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General Agreement on Trade in Services

- What is it?
- What's the fuss?

This paper has been prepared by the Senate Foreign Affairs, Defence and Trade References Committee in order to stimulate comment and discussion about issues relevant to its current inquiry into the General Agreement on Trade in Services (GATS).

Persons and organisations making submissions to the Committee's inquiry into the GATS may wish to use the background paper as a springboard for their contributions.

The background paper does not represent the final views of the Committee.

THE GENERAL AGREEMENT ON TRADE IN SERVICES

What is GATS?

As part of the Uruguay Round of global trade negotiations that concluded in 1994, the Member countries who had been parties to the General Agreement on Tariffs and Trade (GATT) signed the General Agreement on Trade in Services. The Agreement came into force on 1 January1995 and was the first binding multilateral agreement covering international trade in *services*.

Although they are not defined in the GATS, *services* are generally understood in economic terms as activities that add value to another economic unit or good. Typical examples of the services that might operate in the international marketplace include financial and business services, education services, transport and courier services, health services, engineering and environmental services, and tourism.

The coverage of the GATS is extremely wide. All service sectors are covered with two exceptions.

Exceptions:

1. The GATS excludes 'services supplied in the exercise of governmental authority'. These are services provided by the government not on a commercial basis, nor in competition with other suppliers. For example, social security schemes and central banking provided under non-market conditions are not subject to the GATS.

2. The GATS does not apply to air traffic rights and services directly related to the exercise of those rights.

The GATS consists of two broad elements

1. An overall framework which sets out the general rules and obligations that apply to all Member countries and to all services.

2. The national 'schedules of commitments' in which each Member country specifies the degree of access it is prepared to guarantee to foreign service suppliers. The schedules of commitments represent the extent to which a Member country has elected to 'opt in' to international trade in specific service sectors. It is a declaration by the Member country of its commitment

to allow the specified foreign services to be delivered to its citizens under the rules set down by the GATS.

How is the GATS structured?

The preamble to the GATS sets out the three basic considerations that shaped its development:

1. The establishment of a multilateral framework of principles and rules would progressively open up trade in services and contribute to economic development worldwide.

2. Member countries—and especially developing countries—will still need to regulate the supply of services to meet national policy objectives.

3. Developing countries should be helped to improve their participation in the world trade in services through strengthening the capacity, efficiency and competitiveness of their own domestic services.

The GATS as a whole has 29 Articles set out across six Parts. The first Part sets out its scope and definition. Part II, the longest, deals with general obligations and disciplines that apply, for the most part, to all services and all Members. Part III sets out the rules that Members must observe in relation to the specific commitments in the schedules. Parts V and VI cover institutional and other final provisions.

Part I describes the services which are subject to the GATS, and extends a Member country's GATS obligations to its regional and local governments. *Article I* identifies four ways in which a service can be traded. These four ways are known as 'modes of supply'. These 'modes of supply' are critical to the way in which a Member country specifies its commitments in the schedule of services to which it proposes to give access by foreign suppliers.

Mode 1—cross border supply of services

> Here a supplier in one country delivers a service direct to a consumer in another country, comparable to goods being traded across a border. Examples are distance education services, or a lawyer providing legal advice to a client in another country via the internet.

Mode 2—consumption abroad

> Here a consumer moves to a foreign country to obtain the service. For example, a citizen travels abroad to study, or to undergo specialist medical treatment, or to simply be a tourist. A ship being repaired in a foreign port is also Mode 2

Mode 3—commercial presence

> This refers to a service provider establishing facilities in a foreign country. For example, a university or a bank or a courier service sets up a branch overseas.

Mode 4—presence of natural persons

> This refers to individuals travelling from their home country to perform services in another country for a limited period. For example, a consultant, a fashion model, a sports coach, a project manager goes abroad to do a job then returns home.

The particular 'mode of supply' of a service is very significant in terms of the practical implementation of that service in a country and the management by that country of its GATS obligations regarding the provision of that service. This is because the ability to provide a service to a foreign country depends crucially on the government regulations that apply in that country. The regulations that might apply for one mode of service delivery (for example, training delivered by a visiting instructor) may be quite different from the regulations that might apply to another mode of service delivery (similar training delivered, say, via the internet).

Part II of the GATS sets out the general obligations and disciplines that must be observed by the Member countries in the way they allow access by foreign service providers, whatever the 'mode of supply'. Part II also specifies the exemptions that are allowable. There are two basic principles that lie at the core of Part II. These are:

1. The principle of so-called 'most–favoured–nation' (MFN) treatment. That is, Member countries must accord any other Member country treatment that is no less favourable than it accords to like services and suppliers from any other country. However, the GATS provides for exemptions in particular cases under certain conditions which are set out in an Annex to the GATS.

2. The principle of transparency. Because governments' domestic regulations have such an impact on the delivery of services within their jurisdictions, the GATS requires Members to publish all relevant measures of general application that affect the services under the Agreement. Members must also disclose any laws, regulations or administrative guidelines that affect services listed in their schedule of commitments under GATS. Moreover, to assist developing countries seeking to trade internationally in services, Members must establish contact points to whom service suppliers from developing countries can turn for information about all aspects of the supply of the service concerned.

Part II also sets out rules to try and ensure that domestic regulations are applied reasonably, objectively and impartially, with independent tribunals or similar

procedures available to ensure their fair and proper application. As well, government regulations concerning the qualifications of service suppliers, technical standards and licensing requirements should not constitute unnecessary barriers to trade. That is, they should not operate as disguised restrictions on the delivery of a service. The remainder of Part II deals with safeguards and subsidies.

Part III sets out the rules that, along with the categorisation of services into four 'modes of supply', shape the way in which each Member formulates its individual schedule of commitments to admit foreign suppliers of services into its market. The two main Articles in Part III deal with market access and national treatment. These are two key undertakings when a Member decides to list a commitment to accept a foreign service.

1. *Market access*

   For reasons of domestic political concern or national interest, a country may wish to limit access to its market by applying certain measures to would–be foreign suppliers. The GATS lists six measures to limit market access that a Member country may specify in its national schedule of commitments. These are:

   - limitations on the number of service suppliers
   - limitations on the total value of services
   - limitations on the total quantity of service operations or output.
   - limitations on the number of persons engaged in the supply of the service
   - restrictions via a requirement that the service be supplied only through certain forms of legal entity or joint venture
   - percentage limitations on the participation of foreign capital or on the total value of foreign investment

   Unless a Member country clearly provides in its schedule for the use of one or more of these limitations it cannot apply such limitations on market access to a foreign service or its provider. In other words, a foreign service provider has a right to assume full and free market access to a sector nominated by a Member country unless that country clearly specifies certain limitations in its schedule of commitments.

2. National treatment

> The rule concerning national treatment (Article XVII) is essentially that, once a sector has been scheduled for foreign access, a Member country shall not discriminate between foreign and domestic services and suppliers. Article XVII does not list the measures that would be considered discriminatory. It simply states a Member's obligation that in the sectors covered by the Member's schedule of commitments, and subject to those conditions and qualifications clearly set out in the schedule, the member shall, when it comes to measures affecting supply of services, give to foreign services and suppliers treatment that is no less favourable than it gives to its own services and suppliers.

Part IV comprises essentially technical, procedural rules for the implementation of the GATS. They set out the elements to be covered in a Member country's schedule of commitments, and confirm the schedule as forming an integral part of the GATS agreement itself. There are also rules about how a Member country might modify or withdraw commitments from its schedule. Probably the most important element of Part IV is *Article XIX*, which commits Members to enter into 'successive rounds of negotiations with a view to achieving a progressively higher level of liberalisation'. The current round of GATS negotiations is the first of these 'successive rounds'.

Parts V & VI contains an array of standard institutional and final provisions, including dispute settlement procedures and the formal establishment of the Council for Trade in Services.

Attached to the GATS are eight Annexes which amplify issues on *Article II (MFN)* exemptions and the presence of natural persons, while others address special concerns in key service sectors—air transport, financial services, telecommunications and maritime transport.

Structure and function of a GATS schedule

A Member country's obligations under GATS depend profoundly on the specific commitments that the country chooses to include in its national schedule. In its schedule of commitments, a Member country will:

- specify the services sectors or sub-sectors to which the Member will allow access
- specify any limitations to market access that shall apply in the sector(s) concerned and according to the particular mode of supply

- specify any limitations that are placed on national treatment for foreign suppliers of the service
- specify any other binding commitments that the Member country is willing to undertake

The schedule as a whole is set out in two parts. The first part lists 'horizontal commitments' that apply across all sectors. The second part sets out the commitments undertaken in relation to each listed sector or sub-sector. If a sector is not listed in the Member country's schedule, this means that the country has made no specific commitments with respect to that sector.

How is this GATS round negotiated?

Negotiations proceed under the auspices of the WTO's Council for Trade in Services. The current round of services negotiations—the 'GATS 2000 negotiations'—flow from the built–in agenda established at the conclusion of the Uruguay Round which committed Members to embark, within 5 years, upon negotiations to further liberalise international trade in services. These negotiations were formally launched in February 2000 and at the WTO Ministerial conference in Doha, Qatar in November 2001, WTO Ministers agreed on a time frame for the market access phase of the GATS negotiations.

The first phase of the negotiations was a 'rule making' phase, during which Members negotiated new rules about trade in services dealing with subsidies, emergency safeguards and government procurement. This was handled largely through the Working Party on GATS Rules. Negotiations on GATS Rules are still continuing and the mandate has been extended to March 2004.

The second phase is the 'request and offer' phase, where Members negotiate further market access on a sector by sector basis. These market access negotiations are taking place in special sessions of the Council. In this 'request and offer' phase, Member countries make direct requests of their trading partners to open up as far as possible the national schedule of commitments each trading partner is prepared to make. Countries meet on a bilateral basis to 'clarify' their requests of each other. The parties may then make offers in response to those requests.

Australia has lodged requests with 35 Member countries for market openings across 21 service sectors, including financial and education services, mining, environmental and private hospital and aged care services.

While many countries disclose broadly the areas in which they are seeking to achieve greater access, and while some trade organisations produce digests of GATS activity, the detailed requests and negotiations between trading partners during the 'request and

offer' phase are confidential. A document alleged to be the requests made of Australia by the European Union was leaked and found its way on to various websites. The alleged EU request sought 'horizontal' commitments on Modes 3 and 4 and 'sectoral' commitments in such things as postal services, business and financial services, tourism, transport and energy. The confidential nature of negotiations, and the broad range of services under discussion, has led to speculation about the potential negative consequences of GATS, notwithstanding reassurances about governments' right to regulate the nature and extent of services traded. These concerns are explored later in this document.

Under the timetable agreed by Ministers at Doha, Members were expected to lodge initial requests for specific commitments by 30 June 2002. Initial offers are due by 31 March 2003. More than 30 Members have submitted requests for new market openings and the removal of discriminatory practices in the markets of their trading partners. Most developed countries and a small number of developing countries have put forward requests.

Public speculation and concerns about GATS.

> 'The GATS is a new agreement, not yet complete, not terribly user-friendly, with a complex geometry of general and *a la carte* obligations set against the backdrop of [near] universal coverage and sovereign immunity in liberalisation matters. Novelty, complexity and variable geometry all too easily lead to misrepresentation and/or over-interpretation'
>
> *Pierre Sauve, OECD Trade Directorate, Paris*

As the GATS 2000 negotiations have gathered momentum, so too has the level of concern being voiced by NGOs and others about the potential impact of the GATS on, for example, national sovereignty and public services. The question has been raised as to whether some services are simply too important to submit to an Agreement primarily designed to enhance international commerce. The following provides a brief summary of the issues which have gained prominence in the debate. The purpose is not to provide definitive answers to the questions being raised, but rather to canvass the issues that lie behind much of the public disputation over the merits of the GATS.

GATS and public services

GATS critics and supporters have been engaged in a war of words over the extent to which public services fall under the obligations of the GATS. The key provision in the GATS around which this controversy swirls is the following section from *Article I*:

> 3. For the purposes of this Agreement:
>
> (a) 'measures by Members' means measures taken by:

> (i) central, regional or local governments and authorities; and
>
> (ii) non–governmental bodies in the exercise of powers delegated by central, regional or local governments or authorities;
>
> In fulfilling its obligations and commitments under the Agreement, each Member shall take such reasonable measures as may be available to it to ensure their observance by regional and local governments and authorities and non-governmental bodies within its territory;
>
> (b) 'services' includes any service in any sector except services supplied in the exercise of governmental authority;
>
> (c) 'a service supplied in the exercise of governmental authority' means any service which is supplied neither on a commercial basis, nor in competition with one or more service suppliers.

The key question seems to be whether public services are explicitly safeguarded within the GATS. The answers vary wildly.

The WTO has been emphatic that the GATS explicitly excludes services supplied by governments. Others argue that such a categorical statement is not justified by the wording of 3(c) above, which specifies governmental services as those provided neither on a *commercial* nor a *competitive* basis, and leaves these two terms undefined. Critics point out that private providers often deliver services alongside state agencies (e.g. in education, health), that some services may have a mix of public and private funding or that governments may contract out certain services to private companies. Even among those trade experts and representatives who are supporters of the GATS, interpretations seem to differ markedly. Some claim that public services such as health care, education and the provisioning of water would all be included in the GATS purview. Others argue that such public services are exempt.

It seems generally agreed that the GATS itself does not *force* individual governments to privatise public services. But critics note that, because the Agreement mandates greater liberalisation of trade in services through repeated rounds of negotiations, there is a constant pressure being exerted on governments to open up public services to foreign commercial providers.

In its schedule of commitments, a Member country is able to specify which service sectors it is willing to open up to foreign suppliers, and what limits it will place on that access. These provisions are invoked by GATS proponents to emphasise the degree of control that governments have over what they will and won't allow.

However, once a government has scheduled its commitment in relation to certain services, it is very difficult to withdraw from that commitment. There are rules about

timeframe and process which must be followed if a country wishes to alter its schedule, as well as a requirement for the payment of compensation to the foreign provider adversely affected by the change. It is argued that this makes it difficult for a government to reverse the commercialisation of a public service should the government decide that the commercialisation was not successful, or that needs had changed.

On the other hand, a privately provided service must abide by the relevant domestic regulations (as long as these are themselves consistent with the GATS), so it may be argued that governments can apply these regulations to ensure the adequacy of the service provided by the foreign supplier. The foreign supplier can lose its contract if it fails to deliver as required in terms of, say, the quantity, quality and timeliness of service, or if it fails to abide by contractual or domestic regulatory requirements.

There is clearly much more debate required about the meaning and legal character of the Agreement in relation to its implications for the control and delivery of public services. Most WTO countries deliver public services through a mixed system of governmental, not-for-profit and commercial agencies, and governments wish to retain their ability to direct and modify that mix, and to regulate it tightly. Many of the GATS provisions remain untested. Exactly how the GATS rules will be applied in any future dispute is open to speculation. These factors exacerbate the confrontational nature of many of the exchanges between the GATS supporters and its detractors.

GATS and governments' right to regulate

The criticism that the GATS undermines governments' legitimate regulatory role is perhaps most baldly expressed in the claim that the GATS is designed to facilitate international business by constraining domestic governance. The WTO has been at pains to reinforce the message that this is not the case, pointing out that the GATS Preamble explicitly recognises the right of governments to regulate in order to meet national policy objectives. As well, the Ministerial Declaration issued at Doha in November 2001 stated that:

> We reaffirm the right of Members under the General Agreement on Trade in Services to regulate, and to introduce new regulations on, the supply of services.

These statements are considered inadequate by those who judge the GATS provisions to be unclear and subject to conflicting interpretations, and who regard the preamble as having strictly limited legal effect, especially when contrasted with the substantive provisions of the main part of the Agreement. It is argued, for example, that the preamble provides merely a context for interpreting specific provisions. Along with the 'right to regulate', the preamble also highlights expansion of trade and progressive liberalisation.

The section of the GATS that has galvanised the attention of those concerned with governments' right to regulate appears within *Article VI.* This requires that measures imposed by governments do not act as unnecessary barriers to trade.

> 4. With a view to ensuring that measures relating to qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade in services, the Council for Trade in Services shall, through appropriate bodies it may establish, develop any necessary disciplines. Such disciplines shall aim to ensure that such requirements are, *inter alia*:
>
> (a) based on objective and transparent criteria, such as competence and the ability to supply the service;
>
> (b) not more burdensome than necessary to ensure the quality of the service;
>
> (c) in the case of licensing procedures, not in themselves a restriction on the supply of the service.

Negotiations are currently underway in the GATS Working Party on Domestic Regulation to secure agreement on the suitable 'disciplines' by which Member countries will abide when formulating measures to regulate foreign and local service providers on an even-handed basis.

The necessity test—especially the requirement that regulatory measures be no more trade restrictive than necessary—is the means by which an effort is made to balance two potentially conflicting priorities: promoting trade expansion versus protecting the regulatory rights of governments. What concerns GATS detractors is that the alleged commercial bias of the WTO and its closed dispute settlement procedures do not constitute a proper place to balance these potentially conflicting priorities.

It has also been argued that the broadly worded restrictions of *Article VI.4* will have a 'chilling effect' on domestic regulation. That is, governments will be reluctant to press ahead with certain regulations for fear that they might, for example, be 'more burdensome than necessary to ensure the quality of the service', and thereby expose the government to dispute proceedings in the WTO tribunals. Unlike the 'national treatment' and 'market access' provisions, where a government can specify country–specific limitations in its schedule of commitments, domestic regulations subject to *Article VI* cannot be entered into the schedule as limitations.

In response to such arguments, GATS supporters point to the General Exceptions of *Article XIV*. This article states that Member governments shall not be prevented from adopting and enforcing certain specific kinds of regulations—such as measures 'necessary to protect public morals or to maintain public order' or which are 'necessary to protect human, animal or plant life or health'—provided that such

measures are neither 'arbitrary or unjustifiable discrimination' nor 'a disguised restriction on trade in services'.

However, critics say it is unclear whether a Member country can simply *deem* a certain regulation to be necessary, and thereby have it exempted, or whether a Member country actually has to *demonstrate* to the WTO that a measure it has adopted (a) pursues one of the objectives that *Article XIV* considers legitimate, (b) satisfies the qualifying language of the specific exemption invoked, and (c) is not an arbitrary discrimination or disguised trade restriction. Critics have further noted that, unlike its equivalent GATT Article XX, the GATS *Article XIV* omits the GATT reference to exemptions for measures that are "related to the conservation of exhaustible natural resources."

The views about how the GATS impacts upon the regulatory activities of governments at all levels are probably the most polarised of all the conflicts that have arisen between supporters and detractors of the GATS. Because almost none of the GATS provisions have been tested before a WTO disputes tribunal, speculation is rife about how provisions would be interpreted in various circumstances. Worst case scenarios abound, as do earnest reassurances about the benign operation of the GATS.

For some, notions such as 'liberalisation' convey positive qualities of opportunity and mutual benefit, while for others 'liberalisation' is code for privatisation and exploitation. From both sides flow disparaging remarks about each other's attempts to justify their claims. The task is to create a space in which the views of all can be weighed and tested, and where the meaning and implications of the GATS provisions can be brought to something approaching consensus.