

Technical analysis of the problems resulting from liberalisation of services in EU- ACP Economic Partnership Agreements (EPAs)

Why services liberalisation in EPAs?

The services sector is an important source of employment and income in developing countries, often exceeding industry and agriculture. In 2002, the services sector accounted for an average of 49% of GDP in developing countries.¹ Foreign investment in services potentially contributes to development and economic efficiency by providing capital for infrastructure and improved services in cash-strapped countries. However, if liberalised in the wrong way, the impact of foreign services companies in a developing countries' economy can be negligible, or even negative. Developing countries have therefore been reluctant to agree to ambitious new services liberalisation commitments at the WTO. In EPA negotiations, Ministers of African, Caribbean and Pacific countries (ACP) too have consistently shown their reluctance to include services and investment liberalisation, especially because the EU is ignoring their development needs and concerns.

The EU is pushing hard for extensive liberalisation. EU proposals for liberalisation of services and investment on the table of the EPA negotiations are in line with its "Global Europe" strategy aiming to open markets abroad for EU multinationals to be able to grow.² While the EU insists that services liberalisation is essential for ACP development and stresses that EU companies have no particular interest in ACP countries, it has an offensive agenda. The EU wants to prohibit that non EU major services investors -such as those from South Africa in the rest of Africa- get more favourable treatment. Where ACP markets are profitable, the EU knows that investment conditions and regulations are key for its services industries to be able to benefit.

Europe's future economic development depends on growing services sectors, and moving up the value chain such as in telecommunications, finance and transport is very important. The services industry makes up for around 75% of the European economy and employment, and is the fastest growing and most profitable sector. The EU is also the world's biggest

international trader in services, accounting for almost 50% of world trade.³

During 2006-7, the EU has proposed a similar model of text, or 'template', across the six different EPA negotiating regions, with the Title "Establishment, Trade in Services and E-Commerce".⁴ The Title links trans-border services trade and movement of services people, with "establishment" which covers foreign direct investment by services companies (mode 3 in GATS) as well as non-services companies (see separate briefing).

This briefing focuses on the **services** aspects and explains how the EU proposals would :

- **fail to meet ACP countries' development needs and concerns;**
- **restrict ACP countries' capacities to control and select foreign service providers;**
- **limit ACP ability to regulate their service sectors to their own benefit;**
- **require extra regulatory duties that may be too burdensome to achieve.**

In addition to reiterating many provisions of GATS (the WTO General Agreement on Trade in Services), ACP countries are required to:

- **liberalise more services sectors than under GATS;**
- **implement more prescribed regulations and other obligations in sectors they liberalise;**
- **agree on provisions which are still under negotiation in current GATS negotiations.**

The EU's EPA proposals go thus far beyond what is required of ACP countries in GATS, and would make EPAs 'GATS Plus', even though there is no need to include services liberalisation in EPAs.

¹ UNCTAD, *Trade in Services and Development Implications*, TD/B/COM.1/71.

² 'EC, *Global Europe: competing in the world*', October 2006

³ WTO, World Trade Report 2006, 2006, p. 10.

⁴ Unless otherwise specified, all article numbers referred to are from the EU proposed text to SADC text (23 April 2007) and may be slightly different in the other texts.

An unnecessary commitment

ACP countries are not obliged to include services liberalisation in the EPAs: not in order to make EPAs WTO compatible, nor to abide to the Cotonou agreement, and not even to attract appropriate investment.

WTO rules on services, defined in GATS, do not require inclusion of services in the EPAs, especially since 21 of the ACP countries are not even members of the WTO and 39 are least developed countries (LDCs).⁵ It would be sufficient if EPAs are WTO compatible in goods only.

The Cotonou agreement proposes liberalising services in a development friendly way, with the EU providing assistance, especially for example in tourism, distribution, construction, communications and maritime transport (Part 3, Title II, Art. 41-43). It does, however, not contain a binding obligation to negotiate on services within an EPA, but states that such liberalisation can be encompassed in the partnership after some experience has been acquired in applying the Most Favoured Nation (MFN) treatment under GATS (art 41). Since most ACP countries have made few if any liberalisation commitments under GATS, they have acquired little such experience.

Most ACP countries insist that the cooperation programme contained in the Cotonou Agreement needs to be implemented before any services liberalisation is attempted. Negotiating regions have stated they don't want to include services liberalisation, or have offered more lenient versions of the chapter.⁶ The EU has resisted development friendly proposals from some ACP regions and has not even slightly tailored the services chapters to the economic needs of the different regions. This is in contradiction with the Cotonou objectives and recent European Council conclusions⁷, which indicate that the emphasis of any agreement should be on the development objectives and priorities of ACP states.

The EU negotiators have been very intransigent on services⁸, and strongly insist that services liberalisation needs to be included in EPAs in order to achieve development and clearer rules that attract investors. However, there is no proof that liberalisation agreements lead to more investment, especially in those services sectors which countries need. The World Bank and others have noted that investors are more concerned about political stability, available infrastructure and reliable electricity supply etc., than

the absence of an investment agreement⁹ such as the EU proposals on services investment and trade.

Inescapably broad sectoral coverage

Liberalising services within an EPA will result in much broader coverage than if ACP countries were to liberalise directly under GATS. GATS allows countries to make liberalisation commitments in particular services sectors as much or as little as they want to. However, if any services sector is negotiated under a regional agreement like an EPA, it is critical to realise that GATS art. 5 obliges services liberalisation to cover "substantially all" sectors and eliminate substantially all discrimination, even if one of the parties in question is not a WTO member.

Although GATS art. 5 allows some flexibility for developing countries to derogate from these obligations, this provision is poorly defined. This leaves uncertainty over how much ACP countries will have to eventually liberalise if they do so under an EPA, and under EU pressure, instead of directly under GATS. Thus although EPAs follow the general WTO method of using a "positive list" approach to opening investment and services –i.e. letting countries choose the sectors in which they wish to commit liberalisation– the coverage will still have to cover most sectors.

The EU clearly envisages broad liberalisation across all sectors within the EPAs, laying particular emphasis on sectors of its own interest, such as postal and courier services, telecommunications, computing, financial services and maritime transport. The EU proposes not only that these sectors to be included in the EPA text, but that ACP countries undertake extra requirements when making commitments to liberalise these sectors (see below: Extra burdens on ACP countries).

The ACP have an interest in excluding vital government functions from coverage under an EPA. However, the exclusion of governmental activities in the services sector from an EPA (art. 4.c and 12.2.b) can only be done as defined in GATS rules: "activities carried out neither on a commercial basis nor in competition with one or more economic operators". This is a very narrow definition, which means that all public providers in sectors that are liberalised will be treated as if they were private providers and will be subject to EPA rules (see below: market access). This can undermine special functions of governmental or public providers to promote development and environmental protection.

⁵ The 6th WTO ministerial Conference, 13-18 Dec 2005, held in Hong Kong, declared that LDCs should not have to liberalise on market access for services.

⁶ E.g. SADC, *Framework proposa, March 2006*; PAPC *Draft Chapter*;

⁷ Conclusions of the European Council Of Ministers, 15th May 2007

⁸ See for instance P. Thompson (EC), *letter to ECOWAS and UEMOA Commissioners, 27 June 2007, p 2.*

⁹ M. Hallward-Driemeier, *Do Bilateral Investment Treaties Attract FDI? Only a Bit... and They Could Bite*, World Bank, 2003; See also: *Oxfam International, Unequal Partners: How EU-ACP Economic Partnership Agreements (EPA) could harm the development prospects of many of the world's poorest countries*; UNCTAD, *Economic development in Africa. Rethinking the Role of Foreign Direct Investment*, 2005.

The EU's proposed definition is narrower than that proposed by the Pacific draft chapter (art. 6.1.6), which was intended to ensure that essential services such as water, health and education could be excluded.¹⁰

Liberalisation of services trade and investment is potentially beneficial to developing countries if carried out in a sequenced, selective and flexible way, accompanied by appropriate regulations and according to their development priorities. In contrast, locking in broad sectoral coverage and strict liberalisation rules as the EU is pushing for in EPA texts, could be very damaging. Liberalisation of many EU offensive sectors in ACP countries that suffer from lack of regulatory and institutional capacity, especially as regards establishment in a country (mode 3), could pose severe problems for development. Increased competition from well-resourced EU companies across most sectors could drive out local ACP services providers in sectors that are not ready for liberalisation. Even if this brings economic efficiency, it might result in the most profitable parts of the economy being under foreign ownership, with profits going abroad.

It is important to note that in the EU's proposal, there is no right to emergency safeguard measures, nor a right to modify at a later date of any commitments made, as was suggested in the Pacific draft (art. 6.17). So far, the EU has hardly proposed transition periods for gradual services liberalisation. Once liberalised, it will be very difficult to opt out of the EPA rules if there is a change in circumstances or if it becomes clear that a mistake was made in initial commitments. GATS provides for procedures for compensation in case of re-closing markets, but EPAs are not clear on this.

EU defensive in its own liberalisation

The EU has proposed to exclude some of its own services sectors, such as audio-visual services and national maritime cabotage¹¹, from coverage for establishment and cross-border supply (art. 5 and 12), even though these sectors may be of future interest to ACP countries. These exclusions only protect EU interests and actually may not be WTO compatible and contradict the spirit of the substantial coverage obligation, since GATS art. 5.1 (footnote 1) states that any agreement liberalising trade in services should not provide for the *a priori* exclusion of any mode of supply. In addition, a draft EU offer to liberalise its services sectors under EPAs shows that EU member states are each making national exceptions ("reservations") to liberalisation in many sectors.

¹⁰ PAPS draft chapter.

¹¹ As well as mining, manufacturing and processing of nuclear materials; production of or trade in arms, munitions and war materials; and certain air transport services.

The EU's defensive attitude is perhaps most apparent on the issue of the temporary movement of service providing people. ACP countries have an economic interest in the movement of semi-skilled workers: the World Bank estimates that a 3% increase in migration from developing to developed countries would yield benefits that far outweigh full liberalisation of trade and the removal of all agricultural subsidies by developed countries. The EU on the contrary has a strong agenda in EPAs to prevent influx of semi-skilled service workers and has limited the provisions on entry and temporary stay to key personnel, graduate trainees, business services sellers, contractual services suppliers and independent professionals (art. 17.1) whom EU companies need to move around to service their affiliates. Again, it is EU interests that are reflected in the proposed EPA, which is strictly prevented from affecting migration rules such as on access to employment markets, citizenship, residence or permanent employment (art. 1.5). In the past, ACP countries have successfully used limits on the movement of skilled workers to force foreign companies to train local workers to a higher level. But unless they enter a reservation to that effect, they will not be able to limit the number of these specialised professionals entering their countries through quotas or economic needs tests (art. 18 and 19). While there is a need to prevent brain drain from the ACP and exploitation of ACP personnel, temporary stay of ACP persons in the EU can lead to skills development. However, the EU will only define the period of temporary stay during the latest stages of the negotiations (see art. 18.1), which leaves ACP negotiators unclear as to the benefits of any EU commitments (the length of such stay largely determines the benefits of temporary movement of personnel, and the usefulness of this article: the shorter it is, the less impact it will have).

Restrictions on the ability to regulate

One of the key ways in which the EU's proposals would restrict the ability of ACP governments and parliaments to regulate services sectors, is through the requirement that they must provide "**national treatment**" – that is "no less favourable" treatment – to foreign companies establishing presence or carrying out cross-border activities as to local companies (art. 7 and 14) in sectors that they liberalise, unless they make specific reservations to that effect. This requirement is the same as GATS and means that governments cannot give extra support to local companies to compete with foreign companies. Some bilateral investment treaties have provisions to exclude small and medium sized enterprises (SMEs) from national treatment,¹² but the

¹² See: Germany-Mozambique BIT 2004; Kenya model BIT 2004.

proposed EPA text does not show any such sensitivity. Ironically, since large companies have a lot of bargaining power over developing country governments, they end up being treated more favourably than local companies. Such governmental efforts to attract extra investment would still be possible under the proposed EPAs. Better wording would be to require “equal treatment”, although the requirement for national treatment would still pose a problem for local companies competing with large EU companies in their domestic market.

Regulatory capacity will also be prevented by proposed **market access** provisions (art. 6, 13 and 18) in those sectors that are liberalised. Unless they make reservations to that effect, ACP countries will not be able to limit the types, numbers and sizes of (foreign) companies being established or carrying out cross-border activities, including by economic needs test. This would nullify developing countries’ efforts at the WTO to preserve the right to carry out economic needs tests, which are important because they allow consideration of how the local community would be affected by the entry of too many foreign competitors.¹³ Furthermore, even though regulations can be introduced as long as they apply to both local and foreign companies, the market access requirements, which prevent the use of quotas, create legal uncertainty over regulatory autonomy of introducing certain requirements, such as restrictions on certain dangerous activities¹⁴, limitations of competition in a sector, provisions for local employment, universal service provisions, and so on.

The market access rules also mean that governments must allow 100% **foreign ownership** and prohibit governments from requiring foreign companies to enter into joint ventures with local companies (art. 6, 13.2) unless specific exceptions are made. Thus all companies in a sector could be replaced by EU companies, with all profits going abroad.

The possibility of **derogation from market access or national treatment obligations** within these sectors is “simplified” and in doing so, makes it less explicit than in GATS schedules (see explanatory memorandum, art. 6.2., 13.2, 18 to 20, Annexes to Title on Establishment, Trade in Services and E-commerce). It relies on the foresight and technical expertise of negotiators and the administration to make specific “reservations” to be written into the schedules (“annexes”). This effectively means there is a negative list approach to limiting the extent of opening in these sectors and to safeguard the right to regulate. Although the suggested restrictive market access and national treatment rules do not apply to subsidies granted by parties (art. 1.3) so that local

companies can be supported, in practice this can result in unequal support as EU governments can afford such subsidies while the ACP might be restricted in to using any other measure apart from hard cash.

Restrictions on regulatory capacity are particularly worrying in the **financial services sector**, which is the backbone to any economy whose critical role might be undermined by the proposed EPAs. As in the GATS Annex on Financial Services, EU proposes that governments can take measures in the financial sector for prudential reasons, such as the protection of financial stability. Worryingly, however, the EU proposes to restrict these measures more than in the GATS Annex by requiring such measures not to be “more burdensome than necessary” (art. 40). This imposes a necessity test, which is still being opposed by many developing countries, and the US, in ongoing WTO negotiations on services.

The EU’s EPA proposals further sharpen GATS rules by proposing that prudential measures should not discriminate against foreign services suppliers. However, foreign banks are qualitatively different to national banks as they have easier means for capital flight, more complex financial products and, as IMF research shows, are usually not providing credit to all, particularly in rural areas and to poor clients.¹⁵ EPAs would thus have a chilling effect on government and central bank policy, and prevent measures being taken for other than prudential purposes, such as for development reasons and universal access to credit and savings facilities.

Moreover, the EU proposals (Title IV) affect the regulatory capacity on **the movement of capital**. They require all current financial transactions to be allowed, as well as all capital flows related to investments. Such capital movements flows can only be restricted in “exceptional circumstances” and limited to measures that are “strictly necessary” (Title IV art. 3.1) for a maximum duration of 6 months. The EU proposal goes much further than what was agreed in Annex I of the Cotonou Agreement (Financial Protocol: chapter 4, art. 12) and is less explicit to allow to deal with balance of payments problems, as proposed by the PACP draft (art. 6.14) and defined by GATS (art. 11 and 12). Such strict EPA rules would not allow the prevention of capital flight nor preventive or long term measures which the East-Asian financial crisis has shown to be necessary. That this would leave ACP countries unduly exposed to international financial market fluctuations is of little concern to the EU since ‘the absence of a provision on payments and transfers would provide the parties with a

¹³ Despite the Hong Kong ministerial decision to remove Economic Needs Tests, there is still hope to include them.

¹⁴ See US Gambling and Betting Services case 2005.

¹⁵ E. Detragiache, T. Tressel, and P. Gupta, *Foreign Banks in Poor Countries: Theory and Evidence*, IMF, 2006.

mechanism to circumvent many service liberalisation commitments'.¹⁶

Undermining regulation for universal access

The EU proposed Chapter V on the regulatory framework for trade in services and establishment includes requirements that in postal and courier services and telecommunications -when ACP regions liberalise these sectors- universal service obligations must not be "more burdensome than necessary" (art. 27 and 36). This again imposes a novel necessity test, which would allow an EPA arbitration panel to judge the appropriateness or legitimacy of a government's stated policy objective.¹⁷

In the case of telecommunications, ACP countries may even have to consider compensating suppliers or share the cost of universal service obligations if universal service represents an "unfair burden".

Governments must also prevent "anti-competitive cross-subsidisation" in telecommunications (art. 33.a). This provision could threaten regulations requiring universal service, since it is not well defined and since "cross-subsidisation" (transferring profits between different parts of a company) is the key tool used to allow companies to provide universal service. For example phone companies often charge relatively more from low-cost users in large cities, in order to subsidize high-cost users, such as those in remote villages.

In financial services, a "public entity" is defined (art. 39.2.c) according to the GATS definition, which is very narrow. If the financial services sector would be liberalised (a top priority for the EU) public banks which would fall outside this definition would be treated as private banks, preventing them being granted exclusive functions or support in order to guarantee universal access or equal access by poor consumers, etc.

Extra burdens on ACP countries

In the Chapter on the regulatory framework, the EU proposes many regulations which the ACP are obliged or pressed to adopt when they liberalise postal and courier services, computer services, financial services, telecommunication, international maritime services, and electronic commerce. These many provisions will place an extra regulatory burden on ACP countries and not be adapted to a country's need.

Although some regulatory standards could be beneficial, if ACP countries are unable to find the

¹⁶ C. Noonan, *Comparison between the EC Draft and the PACP Draft of a Chapter on Services for a Pacific ACP-EC EPA*; and ESA paper, p 9.

¹⁷ C. Noonan, *Op. Cit.*

resources to meet them, they not only fail to benefit from them, but also will be liable to dispute settlement procedures for failing to meet their EPA obligations. As a result, the ACP would be legally bound to meet many of these standards, at high cost, but there is no proposed language binding the EU to provide technical and financial assistance to assist. Provisions on cooperation (assistance from the EU in meeting all of these standards and procedures) were not included in the first text put on the table by the EU.¹⁸

For example, there are GATS-equivalent strict proposals on **transparency**, including the establishment of national enquiry points (art. 22), and onerous procedures for considering, authorising and reviewing applications (art. 23). In postal & courier services and telecommunications, regulatory bodies must be legally separate from suppliers of such services (art. 29 and 31), and anti-competitive practises must be prevented (art. 26 and 33). This could impose an inappropriate regulatory burden.

There are also far-reaching and specific provisions stipulating the process for reaching **mutual recognition** of qualifications and other measures to authorise, licence and certify service providers (art. 21). Although many developing countries have a strong interest in seeing their qualifications recognised abroad, the proposed method of agreeing on standards relies on the existence of relevant "professional bodies", which are more lacking in ACP countries than in the EU. European professionals are likely to be better represented at joint decision making bodies than representatives of ACP professionals. Although some of these provisions are potentially beneficial to ACP countries, they could also herald the spread of EU levels of standards and rules that may not be appropriate to ACP levels of development. Moreover, an exception in art. 9.2 provides that ACP countries will be excluded from MFN treatment by the EU regarding measures under mutual recognition agreements with non-ACP countries. "This is a case of reverse special and differential treatment"¹⁹ as it benefits only the EU.

For **financial services**, there are best endeavour requirements to introduce measures which are still not being decided upon in the GATS negotiations, such as allowing comments on new laws before they are agreed upon – which benefits professional lobbyists. The ACP are also pressed to adhere to internationally agreed financial standards (art. 41.2), yet developing countries have faced difficulties in participating in the negotiation of many of the mentioned standards.²⁰

¹⁸ Explanatory Memorandum to SADC text (see missing art. 48).

¹⁹ C. Noonan *Op. Cit.*, p 6

²⁰ Standards formulated by the Basel Committee, International Association of Insurance Supervisors, International Organisation of Securities Commissions, OECD, G20, Financial Action Task Force.

Regional integration under threat

The EU proposed preamble and art. 3 claim that EPAs will deepen regional integration of ACP countries –with the aim to foster their integration in the world economy. However, the EU text has extremely few provisions that will endorse regional development in services and the sections affecting regional integration actually do not work to the benefit of the regions. To start with, proposed EPA texts and schedules (annexes) do not follow models of existing regional agreements or negotiations on services trade and investment.²¹

In case ACP countries make offers to the EU to liberalise services sectors, these offers will also apply to other ACP countries within the same region (art. 3.2.). This undermines services sector negotiations among countries in an ACP region, which might result in other liberalisation models, schedules and sequencing.

The ONLY special nod towards regional integration efforts is art. 3.3 (defined explicitly in first sentence of art. 9.2 and 16.2), which allows negotiating regions to derogate from MFN treatment, and provide more preferential treatment to providers based in countries with a regional economic integration agreement than to EU providers. This derogation is however undermined by the requirement that the ACP grant the same treatment (“MFN” treatment) to EU services or service suppliers as to those from any other “major trading country” or community competitor (including within their regional groupings) -broadly defined as any country accounting for more than 1% of world merchandise exports, or a group of countries accounting for more than 1.5% (art. 9 and 16)- with whom an economic integration agreement is signed *after* the signature of EPAs (art. 9.1.(b), 9.3., 16.1.(b), 16.3.). This means that the EU wants the same access to ACP countries as ACP countries might be granting to other groupings or partners of regional agreements that include for instance New Zealand, Australia, China, Brazil and the US.

It is worth noting that under GATS, if the ACP were only to liberalise services amongst themselves, they could allow more discrimination in favour of their own service providers (art. 5.3.(b)). This would be a perfectly logical way of allowing regionalisation to develop at its own pace, without EU interference.

Conclusions: failure to serve development

In order to support national and regional development of services sectors and trade, and to take advantage of services liberalisation, liberalisation needs to occur in a

²¹ M. Vander Stichele, *EC proposal for SADC EPA draft includes undue liberalisation of services and investment: general comments and technical analysis*, SOMO technical analysis, 23 May 2007.

carefully sequenced manner, and in parallel with the development of administrative and regulatory capacity and standards. The EU’s proposals are in direct contradiction with such an approach by proposing:

- extremely broad coverage of sectors to be liberalised;
- serious restrictions on ACP ability to regulate in their national or regional interest;
- costly regulations without financial support;
- little support to regional integration.

Many ACP countries have relatively weak regulatory capacity, a factor compounded by the EU’s failure to fulfil its Cotonou obligation to provide capacity building in services.²² Moreover, ACP regions will have to agree on common liberalisation offers, which is very difficult given the severe time limitations and the mismatch with existing regional integration efforts.

ACP countries have made various proposals for more development friendly EPAs, but these have been ignored in the EU text. Unless and until the EU is ready to fundamental changes, ACP countries should be very wary of including liberalisation in services and investment in EPAs.

If the extreme pressure used by the EU proves too strong to resist, ACP countries could attempt to safeguard their interests and maintain maximum flexibility by pushing for:

- The inclusion of many flexibilities and reservations aiming at sustainable development, and long transition periods that allow gradual liberalisation;
- restrictions on the national treatment rules to allow for local content requirements, support for SMEs, etc.;
- a right to make many exceptions to MFN provisions;
- emergency safeguard measures and broad measures to regulate capital flows;
- the use of only “best endeavour” language in regulatory requirements that may be burdensome;
- strong technical assistance and capacity-building provisions;
- more flexibility on movement of workers, including semi-skilled workers.

[This paper was written by Myriam Vander Stichele, with substantial input from Tasneem Clarke and Markus Krajewski. For comments and information, please contact: m.vander.stichele@somo.nl].

²² Akamanzi, *Op. Cit.*