

B. WHAT DO TRADE IN SERVICES RULES MEAN?


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This section of the toolkit provides a basic guide to the meaning of some key terms and practical examples of what they involve.

What is

- a **'service'** (or what services are covered by these agreements)
- **'trade in services'** (or how are services traded internationally)
- a **'measure'** (or what government actions are covered by these agreements)
- a **'party'** (or which levels of government are covered by these agreements)
- **'supply'** of a service (or what transactions involving services are covered by these agreements)
- **'national treatment'** (or not discriminating in favour of local services providers)
- a **'market access'** restriction (or the ways in which services markets cannot be restricted)
- **'most favoured nation (MFN)'** treatment (or not giving some parties to an agreement better treatment than others)
- a **'discipline on domestic regulation'** (or what restrictions are placed on the governments right to regulate)
- an **'enterprise'** of a party (or which firms can benefit under these agreements)
- **'services supplied in the exercise of governmental authority'** (or the extent of the public services exclusion)
- **'general exceptions'** (or when is a government allowed to depart from its obligations)
- a **'WTO-compatible'** trade in services agreement (or the WTO's rules for developing countries when negotiating an FTA or EPA).

It will be helpful to think of local examples of these terms and rules before starting on the 10-step template for assessing the implications of these agreements on domestic regulation.



WHAT IS ... A 'SERVICE'

(or what services are covered by these agreements)

Some people define a 'service' as anything you can buy and sell, but can't drop on your foot.

The ways in which services are defined in 'trade' agreements reflect the way that commercial suppliers of services view them, not the way that communities or people who use services see them.

Classification of services

Trade in services agreements define that services that they cover by referring to a general sector and the sub-sectors that make up that commercial activity.

Services are defined in the GATS in a services classification document known as W/120 (see Part D). It is based on a classification of services developed by the UN in 1991. The list has 12 categories and over 160 sub-categories:

1. Business services
2. Communications services
3. Construction and related engineering services
4. Distribution services
5. Education services
6. Environmental services
7. Financial services
8. Health-related and social services
9. Tourism and travel-related services
10. Recreational, cultural and sporting services
- 11 Transport services
12. Other services not provided elsewhere

Other agreements use more recent versions of the UN document and sometimes other sources.

WHAT IS ... TRADE IN SERVICES?

(or how are services traded internationally?)

The GATS sets out four ways for delivering a service. They are referred to as modes:

- **'Across the border' (mode 1)** – the person or firm that supplies the service is in a different country from the person or firm who consumes it:

international computerised airline booking systems hosted offshore, the PayPal payments system, consultancy services from overseas via the Internet.

- **'Consumption abroad' (mode 2)** – the consumer travels to the country where the person or firm who supplies the service is located:

international tourists, foreign fee paying students, patients receiving medical treatment in a foreign hospital; or repairs made to a ship or computer in a different country from that of the owner.

- **'Establishing a commercial presence' (mode 3)** - a foreign firm sets up a services operation through foreign direct investment

a hotel owned by a foreign chain, a subsidiary of a foreign bank, a foreign owned supermarket, a franchised real estate agency.

- **'Temporary presence of natural persons' (mode 4)** – the person who supplies the service enters the country temporarily to deliver a service. In theory this applies to every service worker. In practice it allows special immigration rules for selected categories of personnel. 'Temporary' can be up to 3 years, renewable.

Managers, IT specialists, chefs.

IMPORTANT NOTE:

These 4 GATS modes have been reorganized in recent EPAs and FTAs, eg. China-NZ FTA and CARIFORUM-EC EPA. It is now more common to find these categories:

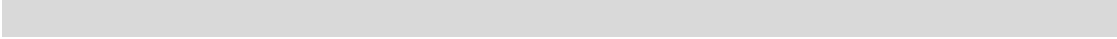
Commercial presence: like mode 3, a foreign firm sets up an operation through foreign direct investment, but it includes both services and non-services activities.

Logging concessions, fisheries canning factory, mine.

Cross-border services: the service is supplied remotely or by the user going overseas to the provider (as per modes 1 cross border supply and mode 2 consumption abroad).

Movement of Key Personnel for a Business Purpose: a more restricted form of mode 4, this covers only elite workers.

Executives, professionals, specialists, highly skilled workers, or contract service suppliers under tight conditions.



WHAT IS ' A MEASURE'?

(or what government actions are covered by these agreements?)

The trade in services rules apply to 'measures' adopted by a state that is party to a trade in services agreement. The agreements do not apply to the actions of private firms and individuals. The term covers every policy decision and regulatory action taken by every level of government that directly or indirectly affects the commercial transactions in services.

'Measures' are defined to mean a ...

Law

The Constitution; Commerce Act; Land law; Foreign Investment Act ...

Regulation

Marine regulations; broadcasting regulations ...

By-law

Council building bylaws, retail shop bylaws, bylaws requiring environmental assessments ...

Rule

Legal Aid Rules, Law Society Practicing rules ...

Procedure

Procedures for recognition of professional qualifications, telecommunication licensing procedures, foreign investment approval procedures ...

Decision

Decision of town planning authority or licensing body ...

Administrative action

Granting of taxi or casino licence, eco-tourism permits, approval of visas ...

Any other form (just in case something is left out of this list!)

Policies to subsidise locally owned buses or television stations, government funded campaigns to promote local services ...

WHAT IS ... 'A PARTY'?

(or whose actions do these agreements apply to?)

Trade in services agreements bind 'parties', which covers all levels of government and bodies that exercise delegated authority.

Central governments and authorities

The Government and all the Ministries and Departments

Regional governments and authorities

Provincial Councils

Local governments and authorities

City Council; Town Council

Non-governmental bodies in the exercise of powers that are delegated by one of the three above levels of government

Visitors Bureau; Trade and Investment Bureau; village council; cultural centre;
Law Society

IMPORTANT NOTE:

The WTO's services agreement (GATS) requires the central government to take '*such reasonable steps as may be available to it to ensure*' that regional and local governments and non-government bodies comply with the obligations.

FTAs and EPAs may impose more onerous obligations. In particular, the EC-CARIFORUM EPA left out the 'reasonableness' proviso. All levels of government and non-governmental bodies are automatically bound to comply with the agreement. It was the same in the PACP-EC Working Draft.

WHAT IS ... 'SUPPLY OF A SERVICE'**(or what transactions involving services are covered by these agreements)**

These agreements are concerned with government measures that affect how a service is 'supplied'.

Supply of a service is widely defined to cover the whole supply chain: production, distribution, marketing, size and delivery of a service.

Using the example of a film (which are classified as audio-visual services):

Production:

all phases of production, such as fundraising, script writing, casting, filming, support services, editing,

Distribution:

organisation of dissemination of the film through TV channels, movie theatres, DVD outlets, airlines ...

Marketing:

promotion through advertising, sponsorships, billboards, events, ...

Sale:

direct transactions, electronic purchases, wholesale distribution, retail,

Delivery:

physical or electronic provision of the hard copy or digital copy of the film.

This definition of supply creates confusion because many of the same activities are described as services in their own right and have their own classifications.

In the case of a film, the product is also a 'good' that is covered by the trade in goods part of an agreement.

Similar confusions and cross-overs arise with 'services related to agriculture', 'services related to fisheries', 'services related to mining' etc.

WHAT IS ... 'NATIONAL TREATMENT'?**(or not giving preferences to local services providers)**

This rule guarantees that firms or individuals from the other party to an agreement who provide services, and the services they produce, are treated at least as well as their local counterparts.

This rule aims to stop discrimination in favour of domestic providers of services or the services themselves.

National treatment can require non-discrimination in relation to:

Subsidies

Fuel subsidies, education subsidies, tax write-offs

Grants

Grants to young indigenous entrepreneurs under an affirmative action programme; start up grants for local business; market research grants for tourist ventures.

Ownership

Foreign owners cannot be excluded from services activities or key elements of the service supply chain, including purchase of land or certain kinds of businesses, eg. a milk bar, Internet café or a bus business.

Board of directors

Foreign services firms cannot be required to have one or more nationals on the board of directors, eg. airlines, telecommunications, post, hotels.

Right to perform certain occupations


Certain occupations or positions in a company cannot be reserved for locals, such as management of hotels, legal advisers, semi-skilled or unskilled workers in the hospitality industry.

Categories of services

Certain activities cannot be reserved for nationals, such as small restaurants, hair salons, taxi services, etc.

Discrimination cannot apply in certain locations

The rule applies to discrimination in specific locations, such as islands, provinces, villages or towns, eg. stores, eco-tourism ventures.



WHAT IS ... A 'MARKET ACCESS' RESTRICTION?

(or the ways in which services markets cannot be restricted)

The goal of trade in services agreements is to expand commercial markets for services and service suppliers, including foreign suppliers. The legal provisions on market access usually give a closed list of measures that are seen as market access barriers. These measures may apply on a national basis or to parts of the country. Like National Treatment they are only binding on services listed in a country's schedule, and subject to any specified limitations on the exposure of that service to the rule.

A limit on the number of firms or individuals who can supply a service:

Television stations, liquor stores, foreign exchange dealers

An economic needs test that restricts the market for foreign suppliers:

Foreign investment laws that require a potential investor to prove a lack of local provision of the service.

A limit on the total number of operations in a particular sector:

Taxi and mini bus operators or capped student numbers at medical school.

A legal monopoly on a service:

Electricity authority, postal service, port authority.

An exclusive service supplier arrangement for a service:

TV, airport terminal management, sport stadium management.

Requiring foreign investors to operate through **a joint venture**:

Motor vehicle repairs, fish processing plants, ports.

Limits on the percentage of foreign shareholding in an enterprise or a sector:


real estate, inter-island shipping, customs agents.

Limits on the total value of a foreign investment, individually or in total:

Limits on operating more than one casino or controlling a certain proportion of total investment in a service sector, eg broadcasting.

A ban on a service activity (a numerical quota of zero):

Casinos or online gambling (have to rely on the public morals exception),
construction in certain locations.



WHAT IS ... A DISCIPLINE ON 'DOMESTIC REGULATION'
--

(or what restrictions are placed on a government's right to regulate)

Regulations in the services sector are complex and often relate to core government policy goals that are 'non-economic', such as environmental or social objectives. They often apply to a number of services or through multiple levels of government. The main GATS 'disciplines' on domestic regulation apply to all levels of government in sectors where a government has made a commitment. These GATS rules are currently restricted to regulations on qualification requirements and procedures, technical standards and licensing requirements, but they are much wider in EPA/FTAs.

How does a domestic regulation differ from a market access barrier ...

Domestic regulations tend to be what is left over from the 'market access', 'national treatment' and MFN categories (see below). That makes it very hard to predict which regulations may fall under which rules:

The successful challenge by Antigua and Barbuda to a US ban on internet gambling concluded that a ban on gambling was a 'zero quota' that breached the US's market access commitments on internet gambling (which the US says it never intended to make).

Qualification requirements and procedures ... for recognition of foreign qualifications and/or practical experience and the process for accreditation and approval to practice:

Medical, legal, accountancy, engineering, trades, real estate, ICT, etc from a wide range of countries and contexts.

Technical standards ... that a service or service provider must meet to establish and continue to meet:

Effluent and emissions levels, construction standards, conditions for laboratory testing, environmental impact requirements, hygiene conditions

Licensing requirements ... for services providers:

Taxi, bus or ferry operators, Internet cafes, casinos and liquor outlets, money changers and forex dealers, telecoms providers, media outlets

Regulations must be not more burdensome than necessary to ensure quality" ...

Under this 'necessity test', a state must prove:

- that its regulations are necessary to achieve one of a list of WTO-approved objectives; and

- there is no less trade-restrictive measure that the government should reasonably have been aware of that could have achieved the same objective:

Industry may argue that water quality regulations designed for environmental protection are not the least trade-restrictive way of achieving that goal and economic incentives are less trade restrictive. The most effective way of meeting social or environmental policy goals is irrelevant. Nor is the temptation for companies to continue to pollute if it is a price worth paying.

WHAT IS ... 'MOST FAVOURED NATION' (MFN) TREATMENT?

(or not giving some parties to an agreement better treatment than others)

This rule prevents discrimination between different parties to an agreement. Each party promises not to give any other country/region in the agreement better treatment than it gives the rest of them. The extent of this obligation varies in different agreements.

Among WTO members in the WTO ...

the MFN commitment applies to all parties. In other words, any liberalisation of any service sector must be extended to 'like services' and 'like service suppliers' in all WTO members. This is subject to any exceptions that were lodged when the country first joined the WTO. It also only applies to market access and national treatment for specific services that are listed in the country's schedule of commitments.

A Pacific WTO member would not be permitted to allow only Australian or US educational institutions to provide distance-training courses and ban those coming from Europe or Asia; only consider entry under mode 4 by professionals from specific countries; or restrict tourism operators to certain countries.

Among WTO members who are parties to FTAs ...

The WTO makes an exception for the special privileges that parties to FTAs give to each other, provided the agreement complies with the WTO's rules. Article V of the GATS permits any WTO member to enter into an agreement to further liberalise trade in services with other parties so long as it has 'substantial sectoral coverage' and is implemented in a 'reasonable' timeframe (see What is ... a GATS-compatible FTA?)

Between parties to EPAs and FTAs ...

- EPAs and FTAs that involve more than two parties will have rules about the treatment they have to give each other:

In the CARIFORUM-EC EPA the CARIFORUM states are required to give each other the same treatment they give to the EU within a certain period.

- Parties in EPAs and FTAs often guarantee to give each other the benefit of any better treatment they give to other states in future FTAs. This is intended to ensure that the competitive position of parties to an agreement is not eroded by future agreements:

The NZ/Singapore FTA means that any agreement on services that NZ enters into with the Pacific states would also be given to Singapore.

- Sometimes the MFN rule applies selectively to future agreements:

The NZ/China FTA only requires NZ to give China the benefit of any future agreements in 7 specific services.

WHAT IS ... 'AN ENTERPRISE' OF ONE PARTY?

(or which firms can benefit under these agreements)

The trade in services agreements guarantee rights to foreign investors through Mode 3. Foreign service suppliers (firms) are also the beneficiaries of MFN treatment.

In recent EPAs and FTAs the foreign investment part of the services chapter has been extended to non-services activities. The EC used this approach in the services and investment chapter of the CARIFORUM-EC EPA and NZ used a variation on this in the NZ China FTA.

Because an enterprise is a legal construct, not a real person, it is important to identify who will be considered an investor of a party and get the benefit of the agreement.

- A company from a third country with a **subsidiary** that operates in a party may get the benefit of an agreement:

A NZ firm that has a subsidiary in Fiji could get the benefit of PICTA without the need for a similar agreement under PACER

- An agreement will often restrict the benefits to foreign investments that are '**owned**' or '**controlled**' by nationals of a party. Those nationals may be natural persons or companies. The definitions will be set out in the agreement:

'Owned' can vary between 15 and 50 percent of the equity interest that is beneficially owned by persons of a party;


'Control' is usually defined by the power to name a majority of its directors or otherwise to legally direct the firm's actions;

- A company that is **legally constituted** in one party is usually required to be engaged in substantive business operations within that territory to get the benefits of the agreement. In other words, it is not a shell company incorporated to take advantage of the agreement or other entitlements of local firms.

A company incorporated in a tax haven for tax purposes is usually excluded.

- It is uncommon for a firm that only has a **paper presence** in a party to get the benefits of an agreement:

A paper company cannot usually gain access to the guarantees or use the enforcement mechanisms of a FTA or EPA, but has been able to do so under some bilateral investment treaties.



WHAT IS ... A 'SERVICE SUPPLIED IN THE EXERCISE OF GOVERNMENTAL AUTHORITY'?

(or the extent of the public services exclusion)

Many services that were traditionally defined as 'public services' and delivered by the state or local authorities are now fully or partly commercialized, and are delivered in competitive markets or by the private sector alone. An exception is included in most trade in services agreements that recognises the sensitivity of public services. But its wording is very specific: 'services supplied in the exercise of governmental authority' must be neither commercial nor provided in competition with other suppliers.

A service supplied in the exercise of governmental authority ...

- may be supplied directly by *central government*:
 - prisons, primary education, hospitals, pension schemes.
- may be supplied by *local government* under a legal authority:
 - ferry transport, landscaping and parks maintenance, rubbish dump.
- may be supplied by a *quasi-government agency or professional body* with delegated authority:
 - museum, legal aid service, radio, tourist advice, tertiary education.
- may be supplied *under contract* from the government:
 - electricity, water supply, nursing education, port management.
- does *not* include services delivered as a result of procurement by central or local government, but whether that includes concessions or public private partnership is unclear.

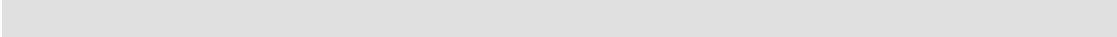
A non-commercial supply of that service ...

is not defined in the agreements and so it is not clear what level of commercialisation or marketisation will take a service outside this exception.

- certainly includes all profit-based charges
- probably includes full cost recovery, non-profit charges because this potentially squeezes out for-profit providers of the same service
- may include partial cost recovery and 'co-payments'

A non-competitive supply of a service ...

Means no public or private competitors provide a 'like' service. How similar the service must be is not clear, eg is face to face and via Internet 'like'.



WHAT ARE ... 'GENERAL EXCEPTIONS'

(or when is a government allowed to depart from its obligations)

Most agreements allow governments to take action that is inconsistent with the agreement. However, the government's action can only be for a narrow set of purposes and it has to satisfy a number of other requirements.

The most common exceptions that are relied on are:

- to protect **public morals** or to **maintain public order**, eg a ban on Sunday trading
- to protect **human, animal or plant life or health**, eg restrictions on tobacco advertising
- actions which the governments considers necessary to protect its **essential security interests**, which is largely self-defining.

Necessity

The kind of action that a government takes must be 'necessary' to achieve its stated purpose. The government needs to consider different approaches it could take and choose the one that interferes least with their obligations to foreign suppliers or services markets under the agreement.

Non-discriminatory and not disguised barrier to trade

Even when the government's 'measure' meets that standard, it must be applied equally to local and foreign services providers (non-discriminatory). The purpose also has to be genuine, ie it cannot be an indirect way of avoiding the country's commitments.

Other exceptions

Governments can also take action

- to secure compliance with laws relating to fraud and default on services contracts, individual privacy, or safety;
- equitable imposition and distribution of taxes relating to services,
- pursuant to a double taxation agreement.

Culture and Indigenous Rights

Some FTAs and EPAs have included special rights of governments to depart from their obligations for cultural purposes, or to meet their obligations to indigenous people, eg the Treaty of Waitangi.

WHAT IS ... A 'WTO-COMPATIBLE' FTA?

(or what rules WTO members have to follow in negotiating an FTA or EPA).

All members of the WTO who negotiate a FTA/EPA that includes trade in services have to comply with GATS rules, even if other parties are not WTO members. The most basic rule is that all WTO Members have to give each other the best treatment they give to any one WTO Member. The GATS Article V: Economic Integration Agreements provides an exception to that rule for free trade agreements (FTAs), but only if the new agreement has 'substantial sectoral coverage' and provides for the removal of substantially all discrimination between the parties within a 'reasonable time frame'. The parties can give each other preferences that they do not extend to others, but in doing so they cannot increase the overall barriers to other WTO members services and service providers. There is a requirement for flexibility for FTAs that involve developing countries, but the extent of that flexibility is not defined. These uncertainties explain why many developing countries have resisted the inclusion of services in their FTAs.

Substantial sectoral coverage ...

'Substantial' is a subjective term that needs to be understood in context, especially as there is no specific method for calculating what is 'substantial'. A footnote to Article V says it is an aggregate of:

- **the number of sectors.** The GATS positive list allows WTO members to make very few commitments. A strict reading of 'substantial' as meaning a large number of sectors would impose much heavier obligations than WTO members are required to make under the GATS.
- **volume of trade affected.** The volume of services trade is notoriously hard to measure, especially because 'trade' includes foreign investment. The volume of trade offers limited assistance when there is very little services trade between the parties to a FTA.
- **modes of supply.** FTAs should not explicitly exclude any mode of supply, such as mode 3 foreign investments or mode 4 temporary movement of personnel. In practice, major powers have been redefining these modes through FTAs to advance the interests of their firms and restrict areas that are of more interest to developing countries.

Remove 'substantially all discrimination' within a 'reasonable' time-frame ...

- Governments must not introduce discrimination against the services and service suppliers of the other parties in sectors that are committed in its

schedule and must rollback and remove substantially all existing discrimination.

- A 'reasonable' time period for a similar obligation on trade in goods is considered to be 10 years, although recent FTAs have provided for 18 or even 25 years.

The relationship of the FTA to a wider process of regional economic integration and trade liberalisation among the parties can be considered in assessing whether it meets this test. Again, it is not clear just what that means.

Flexibility for developing countries ...

in accordance with their level of development is specifically recognised. It says that flexibility *shall ie. must* be provided. Yet not all 'WTO-compatible' EPA/FTAs recognize these flexibilities: eg. there is no reference to 'development flexibilities' in the services chapters of the CARIFORUM-EC EPA.

The flexibility applies to all the above requirements, including that the FTA has 'substantial sectoral coverage'.

It is important to remember that most developing countries have only made a very small number of commitments in the GATS. The exception is countries that acceded after 1996, such as Tonga, which have been required to make very extensive commitments.

A pro-development approach to flexibility should therefore interpret 'substantial' in a narrow and country-specific way.

Within those sectors that are committed, there is particular flexibility regarding the removal of 'substantially all discrimination'. That means both the extent to which it is removed and the time frame for doing so.

Given that a number of the PICs are not even WTO members, this flexibility should be read in a very liberal manner.

In addition, an agreement between developing countries is allowed to increase discrimination against other countries and in favour of the investors of the parties to that FTA (eg from Fiji or Samoa to other PICs).