CHAPTER II
CONDUCTING SERVICES NEGOTIATIONS

A. Organizational and procedural issues

This section discusses a number of important considerations of a predominantly structural and process-related nature, starting with who conducts negotiations and then how the negotiations are conducted.

1. Placing responsibility for the negotiations in the right hands

Whereas it is true that in the context of PTA negotiations, services are only one of several sectors on which negotiations take place concurrently, it is equally true that the officials charged with negotiating on the various services sectors and other related issues will typically be led by a relatively senior member of the government, someone with both policy expertise and political access/influence. The commitments that will be requested (and, in many cases, made) in services negotiations are bound to be some of the most far-reaching, controversial and institutionally difficult to implement; for this reason, the person ultimately responsible for the negotiations (the chief services negotiator) must be up to the task of conducting them responsibly and subsequently "selling" them to the broader political, regulatory and other domestic stakeholder constituencies.

Some countries appoint a chief trade negotiator for the negotiations as a whole, and then appoint heads of sectoral negotiating groups. This approach can work if the chief trade negotiator is sufficiently experienced and adept at trade in goods, trade in services, trade-related intellectual property rights and the various other issues that increasingly find their way into such agreements, such as investment, government procurement, competition policy, trade facilitation etc. For most transition economies that are relatively new to the business of negotiating trade agreements, it is probably wiser to appoint an official to have ultimate responsibility over all services issues and several sectoral negotiators for the biggest services sectors, and then make another (or several) official responsible negotiations on various clusters of related services sectors. This will ultimately be a question of human resources, since it will depend on how many experienced officials a country is able to field in any given negotiation. Box II.1 contains an excerpt from a case study on the PTA concluded in 2009 between Australia-New Zealand and ASEAN

There is an interesting point worth noting concerning the example involving Australia/New Zealand and ASEAN. Whereas most of the negotiating groups were established at the very start of negotiations, others were only set up once there was sufficient consensus on even negotiating the issues concerned as well as the parameters and objectives to which these negotiations would be subject. This is more likely to happen in a North-South context, where the developed country may typically be looking for a very ambitious outcome, whereas the developing country might be seeking to temper some of that ambition. This aspect is discussed in more detail in subsection 3 of this chapter.

Box II.1. Lessons from negotiating the ASEAN-Australia-New Zealand Free Trade Agreement

A Trade Negotiating Committee was established as the peak decision-making body and negotiating forum for goods and issues not covered in other negotiating groups. From the early stages, detailed negotiations on a range of issues were conducted in working groups (rules of origin, investment, services, legal and institutional issues) and sub-working groups (standards technical regulations and conformity assessment procedures, sanitary and phytosanitary measures, and Customs) that reflected the structure and coverage of the FTA.

Some issues, such as intellectual property and economic cooperation, were controversial and required considerable exploratory work before their coverage could be settled. This meant that the Working Group on Economic Cooperation and the Expert Group on Intellectual Property were only established in the final year of the negotiations.

Source: Mugliston, 2009.

2. Delegating responsibilities and process issues

The size of a negotiating team and how it is structured will first and foremost be a function of the resources that the negotiating country can muster and bring to bear on the negotiations, which, in turn, will be subject to various capacity constraints. Another influential factor determining the potential size of the negotiating team to be fielded is the complexity of the envisaged negotiations themselves and the level of ambition pursued. A country that is content to limit itself to status quo commitments may take a different approach to a country that is keen to advanced, clear offensive interests where a rollback of partner restrictions is the key.

Box II.2. Organizational and process-related issues in FTA negotiations

USSFTA: A personal perspective

By Tommy T.B. Koh

[The] USSFTA has 21 chapters. Ralph Ives and I agreed to create 21 negotiating groups, one for each chapter. In each negotiating group, we appointed a lead negotiator. Several of the more experienced negotiators were asked to be the lead negotiator in more than one group. My deputy chief negotiator, Ong Ye Kung, and I supervised the work of all the negotiating groups. During the negotiating sessions, we would ask each lead negotiator to report on the work in his or her negotiating work at our daily delegation meeting. Ye Kung and I would, whenever necessary, suggest solutions to problems encountered. In between sessions, we would meet with our colleagues in the different negotiating groups in order to take stock of their progress and to assist them in preparing for the next round.

Source: Koh and Chang, 2004.

Box II.2 contains an excerpt from a case study carried at on the United States-Singapore FTA (USSFT) written by Ambassador Tommy Koh. It discusses a number of the organizational and process-related issues that he and his counterpart (United States Chief Negotiator Ralph Ives) were confronted with during the negotiations as well as how they dealt with them.

This interesting excerpt highlights a number of relevant issues, i.e., the need to delegate effectively and to have several senior negotiators involved. It also highlights the importance of having the negotiating team leaders meet regularly to discuss progress and identify bottlenecks and negotiating red lines within and across specific issue areas. This is particularly important if commitments in one sector are to be traded off against commitments in other sectors.

Also worth noting in the context of USSFTA was that separate lead negotiators were appointed for telecommunications/information technology and financial services. Some developing countries may not have the resources to conduct negotiations in this way. However, the dynamic nature of the markets involved in these two sectors, and the complex rules and structures established to regulate them, make it imperative that the lead negotiators appointed for these two sectors not only have both technical and substantive mastery of their respective briefs, but also the trust and confidence of the different regulatory bureaucracies on whose behalf they are essentially negotiating.

3. Setting the right tone at the start

Various steps will usually need to be taken at the very outset of the negotiations (Feketekuty, 2008). These include deciding on some logistical and purely procedural issues, such as:

(a) Deciding where negotiations will take place;

(b) Setting the negotiating agenda (an important exercise that involves framing the topics to be discussed and, thus, to a certain extent the potential sectors of substantive coverage that negotiations will cover); and

(c) The rules of conduct that will govern a negotiation, which may also extend to issues such as confidentiality, contacts with the media and even whether interpretation and translation services will be provided.

The start of negotiations could also be used to exchange as information, so that each of the negotiating sides can learn as much about their respective partners' expectations and constraints as possible. This can help avoid unpleasant surprises later on in the negotiations, and may also help to manage expectations on each side.

It is also worth mentioning that typically during the opening stages of negotiations the groundwork is laid for the personal relationships that play a centrally important part in the negotiations and can have a significant impact on outcomes. During the course of the negotiations, which can often take a year or more, it is the quality of the working relationships of the negotiators that drives progress as much as any other factor. This is even more so when discussing complex regulatory issues, where one side is trying to induce the other to make changes to its regulatory regime, and the other side is seeking ways to accommodate the requests while staying true to its own regulatory realities and constituents. Negotiations on behind-the-border measures often require some "out-of-the box" thinking, which can only be achieved in a negotiating environment where each side has confidence in the good faith of the other.

B. Negotiating rules and market access

Marconini and Sauvé (2010) distinguished between two distinct set of substantive negotiating issues when they discussed "Conducting services negotiations", i.e., negotiating rules and market access. They pointed out that when services negotiations took place in a North-South context, the developed country would typically approach the negotiations with a specific and pre-established template, which would normally constitute its point of departure. Any explicit deviations from these rules, to the extent they are less trade liberalizing, will generally tend to be hard fought and paid for with the appropriate negotiating coin.[15]

The example of the 2006 Economic Partnership Agreement (EPA) between Japan and the Philippines[16] is used here to discuss its constituent rules, before turning to the specific market access commitments that it embodies.

1. Rules

Under any North-South PTA, negotiations on rules are likely to be extensive and to go well beyond the relatively loose framework that GATS achieved; they may try to create "conditions on the ground" that could potentially pre-judge the outcome of still pending rules negotiations in the WTO context, such as on disciplines on mutual recognition, domestic regulation or emergency safeguards. Discussions currently underway on the negotiation of a Trans-Pacific Partnership (TPP) offer a good illustration of how PTAs can be rule-making trail blazers, creating new rules that can subsequently be taken up in other PTAs or ultimately at the WTO level. Examples from the TPP in the services realm involve possible new disciplines on digital trade, data privacy as well as state-owned enterprises. Here, developing and transition economies need to have a solid working understanding of the limitations of their own regulatory environments as well as to what extent they wish to harness rules negotiations to address those limitations.

Because most developed country negotiating partners will typically be negotiating on the basis of an established and proven template, the onus is on the developing country to do its due diligence and identify possible inconsistencies in its own regulatory regime. The choice then is whether to negotiate to keep such an inconsistency or to agree to remove it, preferably in exchange for some kind of concession and – where conducive to the development needs of the developing country – subject to a time-frame that allows regulatory authorities and market participants to adapt to the impending changes (through proper sequencing). This is particularly the case where rules negotiations focus on the adoption and implementation of pro-competitive regulatory policies, notably in network industries.

Box II.3 refers to the Japan-Philippines EPA and its Article 82, which addresses each country's right to enact measures to restrict trade in services in order to safeguard their respective balance of payments situations. Following the 1998 Asian financial crisis, this issue was very much front-and-centre in the minds of policymakers and central bankers. As explained below, it was also a final sticking point in the USSFTA that was ultimately only resolved at the highest level of the respective Governments. Article 82 of the Japan-Philippines EPA is examined here in order to gain a sense of the trade-offs made, and how the language that ultimately found its way into this Article likely reflects the concerns of either or both PTA partners.

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[15] The term "negotiating coin" is used here to mean those concessions that must be conceded in order to "pay for" what is being requested.

[16] See www.mofa.go.jp/policy/economy/fta/philippines.html (accessed 2 July 2012).

Box II.3. Article 82 of the Japan-Philippines EPA – 'Restrictions to safeguard the balance of payments'

1. In the event of serious balance-of-payments and external financial difficulties or threat thereof, a Party may adopt or maintain restrictions on trade in services, including on payments or transfers for transactions.
2. The restrictions referred to in paragraph 1 above:
   (a) Shall ensure that the other Party is treated as favourably as any non-Party;
   (b) Shall be consistent with the Articles of Agreement of the International Monetary Fund;
   (c) Shall avoid unnecessary damage to the commercial, economic and financial interests of the other Party;
   (d) Shall not exceed those necessary to deal with the circumstances described in paragraph 1 above; and
   (e) Shall be temporary and be phased out progressively as the situation specified in paragraph 1 above improves.
3. In determining the incidence of such restrictions, a Party may give priority to the supply of services which are more essential to their economic or development programmes. However, such restrictions shall not be adopted or maintained for the purposes of protecting a particular service sector.
4. Any restrictions adopted or maintained under paragraph 1 above, or any changes therein, shall be promptly notified to the other Party.

Source: www.mofa.go.jp/region/asia-paci/philippine/epa0609/main.pdf (accessed 2 July 2012).

Note that the possible scenarios that can justify enacting such restrictions are formulated in broader terms than simply a run-of-the-mill balance-of-payments crisis. They include: (a) "serious BOP difficulties" as well as "external financial difficulties" (brought on by, for example, a rapid currency devaluation or a collapse in confidence in the country's financial stability); or (b) the threat of one of these scenarios (triggered say, by a downgrade in the country's credit rating by one or more ratings agencies, or the nationalization of a major industrial or business entity and the ensuing capital flight that this might provoke). In short, the way that paragraph 1 is formulated is likely to have been at the insistence of policymakers in the Philippines, where short-term financial stability and BOP difficulties are considerably more likely than is the case in Japan.

It should also be noted that the constraints to which such restrictive measures would be subject are relatively "soft", particularly the requirements that they "shall avoid unnecessary damage to the commercial, economic and financial interests of the other Party" and that they "shall not exceed those necessary to deal with the circumstances described in paragraph 1 above". What is "necessary" in the context of both these provisions is likely to be largely at the discretion of the country imposing such restrictions, and it will be up to the other Party to effectively challenge the necessity or proportionality of those measures, based predominantly on counterfactual arguments. These provisions were thus generally formulated in terms that were favourable to the country seeking to have the required policy space to impose them, with relatively weak disciplines constraining their eventual use.

Finally, paragraph 3 of Article 82 confirms the suspicions expressed above as to whose interests it was predominantly adopted for, i.e., the developing country PTA partner. Thus, the Party imposing such measures can vary the incidence or intensity of those measures in line with what it perceives to be its own economic development needs, provided the restrictions in question are not imposed for purely protectionist purposes. Again, this last constraint will place the initial evidential burden (in the event of a

dispute) on the country challenging such restrictions, and it would likely have to prove protectionist intent, which may be difficult, depending on the circumstances under which such restrictions are imposed.

A final remark to be made on rules, and which will be taken up in more detail in chapter III ("Aid for Trade") is the inherently development-friendly aspects of negotiating better rules for both regulators and market participants. Although these may be negotiated under a more mercantilist quid pro quo dynamic, it is important for negotiators to realize that better rules for foreign service suppliers will invariably translate into better rules and enhanced governance for domestic economic operators as well, improving the quality of the business environment more generally.[17] This is particularly the case when it comes to negotiating rules on transparency and domestic regulation. Here, the "quid" asked in exchange for the "quo", may simply consist of firm, quantifiable and actionable commitments from the developed country PTA partner on technical assistance, capacity-building or other aid to help the developing country overcome regulatory and institutional shortcomings and adopt (as well as effectively implement) international best regulatory practices in the services sectors concerned.

2. Market access in general

Market access negotiations in services are typically based on a so-called positive list approach – such as that found in GATS – or a negative list approach, which is more common among many (albeit not all) PTAs, where the level of ambition for liberalization arguably tends to be greater than when a GATS approach is pursued. Regardless of the approach taken, developing country negotiators need to have done their homework and be able to walk into negotiations with a clear idea of what their offensive and defensive interests are. Even where they may not currently be exporting services to their respective PTA partners, the fact that they might potentially do so, and the possible market access and national treatment impediments their services suppliers would then be likely to encounter, is something services negotiators need to understand in order to properly undertake their tasks and responsibilities. This is true across all modes of supply and all key exportable service sectors. An understanding of their own economy, the strength and weaknesses of their own services sectors is as important as detailed knowledge of the regulatory and other barriers that the PTA partner has in place.

3. Market access: Positive or negative list

Whether or not commitments are scheduled on a positive or negative list basis is one of the threshold issues that will need to be addressed even before negotiations begin. Developing countries tend to instinctively favour the policy flexibility inherent to the GATS-like positive (or hybrid-like) list approach (which is the reason why GATS is often referred to as the most "development friendly" of the Uruguay Round Agreements); however, this is not always a choice they will have, given that they may have opted to enter into preferential trade negotiations where the objective is intrinsically to achieve greater liberalization than has been agreed at the multilateral (WTO) level. Developing countries engaging in a North-South PTA negotiation should thus assume that services negotiations will be conducted on a negative list basis, especially if they are negotiating with a PTA partner that is a major exporter of services.[18]

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[17] For example, Article 82 of the Japan-Philippines EPA gives a great degree of discretion to monetary policy officials, but it does not achieve much in the way of legal certainty for foreign (Japanese) investors.

[18] Despite the bias in favour of the negative-list approach, one still finds many examples of North-South PTAs that followed a positive list approach, such as the one between Japan and the Philippines. See also Fink and Molinuevo, 2007, for a discussion of this issue.

Commitments made under a positive list approach are typically scheduled in the format that many will already be familiar with under the GATS framework. Box II.4 contains an example of such commitments as entered into by the Philippines under its EPA with Japan.

Box II.4. Specific commitments by the Philippines in its EPA with Japan

Dentistry services (9312[a])	SS	(1) Unbound (2) None (3) Corporate practice is not allowed. (4) As indicated in the horizontal section for Professional Services.	(1) Unbound (2) None (3) and (4) Certificates of registration shall not be required from the following provided that a previous authority has been granted by the Board of Dentistry: A. Commissioned dental officers of foreign army/navy/air force whose operations in the Philippines are permitted by the Government. B. Foreign dentists/oral surgeons invited for consultations/ demonstrations. (4) As indicated in the horizontal section for Professional Services

[a] Indicates that the specific commitment for that code does not extend to the total range of services covered under that code.

SS – Any terms, limitations, conditions and qualifications on market access are limited to existing non-conforming measures.

Source: www.mofa.go.jp/region/asia-paci/philippine/epa0609/annex6.pdf (accessed 2 July 2012).

Market access negotiations on a negative list basis are inevitably an exercise in determining what the existing non-conforming measures are on a sector-by-sector and mode-by-mode basis as well as deciding whether these measures must be maintained or can be negotiated away. This only increases the need for the so-called trade-related regulatory audit (discussed above) as well as the burden on lead negotiators to understand the ins and outs of their respective regulatory regimes, and the "whys" and "what for" of any non-conforming measures. Only when negotiators understand the inherent policy rationales behind non-conforming measures can they hope to have an understanding of the importance of maintaining them or the value (in terms of negotiating coin) at which they can be traded.

The commitments made under a negative list approach are inevitably scheduled in the form of reservations lists to the respective PTA chapters on services and investment. Box II.5 provides an example of one of the reservations scheduled by Mexico in the context of its 2005 PTA with Japan.

Box II.5. Reservation of Mexico in its 2005 FTA with Japan

Sector:	Transportation.
Subsector:	Land transportation.
Industry classification:	CMAP 973101 Management services of passenger bus terminals and auxiliary services (bus terminals and stations for buses and trucks)
Type of reservation:	National treatment (Articles 58 and 98) Local Presence (Article 100).
Level of government:	State (Sonora).
Measures:	Law 120 of Transport of Sonora (Ley número 120 de Transporte para el Estado de Sonora), Chapter IV.
Description:	Investment and cross-border services. A concession is required for the establishment of passengers and freight bus terminals and stations, to exploit public transportation services. Concessions may be granted only to Mexican nationals by birth. Enterprises shall be wholly-owned by Mexican nationals by birth.
Phase-out:	None.

Source: www.mofa.go.jp/region/latin/mexico/agreement/joint0510.pdf (accessed 2 July 2012).

C. Red lines and negotiating impasses

In many cases, the internal consultation phase – particularly with other government agencies – will reveal what the limits of a negotiating mandate are likely to be. In other cases, the sheer immovability of an entrenched domestic political economy interest group is likely to make itself known long before any of its interests make their way to the negotiating table. Good preparation in the pre-negotiation and fact-finding stages will thus allow most negotiators to realize what their red lines are and to steer negotiations well away from them.

However, even with thorough preparation and an approximation in the level of ambition that both Parties bring to negotiations on trade in services, the request/offer process of market access negotiations as well as those on rules can run up against red lines; this will, more often than not, will lead to a negotiating impasse, depending on how important the issue is to the requesting Party. The issue of red lines is discussed below before considering how to overcome a negotiating impasse.

1. Boundaries of consensus

Red lines are typically concessions that a Party is unwilling or unable to make, and these should be fairly well understood by lead negotiators before they embark upon negotiations. By the same token, well-prepared negotiators will have a sound enough knowledge of the politico-economic or institutional constraints under which their counterpart is operating in order to be able to steer negotiations away from issues where compromise seems unlikely. One well-known example of this was experienced during the now abandoned FTA negotiations that took place between the United States and Malaysia from 2006 until their suspension in 2008. The major stumbling block appears to have been a core policy of the Government of Malaysia that favours ethnic

Malays over other ethnic groups when awarding government contracts. The United States insisted that this market be opened so that its companies could compete against local firms on the public procurement market, but this was a red-line for Malaysian negotiators, who could not be seen domestically to be compromising on this issue with the United States.

At the same time, this was a red line for the United States, i.e., a request that country was not willing to walk away from. The result was the suspension of the talks, which were subsequently subsumed under the plurilateral TPP negotiations currently underway. It is interesting to note that under the TPP, Malaysia has gone on record as saying that it is willing to revise its public procurement policies as part of any final package that results from these talks. This begs the question as to what has changed, and a number of answers suggest themselves, including one that policymakers have become aware how costly these government procurement policies have become (in terms of negotiating coin as well as on economic efficiency grounds) as well as a greater willingness by Malaysian negotiators to make such a commitment in the very different dynamics of the TPP negotiations as opposed to those Malaysia felt subjected to while negotiating bilaterally with the United States.

Box II.6 contains various excerpts from the media documenting the troubles experienced by both countries in dealing with this red-line issue during the course of their PTA negotiations, and how it was last addressed under the TPP.

Box II.6. Media coverage of the United States-Malaysia FTA

Malaysia won't budge on procurement policy as fifth round of trade talks with US ends

By Eileen Ng, Associated Press, 2007-02-09

Malaysia's trade minister reiterated the country would not compromise on its procurement policy that favours ethnic Malay-owned companies at the end of the fifth round of free trade talks Friday with the United States.

Rafidah Aziz reported some progress in the week-long talks, which aim to forge a free trade agreement between the two countries by the end of March, but said several hurdles remain.

The key obstacle is Malaysia's affirmative action program that awards government tenders to Malay-owned companies to give them an advantage to compete with the wealthier minority Chinese. While some government contracts are open to bids from foreign firms, Washington wants more clarity and transparency in the bidding process.

But Rafidah said Malaysian authorities would not alter the programme and suggested that the issue could scuttle any sort of trade agreement.

"We will not move (on government procurement)," she said. "If that's a deal breaker, so be it, but fortunately now, it's not."

Other sticking points in the negotiations are differences over liberalizing Malaysia's services sector and highly protected car industry, its ban on majority foreign ownership of banks, poor intellectual property rights, labour and environmental issues.

Source: www.taiwannews.com.tw/etn/news_content.php?id=386075&lang=eng_news&cate_img=83.jpg&cate_rss=news_Politics (accessed 2 July 2012).

Box II.6. Media coverage of the United States-Malaysia FTA *(continued)*

Malaysia says US will abandon trade pact negotiations

Channel News Asia 19 November 2009

KUALA LUMPUR: Malaysia said Wednesday that Washington had indicated it will abandon a bilateral free-trade deal under negotiation since 2006, and will instead work towards a regional trade pact.

"It was made very clear to us that bilateral FTAs are not a priority for the US," Trade Minister Mustapa Mohamed told reporters. "Their focus is now on a regional approach."

US-Malaysia trade talks which began in March 2006 have dragged on for eight rounds, bogged down in sensitive areas including Malaysia's system of affirmative action for Muslim Malays who dominate the multi-racial population.

In particular, the US had sought access to lucrative Malaysian state contracts that favour Malays and indigenous groups, or "bumiputras" as they are known.

Mustapa said US Trade Representative Ron Kirk informed him of the US thinking on the sidelines of the Asia-Pacific Economic Cooperation (APEC) forum in Singapore last week.

Agreement with the US by November possible, says Muhyiddin

By Paul Gabriel, *The Star Online*, 1 July 2011

WASHINGTON: The Trans-Pacific Partnership (TPP) negotiations between Malaysia and the United States are on schedule. Deputy Prime Minister Tan Sri Muhyiddin Yassin said much progress had been achieved and the target of reaching a broad outline by November was possible. He said the latest round of talks held in Viet Nam had shown promise. "There has been marked progress achieved and it is now a matter of the timeline (set). Labour, environment and intellectual property issues are being negotiated, together with government procurement," he said at the end of his three-day working visit to Washington, D.C. Malaysia joined the TPP fold last November following the collapse of bilateral Malaysia-US FTA talks. Muhyiddin said good progress had been made over access to markets for industrial goods, agriculture, textiles, services, investment and government procurement, adding that the next round of talks would be held here in September.

Source: http://thestar.com.my/news/story.asp?file=/2011/7/1/nation/9006797&sec=nation (accessed 2 July 2012).

2. Overcoming negotiating impasses

Issues on which consensus is reached in trade negotiations relatively rapidly and with a minimum of effort are referred to as "low-hanging fruit" (because it is the first to be picked). Sooner or later, however, most trade negotiations run into difficulties in achieving consensus over issues to which no quick or easy solution appears to suggest itself, at least not within the negotiating mandates originally foreseen. In order to maintain momentum and not let negotiations as a whole falter or become unduly bogged down, these issues are often set aside in order to be dealt at a later stage, perhaps even being put off until the very last round of meetings – "kicked upstairs" to higher-level political leaders who have the authority to decide issues that are likely to be perceived as more contentious politically or to come at a greater cost in terms of their domestic political economy implications.

Ultimately, such issues may also be addressed as part of the built-in agenda of future negotiations between the Parties.

Other times, depending on the strength of the relationship that negotiators from both sides have been able to form over the course of negotiations, they may feel comfortable working together to brainstorm solutions to these issues that allow both sides to achieve their core negotiating objectives. Two case-studies are presented below, each drawn from different issue areas of the United States-Singapore PTA negotiations discussed earlier. The first issue revolved around the desire of the United States to introduce language in the agreement that would heavily curtail the activities of state-owned enterprises (SOEs) in the economy. This was anathema to Singapore, which has a long history of relying on SOEs to implement the city-State's economic development plans. Box II.7 refers to the case-study on SOEs, or "Government-Linked Companies" (GLCs) as Singapore refers to them.

The second case study, drawn from the United States-Singapore FTA negotiations, involved the contentious issue of using trade agreements to discipline capital controls, where the Government of Singapore affirmed a clear desire to maintain the policy space it felt it needed in order to intervene in the unexpected event of massive, sudden and destabilizing capital outflows. As discussed

Box II.7 Getting to yes: Reaching a mutually acceptable agreement

"Let me cite an issue which I thought both sides negotiated particularly well. The issue relates to the Government-Linked Companies (GLCs) of Singapore. We started off badly with wide ideological differences. The US's position was that governments should not be in the business of owning and running commercial enterprises.

[…]

Singapore's starting point was that GLCs were part of our historical legacy.

[…]

Many started off as government departments, which were later corporatized and privatized. Further, GLCs operate commercially and had to compete in the market place. There is nothing wrong with government ownership.

If we had persisted with negotiations along the two different ideologies, never the twain would have met. Fortunately, both sides were able to set aside the ideological differences and focus on our interests. The US's real interest is not to advance their ideology, but to ensure that GLCs do not become anti-competitive or monopolistic companies and hurt their business interests. The US was also concerned that GLCs may become vehicles for the Government of Singapore to implement discriminatory policies. Having learnt that, the Singapore side concluded that it was, in fact, in our interest to address the US's concerns. Having our GLCs that operate commercially and on a level playing field with other market players is a key differentiating factor between them and other state-owned enterprises around the world, and explains why GLCs are viable companies that are not a drain on national resources. Hence, in the USSFTA, we have committed to maintain Singapore's current regime on GLCs but have given the US the assurance that GLCs act in accordance with commercial considerations; do not discriminate against US goods, services and investments; and do not engage in anti-competitive practices.

At the first round we were literally debating Adam Smith's theory, but by the time we reached the last round, we were quibbling over drafting format and choice of words."

Source: Koh and Chang, 2004.

Box II.8. Financial services and capital controls in USSFTA

Impasse over capital controls

[…] [O]ne important issue remained unresolved – the free transfer of capital. This had been an unresolved issue throughout the two years of negotiations, but never attracted much attention. Each side assumed that the other would agree when the rest of the FTA fell into place. But it was not to be. Despite two telephone conversations between Chairman MAS Deputy Minister Lee Hsien Loong and US Treasury Under-Secretary John Taylor in the last couple of days of the negotiations, there was no agreement. The gap in positions was not tactical but fundamental.

The US wanted clauses in the FTA requiring both countries to freely allow payments and transfers of capital into and out of their territories. The "free transfer" clause was a feature of all bilateral trade and investment agreements that the US had concluded to date. Making an exception for Singapore would set a bad precedent for all of the US's future agreements. The free flow of capital was a central tenet of US international economic policy and strongly subscribed to by the US Treasury in particular.

[…] It was only natural that the US would want to protect the ability of its investors to freely move their assets out of the jurisdictions in which they are held.

Singapore shared the US's strong commitment to the free and unfettered flow of capital. An open capital account regime had been and remained a critical factor underpinning Singapore's economic growth. We had consistently eschewed capital controls of any kind – even at the height of the Asian financial crisis. However, in an exchange rate crisis that threatened to severely destabilize the economy, Singapore needed the flexibility to take all appropriate measures, including, as a last resort, restrictions on capital flows when conventional monetary policy tools might be inadequate. We were not opposed to a "free transfer" clause but wanted to include an exception similar to that in multilateral trade agreements, such as GATS, which provided flexibility to impose restrictions on capital flows in the event of serious balance of payments difficulties.

Breaking the deadlock

The two months of negotiations that followed were unique. There were no face-to-face meetings. The negotiations were conducted entirely through a series of telephone conversations and video-conferences, punctuated by exchanges of letters formalizing the evolution of our respective positions. Our embassy in Washington played a key role m building support for our position

The breakthrough came when both sides agreed to set aside the contentious issue of whether capital controls were a legitimate macroeconomic policy tool, and focus on the extent to which Singapore should be subject to claims for damages by affected investors in the event that Singapore imposed capital controls. This meant that there would be a "free transfers" clause without exception (reflecting the US position), but the scope of Singapore's liability in the event we imposed capital controls was significantly reduced (largely meeting Singapore's need for flexibility of action in a crisis).

Source: Koh and Chang, 2004.

above in the case of the Japan-Philippines FTA, the legacy of the 1998 Asian financial crisis provided a context for Singapore's insistence on this issue, even though it had experienced net financial inflows during the crisis (as it was widely perceived as a stable economic and monetary haven within an otherwise destabilized region).

The case study is interesting since it shows how despite interventions from officials at the very highest echelons of the Government of Singapore (the Minister referred to in the case study is Lee Hsien Loong, who would shortly thereafter become Prime Minister), it was only possible for both sides to overcome the impasse once they moved away from their hitherto entrenched ideological positions and delved into the finer and more technical details of how to achieve the outcome that both Parties ultimately sought. Box II.8 describes this in the words of Singapore's then lead negotiator for financial services.

The two sides ended up solving this impasse by ultimately giving USSFTA the clause it needed, while at the same time defining the ability of Singapore to impose controls on what it considered the most potentially destabilizing monetary flows, i.e., short-term capital flows (so-called "hot money") driven more by speculation impulses than by a desire to finance productive activity. The United States, for its part, agreed to limits on Singapore's liability towards investors on whom any controls that Singapore decided to impose would have a negative impact.