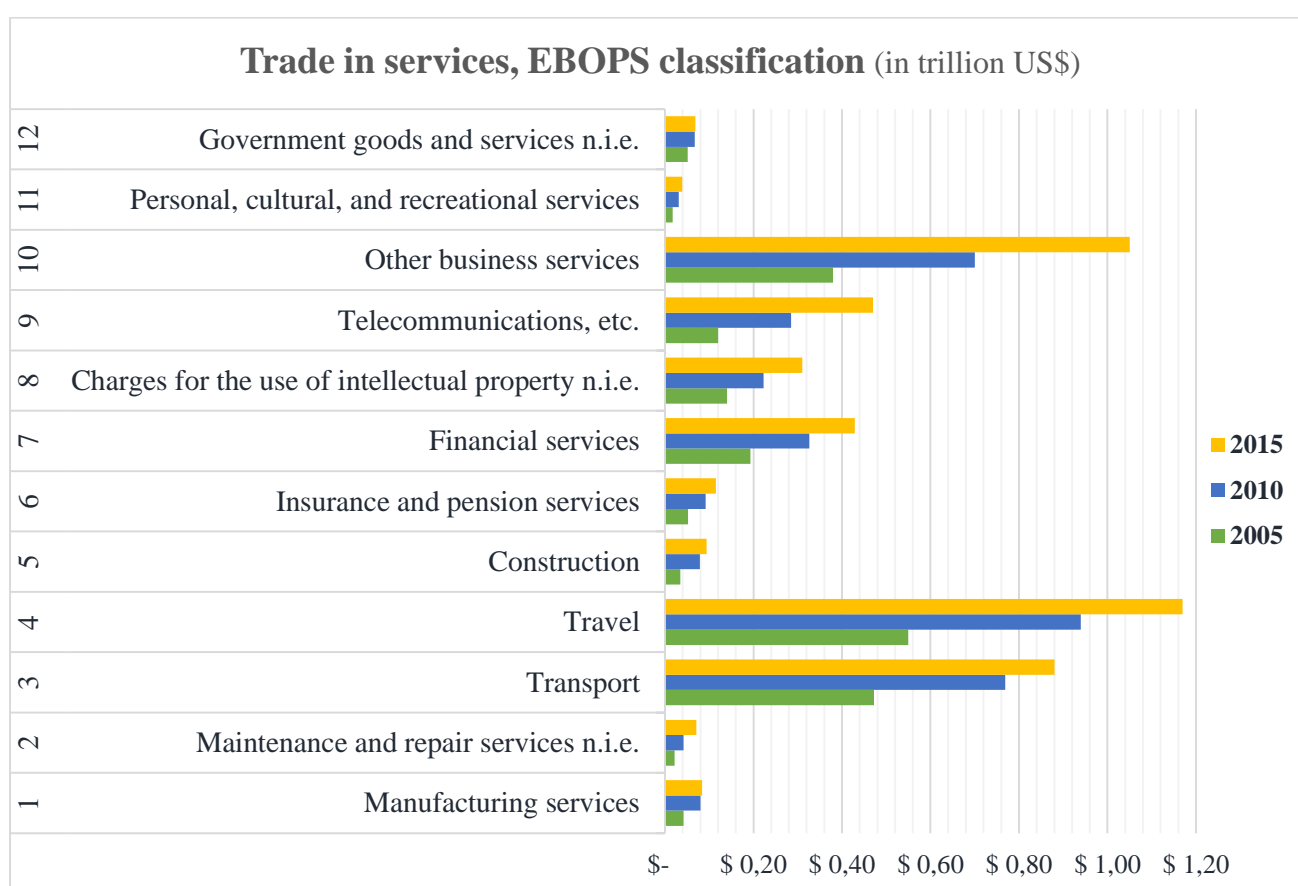


Exhibit 3. Global trade in services (by EBOPS classification) during 2005-2015 (UNCTAD, 2017; ITC, 2018).

It is worth mentioning positive contribution of Voorburg Group on Services Statistics (VG), too – the Group was initiated in 1986 in response to a request from the United Nations Statistical Commission (UNSC) for assistance in developing service statistics. Over the years, the VG has developed a large body of knowledge and best practices on classification, turnover/output, quality indicators, and producer prices for a large number of service sectors. The prime example of VG contributions



for classification systems was the successful development of the Central Product Classification (CPC), for which the VG provided recommendations to the UNSC on classification of services areas (UNSD, 2018).

Although the official statistics on service trade has improved a lot, the level of detail and the richness of the data gathered for the service sector still lag behind what is currently available for manufacturing and agriculture – as erstwhile dominance of the latter two has caused a relative disregard of services for quite a time (Jensen, 2011).

Profoundness of research carried out in the field of services has increased as services augmented their share in global trade. Thus, world trade in services has demonstrated a rapid growth throughout the latter half of the 20<sup>th</sup> century: if world exports of services amounted for US\$ 348.6 billion in 1979, they attained to reach US\$ 1.58 trillion in 1999 and grew up to almost US\$ 5 trillion in 2016 (BOP, current US\$; World Bank, 2018). Even though global trade has run high within the same period (1979-2016), (as mentioned earlier) growth rate of service trade has outpaced that of merchandise trade (14-fold increase in services vs. 9-fold increase in goods trade). Let's further inquire about the forces standing behind such a progressive emergence of tertiary sector of world economy.

To start with, as suggested by Cleveland (1999), structural economic shifts are viewed as an inexorable result of **rising per capita incomes**: consumption of services overtook the purchase of manufactured goods, just like the latter eclipsed the consumption of agricultural produce centuries ago.

Moreover, as explained by Barth (1999), surge towards services is caused by the interaction of two factors – “productivity bias” and “demand bias”. Pursuant to the author, “productivity bias” describes the empirically established fact that the industrial sector has a productivity advantage over the services sector<sup>7</sup>; it can

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<sup>7</sup> Productivity is generally measured as the ratio of output to inputs used in a production process. One way an industry agent can increase its productivity is by producing more goods with the same/smaller amount of inputs involved. E.g., advancement in technology enables a higher output of manufactured goods and agriculture with less labour utilized. However, it is not the case for service realm, where labour is reviewed as the primary, and in most cases – irreplaceable – input; decreasing it will reduce services output and hence, deteriorate productivity.

therefore keep the proportion of industrial goods constant in terms of the national product, whilst at the same time reducing its share of employment. Hence, unoccupied labor will shift towards (a somewhat more labor-intensive) service sector, expansion of which is further justified by “demand bias”. The “demand bias” is the growing demand for services, which goes hand in hand with economic and technological progress. This rise in demand is chiefly due to increased demand from the primary and secondary sectors – and the tertiary sector itself – for services as an upstream input into production (Barth, 1999).

Likewise, rising share of employment in the service sector is supported by Schettkat and Yocarini (2003), who focus on inter-industry division of labor: according to the concept, manufacturing industries increasingly outsource their service activities to firms specialized in the provision of such services (similarly cited by Barth (1999) as “externalization hypothesis”). This proposition will be discussed in more detail in the next paragraph.

Apparently, these rationales are concerned with the **natural movement of factors of production from industry to services**, but it does not substantiate the growth in demand for services per se.

The simplest explanation for the growth of service industry is that **goods production has become increasingly mechanized**: as technologies allow us to produce more goods with smaller workforce, such typical service functions as management, distribution, marketing, sales, accounting and finance become more crucial (Encyclopaedia Britannica, 2018). Growing demand for provision of such professional services comes across with the pursuit of multinational corporations to exploit economies of scope/scale to serve international markets and to utilize

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Generally speaking, raising productivity in services sector is rather a difficult task, as higher output (i.e., number of services provided or customers served) may sometimes come at a price of lower quality. For instance, in healthcare, physicians and nurses are judged by not only the number of patients helped, but also by the quality of services rendered – therefore, higher number of patients serviced does not necessarily mean higher productivity.

Yet, this task is intertwined with gaps in measurement of services productivity: some economists suppose that the empirical lag of service sector behind industrial one (in terms of productivity) appears because of inconsistent scaling in the former (Wölfl, 2003).

competitive advantages, involving a strategy of expansion with the establishment of international network of branches (Barth, 1999). This, in turn, results in the global integration of services, linking of internationally-mobile clientele to the company, and cutting investment and operational costs. Basic example of this is the worldwide presence of “Big Four” accounting firms and other research/consulting/advertising agencies (including “Big Four” agency companies, as well as major market research firms, such as Nielsen Holdings, Kantar Group, GfK, etc.), the network of overseas branches of transnational banking and insurance organizations (HSBC, J.P. Morgan Chase, BNP Paribas, AXA Group), hotel chains (Marriott International, Hilton Hotels & Resorts, Hyatt Hotels Corporation) and air carriers (Qatar Airways, Lufthansa, Turkish Airlines, etc.). All of these facts are positively contributing to the international trade in services<sup>8</sup>.

The **rapid development and widespread deployment of information and communication technologies** can explain such a “leapfrog” of global service trade. Evolution in ICTs, gradual and dramatic fall in prices for IT hardware and software, increased connectedness (via the internet) and plummeting telecommunication costs have noticeably increased the ability of firms to render services around the globe without having to go there personally, and, in so doing, to expand geographical reach of theirs by encompassing most of the world. All of this creates a platform for drastically increased trade in services (Jensen, 2011). As pointed out in Loungani et al. (2017), technological breakthroughs and innovation are making services exportable at low prices, thus causing a shift in a 60-year-old economic paradigm about tradable versus non-tradable sectors.

**Falling transportation and travel costs** have also facilitated international trade in services, as easy routes and lower fares make it less expensive to transport/travel in order to consume or produce services (Jensen, 2011).

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<sup>8</sup> Yet it should be noted that, economies of scope/scale do not exist for all service sectors, e.g. locally-based craft companies, local transport, or many regionally-based professional services and small corporate structures (Barth, 1999).

Undoubtedly, all the aforementioned factors have been accompanied by ever-increasing globalization of world economy, which implies lower costs for goods and services trade, far-reaching technological improvements, and greater spillover effects.

To sum up, the service sector plays an increasingly important role both on national and global levels. Many services are key inputs to all (or most of) domains of economy, e.g. infrastructure services such as energy, transportation, and telecommunications; financial services, which facilitate transactions and provide access to finance for investment; health and education services, which contribute to social development, guaranteeing a healthy and qualified labor force; and legal and accountancy services, which complement the institutional framework required to establish and maintain a healthy market economy (Loungani et al., 2017). Taking into account all the listed points, one can affirm that service sector also determines investment climate of a country, the level of investment flows, growth and overall productivity<sup>9</sup> of economy.

Through the wide range of channels, services facilitate productive and export processes and enable participation in global value chains. Likewise, knowledge and technology-based services facilitate specialization (UN, 2018).

When it comes to cross-national comparisons, several outcomes validate the positive impact of service trade on economic development and social welfare. Firstly, it appears to be a positive relationship between the service sector's share of economic activity and living standards: in Exhibit 4 (which covers over 150 countries) each point represents a single country, and although there is some variation, most countries lie close to the upward-sloping line, indicating that a large share of employment in services and higher income are positively correlated (Jensen, 2011).

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<sup>9</sup> As cited in Jensen (2011), Francois and Hoekman (2010) examined a number of studies that demonstrate the broad-based impact of a competitive service sector: they cite studies showing that service sector productivity is a key driver of aggregate productivity growth differences across developed economies and increased competition in the service sector (and higher levels of service provision stemming from such competition) has a positive impact on manufacturing and productivity and leads to increases in manufacturing exports.

Jensen (2011) explored similar positive correlation between the service sector's share of employment and the level of educational attainment (measured as “school life expectancy”, or number of years a person of school entrance age can expect to spend within the specified level of education (UNESCO, 2018)). Even though it is not easy to define which, if either, causes which, the author suggests that many service activities require high level of educational attainment. Indeed, notwithstanding with the fact that labor force engaged in service production can be relatively unskilled (such as in construction, manufacturing and repair sectors)<sup>10</sup>, major service sectors necessitate decent level of educational achievement and field competency (e.g., ICT, financial, educational, healthcare and business services) (Cali et al., 2008).

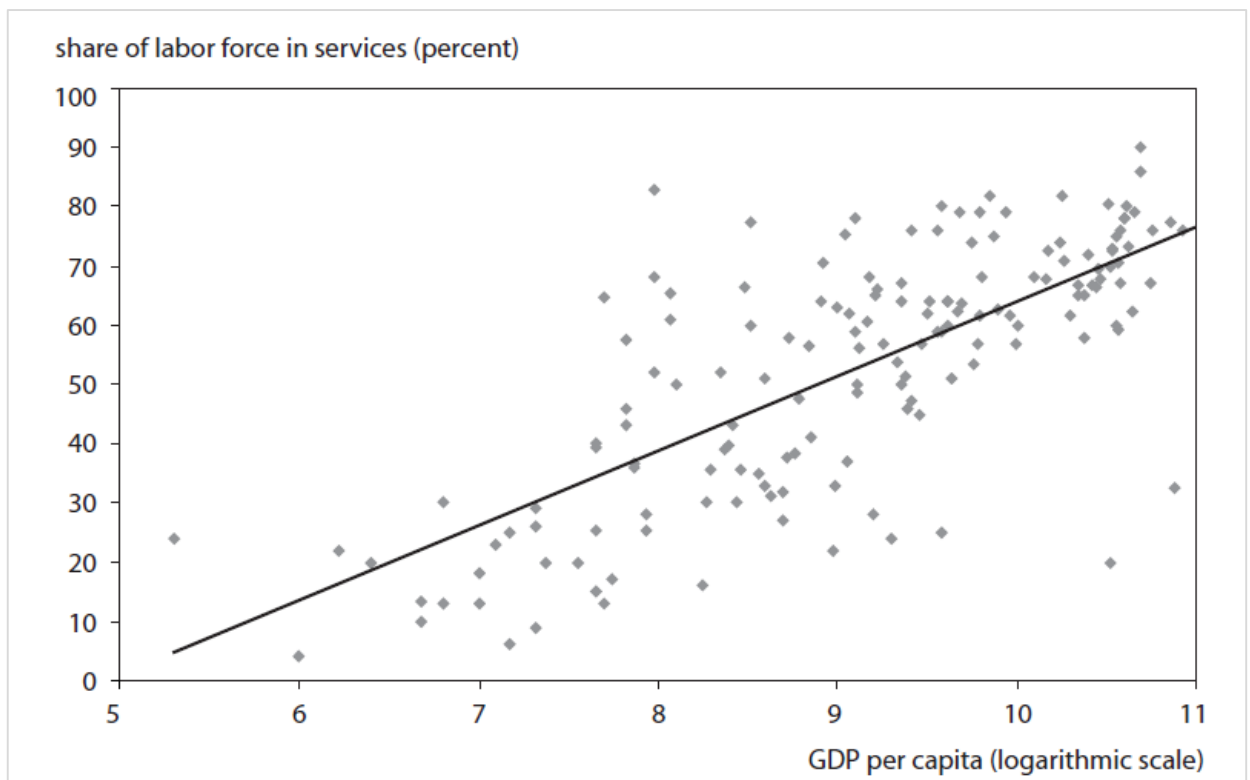


Exhibit 4. Correlation between labor force share of the service sector and income per capita across countries (Jensen, 2011).

Furthermore, trade in services could be more inclusive than conventional trade in goods: Exhibit 6 plots the level of Gini coefficient as an average between 1980-2014 against the average natural log of services export, across a large number of

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<sup>10</sup> On the other hand, such realms of services benefit the unskilled labor, represented by the poor, in particular (Cali et al., 2008).

economies (both developed and developing) (Loungani et al., 2017). Markedly, downward-sloping line verifies that the higher service exports are, the less inequality is.

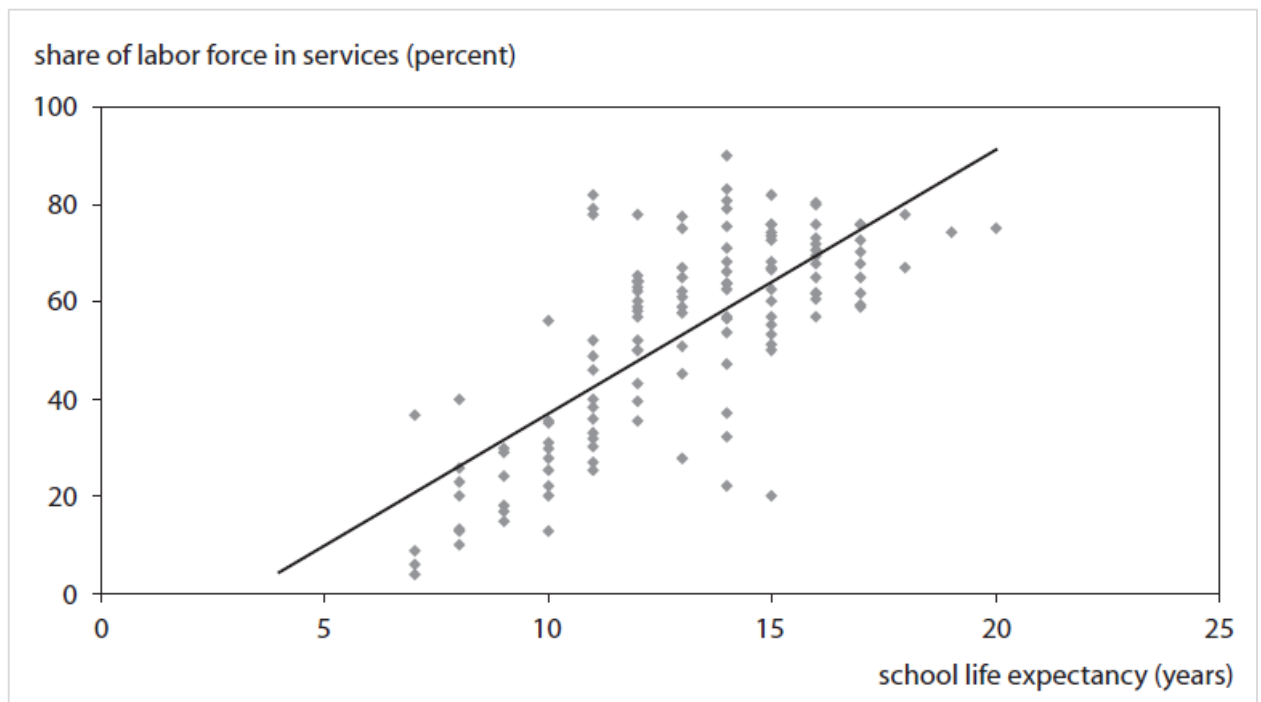


Exhibit 5. Correlation between labor force share of the service sector and educational attainment across countries (Jensen, 2011).

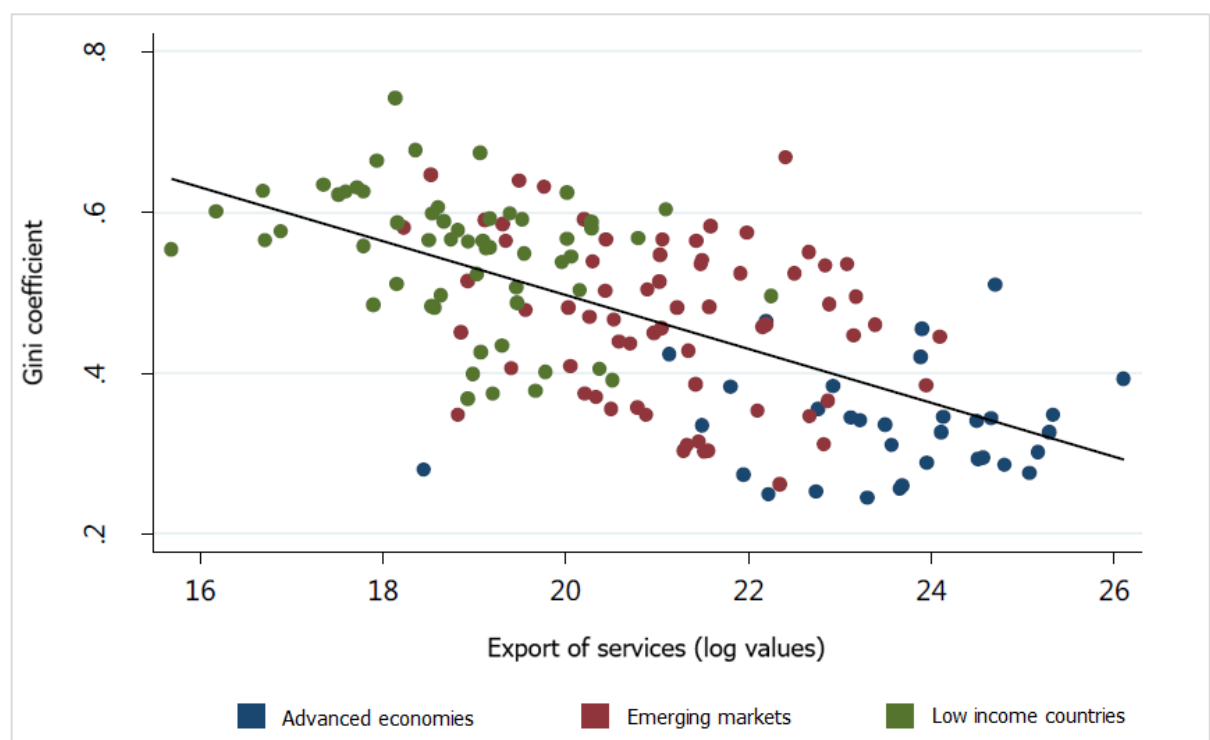


Exhibit 6. Correlation between inequality (measured through Gini coefficient) and service exports. Timeframe: 1980-2014 (Loungani et al., 2017).

At last, modern service industries are critical drivers of technological progress: relying and investing in advanced information technologies, tertiary sector creates a link between economy's services-intensity and its information-intensity, creating a growing market for the cutting-edge ICTs (Cleveland, 1999).

## **1.2 Service trade from the standpoint of international trade theories**

The history of the development of services, alongside with the history of how economists pertaining to different schools have viewed services, is rather complex. Some economists examined services through the same prism of international trade theories as commodities were, whilst some of them disregarded services per se. But do trade theories applicable for goods, fit services as well? To test this supposition, below is presented a quick critique of services from the viewpoint of commonly recognized theories of international trade.

As for **mercantilism** (also regarded as the economics of absolutism), which reigned over economic thought during 16<sup>th</sup>-18<sup>th</sup> centuries, national rule was “*to sell more to strangers yearly than we consume of theirs in value*” (Mun, 1664), and underlying principles were accumulation of wealth by restricting imports and maximizing exports (with national wealth measured by the amount of precious metal it owned), utmost economic self-sufficiency of a nation, protection of local markets and sources of supply. Apparently, this theory has a little to do with services – mercantilists tended to attach more importance on “stocks” of wealth rather than “flows” of income (Hill, n.d.). In addition, services were largely overlooked as a sector of economy within the indicated period.

**Theory of absolute advantage** proposed by A. Smith in 1776 classic “Wealth of Nations” may have had the largest impact on the development of economic discipline. Smith is recognized as the founder of modern economics science and one of the most prominent thinkers challenging mercantilism and arguing in favor of free trade; he also elaborated the notions of “division of labor” and “productivity”. In Smith’s view, it is the division of labor that leads to “*the greatest improvement in the productive powers of labour*”, and because of a more advanced division of the latter, absolute advantage is achieved (Schumacher, 2012). Simply put, absolute advantage is the ability of an economic agent to produce more of an output than competitors, using the same amount of inputs (i.e., labor). Via absolute advantage theory, Smith gives an explanation of why it makes sense for countries to trade: since each has advantages in producing certain output, both parties can benefit from trade.



Analyzing whether services are covered by Smith, we should note his famous and controversial distinction between “productive” and “unproductive” labor, which provoked a long debate among classical economists about the nature of goods and services (Hill, n.d.). Smith defined a “productive” activity being essentially one that produced outputs capable of increasing the stock of material wealth (Hill, n.d.) – a verdict rather akin to mercantilist views (Melvin, 1995). Hence, labor participating in such an activity was considered to be “productive”. Seemingly, due to “immaterial” nature of theirs, services were regarded as “unproductive” activity, and labor force participating in the production of services was labeled as “unproductive labor”. In Smith’s view, the latter put restrictions on the formation of capital and therefore, slowed the economic development (Melvin, 1995): *“the labour of the manufacturer fixes and realises itself in some particular subject or vendible commodity, which lasts for some time at least after that labour is past. It is, as it were, a certain quantity of labour stocked and stored up to be employed, if necessary, upon some other occasion... The labour of the menial servant, on the contrary, does not fix or realise itself in any particular subject or vendible commodity... the sovereign, for example, with all the officers both of justice and war who serve under him, the whole army and navy, are unproductive labourers. Their services, how honourable, how useful, or how necessary soever, produce nothing for which an equal quantity of service can afterwards be procured... In the same class must be ranked ... churchmen, lawyers, physicians, men of letters of all kinds: players, buffoons, musicians, opera singers, opera dancers, ... the work of all of them perishes in the very instant of its production”* (Smith, 1776).

It is clear that Smith’s argumentation deals with intangible nature of services and neglects their added value. Here is why some classical economists opposed to his views: for instance, J.B. Say adduced the example of services rendered by a physician: *“...who prescribes a remedy and takes his leave without depositing any product that the invalid ... can transfer to a third party or even keep for the consumption of a future day. Has the industry of the physician been unproductive? Who can for a moment suppose so? The patient’s life has been saved perhaps. Was*

*this product incapable of becoming an object of barter? By no means: the physician's advice has been exchanged for a fee; but the want of this advice ceased the moment it was given. The act of giving was its production, of hearing its consumption, and the consumption and production were simultaneous. This is what I call an immaterial product*" (Say, 1880). Thus, Say recognizes that services are "immaterial", but refutes the idea of their "unproductivity", and what's more, "perishability" (as the patient continues to benefit from physician's advice even after it has been provided).

On the contrary, some classical economists such as Ricardo, Malthus, and James Mill supported Smith's distinction between "productive" and "unproductive" labor (Melvin, 1995). John Stuart Mill in his "Principles of Political Economy" backed Smith's distinction between "productive" and "unproductive" labor, stating that "*Productive Labor means labor productive of wealth. By Unproductive Labor, on the contrary, will be understood labor which does not terminate in the creation of material wealth*" (Mill, 1848). He also challenged the concept of wealth and whether it consisted of material produce only, arguing that, in principle, human capital could be included in wealth: "*the skill, and the energy and perseverance, of the artisans of a country are reckoned part of its wealth no less than their tools and machinery. According to this definition we should regard all labour as productive which is employed in creating permanent utilities, whether embodied in human beings or in any other animate or inanimate objects*" (Hill, n.d.); however, he finally passed up this definition of wealth, as he deemed that the inclusion of human capital in wealth will "create confusion" ("*I shall, therefore, in this treatise, when speaking of wealth, understand by it only what is called material wealth, and by productive labour only those kinds of exertion which produce utilities embodied in material*") (Mill, 1848).

All of these quotations demonstrate the extent to which conclusions on important issues may be affected by ideas, terminology, and language.

**Theory of comparative advantage** proposed by D. Ricardo in the early 19<sup>th</sup> century demonstrates that economic agents can gain from trade even if one of them

has absolute advantage in both goods. The theory is based on the concept of “opportunity cost” – the benefit one agent forfeits by choosing an alternative option. If the opportunity cost of choosing to produce a particular output is lower for one agent than for others, that agent is said to wield a comparative advantage and gain from trade. Comparative advantage also facilitates trade specialization.

Yet it is worth noting that in his works, Ricardo does not go deeply into services; in general, he shares Smith’s beliefs on the matter (Melvin, 1995).

Both theories of absolute and comparative advantage are rather abstract and consider world economy consisting of only two countries endowed with one resource only (labor), producing two goods (implying complete specialization in equilibrium) with constant returns to scale; they also overlook price differences for resources and any transportation costs (Costinot and Donaldson, 2012), alongside with assuming away distribution of income within countries and allowing no role for other resources (Krugman, Obstfeld, and Melitz, 2012). However, these theories are two important concepts of international trade and have largely influenced the course of economic thought by clearly depicting economic benefits that countries can get trading with one another.

The theory of comparative advantage was further developed by E. Heckscher (1919) and B. Ohlin (1933) (independently from each other) in what is known as **“Heckscher-Ohlin theorem”**. The convincing intuition of Heckscher and Ohlin is that what countries trade depends not only on productivity differences, but also on their factor endowments (such as land, labor, or capital) and relative intensity with which those factors are used in the production of certain output. Basically, the theorem states that, a country which is abundant in a factor exports the good whose production is intensive in that factor; in case of scarcity of a factor, the country will import the goods whose production is intensive in that factor. Empirical evidences bring on mixed results on the Heckscher-Ohlin model of international trade; in addition, most researchers do not believe that differences in resource endowments define patterns of trade or world prices for resources, arguing about technological differences across states and incomplete factor-price equalization (Krugman et al.,

2012). Observably, none of the references suggests that Heckscher and Ohlin referred to or differentiated services while grounding the theorem.

Ultimately, R. Vernon developed **product life-cycle theory** with an eye to give a crisper explanation on patterns of trade. According to Vernon (1966), from the launch to its withdrawal or demise (which comes forth due to the lack of demand), a (fairly exchangeable) product works through three stages: introduction, maturity and standardization:

1. *Introduction – launch of a product, ensuing from the demand of home market* (in Vernon's theory, USA market), with target market being inventor's country (the USA); is associated with limited trade, few competitors, and high production costs. Introduction of a product is followed by growth;
2. *Maturity* – expansion of the demand for a product beyond the home market, impelling increased exports and product differentiation, with target markets now covering home market and advanced economies; is characterized by emerging competition (which is instigated by the mentioned advanced countries) and declining production costs due to larger output as well as progressive economies of scale;
3. *Standardization* – increasing demand, now spanning over developing countries as well, will require higher volumes of output and imply its standardization. Standardized product is said to have high price elasticity of demand, which makes it have an easily accessible international market and sell chiefly on the basis of price. Therefore, factor endowments<sup>11</sup>, opportunities for higher economies of scale and comparative advantages possessed by developing and least developed countries will make producers fully shift production facilities to there. This displacement will cause decline in exports from home market and developed economies and eventually, turn them into net importers of the given product.

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<sup>11</sup> Vernon (1966) supposes that, scarcity of capital in developing and less-developed countries will not prevent investment in facilities for the production of standardized products, as investment will occur in industries requiring significant inputs of labor.

Unlike Heckscher-Ohlin theorem, Vernon's theory takes into account marketing considerations and technological advantages countries possess by the stage of introduction. However, duration of product life-cycle stages is not fixed and depends on the market demand for the product (if the product remains in demand for long and its production costs drop gradually, its life will be longer; if costs are high and demand rather limited, product will withdraw quickly).

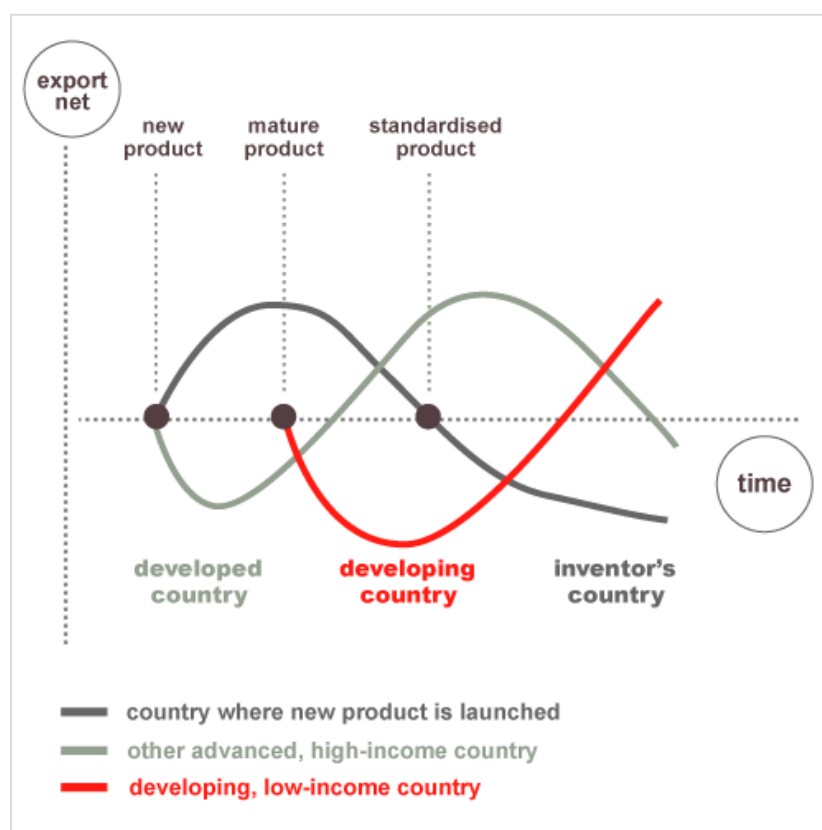


Exhibit 7. Visualization of Vernon's Product life-cycle theory.

In his reasoning, Vernon called to witness conventional trade in goods and industrial products, with no allusion to services (Vernon, 1966).

All in all, it comes clear that the major theories of international trade either dismissed trade in services, or underestimated their importance by citing their "unproductivity". This fact could have been caused by a relative disdain over tertiary sector, described in the previous paragraph. However, are these theories applicable to services indeed? Let's examine this assumption on the examples of Ricardian model of international trade, Heckscher-Ohlin theorem and Vernon's theory of product life-cycle.

For centuries, the underlying thesis was that services are different from goods. But, for instance, a basket of apples, a barrel of oil and a vehicle are very unrelated goods as well. The fact that services were not used to exemplify the propositions of comparative advantage theory does not suggest that these propositions are invalid for services: as McRae and Desbois (1988) suggest, none of the potential difficulties of applying the normative theory of comparative advantage in services appears to yield any reasons to suppose that the theory does not apply.

Yet, when it comes to empirical application of the theory, existence of difficulties is evident. Firstly, output and productivity measures of services are complex and vague (compared to that of goods). For instance, output of educational services can be measured through such ordinary means, as body counts (i.e., enrollment), weighted measures of student exposure, attainment, achievement, satisfaction and attitude (Rivlin, 1973). On the other hand, as cited in Melvin (1995), D. Jorgenson and M. Fraumeni investigated ways of measuring output of the educational sector and proposed a brand new approach, which took the net addition to human capital that results from a student completing a year of education as a basis. The mentioned approach was based on a number of controversial assumptions:

1. *Current wages appropriately reflect future earnings;*
2. *Leisure time is an output of the education system that is valued at current wages. E.g., it is supposed that all individuals spend 10 hours in sleeping, eating, and other maintenance activities, leaving 14 hours that are spent either working or on leisure.*

Thus, output and productivity measures of services embrace mostly qualitative indicators, which are difficult to prove, estimate and gauge.

Secondly, pursuant to Stern and Hoekman (1987), service industries could be targets of government intervention and regulation either in an explicit or covert way, and in some cases, to a higher degree than goods. Though Ricardian approach overlooked such a thing as barriers to trade, their presence (or absence) can have a dramatic effect on trade flows.

Still, Heckscher-Ohlin theorem appears to suite services better than classical theory of comparative advantage. For instance, according to Barth (1999), it is the factor endowments (which vary from one country to another) which determines comparative advantage in services: e.g., when the provision of a service requires a particular type of skilled labor, countries which are relatively abundant in such a resource would export this service; or countries abundant with natural/historical destinations would have a comparative advantage over the countries lacking of such sites (as in case of tourism).

The theorem can be interpreted in a bit different way, too: Deardorff (1985), suggests that, if exporting a particular service requires the export of a factor, then it can be expected that the country exporting that particular type of service is also relatively abundant with the complementary factor (e.g., capital, or labor possessing specific skills). A professional consulting company opening a branch overseas and allocating some of its labor resources from home country (perhaps, for managerial duties or due to expertise within a certain business area) may serve as an example.

Likewise, in case of service trade, factor endowments are of particular importance due to several reasons. First of all, countries endowed with a high-skilled labor and ICT-employed capital stock will find it much easier to reap the comparative advantage in services that intensively use these factors of production (van der Marel, 2011). Business, IT and financial services (requiring high-skilled labor as an input) are basic examples of the proposition. Van der Marel (2011) also tests whether mid-skilled labor forms a source of comparative advantage: he states that, even though mid-skilled labor constitutes no direct determinant for services specialization, countries with a relatively greater stock of such a factor will find it easier to export services than goods. Here, the author explores “push-pull effect” – i.e., increased market for the high-skill - intensive services create a demand for the mid-skill - intensive ones.

As for the product life-cycle theory, let's study its application to tertiary sector on the example of internet services. Originated in the US, local area networking has been considered as a top-notch and pricy product (*product introduction stage*).

However, its utility and benefit determined the demand of local market for modified and sophisticated local-, wide-area networking and public data networks, pushing the development of web-services more and more (*growth*). Digital revolution prompted the popularization of internet and called forth the “world wide web” (*maturity stage*). Progressively, internet hosting and web spanned over the globe, with each year bringing about vital improvements in connectivity, which in turn, resulted in plummeting internet transit prices (*standardization stage*) (see: Exhibit 8).

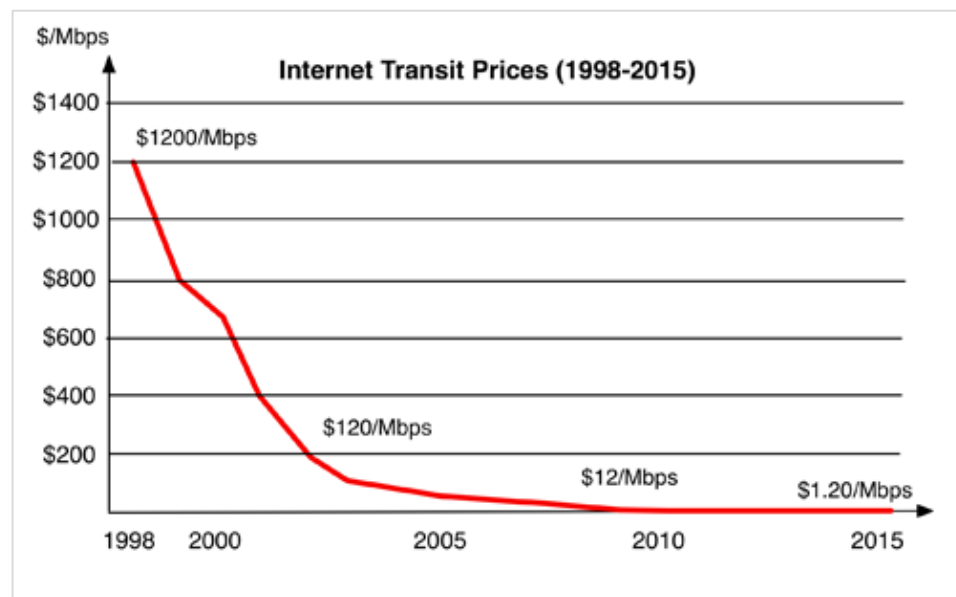


Exhibit 8. Internet transit prices between 1998-2015 (Norton, 2014)

Albeit production and consumption of services occur at once (thus ruling out the shift of production facilities considered in original theory), change in trade patterns of services in standardization stage is anticipated. Beyond any doubt, internet has allowed for increased trade in services, including technology-based ones, and it is worth noting that India is now viewed as the major “exporter” of the latter, ousting the US which has topped the list for long (Walsh, 2017).

In the end, any opinion shared or conclusion reached about the applicability of the theories of international trade to trade in services do not answer the most important question whether trade in services will lead to **gains from trade**. Undeniably, from a normative point of view, a country will take benefit from importing a service, or allowing labor migration from another country, or investment



capital (FDI) as long as the terms of such imports are more favorable than those available at local market. Technology transfer and spillovers, expertise, know-hows as well as potential realization of the “sailing ship effect” (which refers to the introduction of a new technology to a market, which accelerates the innovation of an incumbent one) could be regarded as gains, too.

### **1.3 Regulation of international trade in services: methods and modes**

Studying international market of services, it is important to have a clear idea about its regulation, as well as on nature, variation and intensity of existing restrictions. This paragraph reviews both national and international modes of regulation, as well as studies respective methods of each.

**National regulation** is government intervention to regulate the market, with an eye to prevent the occurrence of market failures. According to Cali et al. (2008), national regulation in services is required in order to:

- *Ensure fair competition between market players* (e.g., by developing anti-monopoly legislation);
- *Ensure equitable access to services* (such as healthcare and education);
- *Guarantee the quality of services rendered* (e.g., by specifying quality requirements in healthcare, leisure, construction, etc.);
- *Maintain financial stability on a national level* (by elaborating rules and obligations in banking sector);
- *Curb information asymmetry in the market* (i.e., protect consumers from misleading information on the availability / certain features of rendered services);
- *Prevent environmental pollution, protect health and safety* (by determining emission standards for transportation services).

However, in certain cases, national regulation can be burdensome, thus creating barriers to trade. Cali et al. (2008) state that, barriers to trade in services can sometimes be an unintended effect of regulation (for instance, where the professional qualifications required are available only from national educational institutions), or be imposed purposely to prevent or control foreign entry to the market or protect domestic industries (e.g., limits on foreign equity participation or requirement for foreign entrants to form joint ventures with local companies).

In theory, barriers to trade are divided into two categories: tariff (tax on imports) and non-tariff ones (licensing, quotation, subsidies, voluntary export

restraints, local content requirements, etc.). As cited in Dee and Ferrantino (2005), border measures such as tariffs are generally difficult to apply to services “*because customs agents cannot observe services as they cross the border*” (thanks to their intangibility). Hence, barriers to trade in services are mostly of non-tariff nature.

Service barriers, just like service sector itself, are diverse and vary based on market conditions and level of protectionism exercised in a specific domain. As cited in van Welsum (2003), barriers to international trade in services can be distinguished as:

- *Barriers to service trade* (NTBs, in their essence);
- *Barriers to the movement of service producers/consumers* (include barriers to the free movement of labor such as limits on duration of stay of foreign nationals, as well as regulations related to GATS modes of supply, to be discussed further);
- *Barriers to FDI in services* (e.g., such restrictions on market entry as minimum capital requirements, conditions on subsequent investment and location, as well as ownership-related constraints (limits on the number of foreign board members and foreign shareholders’ rights) and operational barriers, including ceilings on royalties and limits on repatriation of capital and profits).

Hoekman and Braga (1997) provide a more detailed classification of service barriers:

Class	Type	Example
<i>Quotas, local contents, and prohibitions</i>	<i>Quotas</i>	Company-specific air service agreements, where Country A grants landing rights to a specific company of Country B on reciprocal basis
	<i>Local content requirements</i>	Restrictions on imports of foreign labor or raw materials, necessitating the use of domestic ones

	<i>Prohibitions</i>	Access to local market reserved exclusively for domestic suppliers (a common practice in transportation and telecommunication spheres)
<b><i>Price-based restrictions</i></b>	<i>Price controls</i>	Price-setting by government agencies, (e.g., uniform pricing for transport services)
	<i>Tariffs and taxes</i>	Visa/residence fees, entry/exit taxes, international telecommunication tariffs, as well as discriminatory taxation
	<i>Subsidies</i>	Soaring rail transport subsidies of the EU (EEA, 2007) and China (Tan, 2015)
<b><i>Standards, licensing, and procurement</i></b>	<i>Certification and licensing</i>	Is practiced in the fields of education, healthcare, legal and business services. A basic example is non-recognition of certifications or professional qualifications of foreign service providers
	<i>Public procurement and sourcing policies</i>	Government accounts for substantial share of construction contracts in a number of states. Additionally, in certain states, there's an outright ban on foreign sourcing in different realms (Hoekman and Braga, 1997)
<b><i>Discriminatory access to distribution networks</i></b>	<i>Distribution arrangements</i>	A dominant telecom carrier imposing restrictions on the ability of new provider to connect specific type of equipment to the existing network
	<i>Restrictions on marketing</i>	Limitations on advertisement in insurance sector

Exhibit 9. Examples on the classification of service barriers as proposed by Hoekman and Braga (1997).

Likewise, Dee, Hanslow and Phamduc (2003) refer to a plainer grouping, which breaks service barriers into “discriminatory” and “nondiscriminatory” ones. Indeed, “discriminatory” nature of barriers is determined by whether these barriers are applicable to all of the market players or to foreign entrants only, as well as by the extent of their equitability. An example is presented below:

<b>Service type</b>	<b>Nondiscriminatory barrier</b>	<b>Discriminatory barrier</b>
<b><i>Banking services</i></b>	Minimum capital requirements (capital adequacy)	Restrictions on foreign equity investments, requirements for foreign banks to enter the market through joint ventures with local banks
<b><i>Telecom services</i></b>	Compatibility with international cellular network standards, acknowledged by local licensing authority	Limits to foreign investment / share ownership in local network operators
<b><i>Retailing services</i></b>	Establishment is subject to local environmental impact and sanitary assessments	Acquisition of commercial land is prohibited for foreign companies (by any means)

Exhibit 10. Examples on the classification of service barriers as proposed by Dee, Hanslow and Phamduc (2003).

As recapitulated in the Report from the Commission of the European Communities on the state of the internal market for services (2002), barriers to trade may arise in different stages of service provision:

1. *Establishment of service providers* (barriers to competition, nationality requirements, red tape during authorization/licensing of an agent, tax discrimination);
2. *Use of inputs for service provision* (limitations on foreign labor force deployment/ imports of equipment and materials from abroad);
3. *Promotion of services* (advertising restrictions);

4. *Distribution of services* (monopolistic restrictions on market access, discrimination in the access to distribution networks);
5. *Sale of services* (price controls, government procurement);
6. *Difficulties relating to after-sales service* (discrimination in liability insurance for service providers, and other obstacles in provision of after-sales service).

When it comes to the measurement of barriers to service trade, Deardorff and Stern distinguish direct and indirect types: direct measurements start from the observation of certain policy and then attempt to gauge its economic importance; on the other hand, indirect measurements try to infer the existence of trade barriers by using observed discrepancies between actual economic performance and what would be expected if trade was free (as cited in Mattoo, Stern and Zanini, 2008). Authors suggest that presently, direct measurement is the most preferred option, while indirect one is less common in practice.

A notable example of direct measurements of service barriers is **Services Trade Restrictiveness Index (STRI)**, introduced by the OECD in 2014. It is a unique, evidence-based diagnostic tool that provides an up-to-date snapshot of services trade barriers in 22 sectors across 44 countries (OECD, 2018):

- 35 OECD member states;
- Countries in accession talks – Colombia, Costa Rica, Lithuania;
- Key trade partners of OECD – Brazil, China, India, Indonesia, Russia and South Africa.

This scope represents over 80% of global services trade (OECD, 2018). The sectors examined include digital network (telecom, broadcasting, motion pictures), transport and distribution supply chain (transportation, cargo-handling, storage, customs brokerage), market bridging and supporting services (legal and accounting services, banking and insurance) and physical infrastructure services (construction, architecture and engineering). All in all, these sectors are evaluated by 5 metrics: restrictions on foreign entry, restrictions to movement of people, regulatory transparency, barriers to competition, and other discriminatory measures. The STRIs

take values between zero and one, one representing a totally closed and zero a fully open sector. The index records restrictions that apply on a most favored nation (MFN) principle and does not consider preferential trade agreements (OECD, 2009).

Mattoo (2015) mapped estimated restrictiveness of service trade policy, citing Borchert et al. (2013), who rescaled STRI on a value range between 0 (no barriers) and 100 (extremely high barriers) and extended STRI metrics to 103 countries (79 of which are classified as developing) (see: Exhibit 16).

Barriers to trade in services vary across regions and sectors. Borchert et al. (2013) provide next findings, utilizing the same sample of 103 countries <sup>12</sup> (see: Exhibits 11-15). Overall, region with the highest restrictions is Gulf Cooperation Council, while the lowest restrictions are observed in OECD member states, Europe, and Central Asia; the most protected sector per se is professional business services (scoring 51 scaled p. on average), whereas the most liberal one is retailing (21 scaled p. on average).

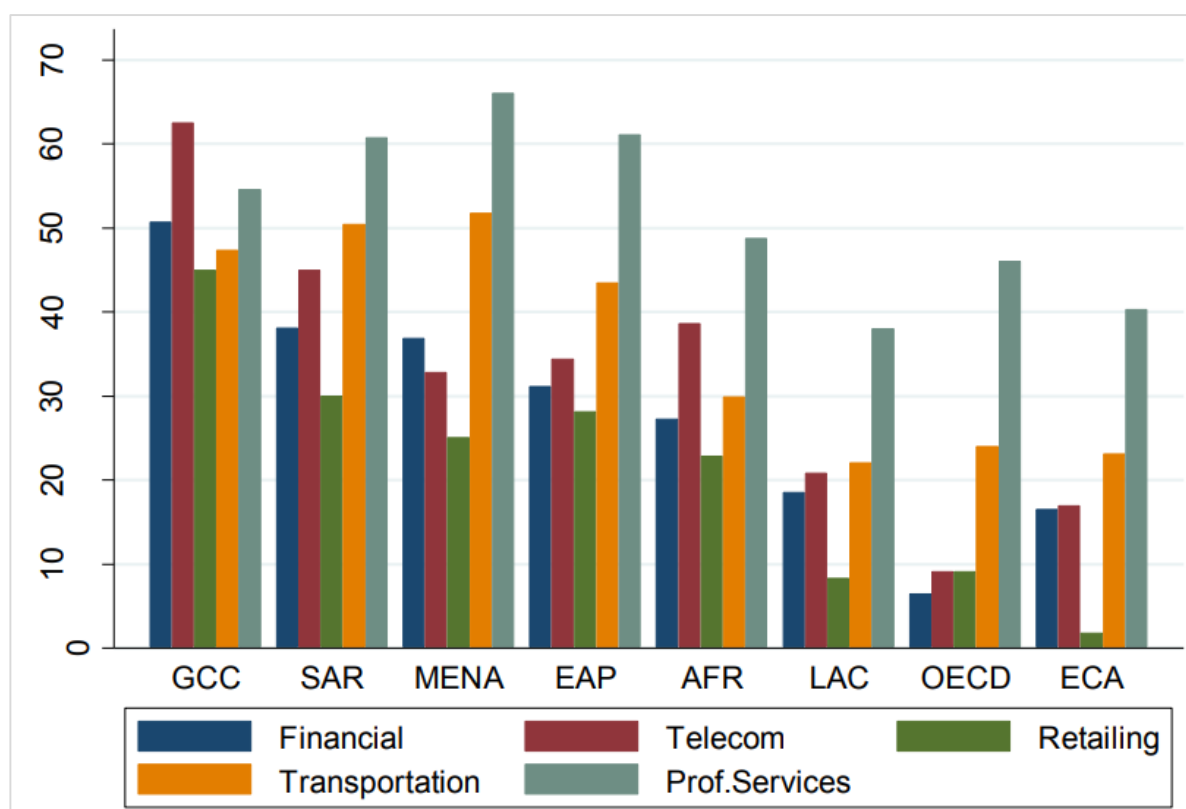


Exhibit 11. STRI by sector and region, within a sample of 103 countries (Borchert et al., 2013).

<sup>12</sup> In their analysis, Borchert et al. (2013) consider Mode 1 (cross-border) and Mode 3 (commercial presence) for the supply of financial and transportation services; Mode 3 for the provision of retailing services; Mode 1, 3 and 4 (presence of natural persons) for the supply of business services. GATS modes of supply will be discussed in detail in paragraph 2.2.

STRI are rescaled, with 0 meaning no barriers to trade, and 100 implying extremely high barriers.

Abbr.: GCC – Gulf Cooperation Council, SAR – South Asia, MENA – Middle East and North Africa, EAP – East Asia and Pacific, AFR – Sub-Saharan Africa, LAC – Latin America and Caribbean, OECD – high-income OECD member states, ECA – Europe and Central Asia.

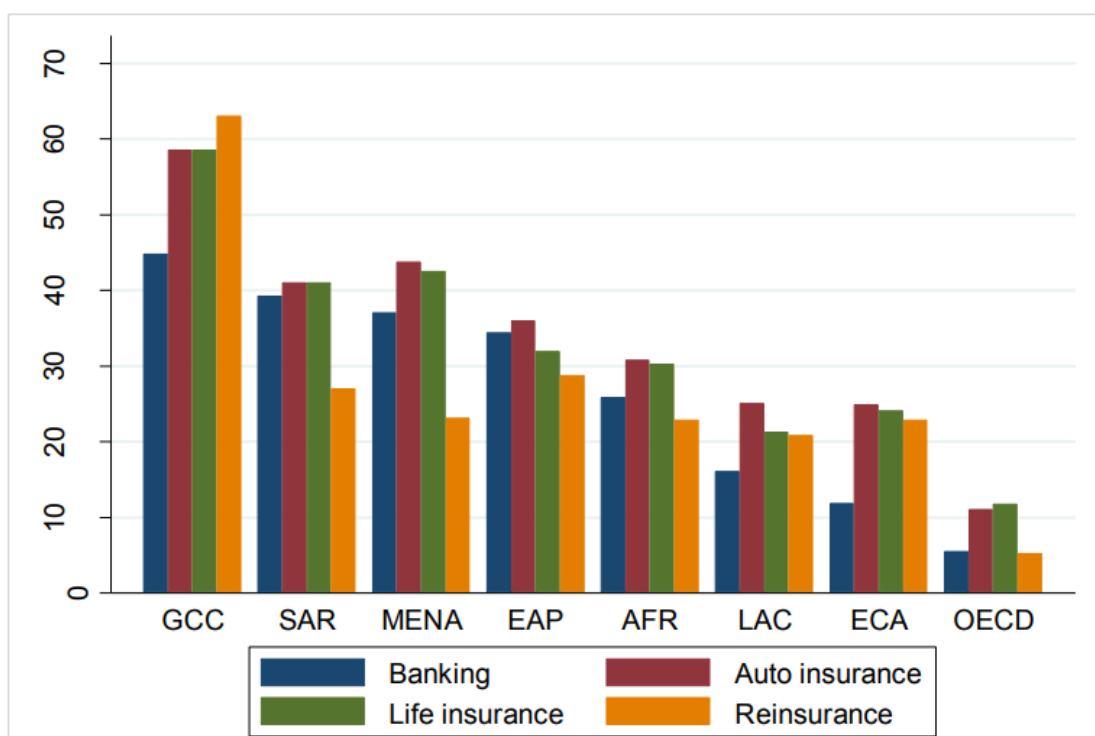


Exhibit 12. STRI in **financial services** by region and subsector within a sample of 103 countries (Borchert et al., 2013). STRIs are rescaled: 0 – no barriers to trade in services, 100 – extremely high barriers.

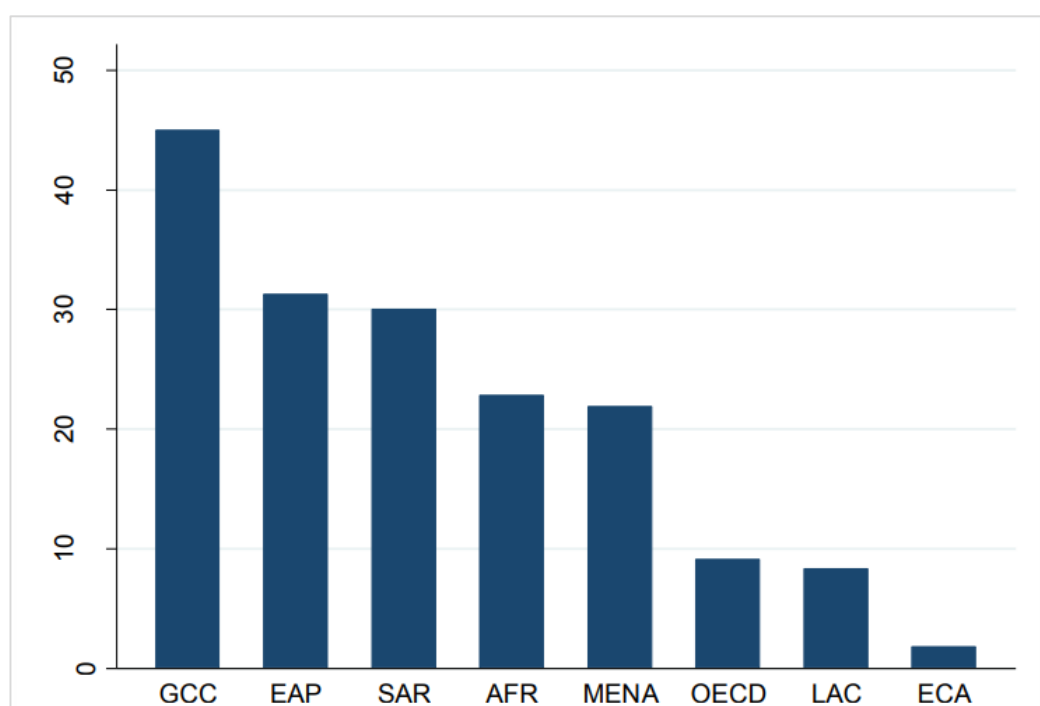


Exhibit 13. STRI in **retailing services** by region and subsector within a sample of 103 countries (Borchert et al., 2013). STRIs are rescaled: 0 – no barriers to trade in services, 100 – extremely high barriers.



Abbr.: GCC – Gulf Cooperation Council, SAR – South Asia, MENA – Middle East and North Africa, EAP – East Asia and Pacific, AFR – Sub-Saharan Africa, LAC – Latin America and Caribbean, OECD – high-income OECD member states, ECA – Europe and Central Asia.

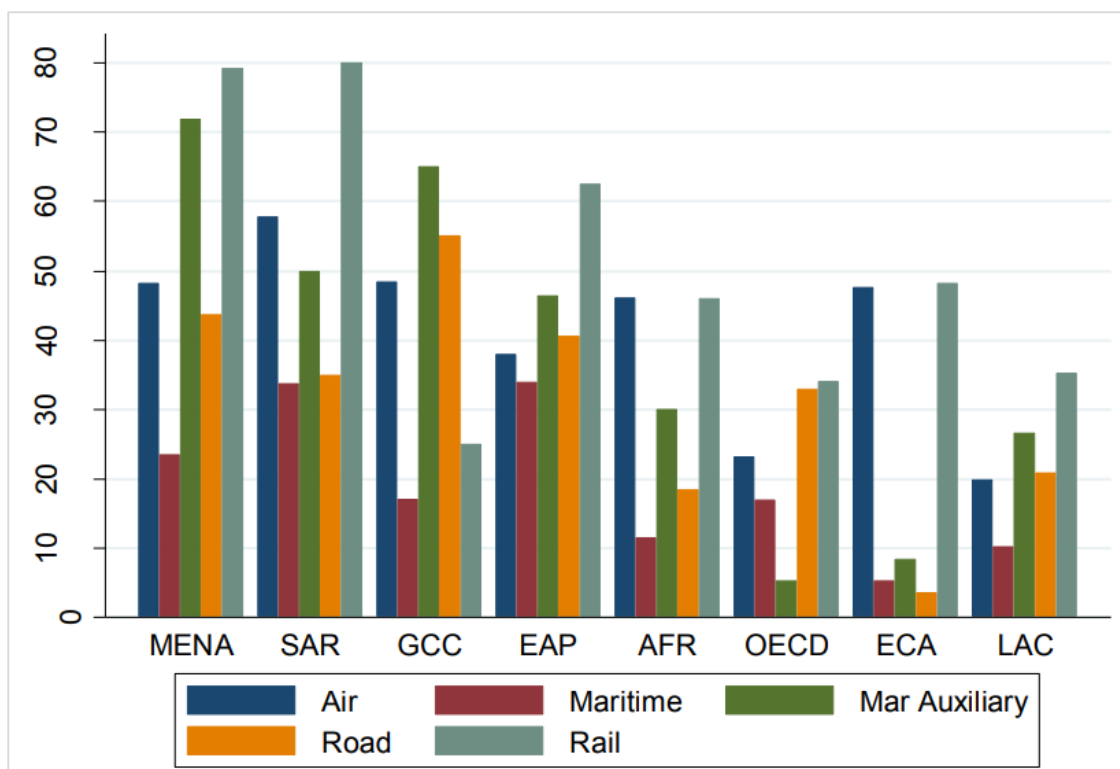


Exhibit 14. STRI in **transportation services** by region and subsector within a sample of 103 countries (Borchert et al., 2013). STRIs are rescaled: 0 – no barriers to service trade, 100 – extremely high barriers.

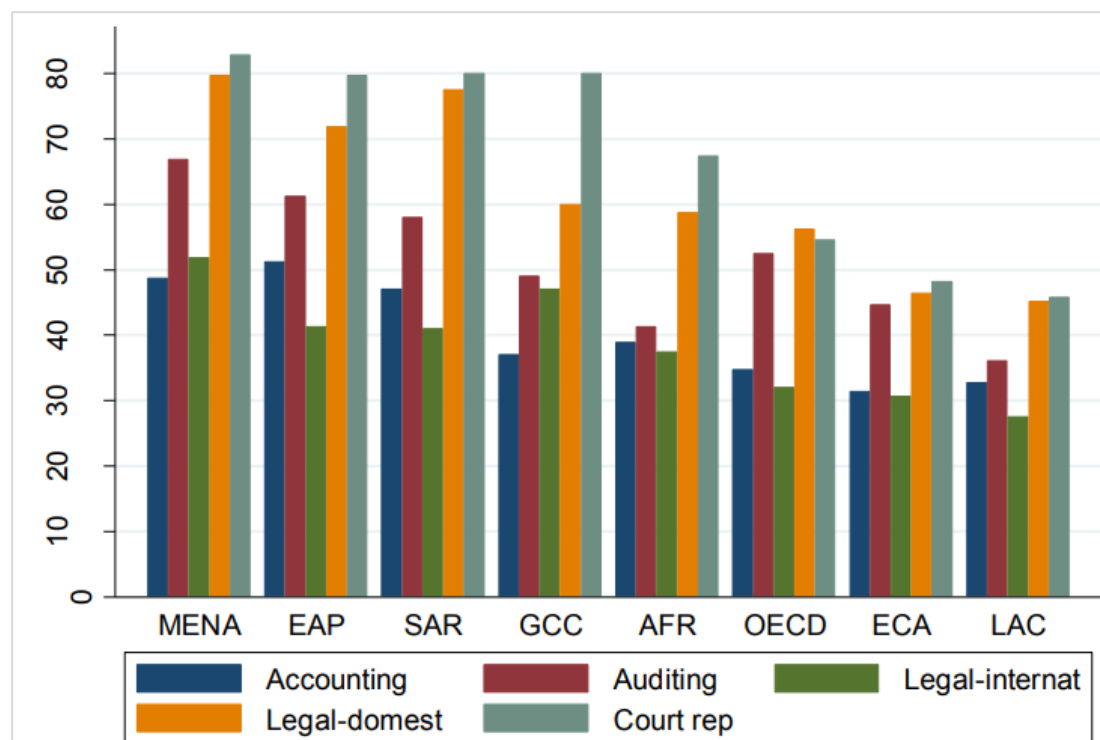


Exhibit 15. STRI in **professional business services** by region and subsector within a sample of 103 countries (Borchert et al., 2013). STRIs are rescaled: 0 – no barriers to service trade, 100 – extremely high barriers.

Abbr.: “legal-internat” – provision of legal advice on international law, “legal-domest” – provision of legal advice on domestic law; “court rep” – legal representation in a domestic court

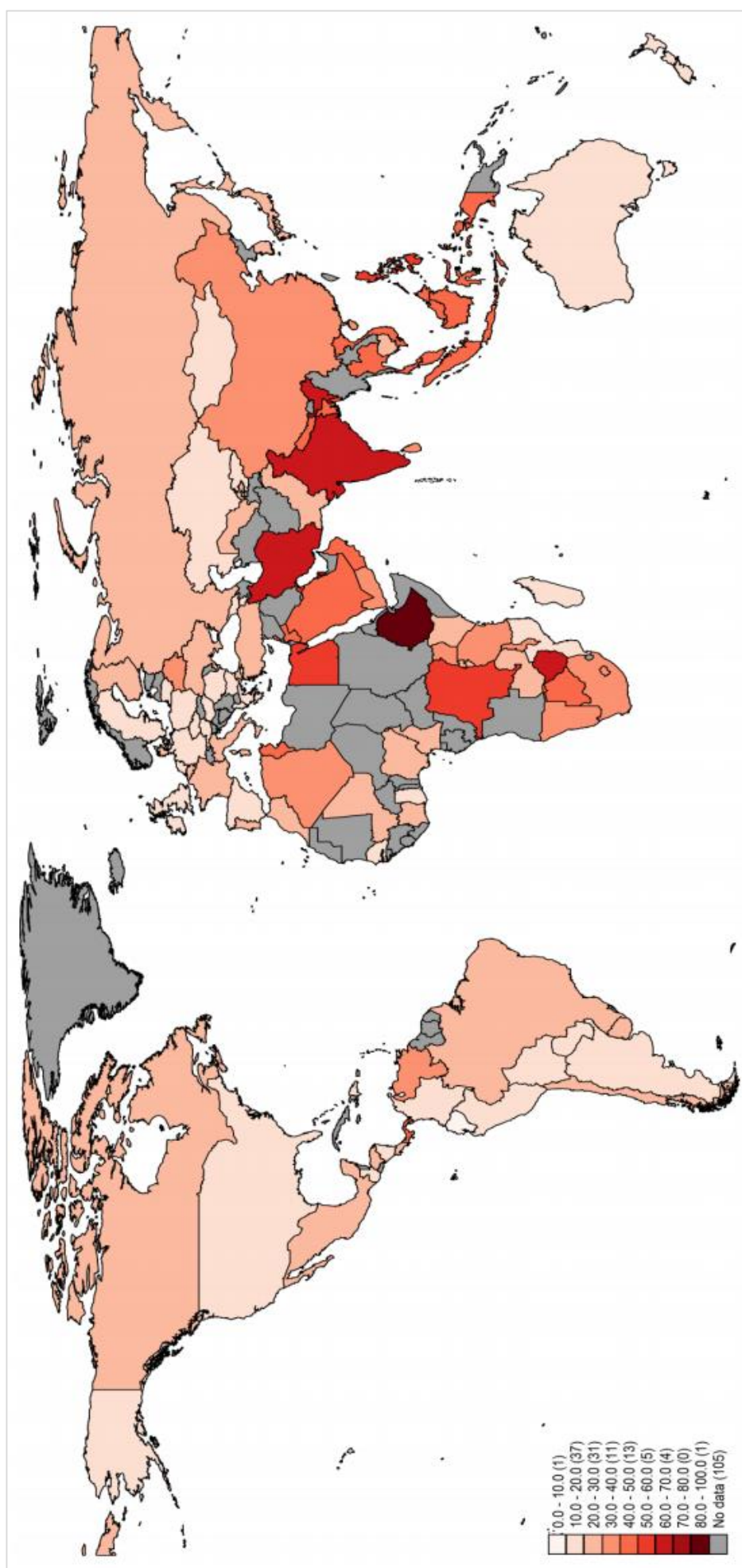


Exhibit 16. Estimated restrictiveness of services trade policy (STRIs) around 103 countries (Mattoo, 2015).

STRIs are rescaled, with 0 meaning no barriers to trade, and 100 implying extremely high barriers.

OECD reviews policy trends on service trade restrictiveness and scrutinizes economic impact of the latter on a regular basis. The latest report (2018) provides following hints:

- **Service trade barriers hamper service exports and investment** – OECD estimates that trade cost equivalent of service trade barriers surpass average tariff levels, observed in merchandise trade. Services trade barriers have a strong anti-export bias that impedes services exports as much as services imports (OECD, 2018). Similarly, Nordås and Kox (2009) suggest that barriers to trade, represented by strict national regulation, discourage not only inward but also outward investments, as local companies find it more difficult to enter foreign markets the more restricted they are at home.
- **It is consumers and firms who pay the cost of trade barriers** – barriers to entry, imposed by the governments, allow incumbent firms to gain market power, restrict competition and delay introduction of innovations – cost of which is borne by consumers and businesses facing higher prices and limited choice (OECD, 2018).
- **Trade in services largely depends on the cross-border movement of factors of production** – mobility of capital, natural persons, and what is more important, of knowledge, is crucial for international business operations and is an important channel for knowledge transfer and retention of expertise.
- **Service barriers inhibit the development of SMEs** – according to the report (2018), for micro firms engaging in cross-border transactions an average level of services trade restrictiveness represents an extra 7% in trade costs relative to large firms; establishing an affiliate abroad involves even higher costs – for a small firm an average level of services trade restrictiveness is estimated to be equivalent to an extra 12% tariff compared to large firms.

Moving further on the regulation of international market of services, one should mention the role of **bilateral agreements**, which deal with certain aspects of trade in services and investment in this area.

Another kind is **multilateral regulation within economic integration units (trade blocs)**, such as the European Union or NAFTA, members of which have abolished restrictions on trade in goods and services internally.

Ultimately, the **World Trade Organization** and its constituent agreement on services (GATS) share almost exclusive role in the global regulation of international market of services. The methods, principles and inferences of such a regulation will be discussed in the next chapter.

## **Chapter 2. ROLE OF THE WTO IN THE REGULATION OF INTERNATIONAL MARKET OF SERVICES**

### **2.1 WTO – determining rules of trade since 1995**

The World Trade Organization (WTO) was established on January 1, 1995. It is one of the youngest international organizations, and the only global institution dealing with rules of trade. Accordingly, the WTO is engaged in the regulation of international trade in goods and services, as well as in governing trade-related intellectual property rights. The organization defines its function as “ensuring that trade flows as smoothly, predictable and freely, as possible” (WTO, 2018).

**History behind the creation.** Original idea of creating an institution (put up as International Trade Organization – ITO) which would handle trade-related issues of international economic cooperation was set forth during the Bretton Woods conference (1944). More than 50 countries participated in negotiations, with ambitious ideas of authorizing the ITO in such domains, as employment, investment, and trade in goods and services. The aim was to set up the organization by the end of the decade.

In the meantime, first talks on trade liberalization kicked off in late 1945. They embraced 15 countries and resulted in a package of trade rules and about 45,000 tariff concessions, which affected US\$ 10 billion of trade – almost one fifth of world’s total (WTO, 2015). The number of countries expanded to 23 by 1947.

Eventually, trade rules envisaged by these 23 states were fused in the General Agreement on Tariffs and Trade (GATT). The agreement was signed in Geneva, on October 30, 1947, and came into force on January 1, 1948. Initially, it was expected that GATT would be included in the ITO Charter, adoption of which was close at hand.

However, negotiations on ITO itself did not go as readily as they were desired to: certain countries, including the USA, fully dismissed ratification of ITO Charter by national legislature. As a result, the ITO “*was effectively dead*” (WTO, 2015), and GATT remained in place as a set of purely provisional clauses.

Yet, fiasco with the ITO did not lead to the standstill in trade negotiations. Efforts towards a more liberal trade continued through a series of multilateral talks, known as “trade rounds” (WTO, 2015)<sup>13</sup>:

Year	Round	Topics covered	Participants
<b>1947</b>	Geneva	Tariffs; adoption of GATS	23
<b>1949</b>	Annecy	Tariffs	13
<b>1951</b>	Torquay	Tariffs	38
<b>1956</b>	Geneva	Tariffs	26
<b>1960-1961</b>	Geneva (Dillon)	Tariffs	26
<b>1964-1967</b>	Geneva (Kennedy)	Tariffs, anti-dumping measures	62
<b>1973-1979</b>	Tokyo	Tariffs and NTBs, “framework” agreements	102
<b>1986-1994</b>	Uruguay	Tariffs and NTBs, services, intellectual property rights, dispute settlement, textiles, agriculture, establishment of the WTO	123
<b>2001-?</b>	Doha	Tariffs and NTBs, agriculture, services, intellectual property rights, NAMA, trade and competition/investments, trade facilitation, special treatment, etc.	164

Exhibit 17. Trade rounds, happening under the GATT (1947-1994) and WTO (1995-...).

Among all the rounds, first progressive steps headed for reforming the system were undertaken during **Tokyo Round**, which lasted between 1973-1979 with 102 countries participating. Its results included an average one-third cut in customs duties in the world’s nine major industrial markets, bringing the average tariff on

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<sup>13</sup> The duration of the rounds varies – progress depends on advancements over “negotiation package”, which typically includes liberalization commitments over selected sectors. The “package” approach is considered to be more fruitful than negotiations on a single issue (WTO, 2015).

industrial produce down to 4.7%; also, tariff reductions involved an element of “harmonization” – the higher the tariff, the larger the cut (WTO, 2015). During the Round, a series of agreements on NTBs were negotiated – between a relatively small number of countries though (due to this fact, these agreements are often cited as “codes” of Tokyo Round). The “codes” embraced such subjects as subsidies and countervailing duties, import licensing, state procurement, anti-dumping measures, technical barriers to trade, and arrangements on certain product groups.

**Uruguay Round** – perhaps, the most significant in the history of GATT – was commenced in 1986, in Punta del Este (Uruguay). The scope of discussions, time span, and number of participating states proved this round to be the largest trade negotiation ever. Agenda, adopted in 1986, covered virtually every outstanding policy issue: for the first time, it included discussions on services and intellectual property rights, alongside with necessitating major moves on such delicate topics as trade in agriculture and textiles, dominated by developing countries. The Uruguay “package” also included a review of GATT clauses and “codes” of Tokyo Round, talks on the GATT system overall, and on a valid dispute settlement mechanism. All in all, it took over 7 years to reach consensus on total of 15 subjects (WTO, 2015).

Undoubtedly, seeking consent of 123 states was not an easy job: discussions lurched between failure and success, hit-or-miss schedules, and caused new conflicts. Namely, discord between the USA and EU over the liberalization of agriculture and measures on tariff and non-tariff barriers became central by the end of the tenner; luckily, both parties settled down the issue in a deal known as “Blair House accord”, in 1992. By 1994, majority of issues were finally resolved. On April 15, 1994, representatives from the most of 123 countries signed the **Marrakesh Agreement** (officially came into force on January 1, 1995), establishing the World Trade Organization.

Once established, the WTO filled in the gaps of antecedent GATT regulations by taking a firmer stance on the regulation of international trade. Here are the basic differences between two coeval but genuinely varied institutions:

- First of all, founding treaty confers a legally binding nature on the organization – hence, commitments made by WTO members are full and permanent. On the contrary, commitments made under the GATT were solely provisional.
- Secondly, GATT covered trade in goods only, while WTO encompasses trade in goods, services, as well as trade-related intellectual property rights and facilitation of investment.
- GATT talks and agreements were of “plurilateral” nature with voluntary membership. Oppositely, all WTO agreements are multilateral obligations and are applicable to each and every WTO member;
- In contrast to GATT, WTO has a more structured dispute settlement mechanism (to be discussed further), which is less susceptible to hurdles.

It should be noted that, the Uruguay Round resulted in unprecedented 22,500 pages of individual countries’ commitments on specific categories of goods and services. These included commitments to eliminate, cut or “bind” tariffs<sup>14</sup> on imports of goods and services (WTO, 2015). The Round also evidenced a radical change in North-South politics: previously, developed and developing countries used to be in opposition, but in the run of Uruguay Round the dissent became less rigid, with some alliances formed between the two. The trend has kept up since then.

Besides, talks in Punta del Este recognized growing importance of service trade and intellectual property rights by extending multilateral trading system to these domains in the form of GATS and TRIPS agreements – integral parts of the core Marrakesh Agreement.

Finalization of the Uruguay Round did not imply the termination of trade negotiations. Most of its agreements set a “built-in agenda” for future works, which covered more than 30 subjects, including services, intellectual property rights, agriculture, textiles, tariff, non-tariff and technical barriers to trade.

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<sup>14</sup> “Bound” rates refer to duty rates committed in the WTO on specific sectors. These rates are maximum a member country can set, and thereby serve as “ceilings”.



A new round of trade talks – this time governed by the WTO – kicked off in Doha (Qatar), in November 2001. Alongside with calling to attention on such new topics as trade in services, trade and investment / trade and competition policy, trade facilitation, technical cooperation, e-commerce, etc., the **Doha Development Agenda (DDA)** incorporated debates over conventional issues, too (trade in agriculture, textiles and clothing, market access of developing nations, NAMA, differential treatment, and so forth) (WTO, 2018).

Despite slight progress achieved (adoption of Trade Facilitation Agreement, “Bali” and “Nairobi” packages), it is presumed that the Doha Round is in standstill. Apparently, deep division and lack of reciprocity between developed and developing countries cause a failure to advance consensus on policy proposals. Opinions on parties liable for downfall of the round vary in depth. On one hand, it is believed that developed countries are leading the deadlock by taking an austere position on several key issues, including subsidies on agriculture produce and granting market access to developing nations. On the other hand, as stated in Charlton (2006), it is LDCs (referred as “preference-dependent countries”) who have a vested interest in the collapse of DDA: *“for them, no deal is a good deal and they have been a thorn in the side of the round from day one”*. The author indicates that, these states are right to say that their circumstances should give them special treatment, but the reality is that they cannot offer anything in return.

**Structure, principles and essence of the WTO.** Hitherto, the WTO is comprised of **164 member states** (36 of which are classified as LDCs) and **23 observer governments**, covering **98% of global trade**. The organization is headquartered in Geneva (Switzerland). Present director-general is Roberto Azevêdo, who has been re-elected for the second four-year term in 2017 (WTO, 2018).

When it comes to the organizational structure, **Ministerial Conference** is the governing body of the organization. It possesses a decision-making power, and is comprised of several committees and working groups. The Conference should be organized once in two years (at least). The latest one (11<sup>th</sup>) took place in Buenos

Aires (Argentina), on December 10-13, 2017. In-between Ministerial Conferences, work is handled by the **General Council**. The General Council meets as Dispute Settlement Body and Trade Policy Review Body on respective occasions. It reports to the Ministerial Conference, and alike the former, is comprised of WTO members.

Three more institutes, covering different realms of international trade, report to the General Council: the Council for Trade in Goods, Council for Trade in Services, and Council for Trade-Related Aspects of Intellectual Property Rights. Each of them has subsidiary bodies – committees and working parties. For instance, the Council for Trade in Services is comprised of two committees (on trade in financial services / specific commitments), as well as two working parties (on domestic regulation / rules of GATS). The detailed organization chart is presented in the Exhibit 18.

The WTO is empowered to define trade rules for member countries by the virtue of Marrakesh Agreement, which, in turn, is comprised of several underlying agreements (see: Exhibit 19):

1. Agreement establishing the WTO (referred as “umbrella agreement”);
2. General Agreement on Tariffs and Trade (GATT);
3. General Agreement on Trade in Services (GATS);
4. Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS);
5. Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU);
6. Trade policy reviews.

Both the GATT and GATS consist of three main parts: **broad principles, additional agreements and annexes**, and eventually – **schedules of commitments**. The latter implies commitments of individual countries to allow foreign providers of certain goods or services access their markets. The WTO distinguishes three types of commitments (Dadush and Osakwe, 2015):

- i. *Full* – when member pledges for unrestricted market access;
- ii. *Partial* – member guarantees certain degree of access, but retains the right to impose limitations it has specified in the schedule;

- iii. *Unbound* – member maintains full discretion over trade restrictions permitted to apply, therefore, no guarantees for market access are undertaken.

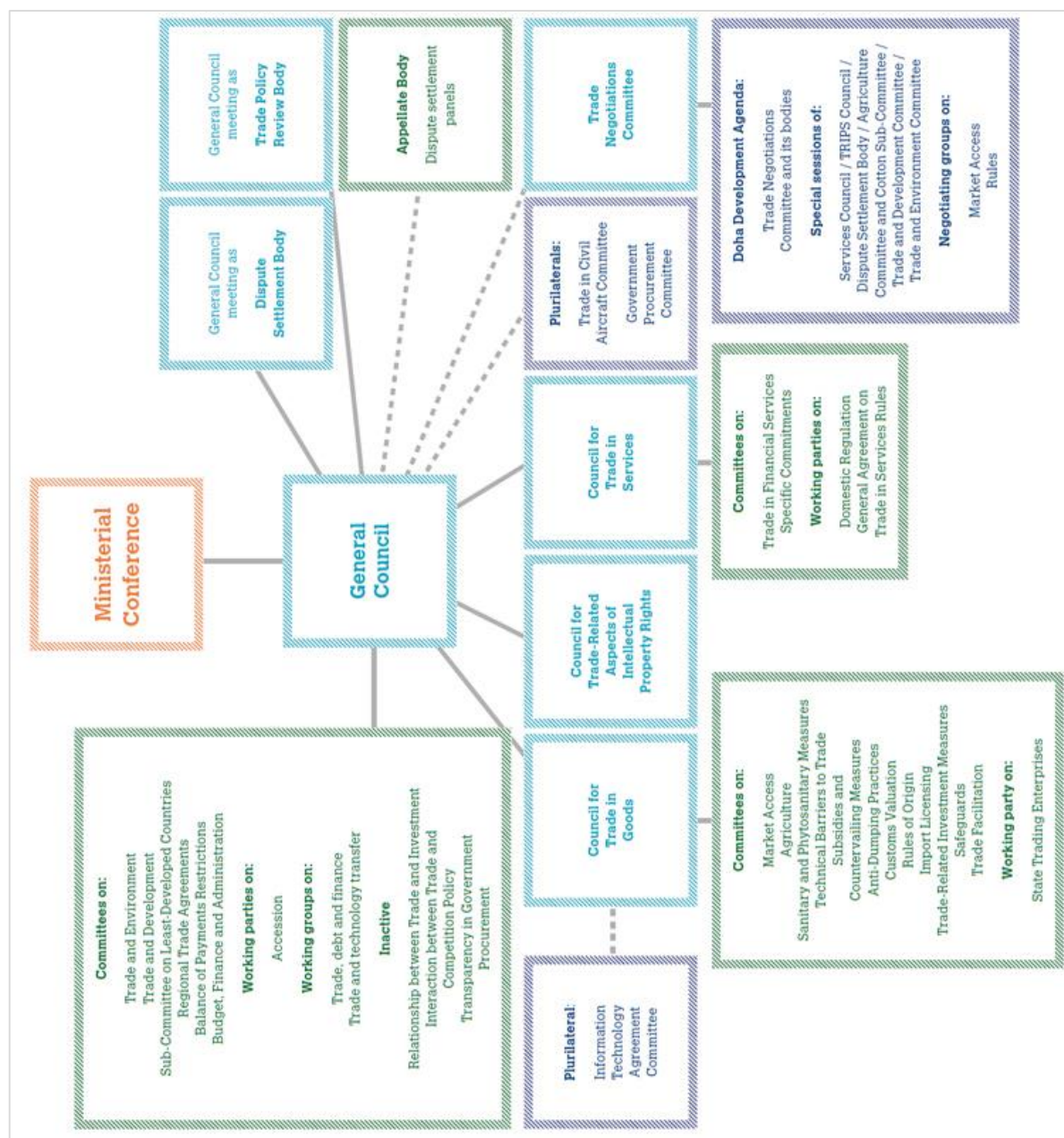


Exhibit 18. Structure of the WTO (WTO, 2018)

In addition to the main six, there are also supplementary legal texts (about 60 agreements and decisions), most of which have been negotiated during the Uruguay Round. These accords include but are not limited to Agreements on Agriculture, Technical Barriers to Trade (TBT), Trade-Related Investment Measures (TRIMS), Rules of Origin, Safeguards, Trade Facilitation, and so on.

<i>Umbrella</i>	AGREEMENT ESTABLISHING WTO		
	Goods	Services	Intellectual property
<i>Basic principles</i>	<b>GATT</b>	<b>GATS</b>	<b>TRIPS</b>
<i>Additional details</i>	Other goods agreements and annexes	Services annexes	
<i>Market access commitments</i>	Countries' schedules of commitments	Countries' schedules of commitments (and MFN exemptions)	
<i>Dispute settlement</i>	DISPUTE SETTLEMENT		
<i>Transparency</i>	TRADE POLICY REVIEWS		

Exhibit 19. The structure of WTO agreements (WTO, 2015).

In the main, the WTO defines its mission as bringing assurance to the world trade – so that, both producers and consumers enjoy secure supply and greater variety of goods and services, and are confident that overseas markets remain open to them. To do so, the WTO urges member countries to abide by **five fundamental principles of trading system**:

- 1. Trade without discrimination** – envisaged in the principles of Most Favored Nation (MFN) and National Treatment (NT). According to the MFN principle, states should not discriminate between their trading partners – if any favor (i.e., lower customs duties) is granted to one partner, it should be extended to all others<sup>15</sup>. NT principle implies that both imported and locally produced goods and services (as well as trademarks, patents and copyrights, and other types of intellectual property) should be treated

<sup>15</sup> Certain exceptions to MFN principle are allowed. Countries engaged in a free trade agreement may exercise preferential treatment to goods and services traded between one another. Granting market access on special terms to preference-dependent countries does not breach MFN either (WTO, 2015).

equally<sup>16</sup>. Both principles are specified in GATT, GATS and TRIPS agreements.

2. **Free trade: gradually, through negotiations.** Opening markets by means of lowering barriers to trade can be beneficial, but it also requires proper timing and interim adjustments. The WTO allows member states to introduce changes stepwise, by means of “progressive liberalization”. In general, developing countries are given longer time to comply with obligations.
3. **Predictability: through binding and transparency.** This principle reflects the very intent of the multilateral trading system – making global business environment stable, secure and predictable to all economic agents by administering barriers to trade, conditioning greater transparency, and surveilling national trade policies on a regular basis.
4. **Fair competition** – is attained by the set of WTO principles (MFN and NT) and policies (e.g., TBT Agreement, Agreements on Anti-dumping, Subsidies and Countervailing Measures, Sanitary Measures etc.).
5. **Encouraging development and economic reforms** is embodied in due respect the WTO demonstrates to emerging, and what is more important, to the least developed countries, by granting them grace periods for adjusting domestic policies, technical assistance, and differential treatment. As a result, more than 60 developing countries systematically implemented trade liberalization commitments after the Uruguay Round. They were moderately active in Punta del Este, and became keener to negotiate during the Doha Round.

The very essence of the organization is **greater extent of trade liberalization**.

Drastic cuts in tariffs, embarked upon by member countries, is one of several ways to accomplish this objective. For developed ones, tariff reductions started straight after the conclusion of Uruguay Round and phased over 5 years, resulting in

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<sup>16</sup> National treatment applies as soon as a product/service/item of intellectual property passes the border (customs) of a country (WTO, 2015).

40% cut of tariffs applied on industrial goods (viz., average tariff dropping from 6.3% to 3.8%). According to the WTO (2018), the value of industrial imports that receive duty-free treatment in developed countries increased from 20% to 44%. Other product groups experienced lowering of import duties, too. Overall, the portion of imports to developed countries from all sectors facing tariffs of more than 15% declined from 7% to 5% (WTO, 2018).

When it comes to the reduction of tariff barriers by developing countries, the latter enjoy special treatment of the WTO. Recognizing their circumstances, the organization lets emerging economies take more time (compared to the advanced ones, which have to comply straightaway in the majority of cases) to adapt and apply policy packages (see: Exhibit 20).

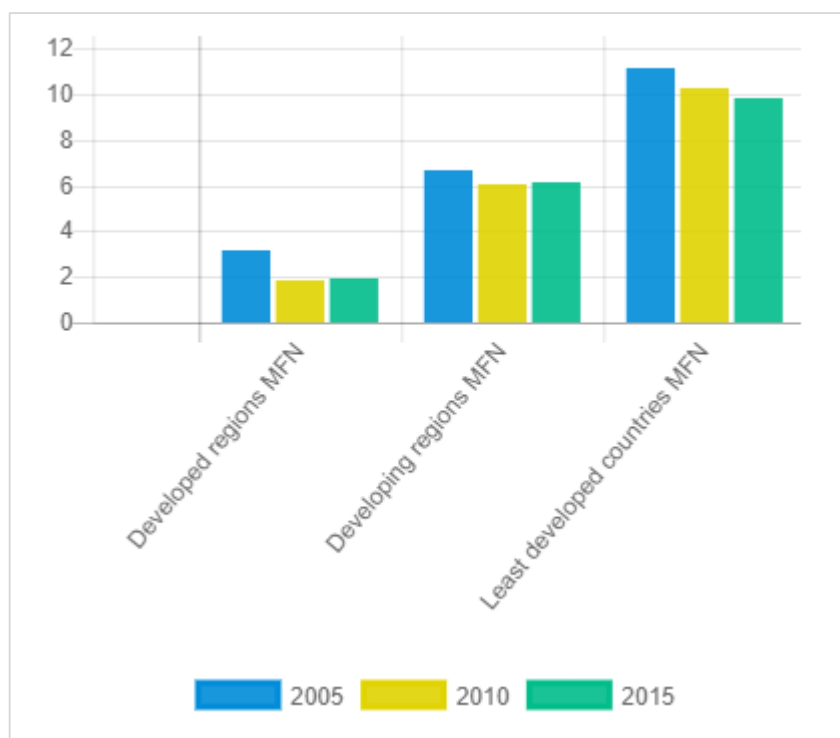


Exhibit 20. Import tariffs applied under the WTO (in %) in 2005, 2010 and 2015 (UN IATF, 2016). As a matter of fact, developing countries and LDCs are entitled to special treatment, which gives them more time to adapt local market conditions to the approved packages.

“Bound” (“ceiling”) tariff rates, introduced by the WTO, are another tool facilitating freer trade and abolishing protectionist hurdles. It is worth mentioning that “bound” rates now cover 99% of all existing product lines in developed countries (up from 78% in 1995), and 73% in developing ones (significantly increasing from 21% in 1995) (WTO, 2018).

with tariff barriers, the WTO also tackles the non-tariff ones by conducting trade policy reviews of member countries and developing apposite policy proposals. Existing WTO agreements watch over such outward NTBs as subsidies and countervailing duties, import licensing, rules of origin, anti-dumping practices, etc. In addition, they envisage subtle forms of trade discrimination too, which may come by as partial customs valuation, manipulation in pre-shipment inspections, exigent sanitary measures, and over-protective safeguards. All in all, the organization aims to prevent red tape and any other hindrances to trade, and ensure its smooth flow.

Undoubtedly, almost all sectors of economy have experienced the impact of trade liberalization, happening under the auspices of the WTO. For trade in goods, the most notable ones would be agriculture and textiles, debates on which spanned over decades.

Success in talks on agriculture and farming came with the Uruguay Round, which evidenced primary reduction in agriculture subsidies and introduction of “tariffication”, “minimum market access” and “tariff-quota” formulas. Within 6 years (1995-2000), developed countries cut tariffs on agricultural products by 36% (on average, minimum 15% cut per product), diminished domestic support by 20% and export subsidies by 36%. For developing countries enjoying longer adjustment period (1995-2004), average cut in tariffs equaled 24% (minimum 10% per product), and reductions in state support and export subsidies made up 13% and 24% respectively (WTO, 2018).

Even though Doha talks on farming halted for long, the “Nairobi Package” adopted during WTO’s 10th Ministerial Conference (2015) broke the impasse as member states agreed to eradicate export subsidies on agriculture (developed countries – straight from 2015, developing countries – by 2018-2023). Director-general R. Azevêdo characterized the decision as “*the most significant outcome on agriculture*” in the 20 years of WTO history (WTO, 2015). As of now, member states’ commitments on agriculture include providing greater market access and healthy competition, ensuring fewer distortions to trade, and avoiding indirect discrimination.



WTO's Agreement on Textiles and Clothing (1995) replaced anterior Multifibre Arrangement and eased down its side effects – quotas and embargoes. In 2005, the sector became fully integrated into GATT framework, and the Agreement was terminated. This was a direct outcome of progressive liberalization: percentage of textile products brought under the GATT between 1995-1997 was 16%, 1998-2001 – 17%, 2002-2004 – 18%, 2005 – 49% (hence, no quotas were left after 2005) (WTO, 2015).

Even if talks on agriculture and textiles witnessed severe confrontation between developed and developing economies (with the former keen on protecting local markets from import competition), consensus on a number of issues was eventually reached. This, in turn, resulted in a gradual shrinkage of tariff barriers, took on by developed states (see: Exhibit 21).

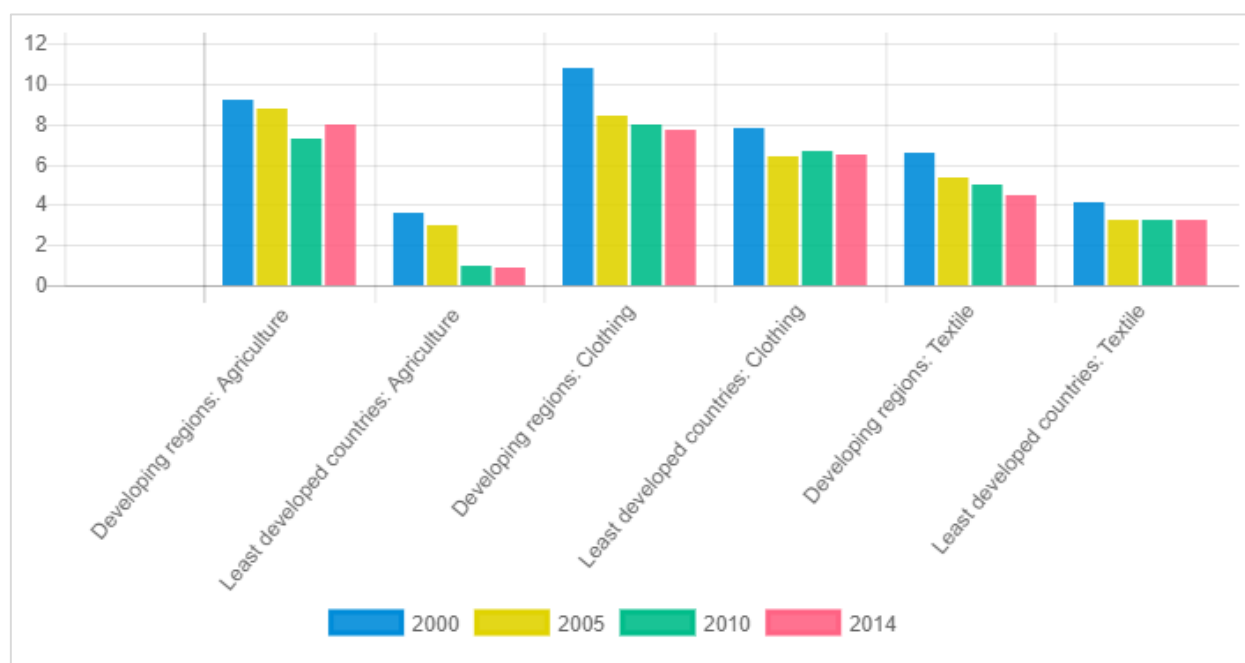


Exhibit 21. Average tariffs levied by developed countries on agriculture and textile products exported by developing and least developed countries, in 2000, 2005, 2010, and 2014 (in %). Historical trend shows gradual reduction in tariffs for the most barrier-sensitive product groups (UN IATF, 2016).

Liberalization of multilateral trading system had a colossal effect on the service realm, too. Extension of MFN and NT principles, as well as the introduction of market-access commitment, “bound” rates and mutual recognition (i.e., of licenses and certifications of service providers) did their bit in achieving a freer and fairer



trade in tertiary sector. An overview of the WTO regulations on services and their outcomes for the world economy will be discussed in the next paragraph.

Presently, the idea of trade has evolved beyond goods and services and encompasses creations of mind, too. The uptrend has been noticed by the WTO betimes, with TRIPS Agreement being incorporated in the core Marrakesh Agreement in 1995. The TRIPS Agreement aims at narrowing down the gaps in the worldwide protection of intellectual property rights and bringing them under shared international rules. The outcome is balanced protection of knowledge, innovations and creativity, disseminating across the continents in the forms of copyrights, trademarks, service marks, patents, industrial designs, and trade secrets.

**Decision-making in the WTO.** The WTO is considered to be a **member-driven rule- and consensus-based** organization. It is run by member states' governments, which are in charge of making all major decisions. Contrary to share vote system prevailing in such organizations as the World Bank and IMF, consensus-based decision-making pursues the best interests of multilateral trading system, since it takes into account the outlook of each member country; it does not draw a distinction between members either.

Where consensus is not possible, the WTO allows for voting (a vote is won with a majority of the votes cast, and takes place on the basis of “**one country, one vote**” principle). Above all, the WTO stipulates four specific situations which enable voting: interpretation of multilateral trade agreements, renouncing obligations imposed on a member state by the agreement, making amendments to the agreement, and admitting new members (WTO, 2015). Yet, in practice, voting occurs very rarely (Hoekman, Mattoo and English, 2002).

According to Hoekman et al. (2002), “*consensus practice is of value to smaller countries, as it enhances their negotiating leverage in the informal consultations and bargaining that precede decision-making, especially if they are able to form coalitions*”. Indeed, increased membership, heterogeneity of trade interests as well as the need to secure agreements by consensus have resulted in a less nominal decision-making power of poorer members (Sutherland et al., 2004). As opposed to

the “Quad” (USA, EU, Canada, Japan), weaker bargainers – developing and the least developed countries – seek to enhance their bargaining power (most prominently) by means of coalescing into groups. The very fact that WTO unites 164 members does not necessarily imply that all negotiations will result in 164 different perspectives on trade issues. In particular, coalitions within the WTO may emerge based on:

Factor	Negotiation group (coalition)
<i>Participation in regional economic integration</i>	APEC, ASEAN, Mercosur
<i>Common interests in a certain product group</i>	Cairns group, Tropical products, “Friends of Special Products”, “Friends of Fish”, Cotton-4, Joint proposal, G-10, G-20
<i>Geographical proximity</i>	African Group, Pacific Group
<i>Identical economic conditions</i>	LDCs, Small vulnerable economies (SVEs)

Exhibit 22. Coalitions in the WTO. Note that the EU is excluded from the list as it participates in the negotiations as a single bargaining unit for all members at all times.

Currently, there are more than 25 coalitions, often speaking with one voice or via a single coordinator/negotiating team (WTO, 2018).

Undoubtedly, every decision made is a consequence of fruitful negotiations. In WTO, trade talks happen in the Trade Negotiations Committee (which is under the authority of General Council) and its subsidiary bodies. They follow “**single undertaking**” (i.e., every item of negotiations is a part of a single package and cannot be agreed separately), transparency, participation, special/differential treatment and sustainable development principles.

If discussions carry it too far, members may call for “Green Room meetings”, where they are able to elaborate new approaches and seek for consensus in an informal setting. As a general rule, these meetings are coordinated by the director-general.

**Dispute settlement in the WTO.** Without an authority and established mechanism for resolving trade disputes, the rule-based nature of the WTO would be

a dubious assumption. Dispute settlement process happening under the WTO represents a set of clearly defined rules and procedures, which contribute to a greater degree of stability and predictability of global trade.

Even though dispute settlement procedure was present under the antecedent GATT, it had no timetables, rulings were easily blocked, and many cases lingered on for a long time with no solution (WTO, 2015). The Uruguay Round corrected these omissions, as the founding treaty of WTO emphasized significance of prompt resolution of quarrels, and debarred losing parties from blocking final rulings.

Disputes arising in the WTO are chiefly about broken commitments – e.g., a dispute may occur if a member country adopts trade policy or undertakes measures breaching WTO agreement it is a signatory to. If one is initiated, Dispute Settlement Body (DSB)<sup>17</sup> is in charge of its resolution. The case would normally run no more than one year (15 months if appealed) and go through several stages:

Stage	Duration	Description
<i>Consultation and mediation</i>	(up to) 60 days	Negotiations between parties to the dispute aimed to test whether they can settle the argument by themselves. Upon need, they may turn to the WTO director-general for mediation or any other type of aid.
<i>Panel set-up</i>	(up to) 45 days	If previous stage fails, panel of experts is set by the Dispute Settlement Body to assist it in making rulings and recommendations.
<i>Panel report to disputing parties</i>	6 months <sup>18</sup>	This stage consists of hearings, rebuttals, interim reports and reviews. Consequently, the panel submits a final report to disputing parties.
<i>Panel report to WTO members</i>	3 weeks	Final report is circulated to the rest of WTO members. If panel decides that the Agreement

<sup>17</sup> Recall that, the General Council is convened as the Dispute Settlement Body on corresponding occasions.

<sup>18</sup> In case of urgency (i.e., when trade in perishable goods is concerned), is shortened to 3 months (WTO, 2018).

		is violated, it recommends the liable party to make its trade measure meet the agreed terms. Final report becomes the ruling in 60 days (unless a consensus rejects it).
<b>TOTAL = 1 YEAR (WITHOUT APPEALS)</b>		
<i>Report of appeals</i>	(up to) 60-90 days	Appeal should be based on legal points rather than examine current state of affairs. Each appeal is reviewed by a permanent Appellate Body (set by the DSB), which consists of 7 members not associated with government. The appeal can uphold, alter or abolish panel's ruling.
<i>Decision on the appeal</i>	(up to) 30 days	Dispute Settlement Body should approve or reject the appeal within 30 days. Rejection is possible by consensus only.
<b>TOTAL = 1 YEAR 3 MONTHS (WITH APPEALS)</b>		

Exhibit 23. The process of dispute settlement in the WTO. Both cases (with or without appeals) are considered.

Once the dispute has been decided by the Dispute Settlement Body and the conflicting party is found accountable for malpractice, it should comply with rulings and recommendations of the panel – either at once or within “a reasonable period of time”. In case if it fails to fulfill rulings, it should enter into negotiations with complaining party and offset its trade losses. If after 20 days no accord is reached, the complaining party may request the DSB to retaliate incurred loss (e.g., by imposing sanctions on the liable party). The DSB should authorize the request within 30 days from the expiry of “reasonable period of time” granted to the liable party, unless there is a consensus against the retaliation.

In sum, the DSB monitors the implementation of approved rulings; any outstanding case remains on the agenda until it is solved (WTO, 2015).

Since 1995, more than 500 disputes have been reviewed by the WTO and over 350 rulings have been made (WTO, 2018). Perhaps, more cases brought to the DSB is good news, as this fact verifies reliance on the rule of international trade law, determined by the WTO.

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All in all, the WTO plays a crucial role in shaping rules of global trade by serving as a forum for negotiations. Progressive trade liberalization has helped to spur growth rates of world trade and hasten economic development altogether. Dwindling barriers to trade, increased transparency and non-discrimination have ensured trade growth to outpace production growth, thus proliferating the former and helping countries to reap its benefits.

Growing number of members and broad scope of discussions happening under the WTO demonstrate that the multilateral trading system is now acknowledged as *“an anchor for development and an instrument of economic and trade reform”* (WTO, 2018).

## **2.2 General Agreement on Trade in Services (premises, essence, and inferences)**

Having discussed the organization in detail, it is time to look at the role of WTO in the regulation of international market of services, solely performed by the General Agreement on Trade in Services.

**History of the GATS.** To start with, services were considered to be an exclusive subject of domestic regulation until the 1970s. However, growing importance of the sector to world trade raised doubts whether services should be left at the discretion of national policies: per Wolfrum et al. (2008), annual growth rate of international trade in services between 1970-1980 was 19%, whilst access to foreign markets was essentially limited or even denied.

Services were first brought to then-GATT agenda during the Tokyo Round (1973-1979), following US initiative. The fact that the USA continued to play a principal role throughout service negotiations was backed by several reasons.

As a matter of fact, financial sector had been one of the most intensively developing domains of US economy since the 1970s. The main investors in the country were not so much commercial banks, as shareholders, investment funds and other contractual financial institutions. Therefore, trading in securities and financial derivatives on stock exchanges and over-the-counter markets was of great importance for the American economy. During the 1970s, uncertainty in the world economy (1973-1975 recession, 1973 oil crisis, 1979 energy crisis) abruptly increased, pointing out to the need for financial hedging and market insurance mechanisms. Trailblazing in the industry, America took the lead as a global center for processing financial information and a generator of innovative technologies in the respective realm. Shortly, financial, consulting and audit services turned out to be an important income item for the US companies. At the same time, demand for such services traversed globally. This fact necessitated suitable conditions allowing American companies to operate in overseas markets. Thus, back in the late 1970s, the USA commenced work on the development of internationally accepted rules for trade in services (Higher School of Economics, n.d.).

At the start, service negotiations progressed rather slowly, getting stuck in the relative scarcity of service trade statistics. For the most part, it was unclear whether service trade was restricted in reality. Consequently, a number of international institutions became involved in the process, including the UNCTAD, OECD and ICC. Studies undertaken by these organizations proved that trade in services was limited by barriers. Finally, in 1980, GATT admitted that trade in services “*is a proper concern*” and agreed to discuss it among other emerging policy issues (Wolfrum et al., 2008).

In 1982, GATT advised contracting parties to examine their national service sector and exchange data. Report, covering 107 countries and drafted by the USA, concluded that all of them experienced a rapid growth in service trade (Wolfrum et al., 2008). Nonetheless, it was argued whether services should be integrated into plurilateral trade system.

In 1984, the USA, alongside with Canada, Israel and Nordic states, called for the establishment of working party on services. Developing countries opposed the offer, contending that information exchange requested in 1982 had not been completed. In fact, obstructive position of developing countries had led to hiatus in service negotiations oftentimes.

It is worth noting that in 1984, the US Congress passed “Trade and Tariff Act”, which largely determined the content of upcoming agreement on services (GATS). The Act sought for increasing the competitiveness of American service industry and compelled to develop international rules applicable to the assumed sphere. Article 305 of the Act further stipulated: the purpose of negotiations on services is to promote the development of trade in services, elimination or reduction of barriers (including violation of national treatment) and restrictions on the establishment and operation of US companies in foreign markets (Higher School of Economics, n.d.). Therefore, there is no wonder why the USA provided such impetus for service negotiations in mid-1980s.

In April 1985, 25 OECD members declared their intention to activate trade talks on services. Conversely, in June 1985, 23 developing countries (led by Brazil and

India) expressed their agreement to begin new round of trade negotiations only if services would be excluded from the agenda. Such a dissent resulted in Preparatory Committee (established in the wake of next trade round) failing to define the list of topics to be discussed (Wolfrum et al., 2008).

Finally, solution offered by the USA in 1986 (and endorsed by the European Communities, Canada, and Japan – “the Quad”) – to discuss services at the next round of GATT talks – was accepted. Contracting parties admitted services as a part of agenda with the adoption of Ministerial Declaration in Punta del Este, where the Uruguay Round kicked off.

As cited in Wolfrum et al. (2008), objective of service negotiations during the Uruguay Round was stated as *“to set up multilateral framework of rules and principles, covering trade in services, with a view of expansion of such trade under conditions of progressive liberalization and transparency... Such a framework shall respect policy objectives of national laws and regulations relating to services, and shall consider the work of relevant international organizations<sup>19</sup>”*. It also stressed the deference to developing countries’ positions and recognized their needs of special treatment.

The 1986 Ministerial Declaration established the Group of Negotiations on Services. The Group was authorized with five tasks at the outset of talks (Wolfrum et al., 2008):

1. To define services per se, and gather statistical data ;
2. To establish “broad principles” on which rules and concepts for trade in services will be based;
3. To negotiate the coverage of multilateral framework for trade in services;
4. To elucidate the relationship between existing regulations and service trade;
5. To establish a framework dealing with measures and practices to which conditions of transparency and progressive liberalization will be applied.

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<sup>19</sup> Considers international industry-specific cooperation, happening under such institutions as the International Telecommunication Union (ITU), International Civil Aviation Organization (ICAO), International Maritime Organization (IMO), etc.



Further, during the Montreal mid-term ministerial meeting held in 1988, over 100 states agreed on the basics of future agreement. Firstly, they defined its scope:

- The multilateral framework regulating trade in services should involve cross-border movement of services, producers and consumers of theirs, as well as of other factors of production;
- No service sphere should be excluded from the framework (a priori).

Secondly, key provisions (principles) of upcoming GATS were agreed upon. They included (i) transparency, (ii) progressive liberalization, (iii) special and differential treatment for developing / least developed countries and their partaking in trade liberalization, (iv) extension of NT and MFN principles to service trade, (v) modes of supply for the cross-border delivery of services, (vi) market access commitments, (vii) safeguard measures, (viii) exemptions related to national security concerns (Higher School of Economics, n.d.).

Accordingly, theoretical framework for service agreement was topped off. The next move was practical implementation.

In 1992, the Trade Negotiations Committee (TNC) adopted a four-track approach, aiming to accelerate service talks. The approach inferred following action items:

1. Negotiations on market access;
2. Negotiations on initial commitments;
3. Conformity of agreements;
4. Interim adjustments.

In 1993, contracting parties were requested to make horizontal commitments applicable to all service sectors (or a number of them) and some sector-specific commitments applicable to a particular sector. At this point, sectoral coverage of future agreement and respective MFN exemptions turned out to be a bone of contention between developed and developing countries. Even though Montreal meeting alluded to (notionally) holistic approach in services talks, developing countries advocated more privileges and less bindings in commercial services

(including tourism); developed ones invoked for concessions in financial, maritime and telecom services. Legal services (taken as a whole) were hotly debated, too.

At long last, it was decided that the MFN principle would not apply to juridical and administrative assistance services. For the time being, issues raised on telecommunications, financial and maritime services remained unsolved. To accomplish the process, TNC advised to prepare ministerial declarations enabling members to resume negotiations in respective fields after Round's conclusion (Wolfrum et al., 2008). Schedules of commitments were reviewed on the matter of compliance with acknowledged decisions once again in early 1994.

Eventually, the General Agreement on Trade in Services was finalized and annexed to the founding treaty of the WTO in 1994 (officially came into being on January 1, 1995). In total, 106 members submitted 97 schedules of service commitments and 350 MFN exemptions<sup>20</sup> (Wolfrum et al., 2008).

The Agreement covers 161 service activities across 12 sectors<sup>21</sup> – with the exception of air traffic rights and services linked to the execution of such rights, and services supplied in the exercise of governmental authority (Chanda, 2002; WTO, 2018). As a brainchild of multilateral framework governed by the WTO, GATS entails non-discrimination, transparency, progressive liberalization, and differential treatment for preference-dependent countries as its key provisions (WTO, 1994).

It goes without saying that, by finalizing service talks during the Uruguay Round and shaping the GATS, both developed and developing countries overcame dividing lines between one another: they surmounted conflicting interests and assumed complex compromises. Yet, pursuant to Marchetti and Mavroidis (2011), perhaps the understanding that trade-offs between (offers in) services and (requests

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<sup>20</sup> MFN exemptions and member-specific Schedules of Commitments will be explained further in the chapter.

<sup>21</sup> Even though the GATS utilizes Extended Balance of Payments Services Classification (EBOPS) statistics, it divides services into sectors according to the Services Sectoral Classification List (I-TIP, 2018):

- |                           |                                    |                                                |
|---------------------------|------------------------------------|------------------------------------------------|
| (1) Business services     | (2) Communication services         | (3) Construction and related services          |
| (4) Distribution services | (5) Educational services           | (6) Environmental services                     |
| (7) Financial services    | (8) Healthcare and social services | (9) Recreational, cultural, and sport services |
| (10) Transport services   | (11) Tourism and travel services   | (12) Other services n.i.e.                     |

in) goods were possible persuaded developing countries to change their stance in service negotiations.

Even after the conclusion of Uruguay Round, each new trade discourse within the “built-in agenda” embraced liberalization in specific service sector. Hereby, state procurement of services, relationship between services and environment as well as maritime services were discussed in 1996 (the latter was incorporated into the DDA afterwards). In 1997, 69 governments agreed on basic telecom services, pledging to extensive liberalization going beyond that was agreed in the course of the Uruguay Round. Also, in 1997, 40 members successfully finalized talks on tariff-free trade in ICT products. In the same year, 70 governments secured a deal in financial services, covering more than 95% of trade in banking, insurance, financial instruments and information (WTO, 2018).

Having started a new page for service negotiations, the Doha Round keeps up with the trend. Under the DDA, they embrace four areas: domestic regulations, market access, rules of GATS, and application of LDC modalities (special and differential treatment).

In the beginning of the Round, WTO members tabled proposals on the subject of the structure and contents of forthcoming service negotiations (WTO, 2018). In general, service talks within the DDA are conducted in two tracks:

1. Bilateral and/or plurilateral negotiations on improving current market conditions, which largely involve adjusting specific commitments made on market access and NT;
2. Multilateral negotiations among all member governments to set all essential rules and disciplines which condition freer trade in services, with certain reservations designed for developing and the least developed countries.

On top of that, negotiations accentuate the need to expand modal and sectoral coverage of service commitments, follow “request-offer” approach, improve overall quality and intensity of talks, as well as to take into account export interests of

emerging economies and LDCs. These facts have been reaffirmed during Cancún (2003) and Hong Kong (2005) Ministerial Conferences.

Adoption of Annex C to the Hong Kong Ministerial Declaration in 2005 is of particular importance for service talks, as the document expounds broad yet ambitious set of rules and principles than any other document of a kind. In general, it allows for a greater flexibility in service negotiations, inciting developing countries to suggest new commitments / modify existing ones, as well as to reconstruct MFN exemptions via scheduling and classification. It also provides ground for plurilateral talks, where a group of countries with common interests may request individual members to adjust commitments made in particular service sector / mode of supply. In 2008 only, 21 collective requests were brought forward, covering but not limited to air transportation, architecture, engineering, construction, finance, legal, tourism, courier, distribution, environment- and agriculture-related services. Considering that the number of such requests steadily increases, there is a sentiment that plurilaterals wholly serve their purport (WTO, 2008).

Further, at the “Signaling Conference” organized in 2008, partaking ministers specified how their governments may improve current service commitments in accordance with the incoming requests.

After a limited progress between 2008-2010, negotiations intensified in 2011. In April 2011, Council for Trade in Services reported to the TNC on the current status of service talks and remaining gaps in all four areas. Pointing out to the existing flaws, the report serves as a roadmap for future efforts.

Next, the 8<sup>th</sup> Ministerial Conference, held in Geneva in December 2011, approved the LDC service waiver. It allows member countries to relinquish the MFN principle if preferential treatment to service suppliers from LDCs is under consideration. Opting for a waiver, a member should specify sectors where such a treatment is granted, and its duration (WTO, 2018).

Currently, there are no open proposals left on the GATS agenda, and the process is completely moved to the “request-offer” phase (WTO, 2018). The Council for Trade in Services intermittently holds special sessions, dedicated to

communications from member countries and discussions of working party progress on GATS rules / domestic regulation. Being an integral part of “single undertaking”, service talks happening under the DDA are to be concluded at the same time with all other negotiation subjects.

**Structure and interpretation of the GATS.** Based on the rules and principles set in the GATS, multilateral negotiations are conducted to achieve a higher level of liberalization and ensure effective market access by reducing or eliminating measures that adversely affect trade in services.

Overall, the Agreement consists of five parts – (1) scope and definitions, (2) general obligations and disciplines, (3) specific commitments, (4) progressive liberalization, and (5) institutional provisions – and is supplemented by Annexes. An overview of the GATS and evaluation of its impact are presented below.

To begin with, under Article I of the GATS trade in services is **defined in four modes of supply** (WTO, 1994):

#	Mode of supply	Definition
1	<b>Cross-border supply</b>	Supply of a service from the territory of one member into the territory of another
2	<b>Consumption abroad</b>	Supply of a service in the territory of one member to the consumer of another
3	<b>Commercial presence</b>	Provision of a service by a supplier of one member, through commercial presence in the territory of another
4	<b>Presence of natural persons</b>	Provision of a service by a supplier of one member, through presence of its natural persons in the territory of another

Exhibit 24. Definition of four modes of supply pursuant to the Article I of the GATS.

To clarify, here are basic examples apt for each mode:

- *Mode 1* – software acquired via the internet; taking e-learning and distant education;

- *Mode 2* – tourists purchasing guide services in a foreign country; patients travelling abroad to receive medical treatment;
- *Mode 3* – banks/insurance/consulting companies establishing affiliate or subsidiary in foreign country;
- *Mode 4* – architects/actors/directors/other specialists – citizens of one country – providing professional services in another country.

According to the WTO (2015), the most preferred mode of supply is commercial presence (Mode 3), accounting for 55% of global service trade (see: Exhibit 25):

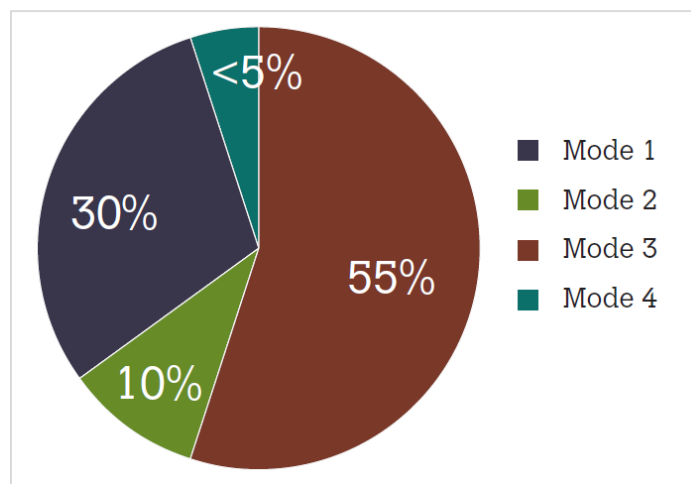


Exhibit 25. Share of modes of supply in international service trade (WTO, 2015).

However, as mentioned earlier, statistics on trade in services do not consider value of services traded through foreign affiliates (Mode 3); thus, total trade in services appears to be twice as much than claimed (WTO, 2015).

When it comes to binding obligations, the GATS framework distinguishes two types of such (ITC, 2018):

1. **General obligations** applying to all members and all services, no matter they are scheduled in commitments or not;
2. **Specific obligations** applying to particular services and listed in members' Schedules of Specific Commitments.

Obligations applying to all services embrace MFN principle, transparency, differential treatment and certain aspects of domestic regulation (set forth in Articles

II-XV). Specific commitments assume market access and NT principle (Articles XVI-XVIII). Both of them are defined further.

First in line of **general obligations** is **MFN principle**, stipulated in Article II. In view of that, *“each member should accord to services and service providers of any other member treatment no less favorable than that it grants to similar services and service providers of any other country”* (WTO, 1994). MFN applies to both *de jure* and *de facto* discrimination (UNCTAD, 2003).

For instance: Country A (which is a WTO member) guarantees zero restrictions on road transport services to Country B (which is not a WTO member) through a bilateral agreement. Bilateral agreements with other WTO members, as well as specific commitments undertaken by Country A do not secure a barrier-free trade in road transportation services. Nonetheless, based on the MFN principle, the right granted to Country B will be extended to such service suppliers of all WTO members by design.

It is worth noting that the MFN principle does not secure market access, but only guarantees non-discriminatory conditions for it. If there is no market access, then the market is isolated for all countries. If the access is limited, it is limited for all members to the same extent (Higher School of Economics, n.d.).

On certain occasions, it is unfeasible to extend the MFN principle to all WTO members for various economic or political reasons. Therefore, the Agreement allows members for MFN exemptions, provided that such exemptions are found in respective lists of theirs. If a member considers to apply exemption, it should provide following information:

1. Description of the sector covered by the exemption;
2. Explanation of the measure (and why it does not comply with Article II);
3. Anticipated duration of exemption;
4. Conditions which cause the exemption.

Exhibit 26 presents the list of MFN exemptions of Georgia as an example, with all four items indicated.

Sector or sub-sector	Description of measure indicating its inconsistency with Article II	Countries to which the measure applies	Intended duration	Conditions creating the need for the exemption
Transport services	Bilateral road transport agreements on the basis of reciprocity, which allow the respective countries to carry out international transportation of passengers and cargo.	All countries with which agreements are or will be in force	Indefinite	Improvement of relations in transport sector. Protection of environment and regulation of traffic rights on the territory of Georgia
Fishing related services	Access to Georgian waters for fish catches is granted on the basis of reciprocity	All countries	Indefinite	In order to regulate the consumption of natural resources
Motion picture or video tape production services	Bilateral agreement between France and Georgia on cinematography. According to the agreement films made jointly by Georgia and France can be produced only with participation of citizens of Georgia, France and other European Union countries, or with participation of persons having the Georgian or French nationality	France and other European Union countries	Indefinite	To facilitate and enrich the cultural relations and develop the exchange of products of cinematography

Exhibit 26. MFN exemptions listed by Georgia upon WTO accession (WTO, 2018)



Exemptions of all members are unique in substance. Technically, they should not exceed a period of 10 years, undergo a review on a regular basis, and be progressively eliminated. As of 2018, 104 member states have undertaken 566 exemptions across 12 sectors. The absolute majority of exemptions are observed in transportation (199) and communication (163) services. The sectoral breakdown of MFN exemptions is provided further in Exhibit 27.

<i>Service sector</i>	<i>Exemptions, tl</i>	<i>Service sector</i>	<i>Exemptions, tl</i>
Cross-sectoral	100	Environmental	1
Business	33	Financial	52
Communication	163	Healthcare and social	3
Construction and engineering	3	Tourism and travel	5
Distribution	4	Transport	199
Education	4	Other services n.i.e.	-
Recreational, cultural, sporting	6		

Exhibit 27. Sectoral breakdown of MFN exemptions under the GATS (I-TIP, 2018).

In general, MFN (or other general obligations) may not be applied in a number of cases: in the event of state procurement (Article XIII), or when it comes to measures aimed at protecting public morals, human, animal, or plant life and health, maintaining enforcement of law and order, preventing fraudulent practices, ensuring safety, and other cases stipulated in Article XIV (WTO, 1994).

Article III on **transparency** obliges members to publish or otherwise, timely communicate measures of general application which may concern provisions of the given Agreement (e.g., adoption of or amendments in existing regulations, adoption of international agreements). Each member should also establish enquiry points (one or more) to provide information on national policies to other members (upon request), within two years from the entry into force of the WTO Agreement. Yet, developing countries may enjoy certain degree of flexibility with regards to timing in fulfilling specified condition (WTO, 1994).

The general obligation on transparency is observed in a number of Articles (V, VII, VIII, X, XII, XIV, XXI), via the requirement to notify the Council on Trade in Services, and all other members, on respective measures undertaken.

In effect, the GATS calls for increasing participation of developing nations. To achieve this objective, Article IV urges developed countries (and, once possible, other member states) to set contact points which will facilitate developing countries' access to such key information as commercial/practical aspects of service supply, local recognition, registration and obtainment of professional qualifications and licensing, etc. (WTO, 1994). At the same time, the Agreement recognizes that technical assistance only is not capable to offset economic and political difficulties developing / least developed countries are facing with. Thus, it entitles them to **differential treatment**, explained onwards.

First and foremost, developing countries are eligible for certain flexibilities, set forth in Article XIX (WTO, 1994):

1. The right to open fewer sectors;
2. The right to liberalize fewer types of service transactions;
3. The right to extend market access in accordance with current economic conditions of theirs.

Secondly, LDCs are vested with “*special priorities*” (Article IV). For instance, LDC modalities (stipulated in Article XIX; adopted by the special session of the Council on Trade in Services in 2003) require member countries to commit “*effective market access*” in sectors / modes of supply of particular export interest to LDCs. If feasible, members are requested to make akin commitments singularly for Mode 4 <sup>22</sup>.

LDCs are not expected to make new commitments under the DDA either.

It is worth noting the aforementioned LDC services waiver, approved in 2011, too. The waiver was operationalized in 2013, and evidenced first steps towards

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<sup>22</sup> The importance of Mode 4 for developing countries will be discussed further in the chapter.

progress in 2014-2015. By 2018, more than 25 developed and developing members notified on sectors / modes of supply the waiver is applicable to (WTO, 2018).

Concessions made for developing countries are largely justified by the increasing role of theirs in global service trade (see: Exhibit 28).

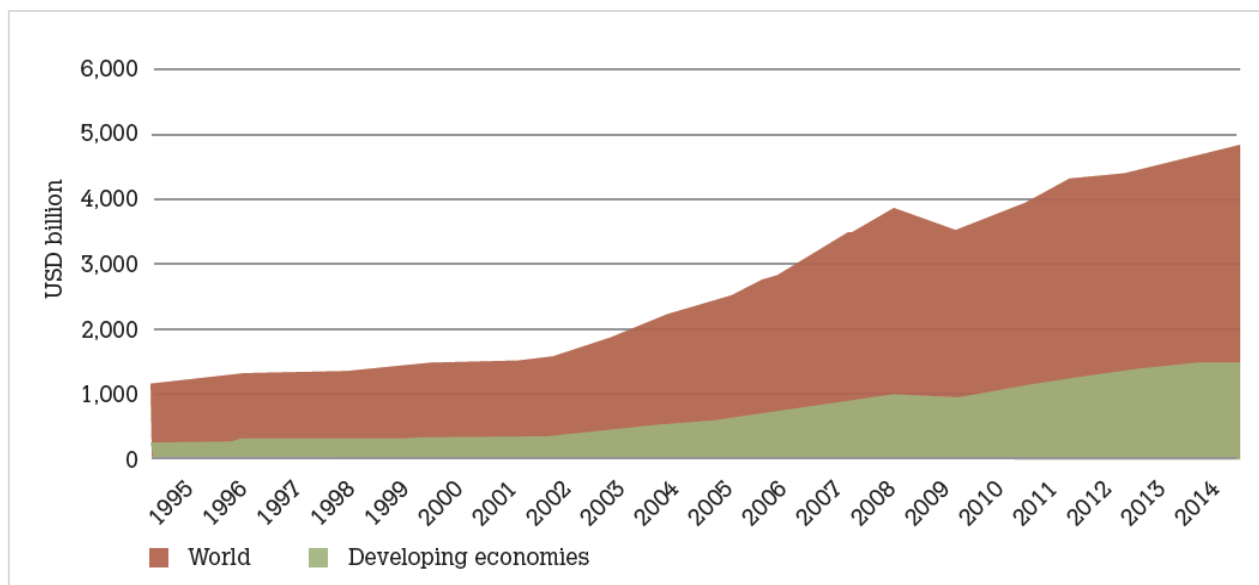


Exhibit 28. Share of developing countries in world export of services between 1995-2014 (WTO, 2015).

Per general obligations, the key to fair trade – **domestic regulation** (specified in Article VI) – must be implemented “*in a reasonable, objective and impartial manner*” in respect to committed service sectors. In these sectors, measures relating to qualification, technical standards and licensing requirements shall not create unjustified barriers to trade in services, and shall:

- *Be based on objective and transparent criteria, such as competence and ability to supply a service* (e.g., the requirement for an applicant to pass an exam subject of which is not directly related to the claimed professional activity breaches Article VI provisions);
- *Not be more onerous than necessary to ensure the quality of the service* (e.g., the requirement for an applicant to reside in the country for at least three years before becoming eligible for service supply violates the Article);
- *Not constitute restrictions to the supply of service in case of licensing procedures* (e.g., overly long procedures for considering the license

application, too many structures verifying applicants and other red tape barriers may impede the provision of service).

In addition, the Article calls for the “*adequacy of procedures*” established to verify the competence of foreign service suppliers operating in committed sectors.

What happens when domestic regulations existent in a committed sector go against the interests of service suppliers, causing discontent of the latter? To cope with such cases, Article VI requires member states to designate juridical, arbitral or administrative tribunals authorized to review complaints raised against administrative decisions which adversely affect trade in services. If the issue is serious enough, Article XXIII urges members to resort to a legal recourse of the DSB (WTO, 1994).

**Mutual recognition** can be regarded as an outgrowth of domestic regulation, envisioned by the GATS. According to Article VII, a member may recognize the education or experience acquired, requirements fulfilled, and licenses or certificates issued in/by another member state. Such recognition may be based on an agreement / arrangement with the country concerned, or may be provided unilaterally (WTO, 1994). Hence, there is no automatic recognition of diplomas, licenses and other documents issued in one WTO member, by other members. However, the Article urges WTO members participating in the recognition agreement to provide other interested members with the opportunity to negotiate their accession to such an agreement.

Notably, the GATS does not provide any requirements for the standards subject to recognition; it merely states that “*such recognition can be achieved through harmonization or otherwise*”, and that “*wherever appropriate, recognition should be based on criteria agreed upon at the multilateral level*” (WTO, 1994).

Obligations on national service regulation are also reflected in:

- Control over **monopolies and exclusive service suppliers** – Article VIII intends to prevent the abuse of market dominance by mentioned types of service providers. In cases when supply of services is carried out exclusively, member states must ensure that the actions of such a

monopoly do not conflict with MFN obligations as well as specific commitments of theirs. In context of the Article VIII, monopoly rights could be granted officially or emerge actually (WTO, 1994);

- Article X stresses that negotiations on **emergency safeguards** (envisioned to tackle serious socio-economic circumstances) should be carried out on the basis of non-discrimination principle (WTO, 1994). Yet, talks on the issue remain deadlocked, even though they were scheduled for completion by 1993 (Trebilcock and Howse, 2005);
- Under Article XI, member states should not apply any **restrictions on international transfers and payments** for transactions related to committed services. No doubt, free movement of capital is a prerequisite for the implementation of trade in services, since the ability to access the market both via cross-border supply and commercial presence depends on the terms of funds transfer. However, restrictions can be imposed with an eye to safeguard balance of payments, provided that they (a) are temporary measures; (b) should be gradually phased out as the BOP improves; and (c) apply on a non-discriminatory basis (WTO, 1994).
- Pursuant to Article XV, members shall exchange information on all **subsidies** which apply to trade in services. If any of members deems that subsidy of another member is disfavoring or adverse, it may request consultation with this member on the given matter. As a rule, such a request should be satisfied (WTO, 1994).

**Specific obligations** are outlined in Articles XVI-XVIII. Such obligations of each member state are spelled out in individual Schedules of Specific Commitments. Level and scope of these commitments should be defined through negotiations between acceding country and interested members of the WTO.

Specific obligations determine the extent of market access and national treatment applicable to foreign service providers at each mode / service sector. A WTO member is bound to fulfill such obligations once they are included in its Schedule of Commitments.

**Market access** (stipulated in Article XVI) is a set of regulatory measures affecting the execution of trade in services. If a member undertook a market access commitment in particular sectors, it should not impose more severe restrictions on such access than what is provided by obligations. As indicated in the Article (WTO, 1994), it shall not:

1. *“Limit the total number of service suppliers, service operations or service output, as well as value of service transactions and assets, in any manner<sup>23</sup>”* (e.g., controlling the issue of road transportation licenses by requiring foreign suppliers to justify their economic needs or considering population density in a given site);
2. *“Limit the total number of natural persons that may be employed in a specific service sector or that a service supplier may employ and who are necessary for, and directly related to, the supply of a specific service”* (e.g., conditioning that the number of employed foreigners should not exceed a certain share from the total labor market in this sector);
3. *“Take on measures restricting or requiring certain legal form of the enterprise, through which a service is ought to be provided”* (e.g., requiring foreign banks to enter the market through joint ventures with local banks);
4. *“Limit participation of foreign capital<sup>24</sup>”* (e.g., necessitating that foreign capital in transport sector should not exceed the total value of local capital invested in the same sector).

**National treatment** aims to remove discrimination between local and foreign service providers entering the particular sector of domestic market. The provision is fixed in Article XVII of the GATS, which infers that:

- NT is provided to services and service suppliers of WTO members;

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<sup>23</sup> In the context of the GATS, “any manner” should be interpreted as numerical quotas, monopolies, exclusive service suppliers or requirements of an ENTs (WTO, 1994).

<sup>24</sup> In terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment (WTO, 1994).

- The member is obliged to provide a NT only to those sectors recorded in its Schedule of Specific Commitments;
- NT is provided only to the extent and on the terms specified in such Schedule;
- The NT obligation is not unconditional. The scope and conditions of NT are determined by the outcome of negotiations between the acceding country and interested members of the WTO;
- In general, NT is provided with respect to measures affecting trade in services, that is, regulations, procedures and administrative actions affecting supply of services (production, distribution, marketing, sale and delivery of services) carried out in one of four modes and across committed sectors only.

It is useful to add that, public procurement is exempt from NT and market access obligations.

Furthermore, members are free to negotiate commitments relating to measures on trade in services other than market access and NT (such as licensing, standards and qualifications). Such talks are known as “additional commitments” and are included to the mentioned Schedules as a separate column.

All in all, per Article XX, each Schedule should incorporate (WTO, 1994):

1. Terms, conditions and limitations to market access (for each mode);
2. Conditions and qualifications for national treatment (for each mode);
3. Additional commitments (if undertaken; for each mode);
4. Period of time required for the implementation of undertaken commitments (wherever appropriate);
5. Date of entry into force of commitments.

Consequently, each Schedule should be annexed to the GATS, serving as an inherent part of the Agreement. Example for the Schedule of Specific Commitments, submitted by Kazakhstan in railway transport services, is presented in Exhibit 29.

Mode (s) of Supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons			
Sector or sub-sector	Limitations on market access	Limitations on national treatment	Additional commitments
E. Railway Transport Services			
Maintenance and repair of rail transport equipment (CPC 8868)	(1) None. (2) None. (3) None, except for the following: - Commercial presence is allowed only in the form of a juridical person of Kazakhstan. (4) Unbound, except as indicated in Part I "Horizontal Commitments".	(1) None. (2) None. (3) None, except as indicated in the column "Limitations on market access". (4) Unbound, except as indicated in Part I "Horizontal Commitments".	

Exhibit 29. Extract from the Schedule of Specific Commitments undertaken by Kazakhstan in railway transport services upon accession to the WTO (WTO, 2018).



The WTO recognizes that member governments may, for various reasons, wish to withdraw or modify their specific obligations, e.g. by raising tariffs or toughening up the access for foreign service suppliers. GATS provides for procedures at such cases, which chiefly involve:

1. *Time-frame* – member may modify or revoke a scheduled commitment only after three years have passed from the date when commitment became effective;
2. *Negotiations for offsetting loss of trade partners* – feasible by reducing the tariff for another product or providing more liberal obligations for access in another service sector (in full accordance with MFN principle). If modifying/withdrawing member and affected member cannot reach an agreement, the latter may resort to arbitration.

In addition, member intending to alter or withdraw its commitment must notify the Council for Trade in Services no later than three months before the planned implementation of alteration or withdrawal. These provisions are listed in Article XXI of the GATS (WTO, 1994).

Altogether, WTO members have undertaken commitments on liberalization in 50 (out of 161) service activities on average. Developed economies committed the absolute majority of activities (average 110), followed by members joining the organization since 1995 (average 104). Naturally, the least number of commitments comes from LDCs (29 activities on average). Exhibit 30 represents full breakdown.

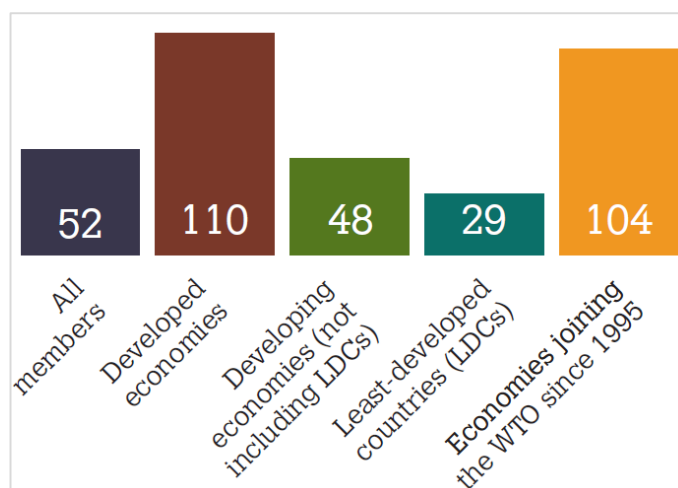


Exhibit 30. Average number of committed service activities, by groups of WTO members (WTO, 2015).

As a matter of fact, the most committed sectors are tourism and infrastructure (finance, business, telecom) services. For the meantime, the least committed ones are education and healthcare, resulting from a (relatively) high degree of state procurement existent in these fields (WTO, 2015) (see: Exhibit 31).

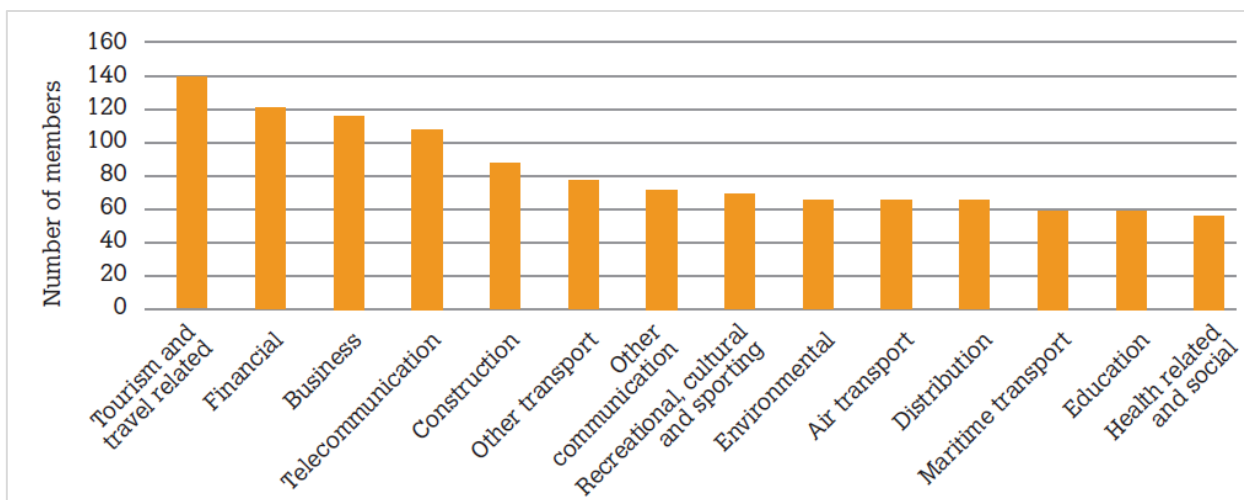


Exhibit 31. Number of WTO member states with commitments, by sector (WTO, 2015).

In recent years, members have been more keen on improving existing commitments rather than undertaking new ones: the trend has been noticed by Adlung and Roy in 2005, and is expected to be preserved at present.

To end with, member countries ought to enter into negotiations not later than five years from the date of entry into force of the Agreement. The process of negotiations should take into account interests of all parties, consider level of their development, respect national policy objectives, and secure proper balance of rights and duties. Overall, **progressive liberalization** should be promoted by means of bilateral/plurilateral/multilateral talks and target to lessen the number of MFN exemptions and enhance the extent of specific commitments undertaken by members (WTO, 1994).

**Dispute settlement in the GATS.** The fifth part of the Agreement (“Institutional Provisions”) contains rules and requirements related to dispute settlement mechanism under the GATS. Principally, it extends normal WTO procedures to trade in services, but has a few exceptions, too.

Firstly, Article XXII necessitates members to provide “*adequate opportunity for consultations*”. Such consultations are regarded as a first step taken in trade

dispute and are governed by the DSU clauses. Where it is not possible to arrive at a satisfactory solution through bilateral consultations, the Council for Trade in Services and DSB may consult with any member (or members) on the matter of dispute.

Secondly, Article XXIII stipulates that, any member may recourse to the DSB if it considers that another member fails to carry out its obligations or specific commitments entailed by the Agreement. If only the DSB concludes that circumstances are serious enough, it may empower a member (or members) to suspend its obligations and commitments from being applied to any other member (or members), guided by Article 22 of the DSU (WTO, 1994). In fact, conditionality of this specific provision (*“if the DSB considers that circumstances are serious enough”*) represents non-conformity with regular WTO practices on dispute settlement. Moreover, it is only responsibilities under the GATS that can be suspended – this retaliation measure does not extend to other WTO agreements (Trebilcock and Howse, 2005).

Article XXIII explains potential cases of *“nullification”* and *“impairment”* of benefits. Hereby, *“if any member deems that any benefit it could expect to accrue under a specific commitment of any other member is nullified/impaired in consequence of the application of any measure not conflicting with the Agreement, it may recourse to the DSB”* (WTO, 1994). If the DSB decides that the measure nullifies/impairs such a benefit in very deed, it shall provide members with mutually satisfactory adjustment; such an adjustment may involve modification or withdrawal of the measure. If consensus cannot be reached, provisions of the DSU shall apply. It is worth mentioning that, causes for action under *“nullification”* and *“impairment”* claims are somewhat different from such causes of action envisaged by the GATT rules (UNCTAD, 2003).

Ultimately, pursuant to the Decision on Certain Dispute Settlement Procedures for the GATS, any panel dealing with complaints on trade in services shall be composed of *“well-qualified governmental and/or non-governmental individuals possessing experience in the issues related to the GATS and/or service trade, and*

*include persons with expertise in the sector which dispute concerns”* (WTO, 1994; UNCTAD, 2003).

**GATS and movement of labor.** Movement of natural persons supplying a service is regulated by a separate Annex to the GATS. The Annex specifies that the Agreement applies neither to measures affecting individuals who seek access to the labor markets of WTO members, nor to measures involving citizenship, residence or recruitment on a permanent basis (WTO, 1994). Thus, measures not affecting service supply are de facto excluded from the scope of GATS.

In addition, the Annex reaffirms the right of a member to take relevant measures on regulating the entry and stay of individuals in its territory, including those measures which are necessary to protect the integrity of its borders and ensure the orderly movement of individuals across them. Such measures can be applied once that they do not impair or nullify benefits accrued by other members in accordance with the terms of a specific commitment (WTO, 1994). E.g., if Country A (a WTO member) grants market access to a particular sector under the Mode 4, issuance of a work permit for a service supplier from Country B (a WTO member) is conceived as an adequate measure; however, requiring a service supplier of Country B to undergo ENT, local market and management needs tests before getting the permit is considered as an impediment to trade.

**Sectoral review of the GATS.** The given section aims to assess the effect GATS has on regulation of various service sectors, including finance, transportation, communication, business, and tourism.

**GATS and financial services.** Finance (involving commercial banking and investment) performs a number of functions vital for national economies, including trade facilitation through enabling international transactions and money transfers, capital allocation to realize investments, mobilization of savings, and risk redistribution.

By the end of Uruguay Round, negotiations on financial services remained incomplete. In 1995, 29 members reached “interim agreement” by improving respective Schedules of Commitments, and ceasing / diminishing the scope of their

MFN exemptions. In total, 97 countries committed in liberalization of finance by the end of 1995 talks (compared to 76 at the end of the Round). Another leap of negotiations started in 1997, and resulted in 104 committing members and a number of countries (including the United States and India) withdrawing broad MFN exemptions of theirs. New commitments implied momentous progress by bringing down / relaxing limitations on foreign ownership, legal restraints on the form of commercial presence and restrictions on expanding ongoing operations. In the end, following decades of “financial repression”, majority of countries undertook liberal reforms concerning financial sector, which led to the facilitation of technological advancements and spurred competition, offshoring, sector’s consolidation and internationalization (WTO, 2018).

Under the Doha Round, negotiations in finance follow the “request-offer” approach. Negotiations aim at reassessing sectoral and modal scopes of commitments (with Mode 3 being of a particular interest), reducing limitations and discrimination, and refining national regulations in transparency. There have been so far submitted 71 offers, representing 95 member states. Yet, the progress is not substantial, and in most of the cases, lags behind current regulatory framework (WTO, 2018).

Specific GATS provisions applicable to trade in finance are found in a separate Annex on Financial Services. Besides defining “*services supplied in the exercise of governmental authority*” (i.e., activities carried out by central banks in the fields of monetary policy and foreign exchange rates; are exempt from liberalization) the Annex provides for the classification of banking, insurance and insurance-related services. It also allows for “prudential measures” of domestic regulation, stipulating that “*a member shall not be barred from taking precautionary measures with a view to protect investors, depositors, policyholders or trustees of a financial service supplier, or to ensure the integrity and stability of the financial system. If such measures do not comply with the provisions of the Agreement, they should not be used as a means for divesting a member from specific obligations or general obligations under the Agreement*”.

So far, 115 members<sup>25</sup> undertook commitments in banking services, and 113 in insurance and insurance-related services. 28 members (all are developing and least developed states) have not undertaken any commitment in finance (I-TIP, 2018). Generally, finance is the second most committed tertiary sector.

Evaluating impact of GATS rules on trade in financial services, Kono and Schuknecht (1998) underline that the Agreement conditions only a limited liberalization of capital flows: whereas commitments made in Mode 1 entail complete liberalization, commitments in Mode 3 cover capital movements which are *“related to the supply of the service”*, without specifying whether this provision *“refers only to capital and equipment to “set up shop” or whether this also includes capital inflows related to service provision”*. Authors also stress that capital outflows linked to the supply of service by foreign establishments oughtn’t to be liberalized under the GATS authority (Kono and Schuknecht, 1998).

Overall, as fairly noted by Sorsa (1997), exemptions allowed and flexibility conditioned by the GATS attenuate the value of the Agreement. However, being the only multilateral institution dealing with barriers to finance, investments and capital mobility, its importance should not be underestimated.

**GATS and transport services.** Transportation covers a wide array of activities, each undergoing transformation on a continuous basis, caused by technological advances, modernization of infrastructure, shifts and changes in global manufacturing and productions processes. GATS provides byelaws for the operation of air, rail, land and maritime modes, as well as of services ancillary to them.

Air transportation (scheduled or non-scheduled) is regulated by the Annex on Air Transport Services. Pursuant to the Annex, *“any obligation or specific commitment shall not reduce member’s obligations under other agreements that are in effect on the date of entry into force of the WTO agreement”* (WTO, 1994). Also, let’s recall that air traffic rights and services related to the exercise of such rights are

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<sup>25</sup> Hereinafter, statistics on liberalization commitments include EU as a single political unit, embracing countries ranked as members of the union as of 1994 (i.e., 12 states). It means that, Austria, Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Finland, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia, Slovenia and Sweden, which jointed the union after 1994, are counted separately.

not covered by the Agreement. These facts circumvent double regulation of the sector – as such establishments as International Civil Aviation Organization (ICAO) and International Air Transport Association (IATA) have been involved in air navigation for long.

Yet, the Annex extends GATS rules on measures affecting aircraft repair and maintenance services, sales and marketing of air transport services, and computer reservation system services. Likewise, it stipulates that developments in air transport services should be regularly reviewed by the Council on Trade in Services (at least, every five years), aiming at full integration of the Annex into the GATS framework (WTO, 1994). The first review happened in 2000-2003, the second review is still ongoing. In the course of the second review, the WTO Secretariat produced a unique tool to measure the extent of liberalization achieved in air transportation – the Quantitative Air Services Agreements Review (QUASAR). The Secretariat also developed the analytical tool visualizing elements of QUASAR database (namely, bilateral ASAs) – Air Service Agreements Projector (ASAP) (WTO, 2018).

Under the DDA, air transport negotiations are conducted based on “request-offer” approach, via policy proposals or plurilateral requests.

As of now, 68 members undertook various commitments on air transport services (I-TIP, 2018).

Among all transport modes negotiated during the Uruguay Round, maritime transport was the most susceptible to hurdles. Even though talks on the matter were scheduled to conclude in 1996, members failed to agree on an acceptable package: the USA refused to undertake commitments on MFN basis, while the EU (influenced by Danish, German and Greek shipping interests) appeared to be uncompromising by requiring unreserved liberalization of the sector. Initial plan considered adoption of commitments on access to the “three pillars” of maritime transport (Barth, 1999):

1. International transportation of freight and passengers (so-called “blue-water shipping”), involving abolition of cargo sharing and unilateral cargo reservations;

2. Auxiliary maritime transport services, implying the freedom to supply cargo handling, loading, storage, as well as customs clearance services;
3. Port services.

The framework for future negotiations under the GATS was set forth in the Annex on Maritime Transport Services. The subject was later incorporated in the DDA.

In the course of the Doha Round, two plurilateral requests were prepared to overcome prevailing circumstances. Both requests refer to the “maritime model schedule”, which features additional commitments together with specific obligations on market access and NT. These commitments embrace auxiliary maritime services, comprising of steering and navigation, icebreaking, towage, anchorage and berth services (WTO, 2018; Higher School of Economics; n.d.). Yet, the progress of talks is abysmal.

Currently, 62 member states have undertaken commitments on maritime transport services – just 30 more than it was in 1995 (I-TIP, 2018; Barth, 1999).

When it comes to rail and road transportation, both modes are governed by GATS provisions. The Agreement pays due respect to the harmonization efforts undertaken by sector-specific institutions – such as International Road Transport Union (IRU) and Intergovernmental Organization for International Carriage by Rail (OTIF). The Agreement also considers the needs to provide public and universal services in these modes. Number of commitments made in rail and road transportation is 40 and 59 respectively (WTO, 2018; I-TIP, 2018).

Per UNCTAD (2006), potential drawbacks of transport regulation stipulated by the GATS is inadvertence over multimodal transport and logistics services. The source also criticizes flexibilities offered by the Agreement, stating that the GATS “*is neither intended as a mandatory instrument nor contains a set of model commitments, allowing Members to determine the degree to which they wish to liberalize a given sector*” (UNCTAD, 2006). Notably, the absolute majority of MFN exemptions are made in transport services (I-TIP, 2018).



**GATS and communication services.** Communications market is on the rise, witnessing sweeping changes all over the past decade. Exhibit 32 represents market development within the stated period (ITU, 2018):

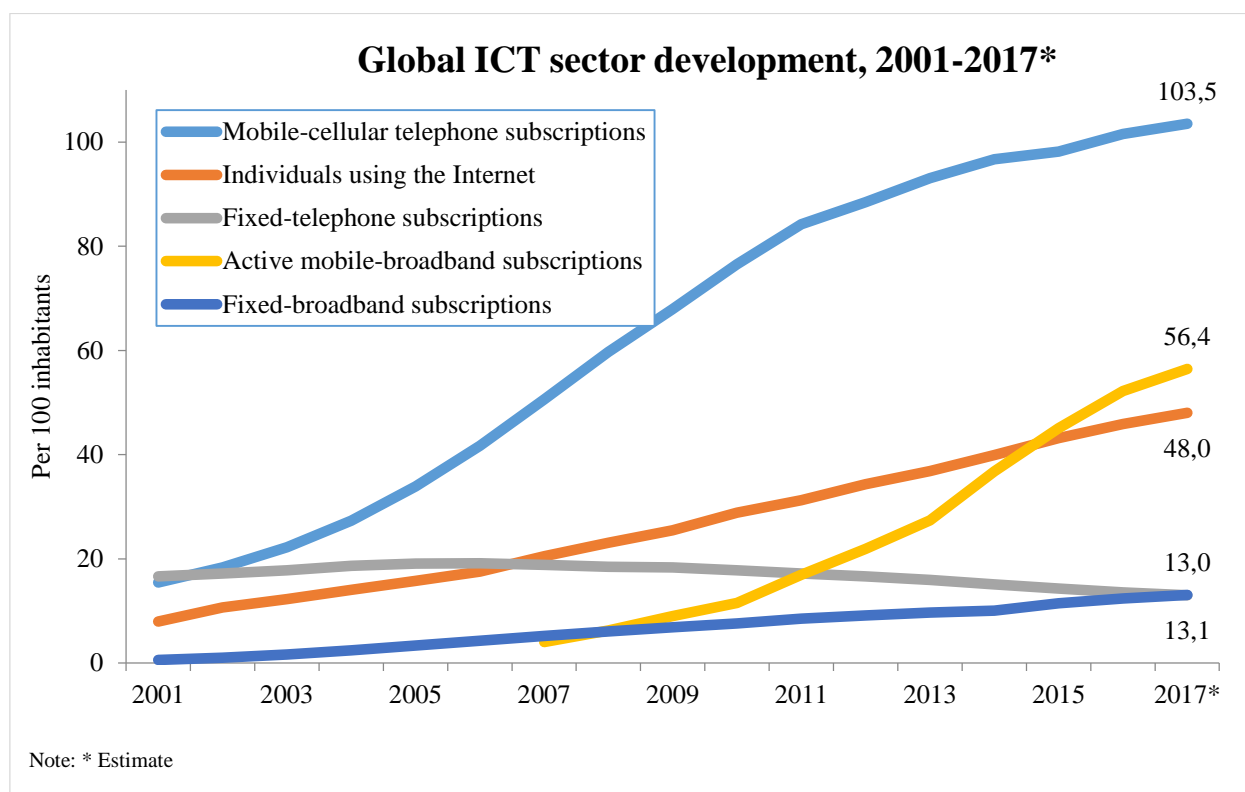


Exhibit 32. Global ICT developments during 2001-2017, per 100 inhabitants (ITU, 2018).

However, it appears that the surge has been observed for long: as stated by Loungani et al. (2017), between 1995-2014, world exports of computer and information services increased much more rapidly than any other services sector, recording 18% growth (on average) per annum.

Uruguay Round talks on communications covered both basic telecoms (voice telephony, packet- and circuit-switched transmission services, telex, telegraph and facsimile services) and value added services (online data processing, storage and retrieval, electronic data interchange). The latter were successfully negotiated during the Round, whereas discussions on the former continued after its conclusion, ending up with the adoption of the Reference Paper (1996) and Fourth Protocol to the GATS (1997). The Reference Paper set out definitions and principles on the regulatory framework of basic telecoms (such as competitive safeguards, interconnections with major suppliers, availability of licensing criteria, allocation and use of scarce

resources). The Protocol provided for the integration of commitments made by 69 WTO members into GATS Schedules of theirs (WTO, 2018).

During the Hong Kong Ministerial Conference (2005), trade ministers mandated a brand new negotiating mechanism for telecom services, targeting a broader coverage in all four modes of supply, intense cooperation with developing and least developed countries, elimination of exclusivity rights, ENTs and other barriers to service trade, as well as gradual reduction of sectoral MFN exemptions (it is worth mentioning that, the communications sphere maintains the second highest number of exemptions) (WTO, 2018).

In general, trade in telecom services is governed by the GATS Annexes on Telecommunications / Basic Telecommunications. The Annexes cease the effect of GATS on measures concerning cable and broadcast distribution of TV and radio programming. In addition, they define requirements for transparency, access to and use of public telecommunications transport networks and services, as well as the terms of technical cooperation with such interstate establishments as ITU and ISO (WTO, 1994).

Other types of communication services, such as postal, courier and audiovisual services, are subject to GATS regulations by default.

To date, a total of 109 member states committed for liberalization in telecom services; 65 – in courier services, 39 – in audiovisuals, and just 14 in postal ones (ranking the last two among the least committed service activities) (I-TIP, 2018).

Obstacles for further liberalization of communications market under the GATS framework involve numerous barriers to trade (content quotas, ownership restrictions, requirements on nationality and residency, cultural components) and significantly high number of MFN exemptions (WTO, 2018).

**GATS and business services.** In the context of GATS, business services are subdivided into accountancy and auditing, advertising, legal, architecture and engineering (herein referred as “professional services”), computer (and related), research and development, real estate, rental/leasing, and other services. In the course of tertiarization of world economy, these services are becoming increasingly

significant. Such features as scope, essence and utility converted them into the second most traded service in the world (ITC, 2018).

Market access for professional services was negotiated during the Uruguay Round. Aiming at deliberate regulation of the sector, Working Party on Professional Services was founded in 1995. It contributed to the development of certain guidelines on mutual recognition in the sector (with a special emphasis on accounting and auditing services). In 1999, the Working Party on Professional Services was replaced by the Working Party on Domestic Regulation (WTO, 2018).

All things considered, the GATS intends not to deregulate occupation-based rules of business services (governed by sector-specific institutions, such as International Accounting Standards Board (IASB) in case of accounting services), but rather to eliminate unnecessary barriers to international trade in such services.

Thus far, 107 member states committed for market liberalization in professional services, 94 – in computer (and related) services, 65 – in rental/leasing services, 62 – in R&D services, and 32 – in real estate services. A broad category of “other services” embodies 103 commitments (I-TIP, 2018).

**GATS and tourism services.** Tourism and travel-related services embrace services provided by hotels and restaurants, travel agents, tour operators, guide services, as well as such basics as sales of craft items, performance of cultural shows, or merely working in a guest house. Currently, tourism is the most traded service in the world, exports of which accounted for US\$ 1.2 trillion in 2016 (ITC, 2018) and are forecasted to grow up to US\$ 1.8 trillion by 2030. Receipts from international passenger transport (visitor exports) were estimated at US\$ 216 billion in 2016, and total international tourism receipts equaled to US\$ 1.4 trillion, corresponding to almost US\$ 4 billion per day (WTO, 2018).

The significance of the sector is undeniable: tourism represents 10% of global GDP and one out of every 11 jobs worldwide (ITC and UNWTO, 2015). This favors developing and least developed countries in particular: tourism is the principal export for approximately one third of developing countries. Markedly, for the LDCs,

tourism exports emerge as a primary source of foreign exchange and employ more than 20% of population (Equations, 2005; ITC; 2018).

Following untrammelled negotiations over tourism and travel during the Uruguay Round, GATS rules are fully applicable to the sector.

In contrast to other sectors, tourism is virtually not affected by any trade barrier. As justly noted by Barth (1999), *“hardly any country restricts the entry of foreign tourists or the spending of its citizens abroad. All countries are basically interested in the income from international tourism”*. Yet, some countries still retain certain degree of regulation, including limited access to computerized reservation systems, complex licensing procedures, and nationality requirements for the provision of guide services. This fact is backed up by the findings of ITC and UNWTO (2015) on main operational difficulties tourism and travel suppliers are facing with (see: Exhibit 33).

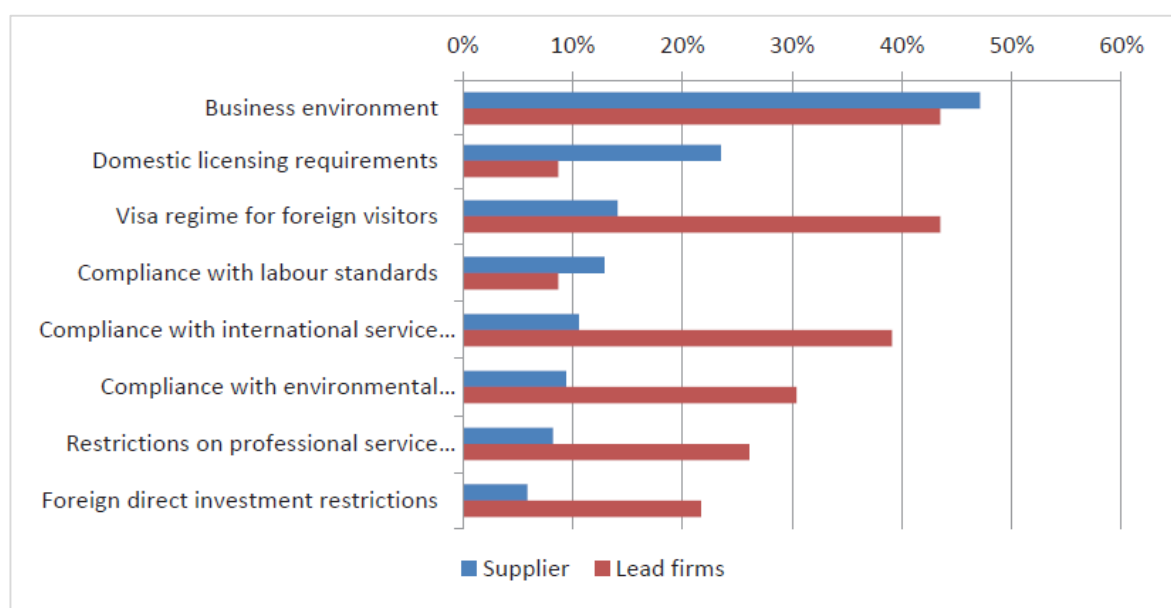


Exhibit 33. Main operational barriers suppliers of tourism and travel services are encountering with (ITC and UNWTO, 2015).

There is no wonder that tourism is the most committed sector under the GATS framework – in total, 144 member states undertook specific obligations in services rendered by hotels and restaurants (including catering), 120 – in those supplied by travel agencies and tour operators, and 70 – in tourist guide services. It should be mentioned that, developing countries constitute the absolute majority of members

committing liberalization in the sector (over 75%). Additionally, number of sectoral MFN exemptions for tourism is exceptionally small (to viz., 5).

**GATS and other/public services.** In general, GATS rules and provisions do extend on such service spheres as distribution, education, energy, environment and healthcare. However, dominance of public entities and pursue of national policy objectives deters member states from undertaking broad liberalization in majority of cases. This explains why the number of commitments in the mentioned spheres is relatively modest:

Sector	Activity	Total commit.
Distribution services	Services of commission agents	49
	Wholesale trade services	65
	Retail trade services	64
	Franchising	54
Educational services	Primary education services	43
	Secondary education services	50
	Higher education services	53
	Adult education	52
Environmental services	Sewage services	60
	Refuse disposal services	59
	Sanitation and similar services	59
Healthcare and social services	Hospital services	56
	Other human health services	28
	Social services	20
Recreational, cultural and sporting services	Entertainment (incl. theaters and circuses)	51
	News agency services	33
	Libraries, museums, etc.	24
	Sporting and other recreational services	51

Exhibit 34. Number of commitments undertaken in other service sectors (WTO, 2018).

Per WTO (2018), existing barriers to trade in the said spheres include:

- Limitations on foreign equity;
- Requirements on joint ventures and joint operations;
- Discriminatory licensing, complex rules on registration;
- Limitations on the types of projects that can be implemented by foreign service providers;
- Restrictions on the movement of natural persons (under the Mode 4).

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To sum up, utility of the GATS is conditioned by several factors:

1. Firstly, it is the only agreement providing regulatory framework for international trade in services;
2. Secondly, it takes into account national policy objectives of member states, especially in sectors where public procurement of services is of particular importance (such as transport, education, and healthcare);
3. Thirdly, it encourages participation of developing countries in service trade by granting them more favorable terms;
4. It establishes guidelines for the settlement of disputes arising in international trade in services;
5. It stands for orderly movement of labor (natural persons supplying a service) across national borders;
6. Eventually, being a trade agreement advocating for a greater extent of liberalization, it fosters exports, technology transfers and spillovers, exchange of expertise, and economic development as a whole (see: Exhibit 35):

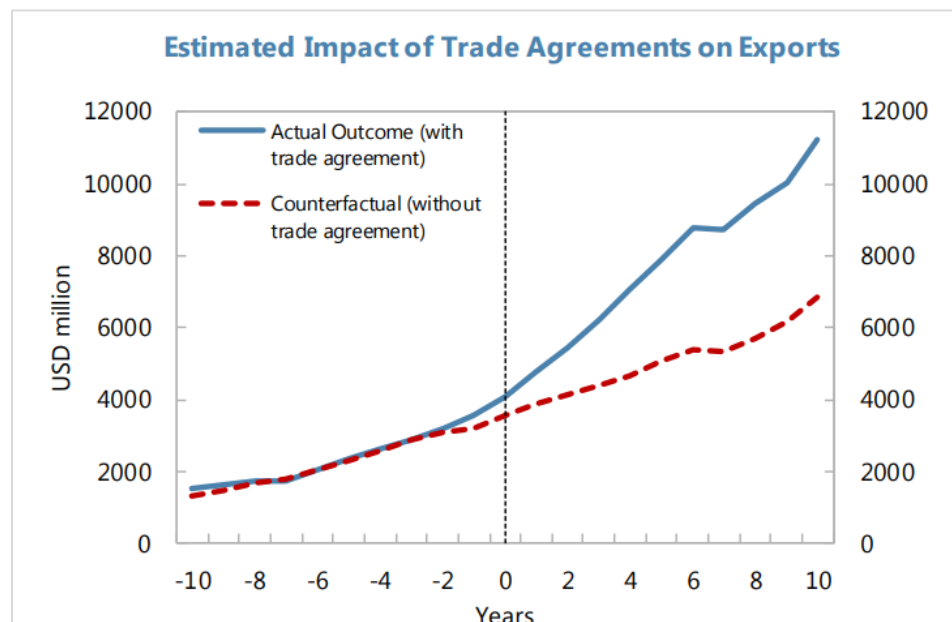


Exhibit 35. Estimated impact of trade agreements on exports. Considers the average of 104 countries, including bilateral trade agreements (IMF, World Bank and WTO, 2017).

### **2.3 Problems for further trade liberalization under the WTO**

Much has changed in service markets over the recent years: government policies, market developments, as well as ways of accessing to these markets. Do current GATS regulations conform to these changes, still standing for extensive liberalization?

Seemingly, it is not a “yes or no” question. The WTO has indeed introduced newness to service negotiations: take plurilateral requests, e-commerce cluster and LDC services waiver for instance. Yet, there appears to be a gap between members’ interests and WTO/GATS provisions, limiting effects of trade liberalization in its entirety.

According to the research, there are several reasons causing this gap:

- Diverse membership and conflicting interests;
- Inefficient scheme of service negotiations;
- High costs of service reforms;
- Definitional difficulties found in the GATS;
- By-effects and “regulatory freeze” of the Agreement;
- Expansion of economic integration.

Each of the them will be discussed in detail further.

First of all, **heterogeneity of WTO membership** hinders advancement in service talks. It complicates the definition of “common ground” – all members have their own sensitive sectors, and pushing forward the agenda in spheres of active interest may trigger inconvenient counter-requests (Adlung, 2009). This fact explains why negotiations on such sectors as air and maritime transport, as well as on certain measures of national regulation (safeguards, subsidies, state procurement) are at impasse.

Secondly, **current scheme of service negotiations** raises concerns over their efficiency. As noted by Adlung and Roy (2005), reliance on numerous request-offer procedures have made negotiations more fragmented, lacking of benchmarks and reference points. Also, **segmentation of service policy competencies** across



institutional bodies of member states may explain slow progress of negotiations. Naturally, service sectors are controlled by many specialized agencies (e.g., Ministries / Bureaus of Education, Transport, Communications, Culture, Tourism, etc.). However, not all are represented in the Council of Trade in Services. Adlung (2009) argues that, chances for getting over protectionist positions are small if competent ministries are not directly engaged in talks (but interact via a country appointee).

What is more, service reforms tend to be more lengthy and require more profound regulatory changes (in contrast to tariff reductions in goods). Implementation may take much time, too, and entail significant long-term investment. These factors embody **cost of such reforms**, which may prevent countries (especially, developing ones, which do not have right regulation in place in major cases) from undertaking broad liberalization commitments (Adlung, 2009).

When it comes to the GATS itself, there are apparent shortcomings which may inhibit the true effect of liberalization. To begin with, certain **definitional difficulties** are observed in the Agreement. For example, Article VI on domestic regulation stipulates that, the authorization for a service where specific commitment has been made should be completed “*within a reasonable period of time*”, without identifying the period per se. In addition, the Article calls for the “*adequacy of procedures established to verify the competence of foreign service suppliers operating in committed sectors*” – without clarifying what “adequacy” should imply (WTO, 1994). Consequently, such ambiguous provisions call for decreasing a barrier, but cannot fully eliminate it.

In general, unlike the GATT and other WTO legal texts, the GATS remains as an agreement terms of which have been explained by arbitration groups and the Appellate Body the least (Higher School of Economy, n.d.).

Moving further on the subject, it goes without saying that barriers existent in service trade are diverse in nature, and are often reflected in various national regulations and policies. **Flexibilities invoked by the GATS**, such as MFN exemptions and right to modify or withdraw commitments, provide leeway for

domestic regulations disfavoring foreign service suppliers. For example, list of MFN exemptions in banking sector, submitted by Turkey, provides that *“if Turkish banks, willing to establish branches in countries whose banks have already opened / plan to open branches in Turkey, will face with conditions stricter than they are subject to under existing legislation, or which are to be made stricter than those implied by Turkish Banks Act, the Council of Ministers may require to annul permissions granted to those failing to comply with the same conditions in Turkey”*. This exemption is applied to all countries for indefinite period of time, citing *“the desire to ensure equal treatment of Turkish banks overseas”* (WTO, 2018). Certainly, the exemption calls for non-discrimination and presumes reciprocity; but it benchmarks a piece of national regulation (Turkish Banks Act) in international trade. Such regulation may hamper trade and disaffect foreign banks<sup>26</sup>.

Identically, member countries have a right to backtrack on undertaken commitments by modifying / withdrawing them. This provision reaffirms the right of members to regulate domestic service industry, but disrupts benign phenomenon of liberalization.

In effect, commitments made under the GATS are of particular relevance to the topic discussed. Per Trebilcock and Howse (2005), scheduled commitments symbolize status quo<sup>27</sup> rather than elimination of existing restrictions to trade in services. Authors refer to such state of affairs as **“regulatory freeze”**, and rebuke it for creating “liberalization frontier” subsequent rounds of talks will have to push back.

Likewise, **modal division of commitments** is regarded as another obstacle to liberalization. Pursuant to Hoekman and Mattoo (2008), commitments applied in certain modes are much more restrictive than in others, with Mode 4 being the least open. It is worth mentioning the importance of Mode 4 for developing and least developed states: this group of countries possesses a structural advantage in

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<sup>26</sup> If no exemption was made, Turkey would have to request a formal consultation / appeal to the DSB referring to the violation of MFN obligations. This, in turn, would have enhanced rule-making nature of the Agreement.

<sup>27</sup> Which is of no surprise: as mentioned in Wolfrum et al. (2008), after first commitments were made upon the conclusion of the Uruguay Round, it appeared to be difficult to appraise them, given the lack of statistical data on service trade and non-quantifiable nature of existing barriers.

provision of labor-intensive services (Stern and Hoekman, 1987), the realization of which is conditioned by free movement of natural persons. The relevance of migration for the service sector is also proved by the fact that around 71% of migrant workers (approximately 65% of all migrants) are engaged in provision of services (UN, 2018).

Another vivid example of “regulatory freeze” is observed in Article VIII on monopolies and exclusive service suppliers, under which members may artificially limit the market access by granting monopoly rights to a single supplier (WTO, 1994). In this case, no liberalization is pondered.

Lastly, special attention should be paid to the phenomenon of **economic integration**. Article V of the GATS touches upon economic integration, stating that members may be parties to agreements aimed at liberalizing trade in services, provided that such agreements “*have substantial sectoral coverage*” (i.e., do not contribute to monopolistic competition) and do not lead to an increase in the overall level of barriers to trade (WTO, 1994). The GATS also allows for cases when such agreements require members to withdraw or modify specific commitments of theirs. However, liberalization occurring in the wake of economic integration may leave WTO/GATS framework out of focus.

The number of PTAs and FTAs, incorporating trade in services has been steadily increasing since 1990s. Recent PTAs tend to become more ambitious, with a wider sectoral coverage comparing to the GATS commitments. Principal differences between service PTAs and GATS commitments include (Hoekman and Mattoo, 2008; Sauvé, 2010):

- Service PTAs cover investment protection and government procurement;
- Service PTAs may involve nonbinding, “soft law” types of cooperation;
- PTAs reflect specialization patterns in service trade;
- Some PTAs address trade in both goods and services.

Sectoral differences in levels of market access (in a scale out of 100) between GATS and service PTAs are presented in the next table (Marchetti and Roy, 2008):

Service activity	GATS	DDA	PTAs
Professional services	30	39	67
Computer and related services	55	74	93
Postal and courier services	14	20	53
Telecommunications	51	58	80
Audio-visual services	17	20	50
Construction services	40	46	75
Distribution services	32	41	76
Educational services	18	25	57
Environmental services	20	30	62
Financial services	36	40	53
Healthcare	8	11	34
Tourism and travel	51	61	83
Maritime transport	12	23	57
Rail transport	14	20	52
Road transport	16	18	56
Auxiliary transport	21	24	58

Exhibit 36. Comparison in levels of market access stipulated by the GATS (in Uruguay and Doha Round talks) and service PTAs (Marchetti and Roy, 2008).

However, PTAs do not seem to guarantee significant market access in all cases (Hoekman and Mattoo, 2008). Presumably, this reason led to the facilitation of regional trade pacts, such as intra-ASEAN FTA, ASEAN-China FTA, KORUS (Republic of Korea-United States of America) FTA, and many others (Schott, Lee and Muir, 2012).

One more outstanding example is Trade in Services Agreement (TiSA) – a draft service-trade only agreement, being negotiated by 23 WTO members, including the USA, EU, Canada, Australia, New Zealand, Mexico, South Korea, Japan, Turkey, and others. Together, participating countries constitute 70% of world trade in services. The Agreement was initiated in 2012 by the USA and other like-minded

countries, forming the “Really Good Friends of Services” coalition in the WTO. TiSA aims at setting mutual commitments and disciplines in domestic regulation, transparency, localization and movement of factors of production, as well as covering various service sectors in all four modes of supply (European Commission, 2017). Initial idea was to attract all WTO members to participate in the Agreement; however, this initiative was averted by BRICS and a small group of developing nations. As an alternative scenario proposed by the coalition, TiSA could be approved as an agreement on economic integration, complying with the Article V of the GATS (Biriukova, 2013). By 2016, there were held 21 negotiation rounds on TiSA. Currently, the talks are on hold and have no deadline for conclusion.

Does economic integration constitute a threat to a 23-years old regulatory exclusivity of the GATS? Even though initiatives described afore are pooled by the virtue of common trade interests and geographical proximity, their scope cannot be compared to that of GATS. Additionally, they are based on the GATS rules, and follow the structure of the Agreement. Nonetheless, their intensity makes one think whether GATS framework keeps up with the time.

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To conclude, as ensued from the reviewed literature, while service negotiations succeeded in setting up basic structure of the Agreement, the liberalizing effects were relatively modest. On one hand, this may be caused by the novelty of the Agreement and assumed need of members to gather experience before considering deeper commitments (WTO, 2018). On the other hand, limited liberalization may be explained by diverse interests and manifold economic outlooks of members. Another reason may be shortcomings of the Agreement itself.

Even so, liberalization of trade may not be reachable through general multilateral rules and negotiations on the removal of certain measures affecting supply of services. While some barriers are overseen by specific obligations, others can only be addressed via regional / sectoral integration, or international regulatory harmonization. To magnify gains from liberalizations, it is essential to take into account restrictions on factor movements as well.

## **Chapter 3. WTO and Azerbaijan: perspectives for local tertiary sector with or without WTO regulations**

### **3.1 WTO and Azerbaijan: overview of accession process**

Azerbaijan exercised its right to access to the WTO by applying to the Secretariat on 23 June 1997. Following the application, the country was granted with “observer” status. Working Party of Azerbaijan was established on 16 July 1997 (WTO, 2018).

Pursuant to Bayramov (2010), the main goals pursued by Azerbaijan in WTO membership are:

- Accelerating integration into the multilateral trade system;
- Conducting trade with member countries on the basis of general rules and principles set forth by the WTO (non-discrimination, transparency, progressive liberalization);
- Making use of benefits entailed by WTO Agreements on trade in goods, services, as well as trade-related intellectual property rights;
- Utilizing WTO mechanism of dispute settlement;
- Attracting more FDI flows once adopted relevant legal framework of the WTO (TRIMs).

The given paragraph analyzes accession process initiated by Azerbaijan, as well as suggests hints for current stalemate in negotiations.

To start with, each applicant to the WTO should pass through several stages in negotiations over accession (WTO, 2018):

1. Firstly, an applicant should describe its economic policies in the spheres covered by WTO agreements in a Memorandum. The document is then scrutinized by the Working Party dealing with country’s accession;
2. Secondly, when the Working Party achieves satisfactory progress on the first phase, bilateral talks kick off between prospective and actual members. In general, such discussions embrace tariff rates, service commitments, and other policy issues concerning trade in goods,

services and intellectual property. Simultaneously, applicant should develop and submit sectoral policy offers;

3. Thirdly, when working party finalizes examination of trade regime prevalent in applying country, and bilateral talks are accomplished, the former concludes terms of accession. These terms are mirrored in “Protocol of Accession” and “Schedules of Specific Commitments” of the applicant;
4. Final package, consisting of reports and documents described above, is presented to the General Council or the Ministerial Conference. Current WTO rules allow for two-thirds majority of members voting “in favor” to formalize the admission process.

What should negotiations target? The answer depends on the economic outlook of applicant. Apparently, first and foremost task of negotiations is to achieve the best terms possible for the country intending to access. In case of Azerbaijan, guiding principles for negotiations are to be:

- Taking into account the fact that Azerbaijan is a developing country (to viz., a country with transition economy), to achieve corresponding level of concessions and benefits granted to other developing members upon accession;
- Ensure effective use of customs duties, tariffs, subsidies and tax exemptions in weaker fields (such as agriculture) and sectors with export potential during the transition period;
- Get grace periods (long enough to adapt local market conditions) before applying relevant WTO regulations in the fields and sectors mentioned;
- Sustain economic security of the country, its producers and consumers, without breaching the WTO rules.

How do matters stand with Azerbaijan’s accession to the organization? Rolling back to the described schedule, Azerbaijan submitted the Memorandum on foreign trade regime on 22 April 1999. In November 1999, there was established a

Coordination Group on accelerating accession process of Azerbaijan. Negotiations taking place between 2000-2018 consist of 14 Working Party meetings, agendas and outcomes of which are described further.

The very first session of the Working Party took place in Geneva, in June 2002. It was attended by representatives of 28 member states, and was dedicated to debates over the Memorandum submitted earlier in 1999. Partaking members (above all, the USA, EU, and Turkey) expressed their readiness to render any kind of assistance to Azerbaijan in order to speed up the accessions process. In their turn, representatives of Azerbaijan addressed questions posed by Australia, Canada, and the EU. Bilateral meetings were held with several governments, including the USA, EU, Canada, Georgia, Lithuania, Moldova, and Turkey. Following the session, a Preparatory Commission concerned with the membership of Azerbaijan was set up in August 2003 (Permanent Mission of Azerbaijan to the UN, 2015).

The 2<sup>nd</sup> session of the Working Party was organized in October 2004. Submitted documents were discussed for the duration of session. Besides, several meetings were held with WTO officials (including director-general, head of Working Party on Accession H.E. Mr. Walter Werner, as well as permanent representatives from Turkey and Pakistan) (Permanent Mission of Azerbaijan to the UN, 2015).

The 3<sup>rd</sup> session was arranged during June-July 2005. In the course of the meeting, Deputy Minister of Foreign Affairs, H.E. Mr. Mahmud Mammadguliyev (Chief Negotiator; Head of the WTO Accession Negotiations Team of Azerbaijan) provided general economic outlook of the country. Members of the Team addressed questions of Working Group. In addition, there were held bilateral meetings with a number of countries, as well as plurilateral meetings on agriculture with delegates of the USA, Australia, Canada, and Malaysia. Notably, initial offers on goods and services were submitted in the interim of the meeting.

The 4<sup>th</sup> session was organized in March 2006, marked for a series of bilateral talks held with the USA, EU, Chinese Taipei, Canada, and Japan (Permanent Mission of Azerbaijan to the UN, 2015).



Subsequent session took place in May 2008. A number of documents – revised offers on goods and services, nearly 30 drafts of legal acts, ad-valorem equivalence of specific duties, etc. – were submitted. The session decided on the preparation of Factual Summary for Azerbaijan.

The 6<sup>th</sup> session was organized in December 2008. During the meeting, Accession Negotiations Team stated that, being a landlocked developing country, Azerbaijan pursues to access to the Organization on corresponding terms and conditions. In the meantime, revised offers on goods and services were considered by the Secretariat; Factual Summary was discussed.

Next session was held in July 2009. Notably, delegates from the EU and USA stressed their position on Azerbaijan's accession to the WTO *“on terms of developed economy”*. Representatives of Azerbaijan opposed to such a stance, reaffirming that *“acceding as a developed country would create inconsistency with national interests and policy objectives of Azerbaijan”*, and insisted on continuing admission on the rights of developing country. Eighth session (took place in October 2010) followed up the agenda.

During the 9<sup>th</sup> session (held in February 2012), WTO members requested more information on national pricing policies, investment climate, competition policy, trade rights and remedies, free trade zones, TBTs and state procurement of Azerbaijan. Besides, a bilateral meeting was organized with the Chairperson of Working Party of Azerbaijan, H.E. Mr. Walter Werner (Permanent Mission of Azerbaijan to the UN, 2015).

The 10<sup>th</sup> annual meeting (took place in December 2012) reviewed progress achieved during the negotiations, as well as examined foreign trade regime of Azerbaijan and its legislative developments. Members requested interpretations on certain trade policy measures of the country (fees and charges for services, subsidy forms, etc.). Bilateral negotiations were commenced with Brazil, Canada, Japan, Norway, the EU and USA on the margins of the meeting (WTO, 2018).

Negotiations on accession resumed in February 2014, with the start of eleventh session of the Working Party. In the course of the session, members evaluated trade

regime of Azerbaijan once again – this time, on the basis of Draft Working Party Report. Alongside with proposing draft commitments, the Report listed up talks held thus far. Certain updates on national legislature were shared with the members (WTO, 2018).

Discussions over the Draft Report continued during the 12<sup>th</sup> session, organized in March 2015. At the outset of the meeting, H.E. Mr. M. Mammadgulyev pointed out to the challenges conditioned by slump in oil prices, and stressed the need for diversification of national economy. Also, members posed questions and comments on discriminatory tax exemptions, work permits, local content requirements, production sharing agreements and other relevant issues. In due course, H.E. Mr. W. Werner urged Azerbaijan to “*change gears*”, and called members to “*move beyond routine to conclude negotiations*” (WTO, 2018).

Another Working Party meeting took place in July 2016, during which Chief Negotiator, Deputy Minister of Foreign Affairs, H.E. Mr. M. Mammadgulyev announced the adoption of strategic roadmap, aimed at branching out the economy. In fine, Azerbaijan was encouraged to submit replies to the questions and comments of member governments, and update on its Legislative Actions Plan (WTO, 2018).

The latest – 14<sup>th</sup> – session was organized in July 2017. H.E. Mr. M. Mammadgulyev stated that Azerbaijan is intended to concentrate more on bilaterals and ensure the implementation of legal reforms, which will eventually bring national legislature in conformity with WTO regulations. Chairperson, H.E. Mr. W. Werner requested the Secretariat to prepare an updated Working Party Report based on inputs received by Azerbaijani government; the latter party was asked to submit revised Legislative Actions Plan. He also called Azerbaijan to “*proactively engage and advance market access negotiations*” (WTO, 2018).

All in all, Azerbaijan submitted 400 documents, including 300 legislative acts, and provided answers to more than two thousand questions of WTO members. Thus far, bilateral negotiations have been completed with Turkey, United Arab Emirates, Georgia, Kyrgyzstan, and Oman. China and Moldova are expected to join the list in a little while. To date, Azerbaijan is in state of talks with 13 member countries

(Zeynalova, 2018). For a crisper picture, Exhibit 37 reflects current state of affairs in Azerbaijan's accession to the WTO.

Evidently, membership application of Azerbaijan has been pending for more than 20 years. What impedes the country from being enlisted in the ranks of full-fledged WTO members?

Firstly, as stated by Bayramov (2010), Azerbaijan failed to reach positive outcomes in bilateral talks with such global trade leaders as the USA and EU (the latter two exhort the Organization to treat Azerbaijan as an “advanced economy” in the course of accession process). Also, opinions of Working Group regarding the commitments on agriculture, NTBs and intellectual property do not coincide with that of Negotiations Team (Gasimli, 2007).

Yet, the simplest explanation will be that Azerbaijan aims to join the WTO under easy conditions, adjourning the final decision with an eye to achieve a better deal (Bayramov, 2010). Strides made in recent Ministerial Conferences suggest that, conditions on accession are to become thornier in the nearest future. A solid example is Nairobi Package (2015), pledging for a complete elimination of export subsidies in agriculture.

At the same time, there seems to be no alternative for Azerbaijan's WTO membership. Steering away from the organization which covers 98% of global trade is somehow imprudent. Eventually, accession will imply lowered trade barriers and increased competition in the local market, which may hurt vulnerable sectors of economy. But the WTO does not bar member countries from developing safeguard mechanisms – the only requirements for them is to be less trade distortive.

A freer trade policy is objectively necessary for Azerbaijan, which has a limited domestic market and seeks for access to overseas markets (Farhat, 2007). No doubt, WTO membership will permit Azerbaijan to fully exploit its economic capabilities, and develop competitiveness in the non-oil sector of economy by conducting a solution-oriented rather than defensive trade policy. Technology and expertise transfers, innovations, as well as FDI flows are envisaged, too.

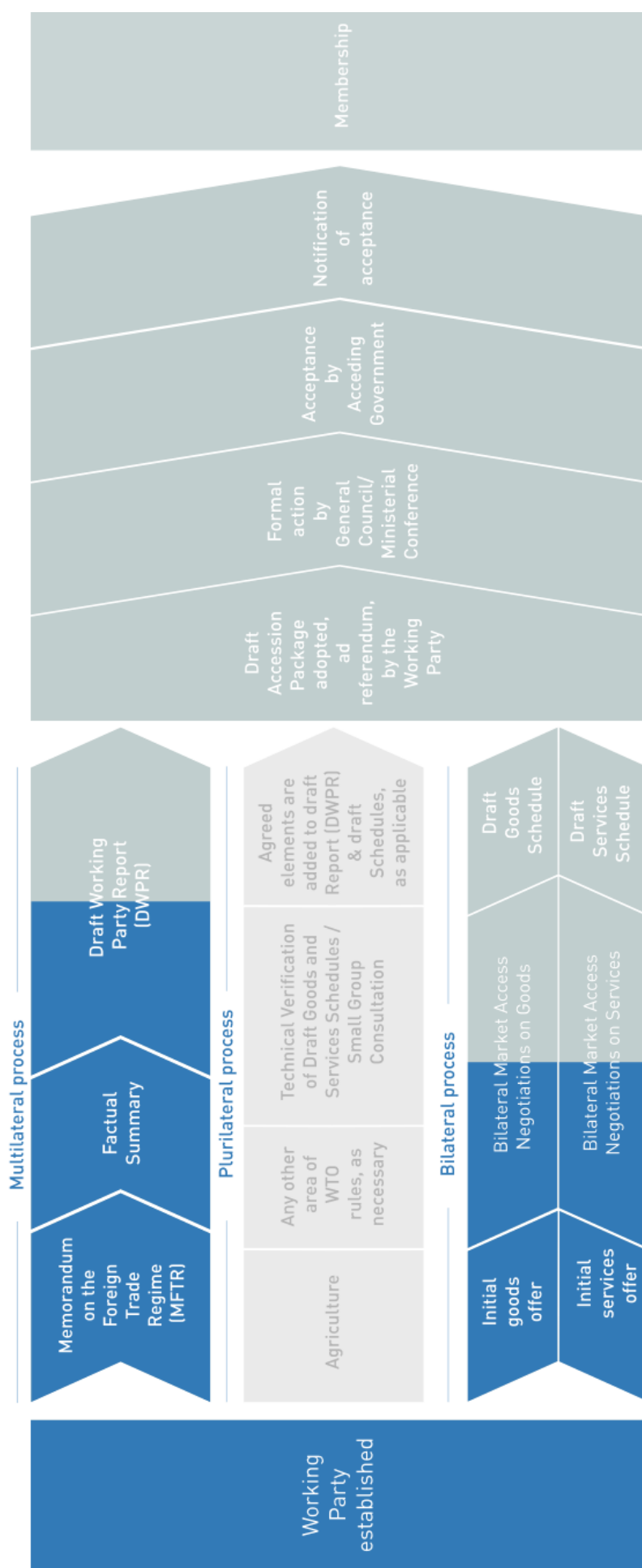


Exhibit 37. Current status in the accession process of Azerbaijan (WTO, 2018).

### **3.2 Cost-benefit analysis for service industry of Azerbaijan under the WTO regulations**

**Review of national service industry.** Local tertiary sector started to expand ever since 1990s, after Azerbaijan gained state independence from the Soviet Union. Prior to this period, service sector (alongside with all other major sectors of economy) were regulated by the state; what is more, state used to be the sole supplier in certain areas (Muradov, 2012).

In the structure of national output, services contribute to 42% of GDP (as of 2016). When it comes to the value added by economy sector (as % of GDP), services are progressively increasing their share, crowding out industry and agriculture, and reaching a record-high 42.3% in 2016 (see: Exhibit 38). Outstanding gap with industry is explained by the fact that oil production and refinery still account for a major part of national GDP (52%) (World Bank, 2018); high growth rates in the manufacturing sector can also be a reason (Muradov, 2012).

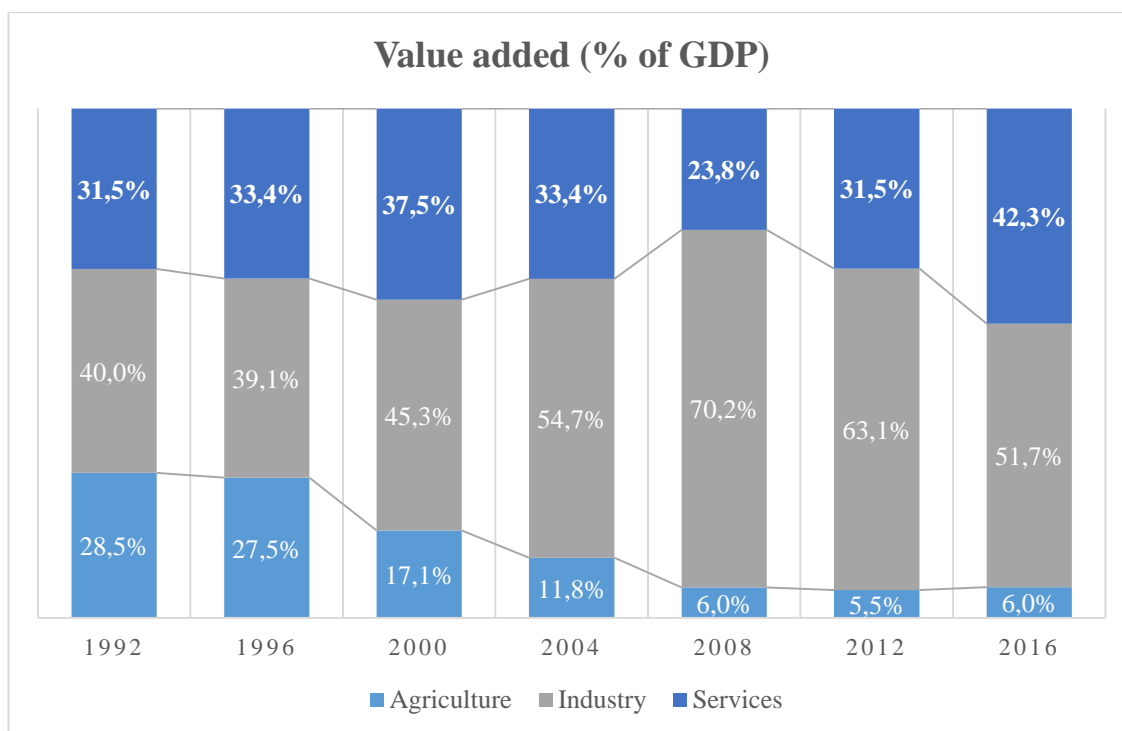


Exhibit 38. Value added per economy sector in Azerbaijan, 1992-2016 (as % of GDP) (World Bank, 2018).

As of 2016, the largest part of labor force – specifically, 57.8% (over 2.5 million people) is employed in the tertiary sector. Out of these 57.8%, the majority (26.4%) is engaged in the supply of distribution services; education (13.6%), construction

(12.5%), and services supplied in the exercise of governmental authority (10.4%) follow up closely (AZSTAT, 2017). Data on tertiary sector employment of Azerbaijan is demonstrated in the Exhibit 39.

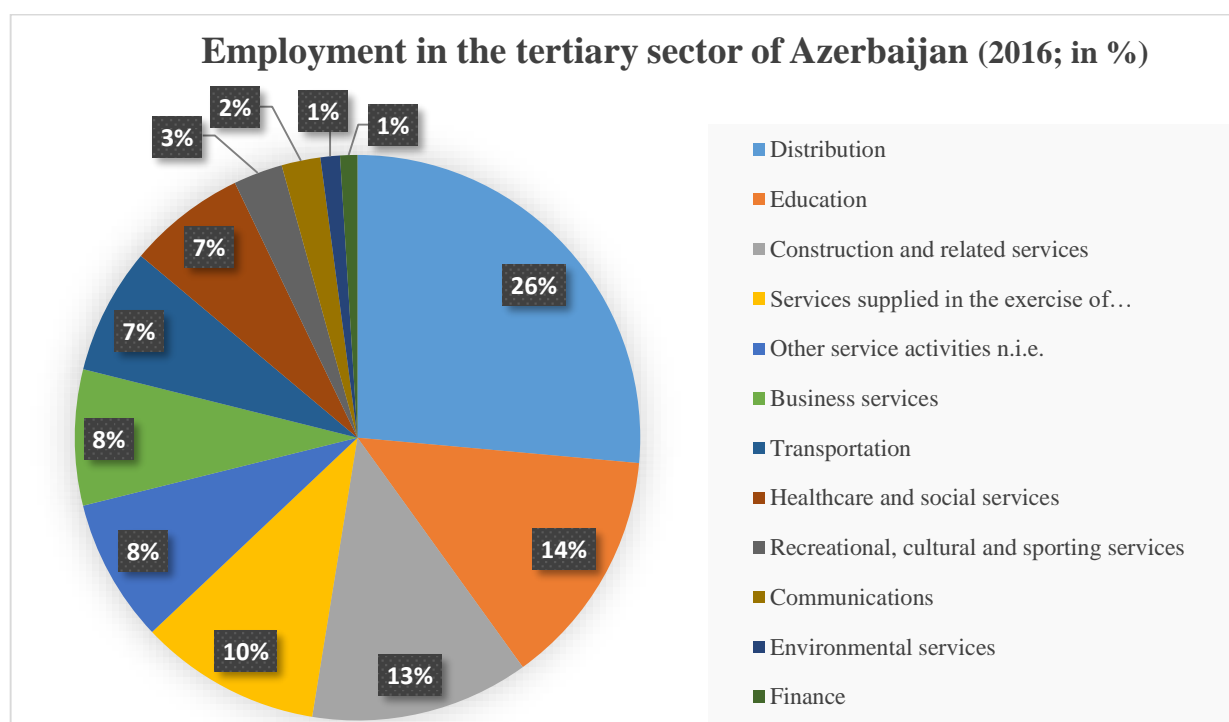
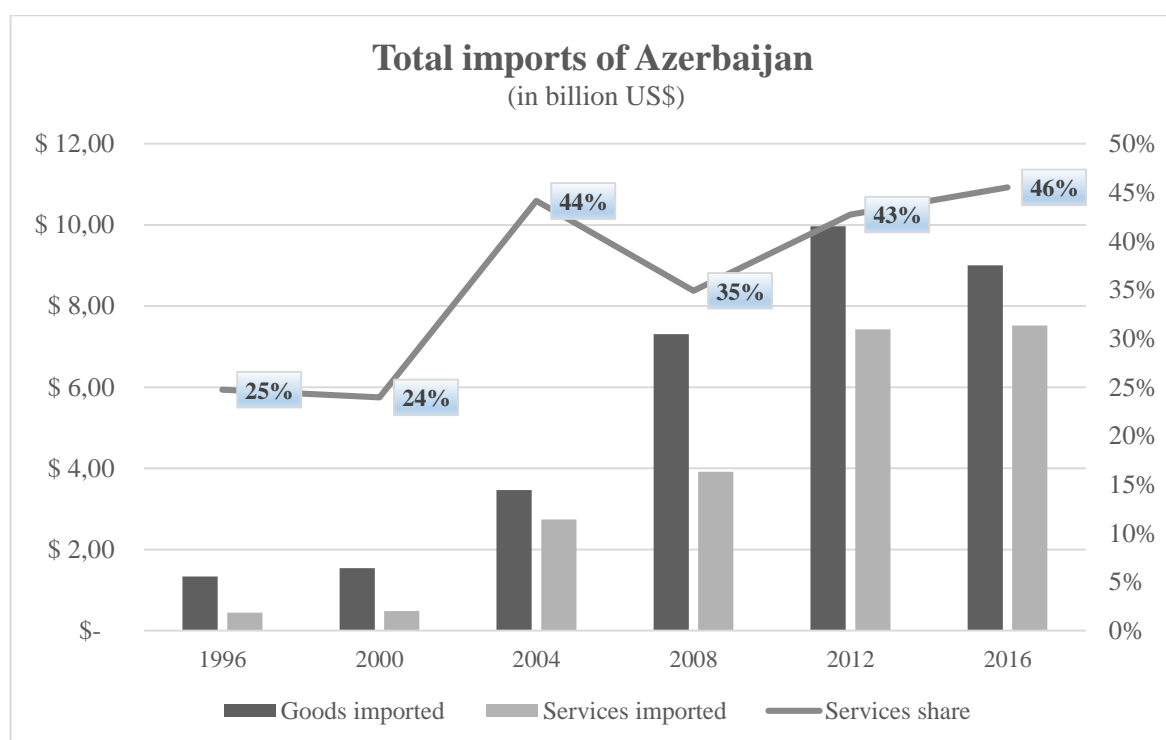
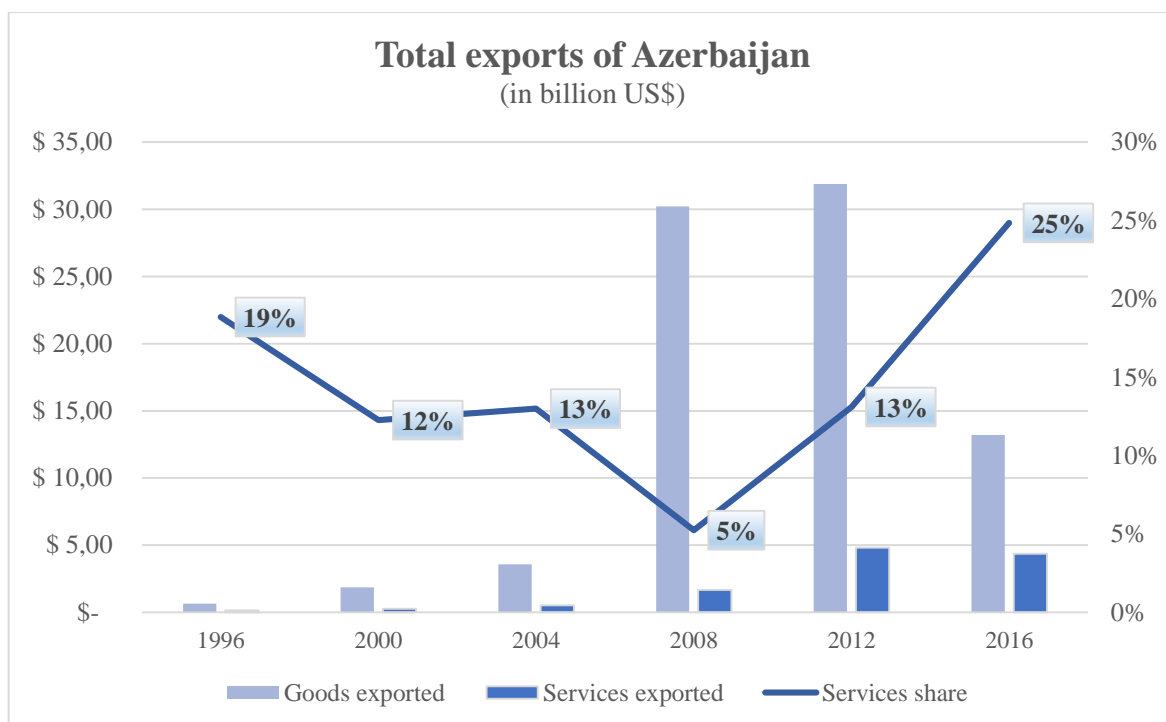


Exhibit 39. Employment in the tertiary sector of Azerbaijan (as of 2016) (AZSTAT, 2017).

Trade in services is swelling, too: as presented in Exhibits 40.1-40.2, both exports and imports of services experienced positive growth between 1995-2013, gradually declining in 2014-2016 (similar to international trade in services, which underwent contraction after oil price shock occurring in the said period). Remarkably, exports of services demonstrated 29-fold increase (versus 3.6 of global growth) over all period. In 2016, they made up 25% of total exports of the country – which is on par with global average of 23.9% (World Bank, 2018).

During 2017, trade in commercial services amounted for US\$ 12.8 billion (BOP, current US\$) – a 7.6% increase in comparison to 2016. Share of service exports was 37%, while imports constituted the rest 63%, retaining identical proportions as observed in 2016. Consequently, Azerbaijan runs current account deficit in service trade. It is worth noting that, the deficit is mainly caused by services related to oil and gas industries (92%) (to viz., supply of construction, engineering,

and other business services). Deficit on services rendered in non-oil sector decreased 1.5 times; overall, transport and tourism services are dominating (CBAR, 2018).



Exhibits 40.1-40.2. Azerbaijan's exports and imports of goods and services during 1996-2016 (BOP, current US\$)  
(World Bank, 2018).

Further, examining the structure of service trade of Azerbaijan during 2005-2016 (in accordance with EBOPS 2010 classification), it comes clear that throughout the period, top exported services have been travel (34.3% on average), transport

(31.0%), business (15.5%), manufacturing and construction services (5.3%). Likewise, top imported services have been construction (30.3% on average), business (25.1%), travel (20.8%), and transport (15.2%) services (WTO Statistics Database, 2018). The most recent information (for 2016) is visualized in Exhibit 41.

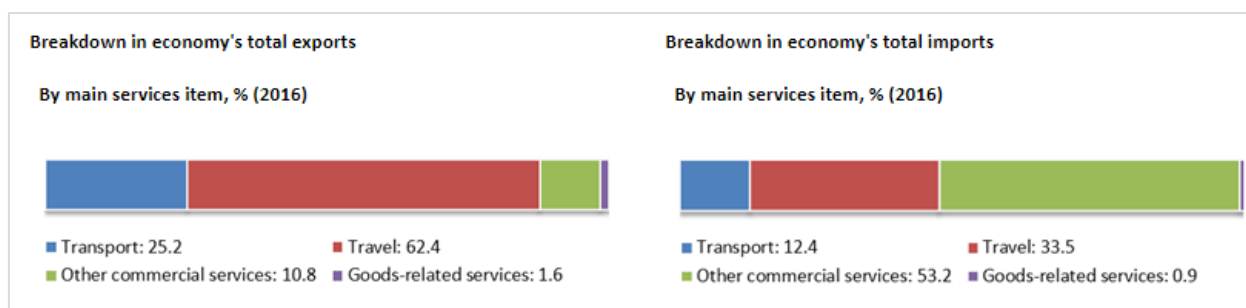


Exhibit 41. Trade in commercial services of Azerbaijan: breakdown in economy's total exports and imports in 2016 (WTO Statistics Database, 2018). As pictured, travel is dominating in both exports and imports, with 62.4% and 33.5% share respectively.

**Cost-benefit analysis of national service industry under WTO regulations.** As a matter of fact, service industry of Azerbaijan has been demonstrating drastic growth for over 25 years. Does it imply that the local tertiary sector is mature enough to withstand foreign competition once market access and national treatment are committed by Azerbaijan? Can we undertake commitments in all sectors? Which sectors will benefit and which will lose under the WTO/GATS rules?

Before addressing questions, I would like to reiterate the fact that Azerbaijan submitted initial service offers to the Secretariat in May 2005. Study carried out by A.J. Muradov (2012), who led accession talks on services between 2003-2009, suggests that the proposals made are somewhat more liberal than existing commitments of WTO members. For instance, in the overall level of commitments Azerbaijan chalks up with 51.3 points (out of possible 100), whereas the WTO members score 28.2 points only. Overall, if acceded, Azerbaijan would rank 27<sup>th</sup> in total level of commitments (Muradov, 2012). Hence, it is no wonder why services do not pose a danger for future membership negotiations.

The following table demonstrates detailed sectoral comparisons of scores obtained by Azerbaijan (based on initial service offers) and the WTO (based on existing commitments), as well as provides for estimated ranking of Azerbaijan



(measured for average level of commitments) among active WTO membership (Muradov, 2012):

Service sector with commitments undertaken	Azerbaijan, score	WTO avg., score	Azerbaijan, est. rank
<b>Business services</b>	63.0	29.3	27 <sup>th</sup>
<b>Communications</b>	48.2	20.2	15 <sup>th</sup>
<b>Construction</b>	68.8	41.4	57 <sup>th</sup>
<b>Distribution</b>	60.0	26.8	33 <sup>rd</sup>
<b>Education</b>	33.8	22.5	42 <sup>nd</sup>
<b>Environmental services</b>	75.0	33.8	38 <sup>th</sup>
<b>Finance</b>	41.5	34.9	69 <sup>th</sup>
<b>Healthcare and social services</b>	44.8	17.9	22 <sup>nd</sup>
<b>Tourism and travel</b>	71.9	53.6	42 <sup>nd</sup>
<b>Transportation</b>	12.5	11.6	50 <sup>th</sup>

Exhibit 42. Scores on initial services offer submitted by Azerbaijan and existing liberalization commitments of WTO members, on a scale between 0-100 (Muradov, 2012).

The author affirms that there is a positive correlation between the average level of commitments undertaken by members and the date they joined the organization: the later countries accede, the more commitments they have to make, and the more requirements they shall face with (Muradov, 2012). In turn, it supports the belief that postponing accession will not benefit Azerbaijan in the long run.

Getting back to the WTO/GATS regulations on service trade, let's review the possible impact of the obligations stipulated by the Agreement through a cost-benefit analysis of service sector of Azerbaijan.

**Financial services.** Banking system of Azerbaijan can be defined as a two-pillar one: Central Bank of the Republic of Azerbaijan (alongside with ancillary Financial Market Supervisory Authority, Banking Ombudsman Institute, Azerbaijan Credit Bureau and Financial Literacy Council), overseeing the operation of commercial banks and other non-bank financial institutions. To date, there are 30 commercial banks and 47 non-bank credit organizations functioning in Azerbaijan

(FIMSA, 2018). The structure of national insurance system is very much alike to the described one, with State Insurance Supervision Service governing activities of local insurers (currently, there are around 20 insurance organizations in Azerbaijan).

Among commercial banks, only 7 have majority (>50%) stake owned by foreign capital: Bank Melli Iran, National Bank of Pakistan, Bank VTB, Access Bank, Nikoil Bank, and Ziraat Bank. From non-bank financial institutions, there is also a few (FINCA Azerbaijan, MolBulak Kredit, Viator Mikrokredit). Among insurance companies, there is only one where foreign investment prevails in the charter capital – AXA MBASK.

GATS may stipulate abolition of following discriminatory barriers to trade in financial services, existent in national legislature (Safarli, 2013):

1. Possible limitations on the participation of foreign capital in the charter capitals of locally established banking institutions;
2. Restrictions on the establishment of branch offices owned by foreign banking institutions;
3. Nationality requirements for the structure of management board in locally established banking and insurance institutions.

*Pros and cons of financial sector liberalization.* Openness to foreign financial service providers may instigate competition, stimulate dynamism and innovations in the sector, bring best practice and expertise, as well as ensure a more efficient allocation of capital (which occurs from enhanced evaluation and pricing of credit risks). Also, foreign banks and insurance companies tend to be less politically allied, thus less likely to exert self-promotional influence on regulatory authorities – consequently helping to reinforce supervisory/legal framework and increase transparency in the sector (Cali et al., 2008). If a foreign bank enters the market in a joint venture with local financial organization, it may streamline and modify its performance, eventually benefiting economy of the host country. The authors support this claim by presenting a set of empirical evidences.

However, as cited in Cali et al. (2008), increased competition does not always lead to desirable outcomes, and may force small players to exit the marketplace

(“crowding-out effect”), or drive down profit margins. Additionally, patterns studied reveal that, foreign banks seek to cooperate with corporate clientele – which is the most lucrative market players (a process referred as “cherry picking”), leaving SMEs out of focus.

Undoubtedly, availability of prudential regulation is required prior to the liberalization of financial sector of a country. Such preventive measures as insolvency and capital adequacy ratios, corporate governance and securities settlement mechanism should be maintained upon accession, via reservations made in specific commitments.

**Transport services.** Transport services are becoming more and more important to the economy of Azerbaijan. Thanks to its strategic location on the world map, Azerbaijan possesses boundless potential of serving as a regional transport and energy hub. Specifically, 2017 was a historic year for the sector’s development, noted for the start of cargo transportation by Baku-Tbilisi-Kars railway, linking Central Asia with Turkey and Europe; progress on talks over Trans-Caspian Transport Route, aimed to connect China and Europe through multimodal cargo transportation, and International North-South Transport Corridor, levelling to increase trade connectivity across the continent; initiation of works on the renovation of Baku International Sea Trade Port and preparation of Alat Free Trade Zone (Tsurkov, 2018). 2018 brought success with the launch of TANAP project, too. Thus, expansion of transport services is an effective tool to steer away from hydrocarbon dependency.

In general, transport industry is perceived to be limited to foreign capital participation in Azerbaijan, and is subject to state procurement: maritime, air, and railroad companies are all controlled by closed joint stock companies (“Azerbaijan Caspian Shipping Company” CJSC, “Azerbaijan Railways” CJSC, “Azerbaijan Airways” CJSC), number of shareholders to which is restricted.

Nevertheless, sector’s regulation is concordant with WTO’s bidding for harmonization and transparency. For instance, international air transportation is executed based on bilateral ASAs (Shirinov, 2018); national air carrier of the country

is also a party to ICAO and IATA. In case of rail transport, the country is a signatory to the Agreement on International Carriage of Goods on Railways (SMGS). For road transport, transnational coordination tools (CMR Convention, TIR Convention) are fully applied.

*Pros and cons of liberalization in transport sector.* Bearing in mind all the circumstances, liberalization of transport sector should be carried out in a progressive manner, and ought to be limited in areas of public procurement (such as air, rail and maritime transport under Mode 3). In general, such approach reflects common practice of active WTO members – let's recall that transport sector has the highest number of MFN exemptions, and negotiations on air and maritime modes are still in deadlock.

Yet, scheduled opening of Alat FTZ and restructuring of the Sea Trade Port may stimulate demand for professional freight forwarding and freight logistics services – in this case, liberalization efforts in these services are essential to instigate competition, technology transfer and spillovers, as well as exchange of expertise with an eye to meet the demand in best ways possible.

**Communication services.** Between 2002-2012, local communications market experienced a striking 9.5-fold growth (Muradov, 2012) – highest among all service sectors. Both value added services and basic telecoms appear to cause hasty expansion. Reviewing that structure of ICT services in Azerbaijan, the highest portion pertains to mobile communications (51.5%), internet broadband services (7.4%) and software development (7.0%) (AZSTAT, 2017). As for national statistics, over 75% of population have access to Internet services (ranking Azerbaijan second among CIS countries for internet penetration). In addition, digital broadcasting covers approximately 99% of the country (Abbasova, 2016). It is worth mentioning that Azerbaijan plans to run the biggest data center in the region, qualified for the provision of such value added services as hosting, backup and recovery, electronic mail, virtual and co-location servers (Aliyeva, 2016).

On the face of it, the sector seems to be open for foreign competition, with a small exception of fixed telephone connection and postal services perceived as

public and operated by respective governmental agencies (“Aztelekom” LLC, “AzerPost” LLC). For instance, major stake (51.3%) in Azercell – the biggest provider of voice and value added services (by market share) of Azerbaijan – was owned by foreign firms (Telia Company AB and Turkcell). Likewise, a number of international courier services (DHL, Aramex, CAMEX, TNT, Pony Express) have established local offices in Azerbaijan.

*Pros and cons of liberalization in communication sector.* Liberal market reforms in communications sphere may boost investment, facilitate technological progress through inventions and innovations, as well as assist the government in meeting its socio-economic goals (e.g., increasing access of population to ICTs and augmenting revenue flows from telecom industry). On the other hand, data privacy and censored contents can be stated as drawbacks of excessive liberalization in the sector.

All in all, given state procurement in postal and fixed telephone connection services, relevant MFN exemptions can be made by Azerbaijan. Also, such matters of regulatory capacity as data confidentiality, cultural components and content restrictions should be stipulated in the Schedule of Commitments.

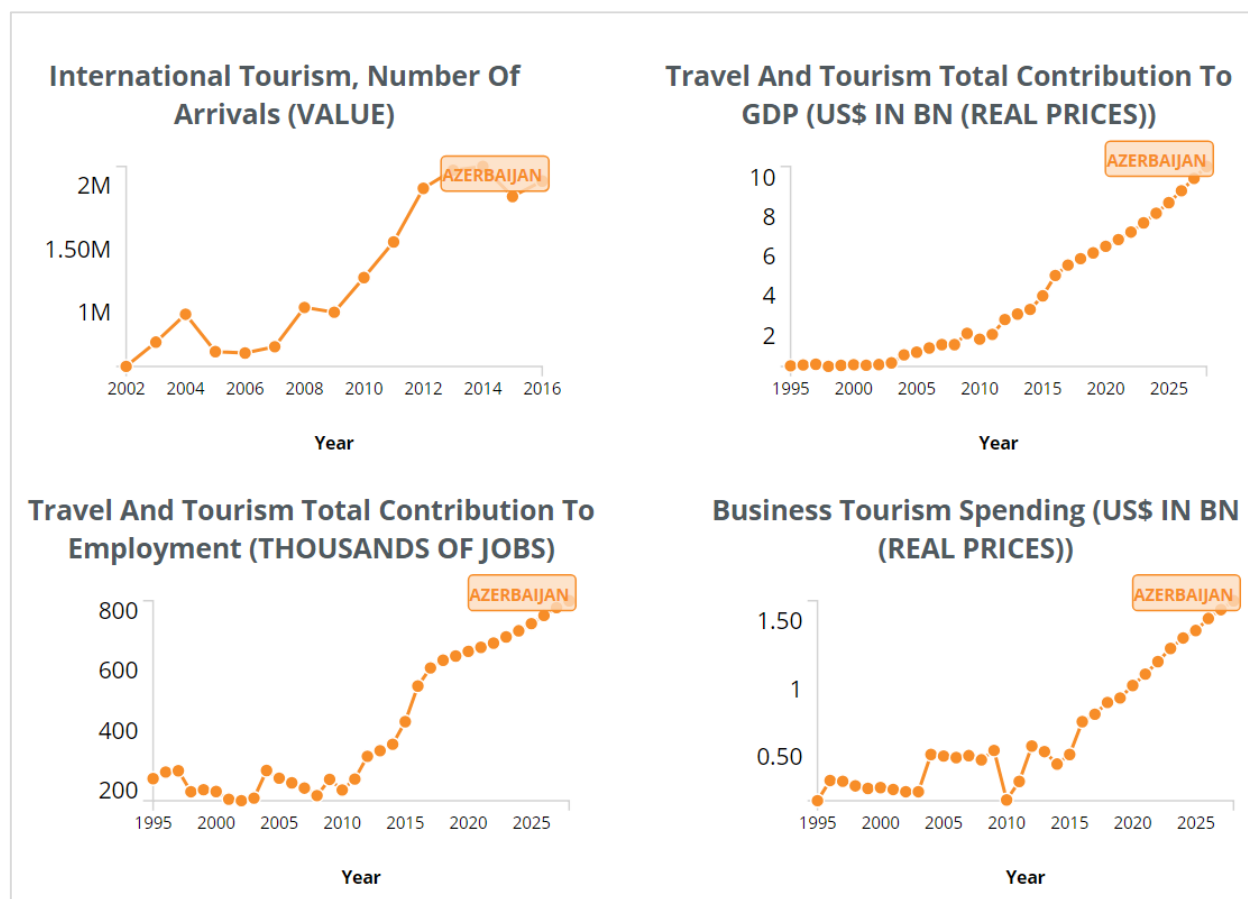
**Business services.** Rapid economic growth of Azerbaijan necessitates the availability of high quality business services, which include but are not limited to accountancy, auditing, legal advice, R&D, marketing and advertising. Though underdeveloped in past decades, local market of business services had witnessed broad expansion, attracting transnational corporations (such as “Big Four” accounting firms (Deloitte, PwC, EY, KPMG), renowned consulting (McKinsey & Company, Baker Tilly) and advertising (McCann Erickson, JWT, Leo Burnett International) companies) and stimulating emergence of local organizations.

*Pros and cons of business services liberalization.* In its entirety, liberalization of business services may enhance competitiveness of the local sector, increase the level of transparency in national economy, as well as contribute to the training of local qualified specialists. Broad education observed in the respective fields may

lead to the surge in business services exports of Azerbaijan and increase the number of coast-to-coast “best practice” cases.

Crowding-out effect can be stated as a potential drawback of extensive liberalization.

**Tourism and travel services.** In a perfect coincidence with global trend, tourism and leisure are top export and import services of Azerbaijan. In 2016, tourism contributed up to US\$ 5.08 billion to country’s GDP; this figure is expected to grow up to US\$ 10.6 billion by 2025 (World Bank, 2018). A detailed picture of current state of affairs in local tourism sector, as well as future projections, are provided in Exhibit 43:



Exhibits 43. Statistics and future projections on tourism sector of Azerbaijan (World Bank, 2018).

Pros and cons of liberalization in tourism sector. Per Cali et al. (2008), liberal policies in tourism sphere are able to attract greater FDI flows – based on the cited report, Mode 3 liberalization would lead to a 10% increase in the physical capital existent in sector, and a 2% increase in total investments. Additionally, settled tourism sector may generate wider employment opportunities for residents.

Crowding-out effect challenges extensive liberalization undertaken in tourism and leisure services, as foreign hotels can displace local ones by virtue of brand value of theirs. To eschew such circumstances, relevant clauses on capacity limitations (with an eye to protect local small- and medium-sized hotels) can be added to the Schedule of Specific Commitments.

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To sum up, analysis shows that liberalization commitments can be undertaken in the majority of sectors, with reservations made in specific spheres where public procurement is of particular importance (education, healthcare, transportation). The WTO/GATS regulations allow for such reservations by means of MFN exemptions and caveats in Schedules of Commitments. Prior to the liberalization, availability of prudential regulation in each sector concerned should be verified.

The supposition that services do not impede the WTO accession talks of Azerbaijan is supported: what is more, progressive liberalization in services described is expected to bring positive outcomes to the economic outlook of the country by attracting investment, facilitating technology interchange, and fostering innovations.

## CONCLUSIONS

Tertiarization of world economy has gone underway: according to the most recent data, services account for 68.9% of world GDP and employ 64.3% of global labor force. Over the past 20 years, growth rate of service trade surpassed that of merchandize trade. Also, factually, service sector is proved to be more resilient to economic downturns and crises (compared to goods). Thanks to their universal nature, services can provide intermediate inputs to all economic activities. They can be bundled with goods. They can also be developed within manufacturing companies.

Rise of service industry coincided with the mid-20<sup>th</sup> century, inciting intensification of scientific research, accumulation of statistical data, and overall performance appraisal of the sector. It came clear that services may also induce comparative advantage and depend on factor endowments – in other words, centuries-old economic theories found their application in services, too.

Due to their intangible nature, trade in services is inherently subject to more constraints than trade in goods. To cope with such barriers, and ensure predictability and smooth flow of service trade, the General Agreement on Trade in Services (GATS) was negotiated within the WTO. Notably, it is the only agreement regulating service trade between such high number of countries.

The Agreement stipulates both general obligations applicable to all members / service sectors falling under its scope, and specific obligations negotiated by each member separately. General obligations encompass extension of MFN principle to service trade, transparency requirements, special treatment for preference-dependent countries, and certain measures on national regulation. Specific obligations comprise of commitments on national treatment and market access. Members are free to determine contents and degree of application of such commitments. Besides, they are eligible to modify or withdraw them.



The GATS also provides for dispute settlement mechanism in service trade and instructs measures concerning cross-border movement of labor (i.e., individual service suppliers).

The impact of GATS varies across sectors: some of them (as tourism, finance and telecommunications) underwent progressive liberalization, while some (transport, education, healthcare) are the least committed ones. Diverse membership and conflicting interests, inefficient scheme of service negotiations, high costs of service reforms, definitional difficulties, by-effects and “regulatory freeze” of the Agreement, as well as the expansion of economic integration can be stated as drawbacks of the GATS.

Yet, there seems to be no alternative for the GATS – indeed, negotiating another multilateral service agreement on mutually favorable terms outside the organization governing 98% of global trade could be less effective.

Eventually, in case of Azerbaijan (which is currently negotiating its accession to the WTO), liberalization of services market in accordance with WTO/GATS rules is expected to be beneficial. The fact that initial service offers of Azerbaijan turned out to be more liberal than existing commitments of WTO members fully supports this assertion. Increased FDI flows, facilitation of technology interchange and innovations are listed among gains of plausible liberalization. However, to avoid potential loss, proper regulation and necessary reservations (be that MFN exemptions, or specific clauses in Schedules of Commitments, especially in areas where state procurement is of particular importance) should be made while seeking membership.

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## XÜLASƏ

Qlobal iqtisadiyyatın inkişafında xidmət sektorunun rolu son 20 il ərzində daha gözəçarpan olmuşdur: belə ki, dünya ÜDM-nin 68.9% və işçi qüvvəsinin 64.3% bu sahədə cəmlənmişdir. Bundan əlavə, xidmət ticarətinin artım sürəti əmtəə ticarətinə nisbətən daha yüksəkdir. Faktiki olaraq, xidmət sektoru iqtisadi tənəzzül və böhranlara daha dayanıqlıdır.

Beynəlxalq xidmət bazarının tənzimlənməsi Ümumdünya Ticarət Təşkilatının (ÜTT) Xidmətlərin Ticarəti haqqında Əsas Sazişində öz əksini tapmış qayda və prinsiplər əsasında həyata keçirilir. Saziş daha azad və daha ədalətli xidmət ticarətini hədəfə alan ümumi və fərdi öhdəlikləri nəzərdə tutur. Ümumi öhdəliklər “ən əlverişli ölkə rejimi” və şəffaflıq prinsiplərindən ibarətdir və bütün ÜTT üzvləri və xidmət sahələrinə aiddir. Fərdi öhdəliklər isə hər bir ÜTT üzvü tərəfindən ayrılıqda razılaşdırılır; bu öhdəlikləri götürərək, üzv ölkələr hansı xidmət sektorlarının xarici iştirakçılar üçün açıq olduğunu və həmin bazarların nə qədər açıq olduğunu bəyan edirlər. Ümumilikdə, Saziş inkişaf etməkdə olan dövlətlərə müxtəlif imtiyazlar təqdim etməklə, onlara xüsusi diqqət ayırır. Üstəlik, Saziş üzvlərin milli iqtisadi maraq və məqsədlərini diqqətə alaraq, ölkələrə müəyyən çeviklik verir.

## РЕЗЮМЕ

За последние 20 лет, терциаризация мировой экономики стала закономерностью ее развития: ныне, на долю услуг приходится 68,9% мирового ВВП и 64,3% занятости населения планеты, а темпы роста торговли услугами превосходят темпы роста торговли товарами. Фактически, сектор услуг оказался более устойчивым к экономическим спадам и кризисам (по сравнению с товарами).

Мировой рынок услуг регулируется Генеральным соглашением по торговле услугами (ГАТС) Всемирной Торговой Организации (ВТО). Основные положения ГАТС заключаются в общих (Режим Наибольшего Благоприятствования, гласность) и специфических обязательствах (национальный режим и право доступа на рынок). В целом, соглашение обуславливает постепенную либерализацию рынка услуг, уделяя особое внимание интересам развивающихся и наименее развитых стран. Также, оно предполагает определенную гибкость по отношению к членам, принимая во внимание цели и задачи национальной экономической политики.

## **REPORT**

Service sector plays an increasingly important role in determining patterns of world trade. Nowadays, services compose a major share of output, employment and investment. They expand faster and with more resilience compared to goods. Notably, service sector reforms constitute a basis for concurrent strategies on economic development and growth.

The World Trade Organization (WTO) has an immense role in fostering service trade on multinational level by developing pertinent rules and guidelines on various sectors of the former. Elucidating its activities will assist in grasping the extent of present regulation, alongside with ensuing its advantages and shortcomings.

All in all, the thesis has attempted to:

1. Review the origins and substantiate the development of international market of services;
2. Evaluate services from the perspective of conventional theories of international trade;
3. Estimate the impact of trade barriers on the international trade in services;
4. Scrutinize the role of WTO in the regulation of global service market, breaking down its constituent Agreement on Trade in Services (GATS);
5. Define pros and cons of WTO regulations on services;
6. Project such regulations on local service market of Azerbaijan.

Studies carried out by both local and foreign authors, as well as statistical publications and issues serve as a theoretical basis of the thesis. When it comes to the methodological framework, the paper utilizes qualitative methods of research, follows an emergent design, interprets available data (both primary and secondary) on the matter through deductive process, and provides tentative conclusions.

The thesis found out that, tertiarization of world economy has gone underway: services account for 68.9% of world GDP and employ 64.3% of global labor force. Over the past 20 years, growth rate of service trade surpassed that of merchandize



trade. Also, factually, service sector is proved to be more resilient to economic downturns and crises (compared to goods).

Rise of service industry coincided with the mid-20<sup>th</sup> century, inciting intensification of scientific research, accumulation of statistical data, and overall performance appraisal of the sector. It came clear that services may also induce comparative advantage and depend on factor endowments – in other words, economic theories found their application in services, too.

Trade in services is inherently subject to more constraints than trade in goods. To cope with such barriers, and ensure predictability and smooth flow of service trade, the General Agreement on Trade in Services (GATS) was negotiated within the WTO. Notably, it is the only agreement regulating service trade between such high number of countries. The Agreement stipulates both general obligations applicable to all members / service sectors falling under its scope, and specific obligations negotiated by each member separately.

The impact of GATS varies across sectors. Diverse membership and conflicting interests, inefficient scheme of service negotiations, high costs of service reforms, definitional difficulties, by-effects and “regulatory freeze” of the Agreement, as well as the expansion of economic integration can be stated as drawbacks of the GATS.

Eventually, in case of Azerbaijan (which is currently negotiating its accession to the WTO), liberalization of services market in accordance with WTO/GATS rules is expected to be beneficial. The fact that initial service offers of Azerbaijan turned out to be more liberal than existing commitments of WTO members fully supports this assertion. Increased FDI flows, facilitation of technology interchange and innovations are listed among gains of plausible liberalization. However, to avoid potential loss, proper regulation and necessary reservations should be made.