

# BACKGROUND briefing

MARCH 2003

## 5 Services and Developing Countries

**The efficiency of the service sectors is a major determinant for development and therefore liberalisation of trade and investment in services should be a key element of policy reform.**

*Clare Short, Secretary of State for International Development, Speech to Ministerial Roundtable on Trade and the Least Developed Countries, London March 2001*

This background briefing sets out some background to the current negotiations on trade in services and seeks to explore some of the implications of the negotiations for development.

### What is trade in services?

International trade can be split into two categories: trade in goods and trade in services. International trade in goods involves the movement of objects between countries and across borders. International trade in services has been defined as trade in 'anything you cannot drop on your foot'. Broadly speaking, a service is a product which cannot be seen or touched (like banking services, tourism services or telecommunications), whereas a good is a tangible object (clothing, food, vehicles).

Trade in services can happen in a variety of different ways. For example an insurance company in one WTO member might supply its services (ie sell insurance policies) in the market of another WTO member by establishing a commercial presence in that market or direct by electronic means across a border. Alternatively, a family might take a holiday overseas. In each case these actions represent international trade in services.

Trade in services accounts for over 20% of world trade, amounting to \$1350 bn in 1997. Developing countries produce one fifth of this, and some feature among the top 25 services exporters (China, Malaysia, Thailand).

### What is the GATS?

The General Agreement on Trade in Services (GATS) was agreed under the Uruguay Round of multilateral trade negotiations and came into force in 1995. It sets out a framework of legally binding rules governing the conduct of world trade in services. It is supported by a number of specific commitments undertaken by individual Members of the World Trade Organisation (WTO) in specified service sectors or across a particular mode of supply (see box 1). These commitments stop Members from changing their domestic law to introduce new barriers to entry into these specified markets or modes.

Countries are free to regulate their domestic markets as they wish, but the purpose of trade negotiations in services is to remove unnecessary regulation. This will make it easier for domestic and foreign companies to do business and will encourage economic growth in all countries – developed and developing.

Some one in five of the world's population live in extreme poverty. Governments worldwide have agreed to work together to halve the proportion of people living in extreme poverty by 2015, and to other targets including universal primary education and improved healthcare. The UK Government is strongly committed to these targets.

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# 1

## Modes of Supply

Trade in services is a more difficult concept than trade in goods. The GATS has identified four 'modes of supply' for services which represent different forms of international trade:

- **cross-border** (trade that takes place from the territory of one country into another e.g. e-commerce or telecoms)
- **consumption abroad** (consumption of services in another country e.g. tourism)

- **commercial presence** (establishment of a firm from one country in the territory of another – particularly important for financial services and professional services)
- **movement of natural persons** (the ability for nationals to work overseas for a temporary period).

# 2

## GATS principles

The GATS is based on 3 principles, 'most favoured nation', 'national treatment' and market access.

- **'Most favoured nation'** (MFN) means treating all trading partners equally, and applies to all services unless they are explicitly excluded from the GATS or exempted by individual Members.
- The **'national treatment'** rule requires Members to treat foreign and domestic

service suppliers equally. In this case, individual countries choose which sectors and modes of supply are going to be accorded national treatment and where limitations apply.

- **Market access** commitments require Members to treat services and services providers no less favourably than is provided for in their schedules. There is no general obligation to grant a firm the right to enter a market or to do business in its preferred manner.

## How does the GATS work?

Under successive rounds of negotiations, aimed at progressive liberalisation, Members individually choose in which sectors they want to make binding commitments, and in which they do not. This is known as a 'positive listing', or a 'bottom-up', approach. Negotiations normally proceed on the basis of requests and offers; that is, countries request each other to consider liberalisation in particular sectors, and respond with offers. Agreement to liberalise is not reached until all participating Members – including developing countries – are satisfied with the total package being offered.

The new round of GATS negotiations was launched on 25 February 2000. A stocktaking meeting in March 2001 reviewed the progress so far. Negotiating Guidelines and Procedures<sup>1</sup>, which

outline principles for the rest of the negotiations, were adopted by consensus among all Members. The Guidelines and Procedures are largely based on a text that was initially prepared by a group of developing countries. Agreement of these guidelines allows the request/offer phase of negotiations to begin<sup>2</sup>.

At the fourth WTO Ministerial meeting in Doha in November 2001, WTO members reaffirmed these Guidelines and Procedures and set deadlines for the initial requests and offers that members will make to each other.

## The UK and the GATS

By convention, the European Commission acts as lead negotiator and speaks on behalf of EU Member States in the WTO on the basis of positions agreed with all EU Member States. The Nice Treaty will

<sup>1</sup> See [www.wto.org](http://www.wto.org)

<sup>2</sup> An outline of the progress of the negotiations is to be found at [www.dti.gov.uk/worldtrade/service.htm#summary](http://www.dti.gov.uk/worldtrade/service.htm#summary)

introduce Community competence and qualified majority voting to most trade in services.

The Department for Trade and Industry (DTI) consults closely with other government departments, including DFID, before agreeing the UK position. DFID's role is to ensure that this position properly reflects development considerations.

### **How can developing countries gain from the GATS?**

Services are potentially a significant source of economic growth for developing countries. The development of services domestically, particularly in the finance and telecommunications sectors, can facilitate growth in other parts of the economy. Without such growth, sustainable poverty reduction will not be achieved. Services liberalisation can act as a spur to domestic reform, encouraging more efficient, varied and competitive markets at home. It can provide access to new markets overseas and can encourage foreign investment.

Many developing countries have liberalised beyond their commitments, and GATS 2000 is an opportunity to make these commitments binding, and take liberalisation forward by going beyond the current levels. Binding liberalisation (ie undertaking not to change regulations to make them more restrictive) creates a fair and secure environment for the investment which could encourage economic growth. Where countries are not ready to open up particular markets, they can gain by pre-committing to liberalisation at a future stage – as some did in the 1997 telecommunications negotiations. Phasing in liberalisation in this way would provide a framework for domestic reform, as well as external assistance.

There are many examples of sectors where developing countries have a comparative advantage in trade in services. For example, China and India are significant exporters of construction services, India and the Philippines specialise in software and data processing exports. Many of the smaller developing countries are specialising in tourism services. Developing countries also want to see removal of restrictions on the movement of natural persons. While developed countries are cautious about this, there is scope for liberalisation of this mode of supply, as all countries recognise

that it would be of benefit to their services industry if individuals could supply services abroad more easily. This area is currently under discussion in the GATS negotiations.

### **Will developing countries be forced to liberalise under the GATS?**

The GATS is a very flexible agreement. It operates on the basis of a 'bottom up approach', which means that each WTO member country may choose both the sectors in which and the extent to which they liberalise further. Every member is free to decide for themselves whether or not opening a particular service to external trade is appropriate and advantageous to them. There is nothing in the agreement that forces privatisation on an unwilling government.

The GATS has been accused of being dominated by multinational companies. But the WTO is an organisation of governments, not of commercial bodies. Companies can lobby their own governments with their concerns, as can any civil society group, but ultimately WTO rules are agreements resulting from negotiations among all its member governments and are ratified by members' parliaments. The rules apply to everyone and as such, they help prevent the biggest and strongest countries from being able to exploit those in a weaker position. We consider it vital to strengthen and support these rules rather than cast them aside.

It is important for all countries that world trade is governed by rules which are fair and transparent, but particularly so for developing countries. The WTO is the forum in which the rules are agreed. Many developing countries have chosen to join the WTO; they now comprise over two thirds of WTO membership.

To counter any risk that developing countries will be prevented, through lack of capacity, from gaining the maximum potential benefit from the negotiations, the UK government is working closely with developing countries to help them make the most of the opportunities which are available.

### **Will the GATS stop governments from regulating?**

The introduction to the GATS specifically recognises the sovereign right of governments to regulate, and to introduce new regulations on, the supply of

services in their territories in order to meet national policy objectives. The Working Party on Domestic Regulation is seeking to ensure that such regulation is transparent, fair and effective.

### Are there any special provisions for developing countries?

Articles IV and XIX of the GATS contain special provisions reflecting the interests of developing countries. In considering progressive liberalisation, the GATS provides that there shall be appropriate flexibility for individual developing country Members (especially least-developed countries) for opening fewer sectors, liberalising fewer types of transactions, progressively extending market access in line with their development situation and, when making access to their markets available to foreign service suppliers, attaching conditions aimed at:

- the strengthening of their domestic services capacity and its efficiency and competitiveness, including through access to technology on a commercial basis

- the improvement of their access to distribution channels and information networks
- the liberalisation of market access in sectors and modes of supply of export interest to them.

### What if a country later finds that a particular sector should not have been liberalised?

Having made a GATS commitment, a government cannot immediately change its policy. However, a commitment may be modified or withdrawn under Article XXI of the GATS three years after it has entered into force.

In addition, Article XIV of the GATS allows for the adoption of measures necessary to protect human, animal or plant life or health. The waiver in the Agreement may be implemented as a last resort. Furthermore, WTO members are discussing the possible introduction of a safeguard clause into the GATS to allow for emergency temporary suspension of commitments.

## 3

### The case of water privatisation in Cochabamba, Bolivia

- In 1999 the Bolivian Government privatised the water system of the city of Cochabamba. This was badly managed, and the price of water rose significantly. The Government reversed the privatisation. It has been suggested that the GATS will lead to more situations of this kind. In fact, the Bolivian government had made no GATS commitments to liberalise the water sector, so this case of privatisation was not related to the GATS.
- The situation was related to the proper management of privatisation rather than the impact of the GATS. It was reported in the Financial Times Global Water Report, issue 93, 14th April 2000 and the Observer 23rd April 2000.
- Clearly the situation in Cochabamba continues to be complex. Only 60% of the population in Cochabamba is supplied with safe drinking water. The situation is becoming more acute because of a depleting ground water resource and a growing population. Poor people buy their water from vendors at significantly higher cost than those supplied from the main system.
- DFID is currently supporting research to understand what structures and safeguards are necessary to ensure that poor people can benefit from safe and affordable water supply, where the private sector is involved. The intention is to ensure that, in future, the private sector responds to the needs of the poor as well as the better off. We also make available funds through an advisory facility for governments and municipalities to draw on, to ensure that they do not embark on a course that is going to lead to the sort of problems experienced in Cochabamba.

## How does the GATS affect public services?

Services supplied in the exercise of governmental authority are explicitly excluded from the GATS and there has never been the slightest sign that any government wants to change that. Such services are those “which [are] supplied neither on a commercial basis, nor in competition with one or more service suppliers”. This is intended to exclude public services such as health and education services (although private services are covered by the GATS). Such services are not supplied for profit, nor do they compete with privately supplied services (which are covered by the GATS).

## What is the Government doing to help developing countries gain from the current GATS negotiations?

The UK Government’s White Paper *Eliminating World Poverty: Making Globalisation Work for the Poor*<sup>3</sup>, published in December 2000, pledges to work with others to strengthen the capacity of developing countries to participate in international negotiations and to take advantage of new trading opportunities.

DFID is contributing to a World Bank Programme on Trade in Services, to help developing countries formulate negotiating positions. We will also support developing country representatives in Geneva to participate in the negotiations.

<sup>3</sup> [www.globalisation.gov.uk](http://www.globalisation.gov.uk)

## In conclusion

The UK Government supports continuing reductions in barriers to trade, both in developed and developing countries, and is working to improve the capacity of developing countries to take advantage of new trade opportunities. Support for open trade is, however, not to be confused with unregulated trade. In the White Paper *Eliminating World Poverty: Making Globalisation Work for the Poor*, the Government pledges to press for trade policy – and complementary economic, social and political policies – to be built into developing countries’ poverty reduction strategy papers, such that the potential benefits of liberalisation may be realised. Much more needs to be done to ensure that developing countries benefit from the negotiations. DFID is working on long and short term capacity building for trade in services.

Further liberalisation under the GATS would be a positive step for developing countries. They could increase their economic growth and so contribute to the reduction of poverty. Income could be generated from individual service sectors where they have natural advantages, for example, tourism. Increased competition in areas such as banking, transport and telecommunications would provide more efficient and effective services at home.

This background briefing forms part of the Trade Matters series. A summary of DFID's policies on trade and development is contained in the **Why Trade Matters** booklet. To obtain further publications in this series, please visit our website at [www.dfid.gov.uk](http://www.dfid.gov.uk) or contact the Public Enquiry Point (address details on page 1).

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