

INTRODUCTION

The General Agreement on Trade in Services (GATS) is a relatively new agreement. It entered into force in January 1995 as a result of the Uruguay Round negotiations to provide for the extension of the multilateral trading system to services. With a view to achieving a progressively higher level of liberalization, pursuant to Article XIX of the GATS, WTO Members are committed to entering into further rounds of services negotiations. The first such round started in January 2000.

All Members of the WTO are signatories to the GATS and have to assume the resulting obligations. So, regardless of their countries' policy stances, trade officials need to be familiar with this agreement and its implications for trade and development. These implications may be far more significant than available trade data suggest.

Hopefully, these materials will contribute to a better understanding of the GATS and the challenges and opportunities of the ongoing negotiations. For users who are familiar with the General Agreement on Tariffs and Trade (GATT), similarities and differences will be pointed out where relevant. Likewise, for users who are familiar with the balance-of-payments definition of "trade", departures from the Agreement's coverage will be explained. Whenever indicated, it is recommended to supplement these materials with documents available on the WTO website (www.wto.org).

To stimulate further thinking about core concepts and implications of the Agreement, several boxes have been inserted to provide "Food for thought".

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BASIC PURPOSE AND CONCEPTS

HISTORICAL BACKGROUND

The General Agreement on Trade in Services (GATS) is the first multilateral trade agreement to cover trade in services. Its creation was one of the major achievements of the Uruguay Round of trade negotiations held from 1986 to 1993. This was almost half a century after the entry into force of the General Agreement on Tariffs and Trade (GATT) of 1947, the GATS counterpart in merchandise trade.

The need for a trade agreement in services has long been questioned. Large segments of the services economy, from hotels and restaurants to personal services, have traditionally been considered as domestic activities that do not lend themselves to the application of trade policy concepts and instruments. Other sectors, from rail transport to telecommunications, have been viewed as classical domains of government ownership and control, given their infrastructural importance and the perceived existence, in some cases, of natural monopoly situations. A third important group of sectors, including health, education and basic insurance services, are considered in many countries to be governmental responsibilities, given their importance for social integration and regional cohesion, which should be tightly regulated and not be left to the rough and tumble of markets.

Nevertheless, some services sectors, in particular international finance and maritime transport, have been largely open for centuries – as the natural complements to merchandise trade. Other large sectors have undergone fundamental technical and regulatory changes in recent decades, opening them to private commercial participation and reducing, even eliminating, existing barriers to entry. The emergence of the Internet has helped to create a range of internationally tradeable product variants – from e-banking to tele-health and distance learning – that were unknown only two decades ago, and has removed distance-related barriers to trade that had disadvantaged suppliers and users in remote locations (relevant areas include professional services such as software development, consultancy and advisory services, etc.). A growing number of governments has gradually exposed previous monopoly domains to competition; telecommunication is a case in point.

This reflects a basic change in attitudes. The traditional framework of public service increasingly proved inappropriate for operating some of the most dynamic and innovative segments of the economy, and governments apparently lacked the entrepreneurial spirit and financial resources to exploit fully existing growth potential.

Services have recently become the most dynamic segment of international trade. Since 1980 world services trade has grown faster, albeit from a relatively modest basis, than merchandise flows. Defying widespread misconceptions, developing countries have strongly participated in that growth. Between 1990 and 2000 their services exports, consisting mainly of tourism and travel services, grew 3 per cent more rapidly per annum, on a balance-of-payments basis, than developed countries' exports.

Given the continued momentum of world services trade, the need for internationally recognized rules became increasingly pressing.

BASIC PURPOSE

As stated in its Preamble, the GATS is intended to contribute to trade expansion “under conditions of transparency and progressive liberalization and as a means of promoting the economic growth of all trading partners and the development of developing countries”. Trade expansion is thus not seen as an end in itself, as some critical voices allege, but as an instrument to promote growth and development. The link with development is further reinforced by explicit references in the Preamble to the objective of increasing participation of developing countries in services trade and to the special economic situation and the development, trade and financial needs of the least developed countries.

The GATS' contribution to world services trade rests on two main pillars: (a) ensuring increased transparency and predictability of relevant rules and regulations, and (b) promoting progressive liberalization through successive rounds of negotiations. Within the framework of the Agreement, the latter concept is tantamount to improving market access and extending national treatment to foreign services and service suppliers across an increasing range of sectors. It does not, however, entail deregulation. Rather, the Agreement explicitly recognizes the right of governments to regulate and to introduce new regulations in order to meet national policy objectives, and the particular need of developing countries to exercise this right.

To a considerable degree, the drafters of the GATS took inspiration from the GATT and used terms and concepts that had already been tested for decades in merchandise trade. These include the principles of most-favoured-nation (MFN) treatment and national treatment. Comparable to its status under the GATT, MFN treatment – the obligation not to discriminate between fellow WTO Members – is an unconditional obligation, which applies across all services covered by GATS. The tariff schedules under the GATT, in which countries bind their tariff concessions on merchandise imports, find their equivalent in schedules of specific commitments which define the relevant trade conditions for services.

Reflecting peculiarities of services trade, however, there are also notable differences in scope and content between the two agreements.

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Excerpt

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A Handbook on the GATS Agreement

- (a) Unlike the GATT, the GATS covers measures affecting both the product (service) and the supplier.
- (b) The definition of services trade covers not only cross-border supply, but three additional forms of transaction (“modes of supply”).
- (c) While quota-free entry (“market access”) and national treatment are generally applicable obligations under the GATT, they apply under the GATS on a sector-by-sector basis and only to the extent that no qualifications (“limitations”) have been scheduled.

Food for thought

- (i) In your opinion, why was the GATS necessary?
- (ii) How does the purpose of the GATS fit with your national development objectives?

Possible reply

- (i) Increasing economic importance of services production and trade as a result of: technical progress, government retrenchment (privatization, commercialization of important services sectors), increased reliance on market forces in general.
- (ii) Role of services, in particular in infrastructurally relevant areas (finance, communication, transport, etc.), as determinants of overall economic efficiency.
- (iii) Positive impact of multilateral access guarantees on inflows of investment, skills and expertise.
- (iv) Possibility of reaping economies of scale and scope within an internationally open services environment.

DEFINITION OF SERVICES TRADE AND MODES OF SUPPLY

The definition of services trade under the GATS is four-pronged, depending on the territorial presence of the supplier and the consumer at the time of the transaction. Pursuant to Article I:2, the GATS covers services supplied

- (a) from the territory of one Member into the territory of any other Member (mode 1 – cross-border trade);
- (b) in the territory of one Member to the service consumer of any other Member (mode 2 – consumption abroad);
- (c) by a service supplier of one Member, through commercial presence, in the territory of any other Member (mode 3 – commercial presence); and

EXAMPLES OF THE FOUR MODES OF SUPPLY (FROM THE PERSPECTIVE OF AN “IMPORTING” COUNTRY A)

Mode 1: cross-border

A user in country A receives services from abroad through its telecommunications or postal infrastructure. Such supplies may include consultancy or market research reports, tele-medical advice, distance training or architectural drawings.

Mode 2: consumption abroad

Nationals of A have moved abroad as tourists, students or patients to consume the respective services.

Mode 3: commercial presence

The service is provided within A by a locally established affiliate, subsidiary or representative office of a foreign-owned and -controlled company (bank, hotel group, construction company, etc.).

Mode 4: movement of natural persons

A foreign national provides a service within A as an independent supplier (e.g. consultant, health worker) or employee of a service supplier (e.g. consultancy firm, hospital, construction company).

Figure 1

- (d) by a service supplier of one Member, through the presence of natural persons of a Member in the territory of any other Member (mode 4 – presence of natural persons).

Figure 1 gives examples of the four modes of supply.

The above definition is significantly broader than the balance-of-payments (BOP) concept of services trade. While the BOP focuses on residency rather than nationality – that is a service is being exported if it is traded between residents and non-residents – certain transactions falling under the GATS, in particular in the case of mode 3, typically involve only residents of the country concerned.

Commercial linkages may exist among all four modes of supply. For example, a foreign company established under mode 3 in country A may employ nationals from country B (mode 4) to export services cross-border into countries B, C and so on. Similarly, business visits into A (mode 4) may prove necessary to complement cross-border supplies into that country (mode 1) or to upgrade the capacity of a locally established office (mode 3).

SCOPE AND APPLICATION

Article I:1 stipulates that the GATS applies to measures taken by Members affecting trade in services. It does not matter in this context whether a measure is taken at central, regional or local government level, or by non-governmental bodies exercising delegated powers. The relevant definition covers any measure, contained in Article XXVIII,

whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form, . . . in respect of:

- (i) the purchase, payment or use of a service;
- (ii) the access to and use of, in connection with the supply of a service, services which are required by those Members to be offered to the public generally;
- (iii) the presence, including commercial presence, of persons of a Member for the supply of a service in the territory of another Member.

This definition is significantly broader than what governmental officials in trade-related areas may expect. It is thus important to familiarize staff at all levels with basic concepts of the GATS to prevent them from acting, unintentionally, in contravention of obligations under the Agreement and to enable them to negotiate effectively with trading partners.

For purposes of structuring their commitments, WTO Members have generally used a classification system comprising twelve core service sectors:

- business services (including professional services and computer services)
- communication services
- construction and related engineering services
- distribution services
- educational services
- environmental services
- financial services (including insurance and banking)
- health-related and social services
- tourism and travel-related services
- recreational, cultural and sporting services
- transport services
- other services not included elsewhere

These sectors are further subdivided into a total of some 160 sub-sectors. Under this classification system, any service sector may be included in a Member's schedule of commitments with specific market access and national treatment obligations. Each WTO Member has submitted such a schedule under the GATS.

There is only one sector-specific exception to the Agreement's otherwise comprehensive coverage. Under the GATS Annex on Air Transport Services, only measures affecting aircraft repair and maintenance services, the selling and marketing of air transport services, and computer reservation system (CRS) services have

been included. Measures affecting air traffic rights and directly related services are excluded. This exclusion is subject to periodic review.

Another blanket exemption applies to “services supplied in the exercise of governmental authority” (Article I:3b). The relevant definition specifies that these services are “supplied neither on a commercial basis, nor in competition with one or more service suppliers” (Article I:3c). Typical examples may include police, fire protection, monetary policy operations, mandatory social security, and tax and customs administration.

Despite its broad coverage, the GATS does not compromise Members’ ability to regulate for national policy purposes. Issues related to domestic regulation will be further discussed in Chapter 3.

GENERAL TRANSPARENCY AND OTHER “GOOD GOVERNANCE” OBLIGATIONS

Sufficient information about potentially relevant rules and regulations is critical to the effective implementation of an agreement. Article III ensures of the GATS Agreement that Members publish promptly all measures pertaining to or affecting the operation of the GATS. Moreover, there is an obligation to notify the Council for Trade in Services at least annually of all legal or regulatory changes that significantly affect trade in sectors where specific commitments have been made. Members are also required to establish enquiry points which provide specific information to other Members upon request. However, there is no requirement to disclose confidential information (Article III *bis*).

Given strong government involvement in many service markets – for various reasons, including social policy objectives or the existence of natural monopolies – the Agreement seeks to ensure that relevant measures do not undermine general obligations, such as MFN treatment or specific commitments in individual sectors. Thus, each Member is required to ensure, in sectors where commitments exist, that measures of general application are administered impartially and in a reasonable and objective manner (Article VI:1). Service suppliers in all sectors must be able to use national tribunals or procedures in order to challenge administrative decisions affecting services trade (Article VI:2a).

Food for thought

Give examples of policies that are currently in place to support your government’s transparency commitments.

Possible reply

Publication of relevant laws and regulations in official journals, government gazettes and so on. Operation of information centres. Consultations with industry, trade and consumer associations.

MOST-FAVOURLED-NATION TREATMENT

The most-favoured-nation (MFN) principle is a cornerstone of the multilateral trading system conceived after World War II. It seeks to replace the frictions and distortions of power-based (bilateral) policies with the guarantees of a rules-based framework where trading rights do not depend on the individual participants' economic or political clout. Rather, the best access conditions that have been conceded to one country must automatically be extended to all other participants in the system. This allows everybody to benefit, without additional negotiating effort, from concessions that may have been agreed between large trading partners with much negotiating leverage.

In the context of the GATS, the MFN obligation (Article II) is applicable to any measure that affects trade in services in any sector falling under the Agreement, whether specific commitments have been made or not. Exemptions could have been sought at the time of the acceptance of the Agreement (for acceding countries: date of accession). They are contained in country-specific lists, and their duration must not exceed ten years in principle.

CONDITIONAL GRANTING OF MARKET ACCESS AND NATIONAL TREATMENT

The GATS is a very flexible agreement that allows each Member to adjust the conditions of market entry and participation to its sector-specific objectives and constraints. Two sets of legal obligations – governing, respectively, market access and national treatment – are relevant in this context. As already noted, Members are free to designate the sectors, and list them in their schedules of commitments, in which they assume such obligations with regard to the four modes of supply. Moreover, limitations may be attached to commitments in order to reserve the right to operate measures inconsistent with full market access and/or national treatment.

The *market access* provisions of GATS, laid down in Article XVI, cover six types of restrictions that must not be maintained in the absence of limitations. The restrictions relate to

- (a) the number of service suppliers
- (b) the value of service transactions or assets
- (c) the number of operations or quantity of output
- (d) the number of natural persons supplying a service
- (e) the type of legal entity or joint venture
- (f) the participation of foreign capital

These measures, except for (e) and (f), are not necessarily discriminatory, that is they may affect national as well as foreign services or service suppliers.

National treatment (Article XVII) implies the absence of all discriminatory measures that may modify the conditions of competition to the detriment of foreign

Basic purpose and concepts

services or service suppliers. Again, limitations may be listed to provide cover for inconsistent measures, such as discriminatory subsidies and tax measures, residency requirements and so on. It is for the individual Member to ensure that all potentially relevant measures are listed; Article XVII does not contain a typology comparable with that of Article XVI. (Examples of frequently scheduled national treatment restrictions are given in Attachment 1 to document S/L/92.) The national treatment obligation applies regardless of whether foreign services and suppliers are treated in a formally identical way to their national counterpart. What matters is that they are granted equal opportunities to compete.

The purpose of commitments, comparable to tariff concessions under GATT, is to ensure stability and predictability of trading conditions. However, commitments are not a straitjacket. They may be renegotiated against compensation of affected trading partners (Article XXI), and there are special provisions that allow for flexible responses, despite existing commitments, in specified circumstances. Under Article XIV, for example, Members may take measures necessary for certain overriding policy concerns, including the protection of public morals or the protection of human, animal or plant life or health. However, such measures must not lead to arbitrary or unjustifiable discrimination or constitute a disguised restriction to trade. If essential security interests are at stake, Article XIV *bis* provides cover. Article XII allows for the introduction of temporary restrictions to safeguard the balance of payments; and a so-called prudential carve-out in financial services permits Members to take measures in order, *inter alia*, to ensure the integrity and stability of their financial system (Annex on Financial Services, para. 2).

Commitments must not necessarily be complied with from the date of entry into force of a schedule. Rather, Members may specify in relevant part(s) of their schedule a timeframe for implementation. Such “pre-commitments” are as legally valid as any other commitment.

Food for thought

Imagine that your country intended to schedule the following services: telecommunications, banking and rail transport.

- (i) What could be an example of a market access restriction in these sectors?
- (ii) What could be an example of a national treatment restriction?

Possible reply

- (i) Existence of exclusive or monopoly operators. Prescribed forms of legal incorporation (e.g. joint stock companies). Quantitative restrictions on presence of natural persons.
- (ii) Restrictions on foreigners’ participation in company boards. Prohibition of foreign land ownership. Discriminatory minimum capital or minimum reserve requirements.

2

MAIN BUILDING BLOCKS: AGREEMENT, ANNEXES AND SCHEDULES

THE BASIC STRUCTURE OF THE GATS

The GATS forms part of the Marrakesh Agreement Establishing the World Trade Organization. It establishes a rules-based framework for international trade in services, specifies the obligations of Members within that framework, and delineates a legal structure to ensure compliance. The Marrakesh Agreement includes two other multilateral agreements – GATT 1994, and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) – as well as a few plurilateral agreements. Of these, the Agreement on Government Procurement is also of relevance to trade in services.

The GATS consists of the text of the Agreement (a Preamble, 29 Articles arranged in six Parts (see Figure 2), and various Annexes) and a schedule of commitments for each WTO Member.

THE TEXT OF THE AGREEMENT

Preamble

The Preamble states the main intentions that inspired the drafting of the Agreement. These include the concept of trade expansion as a means of promoting growth and development and the objective of progressive trade liberalization through successive rounds of negotiations. Further, the Preamble explicitly confirms the right of Members to regulate, and to introduce new regulations, to meet national policy objectives. The two final considerations refer to the objective of facilitating the increasing participation of developing countries in world services trade as well as to the special economic situation of least-developed countries and their development, trade and financial needs.

A framework of principles

The main body of the Agreement outlines Members' obligations concerning their use of measures (laws, rules, regulations, procedures, decisions or administrative actions) affecting trade in services. These principles will be discussed further in the next three sections.

Annexes covering sector- or policy-related issues

Annex on Article II Exemptions. The Annex lays down the conditions under which Members could have been exempted, at the entry into force of the Agreement (for