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Assessment of Trade in Services

The attached communication has been received from the above-mentioned delegations with the request that it be circulated to Members of the Council for Trade in Services.

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1. This paper is a follow-up and elaboration of key points made in the previous paper on assessment of trade in services (S/CSS/W/114, 9 October 2001). It reinforces the call to commence assessment of trade in services and that a first initial assessment is carried out by March 2002. As stated in the earlier paper, further negotiations may only commence after conclusions from this first assessment have been drawn, and negotiations should be adjusted in accordance with these conclusions.

2. Given the Doha Declaration dates for services negotiations, it is all the more imperative that the assessment is commenced as soon as possible. It is important to underscore the fact that assessment has been mandated in Article XIX:3 of the GATS, as well as in paragraph 14 of the negotiating guidelines. There is already sufficient evidence to conduct an assessment, which, as set out in the previous paper, could also be qualitative in nature.

A. REASONS FOR LARGE DISCREPANCY IN THE NUMBER OF SECTORAL PROPOSALS

3. Assessment of liberalization of trade in services is in fact critical given the many proposals already on the table, and, especially given the large discrepancy between the number of proposals from developed and developing countries. The many proposals from developed countries as compared to the considerably fewer proposals from developing countries illustrate:

(a) The huge difference in export capacity between developed and developing countries in the supply of services. While developing countries do have export interests in services, in comparison to developed countries, capacity is small. A big part of this problem is because developing country service suppliers are unable to compete in many sectors which are already dominated by multinational corporations from only a few countries.

(b) This difficulty in competing with the multinational corporations can be seen by the monopoly of services exports by the US and European countries. For instance, WTO's own statistical analysis (from 1997 data) indicates that the US by a huge margin vastly dominates the export market for services, with US$229.9 billion worth of exports versus $85.5 billion for its closest competitor, the UK. US also enjoys an enormous surplus in exports over imports, $229.9 billion in exports versus

$150.1 billion in imports. In contrast, for some developing countries, WTO Secretariat reports show an explosive growth in imports since the implementation of GATS. For example, Egypt's imports increased by 52% between 1996-1997.[1]

(c) The huge difference between the number of sectoral proposals between developed and developing countries also illustrates the discrepancy in preparedness by the service suppliers in the developed countries, and those in developing countries. This therefore means a big difference in the negotiating capacity between developed and developing countries. Developing countries' services industries clearly do not have the resources nor are they usually significant players in their service sector on the world market, to render them able to easily identify their export interests and the barriers preventing their access at this level. For many, export interests may be more regional.

B. IMPLICATIONS: POSSIBLE UNEQUAL OUTCOME OF NEGOTIATIONS FOR DEVELOPING COUNTRIES AND THE SUBORDINATION OF DEVELOPMENT GOALS

4. The implication of this is that the current negotiations are likely to be highly stacked against developing countries. Developing countries will be faced with many requests, but apart from some traditional sectors, will not be equally offensive in their approach. It is instead primarily the export interests of the developed countries that are aggressively driving current GATS talks. Yet at the same time, developing countries, through GATS, as well as the conditionalities imposed upon them by other financial institutions, will be under tremendous pressures to open up. The final balance of negotiations between rich and poor countries, should they proceed in this manner, would therefore be in question.

5. According to one developed country spokesperson, '*Th(ere) is an important distinction between GATS and GATT. With GATS reciprocity is not the same – there is none. If we have a strong interest in the field of health, we're not obliged to make commitments but can take advantage of opening up other markets*'.

6. Should a proper assessment not be carried out and negotiations adjusted accordingly, developing countries may, in the coming negotiations, find themselves under enormous pressure to liberalise in many sectors, without reaping reciprocal benefits.

C. DEVELOPING COUNTRIES' EXPERIENCE OF SERVICES LIBERALISATION

7. Given the above concerns, it is therefore imperative that an assessment of Members' experience not only of GATS, but also of liberalisation of services under structural adjustment is assessed, for its economic implications, and importantly, also for its social, development and welfare impacts.

8. GATS does not mandate countries to liberalise and privatise. However, it certainly does encourage and lock-in a country's liberalisation. Liberalisation in turn encourages privatisation. Many of the problems that have been experienced by countries through privatisation, could therefore well happen through GATS.

9. Developing countries have, (often as a result of pressures from the World Bank, IMF and other regional lending agencies), already had considerable experience of privatization and deregulation of services in the past 15 years. This section will focus primarily on some of the

[1] WTO 1999 S/C/W/94 "Recent Developments in Services Trade: Overview and Assessment", Background Note by the Secretariat, Council for Trade in Services, 9 February.

problems developing countries have encountered. This does not mean that privatization per se is negative for developing countries. That is not the message intended. However, what is important is that there have been some very negative experiences, particularly when theory, implemented in low income countries do not bring about the theoretical benefits. Lessons should be drawn from these experiences when looking at ways developing countries should approach GATS negotiations.

D. PROBLEMS DEVELOPING COUNTRIES HAVE ENCOUNTERED WITH PRIVATISATION

10. For developing countries, privatization by foreign companies is very much a 'natural' consequence of service sector liberalisation, since the government, and local suppliers will not be able to withstand the competition.

11. While there are positive examples, there have, undeniably also been many less successful outcomes of liberalisation and privatisation in developing countries. In many cases, the goals of poverty reduction and development have not materialized, but have even been affected negatively.[2]

12. In theory, when privatization takes place, the private sector is supposed to resolve the problems of state ownership both from a fiscal perspective, as well as from an efficiency point of view.

13. However, the theory has not stood the test when applied to many developing countries. When privatization takes place, low domestic savings and weak capital markets usually prevent the domestic private sector from participating, thus increasing reliance on foreign investment. The result is that competitive forces are less effective because of the prevalence of monopolistic market structures, and even the common practice of holding interlocking directorships.[3] The private sector, driven by profit, is likely to oppose key features for a genuinely healthy private sector – competition and regulation.

14. From a fiscal point of view, privatization, at least in theory, is supposed to give governments revenue from the sale of parastatals, as well as receive tax revenue on the profits from the privatized enterprise. They would no longer have to support loss-making enterprises. However, from the real experience of many countries, this does not happen. The reality is less attractive. Governments find it difficult to sell run-down indebted enterprises. Also, when the private sector does come in and take over, the terms and conditions are stringent, often leaving the government to bear the risks – fiscal, economic and political. For example, in one African country, a private company from a developed country has been awarded a contract to develop a power plant. However, the terms of the concession are such that the government has agreed to buy all the power produced at a price fixed in foreign exchange. This is a substantial financial undertaking for the government, while in comparison, the private contractor bears very little risk.[4]

E. THE PROBLEMS FACED VIS-À-VIS REGULATION

15. The importance of a solid foundation of adequate and appropriate regulation before investors come in, poses another problem for developing countries. The lack of proper regulation can backfire on countries' attempts to improve a sector.

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[2] Bayliss, K. 2000 "The World Bank and Privatisation: A Flawed Development Tool", Public Services International Research Unit, University of Greenwich, November.

See also Mkandawire, T. 1994 "The Political Economy of Privatisation in Africa", in Cornia G and Helleiner G. (editors) "From Adjustment to Development in Africa: Conflict, Controversy, Convergence, Consensus?".

[3] Kumssa, A. 1996 "The Political Economy of Privatisation of Sub-Saharan Africa", International Review of Administrative Sciences, Vol. 62, 72-87- Also, Adam, C. and Cavendish, W. and Mistry, P. 1992 "Adjusting Privatisation: Case Studies from Developing Countries".

[4] Bayliss, ibid.

16. Often, as compared to the developed countries, institutional capacity in developing countries is not as developed. Many countries have not had prior institutional experience. Also, the regulations put in place, (copied from developed country models) may not in fact be appropriate for their situation. In developing countries where there is regulation, it is usually based on the industrialized country model where, for example, the main utilities have specific regulatory bodies. However, where markets are smaller, industries are often monopolistic and therefore the situation, in fact, requires different and situation-specific regulation.

17. There are also cases where in spite of whatever regulation is in place, a monopolistic position of a foreign company in a market with low competition means that the legal niceties of regulation in place could be ineffective. For example, in a Latin American country, the break-up and privatization of the national railway network has been beneficial in the short run with major increases in productivity. However, this positive outcome has been overshadowed by the long-term regulatory capacity of the government. The initial regulatory framework was supposed to apply for 5 years. However, the company is already seeking deviations. Given their monopolistic position, the government's bargaining power has been considerably diminished.

18. There is therefore a major imbalance of bargaining power when developing countries are dealing with multinational companies. This must be recognized and taken into consideration in the GATS negotiations. In one developing country, the president of a major developed country had put pressure on the government to give a major gas exploration concession to one of their private companies, hinting that aid from his country may be affected if this does not happen. With such substantial power imbalances, regulatory processes will have little effect.[5]

19. All these problems that developing countries have encountered in their structural adjustment experiences should send a strong signal for more caution as we approach what could otherwise become an aggressive round of GATS negotiations. Liberalisation and foreign investment may not bring the promised benefits. Also, the weaker regulatory capacity in developing countries, and the not always appropriate regulations of the developed countries - when implemented in developing countries- should also send a signal that developing countries are not in a position to rapidly open their services markets. To do so would likely cause more damage for their long-term development. Many factors must first be put in place, such as increasing the capacity and competitiveness of local investors and suppliers, and building domestic institutional regulatory capacity.

F. Liberalisation Could Increase Prices of Some Services for the Poor

20. While it is sometimes assumed that the state and private sector are substitutable when it comes the provision of goods and services- subject to appropriate regulation- this may not be the case. Private companies' profit-driven objectives may well diverge from the public's interest. This divergence becomes extremely problematic when it comes to the provision of basic services.

21. According to World Bank analyst, Mattoo,

> 'Opening up essential services to foreign or domestic competition could have an adverse effect on the poor… If a country is a relatively inefficient producer of a service, liberalisation and the resultant foreign competition are likely to lead to a decline in domestic prices and improvement in quality. But there is a twist. Frequently, the prices before liberalisation are not determined by the market but set administratively, and are kept artificially low for certain categories of end-users or types of services products. Thus rural borrowers may pay lower

[5] Wells, L. 1999 "Private Foreign Investment in Infrastructure: Managing Non-Commercial Risk". Paper for Conference, 'Private Infrastructure for Development: Confronting Political and Regulatory Risks', 8-10 September, Rome.

interest rates than urban borrowers, and prices of local telephone calls and public transport may be kept lower than the cost of provision. This structure of prices is often sustained through cross-subsidisation within public monopolies, or through government financial support.

Liberalisation threatens these arrangements. Elimination of restrictions on entry imply an end to cross-subsidisation, because it is no longer possible for firms to make extranormal profits in certain market segments. New entrants may focus on the most profitable market segments ('cream-skimming'), such as urban areas, where network costs are lower and incomes higher. And privatisation could mean the end of government support. The result is that even though the sector becomes more efficient and average prices decline, the prices for certain end-users may actually increase or availability decline, or both."[6]

22. According to Mattoo, the evidence on the relationship between competitive market structures and wider access to services is mixed. In some cases, a positive relationship has been observed in services, such as basic telecommunications, especially in countries where initial conditions are feeble (eg. low teledensity or service rationing). However, he also points to evidence that financial services liberalisation in some countries has had an adverse effect on access to credit for rural areas and the poor.

23. The power sector offers several interesting lessons. Since the early 1990s, there have been many Independent Power Producers (IPPs) offering to distribute electricity in many developing countries. They seemed to be an attractive option, since they can facilitate investment where a bankrupt public sector cannot. However, more and more governments have run into problems with them in countries where these arrangements have been established. In countries, such as Philippines and Dominican Republic, electricity utilities have been crippled by payments due to these independent producers.

24. Institutions such as the World Bank have portrayed agreements with Independent Power Producers as enabling developing country governments to conserve limited public resources for other priorities. However, according to analysts Hall et al:

'This is misleading. Investors in an IPP will not construct (or buy) a power plant unless they are sure they will be repaid (with a profit margin), and so usually require that a power purchase agreement (PPA) is in place. Under the terms of a PPA, the electricity utility undertakes to buy (usually) all the power produced by a power plant. The price of the power (usually in foreign currency) and the amount to be sold are specified.'[7]

25. The analysts therefore conclude that in fact, the government is guaranteeing the IPP investors to raise finance and insulating them against risks, not the other way round. The experience of several governments is that they have ended up with increasing debt, as a result of these arrangements.

26. In the Philippines, for example, the electricity utility has amassed debts of around $9 billion as a result of obligations under the Power Purchase Agreements with IPPs. In the Dominican Republic, debts have amounted to $135 million. Electricity charges increased by 51 per cent upon privatization. People protested by withholding payment of bills which landed the government in debt. As a result of arrears, power supplies are being cut, leading to blackouts affecting the economy.[8]

[6] Mattoo, A. 2001 "Trade in Services: Using Openness to Grow", forthcoming.

[7] Hall, D. and Bayliss, K. 2000 "Independent Power Producers: A Review of the Issues", Public Services International Research Unit, University of Greenwich, November.

[8] Hall and Bayliss, ibid.

G. RECOMMENDATIONS

27. While the experiences cited above have largely been the result of structural adjustment programmes, nevertheless, these are extremely relevant since the GATS is promoting a similar model of services liberalisation. We therefore underscore the need for an initial assessment to commence immediately, before Members, in good faith, undertake further commitments. This assessment should:

(a) Not only take into account countries' experience of GATS, but in fact, Members' experience of services liberalisation in general. There is much existing literature on the structural adjustment experiences of countries, not only documented by the World Bank and IMF, but also by other independent research institutes. These studies should be collated for a more holistic perspective and take into account the economic, social, and development implications.

(b) The assessment should proceed no matter how incomplete statistics are. Statistics should and must be complemented by a qualitative assessment, as outlined in the questions in the earlier paper.

(c) The knowledge we have attained through the WTO's Trade Policy Reviews (both from the government and WTO reports) should also be incorporated into the assessment.

(d) The on-going assessment exercise should involve a variety of stakeholders – international organizations, such as the WTO and UNCTAD, as well as other relevant agencies.

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