

# **Reforming Trade in Services Negotiations under AFAS**

REPSF Project 02/003

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The views expressed in this report are those of the author, and not necessarily those of the ASEAN Secretariat and/or the Australian Government.



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## **Preface**

This report has been prepared for the ASEAN Secretariat under the auspices of a project sponsored by AusAID as a part of its ASEAN-Australia Development Cooperation Program – Regional Economic Policy Support Facility (AADCP-REPSF). The assignment focuses on the problems faced in the negotiations in ASEAN. More specifically, the focus is on the examination of the negotiations modalities in services and the extent to which examination on alternative modalities could assist the ASEAN process of negotiations leading to speedier process of regional integration.

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## **Executive Summary**

This executive summary summarizes the results of a project which aims to examine the process of trade negotiations in ASEAN, the modality for negotiations, specifically in the area of trade in services. The negotiation process being examined is done in the context of the ASEAN integration. The project has been requested by the ASEAN Secretariat and sponsored by AusAID under REPSF Project No. 02/003.

### **The focus of the exercise**

The technical focus of the project is on the examination of the various negotiating modalities for the liberalization of trade in services in ASEAN. It has been argued that the process of liberalization in services in ASEAN has been moving less rapidly than desired. This observation has been made against the background of the intended full liberalization in goods and services in ASEAN by 2020. Indeed, with such a goal in mind, the process may indeed be too slow.

Although the focus of this particular report is on the negotiating modality, the broader 2020 integration objective is too important to be treated in a cursory manner even if the focus of our intention is on the mechanical aspect of the modality of negotiations. Accordingly, the study examines briefly the objective of integration and the logic of ASEAN integration as distinct from the liberalization process in the WTO, and difference in the final destination between ASEAN and the WTO, and the need to look at these issues in a brief but comprehensive manner.

### **The context of inquiry and the choice of the approach**

Thus, the project approaches the subject under examination by taking the following steps:

- a. It begins with a brief review of the mandate of services liberalization as specified in various ASEAN official documents concerning the objective of regional integration. This was necessary so as to limit the range of inquiry to those which are directly related to ASEAN.
- b. Having briefly touched on the review of the mandate of regional economic integration as specified by the member governments at the highest level the question of organizational issue in the management of the process is briefly examined;
- c. Given the background above, the specific technical issues of examining the various modalities of negotiations are then examined with a view of developing an approach to negotiations that would be suitable for ASEAN in view of the objective of liberalization in services to achieve the objective of integration by 2020.
- d. A series of recommendations are then offered with respect to the modalities but also, since the question of modalities is linked to the question of process, it also makes attempt to suggest what needs to be done by ASEAN Secretariat by way of organization, because the process of services negotiations will be a permanent aspect of ASEAN activities until 2020 and beyond.

Following the above sequence of examination, the concentration is on how the modality of negotiations in services should be examined in order to be consistent with the objective of integration as stated collectively by the authorities of member states and how the process should be organized, given the complexity of the integration process.

### **ASEAN and the Objective of Economic Integration: Urgency of Developing the Appropriate Paradigm**

Although 2020 seems far away, in fact it is a timeframe that is not so far off that preparation should not be taken at this stage. Indeed, it would be risky not to make the preparation from now. Attempt to start with a road map is a good beginning.

We can also look at the experience of others in integration effort, notably the European experience. In looking at the European experience, the exercise is not done in order to replicate them, because the specific situations differ. We do so in order to ask the set of questions that such endeavors would require, and to examine how the Europeans have done the task, and, whether some of the steps would also have to be done by ASEAN and if so, how would it be done in ASEAN. Thus in examining the European experience, it is important to stress that we do so in order to examine the similarities and the differences in circumstance and goals of the two entities.

In the context of ASEAN we have looked at what the ASEAN mandate on integration has been. In examining the ASEAN mandate, we have looked at them against the background of the EEC experience in the 1950's and 1960's, and in so doing we have looked at the EEC experience as counterpoint. In examining the ASEAN experience, we have done so by examining the official documents, in order to try to decipher just what is meant by integration in the context of ASEAN. We take the ASEAN official documents as the guidelines to proceed with ASEAN integration. The following table describes the different end-points between WTO, EU and ASEAN and the operating consequences of the difference.



**End-Points of WTO, EU and ASEAN**

WTO	European Union	ASEAN
<p><b>End point not clear</b> The “outer frontier” is under continuing negotiations. The goal is “freer trade” not “free trade.”</p> <p><b>Intermediate Steps are Clear</b></p> <ul style="list-style-type: none"> <li>- Continuing path of liberalization through negotiations in multilateral rounds.</li> <li>- The multiple modalities being developed in the WTO reflects that each step of the way towards negotiations to liberalize is carefully choreographed and the pace highly orchestrated.</li> <li>- The WTO Secretariat is actively engaged in the technical work and provides technical expertise and constructive advice to ensure that negotiations succeed,</li> <li>- National agencies vary in the degree of intensity of engagement, with developed countries and some key developing countries taking active interest.</li> </ul>	<p><b>End-point clear</b> Economic union eventually leading to some form of political union. The end-point is specified in treaties.</p> <p><b>Intermediate steps clear</b> Treaty-based procedures outlining the process of integration each step of the way.</p> <p>The procedures are under continuous negotiations and refinements to achieve deeper and speedy integration.</p> <p>The time-table is rigorous and national agencies are continuously and actively engaged.</p> <p>The European Commission takes the lead to ensure coordination and take the leading role in the process.</p>	<p><b>End-point clear</b> Free trade area leading towards economic integration.</p> <p><b>Intermediate steps unclear</b> Under continuous process of defining ASEAN-specific modes of operation.</p> <p>Need more clear steps towards policy harmonization among member states.</p> <p>Need further institutional development in order to ensure sustained activities leading the 2020.</p>

Table V-1 from Chapter V

**Harmonization of rules and policy as important component of integration**

However, if the objective is to be what has been the official objective of integration by 2020, then an eclectic approach to combine various approaches is needed in order to ensure that the process of comprehensive coverage of sectors could eventually be achieved, and in a relatively short time. Moreover, the 2020 objective requires that ASEAN countries takes steps to ensure the emergence of the appropriate regulatory framework that would be mutually compatible to ensure that regional integration could in fact take place.

Accordingly, in addition to the need to accommodate the wide ranging sector that must be included in the process of liberalization for the purpose of integration in 2020, there is also a need to ensure that whole elements constituting the regulatory regime as well as the accompanying facilitating mechanism to ease the flow of trade in services in the region, be the subject of examination and negotiations. This means among other the need to recognize the importance of *harmonization* of regulatory regimes and common practices that make the entire economic space of ASEAN region operating within rules that are compatible to each other.

The above means that the negotiations process must also include a process whereby steps towards harmonization of regulatory regimes would be included in the criteria of success toward the goal of 2020 integration. Thus a specific forum on harmonizing regulatory regimes need to be included as part of the ASEAN process of negotiations towards integration.

## Review of negotiating modalities

As a process, negotiation in services is a new experience for ASEAN and indeed for the global economy in general. The first truly serious exercise ever done was in the Uruguay Round when members of GATT, now WTO, were engaged in negotiations to formulate the overall framework agreement in services and specific sectoral agreements as well as to engage the first ever negotiations for liberalization in services whose results were subsequently inscribed in the schedule of specific commitments in services.

With the experience in the Uruguay Round, ASEAN's process of negotiations in services replicates the experience of the Uruguay Round and also it uses the WTO as a reference point for ASEAN's handling of services. This approach is sound and it has strong logic. The ASEAN – 6 countries, are members of the WTO and those not yet member of the WTO are in the process of completing their accession to the WTO. Moreover, ASEAN principal trading partners remain the countries in the rest of the world and only a relatively small but growing portion of its trade is with each other.

However, as has been mentioned above, although making the WTO the reference point in dealing with services is a sound starting point, not everything in the WTO could be replicated in ASEAN. Or to be more precise, while the process of liberalization in the WTO may be designed to be relatively slow and circumscribed because there is no formal commitment towards the creation of a free trade environment in the global economy, the process of liberalization in ASEAN must necessarily move much further and much faster because the explicit objective is to create at least a regional free trade area and to go even further, as the various official documents say, to achieve economic integration in the ASEAN region by 2020.

## Request and offer approach and its limitations

The modality used in the WTO for services negotiations has been the *request and offer* approach. The process is straightforward because it is intended to be so. In the effort to liberalize trade in services, a member country addresses a specific trading partner with a list of requests for liberalization in terms of: (a) the specific sector or sub-sector; (b) the type of market access and national treatment that it requests for liberalization; (d) the manner that the liberalization would be applied through the 4 modes of supply.

That modality is perfectly suitable for the WTO process because it is a compromise between those who wish to have some clear way of negotiating in services, namely those with export interest, and the developing countries who are largely importers of services and wish to have the opportunity to limit and modulate the extent to which they wish to liberalize multilaterally. This also reflects the fact that the WTO does not have as its formal objective the creation of global free trade in services.

By contrast, in ASEAN, the objective is indeed free trade in the region and the creation of free trade, i.e. the elimination of all barriers to the movement of goods and services by 2020. With the 2020 objective in mind, the modality to be chosen need not be limited to the *request and offer* approach. This approach may be the most appropriate for sectors where countries are not yet comfortable in a speedy approach to liberalization. Therefore, there is a need to maintain this approach to negotiations in some sectors where this would be the only realistic approach to take.

In order to meet the intra-ASEAN requirements of achieving trade liberalization leading to a free trade area, there are other steps that are needed in ASEAN that member countries may not wish to do in the context of the WTO. We have tried to propose various recommendations, keeping in mind the objective of liberalization.

**Some key issues on modalities: rethinking about mode 3 and reconciling services and the need for common investment policy**

Taking the objective of economic integration as given, mode 3 in the context of ASEAN is open to a more creative and imaginative treatment. In the WTO, the developing countries are rightly worried and hesitant about how to commit liberalization of mode 3. Therefore, in the WTO, liberalization of mode 3 is carefully circumscribed.

In the WTO, developing countries are not sure of the extent to which they wish to make binding commitments in the broader area of investments. What they seem to be ready for is to accommodate certain aspects of investment in so far as it would be necessary to permit the delivery of a service. They are therefore careful not to make mode 3 as a window for discussing the possibility of an international agreement on investment.

The situation is different in ASEAN. The preoccupation of developing countries in the WTO about preventing discussion on mode 3 as a prelude to negotiations on investment is not found in ASEAN because, by implication, liberalization of investment and the development of regional investment regime is part and parcel of a regional integration process. Thus a lack of progress in mode 3 can be attributed to an undue adherence to the WTO process, which in the case of integration of ASEAN is not wholly relevant.

**Expanding sectoral coverage and flexibility in the number of countries participating in specific commitments**

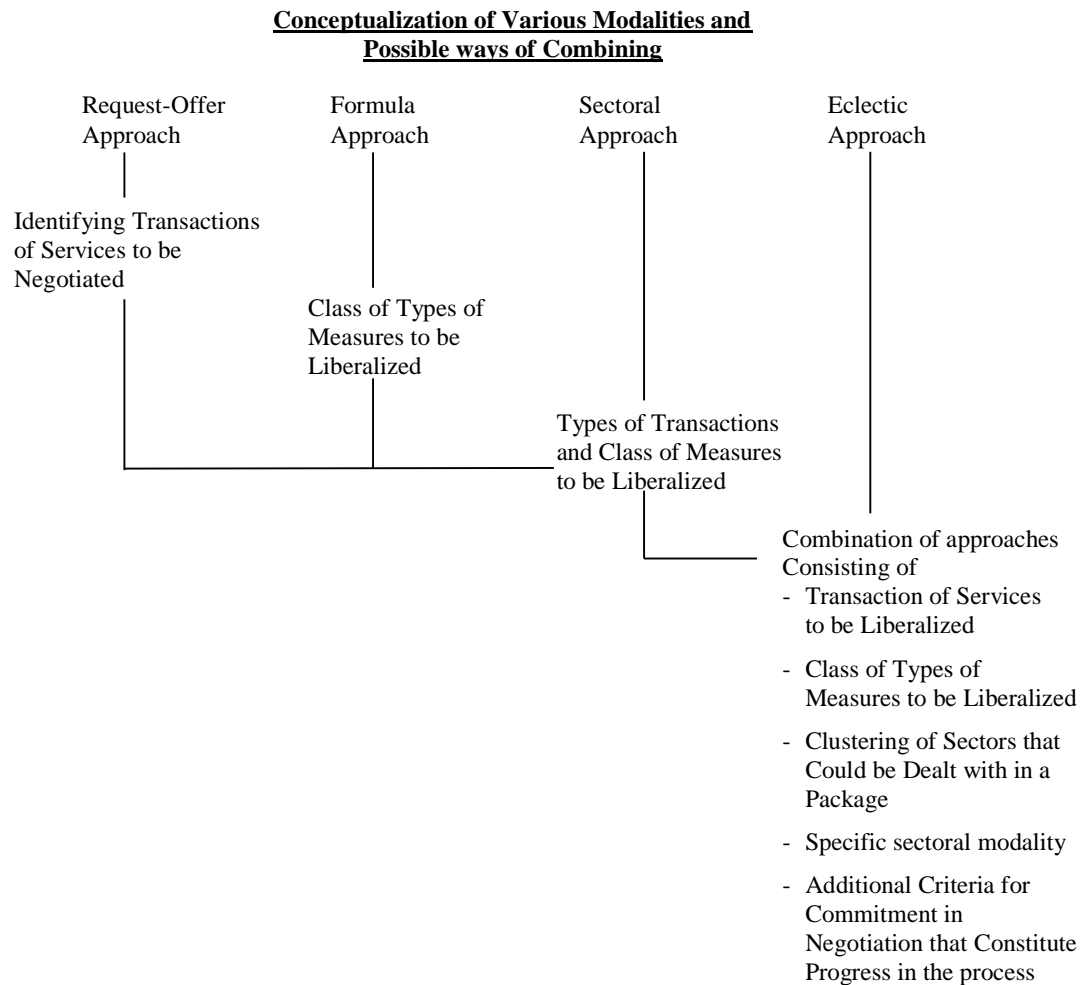
Moving toward the liberalization aspects of the negotiations, the formula of ASEAN-minus-X approach can be further developed towards a more speedy process of integration in ASEAN. However, this must be given more specificity because as it stands it merely allows less than the full membership of ASEAN to initiate moves towards speedier integration, to be followed by others when they are ready. To do so it must be combined with a focus on first identifying the possible sectors that could be susceptible to the use of ASEAN-minus-X approach.

There are a number of factors to consider in the process of encouraging more sectors of services for liberalization. First, it is necessary to examine the sectors where ASEAN members have common interests. In this connection, it should be stressed that those sectors are not necessarily the same sectors where ASEAN members have made commitments in the WTO. This is the case because the WTO commitments were made because developed countries have made requests which were based on their commercial interests and ASEAN had responded to some of the commitments that developed countries had requested.

By contrast, the sectors where ASEAN members have a common interest in trade in services in the region, and where actual transactions among some ASEAN members are already taking place, are likely to be different sectors. Indeed, in those sectors, there are already ongoing

transactions of some economic value, even if they have not appeared as commitments in the official *schedules of commitments* of ASEAN. These areas are potentially promising. Therefore, more imaginative modalities for negotiations need to be developed that are appropriate in the ASEAN context.

The report argues for an eclectic approach to negotiating modalities which can be summarized in a schematic way. The Chart deals with the modalities for negotiations in services.



(Chart III-1 from Chapter III)

The above chart is drawn in order to present a visual framework containing the elements for an ASEAN approach to negotiations modality in services which does not discard the prevailing request-and-offer approach (which on its own would not produce satisfactory outcome) but supplements other features which are more relevant for ASEAN needs.

### Organizational Issues

The process of negotiations for liberalization in services in ASEAN has evolved pragmatically over the years. The ASEAN Secretariat has been similarly moving in the same direction pragmatically. In so doing it has performed its role as the supporting agency which

ensures that the process moves in the direction intended by member states. The years of dealing with economic cooperation have created a body of knowledge and experience in dealing with economic issues among ASEAN officials and the business community. The experience of developing a common ASEAN position in dealing with third parties in a coordinated manner has provided a wealth of experience in ASEAN cooperation.

However, now there is a new challenge being faced. For the first time ASEAN has moved clearly towards more intensive regional cooperation. The decision to establish a free trade area has added a new and even more challenging dimension to cooperation. That decision has wide ranging implications, including in the organizational aspect. The process of creating a free trade area requires a mechanism of consultation and monitoring in order to ensure that the calendar of integration is successfully implemented. This poses a new challenge.

Moreover, in the field of services, the process of liberalization must necessarily follow the path of changing regulatory regimes that would lead over a specifically defined time frame to a more open system for the economic players from the region. It also implies the need to undertake continuous harmonization of regulatory practices throughout the region. Therefore, for the first time, domestic policy of individual member countries become a subject of mutual consultation and discussion. These activities require intensive consultations and negotiations. Accordingly, not all the current organizational arrangements could be maintained without appropriate adjustments.

The following table provides a list of the recommendations with regard to modalities.

**Summary of Recommendations on ASEAN Services Negotiating Modalities**

Recommendations	Content
Recommendation # 1	Creation of consultation mechanism to deal with capital movement
Recommendation # 2	Modality to initiate liberalization of investment in ASEAN
Recommendation # 3	Developing specific modality on free movement of professionals
Recommendation # 4	Developing modalities explicitly dealing with labor mobility
Recommendation # 5	A recording of all the policy harmonization exercises achieved in ASEAN in services to have a more balanced picture of the progress in integration
Recommendation # 6	A specific mechanism is proposed to keep track of progress made in harmonization
Recommendation # 7	Continue to use request and offer approach for difficult sectors where progress is expected to be slow
Recommendation # 8	Developing specific modalities for important but not necessarily sensitive sectors
Recommendation # 9	Developing Modalities for important <i>and</i> sensitive sectors
Recommendation # 10	Modality for Specific ASEAN Sectors (sub-set of Recommendation # 8)

*Table IV-2 from Chapter IV*

The above recommendations deal exclusively with the modalities as such. But this paper also attempts to touch upon broader matters that have effects on modalities but are policy related issue requiring political decision. Therefore, in the consolidated summary below, the recommendations are phrased in a wider context than the technicalities of negotiating modalities. The same technical issues are presented in a more policy-oriented manner.

**Consolidated Summary of Recommendations**

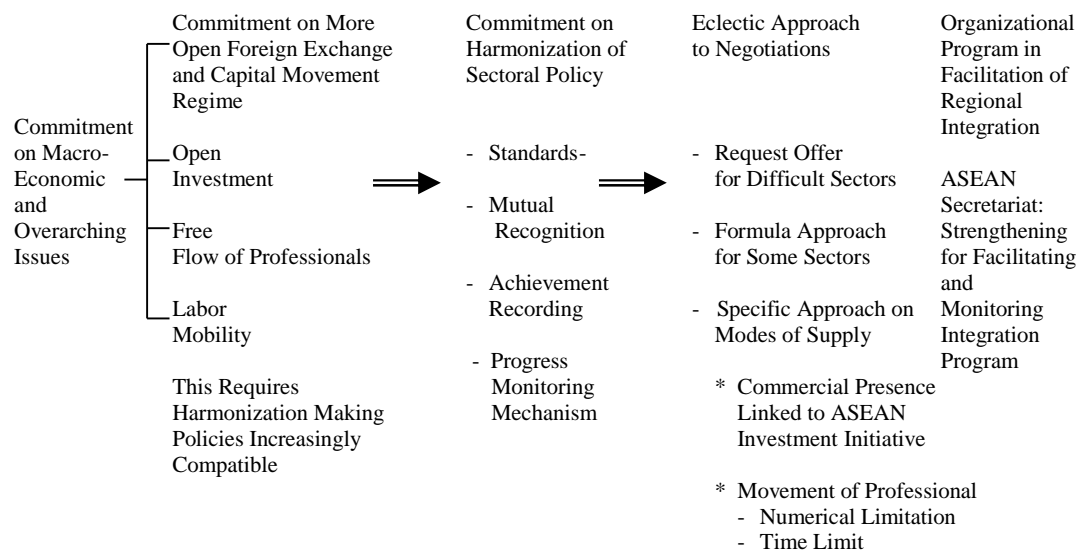
The comprehensive and consolidated recommendations of this report covering: (a) the broader policy issues; (b) harmonization of domestic policy; (c) developing an eclectic approach to modalities for services negotiations; (d) the organizational issues related to the facilitating functions of ASEAN Secretariat are summarized in the following table.

### Consolidated Summary of Issues and Recommendations

Commitments on Macro-Economic and Overarching Issues	
Recommendation # 1	Commitment to more open foreign exchange and capital movement regime
Recommendation # 2	Commitment to more open investment regime
Recommendation # 3	Commitment to free flow of professionals
Recommendation # 4	Commitment to labor mobility
Harmonization of Policy	
Recommendation # 5	A recording of all the policy harmonization exercises achieved in ASEAN in services to have a more balanced picture of the progress in integration
Recommendation # 6	A specific mechanism is proposed to keep track of and continue the progress in harmonization.
Modalities for Negotiation	
Recommendation # 7	Continue to use request-offer approach for difficult sectors where progress is expected to be slow
Recommendation # 8	Developing specific modalities for important but <i>not necessarily</i> sensitive sectors
Recommendation # 9	Developing Modalities for important <i>and</i> sensitive sectors
Recommendation # 10	Modality for Specific ASEAN Sectors (sub-set of Recommendation # 8)
Organization Support	
Recommendation # 11	Strengthening of the ASEAN Secretariat structure to deal with a services free trade area
Recommendation # 12	Initiating technical activities in the ASEAN Secretariat in support of its new and expanded functions in facilitating an ASEAN free trade area
Recommendation # 13	Initiate a unit in the ASEAN Secretariat for helping institutions in member states to deal with services in the ASEAN context

Schematically, the summary of the recommendations and issues contained in this report can be seen in the chart below.

**Schematic Summary of Proposals and Recommendations**



(Chart VI-1 form Chapter VI)





## Chapter I Introduction

This report examines the various modalities for negotiation in services that might be considered by ASEAN. In so doing, the intention is to survey the different ways in which modalities could be applied to suit the specific needs of ASEAN, and to help ensure the success of creating a free trade in ASEAN in the field of services. It surveys the range of possible features of modalities for negotiation that might be used to reduce the chance of progress being hampered by technical reasons due to an inappropriate choice of modalities.

This examination of modalities arises from dissatisfaction with the process and progress of negotiations and therefore to examine the extent to which the modalities for negotiation might be one of the causes of unsatisfactory progress. In approaching the subject of negotiating modalities and the search for alternative modalities, this report does not assume that the slow progress in services negotiations is caused by inappropriate modalities. What it attempts to do is more modest, and that is to ask the following question:

to the extent that inappropriate negotiating modalities may impede the process of negotiations in ASEAN towards the creation of a free trade area, what could be done in the area of modalities for negotiation to speed up the process?

To answer this question, steps need to be taken to examine the range of possible modalities for negotiation that could be used, to identify all the relevant components of the negotiating modalities that are currently being practiced or contemplated, and to see whether some, all or none of them would be suitable for ASEAN purposes.

Therefore, there are two distinct issues that this report regards as issues that need separate treatment:

1. There is some dissatisfaction with the progress so far of liberalization in services achieved in ASEAN, and
2. There is dissatisfaction with the modality for negotiation being used in ASEAN for negotiations in services to achieve the objective of liberalization leading towards a free trade area.

The two facts may be related, but this report *does not* argue that lack of progress in liberalization is *caused* by unsatisfactory modality being used, *nor* does it argue that *if* the appropriate modality is used, the negotiations to create a free trade area in would be moving more rapidly.

What this report does is argue that *if* the current modality for negotiations is regarded as not satisfactory in helping to achieve progress in liberalization rapidly that would: (a) have substantial coverage of sectors, (b) achieve significant reduction of the barriers to market, and, (c) achieve rapid negotiations, *then* it follows that an alternative modality must be found.

The examination of the modalities would then be directed to arrive at one of the following alternatives that might be chosen:

- (a) to abandon and replace the current modality entirely  
or
- (b) to retain the existing modality but add some new features at the margin;  
or
- (c) to formulate a fresh and flexible approach and combine different elements of modalities for negotiations, including elements of the existing modality, to arrive at a multiple choice of modalities that are more suitable to the varied needs of the different sectors of services, and thus to arrive at an eclectic approach.

This report is therefore a technical report to examine the details of various modalities for negotiations in services and to depict all the components of negotiating modalities that would be of relevance to the ASEAN negotiating process.

In so doing, this study treats the subject of this report in the following sequence:

- a. review of current ASEAN practices and the principal features of ASEAN practices;
- b. examination of the WTO process, which is the reference point for all member countries, particularly when dealing with external trade;
- c. development a possible ASEAN approach based on the examination of the many modalities now practiced or contemplated in the WTO or elsewhere, and recommendations on how the approach might be used in the context of ASEAN;

Having gone through the exercise, the report does not claim that if the modalities are made more flexible to meet ASEAN needs that ASEAN negotiations in services would necessarily progress more satisfactorily.

What this report wishes to stress is that if the slow progress in negotiations is caused by an inappropriate use of negotiating modalities, which is a simplistic assumption, then an examination of the modalities would be necessary, in order to see what could be tried to meet ASEAN needs. To do so a detailed examination of the various modalities and their components needs to be undertaken. This is what this report has attempted to do.

## Chapter II

### The ASEAN Guidelines for Services Negotiations

#### I. Introduction

The purpose of this chapter is to summarize the policy framework within which ASEAN has decided to undertake trade liberalization. It briefly reviews the range of those official guidelines in ASEAN that can be considered as the set of instructions in ASEAN to conduct liberalization in services in the context of the objective of creating an ASEAN free trade area. The official ASEAN documents which constitute guidelines are scattered throughout different documents reflecting the evolving policy developments and decisions of member states. It would be useful to examine these guidelines in detail so that the technical discussions on various negotiating modalities could be seen from an ASEAN perspective.

In order to put the services negotiations and the search for more effective negotiating modalities within the broader context of ASEAN policy intentions, the guidelines and mandates are also examined within the context of the intention of creating a free trade area in ASEAN. Some aspects need to be treated chronologically, while other aspects would need to be treated from an analytical perspective. There are important policy reasons to keep in mind as ASEAN reviews the process of negotiations and makes the choice of the modalities for negotiations. To do so an examination is made on the intention of ASEAN as stated in the official documents. The official documents are political directives on ASEAN liberalization.

In those documents the final destination of ASEAN liberalization is clear: the removal of all trade barriers by 2020. Although the final destination is clear, the path between the present and the final date of 2020 remains to be drawn in greater detail by member states. These steps also need to be agreed upon. They are drawn as ASEAN makes the decision on how to move from one stage to another in the process toward 2020. These documents are the guidelines that ASEAN member states have agreed upon in the process of trade liberalization.

Thus, although the assignment in this project is to examine the various modalities for negotiations in services that may be useful for ASEAN, the discussion on the modality for negotiations cannot be meaningfully discussed merely as a mechanical exercise. It needs to be cast against the background of the objective that ASEAN has set for itself, namely to achieve the economic integration of the region. Although the final meaning of integration is yet to be defined, it is nevertheless clear that it would at the very least reach a level of a free trade area by that time. Given the above consideration it is clear that the modalities for services negotiations should serve the final purpose of achieving the 2020 objective.

In the process of developing modalities for negotiations, ASEAN has relied on its experience, or to be more precise, the experience of member countries in the WTO services negotiations. While it is appropriate to do so in general, there are specific aspects of the WTO experience which are not directly appropriate in the ASEAN context. One aspect which is not wholly appropriate to transpose WTO experience to ASEAN is the question of modality. We shall address these questions in other chapters of this report. But first it would be appropriate to state what ASEAN intends to do with liberalization in the context of the 2020 objective.

## II. ASEAN Policies and Plans on Integration and Free Trade Area

ASEAN liberalization process both in the field of goods and in the field of services must be seen from the specific context of ASEAN's intention to create a free trade area. In this respect, there is a critical difference between the process of liberalization in ASEAN and the multilateral process in the WTO. This difference has important implications on the negotiating process in general as well as the specific modalities for negotiations that are not immediately evident but which can affect the outcome of regional liberalization.

ASEAN first made its fundamental step towards a free trade area when it agreed on the step to establish the ASEAN Free Trade Area (AFTA), which was announced in the Fourth ASEAN Summit in Singapore in 1992. In so doing, it clearly declares that at a certain point all barriers against trade in goods and services would be removed. ASEAN has made the political decision that the objective must be achieved by 2020. We can trace this basic commitment in various important documents. What can be inferred from those documents is that ASEAN states have made the commitments to do so. To the extent that this is a commitment made at the highest level of government, it can be regarded as an instruction.

To the extent that actual behavior of governments runs contrary to this objective, then those decisions contravene the agreed objective. To the extent that member countries would systematically take measures that are contradictory to the above intention then the objective would suffer from diminishing credibility. In order to prevent governments from inadvertently deviating from their commitments, it is important to examine the content of the guidelines for proceeding towards a free trade area and examine the extent to which the operating guidelines actually contribute to the realization of the agreed goals to which the members have committed themselves.

The official guidelines and documents reflect an evolving process of thinking in ASEAN that has been taking place over the years. When ASEAN member states made the decision to undertake steps leading towards the creation of a free trade area in the region, ASEAN was clearly embarking on a new path of economic cooperation beyond areas of historic economic cooperation.

For the purpose of examining the modalities for services negotiations, the documents received from the ASEAN Secretariat for the purpose of this study are the following:

- *ASEAN Framework Agreement on Services - 1995*
- *Protocol to Implement the Packages of Commitments Under the ASEAN Framework Agreement on Services (Initial - 1997, Second - 1998, Third - 2001)*
- *The Ha Noi Plan of Action (HPA) - 1998*
- *Mid-Term Review of the Ha Noi Plan of Action (January 1999 – June 2001)*
- *Alternative Approaches to Liberalization of Trade in Services*

These documents are briefly examined below, focusing on the relevant parts that affect trade in services and the possible indications of the concerns of the authorities who have made the decisions.

### III. Details of the ASEAN Services Framework: AFAS

The specific policies and plans in ASEAN regarding services can first be elaborated below. As described in the terms of reference, the ASEAN policies and plan in services are as follows. At the 5<sup>th</sup> ASEAN Summit in 1995, ASEAN countries signed the *ASEAN Framework Agreement on Services (AFAS)* with the following explicit objectives:

- a. to *enhance cooperation in services* amongst Member States in order to improve the efficiency and competitiveness, diversify production capacity, and supply and distribution of services of their service suppliers within and outside ASEAN;
- b. to *eliminate substantially restrictions* to trade in services amongst Member States; and
- c. to *liberalize trade in services* by expanding the depth and scope of liberalization beyond those undertaken by Member States under the GATS with the aim to realizing a free trade area in services.

To date, ASEAN has concluded three packages of commitments from two rounds of negotiations.

#### Reference to GATS

The extensive coverage of the GATS agreement and a framework agreement has enabled ASEAN to find it comforting to refer to the GATS when no specific provision exists in ASEAN concerning particular issues related to services. Thus the *ASEAN Framework Agreement of Services AFAS* in Article XIV (para. 1) states that “The terms and definitions and other provisions of the GATS shall be referred to and applied to matters arising under this Framework Agreement for which no specific provision had been made under it.”<sup>1</sup>

It is therefore appropriate that in undertaking negotiations in the field of services in the region, ASEAN has made it clear that it would deal with the process by making direct reference to the WTO. Furthermore the WTO will form the basis on which regional services negotiations in ASEAN would be conducted. This provision is clearly stated in the AFAS Agreement. Article IV (para. 1) states that:

“Member States shall enter into negotiations on measures affecting trade in specific services sectors. Such negotiations shall be directed toward achieving commitments which are beyond those inscribed in each Member State’s schedule of specific commitments under the GATS and for which Member States shall accord preferential treatment to one another.”<sup>2</sup>

This provision clearly states that the starting-point in ASEAN services negotiations is the existing commitments that individual ASEAN members make in the WTO, and that the ASEAN exercise would proceed from that point but that whatever ASEAN members commit in ASEAN would be restricted only for ASEAN member. This after all is part of the logic of a free trade area, i.e, the implicit right to discriminate against non-members.

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<sup>1</sup> ASEAN *Framework Agreement on Services* (Jakarta, ASEAN Secretariat, 1995)

<sup>2</sup> Ibid.

### **Learning from WTO while developing ASEAN approach**

However the fact that the WTO and the GATS are reference points for the way in which ASEAN deals with services does not necessarily mean that the situation for ASEAN countries in those institutions is identical, and therefore, that the approaches ASEAN takes in the two areas should necessarily be identical. At this point it should also be immediately noted that the provision under Article IV (para. 4) of AFAS presumes a process of request-and-offer. The question is posed whether the request-and-offer approach, which has been regarded as the most acceptable modality for negotiations in services in the WTO, is necessarily the most appropriate for ASEAN.

Although *prima facie* no other method is explicitly prohibited, nevertheless, probably by sheer inertia, the paradigm that appears to operate in the process is indeed principally the request-and-offer approach. This has been the mode chosen by the WTO for reasons of the particular dynamics and political and policy constellation operating in the WTO. In the WTO, this modality has been chosen as a convenient means to modulate the process of liberalization to accommodate those who seek meaningful or not necessarily significant liberalization and those who are worried that liberalization would move too fast.

The operating question for ASEAN is whether the identical dynamics and political and policy constellation prevailing in the WTO also prevails in ASEAN and whether the differences in this area between the two institutions also merit a different approach in the way negotiations are conducted. We shall deal with this aspect more fully in this report below but it is worth signaling at this point because it would constitute one of the aspects that require some reconsideration in order to ensure more satisfactory results in ASEAN.

### **Organizational issues and managing a process**

In the process a new set of approaches would be needed. One aspect that this new situation demands that in previous times was not critical is the need for continuity of process. Creating a free trade area, especially in the context of a regional economic integration, is not a one shot affair. It requires gradual and painstaking efforts. It demands patience, careful attention to detail and continuity. To do so properly, two sets of “mechanical instruments” are needed: (a) a highly developed approach to negotiations that would allow a wider range of processes to take place, and, (b) the facilitating machinery to ensure that the processes are followed up, in sum an ASEAN Secretariat that could be developed for this particular task.

Table II – 1 summarizes some of the key elements that implicitly would be needed in order for the process of facilitating integration to move with some degree of continuity and coherence.

Table II – 1  
Components of ASEAN Free Trade Area as a System

Key Element	Measures Needed
Trade liberalization	Negotiation and implementation of measures of liberalization of the domestic trade regimes of goods and services of member countries
Compatibility of domestic policy	Negotiations and the establishment of harmonization of the regulatory situation so as to achieve the establishment of comparable economic environments throughout the region. This aspect relates to the development of the content of domestic policy that needs to be made increasingly mutually compatible.
Institutional and regulatory framework	The establishment of the regulatory and institutional bases which ensure the continuation of the free trade area on a sustained basis. This requires institutional set up domestically and at the ASEAN level, which basically functions as an intergovernmental forum such where government representatives systematically meet to develop a process of agreeing to undertake harmonization.
The creation of institutional machinery to ensure the management of the system	Organizational framework with the capacity and power to administer what has been agreed upon. This is largely related to the development of the function of the ASEAN Secretariat to serve as a facilitating agency and the guardian of the process integration that has been agreed by member states.

At this juncture it would be useful to discuss briefly the experience of Western European economic integration, which so far is the only realistic reference point for ASEAN can take in its effort to achieve economic integration. We do so not in order to replicate the European experience but to address the questions that are posed by the Europeans that are similarly posed by ASEAN. The key questions are: (a) the extent of integration intended; (b) the path that the integration process is to follow; (c) the sequence of integration; (d) institutional issues.

As will be seen in Chapter V end point and the path of liberalization between ASEAN, EU and WTO are quite distinct even though there are similarities. The path of the EU towards integration is the clearest and the most ambitious. It has chosen a treaty-based explicit series of steps towards the final destination of full integration, with a clear supranational authority, leading to the end point of political union. The steps can be regarded as “hard” integration, following the path outlined in the “mainstream” literature of economic integration, moving from free trade area to customs union, common market and finally a full economic integration. Therefore, institutional set up and the modalities to reach to endpoint are quite clear.<sup>3</sup>

3. For an examination of the difference between the ASEAN process and the WTO process, between regionalism and multilateralism, and between “hard” and “soft” integration, see H.S. Kartadjoemena. “ASEAN

In ASEAN, this is not the case. ASEAN, while committing itself to integration has not made an explicit political decision on what integration means beyond the free trade area. It has clearly decided that by 2020, there would be free movement of goods and services in the region. But the modality to reach that goal has yet to be in a final sense. It has been left to the pragmatic process of developing the modalities through negotiations from one step to the next. In this sense, it can be conveniently describe as “soft” integration.<sup>4</sup>

#### **IV. ASEAN Experience in Services**

Since the process of negotiating on services liberalization in ASEAN began in 1995, there have been commitments made arising from the negotiations. The experience has been criticized for not being far-reaching enough in the liberalizing exercise. Whether this is the case depends on the perspective of the observer who is making the judgment. Irrespective of these judgments, a more “measurable” question is to ask whether the process could be made faster and whether the depth of liberalization could be made more substantial. It would in any case be useful to examine, and how would member countries go about it.

##### **December 1998 Guidelines**

The first round of negotiations covered seven priority sectors: air transport, business services, construction, financial services, maritime transport, telecommunications, and tourism while the second round was to cover all sectors under the Statement of Bold Measures issued in December 1998.

##### **Ha Noi Guidelines**

At the Thirty-Third AEM held in Ha Noi, Viet Nam on 15 September 2001, the ASEAN Economic Ministers (AEM) launched a third round of negotiations beginning 2002 ending 2004, and covering all sectors and modes of supply.

##### **November 2001 Summit Guidelines**

During the Seventh ASEAN Summit held in Bandar Seri Begawan, Brunei Darussalam on 5 November 2001, the Leaders agreed, amongst other things, to speed up negotiations in liberalizing intra-ASEAN trade in services and also to start negotiations on mutual recognition arrangements to facilitate the flow of professional services in the region. Behind the details of ASEAN policies and plans in services there is clearly the objective of arriving at a free trade area as part of a yet undefined long-term objective of economic integration.

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and the Multilateral Trading System: Regional Trade Arrangement vs. the WTO.” *ASEAN Beyond the Regional Crisis: Challenges and Initiative*, Mya Than, ed. (Singapore, Institute of Southeast Asian Studies, 2002). pp. 203 - 42.

4. Ibid. pp. 220 – 28.



## V. Preliminary Search for Modalities in ASEAN: Multi-track Approach

In anticipation of a more detailed discussion on the modalities for negotiations in ASEAN, which will be dealt with further in subsequent chapters, it can be mentioned that designing various approaches to negotiations in ASEAN would lend support to the idea of adopting a more creative multiple approach to services negotiations. The above observations therefore, *prima facie* would lead one to conclude that it would be a sensible effort to develop a multi-track approach, as has been proposed, quite correctly in the view of this consultant, in an internal ASEAN Secretariat technical note.

Concern about the speed of liberalization emerged when it became clear that there was a distinct possibility that the 2020 integration objective might not be achieved if negotiations were to proceed in the way they have gone so far. This report is of the view that there are two major reasons for the seemingly slow progress. One aspect is clearly technical. If the process is either unwieldy or does not focus on those areas where quicker progress could be achieved, then the impediment is mechanical in character.

If on the other hand, lack of speed is due to a reluctance to move further in certain areas, then the problem is political, requiring political decision. In such a situation, it means members are not yet ready to agree on those issues. In such a case, no amount of mechanical device can advance a process and force changes without the required political decision.

A realistic approach in such a situation is to develop a negotiating modality that would decompose the elements into parts or components so as to achieve agreements at least on part of those difficult aspects where agreement could be achieved. The modalities explored in the report attempt to slice into bits elements of agreements that could be achieved while postponing other elements for a subsequent stage.

The issue is how to design the approach and put an operational content to the idea. It would be useful to examine how those with experience in the negotiations process have developed their thoughts in the light of their GATS and WTO experience as well as experience in regional integration and free trade area negotiations.

In the process, it would be important to *not* assume that it is realistic to expect *both* wide sectoral coverage and *greater* depth of commitments at the initial stage. The two may be a trade-off. A possible compromise is to examine whether a combination in some form is possible and acceptable. In this regard, the multi-track approach could be a realistic option. But it must be worked out in detail what this means in operational terms.

In the search for an effective approach to speed the process and increase the depth of liberalization commitments in ASEAN an eclectic approach would be needed. This needs to be done by examining the process and modality of negotiations in greater detail which will be undertaken in the next chapter.

## VI. Conclusion

This brief chapter is necessary in order to underline the importance of the decision to create a free trade area as a basis for undertaking liberalization in the region which makes it distinct

from the decision to liberalize in the context of the multilateral system, the WTO. This difference lies in the extent of commitment that countries make when they intend to undertake a free trade area which is distinct from the commitment for liberalization in the context of the multilateral system. How distinct the process would be in specific term is determined by how member countries intend to proceed with the gradual process of eliminating all barriers implicit in a free trade area which is not the explicit intention of the WTO multilateral system.

## **Chapter III**

### **Technicalities of Negotiating Modalities**

#### **I. Introduction**

Negotiating modalities are technical guidelines for the process of negotiations that are agreed upon by the parties negotiating an agreement before the process of negotiations takes place. These modalities are sometimes very controversial to negotiate because beyond the technicalities, there are major policy decisions that are taken which are sometime contentious in the domestic scene. Therefore, when dealing with negotiating modalities, there is a pitfall to be avoided in assuming that one modality is easily substitutable by another simply by changing a few features, which is technically easy to do. While some of the mechanics are simple, the choice of one substituting one modality with another, which may be technically more efficient, is not merely a mechanical question.

The presumed unsatisfactory progress in ASEAN services negotiations, given the 2020 deadline for ASEAN integration, has led to this project being requested to examine the structure and approach to service negotiations. Accordingly an examination is needed to evaluate various alternative modalities that would help the process of negotiations progress more satisfactorily. A great deal of technical work needs to be done in this area. It must be done in the context of the long-term objective of regional economic integration requiring both organizational steps and policy decisions.

The modalities for negotiations in services in ASEAN have so far been approached in a manner consistent with the WTO framework under the General Agreement on Trade in Services Agreement (GATS). ASEAN members, at least those who are already members of the WTO, are formally and legally obliged to be WTO-consistent. Therefore, it was logical that the first step taken was to ensure of the requirement of being WTO-consistent.

Secondly, the GATS agreement as a framework has been a useful and constructive framework to follow for governments wishing to have a coherent roadmap on how to deal with policies regarding services. This applies both for domestic purposes as well as internationally. The GATS is a comprehensive system dealing with the whole range of issues connected with trade in services. It is the first international agreement ever in the field of services. Thus it was also logical for this reason that ASEAN starts from the WTO realities in its process for conducting negotiations in the context of the *ASEAN Framework Agreement on Services AFAS*. The experience in the WTO is therefore a valuable starting point to examine. In so doing both the similarities and differences could be detected.

The resulting dynamics above led to the approach to negotiations chosen in ASEAN. Similar to the process in the WTO which has chosen to deal with the process through request-and-offer approach, the process in ASEAN started by following the same method, as reflected in AFAS. On the other hand there is an expression of dissatisfaction with the way in which negotiations has progressed so far. The question being posed is whether the lack of progress is due to the selection of a particular modality for negotiations.

In the process, as ASEAN proceeds with the services negotiations using the request-and-offer approach it has been discovered that it has not led to a satisfactory results. To the extent that the modality of negotiation chosen impedes progress, this chapter will deal with that issue.

This chapter reviews the modality currently being used in ASEAN and various other modalities that might be considered. Nevertheless, it should also be noted that there are other reasons for lack of progress which may have to do with more fundamental and policy-based reasons. They should also be pointed out.

## **II. Examination of the Various Modalities of Negotiation**

Since searching for alternative modalities for negotiations is the core concern of this report, it is necessary to explore the various alternative modalities in great detail. Although our direct concern is with the negotiations in services, and therefore the focus would be on how the various alternative modalities would have to be adjusted to the realities of the services sectors, some lessons from negotiations in trade in goods would also be touched upon to the extent that they would help to clear some relevant issues for services.

To the extent that modalities have some effect on the resulting progress of negotiations, there are grounds to examine whether the modality chosen by ASEAN is appropriate for ASEAN objectives and whether other modalities would be more suitable. In order to answer this aspect of the problem, an examination of the various modalities for negotiations in services would have to be undertaken.

### **a. Request-and-offer**

In the WTO the modality for negotiations in services has been the request-and-offer approach. That approach has been favored in the context of the WTO because of the complex nature of the negotiating process with large number of participating governments and vast differences in the economic structures and levels of development. It has the simplicity of having a country approaching its trading partner to request liberalization of access to market and national treatment and, in exchange for the request being granted, the requesting country would offer its own liberalization in return. Whatever is agreed would in turn be applied on a most-favored-nations basis.

Moreover, not all countries in the WTO share the approach to trade and the final destination that they wish to go in the area of trade and the future of the global trading system. With such differences, it would have been difficult to proceed with the process in any other manner than the request-and-offer approach being adopted to initiate concrete steps to reduce specific trade barriers in specific trading partners.

The request-and-offer approach has a long history in the GATT-WTO system, and has been used in parallel or as alternative with the formula approach in the market-access negotiations in trade in goods. Thus, in the area of trade in goods, the trade-off in using the request-and-offer approach is between the depth-of-cut on few sectors where significant cuts are possible while allowing much smaller or even no cuts to be made in some sensitive sectors.

In the Uruguay Round, the tariff negotiations in non-agriculture goods had been conducted on a request-and-offer bases because the most powerful economy in the world, the US, wanted to negotiate for deep cuts in some sectors but it would not) move in some other specific sectors. However, it also has an element of a formula approach in requiring that there be a reduction of some 30 percent on the average even if some sectors do not experience any cut, provided that it was compensated by higher cuts in other sectors.

The industrial tariff negotiations in the Uruguay Round were conducted not through a formula approach but through request-and-offer combined with an American initiated zero-for-zero approach for some selected products. This provides the possibility of a deep tariff cut in selected products. But it also leaves other products untouched. In so doing the principle of comprehensiveness is somewhat sacrificed.

In services, the request-and-offer approach has been applied through the following process:

- In each WTO round of multilateral negotiations, a country with an export interest in specific sectors would present a set of requests, formulated in the format that has been the standard GATS schedule of specific commitments. The requests are therefore directly addressed to a specific country.
- The requested country in question would respond to the request through bilateral consultation
- In the consultation the requested country would respond to the request and provide clarifications
- In the subsequent step, the requesting country would also formulate an offer of liberalization commitment in exchange for its request.
- When agreement is made, the results of the liberalization commitments are then made applicable to all WTO members on MFN basis.

The procedure allows countries to be selective about what to request, what to give and how much to give in each sector. No generalized formula is assumed in this process. Any improvement above a previous level of commitment is therefore registered as an improvement. Table III – 1 summarizes the request-and-offer approach for easy reference.

**Table III – 1**  
**Elements of Request-and-Offer Approach**

<ul style="list-style-type: none"> <li>- In each WTO round of multilateral negotiations, a country with an export interest in specific sectors would present a set of requests.</li> <li>- The request is formulated in the format that has been the standard GATS schedule of specific commitments.</li> <li>- The request is therefore directly addressed to the requested country in question.</li> <li>- The requested country would respond to the request through bilateral consultation</li> <li>- In the consultation the requested country would respond to the request and provide clarifications</li> <li>- In the subsequent step, the requesting country would also formulate an offer of liberalization commitment in exchange for its request.</li> <li>- When agreement is made, the results of the liberalization commitments are then made applicable to all WTO members on MFN basis.</li> <li>- No agreed procedure is implied in the bilateral meetings</li> </ul>
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**b. Formula approach**

An alternative to the request-and-offer approach would be the various formula approaches. This approach has been used in the GATT/WTO system in the negotiations for trade in goods, specifically to negotiate tariff reductions. During the early days of the GATT tariffs

were negotiated through the modality of request-and-offer. Since those early days efforts have been devoted to the search for other modalities in the negotiations of tariffs. It would be useful to examine the evolution of the formula approaches in goods as we deal with services.

### Kennedy Round

In the Kennedy Round and the Tokyo Round, it was beginning to be seen that the request-and-offer approach was cumbersome. A more generalized approach was proposed where governments would agree before hand how much cut in tariff would be undertaken and what would be an “equitable burden” in tariff reduction that would have the same “harmonized” effect in cut between those tariff levels which are high and therefore needed to be cut more deeply and those which are low, and therefore could be cut less.<sup>5</sup>

### Tokyo Round

In the Tokyo Round, the “harmonizing” aspect was achieved by a simple mathematical formula proposed by Switzerland. The Swiss formula and its variances had been the one widely used for tariff negotiations. The purpose is to achieve “harmonization” of tariff cuts where products with high tariffs are cut at a higher percentage than those with low tariffs. In practice however, it also contained exceptions, where tariffs on some products were only reduced slightly and some, not at all.<sup>6</sup>

It is also useful to note that similar to trade in services, regulatory measures that distort trade have also been fully recognized in trade in goods, although dismantling non-tariff barriers could be accomplished by converting them to tariffs, while in services, this is more difficult to accomplish to the satisfaction of countries still wishing to accord domestic protection to their service industries. A formula approach to non-tariff barriers had already indeed been proposed even during the Kennedy Round era. Hindley had touched on this issue long ago.<sup>7</sup>

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<sup>5</sup>. Extensive discussion on formula approach have been initiated as far back as the Kennedy Round era in the 1960's. See Hugh Corbet and Harry G. Johnson, “Optional Negotiating Techniques on Industrial Tariffs.” In *Towards an Open World Economy – A Report by an Advisory Group* Frank McFadzean, et al. ed. (London, Trade Policy Research Centre, 1972) pp. 66-8.

<sup>6</sup>. Gilbert R. Winham, *International Trade and the Tokyo Round Negotiations* (Princeton, Princeton University Press, 1986). pp. 18, 201, 203-4.

<sup>7</sup>. Brian Hindley, “Negotiations for Overcoming Non-Tariff Barriers to Trade.” In *Towards an Open World Economy – A Report by an Advisory Group* Frank McFadzean, et al. ed. (London, Trade Policy Research Centre, 1972) pp. 127 – 36.

### c. **Formula Approach in Services**

The points above, though technically related to trade in goods, have a great deal of relevance for services negotiations. Since the existing level of protection for services vary, a formula approach, if it can be found, would attempt to ask those whose level of protection to undertake deeper cuts than those with less level of current protection. However, Thompson (2000) recognizes the limits of a formula approach which deals with a quantified formula such as the Swiss formula in services as distinct from goods.<sup>8</sup>

The problems to be resolved when a formula approach is to be considered are both technical and also policy-driven, and thus political in nature. Both must be fully examined if the intention is to explore whether the approach could be further developed in order to be directly useful for the purpose of ASEAN negotiations. There are different contents that could be incorporated into a formula approach for guiding a process of negotiations. Thompson's examination of the various modalities for negotiations in the WTO services negotiations has been very helpful. Her brief, compact but detailed paper cited in this chapter has been used to examine the various mechanisms. The tables on WTO-related modalities in this report have been adapted from her tables, but redesigned to make them relevant for ASEAN purposes.

#### Sector-specific guidelines used as reference

In the negotiations during and arising from the Uruguay Round, the approach that has applied some formula are (a) the use of *model schedules*, such as the case in maritime transports, (b) the use of *Reference Paper* such as in telecommunications, (c) the use of a formal *Understanding*, such as the case in financial services. Table III – 2 depicts a summary of the various formulas used for various sectors. These formulas utilize some principles and guidelines appropriate for the specific sectors intended.

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<sup>8</sup>. Rachel Thompson, "Formula Approaches to Improving GATS Commitments." *GATS 2000 New Directions in Services Trade Liberalization*, Pierre Sauve and Robert M. Stern, Ads, (Washington D.C., Brookings Institution Press, 2000). p. 473 – 86.

**Table III - 2**  
**Negotiations Modality: Some Formula Approach**  
**Adopted in the WTO**

*Model schedules*

- A post-Uruguay Round development.
- Applied for negotiations on maritime transport and basic telecommunications.
- Focus is on packaging of core commitments. It could be supplemented by request-(further) offer approaches.
- Identifying a core set of sub-sectors in which commitments would be undertaken by all participants
- Identifying areas of exclusion (such as cabotage in maritime services).
- Identifying areas where differing degrees of liberalization were feasible.
- Does not propose the content of specific commitments.
- Encouraged greater clarity and standardization in classifying and listing of commitments.

Which sectors in ASEAN could be identified for such a model schedule?

*The Reference Paper for Basic Telecommunications*

Contains a set of common regulatory commitments to be inscribed into schedules as additional commitments, which was done in part or in full.

A high proportion of treatment commitments made in sector through commitments on domestic regulatory transparency, access to essential facilities in this and related sectors, and competitive safeguards.

A similar approach was being considered in the maritime negotiations to develop additional commitments on access to and use of port facilities.

How would ASEAN want to deal with basic telecommunications?

*The Understanding on Commitments in Financial Services*

A set of core commitments for the sector on market access, public procurement, the treatment of new financial services, and a standstill commitment. The understanding was incorporated into schedules of most OECD countries on a most favored nation basis.

What does it take for this approach to be taken in ASEAN?

Source: Taken from Rachel Thompson, "Formula Approaches to Improving GATS Commitments." *GATS 2000 New Directions in Services Trade Liberalization*, Pierre Sauve and Robert M. Stern, Ads, (Washington D.C., Brookings Institution Press, 2000). p. 473 – 86, with appropriate modification for ASEAN purposes.

The technical aspects of a formula approach have to do with the way in which a formula is designed. It could therefore contain elements that would focus on modes of supply that could



be negotiated. It has to do with how various modes of delivery of services would be liberalized. Each mode has a specific problem of policy and the question is whether it would be possible to deal with each mode being commonly applied across several sectors. Table III – 3 depicts the issues to be considered when modes of supply forms the focus of liberalization procedure.

**Table III – 3**  
**Formula Approach Focusing on Mode of Supply**

<p><i>All modes</i></p> <p>All participants to make initial offers in sector where they presently have no commitments.</p> <p>Measures listed in GATS Article XVI (Market Access) to be phased out by all participants by a designated date,</p> <p>Measures restricting the provision, transfer, and processing of information and data to be eliminated or phased out, apart from “necessary” measures as provided in GATS Article XIV (General Exceptions).</p> <p><i>Mode 1</i></p> <p>Replace any commercial presence and local certification requirements with local registration and liability insurance requirements.</p> <p>Eliminate or phase out any requirements that provision may take place only through joint ventures with local providers or by approved “brand-name” providers.</p> <p><i>Mode 2</i></p> <p>Elimination or phase-out of all limitations on the consumption of services abroad by a service consumer or consuming unit.</p> <p><i>Mode 3</i></p> <p>Removal or phase-out of economic needs test for approval, quotas on number of firms permitted, and limitations on majority foreign ownership, as general principles for establishment of new services business.</p> <p>Upon and after establishment, guarantee of national treatment for foreign firms in:</p> <ul style="list-style-type: none"> <li>- Scope and geographic location of permitted business activities;</li> <li>- Types of permitted legal entity;</li> <li>- Application of domestic business and professional laws and regulatory licensing.</li> </ul> <p>Removal or phase-out of limitations on ability of foreign firms to lease or buy land and buildings for their direct commercial use.</p> <p>Removal or phase-out of limitations concerning possibility of forced divestiture of existing foreign shareholdings in services business.</p> <p>Removal or phase-out of nationality requirements for board members, directors, and senior executives.</p> <p><i>Mode 4</i></p> <p>Expand and standardize the classification of service occupations and professions for use in schedules.</p> <p>Phase-out or relaxation of:</p> <ul style="list-style-type: none"> <li>- Economic needs test and quotas for entry and stay of skilled services providers for defined periods;</li> <li>- Nationality and permanent residency requirements for intra-corporate transferees and contracted service providers.</li> </ul> <p>Removal or phase-out of other limitations on intra-corporate transferees, business visitors, and services salespersons.</p> <p>Creation of a new category for small teams and self-employed foreign specialists and professionals to undertake services activities on a contract basis.</p> <p>Requirement to specify minimum and maximum time frames for initial period of stay and extension for all categories of personnel.</p> <p>Develop a reference paper for additional commitments on transparency, due process, and redress on visa and licensing procedures, taxation matters.</p>
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Source: Same as Table III-2.

Using formula, focusing on horizontal measures

Alternatively, the formula approach could be centered on the various horizontal measures that would be susceptible to a phasing out in stages. These are measures of general nature that apply across all or most sectors and are applied as a cross sector public policy designed for domestic purposes that limit freedom of entry of foreign service-providers. Focusing on these issues could be a formula for a modality of negotiations dealing with market access. Table III – 4 depicts the elements of a modality for negotiation which focus on liberalization of horizontal measures. These have technical elements of quite specific nature. They are also political in nature, require possible major legislative changes which may not be easy to engineer.

**Table III – 4**  
**Modality for Liberalization Focusing on Cross Sectoral and**  
**Some Horizontal Measures**

*Cross-sectoral*

*Choice of:*

*(1) all scheduled sectors, which in ASEAN is limited from the point of view of a free trade area*

*(2) All sectors unless exceptions agreed by negotiation*

*(3) Clustering of sectors with common characteristics*

Opening round:

All participants to make offers in substantially all sub-sectors where they do not currently have any commitments.

Although desirable that the guiding principle for such an approach would be to create commercially meaningful market access on nondiscriminatory terms, a more realistic goal would be to bring into ASEAN commitment all non-controversial sectors irrespective of current commercial value;

Pre-commitment to further liberalization in the future, even in sensitive sectors. Time table would be useful;

Elimination or phase-out of measures described in Article XVI and XVII of GATS for as many sectors as possible. This is focusing on the horizontal measures;

Reduction and eventually removal of specific types of limitations and expanded coverage of commitment under each mode. This would be more easy where Member States are currently imposing quantitative limitations on the number of suppliers, share, capital structure, etc.

Source: Same as Table III-3, with appropriate ASEAN modification.

There are policy implications that are directly related to the formula approach. Would member governments want to make commitments over a wide range of sectors through a generalized method? What would be the advantages? What would be the impediments?

Finally, in services, unlike in goods, even a formula approach cannot easily be used extensively in a comprehensive manner. The “sectoral specificity” of many services sectors are such that whatever general formula are being used, it appears that it would still require additional adjustments and refinement in order to be more appropriate for certain sectors. Thus it may have to be accepted as a reality that in formulating a modality for

negotiations, while the request-and-offer is inadequate, any formula approach employed would still require additional refinements to meet the need of specific sectors. This brings us to deal with the issues of sector-specific formulas in greater detail.

**d. Specific Sectoral Approach with Specific Formula**

In the area of services there are clearly cases where a sectoral approach to negotiations is more feasible to conduct liberalization negotiations that could go very far. Indeed, the GATS agreement recognizes fully the sectoral specificities of certain important sectors. Accordingly, it allows the existence of specific sectoral agreements as an integral part of the agreement. In the process, what is sought is consistency with the GATS framework.

Arguments for a Sector Specific Approach in GATS

To the extent that sectoral agreements depart from the “mainstream” of the rules and principles of the GATS, the GATS system seeks to circumscribe those departures. In so doing, the GATS maintains its universal sectoral coverage. Thus it was recognized that if no exceptions are allowed, there would be no incentive to include that sector as part of the GATS coverage, and therefore risking the emergence of special sector specific agreements that would be entirely outside the reach of the WTO system.

On the other hand, it was clearly recognized that if a sector specific agreement, even when developed within the ambit of the WTO, is allowed to depart excessively from the WTO system, it would be difficult to bring the sector eventually into the WTO fold and to be in full conformity to the WTO rules. This latter case can be seen in textiles and agriculture where multilateral “tolerance” for deviation has led to difficult negotiations to bring the sectors back into the fold of full GAT/WTO-conformity.

Various sector-specific agreements in GATS

In the process, in the Uruguay Round negotiations in these specific sectors have been conducted in a manner that reflects the sectoral characteristics but maintains the link with the GATS. The modalities in the various special sectors in the GATS negotiations are the following:

- financial services
- telecommunications
- maritime services
- air transport
- movement of natural persons

The characteristics of each of these agreements are summarized in Table III – 5. The table summarizes the principal features of the sectoral approach to services which deviate from some WTO general practice, but about which member governments feel strongly.

**Table III – 5**  
**Sectoral Negotiations, Specific Rules and**  
**Modalities in the GATS**

Sector	Modality
Financial Services	<p>Excludes government operation in the exercise of governmental authorities.</p> <p>Strong prudential carve-out of monetary authorities to exercise their function.</p> <p>Concern about wider impact on the economy.</p> <p>Worry about foreign dominance of the financial sector.</p> <p>Worry about exposure to external volatility.</p>
Telecommunications	<p>Agreement recognizes the dual function of telecommunications as public infrastructure and a commercial activity.</p> <p>Basic telecommunications are especially sensitive because they function also as public infrastructure.</p> <p>Deregulation and market opening must also accommodate the desire of many government the role of government monopolies.</p>
Maritime Transport	<p>Contains specific exclusion from the scope of the agreement: cabotage.</p> <p>Much influenced by old motives of national security.</p> <p>Labor unions in developed countries still opposed to liberalization.</p> <p>How will ASEAN deal with this, since maritime transport is important to the region.</p>
Air Transport	<p>Agreement excludes “hard rights” from negotiations.</p> <p>Sector is still dominated by state-sponsored international agreements (IATA) and market sharing arrangements.</p>
Movement of Natural Persons	<p>In GATS labor mobility is excluded.</p> <p>Emphasis in on intra-corporate transfers of manpower.</p> <p>How will ASEAN deal with this sensitive issue where two countries are exporters of workers.</p>

### Financial services

There are several important points to highlight concerning the specific sectoral agreements in GATS. Their existence reflects the special concerns of those sectors and they need to be examined in the context of ASEAN. First, let us look briefly at the financial services sector. There are strong views being held in all those sectors.

During the Uruguay Round, the process of negotiating financial services was among the most controversial in the negotiations. It the end it pitted a number of ASEAN countries against the major developed countries, notably the US and the European Union. The developed countries

wanted to have developing countries move more quickly towards extensive liberalization in line with major domestic liberalization and deregulation taking place in some of those countries.

Finance ministries and central banks of the region had been uneasy about the pressure of the developed countries to liberalize. They worried about the excessive attention to liberalization while being unconcerned about prudential and supervisory issues. The Asian financial crisis afterward indicates that sequencing the path of financial liberalization and greater attention to prudential issues were important concerns.<sup>9</sup>

Fortunately for the process, the negotiations were handled almost entirely by finance ministries and monetary authorities who had been accustomed to dealing with controversies in a more serene or at least less noisy environment and had preferences to resolve differences without public showmanship. The deal was finally struck and it also added the resolve of finance ministries and central banks to deal with financial services in their own special ways. The mechanism in ASEAN reflects the general practices of the financial community to deal with liberalization through mechanism of consultation where they are dominant.

### Telecommunications

In telecommunications, governments had to cope with the realities that the sector has a dual role as public infrastructure and as a legitimate business endeavor in their own right. Striking a balance between the two functions and redefining the role of the regulators as well as coping with the dilemma of making the state telecommunications monopolies more market responsive while still allowing the existence of state monopolies has been a great challenge in policy making and in negotiating. A special modality in negotiating the basic telecommunications services was necessary and a special sectoral agreement was deemed essential to allow liberalization to take place and yet capture the sectoral-specificity to ensure that governments would feel confident negotiating liberalization under GATS. ASEAN needs to carefully examine how telecommunications liberalization could be designed.

### Movement of Natural Persons

The Uruguay Round never came to an agreement about labor mobility. The best that it could do was to agree on a special agreement on movement of natural persons. It is restricted in effect to intra-corporate transfers. The clause stating that the agreement "...shall not apply to measures affecting natural persons seeking access to the employment market of a Member, nor shall it apply to measures regarding citizenship, residence or employment on a permanent basis..." effectively limits the mobility of labor except as a part of a corporate activity, that is conducted by "...natural person of a Member who are employed by a service supplier of a Member, in respect of the supply of a service."<sup>10</sup>

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<sup>9</sup> The problem of financial liberalization and sequencing of reform had been of concern even before the crisis and cautions had been often aired though not always heeded until the crisis. See David C. Cole, "Sequencing versus Practical Problems in Financial Sector Reform." *Sequencing? Financial Strategies for Developing Countries*, Alison Harwood and Bruce R. L. Smith, eds., (Washington DC, Brookings Institution, 1997) pp. 47 – 59.

<sup>10</sup> "Annex on Movement of Natural Persons Supplying Service under the Agreement." *The Results of the Uruguay Round of Multilateral Trade Negotiations – Legal Texts* (Geneva, World Trade Organization, 1995) p. 353.

In the context of ASEAN, labor mobility might be able to be dealt with a bit differently, with some, and even eventually significant, modulation of the specific provisions. We shall deal with this question in the next chapter when we discuss some recommendations.

### Air Transport and Maritime Transport Services

The GATS special agreements on air transport and telecommunications reflect the closed nature of the sector where market-sharing arrangements and other anti-competitive practices prevail. In air transport, the special agreement excludes negotiations on “hard rights”, making it commercially of limited commercial value from the perspective the GATS. Maritime transport reflects in part the protective inclination of some labor unions in developed countries while also excluding a particular segment of maritime transport, namely cabotage.

Thus, in the WTO, the sectoral agreements which form an integral part of the GATS are agreements in financial services, telecommunications, maritime transport, air transport and movement of natural persons. However, in the context of ASEAN, a sectoral approach need not be confined to those sectors where specific GATS sectoral agreements exist. In the Western Hemisphere, there are no fewer than 167 sectoral agreements on services of various types, 41 being agreements at sub-regional level and 126 at bilateral level.<sup>11</sup>

As we deal with special sectoral agreements and the special modalities for such agreements, it is necessary to be mindful of the rules in the WTO about free trade areas and economic integration. A discussion on this question follows.

### **Beware of WTO Rule on Integration**

As we deal with sectoral agreements, it is important to turn our attention briefly towards the WTO rule on free trade areas and economic integration. This can have implications on the modalities to be chosen. At the outset, it should be emphasized, as we shall see below, that the rules on integration require that both comprehensiveness of sectoral coverage and the volume of trade as well as the whole range of modes of supply of services be covered by an agreement on free trade area.

In the WTO there are two sets of general provisions on two different WTO agreements which address the question of free trade areas, customs union and economic integration. One set of rules which is long standing is the article in the GATT which still applies. It addresses directly the question of free trade areas and customs union in trade in goods. The second is the set of provisions in the GATS, which applies to trade in services.

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<sup>11</sup> Sherry M. Stephenson, “GATS and Regional Integration”, *GATS 2000 New Directions in Services Trade Liberalization*, Pierre Sauve and Robert M. Stern, Eds, (Washington D.C., Brookings Institution Press, 2000), p. 524.

## **GATT Article XXIV on free trade areas and Customs union**

Under Article XXIV of GATT 1947, free trade areas and customs unions are permitted to exist although it contravenes the principle of most-favored-nation (MFN) an Article I of the GATT. The Article (para. 4) states that:

The contracting parties recognize the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries parties to such agreements. They also recognize that the purpose of a customs union or of a free trade area should be to facilitate trade between constituent territories and not to raise barriers to the trade of other contracting parties with such territories.<sup>12</sup>

Thus free trade areas and customs unions are permitted under the WTO and the provisions on those arrangements are in existence since the early days of GATT.

However, there is a requirement that the resulting agreement would "...not...raise barriers to the trade of other contracting parties with such territories." This is further specified in para. 5(a) and (b). Furthermore, the same article, in para. 8(a)(i)and(ii) indicates that the coverage of the trade must be such that "...duties and other restrictive regulations ...are eliminated with respect to substantially all the trade between the constituent territories ...or at least with respect to substantially all the trade in products originating in such territories."<sup>13</sup>

Thus the product coverage, and in services, the sectoral coverage, must encompass *substantially all products*. To be objective, this principle makes sense. It should be understood that if the free trade area or customs union covers only selected products, it means a government sanctioned market-sharing arrangement and would clearly contravene the intended purpose of freer trade. Accordingly, an early commitment on many sectors, even if the depth of commitment is only modest, would approach more the requirement of the provision than a deep cut in only a handful of sectors.

## **GATS Article V on Integration**

It should be added that since the Uruguay Round and the emergence of GATS in services, there is also a similar provision concerning economic integration in the area of services. Article V(para. 1) of the GATS states that:

This Agreement shall not prevent any of its Members from being a party to or entering into agreement liberalizing trade in services between or among the parties to such an agreement, provided that such an agreement:

(a) has substantial sectoral coverage; and,

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<sup>12</sup> "General Agreement of Tariffs and Trade (GATT 1947)." *The Results of the Uruguay Round of Multilateral Trade Negotiations – Legal Texts* (Geneva, World Trade Organization, 1995) pp. 522-3.

<sup>13</sup> *Ibid.* p. 524.

(b) provides for the absence or elimination of substantially all discrimination, in the sense of Article XVII, between or among the parties, in the sectors covered under subparagraph (a), through:

- (i) elimination of existing discriminatory measures, and/or
- (ii) prohibition of new or more discriminatory measures,

either at the entry into force of that agreement or on the basis of a reasonable time frame...<sup>14</sup>

A footnote to that provision further clarifies that the condition of “substantial sectoral coverage to be the following:

This condition is understood in terms of number of sectors, volume of trade affected, and modes of supply. In order to meet this condition, agreements should not provide for the *a priori* exclusion of any mode of supply.<sup>15</sup>

There is moreover the requirement for notification of free trade areas specified in GATT Article XXIV and the GATS Article V.

### **Notification to the WTO**

Up to now there has been no notification on ASEAN because it is just in an early stage of putting in place a free trade area. When the process is in operation, ASEAN must examine how to notify the WTO. Which route would ASEAN take? It is not the intention of this report to deal with this issue. However, to the extent that sectoral negotiations for liberalization in services are now being contemplated, the issue must also be seen against the background of the WTO rules on integration.

However, there is an important point to keep in mind, namely that sectoral agreements which are temporarily not in conformity with the GATS need to be made consistent with the GATS at the outset in order to avoid future uncertainties. They need to be made compatible with, among other things, the provisions of Article V dealing with economic integration. In this connection, it should be kept in mind that sooner or later the question of conformity with GATS Article V will need to be faced directly and it will be important that ASEAN keeps in mind this obligation.

### **Part IV of the GATT: “enabling clause” and Developing countries**

On the other hand it is also worth noting that preferential arrangements among developing countries, which are not intended to be applied on an MFN basis, are covered by other provisions in the WTO. Although its application is still somewhat less than certain, developing countries entering into a preferential agreement can invoke Part IV of the GATT “enabling clause” that would permit developing countries to accord preferences to each

<sup>14</sup>. “General Agreement on Trade in Services.” *The Results of the Uruguay Round of Multilateral Trade Negotiations – Legal Texts* (Geneva, World Trade Organization, 1995) p. 331.

<sup>15</sup>. *Ibid.*



other.<sup>16</sup> This issue will have to be faced sooner or later and while the technical question of modality to speed the process of negotiations is being examined, there is the question of notification to the WTO looming that needs to be addressed as well.<sup>17</sup>

### **Implications of WTO free trade areas and the construction of modalities for negotiations**

Although modalities for negotiations are “mere” technical and “mechanical constructs”, those modalities that would lead to a narrow base of sectoral coverage only would also expose the parties to inconsistency with the WTO rule of “substantial coverage”. Modalities that result in a wide sectoral coverage but lack “depth” in commitment would lead to charges of inconsistency with the clause that substantial coverage “...is understood in terms of number of sectors, volume of trade affected, and modes of supply”. These WTO-related issues need also to be kept in mind as ASEAN considers various modalities for integration.

### **III. Possible Approaches for ASEAN to Consider**

Given the experience in the WTO where extensive negotiations in services have been undertaken since the Uruguay Round and in which the ASEAN-6, Brunei, Indonesia, Malaysia, The Philippines, Singapore and Thailand, were actively engaged, some of the modalities in the WTO negotiations could be considered more closely. As mentioned, for its own reasons and dynamics, the WTO had chosen to adopt the request-and-offer approach to the liberalization in services as the most acceptable approach ASEAN, through AFAS, has also initiated the process through the request-and-offer approach.

However, for ASEAN purposes, the approach has been less than satisfactory. It has proven to be extensive, cumbersome and slow in practice. Therefore, efforts have been undertaken to try different modes of negotiations, adjusted to the particular realities of the different sectors. This report is a further reflection of the desire to look for more appropriate modality suitable to ASEAN needs.

### **ASEAN Guideline on Services**

As mentioned previously in Chapter II and the quotation reproduced here, the AFAS agreement stipulates that:

The objectives of Member States under The ASEAN Framework Agreement on Services ... are:

(a) to enhance cooperation in services amongst Member States in order to improve the efficiency and competitiveness, diversify production capacity and

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<sup>16</sup> For a legal interpretation on Part IV of the GATT on preferences among developing countries, see GATT, *Analytical Index: Guide to GATT Law and Practice* (Geneva, General Agreement on Tariffs and Trade, 1994) pp. 784-5.

<sup>17</sup> Stephenson has made the caution to be attentive to the WTO provision on regional integration and developing countries proceed with their exercise in developing free trade areas. See Sherry Stephenson, *op. cit.*

supply and distribution of services of their service suppliers within and outside ASEAN;

(b) to eliminate substantially restrictions to trade in services amongst ASEAN Member States, and

(c) to liberalize trade in services by expanding the depth and scope of liberalization beyond those undertaken by Member States under the GATS with the aim to realizing a free trade area in services;<sup>18</sup>

### **Request-and-offer approach in ASEAN**

The modality that has been chosen in AFAS is to replicate the experience of WTO in the negotiations in services by undertaking negotiations in services through the request and-offer approach. It generally follows the procedures as described previously in Table III – 1 above.

### **Formula approach for ASEAN**

It must be recognized that one major factor that differentiates between request-and-offer approach and a formula approach is that the in the former, when a country in a request-and-offer approach asks its trading partner to significantly change a policy, it accepts the possibility that the request might be refused in principle and yet it still gains specific “concession”, such as by obtaining a quantitative increase in the number of players allowed to enter a market, if it would not require a major change in legislation. In a formula approach, the focus would be on an agreement to *change policy significantly* in a manner that would be a generalized obligation that would apply to all participating countries.

Secondly, a formula approach would require a deeper understanding of the overall regulatory environment prevailing in the trading partner in order to assess whether a generalized formula commitment would have sufficient commercial value. This implies that agencies in member countries dealing with services must have an adequate understanding of the regulatory regimes in the other member countries in order to be able to formulate some formula approach which then could be considered fair, if the principle of reciprocal and balanced overall concessions remains one of the operating political bases in trade negotiations.

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<sup>18</sup>. ASEAN Framework Agreement on Services (Jakarta, ASEAN Secretariat, 2002)

#### **IV. Towards a Constructive Pragmatism: Mixed approach, the eclectic choice**

What are some of the possible factors that could be considered as elements if a formula approach is to be developed for ASEAN negotiations? In this chapter some of the general aspects of a possible ASEAN formula are discussed. In the next chapter on recommendations, the more specific aspects of the formula are discussed in detail in order to be considered as a possibility. In this section discussions will be presented in some detail on the various approaches that have been taken in ASEAN beyond the request- and-offer approach.

Recognizing the limitations on relying solely on one modality, the ASEAN Secretariat as well as member states has made an effort to examine alternative modalities. An internal paper by the ASEAN Secretariat has dealt with the possible use of a mixed approach to services negotiations that merits deeper examination.<sup>19</sup> However that ASEAN paper, in order to be operationally meaningful must have a more developed content so that it could be implemented. This report will follow the line of reasoning in that ASEAN internal paper and will attempt to indicate the elements needed to make the approach operational.

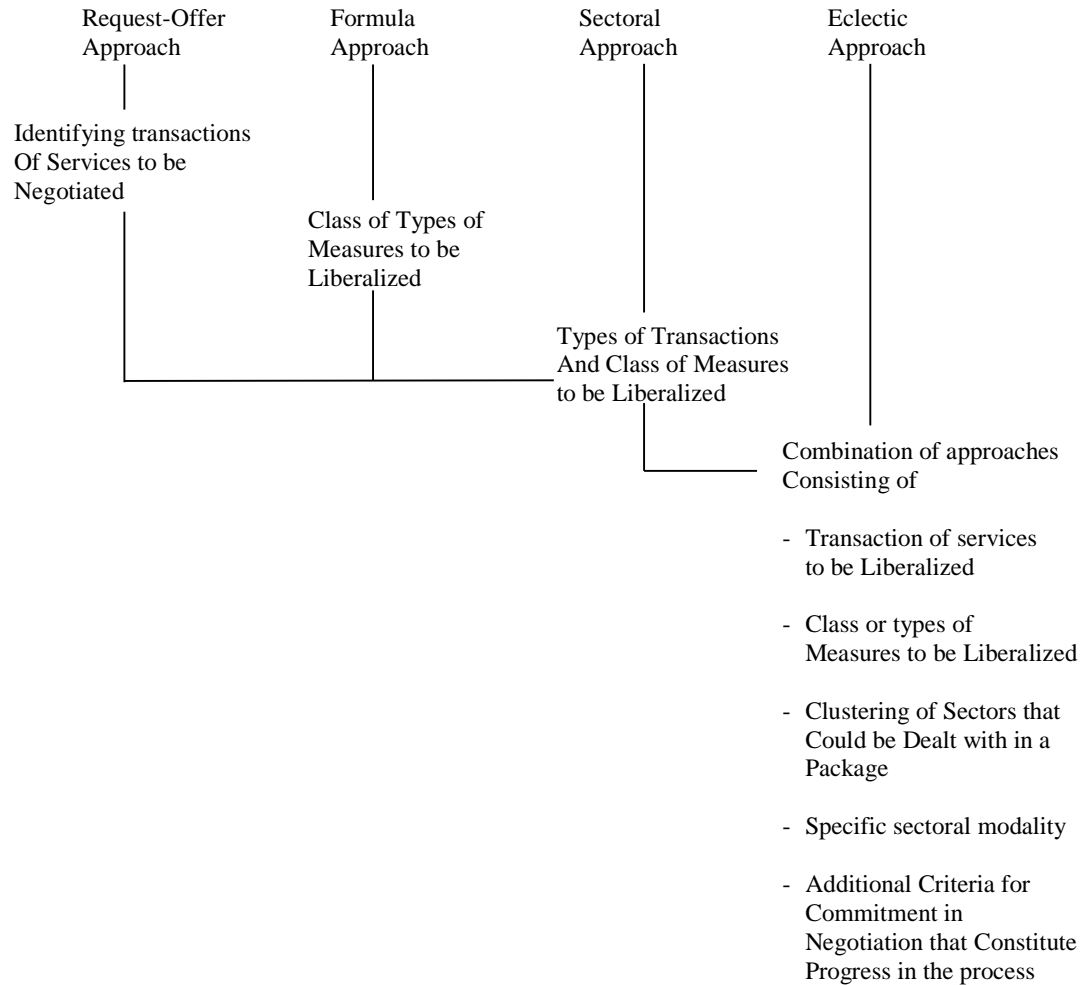
Basically, this eclectic method may be quite promising provided that careful work is done and efforts are devoted to the examination of how it might work. What would be the necessary constituent elements that should be there to make this approach attractive to ASEAN member states and at the same time operationally implementable? This point will be treated in the next chapter as part of the recommendations of this report.

Chart III – 1 summarizes conceptually the way in which a mixed approach might be undertaken in the context of ASEAN. The detailed steps need to be traced in an iterative manner much like a flight plan for pilots. This is an important exercise and indeed the heart of the practical and operational aspects of developing the negotiating modality. It needs to be cast against the background of the discussions of policy mandate given by the authorities and the technical, organizational and policy-based issues that must be addressed.

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<sup>19</sup> *Alternative Approaches to Liberalization of Trade in Services* (Jakarta, ASEAN Secretariat, 2002) Internal Secretariat Paper.

**Chart III - 1**  
**Conceptualization of Various Modalities and**  
**Possible Ways of Combining**



Anticipating the discussion on recommendations about the details of an eclectic approach to developing negotiating modalities in Chapter IV, Table III – 6 outlines the elements that the approach might include in order for ASEAN to better achieve more speedy negotiations towards a free trade area. We can examine how it could be further applied to ASEAN in the next chapter.

Table III – 6  
Features of Sector-Specific Tailor-Made Modalities and Implications for ASEAN

Type of Sector Specific Arrangement	Content of Formula
Model Schedule	<ul style="list-style-type: none"> <li>- More concerned with guiding process by focusing on how to schedule commitments. Keeping track of the formal structure to impose a structured negotiating process.</li> <li>- Specially designed schedule of commitments for a particular sector.</li> <li>- May contain standardized classification list.</li> <li>- May contain agreed upon scheduling guideline</li> </ul> <p>Which sectors would be appropriate for ASEAN?</p>
Sectoral Understanding	<p>May feature the content and agreed interpretation of commitments. Where the sector is particularly sensitive some “soft” liberalization might be initiated. The understandings would outline the “soft” part.</p>
Sectoral Reference Paper	<p>Can be sector-specific but some elements might be replicated in other sectors. May contain agreed upon additional “regulatory” commitments to serve as guidelines. Not necessarily detailed in describing the process of negotiations. Some sectors are quite technical and discreet liberalization, seemingly small, but when done systematically, would result in significant incremental outcome.</p>
“Zero-for-zero” commitments	<p>Sector-specific</p> <p>This has analogy with the processes that have been undertaken in tariff negotiations.</p> <p>It may contain commitment not to impose limitations on market access and national treatment of the types described in GATS Article XVI and XVII. The assumption is that parties are ready to liberalize fully because there is an interest in the sector and do not find the sector to be sensitive.</p>
Harmonization of commitments within sectors	<ul style="list-style-type: none"> <li>- To be applied within one sector.</li> <li>- Where there are already binding commitments , there should be commitment not to impose limitation in one sub-sector,</li> <li>- The process should be facilitated to move on to another sub-sector not yet liberalized to similar extent.</li> <li>- Where there is no sectoral commitment in a particular sector, partial commitment could be initiated.</li> </ul> <p>The formula must be pre-agreed before negotiations starts. This is an essential feature for ASEAN in the longer-term.</p>

## **Conclusion**

This chapter has discussed in some detail the various modalities for negotiations in services. It has first examined the extensive experience in the WTO, specifically in the context of the negotiations under the provisions of the General Agreement on Trade in Services (GATS) and the lessons to be learned from the experience from the time of the Uruguay Round to the current round. In that perspective, attempts have been made to comb through the various methods and modalities used to deal with the different services sectors.

Attempts have been made to draw lessons from the experience and choices made and to select those lessons that could be taken by ASEAN. Attempts have been similarly made to prevent ASEAN from adopting WTO approaches where they are clearly inappropriate for ASEAN purposes. After all this discussion the bottom line is to answer the question of what specific concrete steps should and could be taken by ASEAN in developing modalities and other broader related issues in order to help ensure a more sustained and vigorous process of liberalization negotiations until 2020.

## Chapter IV

# Recommendations on Modalities for Negotiations in Services for ASEAN

### I. Introduction

The discussion in the previous chapter has attempted to undertake an extensive examination of the technicalities of negotiating modalities in order for ASEAN to examine the wide spectrum of choices about the elements that might be incorporated to help the process of negotiations in ASEAN to proceed in a more satisfactory manner. The WTO experience has been a crucial aspect in dealing with modalities of negotiations. It is the accepted multilateral framework to which members would focus as a reference point. However, the reality is that ASEAN requires that the process of services negotiations be adjusted to ASEAN requirements.

Although this report does not intend to deal extensively with some major policy issues that are potentially controversial where member states may not have identical views on the subject at present, those issues are important in making the success of a free trade area possible. Therefore it will deal with them briefly. Accordingly, before this report directly deals with the recommendations that deal with the *technical aspects* that are closer to the request of the terms of reference, there are some *policy aspects* involving the creation of free trade area that would have a bearing on how some modalities for negotiations might be created that need to be touched upon.

In other words, depending on what policy decisions are made by member states on some key issues that are important for the success of a free trade area, the modalities for negotiations in those areas would be directly affected by the choice arising from those decisions. And yet without any clear signs on what member states intend to do regarding those issues, it will be less easy to create a free trade area without appearing unambiguous. The recommendations are an attempt to suggest what steps, in the judgment of this report, are amendable to relatively straightforward measures that can be taken in stages. As mentioned, even those steps with strategic implications requiring political decisions, while admittedly difficult, in the view of this report do not appear to be insurmountable.

Another aspect of the ASEAN process of negotiations is that ASEAN has the specific objective of dealing with regional economic integration. As mentioned in Chapter II one important aspect of economic integration is the need for a process of increasing policy harmonization to ensure that policies in member states become increasingly more compatible with each other and that integration could be meaningfully implemented. This would become increasingly more critically needed to give assurance to the business community that the same rule would gradually apply in the region even if the mechanisms are not always necessarily identical.

## **II. Recommendations for an ASEAN approach to specific core issues in services requiring political consideration**

As mentioned above, this section of the chapter has taken the delicate step of going beyond the discussion of technicalities and making recommendations beyond the technical issues. However, it has been done in order to signal that in view of the objective of creating an ASEAN free trade area, discussions on selecting the use of different modalities may sooner or later touch on those issues.

Therefore, because ASEAN intends to create a free trade area and to pursue the objective of regional integration by 2020, there is a need to address four major policy areas. These areas are often sensitive issues. However, they have an important bearing on services and therefore would be an important foundation for such an endeavor, namely:

- Movement of capital
- Movement of enterprise
- Movement of professionals
- Labor mobility

So far these crucial issues have been approached with timidity. Designing the process or modality for the above is relatively straightforward as mentioned, but it can be technically complicated. But essentially, the process requires major political decision.

In the effort to arrive at a policy stance that is more consistent with the free trade area objective, designing a modality that would facilitate the conduct of discussion and negotiation is a technical issue. This could be accomplished by examining the extent that governments are willing to go for liberalization at any given point and identifying those where they are able to move further. A modality that would be able to dismantle in a piecemeal “salami tactic” fashion the trade inhibiting features of their policies would be a useful effort.

However, these fundamental policy issues need to be addressed directly. In ASEAN this requires an approach to be taken by member states that would be different from the position and posture taken in the WTO, at least with respect to some of the issues above. A meaningful effort to develop a free trade area, leading to economic integration, cannot be achieved without dealing with them politically.

As we approach the subject of mobility of capital, enterprise, professionals and labor, we can recall the experience of the European situation. From the beginning in 1957, when the Treaty of Rome was concluded, it was clearly anticipated that these problems needed to be addressed properly if a free trade area was to be able to function properly and the integration program succeed. It is not argued that ASEAN replicates the EU experience. However, it is argued that ASEAN must decide the approach to take and adopt an explicit view on these issues.

### **a. Movement of Capital**

Mobility of capital is implied in free trade areas and integration. It supplements freedom of movement in goods and services. Such mobility is affected by the exchange regime being



adopted. That is why a free trade area among countries with restrictive foreign exchange regimes would contain provisions on payments and capital movements. In ASEAN-6, the financial and monetary regime that has been adopted is a free foreign regime.

Monetary deregulation has touched on the liberalization of the current accounts and the capital accounts in one form or another. A mechanism needs to be developed for consultations between officials of ministries of finance and central banks of ASEAN countries. Since this is an important underlying support system, the results of the consultation must support the objective of a free trade area and economic integration.

### **Recommendation # 1**

#### **Consultation mechanism to deal with capital movement**

The creation of a consultative committee on capital movement in ASEAN incorporating officials of ministries of finance and central banks.

This machinery is now already in existence in order for the monetary authorities to harmonize and coordinate their macro-economic policy as and when needed. The *Hanoi Plan of Action* indeed also contains provisions on the importance of such ongoing consultations.

In the context of trade in services, the importance of this mechanism is to help ensure that the business community are reassured that whatever emergency measures the authorities may take, the central thrust of the ASEAN system is toward freer capital movement and not towards control.

The purpose of such a mechanism is to help assure the business community and the public that ASEAN is inclined to have an open capital and exchange regime and that accordingly, whenever a choice is available between taking steps that lead to a closed and restrictive regime and taking steps that lead to a more open regime, ASEAN would be inclined to take the option of an open regime.

This point is also important in the selection of the modality for negotiations. In a situation of an open foreign exchange regime where capital movements are not too severely restricted there would be less concern about binding mode 1 (cross-border supply) and mode 2 (consumption abroad) in certain services sectors, such as consultancy, education and health services, because in actual fact there would little that could be done to prevent such transactions from occurring, even if liberalization does not formally appear in a country's schedule of commitments.

#### **b. Movement of Enterprise and Freeing the Investment Regime**

Closely related but distinct is the regime governing movements of enterprise and investment. In the WTO, for their own specific reasons, many developing countries have strongly opposed an international agreement on investment and the freedom of movement of enterprise being discussed and negotiated in the WTO. The GATS mode 3 dealing with commercial presence relates to investments and the movement of enterprises into a market to supply services by establishing a presence in a market.

Indeed, conceptually, this mode of supply, for all practical purposes, deals with investment. However, many governments, especially in developing countries, are careful to circumscribe the meaning of commercial presence in the WTO. They do so in order for the concept not to become the fulcrum to remove all restrictions on investment across-the-board. The resistance may be seen from the strong objections of many developing countries to negotiations on an international agreement on investment in the WTO.

However, the situation in ASEAN is different, if the intention is to create a free trade area. Freedom of movement of enterprise is implicit in a free trade area especially if the intention is to achieve economic integration beyond the stage of a free trade area towards a common market. The thinking among ASEAN members in regard to investment and the freedom of movement of enterprises in ASEAN countries is probably therefore more fluid.

Therefore a concentrated effort focusing on evolving a common ASEAN approach on investment and the freedom of movement of enterprises in ASEAN could bear significant fruit. The issues could be linked to the development of the concept of commercial presence in services that is applicable to ASEAN, but only to be applied among ASEAN countries. Thus a breakthrough could be achieved in the ASEAN context where negotiations on investment in general for ASEAN could help achieve what sectoral negotiations on mode 3 might not be able to achieve.

Issues that touch this area would also involve the definition of an ASEAN company. It may contain criteria on source of capital, percentage of shareholders that is required to qualify as an ASEAN company. Thus, although the discussions could deal with the wider issue of investment, which is a legitimate question to discuss in the context of creating a free trade area, it could also be an efficient way of dealing with the question of commercial presence in services.

## **Recommendation # 2**

### **Modality to Initiate Liberalization of Investment in ASEAN**

The formulation of ASEAN wide criteria to foster a common approach to investment, freedom of movement of enterprises, and common definitions regarding the nature of ASEAN companies. Common definitions of ASEAN companies would provide preferential treatment for ASEAN companies compared to non-ASEAN companies even though it would still not accord full national treatment in the interim.

Although many ASEAN governments do not see an international agreement on investments such as the one being discussed in the WTO Doha Round in too favorable a light, an investment regime for ASEAN is almost inevitable given the 2020 objective. Discussions on investment and commercial presence or mode 3 in ASEAN may be more feasible. This step is technical in formulation but requires a major political decision and some organizational structuring on how to formulate the working group and the composition of officials to deal with them.

The *Hanoi Plan of Action* indeed contains provision for the implementation of the *Framework Agreement on ASEAN Investment Area (AIA)*. Thus services discussion with respect to mode 3 may indeed be more usefully done by examining the linkages between

possible ASEAN investment agreement and the modalities of negotiations for liberalization of mode 3 in services.

**c. Movement of Professionals**

In the course of the existence of ASEAN professionals in the region have had many occasions to meet, to consult with each other and to exchange views. Movement of professionals in ASEAN, cutting across many professions, is therefore a reality. Accordingly, it makes great sense to formulate a policy in ASEAN that reflects this reality. The integration process needs to formulate a policy that focuses on a modality that concentrates on mode 4 (movement of natural persons), but with steps that are distinguishable so as to be able to measure the progress achieved toward a free trade area in the field of professional mobility.

**Recommendation # 3**

**Developing a Specific Modality on Free Movement of Professionals**

To develop a modality, with binding commitments, that would focus on the movement of ASEAN professionals.. The modality must reflect the kind of patience needed to accept incremental liberalization, focusing on quantitative limitations that would be liberalized over time, in a gradual and progressive manner, giving preferential treatment exclusively for ASEAN professionals.

ASEAN professionals have been working together since the creation of ASEAN. Initiatives and innovation in this area can be expected to be driven by associations of ASEAN professionals.

**d. Labor Mobility**

There is a strong economic reason to deal with labor mobility in ASEAN where it is already a reality. Although the subject is sensitive to some, it can be “choreographed” to ensure that control through provision of additional commitments on qualifications could be formulated jointly between exporting and importing ASEAN countries.

**Recommendation # 4**

**Developing Modalities Explicitly Dealing With Labor Mobility**

Modalities on labor mobility that would reflect ASEAN realities and be applicable only to ASEAN nationals should be developed. This should go beyond the GATS provision on movement of natural persons. From the point of view of the scope of coverage it should be superior to the multilateral rules on movement of natural persons inscribed in the GATS.

Importing countries may wish to have the assurance that this will not be a basis for an ASEAN position in the WTO.

It is important to remember that in the interim process towards a free trade area, public support in all countries is crucial. A sense of perceived “balance” needs to be nurtured. For this reason, a “political package” that balances freer movement of investment and professionals with similar attempts to deal with labor mobility would provide the notion of balance.

The four areas are of such political importance that a specific approach to them would be needed in order to help ensure that the momentum for services liberalization in ASEAN would be further encouraged. The above discussions are really connected not only with liberalization of services but also, equally critically, with the need for serious harmonization of domestic policies in key areas. This is an important aspect of regional economic integration. The success or failure of an integration endeavor would depend not only on the liberalization of market access but also on the transparency of the regulatory regimes and the compatibility of those regimes. A brief discussion on harmonization follows before the question of modality is dealt with.

### **III. Harmonization of Domestic Policy as Important Component of Regional Integration**

One important aspect of regional economic integration is the need to ensure harmonization of domestic policies among members. Efforts towards policy harmonization have been undertaken since ASEAN made the decision to create a free trade area and the decision for regional economic integration. However, it appears that the subject has not been given the central position that it should occupy in the steps towards integration. Accordingly, progress to date has not been recognized for the success that it has achieved.

In services, meaningful liberalization can only be achieved by focusing on the regulatory environment that would determine what is permissible and what is not permissible. The economic players in services would then be able to know what they could do in a given market. In the process of negotiations towards services liberalization leading to integration, steps towards policy harmonization become a crucial element to keep in mind. In the end, the domestic regulations of each of the member countries must be transparent and compatible with those of other members. It is neither necessary nor feasible for countries to have identical rules. But compatibility with each other and compatibility with the free trade area and the integration objective is crucial.

If harmonization is of such importance for the integration objective, then it is important that progress in this area be registered properly and accurately so that measurements of the progress towards the 2020 integration objectives could be assessed in a more balanced manner. One mechanism to register progress in this aspect of integration is to develop a way of attaching them as annexes to the final schedule of commitments in order to provide a more balanced picture of integration’s progress, supplementing the more concrete liberalization commitments which are formulated in the schedule of commitment.

Another alternative is to have formal documentation recording the progress achieved in developing a whole range of harmonization exercises that have taken place and those that are planned. Over time, as negotiations progress, those harmonized practices could be converted into binding commitments listed in the schedule of commitments. This aspect is only to a

small extent technical. To a large extent it is a sensitive area and the way in which the recording is made on the progress in policy harmonization should be such that it is kept separate from those aspects of regulatory harmonization where member states have binding commitments in formal negotiations on market access and national treatment.

#### **Recommendation # 5**

##### **A recording of all the policy harmonization activities accomplished in ASEAN in services, in order to give a more balanced picture of the progress in integration**

In the light of the above discussions on harmonization and for purposes of registering the harmonization exercises that have progressed so far, the above recommendation is made. This is made because at the moment the regulatory regimes that are gradually being made compatible may be greater than what has been registered so far.

#### **Recommendation # 6**

##### **A specific mechanism is proposed to keep track of progress made in harmonization. .**

Existing machinery of sectoral meetings may be the initial instrument to proceed. However, for purposes of regional integration, it also requires a more structured mechanism that would systematically lead to better understanding of each others' regulatory regimes and in the process, would be amendable to developing procedures that would systematically explore harmonization exercises.

#### **IV. Dealing with Modalities: Review of Formal WTO Negotiating Procedures and Implications for ASEAN**

This section deals with the question of the specific negotiating modalities and the recommendation on dealing with the choice of modalities being recommended. To do so it briefly reviews the formal procedures that have been the standard practice in the WTO, and which have been covered also in the preceding chapter. In this chapter however, the procedures are briefly touched on again because we are charged with recommending the modalities, i.e. procedures for negotiations in ASEAN.

As mentioned, the purpose of this report is indeed to search for possible alternative modalities for negotiations on trade in services in ASEAN. In approaching the subject, it recognizes the weakness of the standard request-and-offer approach and the need for expansion of the choice of modalities in order to meet the requirements of ASEAN free trade area. However, in so doing, it recommends safeguarding the approach but not relying on these standard modalities as the sole method. The recommendations are presented in this section.

Modalities for negotiations are formal instruments with legally binding meaning. Technically they are agreements. It is true that they deal with procedures. They are carefully constructed and carefully argued. The contents are crafted to meet the political and economic interests of those who are parties to the negotiations to formulate those modalities. In order to be more

precise in dealing with them let us take the question step by step in the context of the formality of negotiations. The question asked is whether a specific ASEAN process could be constructed that could better register the progress of integration achieved in ASEAN, while maintaining those features of the WTO-type of schedule of commitment intact.

### **Process of Registering Liberalization of Commitments in a Schedule of Commitments in the WTO**

In services, the general procedure to make commitments in ASEAN follows the procedures that have been developed in the WTO. The overall approach is to liberalize by a *positive list* approach in the selection of sectors open for commitments. Only those sectors where a commitment is made would appear in the schedule. Those sectors where no commitment is currently intended would not appear in the schedule. This approach, which is standard in the WTO, has also been applied by ASEAN in its regional liberalization commitments.

Thus, in this approach, the services sector that is subject to liberalization as a part of the integration process is added to a schedule of commitments over time through negotiations. In the construction of a schedule of commitments, services sectors which do not appear in the schedule are sectors where the reporting country makes no commitments. This is common knowledge.

Services are supplied through four modes of supply: cross-border, movement of consumers, commercial presence and movement of natural persons. The importing country may make restrictions by regulating how the service is delivered. In the WTO, once a country places sectors in its schedule of commitments, the degree of limitations that a country places on the operation of foreign service-providers are explicitly stated. Those *limitations* are listed in a *negative list* approach. The absence of a limiting item in the list means there are no limitations.

The limitations can be imposed on how the access to market is allowed through the delivery of the four modes of supply. Once the foreign service-providers are in a country, the host country could also impose limitations by not according them full national treatment, that is, limitations are imposed upon them that the domestic industry does not face. The absence of any provision implies the absence of limitations.

### **Registering Commitments on Liberalization by negotiations**

In arriving at specific commitments for the entry of foreign service-providers (through the four modes of supply) a host country may impose limitation on how, through the four modes of supply, the foreign supplier is to gain market access. Once the foreign service-provider enters the market, that is gains market access, the host country can also impose limitations by not giving the same treatment to foreign providers that it gives to domestic providers. The specific commitments are negotiated between a country wishing to enter a market and the country that is being requested to allow entry.

### **Procedures for Negotiations in WTO and ASEAN**

Procedures for negotiations have been developed in the WTO. The experience of the WTO has been useful for ASEAN in initiating its own regional liberalization efforts. The process is complicated because countries negotiate for liberalization technically by requesting removal

or changes in their regulatory regimes. This implies an understanding of the domestic regime of the country to which a requesting country is addressing its request.

The negotiation procedure, that is, the *modality* for negotiations that is the most straightforward and mechanically simple is the *request-and-offer* approach. This has been used in the WTO. It is also the modality chosen up to now for liberalization in ASEAN. In this approach, countries negotiate item by item on what liberalization might be obtained. With experience, this process has proven to be cumbersome and therefore there are grounds to be dissatisfied with the approach.

Other approaches, therefore, should also be applied to achieve better overall progress. These alternative approaches should be applied pragmatically to different sectors where they are appropriate. However dissatisfaction should *not* lead to the decision to discard the approach. It should rather lead to a search for other steps to supplement the approach. Indeed, for some sectors the request-and-offer approach may be the only way to negotiate.

This formality is necessary to know the extent of commitments that governments make in the liberalization of their domestic services market. In the WTO this aspect is crucial in order to have greater security for the foreign players in a market. Accordingly, this aspect must continue to be a central preoccupation when governments enter a process of negotiations that are binding. However, looking at the formal schedules alone does not tell how open an economy is. In ASEAN, the services market is considerably more open than what appears in the formal schedule.

For purposes of ASEAN therefore, what remains to be done is to examine the actual existing regime, and the amount of transactions that actually take place irrespective of the formal commitments. The process might become politically more feasible if it began by a commitment to a “standstill”, meaning no new restrictions would be introduced, and then governments would start on a negotiations process to incorporate elements that gradually insert those new aspects. The process of scheduling might be done by negotiation where elements of the existing level of openness would be incorporated into the schedule of commitments as binding commitments.

## **V. An Eclectic Approach in the Modalities for Services Negotiations in ASEAN**

Upon examining the extensive experience of the WTO in negotiations in services, we can note the existence of a variety of approaches that have been used. They need to be considered because each has merit in dealing with the specific context of a particular sector. This seems to point to the direction of a mixed approach that has been mooted in an ASEAN internal paper.

Specific recommendations could be made, modulated to accommodate different needs of the various sectors, which, in view of their specific sectoral characteristics, could move at different speeds, and thus should not be inhibited from being able to do so simply because of the inflexibility of the modality of negotiations being chosen. Some of these aspects have been touched upon in recommendations 1, 2, 3, and 4 above. The approach taken is eclectic.

**(1) Safeguarding the Acquired Gains from Request-and-Offer Approach**

This report arises from a sense of disappointment resulting from the request-and-offer approach in achieving less progress in ASEAN negotiations than was initially hoped for. This report argues that disappointment with the approach may be justified, looking at the results so far. However, this does not argue for discarding the approach from the ASEAN arsenal of negotiation modalities.

**Recommendation # 7**

**Continue to use Request-and-Offer approach for difficult sectors where progress is expected to be slow**

**(2) Sector-specific issues and approaches**

Some problems are sector specific: some might be technical while other problems might be more policy-driven and political in nature. In any case there are specific sectoral issues that could be addressed exclusively to those specific sectors. These are open for choice. After all, the GATS agreement recognizes sectoral specificity and therefore sectoral agreements do exist to address those specificities.

Therefore there are good reasons why sectoral approaches, tailored to the specific sectoral characteristics of each relevant sector, could and should be examined. The terms of reference of this project mentioned several sectors that have been under discussion and negotiation within ASEAN. These sectors are business services, construction, telecommunications, air transport, maritime transport, financial services, and tourism. What could be possible solutions for these sector-specific issues?

**(3) Dealing with the scope of sectoral coverage**

In terms of sectoral coverage, it is important for ASEAN not to be trapped in the debate of “quality vs. quantity” in the liberalization of services. There may be a temptation to engage in the debate of whether a deep liberalization in a few significant sectors is more important than a set of commitments that cover many sectors but where the “depth” of liberalization is more limited. ASEAN, it must be remembered is committed to both the total elimination of restrictions in services trade in the region *and* a comprehensive coverage of the services sector. This is not necessarily the case in the WTO. For ASEAN there may be a valid trade off between aiming for a large quantum of reform in the interim in lieu of substantial quality reforms in the short run”



### **Recommendation # 8**

#### **Developing specific modalities for important but *not necessarily* sensitive sectors**

In terms of sectoral coverage, attention should also be directed to a process of expanding liberalization in sectors that are *not controversial* and where agreement could be reached more quickly, even if their commercial values are not significant, because their inclusion in the positive *list* contribute to the expansion of sectors under the ASEAN list, and, this in itself constitutes progress in regional integration.

### **Recommendation # 9**

#### **Developing Modalities for important *and* sensitive sectors**

Sector specific approaches need to be constructed for sectors that have specific characteristics. Some of these sectors are not necessarily controversial or sensitive but negotiations cannot be expected to move speedily without constructive intervention. However they may require specific attention and tailor-made approaches to accommodate their specific characteristics and *sectoral specificity*. Some have already been identified.

#### **(4) Specific case of Financial and Telecommunication Services**

Although the WTO sectoral agreement on financial services and on telecommunication recognizes clearly the sectoral specificity of these sectors, and hence the need to deal with them in a special way, the specific situation in ASEAN regarding these two sectors is not identical to the situation in the WTO. Regulatory authorities need to be given space to develop negotiating modalities in the two sectors in which, in fact, ASEAN as a whole is a net importer vis-à-vis the rest of the world. ASEAN member governments are also inclined to take a keen interest in this sector as a special case.

### **Recommendation # 10**

#### **Modality for Specific ASEAN Sectors**

##### **(sub-set of Recommendation # 8)**

Sector specific approaches may be necessary in some other sectors even though these sectors are not part of ASEAN's current round of WTO negotiations:

- professional services
- health services
- educational services
- tourism
- labor mobility

The summary specifications of some of the details of the proposed recommendations on these issues are contained in *Recommendation # 10* are summarized in Table IV – 1.

**Table IV – 1**  
**Specific Sectoral Approach: Some ASEAN Services**

Sector	Mode of Supply	Access to Market	National Treatment	Additional Commitment
Professional Services	In ASEAN countries where exchange control is relaxed, transaction through mode 1 and mode 2 are “acquired facts”. The problem is how to schedule. More creativity is needed. Mode 3 and mode 4 need serious attention.	How to initiate commitment for access in mode 3 and mode 4. The simplest solution is to have a liberal regime but with a time limit imposed on presence of foreign suppliers.	Limitation on national treatment seems inevitable during the first stage. How should the limitation be formulated?	Work needs to continue on such issues as standards and mutual recognition. This is a difficult task. Experience in Europe is instructive.
Health Services	Transactions in Mode 1 and mode 2 are “acquired facts”. Effective Medical services have been provided by some ASEAN countries. Quality is very high, pricing very competitive and users satisfied.	Mobility for Paramedics. Possible limitations may be the number of people allowed and the time frame.	Same as in professional services	Same situation as in professional services
Educational Services	Same situation as in professional services in general. Mode 2 is a fact of life. Families send children to school abroad	Mode 3, establishing jointly financed and managed schools. Time limitation of stay may be a way to accept entry of educational instructors.	Same as in professional services	Same situation as in professional services
Tourism	Mode 1 and mode 2 are similarly facts of life. Transactions occur regularly.	Access through mode 3 and mode 4, joint-venture requirement for entry of major undertaking. Commitment for mobility of tourist professionals needs to be increased.	What aspect of operation could be given extensive national treatment? Tourism has become a complex business. Many aspects could be liberalized without controversy.	Mutual recognition of qualification of professionals.
Labor Mobility	Mode 4. How to set the maximum time?	Transactions have already taken place in practice. Labor has moved from labor surplus countries to net importers. Earnings have been significant to the exporting countries. How could access commitment be scheduled? How could regional preference be formulated?	Difficult to devise ways that would fully satisfy national treatment. There is a dilemma. Labor has incentive to come because locals no longer wish to work at the level of pay offered for the same type of work. But large presence of foreign workers can be troublesome.	A quid pro quo deal may be needed where the host-country would attempt to set the qualifications prevailing and negotiate with the exporting country.

The overall summary list of the recommendations relating to modalities appearing in this chapter is found in Table IV -2. For purposes of what would hopefully be a complete treatment of the implementation aspect of the modality-related issues, recommendations for the facilitating function of ASEAN Secretariat are presented in the next chapter. The entire range of issues and recommendations is summarized in Chapter VI.

Table IV – 2.  
Summary of Recommendations on ASEAN Services Negotiating Modalities

Recommendations	Content
Recommendation # 1	Creation of a consultation mechanism to deal with capital movement
Recommendation # 2	Modality to Initiate Liberalization of Investment in ASEAN
Recommendation # 3	Developing a Specific Modality on Free Movement of Professionals
Recommendation # 4	Developing Modalities Explicitly Dealing With Labor Mobility
Recommendation # 5	A recording of all the policy harmonization activities accomplished in ASEAN in services in order to give a more balanced picture of the progress in integration
Recommendation # 6	A specific mechanism is proposed to keep track of progress made in harmonization.
Recommendation # 7	Continue to use Request-and-Offer approach for difficult sectors where progress is expected to be slow
Recommendation # 8	Developing specific modalities for important but <i>not necessarily</i> sensitive sectors
Recommendation # 9	Developing Modalities for important <i>and</i> sensitive sectors
Recommendation # 10	Modality for Specific ASEAN Sectors (sub-set of Recommendation # 8)

## Conclusion

This chapter attempts to present a set of recommendations in the field of modalities for negotiations in services that address the specific ASEAN situation. With the exception of the first four recommendations, which require major policy steps, the other recommendations are focused on technical issues. However, in real life, it is difficult to remain purely technical when dealing with issues that involve proposals to make at least some changes that require political decision. Moreover, even in the area of the technicalities of designing modalities, it was quickly becoming evident that some of the choices have emerged because of a more fundamental policy decision, of which only a small part appears in the modality, in the guise of technical issues.

## Chapter V

### Some Relevant Issues beyond the Technicalities of Modality

#### I. Introduction

Although this report focuses on the technicalities of the modalities for negotiations, it would be useful to highlight some pertinent issues that may need to be examined as member governments consider the various options for the modalities that could be applied in ASEAN. Some of those issues are discussed briefly in this chapter. The observations in this chapter are meant to stress that the frustration and dissatisfaction about some aspects of negotiations in ASEAN cannot be blamed too much on technicalities.

Undeniably, there are technical steps that must be made and technical efforts and preparation that must be undertaken to ensure that the complex processes of engaging in creating a free trade area are done properly and carefully. The step to examine negotiating modalities reflects the willingness to ensure that all the necessary technical steps are taken to help support the endeavor. There will be many other technical steps that need to be examined in order to see that they are properly undertaken, at least at the technical level.

As technicians and members of an international organization in the service of member states, it is understandable that members of the ASEAN Secretariat are careful not to engage in policy discussions which rightly belong to officials of member states. While remaining in the background and limiting itself to technical issues, at a certain point member states may be increasingly asking for some policy discussions in order to examine what steps to take. In anticipating such an eventuality, some of the issues that may emerge will be briefly discussed here. They may even emerge during technical discussions on how to deal with modalities of negotiations in the coming period.

For purposes of anticipating future developments that may be moving faster than is currently expected, it would be useful to stretch the discussion beyond the technical issues related to the mechanics of developing the modalities for services negotiation. After all, the technical examination was made as a result of dissatisfaction in the way the existing negotiating modality works. There was implicit dissatisfaction also with the way the whole process of creating the ASEAN free trade area has moved.

#### II. Free Trade Area, Economic Integration and Services: the ASEAN Context

While the GATS contains a great deal of detail on various aspects of services and regulatory issues, its purpose in doing so is constrained within the limitation as indicated in the agreement. Unlike ASEAN, which aims for regional integration beginning with a free trade area, in the case of the WTO free trade is not a specific objective. The end purpose in WTO is considerably more modest. This can be seen from reading the umbrella agreement of the *Marrakesh Agreement on the Establishment of the World Trade Organization* and it can also be seen from the text in the *General Agreement of Trade in Services – GATS* itself.

### **ASEAN and economic integration: Liberalization commitments**

In contrast to the WTO, as has been frequently mentioned above, the ASEAN text is explicitly clear that the intention is to go at least as far as a free trade area and perhaps further although how much further is yet to be defined. Having chosen that path, there are clearly additional steps that must be taken which are an integral part of creating a free trade area and a system of regional economic integration. One goal clearly is of course the removal of *all* barriers in ASEAN making the region one single economic zone if not an economic unit.

In addition, ASEAN integration implies the creation of regulatory regimes that are compatible across member countries and, in a transparent way provide a “level-playing field” (that much abused term). What it means is that all economic players of ASEAN nationality would be able to operate anywhere in ASEAN and receive the same treatment as players who happen to reside in their own home country in ASEAN.

Furthermore, it also means that standards that are applied in the ASEAN countries must eventually converge toward commonly accepted norms that are applied and applicable throughout the region. In the field of trade, both in goods and in services, it also implies the establishment of a set of trade facilitating rules that are required in order to enable a free trade area to function effectively. This point strongly argues for early steps to encourage harmonization of policies among member states.

### **Policy harmonization as component of integration**

The process of economic integration also implies the process of policy harmonization so as to develop an increasing level of compatibility of policies and practices among ASEAN countries. In the process, transparency would be enhanced and comparability of measures and effects would be better assured, giving a more precise and transparent picture of the economic and policy environment which is necessary for economic players to benefit from the process of economic integration in the region.

Thus there is a strong argument to support the view that the process of integration would be helped considerably by measures toward policy and regulatory harmonization. There is a strong case for arguing that this is especially the case with services.

This point has an analogy in the European experience where regional integration has gone much further. It may be recalled that Article 2 of the 1957 Treaty of Rome stipulates that harmonization of policy implies the aim of “progressively approximating the economic policies of Member States, to promote ... a harmonious development of economic activities..” By establishing a common market the Europeans wanted to integrate their economies. In so doing they must harmonize their domestic policies, i.e. progressively approximating the economic policies of member states in virtually every aspect of economic life.

This point is particularly relevant to highlight because for most ASEAN countries the magnitude of ASEAN services exports, whether globally or regionally, has not yet reached such a significant level. Exceptions to this can be pointed out in the case of tourism for many ASEAN countries, labor for the Philippines and Indonesia, and several skill based services

and financial services for Singapore, Malaysia, Thailand and the Philippines, where explicit ASEAN based arrangements might be desired by the countries concerned.<sup>20</sup>

Therefore, the push for the harmonization of policies, approaches and regulations in services in order to achieve a high level of compatibility is of sufficient importance for purposes of achieving integration that it should feature as an important part of the process of integration. Accordingly, progress in this area should be considered as an important contribution for the construction of an ASEAN free trade area and regional economic integration.

On the other hand enlarging the scope of criteria which are more compatible with the broader objective of economic integration and hence, also, with the criteria for success in the negotiations, would also make it possible to pursue negotiations in ASEAN, without being unduly focused only on the market access and liberalization aspects of the exercise.

This situation, it may be recalled, has a parallel with the experience in GATS. During the Uruguay Round, it was judged by participating countries to be more urgent to develop the framework of agreement in order to provide the long-term context of trade in services than to push for major liberalization immediately and risk not having a framework for the longer term process.

In the Uruguay Round, participating countries felt that a modest step in liberalization would be acceptable in exchange for an agreement on the framework for steady or continuous progress in market opening and liberalization, with wide ranging rules of the game, rather than to achieve a major liberalization but risk having the exercise becoming only a one-shot affair which would be difficult to repeat. This analogy may be appropriate for ASEAN.

### **The WTO, GATS and ASEAN: A Recapitulation on the Framework and Choices to be made**

As this project proceeds, it is important to stress that although there are similarities and parallels between the context of WTO and ASEAN, there are also some fundamental differences. These differences are not always immediately evident to those who are engaged in services negotiations. It is not uncommon to witness that officials who negotiate in the WTO also negotiate in ASEAN. In the process, officials may forget the differences between the WTO and ASEAN.

In the WTO, the process of increasing trade through gradual liberalization does not imply necessarily or automatically a commitment to free trade, although some governments do have in mind as a matter of policy to proceed toward free trade. However, this is not a legal commitment. Nothing in the rules of WTO membership say that the objective of the WTO is free trade.

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<sup>20</sup>. This point of course also strengthens another argument that if the magnitude of intra-regional trade in ASEAN in goods as well as services is not yet so important, why then should countries be reluctant to open up and liberalize rapidly, since to do so now would meet less resistance than to do so later when new businesses emerge and become well organized to lobby for economic rent. The possible answer to that is that there are already difficult domestic issues that could be exploited during some domestic electoral campaigns that governments are reluctant to take steps at the moment.

Thus some governments do not enter the WTO and engage in WTO negotiations in order to work eventually towards a worldwide system of free trade, irrespective of what the theory says. Therefore even a mercantilistic government could actively engage in WTO negotiation and indeed undertake liberalization measures within the context of the WTO without ever intending to go through to the final step of practicing free trade.

The case is different with ASEAN. In contrast to the WTO, ASEAN explicitly states that it intends to proceed towards free trade for the region, through creation of a free trade area and eventually through integration. Thus, if politically the objective is to deal with all sectors in order to achieve a wide sectoral coverage, it would not be unproductive to explore the inclusion of other sectors for the liberalization in services in ASEAN, even if those sectors are not yet in the list of services open for commitments in the WTO. These commitments may be made as a part of mutual ASEAN obligations even if governments making such ASEAN commitments never intended to open them to other WTO members.

**Table V - 1**  
**End-Points of WTO, EU and ASEAN**

WTO	European Union	ASEAN
<p><b>End point not clear</b></p> <p>The “outer frontier” is under continuing negotiations. The goal is “freer trade” not “free trade.”</p>	<p><b>End-point clear</b></p> <p>Economic union eventually leading to some form of political union. The end-point is specified in treaties.</p>	<p><b>End-point clear</b></p> <p>Free trade area leading towards economic integration (2020).</p>
<p><b>Intermediate Steps are Clear</b></p> <p>Continuing path of liberalization through negotiations in multilateral rounds.</p> <p>The multiple modalities being developed in the WTO require that each step of the way towards negotiations to liberalize is carefully choreographed and the pace highly orchestrated.</p> <p>The WTO Secretariat is actively engaged in the technical work and provides technical expertise and constructive advice to ensure that negotiations succeed.</p> <p>National agencies vary in the degree of intensity of engagement, with developed countries and some key developing countries taking active interest.</p>	<p><b>Intermediate steps clear</b></p> <p>Treaty-based procedures outlining the process of integration each step of the way.</p> <p>The procedures are under continuous negotiation and refinement in order to achieve fuller and speedier integration.</p> <p>The time-table is rigorous and national agencies are continuously and actively engaged.</p> <p>The European Commission takes the lead to ensure coordination and take the leading role in the process.</p>	<p><b>Intermediate steps unclear</b></p> <p>Under continuous process of defining ASEAN-specific modes of operation.</p> <p>Need more clear steps towards policy harmonization among member states.</p> <p>Need further institutional development in order to ensure sustained activities leading the 2020.</p>

Thus the extent to which ASEAN could make liberalization commitments that are not or never intended to be applied on a multilateral basis but could very well be acceptable in the context of ASEAN integration objective should be examined. Table V – 1 summarizes the

different end-points and intermediate steps between the WTO, the European Union and ASEAN.

### **III. Free Trade and the Organizational Implications**

Creating a free trade area also has organizational implications. In looking for the appropriate modalities for negotiations, it will become increasingly evident that the ASEAN Secretariat may be required to take initiatives to assist with the technical aspects of making sure that the modalities chosen are workable in the operating field. There may be occasions when the Secretariat would be asked for advice. To do so properly and to ensure that the appropriate resources are obtained to perform its tasks, there should be an organizational assessment on what would be required for ASEAN to perform its task as a facilitator in the field.

#### **Complexity of Trade Issues under Current Situation**

The preceding section has briefly discussed the existing institutional arrangements within which the conduct of services negotiations has been undertaken in the ASEAN context. It would be useful to place that arrangement within the broader context of ASEAN activities after the free trade area is established. At that point the ASEAN Secretariat will be facing a new challenge with more intensified trade-related activities in the region. There are a number of issues to be addressed in this area.

#### **Rapid expansion of trade-related issues in ASEAN**

There will be an escalation of activities in the area of trade that will require constant attention, monitoring, and administering with the operational issues of AFTA to be implemented. Rapid expansion of trade-related issues should therefore be expected to take place. From now on, one aspect of ASEAN activities that will be a permanent feature would be trade and trade-related negotiations. This is an irreversible scenario, given the political decision to undertake regional economic integration.

Trade negotiation is a complex process. This process must be managed carefully in order to achieve the desired results. This includes, but is not exclusively confined to, negotiations in services. In this connection it should be stressed that services issues are particularly complicated. The process requires government agencies of member countries to pay greater attention to the way in which the substance and the process of negotiations are handled. The negotiating process in services could also be improved by strengthening the Secretariat.

#### **The Special Nature of Services**

The above issues are important to examine because ASEAN is entering another phase and the road is still uncharted from both policy and organizational points of view. On the other hand, the current series of negotiations in services is not the first, and it will not be the last, exercise that the Secretariat has had to deal with which requires it to “shepherd” ASEAN member countries.

It should be stressed that the substance of services is probably among the most complex areas in the ASEAN economic integration process that the Secretariat has to handle. For purposes of a more complete examination of the negotiating process in ASEAN, a specific chapter



devoted to this question appears in order to provide a more complete discussion of why the negotiations in services have been slow.

### **Current Organizational Structure and Possible Adjustments**

It would be useful to briefly review the evolving ASEAN machinery in economic issues. One point that needs to be stressed is that in economic issues, the mechanism of ASEAN Senior Economic Officials Meeting (SEOM), which had been in existence since the early days of the ASEAN Brussels Committee (ABC) in 1976, had been initially the forum in which ASEAN deals with economic issues. It was initially organized for consultative purposes. In the early days it was a significant step. The mechanism has served ASEAN needs quite well in the early period.

With these early mechanisms ASEAN governments had created for the first time an instrument and machinery for communication and consultation on economic issues of mutual interest. Numerous exchanges of views have since been conducted and ASEAN officials have had the opportunity to develop common approaches in various areas through regular meetings since ASEAN's early days. This arrangement has been strengthened by a system of consultation among ASEAN officials stationed abroad, through ASEAN committees managed and conducted by embassies of ASEAN member countries.

Today, given the emergence of the proposed ASEAN Free Trade Area, these very mechanisms need to be re-examined in so far as it has to do with trade negotiations. How could the ASEAN Secretariat's role be adjusted to enhance its facilitating role in those aspects that have to do with trade negotiations?

This aspect of the implementing process needs to be analyzed because of the important role that the Secretariat will be required to play in ensuring the successful conducting of negotiations in services and, indeed, in all the various trade-related issues in the years to come. It should be stressed that when AFTA is in full operation, the nature of the work connected with trade issues will not be the same as before.

In the European case, the intention from the beginning was to create a supranational authority. In ASEAN that decision has not been made by the political authorities of the member states. Therefore it must not be prematurely assumed that the European path is the path that will be chosen. The IMF analogy for the ASEAN Secretariat would clearly be rejected by member states. That leaves the WTO Secretariat as a possible example to examine in dealing with the trade aspects of ASEAN activities.

### **What are the lessons to be learned from other international organizations dealing with trade issues?**

Based on the experience of close cooperation that this consultant has enjoyed with various international secretariats during his active service in government, there are several points that need to be stressed about international secretariats. There are important tasks that they can perform, provided that member governments are cognizant of the various constructive roles that secretariats can play for member governments and the organization they serve.

Because of the important role that the services sector can play in regional integration and the complex nature of the subject, those aspects that have a bearing on strengthening the ASEAN

Secretariat merit attention. It can be described as a combination of several roles, as a “shepherd” in the process of moving trade negotiations in services to achieve their intended results, as a facilitator in the process of dealing technically with the modalities, as a provider of capacity-building advice in dealing with the substance. It performs the role of the custodian of the integrity of the system as a system.

### **WTO Secretariat or EU Commission as possible example to examine**

There are special aspects of an international secretariat in helping the process of negotiations that need to be highlighted. A brief examination of the experience of the WTO Secretariat during the Uruguay Round would be helpful. There are lessons to be derived from the above. What can be inferred generally is that the *style of operation* of the WTO Secretariat is probably more appropriate for ASEAN to examine for its future work while the *range of issues* that the ASEAN Secretariat would be confronted with in the years to come would be more analogous to the EU Commission. This point needs further elaboration.

The lesson to be learned from the WTO Secretariat is the manner in which it guides the member states in tackling difficult issues, particularly whenever there is a gap in the views of members that must be resolved. In trade issues, the area of concern in this report, problems leading to different views among members contain technical and organizational as well as policy components. The Director General of the GATT, and now the WTO, has often been called upon to assist in facilitating and reconciling positions which are far apart.

Implicit in this process is the need to maintain *active neutrality* between all members. In so doing, the WTO Secretariat is not a mere “thoughtless tool” to be aimlessly moving according to the whims of members. Although it does not arrogate the right to make policy decisions, it plays the role of the “guardian” or the “custodian” of the integrity of the multilateral system, as it is guided by the agreements constituting the system. Its neutrality and its commitment to adhere to its role as the custodian of the system creates the foundation of trust for the members.

A second and no less important aspect is the fact that the WTO Secretariat is the storehouse of information and expertise on the technicalities of the agreements, and the rules and principles and their application to any particular situation. The organizational structure of the WTO and the quality of the personnel have made it possible for the WTO Secretariat to perform these tasks, despite the lean organizational structure and the staff limitations arising from the parsimonious way in which funds are allocated by member states. This can be readily contrasted with the more generous budgetary allocation for its step-sisters, the Bretton Woods organizations in Washington.

With respect to the substantive coverage, the Commission of the European Union provides a better indication regarding the subjects that might have to be tackled by the ASEAN Secretariat as the region moves more actively towards regional integration. Some aspects of the activities may need to mimic the way the EU Commission has acted, especially during its early stages of existence. However, the style cannot be the same. The EU Commission is clearly a supranational authority with the right to initiate policy. ASEAN member states have not yet made the decision to follow suit. On its part, the ASEAN Secretariat needs to be developed pragmatically, making conscious decisions to be eclectic in its choice of approaches to particular tasks.

Anticipating the discussion in detail concerning the choice of modalities to be used in services negotiations in ASEAN, it is similarly argued in this report that it should also be equally pragmatic in its approach of choosing negotiation modalities and be ready to make eclectic choices of the modalities.

#### **IV. What should be the core concern of the ASEAN Secretariat?**

Although this report focuses on the problem of structure and approach to services negotiations, in view of the importance of the supporting and facilitating role of the ASEAN Secretariat in enhancing the effectiveness and speed of the negotiating process in services liberalization, what would or should be the core concern of the ASEAN Secretariat? For practical purposes it would be useful to list an inventory of operational issues that would help to enhance the facilitating role of the ASEAN Secretariat, which, if permitted by member governments, would help the process of dealing with the new challenges and tasks that the ASEAN Secretariat is implicitly expected to perform.

Table V – 2 describes in summary the types of facilitating activities that the ASEAN Secretariat might be called upon to perform and how those activities might be initiated. The ASEAN Secretariat needs at the very least to begin to build itself up as the storehouse of information about services in the region. It needs to gradually arrive at a situation where information about services in the region and the statistical data are gathered. It needs to have a gradually more complete data base of regulatory regimes in services that prevail in the region.

The ASEAN Secretariat may be forced to emulate the role of the WTO Secretariat as the source of advice and expertise on services issues, at least in those sectors where institutions in national governments are relatively weak. In those sectors where national authorities have normally acquired high expertise, such as in financial services and telecommunications as well as other more technologically-based services, the ASEAN Secretariat must be a good partner able to give advice on problems that need a common solution.

Table V – 2. Facilitating tasks that may be required and could be done by the ASEAN Secretariat in services negotiations and other trade-related matters

Task	Description	Decision Needed to Perform Task
Facilitator of all ASEAN official processes	To manage all the normal functions of facilitating the functioning of ASEAN programs, including negotiations in services	The obligation to function as facilitator and guardian of the system requires also a corresponding right to take initiatives and make proposals when needed.
Monitoring negotiations	Keeping track of the progress of current negotiations for liberalization	Internal decision by the Secretariat
Monitoring sectoral development of services in ASEAN	Development of statistics Developing data base on main players Analysis Reporting of key developments Policy analysis Developing consultation machinery with national agencies	The ASEAN Secretariat is empowered to make decisions and implement a monitoring system. Concurrence of member states would make the resources available.
Giving technical and some policy advice to member states	There are numerous advisory functions that the secretariat can provide to ensure that liberalization processes to establish a free trade area can be undertaken.	Strengthening the (relevant) unit in the Secretariat to develop advisory capacity to assist member states. In order to give advice and take initiatives the ASEAN Secretariat must be given the right to do so through the consent of member governments
Policy analysis	In order to best serve member states ASEAN must be able to assess the current situation. To do so the ASEAN Secretariat must develop its capacity for policy analysis.	For internal purposes, the decision to develop the capacity for policy analysis can be made autonomously. Member governments may request the Secretariat to do so.
Capacity building	Provide technical assistance to national agencies in dealing with services issues in the region and facilitate communication	Means to provide capacity building must be obtained because it may be an expensive endeavor. Support from national government and international agencies must be sought.
Provide public information	In order to gain public understanding and support, the public must be made aware of developments in ASEAN.	This should be normal practice for the ASEAN Secretariat. But it must be given the resources to do so.

In view of the above discussion, this report would recommend that the following steps be taken:

### **Recommendation # 11**

#### **Strengthening the ASEAN Secretariat Structure to deal with a services free trade area**

At this stage, what is recommended is that the ASEAN Secretariat assesses the need for strengthening its organizational structure and human resources in view of its inevitably increased responsibilities arising from the establishment of a free trade area.

The points in the above table have implications for the operation of the ASEAN Secretariat from a technical point of view. They indicate a work agenda of technical matters that must be addressed. Some of the more obvious tasks have been described in Table V -2.

### **Recommendation # 12**

#### **Initiating technical activities in the ASEAN Secretariat in support of its new and expanded functions in facilitating an ASEAN free trade area**

The ASEAN Secretariat needs to undertake at least the following steps in its expanded technical function to facilitate an ASEAN free trade area in services:

- develop data collection and analysis
- report key developments
- provide policy analysis
- develop consultation machinery with national agencies in member countries
- provide technical assistance in dealing with services issues in the region to national agencies to facilitate communication

### **Recommendation # 13**

#### **Initiate a unit in the ASEAN Secretariat for helping institutions in member states to deal with services within ASEAN**

Although it may appear premature at this stage, an analysis needs to be made of the requirements for the anticipated role of the Secretariat in capacity-building related to services issues in the context of ASEAN.

### **Conclusion**

The issues discussed in this chapter have gone beyond the technicalities with which the ASEAN Secretariat may feel comfortable. The chapter has touched upon policy issues that the ASEAN Secretariat may feel it is premature to discuss. However, in looking at the technicalities of designing modalities, it is inevitable that one stumbles on the more policy-based issues. In anticipation of discussions that may emerge on those broader but related issues, this chapter has at least attempted to place some signposts to use when the time comes to discuss these issues..

Moreover, since endeavors such as creating a free trade area require sound though cost effective machinery to service the process, this chapter has also attempted to signal those issues which sooner or later must be tackled. Writing this technical report has given the opportunity at least to leave some signposts for future travelers to use when the time comes.

## **Chapter VI**

### **Consolidated Summary of Issues and Recommendations**

#### **Introduction**

For purposes of convenience this chapter summarizes the key issues discussed and the key recommendations made in this report. As can be recalled, the report makes an attempt to differentiate between:

- (a) the recommendations that touch on the broader policy beyond the narrow confines of modalities of services negotiations but have important implications on the choice of modalities that would be made;
- (b) the specific recommendations that are directly related to the modalities for negotiations in services; and;
- (c) the recommendations on organizational issues that the ASEAN Secretariat might wish to consider as it looks ahead at its function as the facilitating agency for ASEAN processes in regional integration in services and in trade in general.

The recommendations therefore cover the broader policy issues that could have an impact on how negotiating modalities are to be constructed, the specific technical issues relating to the construction of negotiating modalities, and the necessary organizational issues when these modalities are to be put in operation.

#### **Key Points and Recommendations on the Broader Policy Issues**

On the macro-economic and other overarching issues, the recommendations consist of suggesting steps to reinforce those commitments to policy which are already in place but need re-stressing for ASEAN integration purposes, and to further develop commitments that are already implicit but not yet explicitly stated in the context of integration.

##### **a. Movement of Capital**

Mobility of capital is implied in free trade areas and integration. It supplements freedom of movement in goods and services. Such mobility is affected by the exchange regime being adopted. That is why a free trade area among countries with restrictive foreign exchange regimes would contain provisions on payments and capital movements. In ASEAN-6, the financial and monetary regime that has been adopted is a free foreign regime.

Monetary deregulation has touched on the liberalization of the current accounts and the capital accounts in one form or another. A mechanism needs to be developed for consultations between officials of ministries of finance and central banks of ASEAN countries. Since this is an important underlying support system, the results of the consultation must support the objective of a free trade area and economic integration.

## **Recommendation # 1**

### **Consultation mechanism to deal with capital movement**

The creation of a consultative committee on capital movement in ASEAN incorporating officials of ministries of finance and central banks.

This machinery is now already in existence in order for the monetary authorities to harmonize and coordinate their macro-economic policy as and when needed. The *Hanoi Plan of Action* indeed also contains provisions on the importance of such ongoing consultations.

In the context of trade in services, the importance of this mechanism is to help ensure that the business community are reassured that whatever emergency measures the authorities may take, the central thrust of the ASEAN system is toward freer capital movement and not towards control. The purpose of such a mechanism is to help assure the business community and the public that ASEAN is inclined to have an open capital and exchange regime and that accordingly, whenever a choice is available between taking steps that lead to a closed and restrictive regime and taking steps that lead to a more open regime, ASEAN would be inclined to take the option of an open regime.

This point is also important in the selection of the modality for negotiations. In a situation of an open foreign exchange regime where capital movements are not too severely restricted there would be less concern about binding mode 1 (cross-border supply) and mode 2 (consumption abroad) in certain services sectors, such as consultancy, education and health services, because in actual fact there would be little that could be done to prevent such transactions from occurring, even if liberalization does not formally appear in a country's *schedule of specific commitments*.

## **Recommendation # 2**

### **Modality to Initiate Liberalization of Investment in ASEAN**

The formulation of ASEAN wide criteria to foster a common approach to investment, freedom of movement of enterprises, and common definitions regarding the nature of ASEAN companies. Common definitions of ASEAN companies would provide preferential treatment for ASEAN companies compared to non-ASEAN companies even though it would still not accord full national treatment in the interim.

Although many ASEAN governments do not favor an international agreement on investments such as is being discussed in the WTO Doha Round, an investment regime for ASEAN is almost inevitable given the 2020 objective. Discussions on linking investment and commercial presence or mode 3 in ASEAN may be more feasible. This step is technical in formulation but requires a major political decision and some organizational structuring on how to select the working group and the composition of supporting officials.

The *Hanoi Action Plan* indeed contains provision for the implementation of the *Framework Agreement on ASEAN Investment Area (AIA)*. Thus services discussion with respect to mode 3 may indeed be more usefully done by examining the linkages between possible ASEAN investment agreement and the modalities of negotiations for liberalization of mode 3 in services.

**Recommendation # 3**

**Developing a Specific Modality on Free Movement of Professionals**

To develop a modality, with binding commitments, that would focus on the movement of ASEAN professionals. The modality must reflect the kind of patience needed to accept incremental liberalization, focusing on quantitative limitations that would be liberalized over time, in a gradual and progressive manner, giving preferential treatment exclusively for ASEAN professionals.

ASEAN professionals have been working together since the creation of ASEAN. Initiatives and innovation in this area can be expected to be driven by associations of ASEAN professionals.

**Recommendation # 4**

**Developing Modalities Explicitly Dealing With Labor Mobility**

Modalities on labor mobility that would reflect ASEAN realities and be applicable only to ASEAN nationals should be developed. This should go beyond the GATS provision on movement of natural persons. From the point of view of the scope of coverage it should be superior to the multilateral rules on movement of natural persons inscribed in the GATS.

Importing countries may wish to have the assurance that this will not be a basis for an ASEAN position in the WTO.

The four areas are of such political importance that a specific approach to them would be needed in order to help ensure that the momentum for services liberalization in ASEAN would be further encouraged.

**Harmonization of Domestic Policy as Important Component of Regional Integration**

There is also a need to ensure that the process of increasing harmonization is conducted within a mechanism that will ensure continuity and systematic paths. Hence it is recommended that a specific mechanism be created.

**Recommendation # 5**

**A record of all the policy harmonization exercises produced in ASEAN in services, in order to have a more balanced picture of the progress in integration**

This should be regarded as an important contribution towards regional economic integration just as valuable for the long-term objective of integration as market access and national-treatment.

**Recommendation # 6**

**A specific mechanism is proposed to keep track of and continue the progress in harmonization.**



For appropriately recording the progress made in policy harmonization a mechanism is needed to ensure that this aspect of integration receives the attention that it deserves.

### **Modalities: Developing an Eclectic Approach to Services Negotiations**

There has been criticism about the speed and extent of liberalization of trade in services in ASEAN. It is important to look at the problems within an ASEAN context in order not miss out on the opportunities to make progress.

#### **(1) Safeguarding the Acquired Gains from Request-and-Offer Approach**

This report arises from a sense of disappointment with the level of progress obtained from the request-and-offer approach in ASEAN negotiations that was initially hoped. This report argues that disappointment with the approach may be justified, looking at the results so far. However, this does not provide grounds for discarding the approach from the ASEAN arsenal of negotiation modalities.

#### **(2) Sector-specific issues and approaches**

Some problems are sector specific: some might be technical while other problems might be more policy-driven and political in nature. In any case there are specific sectoral issues that could be addressed exclusively to those specific sectors. These are open for choice. After all, the GATS agreement recognizes sectoral specificity and therefore sectoral agreements do exist to address those specificities.

Therefore there are good reasons why sectoral approaches, tailored to the specific sectoral characteristics of each relevant sector, could and should be examined. The terms of reference of this project mentioned several sectors that have been under discussion and negotiations in ASEAN. These sectors are business services, construction, telecommunications, air transport, maritime transport, financial services, and tourism. What could be possible solutions for those sector-specific issues?

#### **Recommendation # 7**

**Continue to use request-offer approach for difficult sectors where progress is expected to be slow**

#### **(3) Dealing with the scope of sectoral coverage**

In terms of sectoral coverage, it is important for ASEAN not to be trapped in the debate of “quality vs. quantity” in the liberalization of services. There may be a temptation to be engaged in the debate of whether a deep liberalization in a few significant sectors is more important than a set of commitments that covers many sectors but where the “depth” of liberalization is more limited. ASEAN, it must be remembered is committed to both the total elimination of restrictions in services trade in the region *and* a comprehensive coverage of the services sector. This is not necessarily the case in the WTO. If quality cannot be achieved in the short- term, then aim for quantity in the interim.

**Recommendation # 8****Developing specific modalities for important but *not necessarily* sensitive sectors**

In terms of sectoral coverage, attention should also be directed to a process of expanding liberalization in sectors that are *not controversial* and where agreement could be reached more quickly, even if their commercial values are not significant, because their inclusion in the *positive list* contribute to the expansion of sectors under the ASEAN list, and, this in itself constitutes progress in regional integration.

**Recommendation # 9****Developing Modalities for important *and* sensitive sectors**

Sector specific approaches need to be constructed for sectors that have specific characteristics. Some of these sectors are not necessarily controversial or sensitive but negotiations cannot be expected to move speedily without constructive intervention. However they may require specific attention and tailor-made approaches to accommodate their specific characteristics and *sectoral specificity*. Some have already been identified.

**(4) Specific case of Financial and Telecommunication Services**

Although the WTO sectoral agreements on financial services and on telecommunications recognize clearly the sectoral specificity of those sectors, and hence the need to deal with them in a special way, the specific situation in ASEAN regarding these two sectors are not identical to the situation in the WTO. Regulatory authorities need to be given space to develop negotiating modalities in the two sectors in which ASEAN as a whole is a net importer vis-à-vis the rest of the world, and in which governments of the region place a high interest.

**Recommendation # 10****Modality for Specific ASEAN Sectors  
(sub-set of Recommendation # 8)**

Sector specific approaches may be necessary in some other sectors even though these sectors are not part of ASEAN's current round of WTO negotiations:

- professional services
- health services
- educational services
- tourism
- labor mobility

### **What Could be the Core Concern of ASEAN Secretariat?**

The ASEAN Secretariat needs at the very least to begin to build itself up as the storehouse of information about services in the region. It needs to gradually arrive at a situation where information about services in the region and the statistical data are gathered. It needs to have a gradually more complete data base of regulatory regimes in services that prevail in the region.

To this end, it may be forced to emulate the role of the WTO Secretariat as the source of advice and expertise on services issues, at least in those sectors where institutions in national governments are relatively weak. In those sectors where national authorities have normally acquired high expertise, such as in financial services and telecommunications as well as other more technologically-based services, the ASEAN Secretariat must be a good partner able to give advice on problems that need a common solution.

### **Recommendation # 11**

#### **Strengthening the ASEAN Secretariat Structure to deal with a services free trade area**

At this stage, what is recommended is that the ASEAN Secretariat assesses the need for strengthening its organizational structure and human resources in view of its inevitably increased responsibilities arising from the establishment of a free trade area.

### **Recommendation # 12**

#### **Initiating technical activities in the ASEAN Secretariat in support of its new and expanded functions in facilitating an ASEAN free trade area**

The ASEAN Secretariat needs to undertake at least the following steps in its expanded technical function to facilitate an ASEAN free trade area in services:

- develop data collection and analysis
- report key developments
- provide policy analysis
- develop consultation machinery with national agencies in member countries
- provide technical assistance in dealing with services issues in the region to national agencies to facilitate communication

### **Recommendation # 13**

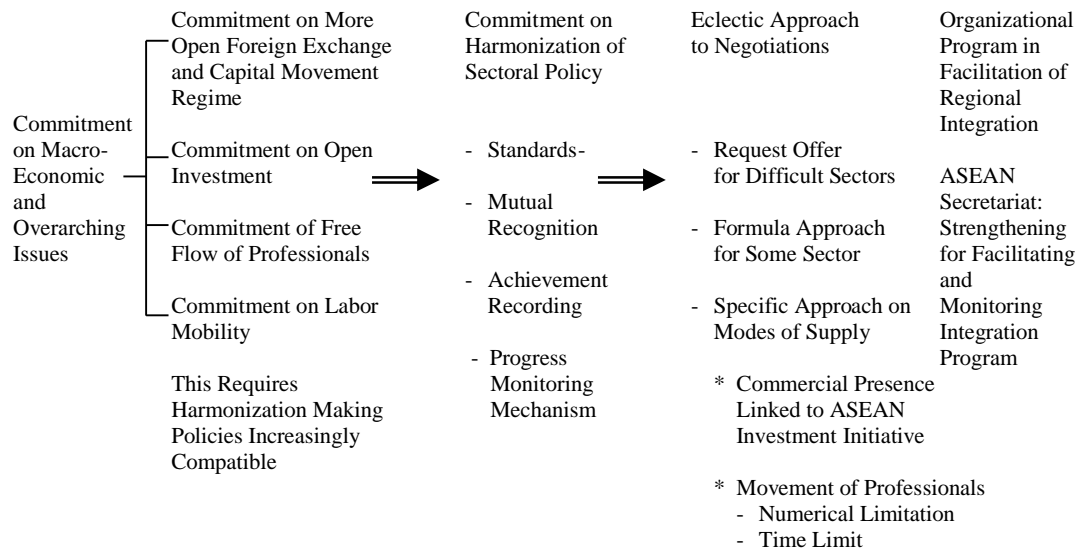
#### **Initiate a unit in the ASEAN Secretariat for helping institutions in member states to deal with services within ASEAN**

Although it may appear premature at this stage, an analysis needs to be made of the requirements for the anticipated role of the Secretariat in capacity-building related to services issues in the context of ASEAN

### Consolidated Summary of Recommendations

This report touches on issues beyond modalities that have direct impact on the process of negotiations and thus also on the choices of modalities. Accordingly, while focusing on modalities of negotiations, this report inevitably had to touch on issues that go beyond the technicalities of negotiating modalities. While the recommendations go to some detail on how to develop an eclectic approach to modalities, the recommendations, which can be visualized in a simplified form in the following chart, enter into issues in such a manner that discussions on modalities are seen both as a technical exercise as well as a part of broader policy issues associated with the goal of integration by 2020.

**Chart VI-1**  
**Schematic Summary of Proposals and Recommendations**



The list of recommendations which are in line with the conceptual framework in the chart above are found in Table VI-1 below. As can be seen some modalities for negotiations in services could easily interact with broader issues of macro-economic policy where negotiations that would support liberalization efforts leading to the creation of a free trade area would have to be conducted requiring political decision and negotiation.

Regional integration also requires policy harmonization. While consultation is normally the mechanism that is used to ensure continued efforts toward harmonization, further steps in harmonization in the coming years would require negotiations. Modalities for negotiations on harmonization would accordingly have to be developed. So far the endeavors have been scattered throughout different exercises, making it difficult to assess the progress achieved. Yet this is an important part of integration. More attention to this question is certainly required.

**Table VI-1 Consolidated Summary of Issues and Recommendations**

Commitments on Macro-Economic and overarching Issues	
Recommendation # 1	Commitment to more open foreign exchange and capital movement regime
Recommendation # 2	Commitment to more open investment regime
Recommendation # 3	Commitment to free flow of professionals
Recommendation # 4	Commitment to labor mobility
Harmonization of Policy	
Recommendation # 5	A recording of all the policy harmonization exercises achieved in ASEAN in services to have a more balanced picture of the progress in integration
Recommendation # 6	A specific mechanism is proposed to keep track of and continue the progress in harmonization.
Modalities for Negotiation	
Recommendation # 7	Continue to use request-offer approach for difficult sectors where progress is expected to be slow
Recommendation # 8	Developing specific modalities for important but <i>not necessarily</i> sensitive sectors
Recommendation # 9	Developing Modalities for important <i>and</i> sensitive sectors
Recommendation # 10	Modality for Specific ASEAN Sectors (sub-set of Recommendation # 8)
Organization Support	
Recommendation # 11	Strengthening of the ASEAN Secretariat structure to deal with a services free trade area
Recommendation # 12	Initiating technical activities in the ASEAN Secretariat in support of its new and expanded functions in facilitating an ASEAN free trade area
Recommendation # 13	Initiate a unit in the ASEAN Secretariat for helping institutions in member states to deal with services in an ASEAN context

### Possible Future Research Needs

Given the discussions above concerning policy recommendations, it may be useful to identify the various research needs connected with the issues touched upon in this report. The area where further work needs to be done is the area of implementing the process of integration. There are of course issues related to the process of integration as envisaged by the mainstream economics of integration when the process follows the path from free trade area, to customs union, to common market and to full economic integration. That is the aspect that deals with “hard integration.” Work in this area will probably continue in the academia.

However, there is also the whole array of institutional and policy issues related to harmonization of practices, measures and approaches that have not been examined systemically in the past because they were regarded to be too premature to examine at that time. However, today, ASEAN has entered an entirely new phase. Therefore, those issues would now need to be further examined. In this connection, without necessarily proposing the EU experience be taken as a model, nevertheless a great deal of experience in Europe concerning institutional and harmonization issues deserve to be closely examined in order for ASEAN to have empirical comparisons.

In connection with the research work being done on ASEAN, it is worth noting that there have been a number of analyses done on behalf of ASEAN Secretariat already to date. Important analysis on competitiveness of ASEAN has been done by the international consulting group McKinsey, *ASEAN Competitiveness Study*. That study could one of the bases to be used to examine where ASEAN might wish to do in the process of implementing to integration objective.

AusAID through the ASEAN-Australia Development Cooperation Program and its Regional Economic Policy Support Facility (AADCP-REPSF) has commissioned a number of services related works which include studies on facilitating movement of service providers, liberalization of financial services, air transport and the open sky regional policy, and harmonization of telecommunications. These and other policy research work would be needed in the years to come to assist ASEAN in moving towards greater integration.

## **Chapter VII Conclusion**

This report has dealt with the technical and mechanical subject of modalities for negotiations in trade in services. The examination is done in the context of the ASEAN decision to establish a free trade area for goods and services by 2020. Its primary focus has been on the technicalities of the elements of negotiating modalities and the search for an appropriate modality for ASEAN in conducting negotiations in services. However, in the search for a constructive approach to speed the process of negotiations and to arrive at modalities for negotiations that are more appropriate for ASEAN's integration objective, it cautions against looking at the issue merely as a search for mechanical negotiation modalities.

In fact, even by looking at the mechanical aspects of the negotiating modalities, one is immediately confronted by the question of why a particular mechanism has been chosen for negotiations over another. One finds that the answers are not mechanical. Some mechanisms are chosen because they serve a particular policy purpose quite well. However, sometimes once a mechanism is chosen, and because it serves a specific context, that particular mechanism may be chosen inadvertently to serve another context, which may seem to be a similar situation, but which in fact is quite distinct.

In that latter case, the mechanism is chosen by default unless appropriate modifications are made. The undue emphasis on the use of one modality, the request-and-offer approach, is an example of the direct transfer of a WTO process to the ASEAN process, without modifications to suit ASEAN purposes and objectives.

Further examination of the modalities for liberalizing services trade in ASEAN has led to the observation that part of the lack of progress in services negotiations in ASEAN has been due to excessive mimicking of WTO processes, whose official "end point" was never explicitly intended to be the creation of a global free trade area. By contrast, ASEAN's "end point" is clearly at least a regional free trade area. That is at least ASEAN's minimum official objective. ASEAN member states have yet to define what integration means beyond the free trade area.

Given that objective, and given the 2020 deadline, each step of the way needs to be designed so that the official objective is achieved. To the extent that the choice of negotiating modalities would help facilitate the process, they must be adjusted to achieve that objective. Furthermore, to the extent that ASEAN's final objectives differ from those of the WTO, then the modalities of negotiations in ASEAN need to be appropriately modified to meet ASEAN needs.

This report has attempted to identify some of the steps that could be taken to ensure that the process of negotiations is more flexible and to accommodate different ways that modalities of negotiations could be shaped to help the 2020 objective. In so doing it has examined extensively the WTO experience in designing modalities and suggests adoption of WTO practices where they are appropriate, while mindful that there are differences in the "end point" of WTO and ASEAN, and that therefore some aspects of the negotiations process in ASEAN must be redesigned to suit ASEAN specific needs.

This report was not intended to examine in details the specific modalities discussed. Looking ahead, it is recommended that further work be done to deal with the specific aspects of

modalities in services negotiations. It needs to be kept in mind that process will continue until 2020. It must be done with persistence and patience because by its very nature, economic integration is a long process.

Moreover, looking beyond the question of modalities, ASEAN is now entering an entirely new phase in its existence. A great deal of institutional work would also need to be done. The experience of the early phases of the EU can now be examined for purposes of comparison in ASEAN's effort to cope with the institutional challenge of economic integration. Policy-oriented research work in this area would be much needed.

If the term "modality" is to be used in its broader and more policy-related meaning rather than the technical meaning in this report, then one can also look upon the whole process of regional integration as a process of developing "integration modalities", not only for negotiation, but for policy development and institutional development in support of the integration process. For purposes of this broader meaning of "modalities", much work remains to be done in ASEAN, including work on policy research.



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