



I Introduction¹

The importance of water to all forms of life is undisputable, yet half a billion people suffer from severe water shortages and nearly one billion people do not have access to safe drinking water. The availability of water is also a limiting factor for many industries, in particular agriculture. Balancing ecological and human requirements for water with the requirements of economic development raises many difficult environmental, social and legal issues.

To meet these challenges, many countries are undergoing systemic changes to the management of water resources and the provision of water services. These changes include the privatization of water services. While privatization can be a useful tool to make domestic water services more functional and efficient, it should take place as part of strategies for sustainable development and not be deemed an end in itself.

Despite concerns that privatization should not be approached as a one-size-fits-all solution, especially in the area of water services, international trade policy making continues to expand, promoting private sector involvement through progressive liberalization of trade in services. These two disparate areas, water management on the one hand and trade liberalization on the other, create unique legal and policy conflicts. In particular, some fear that the application of the General Agreement on Trade in Services (GATS) to water services and trends towards the privatization of water services will infringe on the human right² to water.³

This paper explores linkages between the GATS and domestic water policies.⁴ Chapter 2 discusses recent trends in water management, briefly describing the legal and administrative models that have been adopted for managing water resources and supplying water services. Chapter 3 sets a stage for analysis in the remaining chapters by providing an overview of the GATS. Chapter 4 then looks at privatization, analyzing how the GATS and privatization intersect generally. Chapter 5 discusses problems and pitfalls with the GATS market access when applied to water services. Finally, chapter 6 addresses how GATS obligations may limit regulatory space for implementing universal service obligations (USOs) and providing subsidies.

II Responsible Water Management and Trends Towards Privatization

Historically, administrative responsibility for all aspects of water management has rested with public authorities at different levels of governance. This is because of the essential nature of water services, because they are often natural monopolies⁵ and because of the unique nature of water as a natural resource. Thus, the government has traditionally played multiple roles as natural resource manager, service provider and regulator. This combined responsibility carries a number of inherent conflicts. The necessarily economic nature of providing services often conflicts with a regulator or resource manager's goal of protecting and preserving public goods such as water or ensuring that services are delivered to the poor or marginalized.

Water management has often focused on meeting the immediate needs of industry and agriculture. Historically, this has resulted in over-allocation of water resources for consumptive use, neglecting the needs of the environment. In recent decades, due to water shortages as well as a heightened understanding of water management practices, governments have begun to manage water resources with an eye towards sustainability, both for ecological protection as well as to ensure that marginalized segments of a society have access to clean water.

Despite trends towards sustainable water management, governments still face problems with inefficient management of

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public water services. As a response, many governments have made changes to their water policy to encourage private investment (including foreign), with the hopes of improving the efficiency of domestic water services. States have experimented with various models, including public-private partnerships (PPPs), outsourcing services but maintaining State ownership or full privatization of all aspects of water services.

Central to many of these models is the introduction of a corporate structure to the water service provider, with the government maintaining both ownership and ultimate control. This approach can overcome potential conflicts between the State's roles as resource manager/service provider and regulator and can pave the way for greater competition and private sector involvement, ultimately including privatization.

Overall, governments have a variety of options and models for structuring the provision of water services besides the traditional State-owned and -operated utility. While most water services will inevitably be supplied by monopoly providers, many aspects of services could be supplied by independent, competing entities. This would provide opportunities for foreign, as well as local suppliers in a market traditionally dominated by government-owned and -operated monopolies. In theory, outsourcing can extend to any severable part of water service provision, including management, infrastructure construction and maintenance, customer service or billing. Another option for private sector involvement are financing arrangements through private equity participation. Finally, there are arrangements such as build operate transfer contracts (BOT) that combine both, financing and outsourcing aspects.

Private sector involvement in itself, however, is not the panacea it is widely thought to be. Since private companies are profit-driven, they may be reluctant to service the poorest (and least profitable) parts of a society. For water management to be effective in maintaining a balance between economic interests, human rights and environmental considerations, it is essential that the State maintain control of the pace and conditions of increasing private sector involvement. States should particularly focus on regulating the price of water, as well as maintaining the ability to put in place USOs⁶ and to subsidize water services.

It is not merely advisable but rather essential that States maintain regulatory capabilities such as implementing USOs and subsidies. Access to a reliable, clean water source for drinking and sanitation is a basic human right, which obligates States to progressively fulfill it.⁷ This means that individuals are legally entitled to the provision of water services, and that States must ensure this provision without allowing it to fall prey to the "whims of the marketplace" or

to become a matter of "charity". USOs and subsidies are regulatory tools to that effect.

A State's ability to regulate privatized water services may be compromised by international trade rules, including those contained in the General Agreement on Trade in Services (GATS).⁸ The GATS can reduce a government's flexibility to implement water management policies – both in terms of the provision of water services to the poor as well as the management of water resources.

III GATS: A Brief Overview

The GATS is an international agreement under the legal framework of the World Trade Organization (WTO),⁹ and it is the only multilateral framework to prescribe rules for international trade in services. The GATS aims to increase such trade by providing transparency in, and the progressive liberalization of, services markets. It essentially establishes a framework for WTO Members' services providers to access services markets in other WTO-Member States by setting certain limits on how services provision can be regulated. Once undertaken, GATS rules and commitments are enforceable through the WTO dispute settlement system, which means national decision-making prerogatives may be subject to WTO authority.

The GATS' coverage is broad, both in terms of the services covered and in what is considered "trade" in services. Regarding services covered, the GATS applies to trade in all services, including activities as diverse as financial services, telecommunications, health, water supply and sewage services. The agreement does not apply to services supplied "in the exercise of governmental authority".¹⁰ However, the definition of what is supplied in the "exercise of governmental authority" is both narrow and ambiguous, and there are concerns that this exclusion may only save a limited number of governmental or other regulatory activities.¹¹

As regards the concept of "trade", the GATS covers four so-called modes of supplying services.¹² The GATS definition of "trade" not only includes traditional cross-border trade of services (mode 1), but also the movement of foreigners consuming services (mode 2), the provision of services through foreign direct investment (mode 3) and the movement of "natural persons"¹³ providing services (mode 4).

The GATS aims to liberalize trade in services by posing certain limits on "measures...affecting trade in services".¹⁴ These measures include regulatory measures taken by federal, state and local administrations, as well as those taken by non-governmental bodies exercising delegated governmental authority.¹⁵ Member States must ensure that any

domestic measures that “affect trade in services” are consistent with the rules (or “disciplines”) under the GATS. These rules include *general* as well as *specific obligations*.

The GATS general obligations apply to all WTO Members, all of their service sectors and sub-sectors in all four modes of supply. The GATS general obligations include most favoured-nation treatment¹⁶ and transparency.¹⁷ The GATS specific obligations consist of market access¹⁸ and national treatment¹⁹ obligations. The market access provision prohibits Members from implementing quantitative restrictions or domestic ownership requirements on services, aiming to ensure market access for foreign service providers. The national treatment obligation prohibits governments from favoring domestic over foreign services, in effect, requiring that foreign service providers are treated - at least - similar to domestic ones.²⁰

As specific commitments, market access and national treatment apply only to those sectors, sub-sectors and modes of supply in which Members, on an individual basis, decide to be bound. In theory, this “bottom-up” approach grants flexibility to WTO Member States.²¹ Each Member defines its own services trade regime through its specific commitments, set out in its schedule of commitments. When making specific commitments, a country may include conditions or limitations, which restrict the application of the specific GATS rule in question. For example, a WTO Member can enter into national treatment commitments for transport services, but still retain its ability to provide subsidies to domestic service suppliers only. However, it is crucial that this “condition or limitation” is inscribed in the Member’s schedule.

Once a country commits itself to a specific service sector, it is effectively prevented from rescinding that commitment. While technically the GATS includes provisions allowing a party to withdraw a commitment, there are compensation requirements (in terms of granting market access in another area) attached to such a withdrawal and in practice this mechanism is unlikely to be used.²²

As part of the Doha Round of trade negotiations, WTO Members are currently negotiating to increase the number of their specific commitments. This will expand the application of the GATS specific obligations to more sectors and modes of supply. In that context, Members are also negotiating the elimination of many of the above described conditions and limitations.²³

By analyzing how such conditions can be used to preserve regulatory flexibility to ensure that water is provided to the poor and marginalized and preserved as a natural resource,

this paper highlights the value of such conditions for current and future commitments.

IV Privatization and the GATS: A Multi-Faceted Relationship

1 Introduction

As stated above, there are concerns that the GATS, while aiming to promote growth and development by liberalizing trade in services,²⁴ may have detrimental consequences for the provision of water to the poor. To a large extent, these concerns relate to the fear that the GATS may constrain a government’s ability to regulate privatized water services. Due to the effective irreversibility of GATS commitments, there is concern that Members could be “locked in” to any level of privatization they have undertaken, even if only on an experimental basis. Further, there is concern that changes in domestic policy-making, including increasing private sector involvement in a specific sector, may inadvertently subject service sectors or activities to GATS coverage, even though a Member originally intended to exclude such sectors or activities from GATS coverage by placing conditions on its specific commitment.

To further develop the content of these concerns and identify what is at stake, this chapter explores, first, how the GATS market access and national treatment provisions, as well as political and economic pressure, indirectly encourage privatization. Second, it examines how Members can add conditions and limitations to their specific commitments in order to carve out a certain role for the public sector. In that context, this chapter explores the nuances of such conditions by looking at the specific commitments of those Members that have added relevant conditions and limitations to their environmental services commitments. Finally, again looking at these same examples, the chapter examines how changes in Members’ domestic policies can in turn alter the range of services that are either covered or excluded from these Members’ GATS commitments.

2 The Intersection between Privatization and GATS: Legal, Political and Economic Considerations

Proponents of the GATS point out that nothing in the legal text of the agreement explicitly requires governments to privatize essential services. However, concerns should not be so easily dismissed. Rather, any analysis of the linkages between GATS and privatization should bear in mind two things: the nature of privatization as a broader concept, and the political and economic realities of GATS negotiations which make the GATS more than just a legal framework.²⁵

Privatization, in a narrow, legal sense, involves a change in the control and ownership of services from the public to the private sector. However, in many cases, privatization is also linked to the elimination of public monopolies and the introduction of competition through various forms of private sector participation. It is therefore important to look at how the GATS intersects with both, aspects related to *changes in ownership* of services as well as issues linked to the elimination of public *monopolies*, i.e. those linked to the *number of services suppliers* present in a given market.²⁶

At a first glance, the GATS appears to be neutral as to whether service providers are *privately or publicly owned*. The language of the general obligations does not make a distinction between public or private entities.²⁷ When defining whether a service is “owned” by a Member, the GATS explicitly says that a service supplier could be public or private, indicating no preference.²⁸ In addition, the GATS contains language that is commonly understood to allow “public monopolies.”²⁹

However, the GATS does contain provisions – notably in its specific obligations – which appear to favor privatization, or at least increasing private sector participation and ownership in the relevant economic activities or entities. For example, in terms of ownership, Art. XVI prohibits a Member from placing limits on foreign ownership or foreign investments in a service sector or sub-sector.³⁰ While this obligation does not exclude public service providers, it *does* prohibit a governmental regulation *requiring public ownership* (including setting up a public monopoly) for any mode in any service sector or sub-sector to which it applies, as this would clearly limit foreign ownership. This provision also appears to rule out regulations limiting the participation of foreign investment, including private investment in privatized companies which were previously public.³¹

Art. XVI also prohibits governments from requiring specific types of legal entities or joint ventures for the supply of a service.³¹ Again, this provision may limit a Member’s ability either to require public ownership of services providers or to take a staggered approach to privatizing its water market. Instead of a government being able to require a certain percentage of public ownership or joint ventures, or to limit foreign investment throughout the course of a privatization process, a Member may be forced simply to open up a sector to private interests.

In addition to constraining a government’s ability to impose various legal and financial requirements as regards public ownership of service providers, the GATS also contains obligations concerning limitations on the *number of service suppliers in a sector*. In many instances, privatization, i.e. change of ownership goes hand in hand with the elimination

of a public monopoly. Along these lines, Art. XVI restricts Members from adopting a “limitation on the number of services suppliers whether in the form of numerical quotas, monopolies, exclusive services suppliers or the requirement of an economic needs test.”³³ This provision explicitly requires the elimination of monopolies, whether public or private.

Proponents of the GATS would argue that – despite these inter-linkages – the GATS does not encourage – even less force – privatization because Members are free to select, reject or condition specific commitments as they choose. However, the political realities of trade negotiations paint a different picture. In light of the heavy-handed politics involved in services negotiations, new concerns emerge about privatization of services. For example, it is widely acknowledged that the flexibility allegedly built into the adoption of specific commitments is merely theoretical and that Members, specifically developing countries, are pressured to accept commitments.³⁴

In addition to the political climate, there are also economic realities that effectively limit the role of the public sector. For example, in many countries it is common practice to cross-subsidize public services.³⁵ Again, while the GATS does not, strictly speaking, rule out non-discriminatory cross-subsidization,³⁶ the economic implications of increasing private sector participation effectively limit a government’s ability to cross-subsidize. Private entities are usually attracted to the most profitable segments of markets, leaving other segments un-served.³⁷ At the same time, since private rather than public entities are receiving the revenues, the public is left empty-handed and unable to ensure full coverage.³⁸

Since the GATS does not explicitly mention privatization, it is difficult to determine the legal relationship between privatization and GATS. While, in sectors going beyond water there is substantial evidence to suggest that the GATS encourages privatization, the debate is highly polarized and emotionally charged on both sides. At this point, the debate should move beyond this stage and – along the lines of this paper – embark upon a genuine exploration of the legal and practical relationship between GATS and privatization.

3 Specific Commitments: How WTO Members Carve Out a Role for the Public Sector

Despite the murkiness of the linkages between GATS and privatization, the GATS framework leaves Members a degree of freedom to determine public or private provision, or to otherwise regulate private water services provision. While Members cannot opt out of GATS general obligations, a Member can still reserve certain regulatory capaci-

ty by limiting the scope of its specific commitments.³⁹ This is generally done by “carving out” those service sectors and sub-sectors which Members want to reserve for public or quasi-public management. While the following analysis is based on Members’ existing environmental services commitments,⁴⁰ it may prove instructive for potential future commitments in water services.

The schedules examined in this analysis are the ones of those Members that have added conditions and limitations to their environmental services commitments. The relevant questions are: what types of conditions have Members attached to their specific commitments in order to carve out all or part of public sector provision, and how effective are these carve outs?⁴¹

The US⁴² and Estonia⁴³ for example, two very different countries and economies, adopt a similar approach towards limiting the scope of their commitments.⁴⁴ Both schedules contain a clarification in the first column of the services schedule listing the sector in question, which adds “contracted by private industry”.⁴⁵ This suggests the decisive aspect of whether a service is covered by a commitment is whether or not the *consumer* of the service is *private industry*, as opposed to the public sector or private individuals for personal consumption.

The EC schedule, in its horizontal limitations, specifically allows regulators to use certain tools for “services considered as public utilities at a national or local level”. In an explanatory footnote it adds that “[p]ublic utilities exist in sectors such as related scientific and technical consulting services, R&D services on social sciences and humanities, technical testing and analysis services, environmental services, health services, transport services and services auxiliary to all modes of transport”. In contrast, the Nordic/Swiss approach excludes the “public works function whether owned and operated by municipalities, State or federal governments or contracted out by these governments”.⁴⁶

In assessing how effectively the EC and Nordic/Swiss approaches carve out space for regulatory activities, two key ambiguities must be addressed: what *types of services activities* are considered public service, and does the notion of “public services”, “public works function” or “public utility”, as used and defined by different Members in their specific commitments, differ from that of “services provided in governmental authority”, as mentioned in GATS Art. I. 3 (c)?⁴⁷

In terms of services activities, the EC schedule refers to “services *considered* as public utilities” (emphasis added).⁴⁸ An explanatory footnote contains a list of services sectors in which public utilities exist. The language of Europe’s con-

dition, “services *considered* public utilities” indicates that it reserves the right to define, ad hoc, what services are *considered* public utilities. This “self-defining” interpretation grants considerable flexibility to the EC to define and alter what services are considered public utilities according to its social priorities. The fact that the list in the footnote is “indicative” means that services not currently listed could be “considered” as public utilities in the future.

The situation is different in the Nordic/Swiss approach. While this approach also seems to grant flexibility, much depends on how the term “public service function” or “public works functions” are interpreted.⁴⁹ Since neither the Swiss nor the Nordic commitments contain a specific list of services, this approach could potentially be more easily constrained by an unfavorable interpretation than could the European approach.

What seems to be clear however, is that the word “public” as being used in connection with notion “public service/works function” in the Nordic/Swiss schedule does not imply “public” ownership. Rather, the word “public” appears to indicate the essential nature the service in question has for the general public. The same appears to be the case for the EC schedule, when it uses the term “public utility”. While today, the notion public utility is broader, covering more than merely publicly owned entities, what really matters in the European context is whether or not a service is *considered* a public utility.

Thus, this analysis suggests that Members have realized the highly ambiguous and therefore limited nature of the Art. I “public services exclusion”.⁵⁰ The above mentioned conditions and limitations some Members have included in their schedules are clearly a response to this need to carve out parts of the public sector to preserve regulatory power. However, due to the ambiguous nature of the exercise, it is not clear that the schedules are wholly adequate.

4 Increasing Private Sector Participation: How Can Members Set Conditions Up Front to Manage Change Over Time?

The previous chapter has described how Members – by adding conditions to their specific commitments – can carve out certain services areas for public provision and regulation. Yet, Members still need to take into consideration how those range of conditioned, and consequently carved out services activities could be affected by increased private participation that is occurring after the country has entered into its specific commitment.

To date, many economies experience increasing private sector participation in the provision of essential services. This

trend originates from changes in domestic policy, either induced internally or through mandates from outside sources such as international financial institutions (IFIs).⁵¹ Among the many ways increasing private sector participation comes about, contracting out services or increasing private equity participation are two prominent options.⁵² When defining their public sector carve outs, WTO Members should consider how the scope of these carve outs would be affected by increasing private sector participation in water services. This depends, among other things, on the content of the condition and on the way that private sector participation is introduced.

The previous sub-chapter has described various ways how Members can carve out public sector involvement through their schedules. The US/Estonian approach singles out the nature of the service consumer. The Nordic/Swiss schedules explicitly exclude “public services functions” and “public works functions” from their GATS commitments. The EC schedule states that any service supplier, public or private, providing services “considered as public utilities” may be granted exclusive rights, GATS notwithstanding.⁵³

Similarly, there are various ways for increasing private sector involvement. One way is by contracting out whole services or part of a service, such as management or billing. The US/Estonian approach states that only those services “contracted by private industry” are covered by the GATS.⁵⁴ This means that only service provisions for consumption by private industrial users would be covered by the US/Estonian GATS commitment. In this case, it would be irrelevant how much of the service is contracted out to the private sector as long as the service is consumed by non-industrial or public consumers. The US/Estonian approach not only grants considerable flexibility to regulate public services but also ensures that, in the future, when considering contracting out as a means to increase private participation, the government is free to tailor the level of private sector participation to meet its needs without having to acquiesce to GATS commitments.

The Nordic/Swiss schedules explicitly exclude “public services/works functions” from the relevant GATS commitments – whether those services are State run “or contracted-out by these governments.”⁵⁵ This system is as effective as the US/Estonian approach in ensuring that contracted-out services do not automatically fall under a country’s GATS commitments. However, again, since neither the Swiss nor the Nordic schedules offers a definition of “public services/works functions”, some part of a service sector intended to be carved out may end up falling under GATS commitments.

The language of the European schedule, that “services considered public utilities may be subject to exclusive rights granted to private operators”,⁵⁶ allows for flexibility to define which services are “public utilities” and consequently benefit from more regulatory space. While this is not as effective a system as the US/Estonian or Nordic/Swiss schedules, the European system – by stating that such “public utilities” can be subject to exclusive rights – at least ensures that public services, even if contracted out to private providers, would not be subject to *full* market access and national treatment commitments.

Another way of increasing private sector participation is through (public or private) foreign equity participation in the service provider. In all of the schedules we have thus far analyzed, a key factor in determining whether a service provider is subject to GATS commitments is whether the service provider or the consumer of the service is the private sector. According to GATS Art. XXVIII, a service is considered privately owned if 50% or more of the equity interest is privately owned.⁵⁷

The US/Estonian schedules emphasize the nature of the service consumer, not the provider.⁵⁸ The only questions relevant to whether the service is covered by GATS commitments is whether the consumer is private and whether the consumer is industrial. There is nothing indicating that private investment in the service *provider* would subject the service to GATS. Change of ownership of a public company providing services to the poor doesn’t seem to affect whether a certain arrangement falls under the scope of the commitment. This scheduling grants the Member substantial flexibility to use private sector investment in services.

The Nordic/Swiss schedules specifically exempt all “public services/works functions”, whether they are owned and operated by regional or national governments or contracted out by these governments to the private sector.⁵⁹ This condition allows a public service provider or the regulator to contract out parts of the service to the private sector without subjecting the sector to GATS commitments. While the phrase “public services/works function” seems to suggest that the word “public” does not necessarily imply public ownership of the service provider (but rather the essential nature of the service in question for the general public) one could also argue that the exemption only applies if the service provider is owned by the public. In that case, if more than 50% of the service provider were to be acquired, through private foreign equity participation by the private sector, the condition would no longer apply and the service provider would be fully covered by GATS commitments.⁶⁰ In that case, the decisive aspect would appear to be the 50% or majority ownership of shares.

Also the European schedule does not specifically mention public or private *ownership*. Europe reserves the right in its horizontal commitments to grant public monopolies or exclusive rights to services “considered as public utilities.”⁶¹ As stated above, the word “considered” indicates that Europe reserves the right to define “public utility” for the purposes of its horizontal condition.⁶² Therefore, regardless of what percentage of the service provider is owned by the private sector, as long as the service is something that is *considered* a “public utility”, the GATS does not apply. In addition, if the service provider experienced an *increase* in private sector involvement, through mergers or stock sales for instance, it would still fall outside the GATS commitments as long as the service it provides continues to be regarded as a “public utility.”

When Members are designing specific commitments, they should consider the dynamic aspects of private sector involvement. This is especially important for developing countries, which, to a large extent, will make choices about levels of privatization based not only upon internal policy but also IFI requirements. Finally, the fact that GATS commitments are extremely difficult to change means it is critical that Members are careful in drafting them.⁶³

5 Conclusions

Despite the fact that the legal text of the GATS does not specifically mention privatization, there is strong evidence that the GATS does encourage private sector involvement of traditionally public services. The GATS contains many obligations relating to policies that are relevant for privatization processes. However, the exact boundaries of this relationship, or the depths to which it goes, are still unclear.

A clear understanding of how GATS relates to privatization and the private sector is especially important in terms of drafting specific commitments. Members have attempted to carve out public services – and thereby preserve a role for the public – in various ways. The myriad of approaches, as well as the ambiguities and uncertainties associated with each one, indicate the complexity of doing that. At this point, it remains to be seen how WTO panels or the Appellate Body – in a dispute settlement proceeding – will address questions of defining the various concepts of “public services” either as used in individual Member’s schedules or as used in Art. I.3 more generally.

There are also important interdependencies between domestic policy choices and the scope of GATS commitments. It is important for negotiators and services trade policy makers to realize that changes in the domestic economic environment may affect the scope of their country’s GATS commitments. This is especially relevant considering that many

countries will undergo domestic policy changes involving contracting out to the private sector or increasing foreign equity participation in domestic public services.

For developing countries, the interdependencies between GATS and domestic water policies is particularly important since developing countries frequently do not undertake policy changes, such as increasing private sector involvement, in a truly autonomous manner. Instead, changes in developing countries’ domestic policy regimes are usually conditions in a World Bank or International Monetary Fund (IMF) financial arrangement. Having implemented these policy changes, developing countries might suddenly find that new private sector involvement has broadened the scope of their GATS commitments. To date, developing countries – when determining commitments in current WTO services negotiations or in their WTO accession negotiations – have given even less consideration to the interdependencies between GATS and privatization policies.

In any case, flexibility is important. Privatization has many pitfalls and is not a clear solution to every problem. In cases where privatization fails to solve problems for which it was implemented, governments must revert to public sector provision of services, which could potentially put them at risk of violating their GATS market access or national treatment obligations. If a certain degree of private sector involvement automatically renders the GATS applicable to the service in question, it may deprive governments of the ability to put in place much needed regulations. Governments may also be find it harder to revert to mandatory public sector provision for the sector in question where privatization has failed.

Since changing GATS commitments is extremely difficult politically, economically and administratively, trade policy-makers should carefully develop their commitments, particularly in sectors which may be prone to domestic policy changes in the future.

V Unfettered Market Access: Promises and Pitfalls of the GATS Market Access Obligation

1 Introduction

GATS-driven increases in private sector involvement in services are particularly problematic in areas where the poor or marginalized are geographically isolated. Since private service providers are likely to neglect this segment of a society for better profits elsewhere, the progressive realization of the human right to water is at risk. In terms of GATS, there are fears that market access commitments may give unfettered access to water services to foreign private suppliers and constrain a governments’ ability to regulate once privatization has taken place. These concerns not only relate

to a government's ability to set up monopolies in more general, but also a government's ability to determine the specific boundaries of a monopoly.

Even if one brackets this concern, there is a great deal of uncertainty as to what market access means in services sectors, where the service is a natural monopoly. Since water services, such as sewage services, are often natural monopolies, the question of how the GATS rules, and especially its market access provision, apply to natural monopolies is particularly relevant.

Market access is laid out in GATS Art. XVI:

In sectors where market-access commitments are undertaken, the measures which a Member shall not maintain or adopt either on the basis of a regional subdivision or on the basis of its entire territory, unless otherwise specified in its Schedule, are defined as:

- a) limitations on the number of service suppliers whether in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test;
- b) limitations on the total number of service operations or on the total quantity of service output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test;
- c) measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service; and
- d) limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment.⁶⁴

This chapter discusses potential problems in defining and enforcing market access in water service sectors that are prone to natural monopoly situations. It also looks at how well the GATS framework preserves a government's ability to define geographic or other boundaries for service providers.

2 Natural Monopolies: What is the Role of the GATS Market Access Obligation?

The potential for, or existence of, natural monopolies can make negotiating market access a dubious and unreliable proposition. While there has been much controversy surrounding the EC's recent request for market access in the

water provision sector⁶⁵ how the GATS market access provision applies to natural monopolies has not yet been thoroughly defined. This question of definition is highly relevant, not only for those concerned about market access (private service providers), but also for those concerned about provision of water (civil society).

A natural monopoly occurs when the economic/technological specificities of a particular sector impose a quantitative limitation on the number of service suppliers in a given market. This quantitative limitation arises from economic conditions rather than governmental regulation. Natural monopolies frequently occur in "network services", such as railroads or highway management, where geographic and practical limitations create situations where it is only economically feasible to have a limited number of service providers.⁶⁶ Since water services, much like railroads, depend on an expensive infrastructure (in this case, pipe systems), and since more than one infrastructure is usually not economically feasible to service a population, natural monopolies in water services are common.

An additional factor unique to water provision is that consumer choice and health concerns mandate that water for drinking and sanitation be clean and reliable. This demand requires high standards for reliability and accountability for service providers. In most situations, since mixing water from different sources in one pipe makes accountability and responsibility problematic, one service supplier is more desirable than many.⁶⁷

While water corporations are pushing for more market access commitments in water sectors, it remains largely unexplored how exactly the GATS market access provision relates to limits imposed not by governmental regulation but by economic conditions (i.e. natural monopolies). In essence, the GATS market access provision aims to eliminate certain quantitative and other barriers to trade in services. However, in the case of water services, there are factors limiting market access that go beyond governmental regulations, and which are targeted by the GATS market access mandates. Even if governments do not impose any limitations on market access to water provision, economic limitations may make market access difficult nonetheless. Effectively, the high cost of building new piping systems may mean it is virtually impossible to enter a market that is served by an existing supplier. Therefore, exactly what benefits foreign service suppliers will receive from market access commitments remains a question.

One possible answer lies in the fact that, despite extenuating economic factors, a natural monopoly will most likely still involve governmental concessions or licenses. So, the GATS market access provision could influence the way

service suppliers obtain concessions or licenses. For instance, a market access commitment could mandate that foreign service providers be allowed to participate in the bidding process for concession contracts.⁶⁸ Another way the GATS market access provision becomes relevant is through the sub-headings of Art. XVI that were discussed in the privatization section. The obligation not to place limits on foreign equity participation⁶⁹ or not to require specific legal entities, such as joint venture operations,⁷⁰ are cases in point.

While neither grants new market access in the strict sense, both are relevant in terms of eliminating barriers to economic activities for service providers.

This illustrates that, while GATS tries to give service providers – both foreign and domestic – guarantees to market access, extenuating circumstances such as natural monopolies still limit market access with no remedy found in the text of the GATS. In light of the fact that the GATS market access provision not only fails to provide what it promises, but also creates unnecessary complications negotiators should step back from the negotiating process and seriously examine whether applying GATS to such a complex regulating regime as water services is at all feasible and useful.

3 Governmentally Regulated Monopolies: Does Market Access Interfere With Using Monopolies as a Regulatory Tool?

There are several ways in which the GATS market access provision constrains domestic prerogatives, specifically regulators may wish to resorting to the tool of governmentally regulated monopolies.⁷¹ For example, the GATS may affect a government's ability to define the geographical boundary in which to operate a monopoly. The ability to define geographical boundaries in monopolies is important for market differentiation purposes. It allows a government to define boundaries not just along political lines but along social, economic or need-based lines as well. For instance, in Accra, Ghana, there have been movements to segregate the more profitable urban parts of the city from the less profitable outlying parts of the city.⁷² In other instances it may be useful to combine more and less profitable geographical areas in one concession, with the goal of allowing the private supplier to offset losses with revenues. However, it remains unclear how this kind of geographic segregation relates to two of the GATS' main obligations, Art. I and Art. XVII.

The GATS market access provision, Art. XVII, states that "a Member shall not maintain or adopt either *on the basis of a regional subdivision or on the basis of its entire territory*, unless otherwise specified in its Schedule...(a) limitations

on the number of services suppliers whether in the form or numerical quotas, monopolies, exclusive service suppliers...." (emphasis added).⁷³ This could be interpreted as confirmation that, should a Member choose, it could operate either a regionally based monopoly or national monopoly, so long as it first named this condition in its schedule. The language used in Art XVI also suggests that the GATS allows a Member to define geographical boundaries along social, economic or need-based lines.

However, when read in conjunction with Art. I, Art. XVI appears to grant less flexibility. Art. I defines the "scope and definition" of the services agreement by specifying that the measures it covers are those taken by "central, regional or local governments..." or "non-governmental bodies in the exercise of powers delegated by central, regional, or local governments or authorities".⁷⁴ This could be interpreted to suggest that a Member – when setting up a monopoly, i.e. utilizing a "measure" – must define regional subdivisions along these central, regional or local governmental lines, conforming both, as regards the deciding entity as well as the geographical region with the administrative or political structure of the country in question. However, from an economic or social perspective, it may be useful to organize water management and water provision along market lines instead of administrative or political lines (either to join densely populated areas with disperse populations or to divide them). Each of these subdivisions could incorporate parts of multiple administrative or political regions. It is not clear whether these areas would be considered geographical subdivisions according to Art. XVI, specifically, because it is unclear whether the definition in Art. XVI would have to correspond to central, regional, or local governments and authorities as mentioned in Art. I.

Several items suggest the more flexible reading of the GATS in terms of geographical divisions. First, a possible disconnect between Art. XVI and Art. I can be resolved if one considers that they deal with two different issues and, therefore, may be interpreted in terms of one another only to a limited degree. Art. I deals with the scope of the GATS and, in that context, lists the entities whose actions are considered "measures affecting trade in services".⁷⁵ Therefore, the list in Art. I should only apply to those entities which can issue "measures" as defined in the GATS: measures that have to correspond to their regulatory prerogatives, not only in terms of content but also in terms of scope of application.⁷⁶ On the other hand, the term "regional subdivisions", as defined in Art. XVII, deals with market segregation, the content of the market access obligation. While the measure of course will have to be legitimate in terms of falling – both in content and geographical scope – under the entity issuing it, it cannot be constrained to the geographical subdivisions set out in Art. I. Rather the types of geographical or other

subdivisions are meant to be defined by a Member in its schedule.

Second, Art. VIII on “monopolies and exclusive services suppliers” refers to “the supply of a monopoly service in the *relevant market*”⁷⁷ (emphasis added). Given that markets can exist in terms of services sectors, consumers and geography, it is likely that a condition allowing a government to maintain monopolies for a particular service will also allow monopolies at any chosen regional level or any other geographical subdivision, including those based upon economic, social or needs-based considerations.

Third, and perhaps most compelling, is para 2 of Art. VIII, which states that:

Where a Member’s monopoly supplier competes, either directly or through an affiliated company, in the supply of a service outside the scope of its monopoly rights and which is subject to that Member’s specific commitments, the Member shall ensure that such a supplier does not abuse its monopoly position to act in its territory in a manner inconsistent with such commitments.⁷⁸

This part of Art. VIII deals specifically with abuse of monopoly positions and presents a pragmatic approach to geographical boundaries for monopolies. Specifically, this provision could be read to suggest that as long as a Member does not allow a monopoly to reach beyond its defined boundary and abuse its monopoly positions by interfering with other open markets elsewhere, then whatever boundary the Member defines for the monopoly is acceptable under the GATS. This interpretation protects those areas of the market which are open to competition but also ensures that a Member can provide water services to the most needy members of a society through establishing monopolies.

The above analysis suggests that despite the relationship between Art. I and Art. XVI, it seems probable that Members can define geographic boundaries for monopolies beyond the limited scope of Art. I. This interpretation is also promising because it is consistent with the GATS’ dual goal of “liberalization of trade in services”⁷⁹ and “recognizing the right of Members to regulate”.⁸⁰ This is specifically evident for the reading of Art. VIII, which seems only to prohibit monopoly boundaries in situations where abuse of monopolies hurts competition in areas where – according to the country’s market access commitments – competition is supposed to take place.

However, this reading does not eliminate all ambiguities and is far from broadly accepted. Thus, before WTO Members enter into further-reaching market access commitments, they should aim to achieve clarity about the content

of the obligation, specifically about the constraints it may place upon their ability to design and regulate various monopoly markets.

4 Conclusions

There are concerns about the application of the GATS market access rules to water services, specifically, in light of the fact that access to clean water for sanitation and drinking is considered a basic human right. However, applying the GATS market access provision to water services is also problematic for other reasons.

First, water services are frequently natural monopolies, which in turn raises the question of whether GATS Art. XVI commitments would really have any affect, since conditions other than governmental regulation create the monopolies. Applying the GATS market access provisions to natural monopolies may not have the same market opening effect as applying the market access provision to other services sectors⁸¹ - while creating considerable constraints for regulatory prerogatives.

Second, the GATS market access provision is not only problematic for natural monopolies, but also for situations where Members choose to impose artificial monopolies. Specifically, there are fears that an Art. XVI commitment, when read in conjunction with Art. I, may constrain a regulator’s ability to define and segregate markets along economic, social or needs-based criteria. While some interpretations suggest that Members can define the geographical boundaries of those monopolies based on any considerations they deem appropriate, lack of legal security means that Members should proceed cautiously when negotiating further commitments.

VI Access to Water for the Poor: Protecting Regulatory Prerogatives By Conditioning Specific Commitments

1 Introduction

Among the many concerns civil society groups raise with respect to the GATS and the provision of water are concerns that the GATS will constrain the very policies necessary to ensure that water is provided to the poor. Two of the regulatory tools governments can use to ensure water provision for the poor are imposing universal service obligations (USOs) on private providers or directly subsidizing service providers.⁸² This chapter explores how WTO Members have addressed similar concerns in their existing environmental services commitments.⁸³

2 **Imposing Universal Service Obligations (USOs): Is there Flexibility for Defining the Nature of Universal Services and of Universal Service Obligations?**

The private sector is likely to be most interested in those service sectors and segments of markets that are profitable. Consequently, private sector participation may not improve access to water for all of society. In order to ensure that private service providers still service the poorest and least profitable parts of a society, a State may want to make USOs an integral part of its contractual arrangement with the private service providers. USOs are requirements imposed on the service provider by the State. They usually involve an agreement to expand service delivery to certain previously un-served areas, or to provide the service at an affordable price. In very impoverished or marginalized areas, “affordable” can mean that the service provider has to provide the service below their cost.⁸⁴

A State must define what it considers a “universal service” and determine how it will design and implement obligations to perform these services. To effectively use USOs as a means of ensuring services to the poor, a State must have maximum freedom to do both.

There are concerns that WTO Members’ ability to establish USOs could be constrained by GATS if Members do not carefully formulate conditions and limitations before signing onto specific commitments.⁸⁵ For example, a Member may decide not to apply USOs to all service providers in a sector but only to new service providers. New entrants are most likely those services, that enter markets with the primary goal to make profits, rather than to pursue broad public policy objectives. Given that, in many cases, these new entrants would be foreign private providers, a USO targeting such new entrants, could be found to be discriminatory and consequently prohibited under GATS national treatment requirements.

Some WTO Members appear to have recognized these potential problems surrounding their ability to apply USOs once they have entered into full market access and national treatment commitments. In order to retain the ability to do so, they have placed conditions and limitations on their commitments, with varying degrees of apparent effectiveness.

The European schedule, for example, reserves the right to subject certain services considered as public utilities “...to exclusive rights granted to private operators.”⁸⁶ An explanatory footnote specifies that “[e]xclusive rights on such services are often granted to private operators, for instance operators with concessions from public authorities, subject to

specific service obligations.”⁸⁷ This schedule seems to allow the use of USOs, yet it does not provide a definition for “universal service” or for “exclusive service contract”.⁸⁸ This shortcoming is not particularly problematic, however, since a lack of a uniform definition in the European schedule could also allow flexibility for Europe to adopt definitions on a case by case basis, depending on the sector and social situation in question. Such an interpretation suggesting flexibility to define a universal service also appears to be fully consistent with the GATS preambular reference to the right to regulate⁸⁹ and references to universal service aspects in other texts of the GATS legal framework.⁹⁰

The next question is how a Member may design and implement USOs within the framework of the GATS. In this context, the primary concern of this paper is the ability of governments to require private service providers to “roll-out” service provisions to previously un-served geographical areas or to provide services to those unable to pay.

Most likely, the European condition, with its reference to “specific service obligations”, does not limit the nature of these obligations and would therefore allow all types of USOs. Europe’s ability to impose USOs could be hindered, however, if the USOs or their implementation were to exhibit discriminatory effects. Privatization of public services usually involves a private foreign entity wanting access to the profitable part of a domestic market. If Europe were to impose a facially neutral USO on all new water service providers, it could amount to a *de facto* violation of national treatment obligations, since it would only apply to foreign service providers.⁹¹ Again however, the European schedule appears to grant leeway, as the condition it contains applies to both the market access and the national treatment obligation.

Unlike the European approach, the Nordic/Swiss approach does not explicitly state what type of regulatory action is allowed for public utilities. Instead, it excludes the “public work function” aspects of services from the commitments as such, even if the services are contracted out.⁹² This approach is simpler and overall appears to grant more flexibility for governmental regulatory prerogatives. Once the threshold question of what is included in the term “public service/works function” is passed, none of the GATS specific commitments apply to regulatory action undertaken in that field. That suggests that any measures taken to require USOs are permitted, as long as they do not violate the GATS general obligations.⁹³

The US/Estonian schedules explicitly limit the application of national treatment and market access to “services contracted by private industry”. Assuming that the US/Estonian commitment only covers private industry consumption of

services, the US or Estonia would be able to put in place USOs, even if discriminatory, as long as the purpose of the USOs is not to facilitate private industry, but rather to facilitate private individual consumption of water services.⁹⁴

Imposing USOs is a useful way for regulators to ensure that water is provided to even the poorest segments of a population while still allowing privatization in more lucrative segments. More significantly, the imposition of USOs could be a significant means of WTO Members meeting their obligations under international human rights law in relation to the principle of non-discrimination.⁹⁵ However, WTO Members must be sure to design their specific commitments so that they retain the ability to define universal services and to determine how to apply USOs.

3 Providing Subsidies: Is Carving Out Regulatory Space Through Conditions on Specific Commitments Enough?

Along with USOs, subsidies are an important tool for ensuring affordable water services to all segments of a community. For instance, a State may choose to subsidize water services to poor areas because that segment of the market is unprofitable and otherwise would not be serviced at all. However, providing subsidies can be difficult for governments, either because they lack the capital or revenue to do so, or because they are constrained by international legal obligations such as those of the GATS agreements. In terms of GATS, certain subsidies could be found to constitute anti-competitive behavior or violations of national treatment provisions.

If a State subsidizes providers servicing poor areas which would otherwise have trouble attracting service providers (and indeed are only serviced by subsidized *public* service providers), anti-competitive behavior may not be a problem since the very fact that there is no competition for the specific area necessitated the subsidies in the first place.⁹⁶ However, a State may still run afoul of Art. XVII national treatment provisions, which require a Member to treat all foreign and national service providers equally within a specific sector, regardless of whether they are only servicing a profitable part of the market.⁹⁷ Thus, Members may wish to consider conditions or limitations for their national treatment commitments.

Many Members have done so, addressing subsidies in their horizontal conditions to the national treatment commitments.⁹⁸ Both the European and Bulgarian horizontal limitations, for example, state that “[t]he supply of a service, or its subsidization, within the public sector is not in breach of this commitment”.⁹⁹ Such a commitment would clearly allow a government to subsidize public provision of the

service. However, would the subsidy still be allowed if, for instance, the public sector out-sources certain aspects of the services to the private sector, thereby removing the sector from being “within the public sector”?

This question does not matter so much for the Nordic/Swiss approach, which altogether excludes the “public service/works function” of certain services, even if contracted out to private providers.

Similarly, the US/Estonian schedule. Assuming the interpretation which implies that only private industry *consumption* is covered by the commitment, then public provision of services to the general public or citizens for private consumption would be excluded from the commitment. Given that the market segment of private consumption for non-industrial use may be the segment most in need of subsidization, it appears that the US/Estonian approach preserves adequate regulatory freedom for subsidies in this area.¹⁰⁰

Finally, another question arises when a government provides investment incentives to attract investment in a poorly developed water sector. Would such investment incentives be considered subsidies, and therefore – if more favorable to domestic investors – be considered a national treatment violation? Again, to date there are no clear answers to these questions.

In any case, many of these issues remain open and undetermined, and Members may wish to carefully design and double check their commitments and limitations as regards subsidies. An issue underlying all subsidies issues in the GATS is that, to date, subsidies are only prohibited in so far as they constitute anti-competitive behavior or a national treatment violation. If they are trade distortive, but not discriminatory and not-anti competitive, they are not covered by any existing trade rules. WTO Members are, however, negotiating rules for trade distortive subsidies.¹⁰¹ It is important that any eventual rules will not further constrain governments’ abilities to provide subsidies to ensure the provision of services to the poor and those in need.

4 Conclusions

The potential of the GATS to constrain governments’ abilities to effectively impose USOs and provide subsidies are among the key concerns civil society groups have voiced with respect to the GATS. The previous analysis describes different ways WTO Members have designed – and thereby limited – their GATS commitments, with the view to preserving a degree of regulatory flexibility. The fact that some WTO Members have gone to great length to include such conditions and limitations in their commitments suggests that at least those WTO Members share some of the con-

cerns civil society has been voicing in terms of how the GATS affects the provision and regulation of public services.

In addition, the conditions reviewed in this chapter may provide valuable models for Members when negotiating future commitments, especially in sensitive sectors such as the provision of water. In cases where a Member decides to proceed in accepting water commitments, examining how other countries have conditioned related commitments in the past could offer instruction on how to effectively protect regulatory flexibility, including the flexibility needed for current and future privatization in service sectors.

Nevertheless, conditioned and carefully designed GATS commitments are no guarantee that private sector water provision will result in progressive fulfillment of the human right to water. While carefully drafted GATS commitments may allow flexibility for regulatory flanking policies they do not ensure that regulators take the right complementary action, necessary to ensure that water is provided to the poor.¹⁰²

Another key element is the nature and content of the legal relationship between the government/regulator and the private service provider. Clearly, governments need as much regulatory space as possible to negotiate the type of service contracts that best suit the needs of their particular social and economic situation. Careful scheduling of GATS commitments can help preserve that space. In the cases examined here, the EC schedule makes a specific reference to this contractual relationship (the “exclusive service contract”), and thereby carves out a certain degree of flexibility for the negotiation of such arrangements. However, while there is increasing analysis on the effects of the GATS on the provision of water to the poor, to date, there is only limited analysis on how the *nature* of contractual arrangements with private service providers either contributes to or impedes progress toward this goal.

VII Final Observations

Globally, governments are seeking new solutions to ever-mounting water problems: both in terms of threats to natural water reserves as well as the difficulties of providing safe, accessible and affordable water services to growing populations. Governments are increasingly choosing to solve these problems through greater private sector involvement in the provision of water services. Since access to water for drinking and sanitation is considered a basic human right, more than ever, it is essential that governments maintain the appropriate regulatory powers to ensure con-

tinued provision of this essential service to all, most especially the poor.

The GATS increases the momentum towards the liberalization of water services. Some are concerned that the GATS in effect drives privatization processes. However, civil society is also concerned that the GATS may impair governments’ abilities to provide the increased level of regulation necessary in an open, privatized market. Specifically, there are concerns that the GATS may constrain flexibility when implementing monopolies or prevent the imposition of USOs and subsidization of services.

The extent to which the GATS impacts a country’s policy choices depends significantly upon the way the country phrases its specific GATS commitments. While no country has yet made commitments in terms of water services, reviews of specific commitments made to date in the environmental services sector show that WTO Members have taken a range of approaches to placing limitations on these commitments.

These approaches range from placing horizontal limitations on all services or all environmental services, to specifically conditioning access to particular sectors and sub-sectors. Many countries have included safeguards for continued public sector involvement by excluding “public utilities”, “public services” or “public works functions” from the scope of their GATS market access and national treatment commitments. Governments have included these conditions notwithstanding GATS Art. I.3. (b), an express exemption for services supplied in the exercise of governmental authority. Many countries have also conditioned their commitments to ensure they will continue to be able to subsidize services. This display of awareness suggests that similar conditions might be placed on the opening of water service markets, if commitments will be undertaken in that sector at all.

Pro-GATS groups argue that the conditions placed on existing services commitments demonstrate that the bottom-up approach works, and that the framework provides adequate flexibility to address any concerns that an individual government may have. However, the need for limitations across the board, where public utilities are involved, suggests a fundamental flaw in the structure of the GATS as it applies to essential services and the types of obligations it places upon governments.

From this review, it seems clear that governments share many of the concerns of civil society in terms of how GATS affects the provision and regulation of public services, including implementing USOs. The various approaches

adopted by WTO Members to conditioning market access all aim (so it would seem) to achieve the same end, regulatory flexibility. However, the varying nature of these approaches creates ambiguity in terms of what exactly the parties intended, which creates potential for disputes. In the case of a dispute, a WTO panel or AB ruling would ultimately interpret a commitment, rather than the Member itself who crafted the commitment. Even in the absence of ambiguity, a real risk remains that Members, particularly developing countries, will make commitments without knowing the long-term consequences or simply as a result of political or economic pressure exerted in negotiations. Injecting further speed into the negotiating process would provide additional challenges to developing countries.

As stated above, privatization of basic public services is a great concern of civil society. While negotiators have addressed issues that stem from privatization, such as the loss of regulatory flexibility, no one has yet addressed privatization and the GATS encouragement of privatization directly as such. The reason negotiators have not addressed privatization head on in specific commitments may not have to do so much with the fact that they are out of tune with their constituencies but rather that the GATS process in general is in-conducive to attempts to reduce privatization of basic public services.

Ideally, water services should not be covered by either specific or general GATS disciplines. Governments should be free to involve the private sector in water services secure in the knowledge that they have every possible regulatory tool at their disposal.

GATS and Water: Retaining Policy Space to Serve the Poor

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Endnotes

¹ Elisabeth Tuerk, CIEL etuerk@ciel.org, Aaron Ostrovsky and Robert Speed. This is a second draft of a paper, contributing to the workshop on water and international economic law, 3 March 2003 in Geneva. We are grateful to Markus Krajewski, Mahesh Sugatan and Simon Walker for valuable comments on an earlier version of this draft. Special thanks to Mireille Cossy for the numerous challenging discussions surrounding the issues discussed in this paper and to Suzanne Garner for her editing assistance.

² “The human right to water entitles everyone to sufficient, safe, acceptable, physically accessible and affordable water for personal and domestic uses. An adequate amount of safe water is necessary to prevent death from dehydration, to reduce the risk of water-related disease and to provide for consumption, cook-

ing, personal and domestic hygienic requirements.” Committee on Economic, Social and Cultural Rights, “The right to water: articles 11 and 12 of the International Covenant on Economic, Social and Cultural Rights”, General Comment no 15 (E/C.12/2002/11).

³ Ellen Gould, *Water in the Current Round of WTO Negotiations on Services*, Canadian Centre for Policy Alternatives Briefing Paper Series: Investment and Trade, Vol. 4, No. 1; John Hilary, *GATS and Water: The Threat of Services Negotiations at the WTO*, A Save the Children Briefing Paper, (2003); Hilary, John; *The Wrong Model, GATS, trade liberalization and children's right to health*; Save the Children, London 2001; [Woodroffe, Jessica/Joy, Clare; *Out of services: The development dangers of the General Agreement on Trade in Services*, World

Development Movement, London, March 2002; Woodroffe, Jessica; *GATS: A Disservice to the Poor*, World Development Movement, London January 2002; Ellis-Jones, Mark/Hardstaff, Pete; *Serving (up) the nation, A guide to the UK's commitments under the WTO General Agreement on Trade in Services*, World Development Movement, London November 2002; Sinclair, Scott, 2000: *GATS - How the World Trade Organization's new "services" negotiations threaten democracy*, Canadian Centre for Policy Alternatives, Ottawa 2000;

Note that these concerns are not only voiced by non-governmental organizations (NGOs), but also by inter-governmental organizations (IGOs), including the World Health Organization (WHO) or the United Nations High Commissioner for Human Rights. UNHCHR (2000), Economic, Social and Cultural Rights: *Liberalisation of Trade in Services and Human Rights*, Report of the High Commissioner E/CN.4/Sub.2/2002, (June 2002);

Early civil society documents have given rise to a fierce response by the WTO Secretariat. See: WTO Secretariat, *GATS – Fact and Fiction*, The World Trade Organization, at http://www.wto.org/english/tratop_e/serv_e/gatsfacts1004_e.pdf (Mar. 2001). For a response see generally Scott Sinclair and Jim Grieshaber-Otto, *Facing the Facts: A Guide to the GATS Debate*, Canadian Centre for Policy Alternatives (2002)(for a response to this document). See also Ellen Gould, *Separating WTO Fact and Fiction*, The Council of Canadians, at http://canadians.inline.net/display_document.htm?COC_token=024OJ24&id=128&isd=1&catid=77 (June 2001); *The GATS Debate: A response to the common arguments used against the critics of the General Agreement on Trade in Services*, World Development Movement at <http://www.wdm.org.uk/cambriefs/wto/gatsdeb.pdf> (May 2001); Chakravarthi Ragavan, 'GATS – Fact and Fiction' at best a partial truth, Third World Network, at <http://www.twinside.org.sg/title/fiction.htm>, (April 2001); Vice Yu III, *Technical Comments on the WTO's 'GATS – Fact and Fiction' Paper*, Friends of the Earth International, at <http://www.gatswatch.org/factfict.html> (April 2001).

⁴ As part of a volume containing other, related contributions, this paper only looks at a limited set of issues. For example, this paper does not address the classification of water services, nor does it discuss questions about government procurement (e.g. which sort of water management arrangement could be considered government procurement and therefore would fall outside the scope of the GATS) or how Art. 1, 3 (b), the GATS public services exclusion, would apply to water services. For a comprehensive analysis of these and other aspects, see Cossy, Mireille, *Water Services and the GATS – Selected Legal Aspects*, INSERT . For a discussion about GATS and water from an environmental perspective, see Elisabeth Tuerk, Robert Speed and Aaron Ostrovsky, *Water and the GATS, a WWF/CIEL discussion paper*, World Wide Fund for Nature (forthcoming 2003).

⁵ A natural monopoly is situation where for technical/economic reasons there cannot be more than one efficient provider of a good or service. Public utilities frequently exhibit natural monopoly characteristics. This is especially true in the case of water provision services, as it is hardly conceivable that, within

one geographical market, there will be two competing water service providers, operating two sets of pipes in parallel.

⁶ USOs differ globally, but common examples are providing water services free to impoverished areas or providing phone systems or postal services to remote areas.

⁷ The 1977 United Nations Water Conference in Mar del Plata, Argentina, established the concept of basic water requirements to meet fundamental human needs, which was reiterated at the 1992 Earth Summit in Rio de Janeiro, Brazil in 1992. Source: The World Health Organization, *The Right to Water*, 3 Health and Human Rights Publication Services, (2003).

⁸ General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization [hereinafter the WTO], Annex 1B, Legal Instruments – Results of the Uruguay Round vol. 31, 33 I.L.M. 81 (1994) [hereinafter GATS].

⁹ For a comprehensive analysis of the GATS and its legal aspects, see Markus Krajewski, *National Regulation and Trade Liberalization in Services – The Impact of the General Agreement on Trade in Services (GATS) on National Regulatory Autonomy*, London: Kluwer Law International (2003) forthcoming.

¹⁰ GATS, Art. I, 3 (b).

¹¹ For a legal analysis of this provision, see generally Markus Krajewski, *Public Services and the Scope of the GATS*, a CIEL Research Paper (2001). Available at <http://www.ciel.org>. See also Markus Krajewski, *Public Services and Trade Liberalization: Mapping the Legal Framework*, Journal of International Economic Law 6(2), 341-367 (2003). It is interesting to note that by now, even proponents of the GATS have acknowledged the limited nature of Art. I. Consequently, Members are currently trying to change their existing commitments to include a broad horizontal limitation that effectively excludes public utilities or public services entirely from the scope of their commitments.

¹² GATS, Art. I, 2.

¹³ "Natural Person" is defined as "a natural person who resides in the territory of [another] Member...and who...is a national of that other Member." GATS, Art. XXVIII (k).

¹⁴ GATS, Art. I, 1.

¹⁵ GATS, Art. I, 3 (a).

¹⁶ GATS, Art. II.

¹⁷ GATS, Art. III.

¹⁸ GATS, Art. XVI.

¹⁹ GATS, Art. XVII.

²⁰ Note that the GATS national treatment provision explicitly covers both, *de jure* and *de facto* discrimination.

²¹ Recently, this theoretical flexibility has been increasingly questioned. For example, see Peter Hardstaff, *The “Flexibility” Myth: Why GATS is a Bad Model for a new WTO Investment Agreement*, paper to Seminar on WTO Investment Agreement, Geneva, March 29th, 2003; See UNCTAD (2002a) *Trade in Services and Development Implications*: Note by the UNCTAD Secretariat Document TD/B/COM.1/55. UNCTAD, Geneva. See also Mina Mashayekhi, Elisabeth Tuerk, *The WTO Services Negotiations: Some Strategic Considerations, Trade-Related Agenda, Development and Equity*, Occasional Papers 14, South Centre, (January 2003).

²² While the WTO Secretariat points to the flexibility granted by this mechanism, (see GATS – Facts and Fiction, available at: http://www.wto.org/english/tratop_e/serv_e/gats_factfiction_e.htm), civil society groups have pointed to the practical limitations of this system (see Jessica Woodroffe and Clare Joy, *Out of Service: The development dangers of the General Agreement on Trade in Services* (March 2002)). It remains to be seen how easy it will be for WTO Member to successfully use this process. Currently, the European Communities is considering various options to withdraw the existing commitments of its most recently acceded Members.

²³ In addition, WTO Members are negotiating new, possibly general rules on services trade.

²⁴ GATS, pmbl.

²⁵ Civil society’s concerns about the GATS as more than a purely legal framework need to be addressed not only in terms of privatization but in general as well.

²⁶ See Cossy *supra* note 4.

²⁷ GATS, Part II.

²⁸ GATS Art. XXVIII (n) states that “a juridical person is: (i) ‘owned’ by persons of a Member if more than 50 per cent of the equity interest in it is beneficially owned by persons of that Member.” “Juridical Person” is defined in Art. XXVII (l) as “privately-owned or governmentally-owned”.

²⁹ GATS, Art. VIII. For a discussion of these aspects, see also Cossy, *supra* note 4.

³⁰ GATS, Art. XVI, 2 (f).

³¹ *Id.* Frequently, however, governments may wish to resort to such regulations not because of economic rationale but rather to respond to the general feeling of the public to not sell off state companies to foreigners.

³² GATS, Art. XVI, 2 (e).

³³ GATS, Art. XVI, 2 (a).

³⁴ See *supra*, note 21.

³⁵ There are many definitions of cross-subsidies. For the purposes of this paper, a services pricing scheme has cross subsidies if the price of the service for some consumers is above average and the price of the same service for other consumers is below average. See Paulina Beato, *Cross Subsidies in Public Services: Some Issues*, Sustainable Development Department Technical Papers Series IFM-122, Inter-American Development Bank, at <http://www.iadb.org/sds/doc/IFM-122-CrossSubsidies-E.pdf>. (Jan. 2000) (for a more detailed discussion of cross-subsidies in public services).

³⁶ See GATS, Art. VIII. The GATS legal framework focuses mainly on anti-competitive aspects of cross-subsidies.

³⁷ This practice is often referred to as “cream skimming” or “cherry picking”.

³⁸ For example, in 1993, Ghana began implementing a World Bank-backed policy to segregate water markets in and around the capital city of Accra. The policy was implemented to encourage privatization of profitable parts of the water market. These policies require a community to contribute financially to the installation and repair and maintenance of water infrastructure. The poorest areas, where residents spend between 18-25% of their income on water, have not been able to meet the costs and, as a result of unsafe water, have experienced a dramatic increase in cases of guinea worm. Ghana now has the highest incidence of guinea worm in the world after Sudan, whose outbreaks are attributed to Sudan’s civil war. Source: Rudolf Amenga-Etego, *Water Privatization - Analysis*, Public Agenda (Accra, Ghana), (July 7, 2003).

³⁹ While retaining regulatory flexibility in spite of GATS commitments is - in theory - possible, this should not encourage Members to rush into adopting commitments. In addition, current negotiating processes develop new rules under the GATS, which in turn might constrain regulatory flexibility - once they are in force.

⁴⁰ Specifically “Sanitation and Similar Services” (CPC 9403). For the purposes of this analysis, sanitation services provide a good close approximation of water services since both are subject to natural monopolies and both are considered essential to human health.

⁴¹ For example, the various models differ in the way the qualifications are introduced. While the EC uses a horizontal limitation, applying to all services sectors, Switzerland and the Nordic countries specify limitations only for the environmental services sector.

⁴² The United States of America, *Schedule of Specific Commitments*, GATS/SC/90 (Apr. 15, 1995).

⁴³ The Republic of Estonia, *Schedule of Specific Commitments*, GATS/SC/127 (Oct. 5, 1999).

⁴⁴ The Korean schedule is somewhat different. In a footnote to the first column of the row including commitments for “refuse water disposal services” the schedule specifies that Korean com-

mitments cover "[O]nly collection and treatment services of industrial waste water under CPC 9401" (emphasis added). The Republic of Korea, Schedule of Specific Commitments, GATS/SC/48 (Apr. 15, 1995).

⁴⁵ For both countries this clarification only applies to two of the four environmental services sub-sectors mentioned, namely sewage services and refuse disposal services. Sanitation services and other (landscape protection) services do not contain such a clarification. In all sub-sectors, both market access and national treatment are fully committed, without conditions and limitations, only mode 4 is listed as "unbound, except as indicated in the horizontal section".

⁴⁶ Note that Sweden refers to "the public works functions" in plural (Sweden, *Schedule of Specific Commitments*, GATS/SC/82 (Apr. 15, 1994)), as does Norway, referring to the "public service functions" (Norway, *Schedule of Specific Commitments*, GATS/SC/66 (Apr. 15, 1994)) while Switzerland refers to the concept in the singular, "public work function" (Switzerland, *Schedule of Specific Commitments*, GATS/SC/83 (Apr. 15, 1994)). Strictly speaking also Liechtenstein belongs to this category, Liechtenstein, *Schedule of Specific Commitments*, GATS/SC/83-A (Apr. 15, 1994).

⁴⁷ An analysis of this question is, however, outside the scope of this paper. For a detailed discussion of Art I, 3 (b) see Krajewski *supra* note 11.

⁴⁸ European Communities and their Member States, *Schedule of Specific Commitments*, GATS/SC/31 (Apr. 15, 1994).

⁴⁹ Switzerland, *Schedule of Specific Commitments*, GATS/SC/83 (Apr. 15, 1994); Norway, *Schedule of Specific Commitments*, GATS/SC/66 (Apr. 15, 1994); Sweden, *Schedule of Specific Commitments*, GATS/SC/82 (Apr. 15, 1994).

⁵⁰ The limited capacity of GATS Art. I, 3 to preserve regulatory autonomy particularly for "essential basic services" originates from several factors. Most importantly, the Art. I, 3 exclusion does not explicitly address essential or basic services but rather "services provided in governmental authority". Further, the definition of a "service provided in governmental authority" is ambiguous and the provision's application to new economic circumstances, such as increasing private sector participation in essential services sectors, may have unintended side-effects. These factors are compounded by the lack of additional guidance on how to interpret the exclusion. Members have not adopted any interpretative notes and information about the provision's drafting history is limited. Even proponents of the GATS acknowledge that this provision is "a piece of clumsy drafting".

⁵¹ For policy inter-linkages between the WorldBank, the GATS and investment agreements affecting the provision of water see also *Going With the Flow: How International Trade, Finance and Investment Regimes Affect the Provision of Water to the Poor*, CIEL Issue Brief, (2003), <http://www.ciel.org>.

⁵² These are two very common forms of private sector participation mandated by IFIs.

⁵³ GATS/SC/31 (Apr. 15, 1994).

⁵⁴ GATS/SC/90 (Apr. 15, 1995); GATS/SC/48 (Apr. 15, 1995); GATS/SC/127 (Oct. 5, 1999).

⁵⁵ GATS/SC/83 (Apr. 15, 1994); GATS/SC/66 (Apr. 15, 1994); GATS/SC/82 (Apr. 15, 1994).

⁵⁶ GATS/SC/31 (Apr. 15, 1994).

⁵⁷ See *supra* note 36.

⁵⁸ GATS/SC/90 (Apr. 15, 1994); GATS/SC/48 (Apr. 15, 1995); GATS/SC/127 (Oct. 5, 1999).

⁵⁹ GATS/SC/82 (Apr. 15, 1994); GATS/SC/66 (Apr. 15, 1994); GATS/SC/83 (Apr. 15, 1994).

⁶⁰ See *supra* note 36.

⁶¹ GATS/SC/31 (Apr. 15, 1994).

⁶² "Public Utility" in the European schedule does not necessarily mean a utility which is owned publicly, but rather services traditionally considered important for the public good.

⁶³ For more on the GATS "lock in effect", see Cossy and Ostrovsky/Speed/Tuerk *supra* note 4.

⁶⁴ GATS, Art. XVI, 2 (a), (c), (e), (f).

⁶⁵ See Press Release, European Union, WTO services: Commission submits draft offer to Council and Parliament – public services fully defended (Feb. 5, 2003) at http://europa.eu.int/comm/trade/services/pr050203_en.htm. See also *EU to block talks on more public services liberalization*, FINANCIAL TIMES (London), Feb. 5, 2003; *EC Suggests Financial Services, Telecom For Possible Liberalization, Excludes Others*, INT'L TRADE REP., (Feb. 6, 2003).

⁶⁶ Recently, there have been trends in railroad management to separate the entities providing track from those providing trains, suggesting that railroads are no true natural monopoly. However, this type of system has also shown that such developments give rise to even more careful and thorough intervention by the relevant regulatory authorities.

⁶⁷ Again, it could be argued that the circumstances which necessitate natural monopolies could be mitigated with increase regulation – in this case, strict water purity standards enforced at the water service provider level.

⁶⁸ For example, such arrangements could possibly also be considered domestic regulations, falling under GATS Art. VI or government procurement, currently excluded by means of Art. XIII. See Mireille Cossy, *Water Services and the GATS – Selected Legal Aspects*, INSERT (for an analysis of the latter aspect); an interesting question arising in that context is whether a commitment for the GATS national treatment provision already grants national treatment in the bidding process, or only once the services supplier is providing its services. The latter aspect, however,

appears to be less relevant when dealing with a natural monopoly situation, which in its very nature excludes services provision by two competing suppliers.

⁶⁹ GATS, Art. XVI. 2 (f).

⁷⁰ GATS, Art. XVI. 2 (e).

⁷¹ Among those, the best known is the fact that full market access commitment rules out limitations on the number of services suppliers, including monopolies.

⁷² See *supra* note 29.

⁷³ GATS, Art. XVI, 2 (a).

⁷⁴ GATS, Art. I, 2 (a), (i), (ii).

⁷⁵ It could well be argued, however, that the scope of application of a market access restriction corresponds to the area of competence of the respective authority undertaking this measure. This would suggest a linkage between the concepts of GATS Art. I and XVI.

⁷⁶ “Measures” are defined as “any measure by a Member, whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form,” GATS, Art. XXVIII, (a).

⁷⁷ GATS, Art. VIII, 1.

⁷⁸ GATS, Art. VIII, 1.

⁷⁹ GATS, pmbl.

⁸⁰ *Id.*

⁸¹ In network services, most of which have natural monopoly characteristics, WTO Members have responded by considering additional regulatory frameworks, for instance so-called reference papers. Such reference papers may constitute a complementary tool to market access commitments. Members should however, not proceed hastily but rather should assess the implications and effects of their options.

⁸² Subsidies are an important mechanism for compensating companies required to provide commercially-unviable universal services. Civil society has expressed concerns that the GATS may impede governments’ abilities to subsidize the provision of services, including basic services. These concerns mainly relate to situations where public and private provision of services co-exists: the private provider serving the profitable market and the public provider serving the less profitable market. The government may provide subsidies to the public domestic company, while not providing any to private foreign companies. Providing subsidies to one company and not another could be inconsistent with the GATS national treatment provision.

⁸³ Subsidies given to individuals rather than to service suppliers fall outside the scope of this paper.

⁸⁴ See generally, Omar O. Chisari, *The Needs of the Poor in Infrastructure Privatization: The Role of Universal Service Obligations*, Universidad Centroamericana at <http://bjcu.uca.edu.ni/biblioteca/debates/Chisari.pdf> (Jan. 1999) (for a discussion of the relationship between USOs and the poor).

⁸⁵ The only place USOs are specifically mentioned in the context of the GATS is the Telecom Reference Paper which states USOs “will not be regarded as anti competitive per se, provided that they are administered in a transparent, non-discriminatory and competitively neutral manner,” Negotiating Group on Basic Telecommunications, *Telecommunications Services: Reference Paper*, art. 3, World Trade Organization (Apr. 24, 1996), at http://www.wto.org/english/tratop_e/serv_e/telecom_e/tel23_e.htm. The Telecom Reference Paper informs our discussion on water services and USOs since both telecom and water services are network services.

⁸⁶ GATS/SC/31 (Apr. 15, 1994).

⁸⁷ *Id.*

⁸⁸ Art. VIII provides some insight into how to define “exclusive rights”. For a general discussion of defining exclusive services contracts under GATS, see Elisabeth Tuerk and Robert Speed, *GATS and Water, A Draft Discussion Paper for the Workshop on Trade and Water - Geneva*, (March 3, 2003) (on file with author).

⁸⁹ GATS, pmbl. fourth recital.

⁹⁰ The Telecom Reference paper explicitly recognized Members’ “right to define the universal service obligation they wish to maintain”. Specifically, Art. 3 of the Telecom RP reads that, “[a]ny Member has the right to define the kind of universal service obligation it wishes to maintain.” *Telecommunications Services: Reference Paper*, S/L/20 (Apr. 24, 1996).

⁹¹ Note that Art. 3 of the Telecom Reference Paper states that USOs are “...not ... regarded as anti-competitive per se, provided they are administered in a transparent, non-discriminatory and competitively neutral manner and are not more burdensome than necessary for the kind of universal service defined by the Member”.

⁹² For example, the Swiss approach on environmental services commitments includes a footnote stating that “[n]othing in this commitment should be construed to include public works function, whether owned and operated by municipalities, cantons or federal government or contracted out by them,” GATS/SC/83 (Apr. 15, 1994). The Swedish approach states that “[t]he offer does not include public works functions,” GATS/SC/82 (Apr. 15, 1994). Likewise, the Norwegian schedule states that “[t]hese commitments do not include public service functions,” GATS/SC/66 (Apr. 15, 1994).

⁹³ It is important to note, however, that even if a measure falls outside the GATS’ specific commitments, Art. VIII still applies if the measure relates to the “public works function” of the serv-

ice. This is subject to the assumption that Art. VIII would apply to natural monopolies.

⁹⁴ Non-discriminatory universal service obligations would of course be permitted. In addition, if the US/Estonian schedule is read to only cover private industry consumption, this could lead to national treatment violations if foreign services are the only ones servicing industry and therefore responsible for following the USO.

⁹⁵ The human rights principle of non-discrimination is a basic principle of human rights law and the prohibition on discrimination in relation to at least several of the categories is considered part of customary international law – and thus of application to all WTO Members. See, e.g., United Nations General Assembly, “Report of the International Law Commission 53rd Session, 23 April – 1 June; 25 July – 10 August 2001, p. 208 (A/56/10). In order to protect against discrimination, States should take steps to remove de facto discrimination on the basis of sex, race, ethnicity, social status and several other categories, where individuals and groups are deprived of the means or entitlements necessary for achieving the right to water. *See supra note 2.*

⁹⁶ Art. VIII could be read to allow cross subsidies (using funds from one service sector or one part of a market in the same service sector to subsidize another sector or another part of a market)

as long as the subsidy is not anti-competitive, abusing the provider’s monopoly position (that is generating the funds) outside the scope of its monopoly rights. *See* GATS, Art. VIII, 2.

⁹⁷ GATS, Art. XVII, 1. Of course, any finding on that issue would depend on a series of issues, notably the exact nature and design of the subsidies regime and how the WTO panels or AB would interpret GATS concepts such as like services, like service providers or de facto discrimination.

⁹⁸ Some horizontal limitations include statements that eligibility for subsidies may be limited to juridical persons established within the territory of the Member in question or even of a particular geographical sub-division thereof.

⁹⁹ GATS/SC/31 (Apr. 15, 1994); Republic of Bulgaria, *Schedule of Specific Commitments*, GATS/SC/122 (May 21, 1997). The EC is currently in the process of renegotiating its commitments.

¹⁰⁰ Questions would arise however, if the government were to subsidize water or energy for industrial consumption.

¹⁰¹ GATS, Art. XV.

¹⁰² CITE WDR box if possible.

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