



Why Inclusion of Services in the EPAs is Problematic: Legal and Development Implications

I. Introduction

Regional Trade Agreements (RTAs) are an important instrument in international trade. RTAs create bigger markets through reduction or elimination of tariff and non-tariff barriers to trade between members. Traditionally, these Agreements have focused on the liberalization of merchandise trade among members. However, new trends show inclusion of services. Examples include the Chile, Singapore Free Trade Agreements (FTAs) with the US, and the North America Free Trade Agreement (NAFTA), which have provisions allowing temporary entry of business professionals into member countries to facilitate trade in services.¹ The Southern African Development Community (SADC) has been negotiating a draft protocol on

energy, transport, telecommunication and other services. Among the roughly 153 RTAs operational in the world today, 43 are economic integration agreements notified under the WTO's General Agreement on Trade in Services' (GATS) Article V.² Increase in coverage of services makes RTAs an important tool in harmonizing regulation, and enhancing market access.

II. The Role of Trade in Services in ESA Countries

Services trade is an increasingly important economic activity for countries across the globe. Figures from the UNCTAD *Handbook on Statistics* indicate that services trade is growing, making bigger contributions to the gross

Executive Summary

The outcome of Economic Partnership Agreement (EPA) negotiations will change a decades-old reciprocal trading regime between the European Union and African Caribbean Pacific (ACP) countries. This Policy Brief analyses legal and development implications for Eastern and Southern African (ESA) countries in negotiating trade in services under the EPAs. It concludes that ESA countries should focus on developing domestic capacity to provide universal access to basic services, develop export capacity in niche sectors, design and improve regulatory capacity and mainstream intra-regional trade.

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domestic product of countries.³ For the period 2000-2003, trade in services represented 16 per cent of the total trade of developing countries, expanding at the same pace as their trade in goods. While the share of workers employed in services activities is about 30-40 per cent in developing countries as a group, it has reached 53 per cent in some developing economies and hovers around 70 per cent in most developed countries.⁴

The countries that constitute the ESA negotiating group are Burundi, Democratic Republic of Congo, Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Uganda, Zambia and Zimbabwe. Many ESA countries are the least developed in the world, with weak services sectors. A real challenge these countries face is ensuring universal accessibility to basic services such as health, education, sanitation, and water. In such cases, services play a key role in basic livelihood, poverty alleviation, and the achievement of social and development objectives. Services are also a hub for economic activity (tourism, professional services), and provide interconnectivity (through distribution, telecommunications, financial services), with other important sectors of the economy like manufacturing, and agriculture.

World Bank statistics indicate that the services sector contributes up to an average of 50 per cent to Gross Domestic Product (GDP), in many ESA countries.⁵ However, the participation of these countries in international trade in services, through their exports, is very low accounting for only about 0.5 per cent of world exports.⁶ More than half of these exports have been destined for Europe, with about 77 per cent of these accruable to the transport and travel services. Tourism in particular has stimulated exports in these two sectors, with its importance in most ESA countries (Malawi, Mauritius, Seychelles, Uganda and Rwanda), forming about 50 per cent of total commercial services exports.

ESA countries have, for a long period, relied on agriculture, for exports and GDP earnings. In these countries, services trade capacity, infra-

structure and regulation is weak owing *inter alia* to the fact that for a long time, services were viewed as non-tradable, with monopoly provision from the State in sectors like health, education, banking, telecommunication, and transport. In the mid-1980s, the International Monetary Fund (IMF), World Bank-led de-regulation process led to privatisation of many previously State-provided services. This resulted in an unprecedented wave of unilateral services liberalisation. The absence of efficient regulation, institutional and administrative structures to shoulder the challenges and risks that came with this liberalisation, led to untold reduction in welfare. Governments are now looking at alternative ways in which their services sectors can be propelled to contribute to their development objectives. The challenge is how to draw lessons from the past failures, yet balance it with renewed efficient regulation and institutional frameworks to oversee the performance of the various sectors (and sub sectors), so that liberalisation of trade in services can contribute to the attainment of overall national development objectives. This policy brief seeks to analyse whether EPA negotiations can contribute to overcoming this challenge.

III. The GATS and RTAs

The Most Favored Nation (MFN) principle is a core non-discrimination principle in the GATS. It creates a right of immediate and unconditional access for all WTO Members to treatment given to services and services suppliers by one Member to another. A limited scope of exceptions, subject to conditions, is envisaged, such as in situations where members list MFN exemptions in the Annex on Article II: 2 exemptions.⁷

A key exception that allows countries to give more favorable treatment to some members *beyond* what is available for others, is that which allows countries to engage in economic integration agreements on trade in services. Article V of the GATS lays out the criteria that must be fulfilled for such an integration process to pass the test of WTO compatibility. Compatibility entails two basic conditions:

- i) The Agreement must have “substantial sectoral coverage” i.e sectors, volume of trade affected and modes of service delivery, with no *a priori* exclusion of any mode of supply; and,
- ii) It must provide for national treatment for services providers of Members eliminating “substantially” all discrimination. This can be done through elimination of existing discriminatory measures, or the prohibition of adoption of new or more discriminatory measures.⁸

These conditions must be complied with either upon entry into force of the Agreement or within a reasonable time frame thereafter.⁹ According to Article V (3), where developing countries are parties to such an Agreement, flexibility may entail the enjoyment of a wider spectrum of national treatment limitations, or the ability to open fewer sectors, a lower volume of trade and fewer modes of supply. These are entitlements for ACP countries that can be claimed in the EPA services negotiations. Further flexibility is provided in cases where the economic integration Agreement involves *only* developing countries. Here, it is allowed to give more favourable treatment to juridical persons (companies) owned or controlled by natural persons of the parties to such an Agreement. This means that developing countries, such as those in ACP, can give more favours to their own companies in the context of their own regional trade integration Agreements on services. A critical question is whether the EU proposals to ACP countries take this into account. In the following section, we take a look at the EU proposals to ESA countries and implications thereof.

IV. The EU Positions in Services and Implications for ESA Countries

The Cotonou Partnership Agreement (hereinafter referred to as Cotonou), lays out the goals of EPA negotiations as the promotion of sustainable economic growth and development and the eradication of poverty. According to Article 34 of Cotonou, “fostering the smooth and gradual integration of ACP States into the world economy” and “enhancing the production, supply and trading

capacity of ACP countries, as well as their capacity to attract investment” are the main focus. Article 35 provides that the EPAs “shall build on regional integration initiatives of ACP States”, while Article 37 suggests the establishment of a timetable for the progressive removal of barriers to trade between the parties.

African countries look at the EPA negotiations as a process that can assist them in developing capacity to overcome the challenges they face in trying to integrate and penetrate the international services market, the so-called *supply-side constraints*; such as inappropriate and weak infrastructure, and discriminatory regulatory regimes in services. The EU looks at this as a process that can lead to *enhanced market access*, building on the Lomé Conventions on establishment and services,¹⁰ which contained non-binding national treatment of national and foreign companies from the contracting parties.¹¹ In Title IX of the Lomé Conventions, the objective of covering services was given as to “support ACP States’ efforts increase their domestic capacity to provide services with a view to improving the working of their economies...” Sectors such as tourism transport and communications were singled out as priority.¹² Cotonou introduces a new dimension to the relationship on services, which focuses on *trade liberalization* and not *development of capacity*. This difference in intention and expectation is important to bear in mind in assessing the development challenges of these negotiations to ESA countries.

In order to organize EPA negotiations, the African continent was sub-divided into several negotiating groups, mostly based on existing RTAs such as CEMAC,¹³ SADC, and ECOWAS.¹⁴ For the ESA region, an *ad-hoc* group was put together consisting of some members of the Common Market for Eastern and Southern Africa (COMESA), and others. In ESA you have members of the East African Community (EAC), including Kenya, Uganda, and Rwanda, SADC including Mauritius, Seychelles, Zambia, and Zimbabwe, Economic Community of Central African States (ECCAS), including Burundi, Democratic Republic of Congo, and Rwanda; Inter Governmental Authority on Development (IGAD), including Dji-

bouti, Eritrea, Ethiopia and Kenya; and others. Tanzania, a member of the EAC is negotiating EPAs with SADC. This issue of multiple memberships is likely to produce problems at the implementation stage as we can see below in the case of national treatment obligations.

The EU is seeking *full national treatment* in ESA countries. This would mean that EU services and services suppliers get treatment no less favorable than is given to “like” ESA services and services suppliers in their various regional groupings. What this translates to is that EU companies, which already have clearly proven capacity in the provision of various services such as telecommunication (Vodacom), financial services (Standard Bank, Barclays Bank), transport services (KLM, SN Brussels, British Airways), to mention but a few, would have unlimited access to the ESA market on terms similar to local services suppliers of “like” services. ESA countries would not be able to favor domestic services suppliers. This blocks policy options and space for ESA countries to

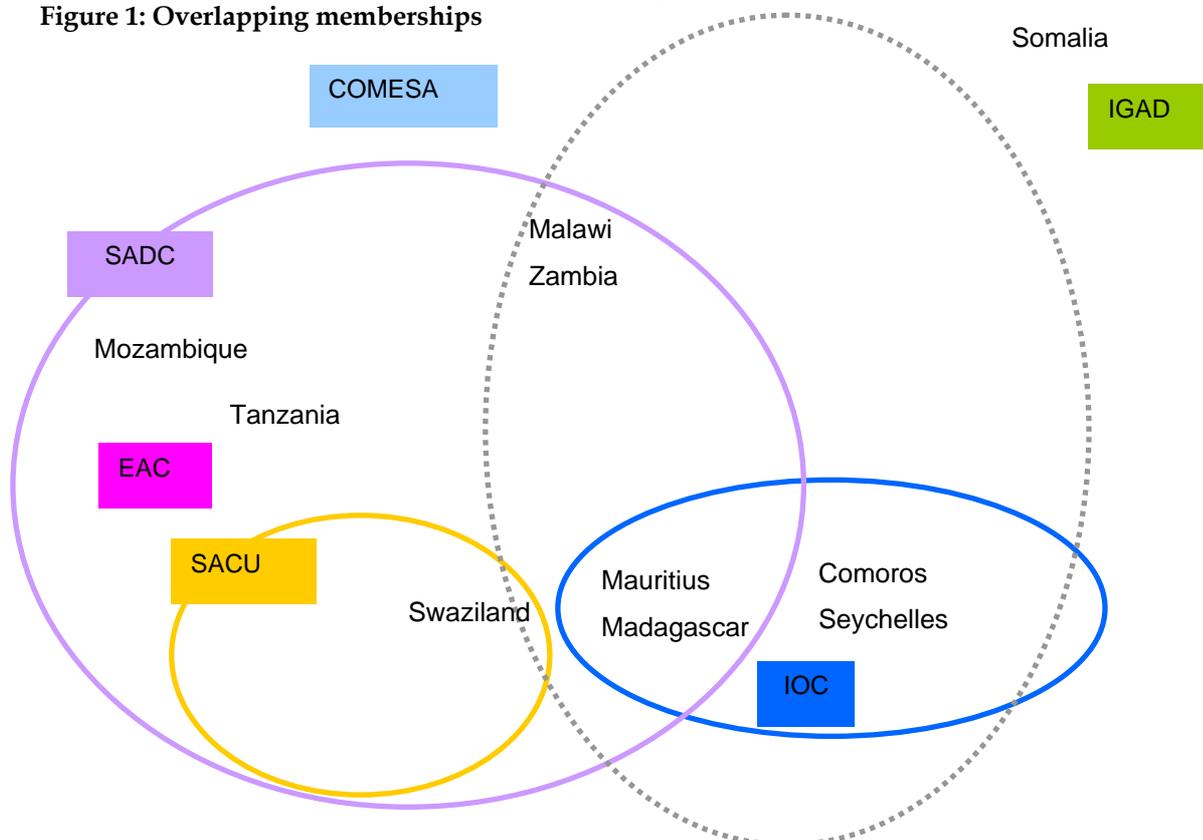
regulate in favor of increasing the participation of local services suppliers in domestic and intra-regional trade.

Since ESA is an amalgamation of many other regional groups, if the EU were to get tighter disciplines on national treatment from SADC (no national treatment), and more flexible ones from ESA, (full national treatment), this would mean that while EU services suppliers have same rights as domestic ones in ESA, they do not in SADC.

However, with the multiplicity of membership, it is likely that the SADC non-application of national treatment would be redundant, since an EU company would simply locate in Uganda, have access to Tanzania (under the EAC integration process), and therefore penetrate the SADC market (since Tanzania negotiates EPAs with SADC). By setting up presence and having substantial business operations in Tanzania, the EU company would fit within the meaning of “origin” for purposes of benefits for juridical persons and take advantage of the SADC market with similar

The figure below summarizes the ESA constituency in EPA negotiations.

Figure 1: Overlapping memberships



Source: Adapted from ECDPM. 2006. *Overview of the regional EPA negotiations: ESA-EU Economic Partnership Agreement (ECDPM InBrief 14E)*. Maastricht: www.ecdpm.org/inbrief

treatment like other SADC originating companies. Article V: 6 of the GATS provides that a services supplier of any member that is a juridical person constituted under the laws of a party to an economic integration Agreement on services shall be entitled to treatment granted under such Agreement, provided that it engages in substantive business operations in the territory of the parties to such Agreement. This means that any other companies, although non-European, that are conducting substantive business operations in Europe, will be eligible to participate in the ESA markets on the basis of the EPA. Avoiding this is a very difficult process that would require strict regulatory oversight—an unavailable luxury on the already fragile regulatory regimes in these countries.

ESA companies involved in services provision can not compete with their EU counterparts. While the EU is an important market for ESA services exports (tourism, and transport), ESA countries comprise only a fraction of Europe's import sources collectively, providing only 6.6 per cent of Europe's services imports.¹⁵ There is no credible research that shows that with a trade Agreement, this dynamic will change. In all likelihood, trade will continue to flow mainly in a one-way manner, taking full advantage of the weak regulatory capacity to extend the scope of market far and wide, beyond ESA to include all the other regional groupings that this group represents, and more.

If ESA were a solid regional grouping, the issues raised above would be dealt with on the basis of a common regional approach to regulation. Unfortunately, at this stage, the different groupings within ESA are all at very infant stages of developing regional integration policies, especially on trade in services. COMESA had planned to be a fully functioning FTA by 2000 and a Customs union by 2004. Neither of these goals has been fully achieved, although a Common External Tariff (CET) of 0, 5, 15, and 30 per cent (tariff rates) has been adopted for implementation. Currently, only six countries in this group (Democratic Republic of Congo, Eritrea, Madagascar, Malawi, Zambia, and Uganda) have maximum *ad valorem* tariff rates that place them within the range of the CET. In the case of services, only

recently has the level of discussion evolved to a framework Agreement on trade in services. The East African Community (EAC) has its own trade liberalization programme, separate from that of COMESA, not yet fully considering the liberalization of trade in services amongst each other. It is difficult to see how a reciprocal Agreement on trade in services with the EU (a fully integrated regional block); can work to the benefit of ESA (a weak and fragile region with highly fragmented policies and regulation in each of the group members on services).

In the EU request for *MFN liberalization* lies an ambition for enhanced market access for European services in ESA and all the other regional groupings in which they are party. This means that the treatment ESA countries give each other over and above that which is available to other WTO members (which is the essence of the RTA process), will be immediately and unconditionally available to EU services suppliers, and all companies undertaking substantial business operations therein. It may be argued that ESA countries will also benefit from MFN terms equivalent to the benefits that EU-Member States get. However, the important question here is whether ESA countries can actually compete in the EU market. There is still need to develop capacity to supply services efficiently. Many of the ESA services firms are small and medium size, weak in skills, having limited access to financial resources, even *for domestic expansion*.

Another argument for MFN liberalization in EPAs may be that it will lead to tremendous investment flows owing to the certainty and predictability that locking in of reforms in a trade Agreement brings. However, in the past, investment has concentrated in a few areas like banking. Even in such cases, the banks do not extend services to rural communities. In these cases, foreign investment has failed to contribute to Government's non-avoidable role of providing universal access to basic services. It is also worth noting that these investment flows have taken place in the absence of a trade Agreement.

In terms of *sectoral coverage*, the EU pro-

poses the exclusion of mining, manufacturing and processing of nuclear materials, production and trade in arms, ammunition and war material, audio-visual services, national maritime cabotage, and air transport. These are not sectors of 'sensitive' interest to ESA countries such that exclusion would raise comfort levels.

The EU also seeks *removal of quantitative restrictions* like quotas, limitations on the total value of transactions, economic needs tests, limitations on number of operations or the participation of foreign capital, or even restrictions on the types of establishments. In effect, the request is to open up a sector *totally*. This may not be the best approach in meeting national development objectives. If a country wants to increase domestic capacity in banking, limiting foreign participation might be inevitable, and yet this will be a breach of Agreement if ESA countries agree to the sorts of proposals the EU is presenting. If a country wants to target *brick and motor investment*, ceilings on initial capital cannot be avoided, yet this will contravene Agreement to no limitations on type of and amount of investment. It is worth recalling that developing countries, ESA included, have flexibility to attach any such conditions in the GATS. It is questionable whether these flexibilities should be lost in the EPAs.¹⁷

Progressive liberalization is a GATS cornerstone.¹⁸ Countries are expected to be the judge of the extent, scope and timing of their services liberalization, taking into account their national policy objectives. Developing countries can open fewer sectors, liberalize fewer types of transactions and progressively extend market access to others, while attaching conditions thereto, aimed at increasing their participation in international trade in services. Asking ESA countries to open *totally*, lays to rest the rationale behind progressive liberalization. The situation is worsened for ESA Least Developed Countries (LDCs) who in opening up services markets to the EU lose GATS flexibilities such as recognition of their difficulty to accept negotiated specific commitments, and the breathing space given to them in the Doha Round concerning non-expectation to make market access commitments.

V. So What is in this for ESA Countries? The Modal Perspective

The EU wants ESA countries to open markets for cross border supply (Mode 1), and commercial presence (Mode 3). ESA countries would need developed telecommunications infrastructure, financial services, running electricity, highly sophisticated skills and efficient regulatory capacity to benefit from Mode 1. These capacities are only being developed, with many countries still grappling with provision of electricity, to their constituents. On the other hand, the EU is highly competitive in cross-border trade.

In order to benefit from mode 3, ESA countries will have to set up registered office, central administration, or principal place of business in EU territory. This is difficult for the largely small and medium size firms in ESA countries. On its part, the EU has a tradition of big business that supplies mainly through commercial presence in other territories.

ESA countries want the EU to make commitments in mode 4 in semi-skilled categories of services providers. The EU is proposing openings only for *key persons* (managers, specialists), graduate trainees, business visitors, contractual services suppliers, and independent professionals, all of which come with very high minimum qualifications- a position they maintain even in WTO negotiations.

VI. What can be done?

ESA countries need to develop national policies on services, capacity to supply the domestic market *universally (read entirely)*, export capacity in niche sectors, and sector-specific regulation. The ability of the EU EPA proposals to contribute to this seems far and sparse.

Drawing lessons from complexities in their own *intra-regional processes* of integration, ESA countries need to let their own process mature. This will allow for benefiting from a wider mar-

ket while experimenting with regulation to balance out commercial interest and obligations central to services provision such as universal access. *Intra-regional* liberalization should take first choice, allowing for the operation of other options at such point when it is mutually beneficial.

VII. Conclusion

The EPA services negotiations are said to build onto the GATS. The GATS is at a stalled stage with limited progress. It is premature to build onto a non-existent outcome. Progressive liberalization and full utilization of flexibilities, is a must-have. There is no real obligation to negotiate trade in services in the EPAs. One of the reasons that the EU

has put forward for the EPAs is the expiry of the Cotonou waiver at the end of 2007. This waiver relates to trade in goods only. ESA countries have leverage with this. If the services Agreement is going to be one that fosters one-sided benefit, it is not worth having.

As such, ESA countries should move really slowly and cautiously on services liberalization with the EU. There is absolute merit in strengthening cooperation, along the lines of what the Lomé Conventions used to contain so that real capacity can be built to provide domestically, to provide for export, to regulate, and so that it is mutually advantageous. As such, ESA countries may want to consider strengthening cooperation as an option to a trade Agreement.

End Notes

1. Available online at http://www.ustr.gov/Document_Library/Fact_Sheets/2003/Chile_Singapore_FTAs_Temporary_Entry_of_Professionals.html
2. Article V deals with regional trade Agreements in services.
3. See UNCTAD, *Handbook of Statistics, 2004*. Also see *Participation of the developing economies in the global trading system*, WT/COMTD/W/136.
4. Ibid.
5. World Bank WDI 2005, online available <http://www.worldbank.org>.
6. Commercial services, WTO SDB database, online available <http://www.wto.org>.
7. Also see GATS Article XIV on General exceptions.
8. See GATS Article V: 1(b) (i) and (ii).
9. Except for those measures that relate to restrictions on international transfers and payments for current transactions relating to its specific commitments, with the exclusion of measures adopted when countries face serious balance of payments and external financial difficulties. See GATS Article V: 1(b) (ii). Other exceptions allowed include those in relation to general exceptions (such as for the protection of public morals), and security exceptions. See GATS Articles XIV and XIV Bis. Also-see GATS Article V: 1(b) (ii). Other exceptions allowed include those in relation to general exceptions (such as for the protection of public morals), and security exceptions. See GATS Articles XIV and XIV Bis.
10. See Title V, Lomé Conventions.
11. Article 62, Chapter 1; Title V, Lomé Conventions.
12. The references provide that EU member states would implement programmes to assist and enable ACP Member States to develop their services capacities.
13. Economic and Monetary Community of Central Africa.
14. Economic Community of West African States.
15. These figures reflect the picture of the EU 15.
16. Excluding aircraft repair and maintenance, selling and marketing of air transport services, computer- reservation systems.
17. See GATS Article XVI: 2 which allows for these limitations if they are scheduled.
18. See GATS Article XIX.



SOUTH CENTRE

Chemin du Champ d'Anier 17
PO Box 228, 1211 Geneva 19
Switzerland

Telephone: (4122) 791 8050
Fax: (4122) 798 8531
E-mail: south@southcentre.org

Contact us in the web:

<http://www.southcentre.org>

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