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Gats negotiations: Outline of some risks and challenges for developing countries

Many developing countries have undertaken autonomous liberalisation of services sectors. There have been cases where this has both attracted investment and led to development and improvement of the service sector. Liberalisation of services and commitments under GATS are therefore often presented to developing countries as a way to make their economies more efficient; for instance, allowing foreign banks or telephone companies to establish themselves in developing countries and run these services, might improve communication and financial transactions, and ultimately improve productivity. However, improvements in services or the development of the services sectors are not always the outcome of such liberalisation.

In the discussion and GATS negotiations many aspects and impacts of liberalisation are ignored or not addressed. GATS rules include many limitations on services market openings that suit a country's own national priorities and speed. They restrict regulating the committed services sectors in a way that is not the case under unilateral liberalisation. There is in fact no need for liberalisation to be done under the aegis of GATS nor to commit sectors under GATS which a country has unilaterally liberalised.

This paper briefly outlines some of the risks, concerns and problems against which the current GATS negotiations need to be assessed.

1 GATS is de-facto an investment agreement

Most "trade in services" is, in practice, happening mostly through mode 3, which is defined by the GATS as "commercial presence" by a foreign company and means establishment through foreign investments. Worldwide, 60% of investments happen in the services sector. This includes the acquisition of privatised public services by foreign companies and mergers/acquisitions of domestic services companies by foreign services companies, mostly large multinationals.

The GATS is often presented as an investment agreement that will help attract investment. So far, there is little substantial evidence and little confirmation from business people that GATS helps to attract new foreign direct investment in the services sectors. Often there is no additional investment (as is often the case with water companies) or the investment comes from IDA money, which is still a loan and has to be repaid by the recipient country at a higher rate than what the government could get.

The service sector, which includes basic supplies such as water, energy, health services, public transport, post, retail services but also sectors such as tourism, landscape and environment conservation, as well as construction and banking, is characterized by its regulations, based on numerous procedures and legislation. In the context of the WTO, such regulations are increasingly defined as obstacles (or barriers) to free trade.

A commitment to liberalise certain services sectors under the GATS seriously limits the right to regulate in different ways, as do investment agreements. For instance, the GATS rules demand that foreign investors are treated no less favourably than are the national services companies, regardless of whether domestic companies are much smaller and less developed or still need support to be able

to compete (Art. XVII: national treatment principle). Also, Art. XI of GATS requires that all international financial transfers and payments (for current transactions; e.g., profit repatriation) should be allowed for companies within the sectors that are committed under GATS. This does not allow making requirements for foreign investors to re-invest their profits and to stay for a certain period of time.

Some GATS rules particularly affect the way governments and parliaments can regulate and current GATS negotiations might even further curtail the capacity of countries to regulate to allow the protection of their citizens and economic development. The focus in the current GATS negotiations on limiting regulation in order to attract foreign services companies is a wrong approach that undermines long-term sustainable services sectors in developing countries, as well as in developed countries.

The GATS rules and current negotiations restrict the right to regulate in the following way:

1.1 Domestic regulation (Art. VI)

The present negotiations have the mandate (Art. VI.4) to strengthen and further develop disciplines in order to ensure all measures relating to qualification requirements and procedures, technical standards and licensing requirements “do not constitute unnecessary barriers to trade in services”. This is meant to guarantee both the right of states to regulate and to allow some progress in trade liberalization. However, the outline of that mandate is so widely defined and unclear that practically all regulations can be defined as "technical standards". This allows the opening of a black box, because social procedures, environment laws, as well as standards concerning consumer safety, local tourism, construction, landscape conservation, education, health care, requirements to use local resources, requirements to use local labour (and or to employ specific disadvantaged groups such as women or indigenous people) and regional development could be considered as technical standards and have to be in conformity with WTO principles. Dispute panels of the WTO have backed such limitations. The draft text of the Working Party on Domestic Regulation (WPDR) currently being proposed during the GATS negotiations on domestic regulation include several principles that might undermine developing countries’ capacity to regulate according to their own needs.

1.1.1 Proposal to subject national legislation to a necessity test

A specific cause of concern during the current GATS negotiations is the proposal to introduce in Art. VI.4 a so-called necessity test. Few countries support the introduction of a necessity test in the domestic regulation provisions but a small number of countries such as Switzerland, Hong Kong and Australia have been extremely demanding in their request for such a test. As a consequence, it has consistently been included in the draft texts proposed by the chair of the WPDR. Based on such a test, governments at a national, regional or municipal level would be required to prove that existing or newly introduced measures and procedures are not "interfering with free trade more than necessary". This request is particularly contentious for the following reasons:

- Up till now, the outcomes of WTO dispute settlement cases have shown that countries have had a difficult time justifying that their legislation was “not more burdensome than necessary”. The *Mexico-telecommunications* case is particularly illustrative in this regard. Governments are told that GATS offers them sound protection for services delivered under government authority but they nearly always lose these cases. In similar cases related to goods (GATT 1947 rules included in the WTO) eleven out of thirteen cases of litigation under the WTO, governments did not succeed with their defence.

- It is difficult for governments to prove that a regulation ‘needs’ to be just the way it is and that for a country a regulation cannot be any different. Within WTO, the precautionary principle is not accepted. Measures for the protection of the population or the environment therefore are not

acknowledged unless their necessity is scientifically established (see Art. XIV that allows a few exceptions to protect the health and life of people and animals, but in the GMO case the precautionary principle was not acknowledged). It is therefore possible that individual WTO members could be forced, due to pressure by other WTO members, to abolish or change their regulations based on the necessity test. In many developing countries there are various laws which require a guarantee that the local population will benefit from investments. As an example, in countries where all banks are required to grant a certain percentage of affordable loans to small and medium-sized enterprises, such legislation would most probably not pass a necessity test (and also be attacked according to Art. XVI: see below). Similarly, it might prove difficult in the future for countries which try to implement measures to regulate the tourist flow in a sustainable way.

- In the latest documents circulated on paper by the Chair of the WPDR, language on the necessity test has been included in the preamble. This has been presented as a possible compromise. However, keeping “necessity” language in the preamble would influence the interpretation of the whole document. This would convert several provisions into operational necessity tests. A new Art. VI, designed as currently proposed, will make new WTO members refrain, even if there is an urgent need, from introducing the necessary legislation or standards in the future because of fear of breaching the new GATS Article and being brought before a WTO panel. This is true in particular for developing countries, which in many instances still don't have such laws in effect. This new GATS Article will prohibit them from enacting new regulations that they would like to introduce in response to negative consequences of a hasty liberalization.

- “Necessity tests” would in practice constitute an excessive breach of states’ sovereignty and to their ability to meet their people’s basic needs. They should not apply to domestic regulations of services provisions as this would allow WTO panels to second-guess democratic judgments about the quality of a service. The necessity test prioritizes business concerns above all others in the regulatory process, despite the «right to regulate» clauses that are inserted in the introductory language.

1.1.2 Services regulations need to be non-trade distorting, “objective” and “relevant”

In the newest draft negotiation text (March 2007) proposed by the chairman of the WPDR, the status of introducing a necessity test has been downgraded from previous versions, but it still remains part of the text. The preamble language obliges governments to «ensure that domestic regulations are «no more burdensome than necessary” and are “based on objective and transparent criteria”, » and this applies to all five forms of domestic regulations (licensing requirements and procedures, qualification requirements and procedures, and technical standards). In practice, this still constitutes a necessity test language and will be used to interpret the operational disciplines (e.g. objectivity, relevance) in the main part of the text. The obligation to be “objective” might also result in some kind of necessity test.

The GATS Art. VI.1. does not define “objective” or “relevant”. The interpretation can be a slippery slope and controversial as it would allow many ways to attack domestic legislation because the complaining country does not consider a law objective or relevant. Also, in a case it can be argued that there are alternative measures or standards that can be introduced that are less-trade-restrictive than the existing standards or measures, the existing ones would be judged to be in conflict with the agreement.

1.1.3 Negotiations on transparency have implications on developing new laws

The current negotiations on domestic regulation also include more specification about the transparency of regulations made and administrative decisions taken (Art. VI,1.-2.). The draft negotiation text circulated in the beginning of 2007 is proposing that the text contain a clause by which interested persons are consulted in the period that a new services law is being developed ("Each Member shall endeavour to ensure that any measures of general application it proposes to adopt in relation to matters subject to these disciplines are published in advance, and a reasonable opportunity is available for interested persons, those of other members, to comment on such proposed measures.")

In practice this will mean that foreign services companies have the right to comment on any proposed legislation to which they will be subject in the future and that they can lobby against laws by which they might be regulated. There are no guarantees in the current text that parliamentarians and citizens have equal capacity to have their interests defended. Nor is there any GATS rule that requires WTO member governments to have laws that provide much more transparency about the operations, profit making methods, tax payments, lobbying practices and ownership structures of the foreign services companies operating in their territories.

1.2 Limits to the right to regulate under market access rules

Art. XVI on market access explicitly prohibits several "market access" restrictions or laws that governments might have enacted to limit the negative impact or domination of foreign investors. Art. XVI requires governments not to:

- Limit the number of service suppliers; e.g., in the form of quota's
- Limit the total value of services transactions or ownership (assets). This means that foreign companies that are often financially better resourced are not limited in the amount of real estate, land, etc. that they can buy.
- Limit the number of service operations and the number of persons that may be employed
- Limit or prohibit the establishment of a foreign service company after the authorities have implemented an economic needs test. Such an economic needs test allows authorities to assess the economic, social and environmental impact of a future establishment of a service company and prevent an establishment if the assessment proves to show too many negative effects. In other words, GATS Art. XVI forbids such an economic needs test.
- Limit the form and level of foreign ownership; i.e. that foreign companies should not be prohibited from 100% ownership of domestic services companies (and thus allow full mergers or acquisitions) nor should foreign service companies be requested to invest and service through a particular type of legal entity or joint venture.

These limitations to managing and regulating foreign services companies can undermine the development of a domestic service industry as the latter might not be able to compete with the foreign companies. Transfers of technology or skills are undermined by the above regulations. It should be noted that the services sector is a sector with a lot of value-added and leaving this sector in foreign hands might exclude developing countries from the most profitable sectors, even in their own countries, and limit the diversification of their domestic industries and economy.

It is important to note that governments, when they schedule their commitments during the GATS negotiations, are able to write exemptions to these rules of Art. XVI, provided they do so in their schedules. These are technicalities that require careful consideration by each country.

1.3 Liberalisation commitments made under GATS become practically irreversible for developing countries

Although GATS rules allow countries to change or withdraw the liberalisation of services sectors that have been committed under GATS, in practice the conditions set out by the GATS to do so make liberalisation commitments by developing countries virtually irreversible. According to GATS Art. XXI, governments cannot change or withdraw commitments until after 3 years have elapsed from the time a commitment went into force. In addition, any other WTO member(s) can request the country that withdraws or modifies its commitments to enter into talks and to follow WTO procedures so as to reach an agreement on how to compensate the other WTO member for lost trading opportunities. These procedures and compensation make it extremely costly and difficult for developing countries, and certainly least developed countries, to use the GATS modification rules. Even if the liberalisation commitment has caused severe economic or social problems, the commitment is very difficult and costly to reverse.
The GATS (Art. XIV) has also strict conditions to regulate, for instance, the protection of the health and life of citizens when liberalisation has caused negative effects, in case such legislation is deemed to be inconsistent with GATS rules.

This irreversibility in practice means that developing countries, and especially least developed countries, should not make any commitment to liberalise privatised public services and basic utilities such as water services and health services under GATS rules. This would undermine a country's capacity to fulfil its human rights obligations towards its own population, as GATS rules get precedence over human rights rules.

2 The costs and benefits of services liberalisation of services in developing countries need to be carefully assessed

2.1 Losses and/or deterioration in job quality resulting from liberalisation

There is ample evidence[1] that services liberalisation and market opening to foreign service providers often leads to job losses, especially for low-paid workers, mainly women. However, one needs to look at this on a case-by-case basis and sector by sector. Developing countries especially need to look at the likely up-stream and down-stream impacts of such liberalisation. Often, the liberalised service transforms and merges with other sectors: so, telecoms has often merged into the whole information and communication technology (ICT) sector in some countries and/or has had consequential impacts on other (technology) sectors. What is important is to have a good understanding of two elements: what is the total jobs impact up/down-stream over a medium-term period; and, even if there is not severe job loss, what happens to the quality of the jobs (wages and conditions that go into what the ILO calls 'decent work')? Many multinational corporations in the services sector do not employ the people executing "non-core" tasks but use outsourcing, whereby a large number of people working for such a corporation get much lower wages and social benefits than the employees of that corporation. In order to further reduce personnel costs, some corporations might suppress the right to organise and collective bargaining. If one gets some services improvement but at the cost of pauperising the workforce and surrendering national sovereignty, what is the cost-benefit?

[1] See for instance various publications on the website of the University of Greenwich Public Services International research Unit: www.psiru.org

2.2 The poor who need the services most are not always benefiting

In order to reach the profit requirements that corporations set themselves, they often use strategies in developing countries whereby they focus their services to the richest clients in a country and the richest regions, and ask high prices for their services. This can lead to poor clients paying more for some services; e.g., the poor in Ghana have to pay to deposit their money in the foreign bank. Or the poor can just be denied the service: not only might water or electricity be cut off when clients are to poor to pay increasing fees but also foreign banks are not interested in lending to small or domestic companies, as has been the case in Mexico, or to small farmers, even though the economy would much benefit from such loans. The right to provide universal services, or the right to universal access to services, is only permitted subject to being consistent with different GATS rules once a service sector has been committed. Developing countries need to carefully assess whether the GATS rules limit their capacity to regulate against marginalisation of poor people from liberalised services, or even whether regulation will be effective and non-liberalisation might be a better option.

3 Mode 4: Little illusion that rich countries will make concessions to demands from the South

Most developing countries seem to see Mode 4 commitments (temporary movement of national persons) as their main offensive interest in trade in services negotiations. As a result, developing countries have pressed for increased access for their workers through free trade agreements (FTA) or WTO negotiations but the door remains firmly closed and there is little prospect that developed countries will open up much in those mode 4 areas of interest to developing countries; rather the North is interested in freedom of movement for management staff. As a result, migration to developed countries continues to occur on a large scale through unofficial routes. It places migrant workers in extremely precarious positions where their labour rights are not upheld and wages and conditions are often deplorable. Access into the labour markets of rich countries for migrant workers must be on the basis that core rights are maintained (labour rights, working conditions, health and safety laws).

4 GATS negotiations linked to EPAs and other FTA negotiations

4.1 Art. V: little choice for selecting and limiting the liberalization of services sectors

The provisions of GATS Art. V. about WTO compatibility of regional or bilateral free trade agreements covering services require substantial sectoral coverage, in terms of the number of sectors, volume of trade and modes of supply. In principle, this means that developing countries involved in free trade agreements (FTA) negotiations would have to go way beyond their existing multilateral commitments to pass such a test.

However, it is important to mention that WTO disciplines on regional trade in services do contemplate flexibilities for developing countries as they enter into trade arrangements with developed countries. Therefore, the requirement of WTO compatibility should be so constructed as to provide flexibility to developing countries involved in FTA negotiations in terms of coverage and discrimination. The problem is that there is no clear definition of how much flexibility developing countries have.

4.2 Experience from agreements between the EFTA (Switzerland, Norway, Iceland and Liechtenstein) and developing countries

In the last few years, the EFTA has made an effort to conclude bilateral free trade agreements with selected developing countries: with Chile, Singapore, Mexico, SACU and Korea. Under negotiation or in exploration are agreements with Thailand, Indonesia, India, Peru, and Colombia. Especially Switzerland is interested in having better access to the global service market, especially in tourism, financial sector, transport, consultants and logistics.

In the financial sector, Switzerland (and Liechtenstein) would like developing countries to sign a framework agreement which corresponds at least to the «Understanding on Commitments in Financial Services» of the GATS. Only about 30 countries (mostly developed countries) have signed this commitment within the GATS. It contains – contrary to the usual GATS approach of positive lists – a negative list approach: that means: a country is forced to liberalize the whole financial (and services) sector in all modes of supply, including any new financial service. So, the countries have to remove or limit any significant regulation which could have – in trade language - an «adverse effect on financial service suppliers of any other Member and prevent financial service suppliers from offering all the financial services permitted by the Member».

With a negative list approach, developing countries would agree to a far-reaching opening up of the financial sector. In separate lists they have the possibility of declaring exemptions but there will be ongoing pressure by the EFTA countries to give up these exemptions.

Negative list approach in general
It is worrying that, in the future, Switzerland intends to claim for a negative list approach in all service sectors. For developing countries, it would be impossible to foresee all the dangers linked to liberalization steps and to put in place strong regulations. If developing countries accepted a negative list approach with EFTA countries, this would also have a consequential pressure effect for the GATS negotiations.

Also, the EU is being pressed by its services business lobby to adopt a negative list approach in the new FTA negotiations that will start with some Asian and Latin American regions and countries.

4.3 Lack of coordination between GATS and FTA/EPA negotiators in developing countries

Developing countries are very strong in defending the existing GATS flexibilities in the context of the current WTO negotiations. In addition, they are also very active in the Working Party on Domestic Regulations negotiations to defend the right to regulate trade in services. However, there is a real risk that they will lose some of the flexibilities they have preserved in the GATS at the multilateral level through FTA or EPA negotiations.

Multilateral or regional commitments being effectively irreversible, a commitment that might seem appropriate cannot be reversed if it has unforeseen consequences or if circumstances change and it becomes inappropriate in the future. Because of this, it is essential that government officials involved in multilateral and free trade agreement negotiations coordinate their strategies, base their commitments on national assessments of trade in services and retain the right to regulate in the public interest.

Recommendations and concluding remarks

- Developing countries should oppose the necessity test and any definitions of “objective” and “relevant” that limit a broad definition of the right to regulate.

- Developing countries should not be under any pressure to open up their services sectors, especially through irreversible GATS commitments, and should have the necessary time for the development of their domestic services industry and for a liberalisation speed and sequencing that they choose, with the objective of an equitable and sustainable service sector (private and public).

- Developing countries should not accept basic utilities and (former) public services being liberalised under GATS or FTA commitments, even if autonomously liberalised.

- As many sectoral studies show, any liberalisation of a services sector should suit a country’s own national priorities and speed, which, for many developing and especially least developed countries, means that they should not take GATS commitments in the current round. Moreover, the relevant regulations should be in place at the time of liberalisation. Such regulations and subsequent adaptation to reverse (unexpected) negative economic, social or environmental consequences should not be undermined by GATS rules and other bilateral or regional integration. No GATS commitments should therefore be undertaken and no commitments in unilaterally liberalised sectors, as experiences show that changes might later be needed, which could be prevented by GATS rules.

- Developing should never accept a negative list approach in FTA or EPA negotiations.

This paper was prepared for the services working group of the Our World Is Not For Sale (OWINFS) network. OWINFS is a worldwide network of organizations, activists and social movements fighting the trade and investment liberalizing aspects of the current model of corporate globalization, and is committed to a new, socially just and sustainable trading system.

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