

# **NON-FINANCIAL SERVICES IN THE DOHA ROUND: SUMMARY AND RECOMMENDATIONS**

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## **1. Background**

This paper is on the services negotiations at the World Trade Organization (WTO), focusing on non-financial services. It was written in response to a request by Ecuador to map out the issues in the negotiations and to point to some policy implications.

There are two main aspects to the WTO services negotiations – market access and the establishment of new rules (domestic regulations, government procurement, subsidies and emergency safeguards). The paper covers both aspects, although the main focus is on market access. Since there are also important trade and investment negotiations that cover services outside the WTO, the paper also deals briefly with bilateral free trade agreements (FTAs), and bilateral investment treaties (BITs).

## **2. The importance of an appropriate and supportive services policy for development**

In most developing countries, services are a significant part of the economy and a large employer. Services also support other sectors such as manufacturing and agriculture. Therefore it is important to have an optimal services policy that suits the developing country's level of development. This services policy should be based on the country's development goals and plans and it should support and enable these development objectives, rather than being an end in itself.

The decision as to whether to liberalise services and investment should therefore only be made once this services policy is in place and the decision should be made in accordance with this services policy and development plan.

## **3. Why the degree of liberalization is an important part of services policy**

The degree of liberalization is an important issue for national development. One of the key policy issues in services is the extent to which a developing country should develop and expand its domestic services (public sector and private enterprises) and the extent to which it should open up to foreign participation and at what pace and in which ways the liberalization should be carried out. Developed countries advocate for developing countries the fastest and broadest liberalization in services. Institutions such as the World Bank also encourage or pressurize developing countries to liberalise services on the ground that they can become more efficient. However it is wiser for developing countries to take a cautious approach towards services liberalization.

There are several reasons why it is important for a developing country to maintain a significant degree of local participation (including ownership and control) over services. Presently, the services sector is in many developing countries the largest sector, and it is the area where local firms have larger participation and are better able to compete, as compared with the manufacturing sector. While it is important to upgrade technology and techniques, this can often be done by the local firms, including through importing modern technology. It does not necessarily require that large foreign firms take over, in order for a country to have modern and efficient services. Some developing countries also encourage or require foreign firms to set up joint ventures with local service firms, to enable the sharing of benefits (such as profits and technology) with the national economy.

While there are benefits to foreign investment, there are also costs, and thus a balance is required. There are good reasons for this balance and for national-interest considerations.

First, there are good macro-economic reasons. This sector usually produces services that are “non-tradables”. Thus, there is significant foreign exchange loss associated with foreign service providers, as there is an outflow of profits, while most of the output is for local use. Many developing countries have a deficit in the services component of their balance of payments, indicating a net deficit in the flow of foreign exchange on account of services. It is wise for the balance not to have a large deficit, and to prevent it from becoming larger.

For example, Ecuador already imports more than twice as many services as it exports and it has a large services deficit of US\$1.5 billion (as at 2009). Further services liberalisation at the WTO (or via FTAs) could be expected to worsen this deficit, since Ecuador cannot be expected to improve its services export capacity in the short term).

Secondly, when the government spends money on services, the multiplier effect on the national economy tends to be higher if the expenditure is on domestic services, as the money tends to stay inside the domestic economy. On the other hand, government spending on foreign services usually has higher “leakage” to outside the economy due to outflow of foreign profits and foreign payments (for example, payments to headquarters for overheads, management and license fees) and imported inputs. This is especially an important point during recessionary conditions when the government may want to increase its expenditure to stimulate the economy.

Thirdly, for economically strategic reasons, it is also important that there be a certain minimum degree of local control over economically important services sectors, particularly financial services.

Fourthly, there should be a significant degree of national control (and also public sector control) over important utilities and infrastructure that are strategic to security including water, energy services, electricity and power supply, telecommunications, transportation etc.

Fifthly, services that are essential to meet basic needs, such as water, health, transport, education, and distribution of food supply, should also be carefully guarded, with not only a significant degree of national control but also participation or ownership by the public sector.

Sixthly, there are sectors such as audio-visual services (radio, TV, video, internet services) that have an important influence over the cultural life of the country.

Developing countries need to have a comprehensive national services master plan, in order that there be a coherent policy framework. Based on such a plan and framework, the country can formulate positions based on its national interests, whether at the WTO or in a possible FTA.

#### **4. Imbalances in the WTO Services Agreement**

The developing countries that were relatively active during the Uruguay Round initially resisted the inclusion of services in the Uruguay Round itself and later in the WTO. However they eventually gave way. The basic imbalance or inequity in the services agreement in the WTO or in FTAs (free trade agreements) is the great difference in capacity of service firms in developed and developing countries. Developed countries have large service firms, which are able and eager to enter developing countries, whereas most developing countries like Ecuador have small service firms that are unable to establish themselves in developed countries, nor can they compete if the big foreign firms enter their home markets.

Because of this, developing countries tend to have deficits in their services account of the balance of payments. Liberalisation as a result of WTO or FTAs will tend to worsen the situation. According to the WTO secretariat, Ecuador recorded a deficit on its international services trade averaging around US\$570 million between 1999 and 2003, with exports of services during this period averaging roughly US\$850 million, and imports US\$1,420 million. By 2009 the services deficit had risen to US\$1.5 billion.<sup>1</sup>

*Thus, Ecuador has to be cautious about further liberalisation in services as it is already a net services importer with a deficit which is contributing to its existing balance of payments problems, and it cannot be expected to increase its services exports significantly in the short term.*

Developing countries could benefit in services if the developed countries liberalise in Mode 4 (labour movements) but this has not been the case and the likelihood is that there will in future be tighter control rather than relaxation of their labour market.

*Ecuador, together with some countries, may wish to undertake deeper analysis on the imbalances in the services agreement and make some proposals on how to rectify the situation.*

#### **5. Make Use of Development Flexibilities in GATS and the Doha Round**

Nevertheless, the developing countries succeeded in putting a number of development dimensions and safeguards in the WTO's General Agreement on Trade in Services (GATS) that

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<sup>1</sup> [http://www.wto.org/english/res\\_e/booksp\\_e/anrep\\_e/trade\\_profiles10\\_e.pdf](http://www.wto.org/english/res_e/booksp_e/anrep_e/trade_profiles10_e.pdf)

allowed developing countries the policy space to choose the sectors and the extent as well as the speed in which they would like to commit to liberalise.

In the new round of services negotiations, many developing countries have attempted to make use of the flexibilities in GATS, to choose their own pace and sectors to liberalise. They have been cautious about increasing their binding commitments at the WTO, because (1) they are worried about the possible consequences, especially since it is difficult to backtrack, even if the commitment turns out to be an error; (2) they are unable to benefit from the liberalization of other countries, due to supply constraints (and due to continued protection of the labour market in the North) and thus if they were to themselves liberalise, they would have more costs than benefits; (3) they are within their rights to choose whether to liberalise, in which way, and in which sectors, if at all.

*Ecuador should analyse all the existing flexibilities in GATS and the Doha services negotiations and make full use of these flexibilities for its development objectives. It has the right and the policy space to choose whether to liberalise, and in which sectors, to what extent and when.*

## **6. Be on Guard Against New Attempts to Pressure Developing Countries in GATS liberalisation**

In 2001, when the new round of services negotiations began, the WTO members adopted the Services Guidelines to guide the negotiations. The Guidelines were rather development-friendly as they recognized the policy flexibilities for developing countries to liberalise in fewer sectors and at their own pace.

However, the developed countries were unhappy by what they perceived as the slow movement by developing countries in the WTO as their large services firms have been eager to get entry into the developing countries' markets. They have continuously made attempts to introduce new principles and methods, to get developing countries to commit to liberalise in a significant portion of the services sectors. These attempts include "benchmarking" (requiring developing countries to make commitments in a significant number of sectors), liberalizing in "clusters" of sectors (so that more sectors are covered), and binding the present actual levels of liberalization of various sectors as commitments under GATS. An attempt in 2008 to adopt a report by the Chair of the Services negotiations that called on countries to bind their present level of commitment in the WTO schedules, and to increase their liberalization in other areas, was stopped only because of opposition by four countries (Bolivia, Venezuela, Cuba and Nicaragua).

*These attempts have so far largely failed, but the developed countries are expected to make new attempts in 2011 due to the new intensive phase of negotiations to try to complete the Doha Round. Thus, Ecuador and other developing countries should be on their guard to prevent new attempts along similar lines. Ecuador may join other countries in resisting such fresh attempts.*

## **7. WTO's Plurilateral Services Negotiations**

On the methods of negotiations, the normal bilateral request-and-offer method has now been supplemented by the plurilateral approach, in which demandeurs (countries that are making demands on others to liberalise) and target countries (those who are facing the demands to liberalise) form groups of about 20-30 members to negotiate to liberalise in various sectors. Over 20 such groups have been formed. The members are mainly developed countries (who are the main demandeurs) and some middle-income developing countries. The majority of small economies, and the LDCs, are not expected to be in these groups.

*Ecuador and other countries can continue to insist that participation in such groups is on a voluntary basis, and that no country (especially small economies) should face pressures to become a target country or to participate in any of the plurilateral groups.*

## **8. Negotiations on Establishing New Rules in Services.**

The Doha negotiations also include establishing new rules in services. The proposals for establishing these rules (disciplines on domestic regulations, government procurement, subsidies and emergency safeguard measures) may alter the conditions under which national regulations are made. They could have negative or positive effects. Developing countries therefore have an important stake in these negotiations.

The main negotiations are on domestic regulations disciplines, and the rules being proposed may have some important effects that limit the ability of developing countries to regulate their services. Developing countries are advocating that they be given more flexibilities to regulate.

The proposal to liberalise government procurement business to foreign firms is seen as a risk to developing countries, which usually provide preferences to local companies. On the other hand, developing countries want to establish "emergency safeguards" so that they can be allowed to suspend their obligations if they face an emergency situation.

*Ecuador should play an active role in these negotiations and join with other like-minded developing countries to protect its interests, especially its policy space to be able to regulate its domestic regulations. It should also analyse the implications of the proposed rules for the implementation of its Constitution and its National Plan for Good Living. (See the main paper for tables presenting a preliminary assessment of these implications.)*

## **9. Avoid FTAs or EPAs with Services or Investment Components**

Developed countries have placed services and investment at the centre of bilateral and plurilateral FTAs and economic partnership agreements (EPAs). The principles and provisions of the services component or chapter of these FTAs are counter to development principles, and are more extreme than the demands made through the WTO's services negotiations. It is not necessary to have services in a FTA; however if it is included, then the countries have to provide

“substantial sectoral coverage” in their liberalisation (or of a large number of sectors), according to GATS. Developed countries take advantage of this and pressurize developing countries to open up many of their services through the FTAs. This would have detrimental effects on the local service firms which are unable to compete with the large foreign firms.

*Developing countries like Ecuador should avoid such FTAs or at least insist on excluding services from an FTA or EPA involving a developed country as a partner.*

## **10. Formulate a National Services Policy**

*Developing countries like Ecuador should as a matter of priority have a National Services Policy, in the same way that many countries have an Industrial Policy or an Agriculture Policy. Such a Policy is necessary to guide the position that Ecuador is to take with regard to trade or investment negotiations (whether multilateral or bilateral).*

Such a Services Policy would have to incorporate the country’s needs and policy objectives, its productive capacity and ability to compete with large foreign companies, and its need for regulation and for participation of the domestic firms and agencies (public and private) in the various sectors. Consideration should be given to critical services that are important to the economy (finance), to security (telecommunications, energy, power and electricity, water), to public needs (water, education, health, food distribution) and to information and culture (audio-visual services etc), so that a critical minimum of local participation (and public sector participation) is secured. For these critical sectors, there should be a very cautious approach taken on liberalisation to foreign firms through the WTO or through FTAs, as local control over these sectors is important.

## **11. Distinguish Between Actual Liberalisation and Liberalisation Commitment under GATS**

*In such a policy, it is important to distinguish between actual liberalization and a commitment to liberalise under the WTO or a FTA.*

It may be useful for a country to liberalise in order to obtain some benefits from foreign participation in certain areas, but refrain from making a binding commitment of this liberalization in the WTO. Thus, if the country wants to reverse that policy later, it has the policy space to do so. Whereas once a commitment is made in the WTO or via an FTA, compensation has to be provided if a policy reversal is needed.

## **12. Implications of Ecuador’s Constitution and National Plan for Good Living for Services Policy**

*For Ecuador, the national services policy should take into account its Constitution and the National Plan for Good Living.*

The implications of these two key documents for a national services policy will be very important. An attempt to show some of these is the Table in Annex 1 of the main paper, which provides details of some of the provisions of the Constitution and the National Plan, and how these have implications for Ecuador's positions in trade and investment negotiations in various fora.

Ecuador's Constitution (2008) and the National Plan for Good Living (NPGL), 2009-2013 must be complied with and they provide the principles, objectives and policy guidelines for any services or investment liberalisation. Therefore where the Constitution and NPGL establish requirements for Ecuador's position on services or investment, Ecuador may not compromise on these positions during bilateral, regional or international negotiations in any fora.

Some of the ways in which the Constitutional and NPGL provisions can be translated into services liberalisation or investment liberalisation or protection principles, objectives and policy guidelines are set out in the Tables in Annex 1 of the main paper. These include analysis of the ways in which services liberalisation may make it difficult to implement tobacco control and provide free health care sustainably.

The Constitution also requires priority to be given in public procurement to domestic goods and services. This makes it clear that Ecuador cannot agree to the current negotiations to liberalise government procurement at the WTO or in an FTA.

The Constitution clearly prohibits:

- the application of international trade instruments from undermining directly or indirectly the right to health or services
- Ecuador's entry into treaties that allow investor-to-state dispute settlement

The National Plan for Good Living (NPGL) prohibits the negotiation of agreements resembling FTAs.

The NPGL requires foreign direct investment to be provided with transfer of technology. This requirement would need to be listed as a national treatment limitation in any services and investment commitments and the Tables discuss other possible restrictions on technology transfer requirements that Ecuador would therefore need to avoid in any trade or investment negotiations.

The domestic regulations disciplines being proposed at the WTO, if agreed and applicable, may also make it difficult to comply with a number of the social (including labour law), cultural, environmental and economic requirements set out in the Constitution and NPGL as the Tables in Annex 1 indicate.

(Summary of Paper prepared for the Government of Ecuador, 2011.)

