Chapter 2

General and supporting obligations

By the end of the Uruguay Round, despite initial scepticism, significant progress had been made in developing general disciplines for governments regarding international transactions in services. Those disciplines can be described in four categories: legal rights; the general obligations of transparency and MFN treatment; the conditional obligations of market access and national treatment; and other supporting obligations. The general obligations of Members are modelled in large part on experience under GATT, the difference being that each obligation undertaken is extended to both the services and services suppliers of Members. This chapter covers general and supporting obligations; conditional obligations are taken up in chapter 3.

In order to illustrate each of the disciplines, sample trade scenarios are presented below in italics. These scenarios are composites created from situations reported by a range of exporters (rather than actual occurrences) and are intended only to help clarify the principle under discussion.

Rights of Members

Members of a service industry association in an Asian country have been lobbying their government to ensure both that foreign professionals coming to work temporarily in their country meet domestic licensing criteria and that national licensed professionals have the *ability to work temporarily in export markets abroad. The association's executive director hopes that GATS provides support for such a request.*

At the heart of GATS is a commitment (stated in the preamble) to "securing an overall balance of rights and obligations". Central to that balance is the recognition that Members have the right to regulate the supply of services within their territories as long as the measures used are administered in a reasonable, objective and impartial manner and are not trade-distorting in their impact. Similarly, Members have the right to define and pursue their own national policy and economic development objectives as long as those objectives do not interfere with the multilateral obligations they have undertaken. In the example cited above, any licensing criteria that are transparent and objective (e.g. competence and the ability to supply the service) are well within the prerogative of a national government to require, especially if the intention is to ensure the quality of the service and protect consumers from unethical practices.

At present, the rights of Members are recognized as extending beyond establishing objective criteria to include measures that have as their goal the protection of domestic labour markets or in general limiting foreign access to the domestic market. Asian professionals wishing to work abroad, for example, might face quotas or economic needs testing for foreign suppliers without such measures being deemed inappropriately protectionist. The premise of GATS is progressive liberalization as an ongoing process, and developing country Members are not expected to liberalize as much as and as fast as developed country Members.

Members' rights also include provisions under Article XIV that allow for the enforcement of measures considered by the Member to be necessary to protect public morals and human, animal or plant life or health. Other areas of discretionary action by Members, regardless of GATS rules or specific commitments made, include measures to:

- Maintain public order and safety;
- Prevent deceptive or fraudulent practices;
- Prevent or contain the effects of default in services contracts;
- Protect individual privacy and the confidentiality of records;
- Impose or collect direct taxes;
- Protect essential security interests;
- Provide for prudential regulation in financial services.

The only requirement is that the regulations imposed should not discriminate arbitrarily or contain a disguised restriction to trade, and that the Council on Trade in Services should be informed of the actions taken.

The obligation of transparency

A computer training firm in a transitional economy has been working on a strategy to deliver 'distance training' electronically to small United States firms. It has just learned accidentally that it will be required to obtain a certificate of authority in each State where it does substantial business. This is news to the company, and it feels that such a requirement should have been made clear to it sooner.

A South American technical laboratory and testing firm wishing to export its services to a country has just discovered that this country requires foreign laboratories to work with locally owned laboratories to provide such services. The firm has already invested time and resources in developing an export development strategy and believes that the target market should have made this restriction known under Article III of GATS.

Access to information on rules and regulations is a critical adjunct to trade expansion. The principle of transparency of regulations (Article III) requires Members to identify and make public their "measures" affecting the services trade. The obligations under GATS are prompt publication of measures (ideally before they enter into force), notification (at least annually) of regulatory changes in sectors where commitments have been made, and maintenance of enquiry points and prompt response to queries. Note that there is no requirement to disclose confidential information.

Two specific obligations exist to increase access to information on domestic regulatory environments. First, Article III requires Members to establish enquiry points from which other Members can seek clarification on local laws and regulations affecting trade in services scheduled. Private-sector firms are expected to obtain information through their own government's enquiry point. Second, there is a requirement for developed country Members to establish contact points to provide information of special interest to services suppliers from developing and transition economies (Article IV).

Since the publication and notification process takes place on a government-to-government basis, services enterprises may not necessarily receive that information in a timely and efficient manner. In the first example above, the computer services firm may have a legitimate complaint if the United States Government had not listed certificates of authority as a State-level requirement for firms doing business in the country. However, since the requirement for a certificate of authority also applies to any United States firm from outside a particular State, the United States could argue that the requirement is not itself trade distorting and so does not have to be notified. If the information was listed and available to other governments but either had not been passed on to the private sector or had not been sought by the computer training firm, then the issue is one of communication between the public and private sectors or inadequate market research rather than a lack of transparency *per se*.

Members have the general obligation of transparency in regard to regulatory information on services sectors covered by GATS as well as to establish an enquiry point and respond to queries or complaints; however, they are obliged to notify changes in laws or regulations only for services sectors where they have scheduled liberalization commitments. In the second example above, checking the relevant schedule of commitments would have revealed that technical testing and analysis are unbound for government-funded projects. This should have alerted the South American firm to the fact that any number of restrictions might apply about which they would have to find information on their own. Unbound sectors are often sensitive sectors subject to many restrictions and discriminatory practices.

The obligation of most-favoured-nation (MFN) treatment

An African market research firm wishes to expand its offices abroad, especially into Europe. It has heard about 'MFN' and 'conditional MFN' and wonders if these concepts are relevant to its market selection.

The MFN obligation applies across all sectors and all modes of supply unless otherwise negotiated through an MFN exemption. Under the MFN obligation, a Member must give to all WTO Members immediately and unconditionally the most favourable treatment it has accorded to any of its trading partners (whether or not that trading partner is a Member). In the context of GATS, the MFN obligation (Article II) is applicable to any measure that affects trade in any services sector *whether specific commitments have been made or not*.

The MFN obligation has been the cornerstone of trade liberalization since the Second World War as it avoids the slower process of bilateral trade negotiations or the constraints of bilateral reciprocity. It embodies the principle of non-discrimination among trading partners and allows smaller economies to benefit from concessions gained by larger negotiating partners. In the case above, if a particular Member allows market research firms from the United States and France to establish offices, then it cannot arbitrarily refuse to allow in the market research firm in question. 'Conditional MFN'[1] would not apply as MFN is an all-or-nothing concept. Note that the MFN obligation is not retroactive – i.e. there is no obligation to give newcomers the same treatment that was accorded to services suppliers which entered the market prior to the coming into force of GATS. There is discussion under WTO auspices, however, of whether 'grandfathering'[2] is a single event or whether the more favourable conditions granted under 'grandfathering' would be subject to a new decision each year, in which case MFN obligations would need to be reviewed.

Ultimately, the MFN obligation means that Members must accord trade concessions to each other, across all sectors and all Member countries, on the basis of overall trade benefits to be gained rather than on a sector-by-sector basis. Because of the fear of 'free riders' (i.e. Members who might benefit from the concessions of other Members without giving any in return), there is a mechanism under Article II for Members to take a one-time exemption in order to offer more favourable treatment to certain trading partners for a period of no more than 10 years. More than 90 Members have submitted MFN exemptions primarily in the financial services, basic telecommunications, maritime transport and audiovisual services sectors. The most common use of the MFN exemption is to allow for preferential regional trade agreements. In the case of the African market research firm cited above, for example, the favourable market entry conditions agreed among members of the European Union do not mean that the African firm could expect the same liberal treatment.

1 MFN clause to which conditions are attached.

2 Also referred to as the 'grandfather's clause' under which, if any legislation is changed to the disadvantage of a foreign investor, the laws in force at the time the enterprise with foreign investment was registered continue to be applied for a certain period after the date of registration.

GATS also provides specifically for exemptions to cover economic integration agreements and obligations agreed prior to GATS. Such obligations include bilateral civil aviation agreements and bilateral double taxation treaties.

The supporting obligations of Members

In addition to the two primary obligations of transparency and MFN, there are a number of other obligations that also apply across sectors.

Economic integration

A Mexican architectural firm is aware that provisions under the North Atlantic Free Trade Agreement (NAFTA) and GATS for the temporary movement of its design support personnel are not the same. Which will prevail if it is pursuing a contract in Canada?

Economic integration agreements (EIAs), under which a group of Members agree to liberalize trade in services among themselves more rapidly, are permitted under GATS (Article V) as long as such an agreement:

- Has substantial sectoral coverage,
- Provides for the absence or elimination of virtually all discrimination.

To be allowed, EIAs must provide for specific liberalization, or at least prevent an increase in overall restrictions. In addition, subsidiaries of firms from non-EIA countries which are engaging in business operations in an EIA country must benefit from the same treatment accorded to the subsidiaries of firms from EIA countries. Nearly all WTO Members have signed regional trade agreements, of which there are more than 100 (e.g. the European Union, NAFTA, and the Southern Common Market or MERCOSUR). WTO has now established a Committee on Regional Trade Agreements to review existing EIAs and their potential repercussions on the functioning of the WTO system and to examine in detail future regional trade agreements notified to WTO. It is interesting to note that the treatment of trade in services is more liberal in all existing EIAs than it is at present under GATS.

Under Article V *bis*, GATS addresses agreements on labour market integration. Such agreements differ from free trade agreements in that they seek to create a 'borderless' environment for their workers. If an agreement does establish full integration, exempting citizens from requirements of residency and work permits, then GATS does not view national treatment obligations *vis-à-vis* other Members to have been violated.

The role of EIAs continues to be debated. Opponents of EIAs argue that such agreements can distort trade flows by encouraging a country to import from a member of its trading bloc rather than from a supplier outside its region or, in more extreme cases, by erecting barriers against other trade blocs. Supporters of EIAs argue that such arrangements have tended to increase the flow of trade and, to date, have had more liberal services trade provisions than GATS. The temporary business entry provisions of NAFTA are a case in point, and the Mexican architectural firm mentioned above would benefit from those more liberal provisions. A further benefit reported by the World Bank is that developing and transition economies participating in EIAs become more knowledgeable negotiators on behalf of their services firms.

Recognition of qualifications

An employment agency for Asian nurses has had difficulties in marketing its nurses in North America despite a shortage there of nursing personnel. The problem seems to be a lack of recognition of the nurses' credentials. The agency is wondering if such lack of recognition is allowed under GATS.

At present, there is no requirement that all Members recognize the licences or certification of professionals from other Members. Article VII permits Members to recognize qualifications bilaterally, plurilaterally or multilaterally provided that:

- Recognition is based on objective criteria and does not discriminate among Members where similar conditions prevail.
- Members in a mutual recognition agreement shall give other Members adequate opportunity to negotiate their accession to that agreement or to negotiate comparable ones.
- If recognition is accorded automatically, the Member shall give other Members the opportunity to demonstrate that the education, experience, licences or certifications obtained in their territory should likewise be recognized.
- Other Members are notified of existing mutual recognition agreements or the launching of negotiations to create a mutual recognition agreement.

There is, however, under Article VI a requirement that Members should provide for a mechanism to verify the competence of professionals of any other Members. In the example above, non-recognition of nursing credentials may well be allowed.

Members have an obligation to notify the Council for Trade in Services of existing recognition agreements, as well as new ones that are negotiated. Over time, Members are expected to conform to standards set by recognized international bodies based, where possible, on multilaterally agreed criteria. The longer-term objective is to develop and adopt common international standards for the recognition of credentials and the practice of relevant services trades and professions. The *Guidelines for Mutual Recognition Agreements or Arrangements in the Accountancy Sector*, developed by the Working Party on Professional Services, is a first step (*see* Appendix IV).

Monopolies and exclusive services providers

A Latin American baggage-handling company would like to apply for a contract with an airport abroad on the basis of its reputation for efficiency. It wants to know whether it can be excluded from consideration if the targeted airport is government controlled.

GATS does not forbid monopolies or exclusive services providers *per se* (Article VIII) as long as the monopoly supplier observes the MFN obligation and does not abuse its monopoly position. In addition, Members must report the formation of new monopolies to the Council for Trade in Services and follow the procedures for compensatory adjustments under the rules for modification or withdrawal of commitments. In the example cited above, the national government would be within its rights to continue managing airport services through a monopoly arrangement.

Business practices

An African airport authority would like to reserve the right to restrict all equipment maintenance and repair to airport employees. Is this allowed under GATS?

There are a number of business practices, in addition to monopolies, that may constrain competition and so restrict trade in services. Article IX requires Members to enter into consultation as requested, in good faith, including supplying publicly available non-confidential information regarding the practices in question. In addressing potentially restrictive business practices, it is helpful to remember that anti-competitive practices can arise from private-sector enterprises or from professional associations. In the first instance, the current trend towards collaboration among services providers in order to compete more effectively can create problems if market dominance is abused. Alliances among market leaders may effectively exclude smaller players from the market or may restrict their ability to negotiate favourable terms as suppliers or affiliates. In the second instance, professional associations can block market opportunities for services exporters in developing countries by reducing price competition and restricting new entrants in an attempt to ensure the provision of services at certain quality levels.

The topic of trade and competition policy was not addressed in the main body of GATS, though some initial principles have been developed for telecommunications (as embodied in the *Reference* Paper drawn up by the Negotiating Group on Basic Telecommunications – *see* Appendix IV). In the example cited above, the national government would have the right to restrict who provides the services as long as the services are supplied under reasonable and non-discriminatory terms and conditions, in accordance with the GATS provisions on monopolies and exclusive service suppliers.

Domestic regulation

A communications and printing company in Latin America would like to bid on contracts for the production of media materials from Canadian firms. It is concerned, however, about Canadian content regulations and whether these regulations would apply to such contracts.

An Asian firm wants to establish a joint venture to supply data processing services to public-sector organizations in Massachusetts. It is wondering if there are State regulations that would affect its joint venture plans.

One of the challenges of services trade liberalization arises from the fact that many barriers to export expansion are domestic regulations that were developed without regard to potential competitive distortions. GATS recognizes that domestic regulations, rather than border tariffs, create the primary barrier to trade in services. Addressing market access and national treatment barriers will not lead to the expansion of the services trade unless domestic regulations are also included.

GATS provides under Article VI for domestic measures to be administered in a reasonable, objective and impartial manner. Members are required to render decisions on the right to operate in the Member's territory "within a reasonable period of time" after the submission of an application that is complete under domestic law, as well as to provide information concerning the status of that application.

Rationalizing services industry regulations across subfederal jurisdictions (e.g. educational requirements for professional licensing, reserve requirements for insurers or financial institutions) would not only meet GATS obligations for progressive liberalization but also support the growth of domestic services suppliers. The following are types of regulations that are currently in place which can constrain economic growth; some are a matter of domestic regulation and some of national treatment (Article XVII):

- ❑ *Regulations restricting growth opportunities*
  - Differing technical and licensing requirements across subfederal jurisdictions, necessitating re-qualification in each jurisdiction.
  - Technical standards for licensing that include variables unrelated to professional competence (e.g. requirements for citizenship or residency). [Article XVII]
  - Absence of domestic legislation to protect intellectual property rights or to support environmental initiatives. [Article XVII]
- ❑ *Regulations increasing operating costs*
  - Expensive Internet connections (usually by monopoly providers) which effectively block access to on-line facilities and services.
- ❑ *Regulations reducing competitiveness*
  - Price controls requiring uniform pricing, imposing minimum or maximum prices, or enforcing price-setting formulas (e.g. on air transportation, financial services, telecommunications).

– Restrictions on business structures (e.g. options for the legal entity; use of an internationally recognized firm or brand name; scope of services, particularly multi-disciplinary professional services practices). [Article XVII]

The challenge in revising any domestic regulation is to ensure appropriate consumer protection and subfederal autonomy while not unduly restricting growth and innovation opportunities for services firms.

Principles to help Members ensure that domestic regulations are not trade distorting have yet to be developed, with the exception of those now developed for accountancy under the Working Group on Professional Services (the *Disciplines on Domestic Regulation in the Accountancy Sector*). With regard to qualification requirements and procedures, technical standards, and licensing requirements, such principles will include the following criteria:

- Requirements should be based on objective and transparent criteria, such as competence and the ability to supply the service;
- They should not be more burdensome than necessary to ensure the quality of the service;
- Licensing procedures should not in themselves be a restriction on the supply of the service.

In the first scenario cited above, the Canadian Government has the sovereign right to impose Canadian content requirements as long as these apply impartially to domestic and foreign suppliers alike. In the second example, Massachusetts currently has legislation prohibiting the award of State contracts to firms doing business in the Asian country concerned (a subfederal measure currently under review by WTO), which would make the joint venture untenable.

Payments and transfers

A Middle Eastern translation firm is about to launch an export development initiative to establish offices *abroad for its multilingual conference support services. It has concerns, however, about being able to capitalize initial operations abroad and repatriate profits once established.*

GATS Article XI requires Members to allow international transfers and payments for current transactions relating to specific commitments, which is usually interpreted by IMF as including the transfer of profits. With regard to capital movements in connection with commercial presence, a Member is obliged to allow the related capital flow into its territory but has no obligation to allow capital outflow. In the example above, if the translation firm selected a target market where commitments had been made to allow commercial establishment in translation services, then it should theoretically have no difficulty either bringing in capital to begin the commercial venture or repatriating profits. However, the firm may face restrictions from its own government with regard to the amount of capital it can move abroad.

Access to telecommunications systems

An Asian cellular telephone communications firm wants to provide its services in a target market that has traditionally restricted cellular licences and wonders if the new WTO Agreement on Basic Telecommunications will improve opportunities.

As a result of the Uruguay Round negotiations, most countries undertook commitments on value-added telecommunications services, but only a few countries included basic telecommunications. The follow-up 1997 negotiations on basic telecommunications resulted in binding commitments by 69 signatories in most basic telecommunications subsectors. The new agreement, called the Agreement on Basic Telecommunications, consists of the Fourth Protocol of GATS and the commitments and MFN exemption lists annexed to it. It entered into force on 5 February 1998 with 72 signatories. At its heart is the reference paper developed by the Negotiating Group on Basic Telecommunications.

The paper (reproduced in Appendix IV) contains the basic definitions and principles for the regulatory framework for telecommunications services which were negotiated and accepted by the signatories and which those signatories are expected to follow in order to ensure non-discriminatory market access. The paper covers the following issues:

- Safeguards against anti-competitive activities such as cross-subsidization, using a competitor's proprietary information against them, and withholding technical and commercial information necessary for other suppliers to provide services.
- Non-discriminatory interconnection, covering issues of interoperability, rates, connection quality, end-user access, timeliness and unbundling. Interconnection arrangements should be transparent and the procedures publicly available.
- Universal service obligations, which can be defined freely by the signatories as long as they are transparent, non-discriminatory and competitively neutral.
- Public availability of licensing criteria.
- Allocation and use of scarce resources, such as radio spectrum and telephone numbers, and the inherent right-of-way issues involved with building outworks (i.e. conduits, poles and transmission towers on public and private land).
- The establishment (or maintenance) of an independent regulator to make sure the above requirements are impartially enforced.

Some Members have been allowed to phase in market access commitments because they were either bound by current contracts preserving the status quo for a fixed period, or because some changes were too difficult to be implemented immediately. So, for example, the dates for liberalizing services such as public voice telephony vary from 1998 to 2011.

Progressive liberalization

Under Article XIX, Members are committed to enter into a new round of negotiations no later than January 2000. This reflects the statement in the preamble to the effect that the Members desire to achieve "progressively higher levels of liberalization of trade in services through successive rounds of multilateral negotiations". In general, the approach to liberalization under GATS is based on mutual exchanges of concessions (the traditional request-and-offer approach). However, recognizing the benefits to be gained from liberalization, particularly in terms of becoming more attractive to foreign investors, some Members have liberalized autonomously. In preparation for the next round of negotiations, GATS provides for the establishment of negotiating guidelines that recognize the liberalization undertaken autonomously by Members since the previous negotiations.