

# **GATS and Water**

**A Draft Discussion Paper for the  
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## GATS – WATER<sup>1</sup>

### I Introduction

The importance of water to all forms of life is undisputable. Equally evident is the growing threat to this precious, limited resource. Many of the world's freshwater systems are severely degraded, and many freshwater sources have been contaminated. While ecosystems suffer from reduced, polluted water flows, the human world continues to compete for available freshwater reserves. Nearly half a billion people suffer from severe water shortages and around one billion people do not have access to safe drinking water. Economic development is also closely linked to water, with the availability of water a limiting factor for many industries, in particular agriculture. Balancing ecological and human requirements for water, as well as providing the infrastructure and facilities necessary to supply this basic right to an ever growing population, raise 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. At the same time, the breath of international trade-policy making continues to expand, with the ongoing liberalization of trade in goods now joined by negotiations towards the progressive liberalization of trade in services. These two disparate areas, water management on the one hand and trade liberalization on the other provide some unexpected legal and policy conflicts.

This paper explores some of the linkages between international trade law, in particular the WTO's General Agreement on Trade in Services (GATS) and domestic water policies. Chapter 2 provides some background, by discussing the nature of and trends in water management. It briefly describes the legal and administrative models that have been adopted for managing water resources and for the supply of water services. Next, chapter 3 describes some of the civil society concerns surrounding GATS and water and it concludes by explaining the rationale for the analysis undertaken in this paper.

Chapter 4 describes WTO Members' existing commitments in environmental services. Chapters 5, 6 and 7 then conduct a more detailed analysis of these commitments, focusing on those aspects which are most relevant for the design of any future commitments in water related sectors. Chapter 5 specifically analyses various questions relating to the scope of existing commitments, focusing on whether they include "public services" and what would be the effects of increasing private sector involvement at the domestic level. Chapter 6 addresses the content of specific commitments, analyzing whether they preclude public monopolies and whether they constrain governments' abilities to put in place universal service obligations. Chapter 7 outlines certain questions related to subsidies, and chapter 8 concludes.

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<sup>1</sup> Robert Speed (CIEL) and Elisabeth Tuerk (CIEL). This is a first draft of a paper, contributing to the workshop on water and international economic law, 3 March 2003 in Geneva. We are looking forward to comments under [etuerk@ciel.org](mailto:etuerk@ciel.org) and [speedybob@freemail.com.au](mailto:speedybob@freemail.com.au). We grateful for valuable comments on an earlier version of this draft [INSERT IF SBDY READS THIS]. Special thanx to Mireille Cossy for the numerous challenging discussions surrounding the issues discussed in this paper.

## II Background

### 1 *Water Management*

Water management can be divided into two distinct elements: management of water as a natural resource (i.e. regulation of the taking of water) and the supply of water services (including provision of water supply infrastructure, sewage services etc).

Administrative responsibility for all aspects of water management has historically rested with the State, both because of the essential (public) service nature of water services, as well as their status as natural monopolies.<sup>2</sup> Thus, the State has often performed the multifarious roles of:

- natural resource manager – i.e. responsibility for determining the water available for consumptive use, both by industrial, productive as well as private consumptive use;
- service provider – i.e. responsibility for providing, maintaining and operating water infrastructure and ensuring supply to end users; and
- regulator – i.e. responsibility for ensuring the standard of the water service provided (e.g. water quality, pricing, accessibility etc).

This combined responsibility carries a number of inherent conflicts, especially between the State’s role as service provider and that as regulator and resource manager.

Two trends in water management have been particularly evident during the recent years. These two trends have both highlighted the inherent conflicts in traditional water management practices as well as provided the opportunity to address these conflicts. The first trend is the shift to incorporate the principles of ecologically sustainable development (‘ESD’) into the way in which water resources are managed. And second, there is the increased corporate focus on the provision of water services, particularly with the privatization of water service providers.

### 2 *Water Resource Management*

Historically, States have been slow to recognize the environmental significance of freshwater systems and the need to manage them in an appropriate manner. Water has been managed generally with a view to meeting the immediate needs of human users and the environment has often not been recognized as a legitimate “user” of water. Thus, poor planning has resulted in the environment suffering from over-allocation of water resources for consumptive use.

Increasingly, States are incorporating the principles of ecologically sustainable development into the way freshwater systems are managed, often by adopting a more comprehensive planning approach towards the allocation of water resources.

Further, the desire to ensure water resources can be used in the most effective and efficient way to allow for social and economic development has resulted in moves to create water markets to allow for the trading of water. It has also resulted in the revision of the way water entitlements are defined, with the goal of providing greater security and certainty to water users, including water service providers or other service providers relying on the use of water as an input into their

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<sup>2</sup> A natural monopoly is situation where for technical or social reasons there cannot be more than one efficient provider of a good or service. Usually, public utilities are considered to be natural monopolies. In the case of water provision services, it is hardly conceivable, that within one geographical market, there will be two competing water service providers, operating two sets of pipes in parallel.

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service provision. This approach requires a delicate balancing act, to ensure that water entitlements are sufficiently secure and adequately defined to allow them to underpin investment, while maintaining flexibility for adaptive management of water resources (e.g. in response to changes in scientific thinking or ecological or demographic developments).

### *3 Corporatization and Privatization of Water Services*

Many States have made changes to the way in which water services are managed and owned, generally in the hope of improving efficiency and (in some cases) encouraging foreign investment. The spectrum of these changes ranges from corporatizing (but maintaining State ownership) to full privatization, with outsourcing or contracting-out being another of the various alternatives to increasing private sector involvement.

The most common example of these changes is the introduction of a corporate structure to the water service provider, while the State maintains both ownership and ultimate control. This approach can overcome potential conflicts between the State's two roles as resource manager/service provider and regulator/service and can pave the way for greater competition and private sector involvement, including ultimately privatization.

Privatization, essentially implying change of ownership from public to private, can be partial (eg with the State maintaining a majority shareholding) and may be limited in terms of foreign investment in the case of services considered of national importance.

As a corollary, it is possible to outsource various parts of the service provision, taking them out of the hands of the monopoly supplier. While many water services will inevitably be supplied by monopoly providers, many aspects of the service can be severed from the monopoly and supplied by independent, competing entities. This could involve contracting meter reading of water meters (or electricity meters within the electricity industry, etc) to a private company, on the basis that the company can perform the function more efficiently than the State, perhaps because of some comparative advantage originating from a focus on one particular activity (reading meters) rather than providing a whole range of water-related services. This can provide opportunities for foreign as well as local suppliers, in a market traditionally dominated by a state-owned and run monopoly. Some of these contractual arrangements could also be considered government procurement.

In theory, outsourcing can extend to any severable part of water service provision, including infrastructure construction and maintenance, customer service or billing. The private sector can equally become involved in financing arrangements; for example all domestic water meters in Brisbane, Australia are owned (as part of the financing arrangements) by a Singaporean company. Outsourcing can be done on a geographical basis, so that different contracts could be let for different aspects of the service (meter reading, maintenance etc) for different regions.<sup>3</sup>

Thus, governments have a variety of options and models, other than the traditional state-owned and operated utility, to choose from in providing water services.

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<sup>3</sup> Various forms of outsourcing from a state-owned company could also be considered government procurement.

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## **4 Regulation of Service Providers**

Where water services are provided by an entity other than the State (and even in some instances where the State is the provider), it is necessary for the State to maintain a role as a regulator of the service. This is necessary for a number of reasons, including ensuring that the service provider does not abuse its position as a natural monopoly (which water services will nearly always be) and that major public assets are appropriately maintained. Most importantly, regulation is necessary to ensure a safe, affordable water supply is available to all. The regulator is then responsible for setting and enforcing standards in terms of:

- Water quality;
- Water price;
- Customer service;
- Asset management; and
- Access to water.

To ensure adequate access and price of water services, it is especially important that powers exist to require service providers to meet ‘universal service obligations’. This may include for example the obligation to provide water services to parts of the population that are not commercially attractive to private corporations and providing water to sections of the community at ‘below-cost.’ Where such obligations are imposed, the cost of doing so is likely to be subsidized either directly by the State, or by allowing the service provider to charge a premium on other services it provides.

## **5 Domestic Regulation Requirements**

Thus, for water management to be successful, particularly with increasing private sector involvement, it is essential that the State maintain capacity to:

- 1) regulate the take of water, including flexibility for ‘adaptive management’ of water resources; and
- 2) regulate water service providers, including the ability to control pricing to ensure assets are maintained, and to put in place universal services obligations to ensure water is provided to all members of the community;
- 3) subsidize the provision of water services, where it chooses to do so.

It is important that States maintain the ability to implement and modify laws and regulations in respect of these matters. However, the capacity of a State to do so can be fettered by its obligations under international trade rules. This paper considers how trade laws, in particular the General Agreement on Trade in Services (‘GATS’),<sup>4</sup> can reduce a government’s flexibility to implement water management policies – both in terms of the provision of water services as well as the management of water resources. Amongst the many interesting issues, this paper looks at one narrow aspect: the extent to which the GATS may threaten governmental regulatory functions to provide adequate water services to its citizens.

Whilst this paper places its focus on the provision of water services, it is important to note that many water related questions arise in services sectors other than the provision of water. In particular when it comes to questions of water resource management, services sectors that require water as an input into their production process, or that may pollute or contaminate water may be

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<sup>4</sup> General Agreement on Trade in Services, Annex 1 B to the Marrakech Agreement Establishing the World Trade Organization.

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equally crucial. These services can range from tourism to energy services, but also include production related or extractive services.

## III Civil Society Concerns about GATS and Water

### 1 Overview of GATS

The GATS is the first multilateral agreement on trade in services. A part of the WTO, the pre-eminent body governing international trade, the GATS aims to liberalize trade in services. It does this by disciplining domestic governmental measures which affect trade in services. The GATS covers trade in all services, including activities as diverse as financial services, telecommunications, health or water services. The Agreement specifically excludes “services supplied in the exercise of governmental authority”<sup>5</sup> although the exact breath of this exclusion is considered ambiguous and unclear, raising concerns with those who see the broad scope of the Agreement as a potential challenge.

The GATS’s coverage is broad both in terms of the services covered, as well as what is considered “trade” in services. “Trade” includes traditional cross-border trade of services (mode 1), as well as the movement the foreigners consuming services (mode 2), the provision of services through foreign direct investment (mode 3) and the movement of the natural person providing services (mode 4).<sup>6</sup>

The GATS framework agreement defines the key obligations of Members party to the Agreement. It distinguishes between two sets of obligations:

- those applicable to all Members for all services sectors, so-called rules of general application; and
- obligations applying only to sectors and sub-sectors for which Members, on an individual basis, decide to be bound, the so-called specific obligations.

Transparency obligations (Article III) and the obligation to provide most favored nation treatment (Article II) are of general application. ‘Market access’ (Article XVI) and ‘national treatment’ (Article XVII) are specific obligations, only applying once a Member agrees to be bound. The GATS’ market access obligation prohibits Members to put in place certain domestic policies, including quantitative restrictions or domestic ownership requirements. The GATS national treatment provision prohibits governments to accord more favorable treatment to domestic services or service suppliers than to foreign ones.<sup>7</sup>

WTO Members’ decisions to be bound by one or both of these obligations are contained in a separate legal document, their schedules of specific commitments. On a sub-sector by sub-sector basis, the schedules (one for each WTO Member) set out for which services sectors and modes of supply this Member has agreed to be bound by which of the GATS specific obligations. A Member can place conditions or limitations on its specific commitments, thus limiting the extent to which it must comply with the market access or national treatment requirements. These conditions and limitations are also included in the schedule of commitments.

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<sup>5</sup> GATS, Article I:3

<sup>6</sup> GATS, Article I:2

<sup>7</sup> Note that the GATS national treatment provision explicitly covers both, *de jure* and *de facto* discrimination.



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As part of the Doha Round of trade negotiations, Members are currently negotiating further liberalization of trade in services. Negotiations encompass both, the design of new rules as well as, most importantly, making further specific commitments in additional services sub-sectors and modes of supply.

## 2 *Civil Society Concerns*

### A *Introduction*

The GATS aims to promote growth and development by liberalizing trade in services between WTO Members.<sup>8</sup> Yet there are concerns that the GATS and current negotiations to expand its affect may have detrimental consequences. These concerns relate to both the content of new rules for services trade (for example, in domestic regulation, subsidies or government procurement) and to the scope of services sectors and sub-sectors that may be covered as a result of negotiating deeper specific commitments (for example, the provision of water or basic health or educational services). Most prominent amongst the concerns is the fear that liberalization of international trade in services may inappropriately constrain domestic regulatory prerogatives, particularly in respect of policies that favor those most in need, and affect the supply of basic services.<sup>9</sup>

Proponents of the GATS reject this criticism, pointing to the flexibility the agreement grants to WTO Members. Currently, the general rules are of a limited nature and with respect to the more far reaching obligations, notably market access and national treatment, Members are free to decide for which sectors and sub-sectors they wish to be bound by these two obligations. This ‘bottom up’ approach allows a Member to decide on a case-by-case basis which of the many services sub-sectors, in which of the four modes of supplying services, and for which of the two specific commitments (market access or national treatment) and to what extent it wants to be bound. This flexibility is also central to the mandate to progressively liberalize trade in services<sup>10</sup> under which Members are currently negotiating to deepen their respective market access and national treatment commitments.<sup>11</sup>

Critics of the GATS argue that the GATS’s flexibility must be considered in the context of the political reality of trade negotiations. Whilst in theory a country is free to decide whether or not to undertake a market access commitment, the political reality is different, and WTO Members, in particular economically-weaker developing countries, may be pressured into agreeing to commitments.<sup>12</sup>

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<sup>8</sup> GATS, Preamble, second recital.

<sup>9</sup> 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 (2002), *Liberalisation of Trade in Services and Human Rights Report to the Sub-Commission on the Promotion and Protection of Human Rights at its fifty-fourth session Document E/CN.4/Sub.2/2002/9*.

<sup>10</sup> GATS, Article XIX

<sup>11</sup> This flexibility has also been confirmed in other documents relevant for current negotiations, including the GATS Negotiating Guidelines, paragraph 2. See WTO, 2001, *Guidelines and Procedures for the Negotiations on Trade in Services*, Adopted by the Special Session of the Council for Trade in Services on 28 March 2001, S/L/93, 29 March 2001. Implicitly, the Doha Ministerial Declaration, with its reference to the right to regulate, to the Services Negotiating Guidelines and to GATS Article XIX also confirms this flexibility. See WTO Ministerial Declaration, Ministerial Conference, Fourth Session Doha, WT/MIN(01)/DEC/W/1, 9-14 November 2001.

<sup>12</sup> *Julsaint, Martine*; *Services Negotiations -- Progress and Pitfalls*, in *South Bulletin* 45, 30 October 2002, pp. 8-10; *Tuerk, Elisabeth/Mashayekhi Mina*; *The WTO Services Negotiations: Some Strategic*

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Further, the lack of consensus over the legal affect of GATS specific commitments makes it difficult, if not impossible, for countries to assess the consequences of their commitments. This legal ambiguity, the lack of capacity amongst developing countries and the continual pressure to move forward on services commitments makes it likely that countries, especially those less well-resourced, will make commitments without fully understanding the long-term consequences of their actions.<sup>13</sup> This is particularly a problem when it comes to basic services sectors: those of vital social, developmental or environmental importance.

Concerns about the negative effects – legal, economic and social – of open-market commitments are fuelled by the statement of the Directorate General Trade of the European Commission that Europe will not offer market access in certain basic services sectors to its trading partners.<sup>14</sup> Thus, whilst Europe is aggressively demanding market access in these services sectors from its WTO trading partners, including developing countries, it refuses to make the same commitments for its own services market. This suggests that civil society concerns associated with trade liberalization in these sectors are shared by the European Commission.

Civil society concerns relating to the GATS and basic services, particularly the provision of water to the poor, are many and diverse.<sup>15</sup> They range from broader concerns about the impact and

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Considerations, Trade-Related Agenda, Development and Equity, Occasional Papers 14, South Centre, January 2003.

<sup>13</sup> *Tuerk, Elisabeth and Mina Mashayekhi*; The WTO Services Negotiations: Some Strategic Considerations, Trade-Related Agenda, Development and Equity, Occasional Papers 14, South Centre, January 2003.

<sup>14</sup> Note that there is considerable confusion as to in what sectors exactly refrains from making commitments. In a 5 February press release DG Trade stated that its "...offer does not affect the provision of public services within the EU, the right of the EU to regulate its services sector, and to design its own appropriate regulatory frameworks. Thus, it maintains the EU position of taking no commitments in the audio-visual sector, and also proposes no commitments on either education or health services." At the same time "[t]he draft offer proposes to further open to foreign competition sectors such as....postal services...environmental services...and transport services". See EC press release on draft EU GATS offer; WTO Services: Commission submits draft offer to Council and Parliament – public services fully defended, IP/03/186, Brussels 5 February 2003. See also EU to block talks on more public services liberalization, Financial Times 5 February 2003 and EC Suggests Financial Services, Telecom For Possible Liberalization, Excludes Others, International Trade Reporter, 6 February 2003, ISSN 1533-1350.

<sup>15</sup> *Zagama, Bertram*; GATS and Water, Milieudefensie (Friends of the Earth Netherlands, as part of the Publication GATS and Democracy, Seattle to Brussels Network, at: <http://www.gatswatch.org/GATSandDemocracy/water.html>; *Barlow, Maude*, A GATS Primer, Council of Canadians, February 2001; *Caplan, Ruth*, GATS Handbook, Alliance for Democracy, November 2002; Friends of the Earth US; A Disservice to the Earth: The WTO General Agreement on Trade in Services (GATS) and the Environment, <http://www.foeeurope.org/trade/wto/wto.htm>; *Waskow, David/YU, Vicente Paolo*, 2002: A Disservice to the Earth, The Environmental Impact of the WTO General Agreement on Trade in Services (GATS), Friends of the Earth United States, forthcoming; *Sinclair, Scott*, 2000: GATS - How the World Trade Organization's new „services“ negotiations threaten democracy“, Canadian Centre for Policy Alternatives, Ottawa 2000; *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; *Hilary, John*; The Wrong Model, GATS, trade liberalization and children's right to health; Save the Children, London 2001. See also, *Tuerk, Elisabeth/Howse, Robert*; The WTO Negotiations on Services: The Regulatory State up for Grabs; Canada Watch, Vol. 9 No. 1-2, September 2002; Special Double Issue – From Doha to Kananaskis: The Future of the World Trading System and the

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power of multinational corporations, to concerns relating to human rights. More specifically relating to GATS concerns can be clustered as follows:

- concerns relating to public versus private provision of water;
- concerns over government's abilities to place universal service obligations on private service providers; and
- concerns over governments' abilities to provide subsidies (to certain services providers or consumers).

### *B Privatization*

There are concerns that the GATS mandates, induces or at least “locks in” privatization.<sup>16</sup> Whilst the legal text of the GATS does not explicitly require governments to privatize the provision of essential services, two aspects should be considered in determining the relationship between the GATS and privatization:<sup>17</sup>

- *The nature of privatization:* Privatization fundamentally involves the change in ownership of and responsibility for services from the public to private sector. In the eye of the general public, privatization is also frequently linked with the elimination of (public) monopolies, the introduction of competition through various forms of private sector participation and the potential, that the final outcome is a private rather than a public monopoly. Thus, responding to public concerns about the GATS requires analysis of both consequences of the change of ownership as well as issues linked to the elimination of public monopolies, i.e. questions related to the number of services suppliers in a market or questions related to private sector participation, including through contracting out or other models.<sup>18</sup>
- *Practical impacts of the GATS:* The primary effect of the GATS originates from the legally binding character of its rules, which can require changes to domestic policies for a country to comply with its GATS commitments. However, there are also more practical linkages between the GATS and privatization than a purely legal analysis would identify. These are the flow-on effects to domestic policy arising from the implementation of GATS consistent policies.

For example, some concerns about privatization do not so much relate to private sector provision of certain segments of the market, but rather to the fact that private sector

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Crisis of Governance; York University Centre for Public Law and Public Policy and the Robarts Centre for Canadian Studies of York University.

<sup>16</sup> *WTO Secretariat*, GATS - Facts and Fiction, March 2001, [www.wto.org](http://www.wto.org); For a response to this WTO document, see *Sinclair, Scott/Grieshaber, Otto: 2000: GATS – Facing the Facts: A guide to the GATS debate*, Canadian Centre for Policy Alternatives, Ottawa 2002; See also: *Gould, Ellen; Separating WTO Fact and Fiction*, Council of Canadians, June 2001; *World Development Movement; The GATS Debate; A response to the common arguments used against the critics of the General Agreement on Trade in Services*, June 2001; *GATS – What Is Fact and What is Fiction? A Civil Society Response to the WTO's Publication “GATS –Facts and Fiction”* (25 May 2001); *Ragavan, Chakravarthi; GATS – Fact and Fiction at best a partial truth*, Third World Network, April 2001; *Yu, Vice; Technical Comments on the WTO's GATS: Fact and Fiction*, Friends of the Earth International, April 2001; all available at <http://www.gatswatch.org/factfict.html>.

<sup>17</sup> This is not only the case with respect to questions relating to privatization, but also more generally with respect to other civil society concerns with the GATS there is a need to address these broader concerns.

<sup>18</sup> See *Cossy, Mireille; INSERT TITLE*, forthcoming, another discussion paper for this conference. See also, *Delmon, Jeffrey; Water Projects, A Commercial and Contractual Guide*, Kluwer Law International, INSERT YEAR.

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involvement, focusing on the profitable segments of the market, may deprive the public sector from valuable revenue sources. Consequently public provision – in those unprofitable market segments where public provision is clearly needed – can be even harder. Thus, the mere fact that the GATS encourages and enhances participation of the private sector (including foreign companies) can threaten public sector provision of essential services.

It is important then to also consider these broader consequences of the GATS, complementary to any more limited, legal analysis between the GATS and privatization. The latter would essentially involve two aspects: first, how the GATS relates to governmental decisions regarding the ownership of service suppliers; and second, how the GATS relates to governmental decisions regarding the number of service suppliers in a given market. (see boxes 1 and 2).

### **Box 2 on Privatization - *Number of Service Suppliers in a Given Market***

As regards the number of service suppliers, the GATS market access provision states that in sectors where market-access commitments are undertaken, a Member shall not maintain or adopt 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.” At a first glance, this provision clearly requires the elimination of monopolies, whether public or private.

However, for assessing whether or not this provision requires the elimination of monopolies, two points are relevant.

First, the GATS market access obligation is a specific commitment and Members are therefore allowed to decide to what extent and for which services sub-sector they wish to be bound. Thus, in theory the decision whether or not to eliminate a governmental monopoly is for governments to decide on a case-by-case basis, including for the provision of water.

Second, GATS Article VIII explicitly addresses monopolies and exclusive services suppliers placing certain obligations upon Members, rather than prohibiting monopolies in a straight-forward way.

From a strictly legal perspective, the GATS therefore does not rule out or prevent monopolies, nor does it require their elimination. It is important to note however, that the political dynamics of services trade negotiations may bring about a different situation.

### *C Imposing Universal Service Obligations*

There are concerns about the effect of the GATS on a government’s ability to attach universal service obligations on private service providers. Universal service obligations are requirements placed on a service provider to ensure that their service is available to all. These may include a requirement to provide the service (for example, water or telecommunications) to remote areas, or at a price which is below the cost of provision. Universal service obligations will not necessarily (or even normally) apply to all providers of a service. The obligation may only be placed on the primary (or former primary) provider of the service, who will be required to be the default provider. Some argue that a universal service obligation could thus be found to be discriminatory and therefore prohibited under the national treatment requirements of GATS.

### *D Subsidizing Service Provision*

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

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co-exists: the private provider serving (typically) the profitable and the public provider serving the less profitable market (for example customers unable to pay or low-density regions that are expensive to supply).

Subsidies can be important to allow public companies to continue providing services to these markets. Thus the government may provide subsidies to the public domestic company, whilst not providing any to private foreign companies. Some argue that providing subsidies to one company and not another could be inconsistent with the GATS national treatment provision.

### *3 Rationale for Analysis Undertaken in this Paper*

There are no clear-cut answers to many of the concerns raised by civil society. Rather, answers will depend upon the specific practical situation in question, the interpretation WTO panels and the Appellate Body (AB) give to the GATS provisions, as well as future developments of the GATS legal framework through current negotiations. It appears that WTO Members have carefully worded their existing specific commitments in an attempt to avoid certain challenges and arguments from arising. As the present negotiations continue, governments may be encouraged to adopt a similar approach. In particular as market access in sectors such as the provision of water or other basic services is negotiated, negotiators may wish to think about how to carefully design their country's commitments.

#### **Box 3 on Privatization - Ownership of Service Suppliers**

As regards the effect of the GATS on ownership of service providers, again Article XVI gives some indications. The GATS market access provision prohibits Members taking measures that place "limitation on the participation of foreign capital" (sub-paragraph f)<sup>1</sup> or that "restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service" (sub-paragraph d)<sup>1</sup>.

Both provisions give rise to a series of questions related to privatization.

First, sub-paragraph f, prohibiting any limits on foreign ownership for individual or aggregate foreign investments in a services sector or sub-sector, does not rule out the existence of a public company. It does however, prohibit a governmental regulation setting up a public monopoly in a services sector or sub-sector, as this would clearly limit foreign ownership to zero.

Similarly, sub-paragraph d appears to rule out regulations limiting the participation of foreign investment in certain previously publicly owned individual companies, when they are "privatized". Frequently however, governments may wish to resort to such regulations, if not because of economic rationale but rather to respond to the general feeling of the public to not sell off state companies to foreigners.

Third, also sub-paragraph d, requiring specific types of legal entity or joint ventures for the supply of a service, may become relevant in the context of privatization processes. When changing from a system of domestic monopoly provision to private sector provision, including foreign private sector, the governments may wish to adopt a staggered approach, requiring certain forms of joint ventures rather than merely private provision by foreign companies.

All of the relevant provisions are so-called specific commitments, thus from a strictly legal perspective, it is upon each individual WTO Member to decide whether and by which of these obligations it wants to be bound. However, similar to the situation as regards the number of service suppliers, the political dynamics of services trade negotiations may change this picture.

This paper aims to contribute to facilitating this task by reviewing the conditions and limitations governments have included in existing environmental services commitments. This approach has been taken because the provision of water services is regarded by most as an environmental

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service<sup>19</sup> and because the social considerations and regulatory aspects of the provision of water are similar to those of other environmental services. Whilst water provision services differ significantly from environmental services such as noise abatement or waste incineration, other environmental services, such as certain sewage services, exhibit the same natural monopoly characteristics as water services. Thus, by reviewing existing environmental services commitments, this paper aims to assist services trade policy makers and those affected by services trade policy making to approach liberalization requests in the water sector on an informed basis.<sup>20</sup>

## IV Specific Commitments

### 1 Introduction

As explained above, the GATS bottom up approach provides WTO Members with a certain degree of flexibility in designing their specific commitments. For each services sub-sector (e.g. metering services, purification, provision of water), in each mode of supply (cross-border, consumption abroad, commercial presence or movement of natural persons) and for each of the two specific commitments (market access and national treatment) a Member can decide whether to be bound and to what extent. Each Member inscribes these decisions into its schedule of specific commitments.

Where a Member chooses not to commit itself to allowing equal market access and national treatment for foreign providers, it enters “*unbound*” into its schedule. If a Member decides to be fully bound (either by market access or national treatment or both) in a certain sub-sector and mode, it indicates this by entering “*none*” in its schedule.<sup>21</sup> However, a Member can also include in its schedule “limitations” and “conditions” on individual commitments, stating that (for example) the GATS national treatment rules will apply, but subject to certain caveats.

Before reviewing existing commitments, it may however be useful to ask a more fundamental question. What would be the consequences of a GATS market openness commitment in the water sector?<sup>22</sup> In other words, what rights would a full market access and national treatment commitments confer to the foreign services provider?

This question is particularly relevant in these water related services, which constitute a natural monopoly, such as the provision of water through pipes or certain sewage services. Arguably in case of a monopoly, a market access commitment will entail something different than in a sector where competition is possible. Purification of water, or metering services may be an example of the latter. Unlike in truly competitive markets, in a natural monopoly even if (legally) the market is fully open, there will still be only one supplier. Thus, there would still be a quantitative limitation on the number of suppliers, not as a result of a decision of the government but because

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<sup>19</sup> See, *Cossy, Mireille*; for a description of various classification proposals.

<sup>20</sup> Whilst many of these issues are inherently linked to questions related to the scope of the GATS’s carve out for services provided in governmental authority (Article I.3) or for government procurement (Article XIII), this paper will not conduct an in-depth analysis of these issues. This paper only focuses on Members’ specific commitments, building upon other pieces of analysis discussed at this conference. There are however issues going beyond what is being discussed in those two complementary pieces, notably questions surrounding GATS VI.4 which require additional analysis in the future.

<sup>21</sup> The term „none“ indicates that this Member does not wish to qualify its commitment by any conditions or limitations.

<sup>22</sup> This section benefits from various conversations with Mireille Cossy.

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of the economic specificities of the sector in question. Most likely, the one service supplier would still be subject to a governmental concession, however.

Thus, in such as case, GATS commitments could possibly entail the right to:

- participate (on an equal footing) in the bidding process for being granted a concession/exclusive service arrangement. The GATS national treatment provision (Article XVII) would then require that this bidding process treats foreign companies the no worse than domestic companies. There are many questions however, under which of the GATS provisions such concession or other exclusive service arrangements.<sup>23</sup> ;<sup>24</sup>
- acquire ownership through private equity participation. A market access commitment would allow foreign investors to buy shares, without any limit on foreign equity participation. GATS Article XVI (f) would be the provision granting foreign investors such rights; or
- supply the service without being obliged to operate as a joint venture or other specific legal entity. GATS Article XVI (e) would be the provision granting foreign investors this right.
- WHAT ELSE

Whatever the exact rights a market access commitment would confer in a natural monopoly situation, WTO Members may wish to get a clearer conception of this before entering into any commitments. Having a clearer understanding of what a market access commitment in a monopoly situation would entail, would also allow Members to better determine the nature of the conditions and limitations they should attach to their commitments. Reviewing the way existing commitments are designed is another step to facilitate this task.

A quick review of the specific commitments for environmental services reveals several differences between the approaches undertaken by various WTO Members. For example, these differences relate to:

- the *way the conditions and limitations to the commitments are introduced* into the schedule;
- the *scope* of the commitment; or
- the *content* of the commitment.

As regards the way the conditions and limitations to commitments are introduced into the schedule the approaches taken by the Nordic, Swiss and European governments for various forms of public services illustrate a range of different options. For example, this can be done as:

- a horizontal limitation for the whole schedule (European Communities);
- a horizontal limitation to the environmental services sector (Norway)<sup>25</sup>; or
- a clarification added to the sector as mentioned in the descriptive, first column of a schedule, either directly in the column (Sweden<sup>26</sup> and Bulgaria<sup>27</sup>) or in a footnote (Switzerland)<sup>28</sup>;

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<sup>23</sup> For example, such arrangements could possibly also be considered domestic regulations, falling under Article VI GATS or government procurement, currently excluded by the means of Article XIII. For an analysis of the latter aspect, see *Cossy, Mireille*; INSERT PAPER

<sup>24</sup> 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.

<sup>25</sup> *Norway*, Schedule of Specific Commitments, GATS/SC/66, 15 April 1994.

<sup>26</sup> *Sweden*, Schedule of Specific Commitments, GATS/SC/82, 15 April 1994.

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As regards the limitations to the *scope* of commitments this can be done by:

- explicitly limiting commitments to *private industry service provision* (US/Estonia first interpretation);
- explicitly limiting commitments to *service consumption by private industry* (US/Estonia second interpretation); or
- either excluding various forms of *public services or public works functions* (Nordic countries, Switzerland, Bulgaria).

Finally, limitations addressing the *content* of commitments, respectively the policy choices allowed by the condition or limitation can:<sup>29</sup>

- limit the commitments as they apply to public utilities to allow, for example, for monopolies or other exclusive services provider arrangements; or
- specifically allow certain types of subsidies.

Many WTO Members of course have not taken any commitments, or some have limited their commitments to a particular services sub-sector. African countries, for example South Africa<sup>30</sup> and Lesotho,<sup>31</sup> both limit their entries in the environmental services sector to consultancy services only.<sup>32</sup>

## 2 *Limiting the Scope –the US/Estonian Commitments*

The US<sup>33</sup> and Estonia,<sup>34</sup> two very different countries and economies, adopt a similar approach towards limiting the scope of their commitments. In both schedules, the first column of the services schedule, i.e. the one listing the sector in question, contains the clarification, in brackets “(contracted by private industry)”.<sup>35</sup>

This US/Estonian commitment could be read to include only services contracted *to* private industry. Thus, the decisive aspect, determining whether or not a service would fall under the commitment, would be whether or not the service *provider* is a *private industry*. However, an alternative interpretation of the US/Estonian schedule is that the US/Estonian language is not limited to the *provision* of services by private industry, but rather to the *consumption* of services by private industry. Specifically, the US/Estonian schedules mention services “contracted *by* private industry” as opposed to services “contracted *out to* private industry”. Thus, in that case,

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<sup>27</sup> *The Republic of Bulgaria*, Schedule of Specific Commitments, GATS/SC/122, 21 May 1997.

<sup>28</sup> *Switzerland*, Schedule of Specific Commitments, GATS/SC/83, 15 April 1994.

<sup>29</sup> Note that technically speaking, the European Communities take a different approach. Rather than either limiting commitments to private sector provision (or to private sector consumption, depending on what reading of the US schedule one adopts) or excluding public utilities from its commitments, Europe has limited its commitment for public utilities so as to explicitly allow certain, otherwise GATS inconsistent practices.

<sup>30</sup> *South Africa*, Schedule of Specific Commitments, GATS/SC/78, 15 April 1994.

<sup>31</sup> *Lesotho*, Schedule of Specific Commitments, GATS/SC/114, 30 August 1995.

<sup>32</sup> For these however, they are fully open, with no conditions or limitations.

<sup>33</sup> *United States of America*, Schedule of Specific Commitments, GATS/SC/90, 15 April 1995.

<sup>34</sup> *The Republic of Estonia*, Schedule of Specific Commitments, GATS/SC/127, 5 October 1999.

<sup>35</sup> For both countries however 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”.



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the decisive aspect would be whether or not the *consumer* of the services is *private industry* as opposed to the public sector or private individuals for personal consumption.

### **3 Limiting the Scope and Content – Various European Commitments**

There are various European approaches to exclude various forms of public services, public utilities or the public works function of certain services. Whilst overall the Nordic/Swiss and European approaches may aim to achieve similar results, they differ in several fundamental ways.

First, they differ in the *way the qualifications are introduced*. European does this as a horizontal limitation, applying to all services sectors. Switzerland and the Nordic countries however do this for the environmental services sector specifically.

Second, they differ as to the *scope of either the exclusion or commitment*. The EC schedule in its horizontal limitations refers to “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 Swiss, Norwegian and Swedish approach excludes the “public works function whether owned and operated by municipalities, state or federal governments or contracted out by these governments”.<sup>36</sup> Again slightly different (and maybe with a different intention), Bulgaria states that its “...commitments do not include environmental services supplied in the exercise of governmental authority” and clarifies in a footnote that “[t]hese are regulatory, administrative and control services by government and municipal bodies related to environmental issues.” CHECK QUOTES ONCES WTO DDF WORKS AGAIN

Finally they differ as to the *content of the commitment*, or more specifically, the *content of the exclusion*. The Swiss, Nordic and Bulgarian approaches do not go into the content of what is allowed or prohibited but rather altogether exclude certain aspects fo services provision. The Swiss/Nordic approach broadly states that “[t]he offer does not include public works/service functions...” and the Bulgarian schedule states that “the commitments do not include environmental services supplied in the exercise of governmental authority”. The EU, however, takes a different, more limited approach focusing on which – otherwise prohibited - policy choices are exceptionally allowed by its condition. Specifically, it states that “services considered as public utilities at a national or local level may be subject to public monopolies to exclusive rights granted to private operators”. The accompanying explanatory footnote, states 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.”<sup>37</sup>

### **4 Limiting the Content of the Commitments – Subsidies**

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<sup>36</sup> Note that Sweden refers to “the public works functions” in plural, so does Norway, referring to the “public service functions”, whilst Switzerland, refers to the concept in singular. CHECK, WHEN WTO DDF IS UP AGAIN, Note that also the cantonal structure.

<sup>37</sup> Quite ambiguous in its formulation, is the Croatian schedule. In the market access column on mode 3, it states for three sub-sectors (sewage services, refuse disposal services and sanitation and similar services) that “[t]hese services are legally considered as municipal activities, provided primarily by these entities owned by local authorities. Private operators may be allowed to provide those services on the basis of a concession granted by local authorities.”

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Mostly, Members' limitations as regards subsidies are not made for environmental services only, but rather inserted as a horizontal limitation at the start of the schedule. Generally, these horizontal conditions and limitations allow the government:

- to limit the granting of subsidies to juridical persons established in the country in question (mode 3);
- to limit the granting of subsidies to natural persons being nationals of a the country in question (mode 4); or
- to provide subsidies in the public sector.

Most important for the issues discussed in this paper is the last of these three. Slovenia and Bulgaria for example, both include a horizontal condition in the national treatment column, stating that “[t]he supply of a service, or its subsidization, with the public sector is not in breach of this commitment.”<sup>38</sup> Also the European schedule, as a horizontal condition to mode 3 includes an equivalent commitment. It states that “[t]he supply of a service, or its within the public sector is not in breach of this commitments”.<sup>39</sup>

The Swiss schedule in contrast does not include any limitation specifically for public services or the public works function, but only states that “[e]ligibility for subsidies, tax incentives and tax credits may be limited to persons established in a particular geographical sub-division of Switzerland.”

## **6 Conclusion**

A quick review of Members' existing environmental services commitments offers a broad variety of different approaches. For the purpose of designing future commitments in the environmental services sector, including for water services, Members may carefully review their existing commitments and different options for formulating them. In addition, it may be useful for services trade policy makers, water provision companies and the general public to carefully consider what rights a market access commitment would entail.

The next sections analyze these commitments in light of the regulatory issues and civil society concerns reviewed above. In that context, the following sections will attempt to draw parallels between Members' existing commitments in environmental services and possible future commitments in water related sectors, including the provision of water through pipes or mains. The analysis addresses both the scope and content of the respective commitments.

## **V GATS Specific Commitments – Scope**

### ***1 Introduction to Issues Regarding the Scope of Specific Commitments***

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<sup>38</sup> Note that the Slovenian schedule applies this condition to mode 3 only, whilst the Bulgarian schedule more comprehensively includes this limitation for all four modes of supply. Note also that both, the Bulgarian and Slovenian schedule state that the “[e]ligibility for subsidies from the Republic of ...[Slovenia/Bulgaria]... may be limited to juridical persons established within the territory of ...[Slovenia/Bulgaria]... or a particular geographical sub-division thereof. Unbound for subsidies for research and development.”

<sup>39</sup> Note that this is not the only condition / limitation Europe has introduced with respect to subsidies. Rather, the European schedule also contains other mode 3 and some mode 4 limitations for subsidies.

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When considering water related commitments, it is important to consider the various options for limiting the scope of the commitment to best preserve a government's flexibility to ensure adequate provision of water.<sup>40</sup> Whilst there has been much discussion about whether or not the GATS threatens “public services” there is no clear, common understanding about the meaning of “public services”.

Amongst others, ambiguity exists with respect to two aspects:

- first, the *type of services activity* considered a public service (access to water and phone lines, the provision of phone directories or the provision of public transport); and
- second, whether the *notion of “public services”* differs from that of “services provided in governmental authority”, as mentioned in GATS Article I,<sup>41</sup> from that of “public utilities” as used in the European schedule, from that of “the public works function” as mentioned in the Nordic / Swiss schedules, or from the more general notion of “the public sector”, as used in some of the horizontal limitations regarding subsidies.

This chapter looks at the different approaches WTO Members have taken first, as regards the services activities covered by their respective commitments, and second, as regards different notions of “public services”, “public utilities” or other similar concepts. It also looks at the extent to which increasing private participation in the provision of a particular sector can have an impact on whether this particular service is still covered by the notion of “public service”, “public utility” or any other of the above mentioned, similar notions.

### ***2 Different Services Activities – Which are Considered “Public Services”?***<sup>42</sup>

#### *A Public Services – The European Approach to listing Services Considered Public Utilities*

In the horizontal part of its schedule, Europe refers to “services *considered* as public utilities” (emphasis added). In an explanatory footnote it offers an indicative list of sectors in which public utilities exist, including R&D services on social sciences and humanities, environmental, health or transport services. The European schedule potentially grants considerable flexibility for two reasons:

1. Those services sectors explicitly listed in the footnote are clearly public utilities, and Europe has only accepted limited commitments for them. Thus, in these sectors Europe retains at least some degree of regulatory flexibility, going beyond what is allowed by full market access or national treatment commitments.
2. The European limitation is “self-defining”, in that the condition/limitation refers to “services *considered* as public utilities” (emphasis added). This language would mean that Europe, its politicians, policy makers and citizens define what they consider are public utilities. Whether other WTO Members have a different understanding may be irrelevant. Rather, the European legal framework about services trade liberalization may give indications.

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<sup>40</sup> Note that it is outside of this paper to discuss from an economic perspective, which policy choice would bring about better services access to the poor. Rather, this paper starts from the assumption that the more regulatory freedom for the government, the better.

<sup>41</sup> *Krajewski, Markus*; INSERT NEW ART I PIECE

<sup>42</sup> Note that – as mentioned above – there is no uniform definition of what are public services. In this section, we use this term in its colloquial meaning, encompassing essential basic services such as the provision of water, health and education services, but also public transport, certain telecommunications services and others.

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On the other hand, one could also argue that what counts is the understanding of the WTO Membership as a whole. In any case, the understanding of other WTO Members may be irrelevant for those services sectors Europe has mentioned in its indicative list: these are clearly public utilities for the purposes of the European commitments. Any doubts would only arise with respect to services sectors, for example, educational or health services, which are not listed in the current footnote. It remains to be seen how panels or the AB will approach this issue.

### *B Public Services – Various Other Approaches Not Listing Individual Services Activities*

Slightly different is the Swiss/Nordic approach. The Norwegian schedule excludes “public service functions” and in the Swiss and Swedish schedule exclude “public work[s] function[s]”. [CHECK EXACT WORDING] At a first glance, the Swiss/Nordic approach also appears to grant considerable flexibility, broadly excluding “public services” or the “public works functions”. However, comparing it to the European schedule gives rise to a series of questions, especially in respect of the lack of clarity about what exactly are “public services” or the “public works functions”. The Swiss / Nordic approach does not contain any list, mentioning the services sectors falling under this concept. Also, the Swiss / Nordic approach also does not contain any language indicating a self-defining character of the exclusion.

In any case, WTO Members including appear to have realized the highly ambiguous and therefore limited nature of the GATS’s so-called “public services exclusion”.<sup>43</sup> Various references to “public services”, “public utilities” or the “public works function” may have been a response to this uncertainty, aiming to preserve regulatory freedom for much needed governmental regulation / intervention to ensure that basic services will be provided to the poor.

Bulgaria’s commitments on environmental services appear to be another example for a response to the uncertainties surrounding the scope of the Article I.3 exclusion. In its schedule, Bulgaria prescribed that its environmental services commitments “...do not include environmental services supplied in the exercise of governmental authority”. In an explanatory footnote, the Bulgarian schedule then states that “[t]hese are regulatory, administrative and control services by governmental and municipal bodies related to environmental issues”. Thereby, Bulgaria put forward a very limited understanding of the concept of “services supplied in governmental authority” and it appears as if Bulgaria’s main objective was not to preserve the greatest possible extent of domestic regulatory freedom.

Whilst this approach may serve the particular needs of Bulgaria, it may give rise to skepticism by some other WTO Members, particularly those who envisage a much broader understanding of this exclusion. These Members may question whether services in governmental authority, as mentioned in the Bulgarian environmental services schedule would constitute an adequate reading of GATS Article I.3, particularly as the latter would also apply to other sectors, such as

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<sup>43</sup> The limited capacity of GATS Article I.3 to preserve regulatory autonomy particularly for “essential basic services” originates from several factors. Most importantly, the Article I.3 exclusion does not explicitly address essential or basic services but rather “services provided in governmental authority”. Further, the definition of what is 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 note and information about the provision’s drafting history is limited. Today, even proponents of the GATS acknowledge that this provision is “a piece of clumsy drafting”.

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education and health services.<sup>44</sup> Similarly, there might be some asking whether it would at all be adequate to draw parallels between what Bulgaria views as “services supplied in the exercise of governmental authority”, and what other WTO Members view as the “public works” or “public services” functions.

### *C Public Services – Some Conclusions*

The above shows that questions surrounding the exact scope of public services, the public sector, public utilities or services provided in governmental authority are many and diverse. To adequately preserve regulatory flexibility, WTO Members may therefore carefully analyze, for which sort of services sectors they want to enter into commitments and how to phrase their commitments. In addition, they may wish to think about whether or not a clarification of Article I.3 b is warranted.

### **3 Increasing Private Sector Participation – Would it Remove Public Services from Being Covered by the Various Exclusions?**

#### *A Introduction*

Regardless of the type of services activities (i.e. administrative control versus essential services such as water provision) covered by the various notions of “public utilities”, “public service / works function” or “services supplied in the exercise of governmental authority” there are two aspects, governments may wish to bear in mind when designing their commitments. In particular, governments may bear in mind, that for certain services sectors, specifically essential services such as sewage services (or the provision of water):

- *it may be more adequate to publicly provide these services.* Thus, GATS commitments should grant governments the flexibility they need to publicly provide such services. It may be even better if GATS would also clearly allow to reverse back to public provision once private sector participation has failed.
- *these sectors also require a high degree of governmental regulation.* Particularly when it comes to private sector participation in the provision of these services – governments must be in a position to put in place this regulation. Again, GATS commitments should be designed in a way to allow for this flexibility.

Both aspects are relevant, particularly in the current context of increasing private sector participation. The following paragraphs will quickly review two aspects: first, what are the implications of different ways to carve out public sector service provision; and second, what are the implications that increasing private sector participation, either through contracting out or through private equity participation would have on the scope of existing GATS commitments.

#### *B Recognition of Private Sector Involvement*

As explained above, WTO Members in their schedules have taken several approaches as regards the public or private provision of services.

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<sup>44</sup> This is even more so as GATS Article I.3 was said to relate particularly to social insurance services – take out quote from Markus paper. Etc. However, then one could say that the Ireland understanding only is about *environmental* services provided in governmental authority and not for others. But even if that were the case, the provision of water – an essential service most likely considered an environmental service – would not be falling under this notion and thereby included in the Ireland schedule of commitments.

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As regards *private sector involvement*, some of the schedules exclude certain forms private sector involvement in the provision of “public services” from the commitments:

- the Nordic/Swiss approach explicitly excludes the public services/works function “...whether owned and operated by municipalities, state or federal governments *or contracted out by these governments*” (emphasis added);
- the European schedule states that “services considered as public utilities ... may be subject to ... *exclusive rights granted to private operators*” (emphasis added); however;
- the US/Estonian approach explicitly states that the services covered by the commitment are those services “*contracted by private industry*” (emphasis added). When adopting the reading that the decisive aspect is the private industry nature of the service provider<sup>45</sup> private sector involvement in the provision of public services would render them part of the GATS commitments.

As regards *purely public provision* of services, all of the above-mentioned approaches in some way or the other exclude purely public provision of services:

- the Swiss/Nordic approach excludes purely public provision of services, as long as the service is considered a “*public works / services*” function;
- the European approach grants certain more to public sector provision of services (i.e. allows public monopolies), as long as the services are *considered public utilities*;
- the US/Estonian approach, when adopting the reading that the decisive aspect is the private industry nature of the service provider<sup>46</sup> appears to grant even more leeway and flexibility by *excluding purely public provision* altogether, irrespective of the nature of the environmental service sector in question, i.e. whether it is a utility or whether it serves a public works function.

However, this assessment of the public sector “carve out” may change once there is some private sector involvement. Amongst the many ways of private sector involvement, the following paragraphs will discuss:

- private sector involvement through *contracting – out*; and
- private sector involvement through increasing (*foreign*) *equity participation*.

### *C Private Sector Involvement Through Contracting – Out*

As regards private sector involvement through contracting-out of services, the US/Estonian model appears to result in two different outcomes, depending upon the reading one adopts. Adopting the reading that the US/Estonian schedule only covers provision of services when this *provision is contracted-out to private providers*, increasing private sector participation through contracting-out would automatically bring these services under the scope of the commitment, notably full market access and national treatment. In that case, private sector participation would significantly limit the choice of regulatory actions governments could take with respect to these services.

Slightly different the result when adopting the other reading of the US schedule, namely that the only service provision covered is the one designed for *consumption by private industrial users*. In that case, whether or not there is increasing private sector participation in the provision of the

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<sup>45</sup> One could also adopt the other reading of the US/Estonian schedule, namely that the decisive aspect is the private industry nature of the service *consumer*. In that case, provision of services to private individuals, also when supplied by a private provider would be excluded from the commitment.

<sup>46</sup> Again, one could also adopt the other reading of the US/Estonian schedule, namely that the decisive aspect is the private industry nature of the *consumer*. Again, supply of essential services to private individuals though public provider would be excluded from the commitment.

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service to private non-industrial consumers would be irrelevant and not affect the scope of the commitment. Thus, such a reading of the US schedule would appear to grant considerable flexibility to domestic regulatory prerogatives.

Similar the situation in the Swiss/Nordic approach which explicitly excludes public services (the public works function) “whether owned or operated by municipal, state or federal governments *or* contracted-out by these governments.” For any private sector involvement – as long as it could be considered “contracted out” - the exclusion would take effect. Similarly, in the European schedule, which explicitly states that services considered public utilities may be subject to exclusive rights granted to private operators. As mentioned above, this approach does not in reality “exclude” public utilities. Rather, it allows – for public utilities - certain policies which may be otherwise considered GATS inconsistent. But as long as one considers that private participation is taking place through “exclusive rights granted to private operators” then these services - whilst forming part of the services commitment – would at least not be subject to *full* market access and national treatment commitments. This approach would thus grant some extent of regulatory flexibility to governments.

### *D Private Sector Involvement Through Increasing (Foreign) Private Equity Participation*

Another way of increasing private sector participation is through (foreign) equity participation. Again, the question arises how this would play out under the US/Estonian, the European and the Nordic/Swiss model. Whilst taking different approaches, in most of the various models (apart from the European model) the ownership of the service provider (or consumer) appears to be relevant.

In that case, GATS Article XXVIII (n), providing definitions of ownership and control of a juridical person may be of assistance.<sup>47</sup> Specifically, it states that “a juridical person is: “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 Members;” Whilst this definition relates more to domestic versus foreign ownership, its rationale could also apply to private versus public sector ownership. Thus, if private sector participation in an ownerships public company does not amount to 50 %, the company would possibly be considered “owned” by the relevant public entity. The following paragraphs will review how this will play out in the different models, playing it through for both of the possible readings of the US/Estonian schedule.

One could first assume that the decisive aspect in the US/Estonian schedule is the private industry nature of the service *provider*, i.e. that the US/Estonian schedule only covers services provided by private industry. This reading suggests that the notion of “contracted by private industry” would not include private sector involvement through equity participation. Thus, services provision through a company would be outside of the scope of this commitment as long as this company is not considered “private industrial”. As long as the public sector owns a majority of the shares of the company this might be the case.

One could also adopt the other reading of the US/Estonian schedule, namely that it covers all provision of the service as long as the *consumer* is private industry. This offers an even less clear-cut picture. First, a public provider, providing to private individuals, for non-industrial use would be outside the scope of the commitment, even if there is majority private equity participation in this public provider. As mentioned above, the decisive aspect is the private industry nature of the

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<sup>47</sup> Given that the definitions apply “ for the purposes of” the GATS, they are likely to be relevant in interpreting any commitments made under the GATS.

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service consumer. What however, if that very company then contracts out to another private company in question? Would that render the first, public / private company an industrial consumer of services? If yes, one could still argue that as long as the public / private company is majority owned by the public sector, it would not fall under the scope of the commitment.

A quick glance at the Swiss and Nordic approach provides a similarly confusing picture. Specifically, these schedules state that their commitments do not include public service functions “whether *owned* and operated or contracted out” (emphasis added). It appears that in that case, the exclusion can apply either if a public service is *owned* and *operated* by the relevant mentioned public entity (local, regional or central government) or if it is a corporation *owned* by the public which is then *contracting the service out* to private suppliers. What now if there is private involvement through foreign equity participation in the public company? Would the service provider then still be “owned” by the relevant public entity? Again, the decisive aspect appears to be the 50 % or majority ownership of shares.

Finally there is the European approach, which does not mention any aspects of ownership. This begs the question whether a public utility, after having granted private equity participation would be still covered by the horizontal exclusion. The European schedule does not appear to provide a clear cut answer to that question.

### *E Private Sector Involvement – Some Conclusions*

Thus, the above paragraphs have reviewed a series of question arising when governments increase private sector involvement in the provision of what used to be public services. Whether it be private involvement via contracting-out or via private equity participation, changes in the domestic policy environment can bring about different results as regards the coverage of specific services schedules. It is therefore important for services trade negotiators to notice these interdependencies and to bear them in mind when designing their countries’ services commitments.

### **4 Conclusions as Regards the Scope of Services Trade Commitments**

This chapter has reviewed two aspects relating to the scope of WTO services trade commitments, issues relating to so-called “public services”, and issues relating to increasing private sector participation. Both sets of issues appear to share two conclusions: First, both set of issues appear to be complex, lacking clear-cut solutions or common understandings. Most likely, it remains to be seen how panels or the AB will address these question in case of a WTO dispute settlement proceeding. Second, there are important interdependencies between domestic policy choices and the scope of GATS commitments. Thus, it is important for negotiators and services trade policy makers to realize is that changes in the domestic economic environment may affect the scope of their country’s GATS commitments.

Whilst most of the above-mentioned examples relate to industrialized country Members, these issues are particularly relevant for developing countries. To date, developing countries may even less bear in mind these interdependencies, when considering what commitments to make in current WTO services negotiations or in their WTO accession negotiations. However, bearing in mind these interdependencies between GATS commitments and domestic policy changes is even more important for developing countries. This is the case particularly, as developing countries frequently do not undertake these policy changes (increasing private sector involvement) in a truly autonomous manner, but rather they do so because changes in their domestic policy regime are so-called conditionalities, forming part of a World Bank or the IMF financial arrangement.



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Having implemented these policy changes developing countries might suddenly find that – due to private sector involvement - the scope of their GATS commitments is broader than before.

In that case, flexibility becomes important. Privatization has many pitfalls and there is no guarantee of success. It can fail completely, thus requiring the government to revert to public sector provision of services, or at least require governments to step in with regulatory measures which risk being in conflict of the GATS market access or national treatment obligations. If a certain degree of private sector involvement automatically renders the GATS applicable, it may deprive governments of the possibility to put in place such much needed regulations.

For example, a government providing services through public sector only may have committed this very sector “for private participation” without limitations to preserve the right to attach universal service obligation or to grant possibly discriminatory subsidies. Once it changes its domestic services regime to include private sector participation it may then not be allowed to place such limitations upon foreign services providers, without having “re-negotiated” its GATS commitments. Re-negotiation however is a burdensome process, particularly for developing countries.

This suggests that services trade policy makers should give considerable attention to the development of their commitments, particularly in sectors which may be prone to domestic policy changes in the future.

## **VI GATS Specific Commitments – Content – Public Monopolies, Exclusive Rights Contracts and Universal Services Obligations**

### ***1 Introduction***

As described above, the European commitment includes a horizontal condition allowing public utilities to be subject to public monopolies or to exclusive rights granted to private operators. In a footnote, the European schedule then states 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”. This raises a series of questions, in particular when considering whether to adopt a similar approach for water services.

### ***2 Multiple Monopolies - The European Approach***

Specifically, the European approach gives rise to two questions relating to the number of monopolies or exclusive services arrangements, namely:

- whether governments could decide to operate several public monopolies; and
- what is the nature of the geographical sub-division in which monopolies operate.

The first question is whether, according to the European schedule, a government could decide to operate several public monopolies, i.e. one in each geographical subdivision of a country. Nothing in the European schedule suggests that this would not be the case. The ability to operate several public monopolies is also confirmed by GATS Article XVI:2. This provision 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 of numerical quotas, monopolies, exclusive service suppliers....” (emphasis added). Thus, nothing suggests that for a certain services sector, each WTO Member country can only operate one single monopoly, covering its entire territory.

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The second question arises about the nature of the geographical sub-division in which monopolies operate. Whilst the European schedule only refers to public utilities at the *national* and *local* level, it can be assumed that the European schedule would also allow monopolies in *regional* subdivisions. What however, if a government decided to organize its water provision management along other than administrative or political sub-divisions of the country? For example, it might be useful to organize water provision according to sub-divisions depending upon the characteristics of the markets to be serviced, i.e. highly dispersed population in one area versus densely populated in another. These sub-divisions could well incorporate several parts of a country's administrative or political sub-divisions. Would these areas be considered geographical sub-divisions according to Article XVI GATS? Or would geographical subdivisions according to Article XVI be only those, corresponding to central, regional, or local governments and authorities as mentioned in Article I.3 GATS?<sup>48</sup>

Several arguments suggest that Article I.3 GATS shall not be decisive in that case. First, Article I defines the scope of the GATS Agreement and does so by listing those entities, whose actions can be considered “measures affecting trade in services”. Thus, GATS Article I deals with a concept (entities whose actions can be considered “measures affecting trade in services”) different from the concept of market access restrictions under Article XVI (particularly the geographical application of market access restrictions).<sup>49</sup> Therefore, Article I shall not be seen as giving an exclusive list for what can be considered “geographical sub-divisions” under Article XVI. Second, the GATS defines “monopoly supplier of a service” as those being established as the sole provider of the service “in the relevant market”. Given that markets can exist both in terms of different services and geographically, 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 sub-division.

### ***3 The Ability to Grant Exclusive Rights - The European Approach***

Also the European schedule's reference to “exclusive rights granted to private operators” gives rise to a series of questions. For example, there are questions:

- whether such exclusive rights arrangements can have certain discriminatory aspects; and
- what is the exact nature of these exclusive rights arrangements.

The first question is whether the exclusive rights, through which public utilities are managed, can be offered to domestic services providers only? For public policy reasons, a government may decide to open up water services to competition, but it may wish to allow access only to domestic companies. Thus, the question is whether the way the European horizontal limitation is phrased would allow for discriminatory aspects in the granting or administration of the exclusive rights? This is where the GATS provisions on scheduling come in. According to GATS Article XX:2 “[m]easures inconsistent with both Articles XVI and XVII shall be inscribed in the column relating to Article XVI. In this case the inscription will be considered to provide a condition or qualification to Article XVII as well”. Thus, also if Europe has not explicitly put any limitation or

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<sup>48</sup> The relevant parts of Article I:3 read: “[f]or the purpose of this Agreement: (a) “measures by Members” means measures taken by: (i) central, regional or local governments and authorities; and (ii) non-governmental bodies in the exercise of powers delegates by central, regional or local governments or authorities. ....”

<sup>49</sup> 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. Thus, this would suggest that there is some sort of linkage between the concepts of Article I and XVI GATS.

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condition in its national treatment column, discriminatory aspects of the condition, i.e. the exclusive rights arrangement, inscribed in the market access column would be allowed.

Next, there are questions relating to the nature of the “exclusive rights” arrangements. As indicated in the footnote to the European schedule, such exclusive rights are often granted “subject to specific service obligations”. For example, a government may wish to require a corporation benefiting from an exclusive services supplier arrangement to have a specific type of legal entity or to operate in a joint venture.<sup>50</sup> Similarly, a government may wish to require these exclusive service providers to source certain input locally or to transfer technology.<sup>51</sup> Finally, and most importantly for present purposes, governments may wish to place universal services obligations upon private service providers. Would these measures be allowed as part of the “specific services obligations”?

It is arguable that all of these measures are “specific services obligations” forming part of the concession contract and thus allowed by the European limitation. On the contrary one could argue that a joint venture requirement would be an obligation relating to the service *supplier* rather than to the *service* provided, and that therefore this type of requirement would not be covered by the “specific services obligations”. It remains to be seen how this issue will play out in the future. Most likely however, the reference to “specific services obligations” is envisaged to allow governments to place *universal service obligations* upon operators.

#### **4 The Ability To Put in Place Universal Service Obligations – The European Approach**

It appears clear-cut that the European schedule’s reference to “specific services obligations” would allow governments to put in place universal service obligations to ensure that essential services are provided to the poor and marginalized. Yet, three additional aspects appear relevant as regards the European schedule. These question are:

- whether Europe can define what it considers a universal service;
- whether the European schedule allows for certain discriminatory aspects in the universal services obligation; and
- whether the European schedule would allow to place universal services obligations also without the operation of exclusive rights contracts.

The first question is whether the European schedule allows European policy makers to define what they consider a universal service? The European schedule only refers to “specific service obligations”, and thereby does not appear to limit the regulator’s ability to define the content of the specific service obligation. Thus, it appears as if the European would also not limit the ability to define what is a universal service, which should be provided as a result of the universal service obligation.<sup>52</sup>

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<sup>50</sup> Also joint venture and specific legal entity are measures specifically prohibited by Article XVI and therefore a country wishing to impose such a requirement will need to include specific market access “limitations”.

<sup>51</sup> Technology transfer and local content requirements, whilst not explicitly mentioned in or prohibited by Article XVI GATS are sometimes enshrined as conditionalities to specific commitments, for example in developing countries’ mode 3 commitments.

<sup>52</sup> For a discussion of WTO jurisprudence as regards legitimate policy objectives see, *Neumann, Jan/Türk, Elisabeth*; *Necessity Revisited - Proportionality in WTO Law after Korea- Beef; EC-Asbestos and EC-Sardines*; *Journal of World Trade*, Vol 37 No 1 February 2003; Kluwer Law International.

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The next question is whether the European schedule allows certain discriminatory aspects in a universal service obligation? Specifically, there are questions whether a government could impose a universal service obligation which only applies to foreign providers? Or could universal services obligations differ between different regional sub-divisions, such as placing a more onerous stricter universal services obligation in one area than another? Or, what if a universal service obligation is unintentionally more favorable to the domestic incumbent, and more burdensome for new foreign entrants to meet? Such a situation could be a violation of the *de facto* national treatment obligation.

Again Article XX:2 may be relevant for such situations. According to this provision, the conditions and limitations placed on market access can also permit what would otherwise be discriminatory measures. In that context, it is also positive to note as regards the European schedule does not condition the “specific service obligation” to a “necessity” or to any other “not more burdensome than necessary” test. As described above, what counts is what is “considered as public utilities”. Once this threshold is passed, a regulator can place specific service obligations, whatever their objective (i.e. to ensure adequate provision of water or the provision of phone directories) and whatever the nature of their impact upon private service providers. The only limiting aspect is the obligation to comply with the GATS’s general obligations.<sup>53</sup>

There is another, third specific concern with the way the European schedule is worded. The European schedule links the right to attach universal service obligations to the establishment of an exclusive services arrangement, specifically the “exclusive rights granted to private operators”. What however, if a country decides to privatize and introduce competition without granting monopolies or other exclusive rights to supply services? A WTO Member may want to place universal services obligations on companies in general, without doing that in connection with any exclusive services supplier contract or it may want to place universal service obligations on service suppliers which are not operating as a monopoly. Would the way the European schedule is phrased allow this?

Again, there are two questions to be distinguished, namely:

- whether the European schedule would allow governments to place universal service obligations in a fully open market regime, i.e. without any “exclusive service arrangement”; and
- whether the European schedule would allow governments to place universal service obligations upon several service suppliers, serving the same market, i.e. which are not operating as a “monopoly”? This question more relates to the nature of what is an “exclusive service provider”.

As regards the first issue, it appears as if the European schedule would require some sort of exclusive services arrangement. Thus, a market that in practice is “fully open”, i.e. in which governments are not operating with any exclusive service arrangements, would maybe deprive a government from putting in place universal service obligations.

As regards the second question, a first glance suggests that the European schedule conditions universal service obligations to the granting of a monopoly right. It appears to be the nature of the word “exclusive” that exclusively one service provider – at least for each geographical sub-

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<sup>53</sup> Currently these are rather limited obligations, notably transparency and MFN. This could however change with the results of the current negotiations, for example under the mandate established by Article VI.4 GATS.

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division – would be accorded the right to provide the services. However, there are doubts whether this would be a correct reading of the GATS.

For example, the concept of “exclusive services providers”, as used in the GATS goes beyond monopolies. Whilst the GATS’s section on definitions does not contain a definition of “exclusive service providers”, Article VIII may provide insights about the nature of the exclusive service provider concept. Paragraph 5 of Article VIII states that its “provisions...shall also apply to cases of exclusive service suppliers, where a Member, formally or in effect, (a) authorized or establishes a *small number of service suppliers* ...” (emphasis added). This suggests that exclusive rights can also be accorded to more than one, but to a *small number* of service suppliers. Thus, even if the European schedule requires some sort of exclusive service arrangement, it does not require monopoly arrangements.<sup>54</sup>

The above analysis has shown that the European schedule gives rise to a series of questions about the actual extent of regulatory freedom, it grants governments to put in place universal service obligations. As a next step, it would be interesting to compare whether the European Communities’ allowance for universal services obligations in their existing commitments grants more or less scope for regulators than the Telecom Paper.

### ***5 The Ability to Put in Place Universal Service Obligations – How Would the Above Questions Play Out In Other Than the European Schedule?***

None of the other schedules reviewed in this paper explicitly refers to universal service obligations. However, several of the schedules include language which may be relevant for a government’s ability to put in place such universal service obligations.

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.” The Swedish approach states that “[t]he offer does not include public works functions...” Likewise, the Norwegian schedule states that “[t]hese commitments do not include public service functions...”.

Thus, unlike the European approach, the Swiss and Nordic approaches do not explicitly state what is allowed for certain public utilities, but rather they exclude “public work function” aspects of covered services from the commitments (see above). This approach is simpler and appears to grant more flexibility for governmental regulatory prerogatives. Once the threshold question of what is included in the “public service/works function” is passed, none of the GATS specific commitments apply to regulatory action affecting that field. That suggests that whatever measures to ensure universal service obligations, as long as not in violation of the GATS general obligations, i.e. transparency or MFN treatment are allowed. It is important to note however that

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<sup>54</sup> This latter reading also appears to be more in line with the objectives of the GATS, namely to liberalize trade in services. Otherwise, if adopting the first reading, this would suggest that a universal service obligation, a measure potentially restricting trade is only possible if the country opts for a trade restricting measure in the first place, namely the granting of a monopoly. It would suggest that if a government opts for a less trade restrictive measure in the first place, i.e. allowing more than one service providers or free competition in the, universal service obligations would not be allowed. Thus, this could induce Members to opt for the more trade restrictive measure in the first place, an outcome clearly in contradiction to the GATS main objectives, namely to liberalize trade in services.

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even if falling outside the GATS’s specific commitments, GATS Article VIII would still apply, also to measures relating to the “public works function” of the service.<sup>55</sup>

In contrast the US/Estonian commitment, which explicitly limits the application of national treatment and market access to “services contracted by private industry”. Assuming that the US/Estonian commitment only covers private industry provision of services, as long as a federal, state or sub-regional authority operated a public monopoly, this would be outside the national treatment and market access commitments. However, if the public entity contracted out the service in question this would automatically place the service within the scope of the GATS commitments. Thus, once contracted out, any regulation as regards this service would have to comply with both, the market access and national treatment obligation.<sup>56</sup> What would that mean for the ability of the government to grant exclusive rights (i.e. create a monopoly situation) or to place universal service obligations, especially if these were easier for US companies to meet (because they are established) than for foreign companies? At a first glance, it seems, as if under that contracting-out reading, discriminatory universal service obligations would be prohibited.<sup>57</sup>

### Box 3 on Telecommunications and Universal Services

The Reference Paper for Telecommunications Services (‘the Telecom Paper’) is the only WTO document specifically mentioning the notion “universal service obligations”. Article 3 of the Reference Paper recognizes Members’ “...right to define the universal service obligation they wish to maintain” and states that “[s]uch obligations will not be 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.”

At a first glance the Telecom Paper suggests that each Member is free to design its own universal service obligation. However, it is useful to differentiate between the *universal service* and the *obligation to provide this universal service*. Specifically, the Telecom Paper allows each Member to define “the kind of universal service”. In other words each Member has freedom as regards the *content of the universal service*, be it the obligation to supply geographically-remote areas or others. What matters is that the *obligation to provide these services* is administered in a transparent, nondiscriminatory and competitively neutral way and that the obligation is not more burdensome than necessary for the “kind of universal service defined by the Member”.

This approach, to allow each individual Member to determine its legitimate objective, but to constrain regulatory prerogatives when it comes to choosing the type of policy measure that will be put in place to achieve this objective is in line with past WTO jurisprudence. In several cases addressing questions surrounding necessity tests and legitimate objectives, WTO panels and the AB emphasized that it is upon each individual Member to determine its legitimate objective and that panels/AB would only subsequently assess the “necessity” of the measures to achieve this objective.

Would that be different when assuming the other reading of the US schedule? What would be the situation if the US/Estonian schedule only covered private industry consumption, whilst provision of services, whether private or public to the general public and to citizens for private, non-industrial use would be excluded? Would such a reading of the US schedule bring about a result that would constrain the government’s prerogative to put in place universal service obligations? Questions could arise if one private foreign company serves both, private industrial consumers

<sup>55</sup> This is subject of course to the assumption that Article VIII would apply to natural monopolies.

<sup>56</sup> Note that again, GATS Article VIII, being a general obligation would apply irrespective of whether the service is contracted out or not.

<sup>57</sup> Note however, that non-discriminatory universal service obligations would of course not be prohibited.

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and private individual consumers. What if, then at the same time, a domestic public company only serves the public needs and if the regulator then decides to place a universal service obligation but only on the private company serving both, the private individual and private industrial consumers? If there were no corresponding universal service obligation for the domestic public company, would that amount to a national treatment violation?

### **6 *Conclusions for Universal Services***

These were just a few of the many considerations arising in the context of universal service obligations. What is important is to ensure that each WTO Member retains the ability to define for itself what it considers a “universal service”. This is even more important as WTO Members may find it hard, if not impossible, to arrive at a common understanding about what are universal services. What may be considered a universal service depends – amongst others – on the country’s level of development as well as on its economic orientation. But also within one aspect which is broadly considered a universal service there might be fundamental differences. As regards water for example, the provision of essential drinking water would be considered a universal services, whilst water for swimming pools, watering the garden, washing the care etc would not. In any case, this suggests that it is crucial for WTO Members to retain the ability to determine on their own what they consider a universal service.

## **VII GATS Specific Commitments – Content – The Ability to Use Subsidies as a Tool To Ensure Adequate Provision of Water Services**

### **1 *Introduction – the Potential for Discrimination***

Besides universal services obligations, also subsidies are an important tool for ensuring continued and affordable supply of the service to all segments of the community. For example, subsidies allow a government to ensure that water will be supplied free, or below cost, by meeting the cost on behalf of the consumer.

For these purposes, a government may chose to ensure adequate provision of water to those in need by subsidizing the provision of water through a public domestic company, while not subsidizing the company’s private competitors. This situation may arise, if the commercially unattractive segment of the marked were served by the domestic (public) company, whilst its (foreign, private) competitors were serving the more lucrative markets. This could possibly be considered a national treatment violation.<sup>58</sup> Thus, Members may wish to consider conditions or limitations for their national treatment commitments.

In effect, many Members address subsidies in their horizontal limitations in the national treatment column, thereby applying to all services sectors. The 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. Several schedules also contain similar wording with respect to natural persons. These conditions and limitations however, do not appear to preserve regulatory freedom in the above mentioned case.

### **2 *Various Approaches Specifically Relating to Subsidies for Public Sector***

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<sup>58</sup> Note that 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 the interpretation the WTO panels or AB would interpret GATS concepts such as like services, like service providers or de facto discrimination.

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Other schedules, however take a more effective approach to preserving regulatory freedom for subsidies, even if exclusively granted to the public sector provider. 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”. The question arises, what these, European or Bulgarian commitments mean exactly? Would these conditions and limitations permit all subsidies governments may wish to grant to ensure the supply of drinking water to the poor and marginalized? At a first glance, it appears as if the wording “subsidization within the public sector is not in breach of this commitment” would be a good step towards preserving regulatory space. Such a commitment would clearly allow a government to subsidize public provision of the service.<sup>59</sup> It might be more problematic however, if the subsidization is not – strictly speaking – taking place “within” the public sector? One could well imagine situations where the public sector out-sources – contracts out – certain aspects of services delivery, which would not be viable per se and thus need subsidization from the public entity. Would this process be considered subsidies “within the public sector”?

This question maybe does not matter so much for the Nordic/Swiss approach, which altogether excludes the public works function of certain services, even if being contracted out to private providers. This situation may however arise in the context of the European commitments. In that case, one could assume that the subsidization would be considered as part of the “exclusive rights” aspect, and thereby be exempt from market access and national treatment commitments.<sup>60</sup> In that case, in that case, at least with respect to potential discriminatory aspects, the question of whether or not such subsidies are “within” the public sector, appear irrelevant.

Even more complex however, is the Slovenian schedule. This document states that “[t]he supply of a service, or its subsidization, with the public sector is not in breach of this commitment”. This gives rise to the question, whether the concept of subsidies “with the public sector” go beyond what are subsidies “within the public sector” or is this just an example of a drafting error?

Similarly complex the US/Estonian schedule. Assuming the reading 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. 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. What however, if a public service provider not only serves the individual citizens market but also the private industry clients? What if the public provider, in order to adequately serve the needs of the less profitable market receives subsidies, whilst the other private providers, serving only the private industry consumers, does not receive subsidies? Subsidies to the public provider for the public service function it covers could effectively imply cross-subsidization of for the other service function, namely the serving private industrial consumption? Would that be permitted by the US/Estonian schedule?

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 being more favorable for domestic investors, be considered a national treatment violation? Again, to date there are no clear-cut answers to these questions.

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<sup>59</sup> Note that a comprehensive discussion of cross-subsidization would fall outside the scope of this paper.

<sup>60</sup> This might well be the case as any arrangement to contract out may include the right to have access to certain subsidies; these rights in turn could be complemented with obligations, notably the universal service obligations.



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## 3 *Conclusion*

In any case, many of the above issues remain open and undetermined and Members may wish to carefully design and double check their commitments and limitations as regards subsidies. A question underlying all subsidies issues in the GATS is that to date, subsidies are only prohibited in so far as they constitute a national treatment violation. If they are trade distortive, but not discriminatory, they are not covered by any existing trade rules. WTO Members are however, negotiating rules for trade distortive subsidies. 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.

## VIII **Conclusions**

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. These solutions are increasingly involving shifts towards greater private sector involvement, a trend encouraged by the pillar international financial institutions. With this shift away from public provision of water services, it is essential that governments maintain the appropriate regulatory powers to ensure continued provision of this essential service to all, most especially the poor.

The GATS provides further momentum towards the liberalization of water services. However, there are concerns amongst civil society that as well as promoting liberalization, the GATS may impair governments' abilities to provide the increased level of regulation necessary in an open market. There are also concerns that the non-discrimination provisions of the GATS may prevent the imposition of certain universal services obligations and certain subsidization of services.

The extent to which the GATS impacts upon a country's policy choices depends significantly upon the way this country's specific GATS commitments are phrased. While no country has yet made commitments in terms of water services, similar considerations are likely to be given in making commitments as those made, for example, in respect of sewage services, another essential service cum natural monopoly. The reviews of the specific commitments made to date in the environmental services sector shows a range of approaches that have been taken 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 made allowances for continued public sector involvement, excluding "public utilities", "public services" or "public works functions" from the application of the GATS market access and national treatment commitments. Governments have included these conditions notwithstanding the existence in the GATS of 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. It is likely that similar conditions will be placed on the opening of water service markets.

From this review it seems clear that governments share many of the concerns of civil society regarding the consequences of the GATS for the provision and regulation of public (or formerly public) services, including in terms of subsidies and universal service obligations.

Pro-GATS groups are likely to argue that the conditions placed on environmental services commitments demonstrate that the bottom-up approach works, and that the framework provides

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adequate flexibility to address any concerns that an individual government may have. On the contrary, 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. The various approaches adopted by WTO Members to conditioning market access all aim (so it would seem) to achieve the same end. However, the varying nature of these approaches creates ambiguity in terms of what exactly the parties intended, leaving open the potential for disputes and for the exact meaning of a commitment to be ultimately determined by a WTO panel or AB ruling.

Even in the absence of this ambiguity, there remains a real risk of countries, particularly developing countries, making commitments without knowing the long-term consequences of their commitments, or giving commitments simply as a result of political or economic leverage exerted in the negotiations.

Ideally, water services (along with other essential services) should not be covered by the existing and future GATS disciplines, both specific and general. Private sector involvement in water services would still be possible, but governments could choose to involve the private sector secure in the knowledge that they retain a full suite of regulatory tools. In the alternative, the exclusion for services provided in “the exercise of governmental authority” should be expanded to ensure that regardless of the commitments a government makes, it will retain the ability to properly regulate water services. At the same time, consensus should be reached on standard limitations and conditions that members can apply to commitments regarding water services and other similar services.