

# TACD

TRANS ATLANTIC      DIALOGUE TRANSATLANTIQUE  
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## **DRAFT TACD Background paper on Trade in Services**

**Prepared for TACD by Ellen Gould, Consultant to TACD, October 2002**

### **I. Introduction**

The General Agreement on Trade in Services is an existing WTO agreement that is being renegotiated to expand its reach. The GATS contains provisions that set it apart from other WTO agreements, such as by defining “trade” very expansively to include not only the cross-border delivery of services but also investment and services that are consumed or provided abroad.

Some provisions of the GATS apply to every service automatically, and others only apply to those services where governments make specific "commitments." This structure provides governments with a certain degree of flexibility. When they initially make their commitments, governments can place limits on them. For example, when the US committed adult education in the first round of GATS negotiations, it qualified how much the GATS national treatment provisions should apply by saying that scholarships and grants "may, in some cases, only be used at certain states' institutions".<sup>1</sup> Otherwise the GATS would have required students attending foreign-owned institutions in the US to be eligible for the same grants as those attending state ones.

The agreement provides for repeated rounds of negotiations. Through these negotiations, WTO members bargain with each other not only about making commitments of new services, but as well about removing limits they might have originally placed on their commitments. For example, in this round of bargaining the EU is asking the US to make an entirely new commitment in the area of "Water collection, purification and distribution". But it is also asking the US to remove the limitations it has placed on its existing environmental services commitments, such as under waste water services where the EU has requested the US remove its "limitation of commitments to services contracted by private industry."<sup>2</sup>

The current round of GATS negotiations began in January 2000 and is scheduled to be completed by 2005. As of June 2002, WTO members started to exchange formal negotiating “requests”, which comprise lists of changes they want their negotiating

partners to make to their GATS commitments. By March 2003, each country will need to respond and state what changes they are willing to make.

The GATS is intended to lock in liberalization and make it irreversible. The WTO Secretariat has said that: “(B)indings undertaken in the GATS have the effect of protecting liberalization policies, regardless of their underlying rationale, from slippages and reversals...”<sup>3</sup> Developing countries, which have relatively few service firms that compete internationally, are told that the advantage for them in taking on more GATS commitments is that these commitments will provide certainty to potential investors that their policies on opening up to foreign competition will never change. In his testimony to the US Congress on behalf of the US Coalition of Services Industries<sup>4</sup>, Dean O’Hare said that US private health care providers had experienced regulations in developed countries as barriers to being able to enter their health care markets. He commented that while “Existing regulations are by and large not a problem in emerging markets”, the danger was they could be without GATS disciplines.

The irreversibility of liberalization under the GATS is achieved in two ways. As with other WTO agreements, members who violate their GATS obligations can be challenged and sanctioned under the WTO dispute system. In addition, while there is a GATS provision that allows a government to change the commitments it has made, the conditions imposed are so stiff it is unlikely ever to be used.<sup>5</sup>

A 2001 TACD paper on the GATS summarized key aspects of the agreement and the scope of the present round of negotiations. The paper analyzed the significance of negotiators' decision to put all services - including education, health, water, and energy - "on the table" in the current bargaining process. The paper noted that the GATS does have an exemption for "services supplied in the exercise of governmental authority", but the agreement applies to public services where they are in competition with other service suppliers or provided on a "commercial basis". The TACD recommendations on the GATS submitted to the EU-US summit in May 2002 are included as Appendix A. They deal with concerns about access to services, restrictions on regulations, the challenge to non-discriminatory regulation, and transparency problems with key GATS documents being kept from the public.

The current round of GATS negotiations involve more than expanding and deepening commitments. Certain issues were left unresolved when the agreement was originally signed, and one of these was the question of GATS constraints on domestic regulation. The analysis that follows will focus on this aspect of the GATS negotiations, since it is an area that stands to have a particular impact on the work of consumer groups. While the proposed amendment on domestic regulation is still being negotiated, its potential effects can be predicted as it is being modelled on provisions in other WTO agreements. As well, GATS negotiators have submitted examples of the specific government regulations they think need to be disciplined. The examples emerged from consultations with business on which regulations they saw as problems and want addressed through the GATS. So it is possible to anticipate with some confidence what kinds of GATS disputes

over domestic regulation would be likely to emerge if negotiators go ahead with new binding obligations on domestic regulation.

The GATS negotiations on domestic regulation could create new grounds for legal challenges to regulations that consumers have worked hard to get implemented. Key decisions are yet to be made - whether the new provisions would apply to all service sectors, what the legal wording of the new constraints would be, whether new constraints are even necessary given other provisions in the GATS. But what is noticeably missing from the recorded minutes of these negotiations is examination of how the proposals on domestic regulation would impact consumers. This paper focuses on the aspect of the current GATS negotiations dealing with domestic regulation to draw out the implications for consumers.

## II. Background on the GATS Negotiations on Domestic Regulation

### i. Origins of the Negotiations

*“In order to pursue meaningful services negotiations, WTO members will have to consider making adjustments to their regulatory regimes.”*

Dean O’Hare, Chair of the Coalition of Service Industries <sup>6</sup>

The GATS Working Party on Domestic Regulation began its work in 1999. It took over from the GATS Working Party on Professional Services, which had completed a draft agreement to constrain - to “discipline” in WTO terms - regulation over the accounting profession. The mandate of this GATS negotiating group was officially described as: "In accordance with paragraph 4 of Article VI of the GATS, the Working Party shall develop any necessary disciplines to ensure that measures relating to licensing requirements and procedures, technical standards and qualification requirements and procedures do not constitute unnecessary barriers to trade in services."<sup>7</sup>

Only one aspect of the negotiations currently underway is dealing with issues like recognition of credentials for professionals working overseas. Negotiators are primarily focused on using the draft agreement on accounting as a model for across-the-board disciplines on government regulation. The draft agreement on accounting is analyzed below to assess the specific impacts it could have on government efforts to reform the accounting profession.

The Working Party on Domestic Regulation is developing disciplines not only for professional services like engineering, architecture, and law, but over all services and service providers. This would cover sectors where consumer groups have taken an active interest, including advertizing, marketing, water and energy. If the GATS is amended to include these new disciplines on regulation, they could come into force in 2005 when negotiators hope to conclude the current round of negotiations on the agreement.

The GATS does have in its preamble a statement asserting WTO members’ right “to regulate, and to introduce new regulations”, a right repeated in the 2001 WTO ministers’ statement made in November 2001 in Doha. But the preamble also contains a commitment to expansion of trade in services. The WTO Secretariat has said that new disciplines on domestic regulation are a way of balancing these two goals. <sup>8</sup>

The preamble in any case would only be referred to if a dispute panel were unclear about what negotiators intended by a particular clause in the agreement. An agreement’s preamble does not carry the same legal weight as the binding articles of the text.<sup>9</sup> The Transatlantic Consumer Dialogue and Consumers International have asked that the GATS be amended so that the right to regulate would be a provision in the body of the agreement.

## ii. Existing GATS Restrictions on Regulation

The GATS already addresses key issues that might be of concern to those trying to provide services in foreign countries. Governments are required to make public all measures that are relevant to the GATS.<sup>10</sup> Where governments make specific commitments of services, they have to:

- notify the WTO annually of any changes to regulations that might affect these commitments.<sup>11</sup>
- “ensure that all measures of general application affecting trade in services are administered in a reasonable, objective and impartial manner.”<sup>12</sup>
- set up a process for review and “appropriate remedies for” administrative decisions.<sup>13</sup>

### National treatment

Unless they have listed a specific exemption, under the GATS governments are obligated to provide “most favoured nation” treatment to all WTO members - they are not permitted to give better treatment to foreign suppliers and services from one country than another.<sup>14</sup> A commitment of a service to the GATS “national treatment” obligations of the GATS means that foreign service suppliers have to be afforded the same “conditions of competition”.<sup>15</sup> Trade officials sometimes make the mistake of saying that as long as the same rules are being applied equally to foreign and local firms, then countries are meeting their GATS commitments. But applying the same rules in the same way is not enough to avoid being in violation of the GATS - the same “conditions of competition” have to be provided.

What does this broad interpretation of national treatment in the GATS mean in practical terms? For example, according to the WTO Secretariat when it comes to setting construction standards and technical specifications: “Even if the same measures are applied to all suppliers, domestic or foreign, they may be found to be more onerous to foreign suppliers.”<sup>16</sup>

The restraints on domestic regulation being developed would go even further, limiting regulations regardless of how non-discriminatory they were. The Secretariat recommended to the Working Party on Professional Services that “In the light of the potentially broad application of Article XVII [National Treatment] of the GATS, Members of the Working Party might wish to consider what is entailed by ensuring that non-discriminatory qualification requirements should not be unnecessarily burdensome.”<sup>17</sup> The Secretariat appears to be suggesting that given how extensive GATS national treatment obligations already are, WTO members should consider whether these existing disciplines could address problems members might have with regulations.

## **Market Access**

The market access provisions of the GATS are unusual in a trade agreement. According to two GATS experts:

*“(T)he GATS article on market access extends beyond traditional concerns of access for foreign service suppliers to encompass all policies which restrict access to a market. This is a major extension of multilateral trade disciplines into the realm of domestic policy.”<sup>18</sup>*

As with national treatment, under market access governments can place certain kinds of limits on the extent of their commitments. Full market access commitments, though, mean countries cannot place certain restrictions on the supply of a service, such as maintaining monopolies, or require that suppliers take particular legal forms, such as joint partnerships.<sup>19</sup>

The reach of GATS market access provisions will become more obvious as governments negotiate to have it apply to more services. For example, the central objective of the US in this round of negotiations is to get broad commitments under energy.<sup>20</sup> It has been pointed out, though, that if the US itself had already made full market access commitments for energy before the California electricity crisis, then actions taken to solve the crisis would have violated the GATS.<sup>21</sup> According to Peter Evans, the September, 2001 decision of the California Public Utilities Commission to suspend competition in retail sales of electricity would likely have been a GATS market access violation “since it effectively limited the number of service providers...”<sup>22</sup>

### **Exceptions Allowed - If "Necessary"**

If challenged that it has violated the agreement<sup>23</sup>, a government can use the defence provided for in GATS Article XIV that its action was necessary “to protect public morals or to maintain public order” or “to protect human, animal or plant life or health.” It should be noted that exception clauses like the one in the GATS have only successfully been used as a defence in WTO cases once, in the challenge against France's ban on asbestos. A WTO panel has to be convinced that what a government did was *necessary* in the sense that in meeting their objectives there were not other things the government could have done that were less trade restrictive. The meaning of necessity tests is examined in detail below.

Vital consumer protections - “the prevention of fraudulent and deceptive practices” and “the protection of the privacy of individuals” have a weak status as exceptions in the agreement because even if a policy is explicitly designed to prevent fraud or protect privacy, it can still be challenged successfully if it is inconsistent with the provisions of the GATS. Article XIV (c) allows measures relating to the “prevention of deceptive and

fraudulent practices” and for the “protection of privacy”, but these are only permissible if they are not “inconsistent with the provisions of this Agreement.” Furthermore, negotiators have stated that these exceptions should be “interpreted narrowly”.<sup>24</sup>

The current round of negotiations to expand commitments governments make under the GATS will mean an increased range of services will be governed by the agreement. Given how forceful the existing GATS provisions are, the question has been asked why there would be a need to place further restrictions on government regulation through an amendment to the GATS.<sup>25</sup>

### **III. What Options Are Negotiators Debating?**

#### **i. The Broad Scope of the Negotiations on Domestic Regulation**

The mandate on domestic regulation in the GATS directs negotiators to develop any “necessary” disciplines to require that measures *relating* to qualifications, licensing, and standards over services are “no more burdensome than necessary to ensure the quality of the service.”(GATS Article VI:4) “Qualifications” generally refers to requirements placed on individuals and “licensing” generally refers to requirements placed on firms. The WTO Secretariat defines “standards” in the context of the GATS very broadly as “the rules according to which the service must be performed.”<sup>26</sup> As the US delegate commented “coverage appeared to be very broad, and it was difficult to imagine regulatory restrictions that might be excluded.”<sup>27</sup>

There is no bright line dividing WTO rules that apply to goods from those that apply to services. The two key cases that governments lost involving the GATS concerned autos and bananas, not items one would expect to be governed by a services agreement. However, nearly all goods have to be advertized, transported, stored, and sold, so measures dealing with goods can fall under the scope of the GATS as measures “*affecting* trade in services.”<sup>28</sup>

Negotiators have agreed that whatever the results of their discussions, any new obligations on domestic regulation should discipline government measures that cannot already be dealt with through the national treatment and market access provisions of the GATS.

Services regulations are much more extensive than those for goods, and are the embodiment of diverse social and cultural policies. For example, the hours liquor stores are allowed to stay open - or in fact if there are liquor stores at all - is a reflection of community values, not just commercial considerations. The new restrictions on government regulation being negotiated go far beyond what reasonably would be expected from a trade agreement on services.

## **ii Options for the negotiations**

Negotiators have raised a number of different possibilities in their meetings on new GATS disciplines on domestic regulation. These vary greatly in terms of their likely impacts. The possibilities include:

### **A Decision that No New Regulatory Disciplines Are Necessary**

Existing GATS articles in the agreement dealing with government procurement, subsidies, an “emergency safeguard measure”, and domestic regulation provide negotiators with a mandate to negotiate on these issues. This does not mean at the end of the day there has to be an agreement to create new GATS articles. There has been stiff resistance, for example, to amending the agreement to allow governments to suspend their obligations temporarily to deal with an emergency. The question has been asked whether new GATS disciplines on domestic regulation are necessary at all given what is already in the agreement.<sup>29</sup>

### **A Decision to Limit Application of Any New Disciplines**

Some negotiators have raised the possibility that new disciplines would not have to apply to sub-national governments such as states and municipalities, but this view is not receiving much support. Negotiators are also debating whether the new disciplines should apply to all services including services that governments have not committed to the market access and national treatment rules of the GATS. There is repeated reference in the minutes to GATS meetings that a provision is being sought so that some disciplines can be applied across-the-board to all services.

Limiting the new constraints on domestic regulation to where governments have already made GATS commitments would still mean they would have a very broad impact. Some of the key sectors where consumers have a particular interest, such as retail services, are already extensively committed. In addition, since there is provision in the GATS for repeated rounds of negotiations to get ever-increased commitments, this limitation would tend to disappear over time.

### **A Strict Necessity Test**

Among the options negotiators are considering is a requirement that WTO members only adopt the “least trade restrictive” of their regulatory options. This discipline would commit WTO members to extensive deregulation as they would have to revise their regulations to ensure only the regulatory tool that restricted commercial activity the least was adopted. The fact that the GATS defines “trade” very broadly to include investment is key to understanding the impact of this wording. Being obligated to only do what is the “least restrictive” to investors would tip the regulatory balance very heavily in favour of commercial interests.

Other options negotiators are considering include a requirement to regulate in ways that are “no more burdensome than necessary” or “no more trade restrictive than necessary.” Using the term “burdensome” would effectively uncouple the new GATS disciplines from trade considerations and signify WTO involvement in setting non-trade related criteria for judging domestic policy.

The European Communities says either of these options - “no more burdensome than necessary” and “no more trade restrictive than necessary” - should be interpreted to mean governments have to assess how trade restrictive a regulation is “in proportion” to the objective pursued.<sup>30</sup> The European Union has adopted a concept of regulatory “proportionality” within its jurisdiction. In a presentation to the March 2002 OECD-World Bank experts meeting on the GATS and domestic regulation, Claude Trollet and John Hegarty explained the significance of this concept:

*“The most interesting aspects of the EU jurisprudence on proportionality from the point of view of regulatory reform are the way it addresses the cumulative effect of regulations in the home and host Member State as well as in the host Member State alone, and the obligation to let less demanding provisions capable of achieving the same result prevail. A requirement can be justified only if no already existing provision, in either the home or the host Member State, can achieve the same objective. Contrary to the text of the GATS or of the Disciplines [on accounting] which remain silent in this regard, the Court imposes that the least demanding measure always be favoured.”<sup>31</sup>*

From this analysis, it does not seem that use of the concept of proportionality would moderate the strictness of the proposed GATS disciplines on domestic regulation. The European Court of Justice's interpretation that “proportionality” means “that the least demanding measure always be favoured” would carry weight within the WTO dispute system, as ECJ decisions are referred to by WTO panels. Importing this concept into the context of the WTO where so many countries with diverse approaches to regulation can initiate challenges could significantly weaken domestic regulatory authority.

### **iii. The Kinds of Regulations Being Targeted**

So that they would have a clear picture of the kinds of regulations they were trying to constrain, negotiators first surveyed their domestic service companies on the regulations they thought presented problems for them in foreign services markets. WTO delegations submitted lists of these regulations, and the WTO Secretariat winnowed down the submissions to exclude regulations that were already covered by GATS market access and national treatment obligations. The result was distributed among WTO delegations as a document entitled “EXAMPLES OF MEASURES TO ADDRESSED BY DISCIPLINES UNDER GATS ARTICLE VI:4”, which is attached as Appendix B.

Some of the examples are very specific and give an indication of the extent to which local decision-making could be impacted: eg. “Restrictive regulations relating to zoning and

operating hours, to protect small stores." Others cover the diversity of regulations at the state or provincial levels, eg. "Federal and sub-federal licensing and qualification requirements and procedures are different, making a license or qualification recognition obtained in one state not valid in other states." Making it a GATS violation to have sub-federal differences over regulations like the licensing of nursing homes would threaten the ability of sub-federal governments to innovate and take the lead in protecting consumers. Often consumer groups win significant national victories by first convincing governments at the sub-federal level to adopt new regulations that are then adopted on a nation-wide basis.

Many of the examples on the list beg the question of how the terms should be interpreted and by whom. "*Inadequate* information available to market participants", "*too many* licenses required", "changes without *adequate* prior notice", "*long* delays", "*overly complicated* licensing procedures" - these complaints can be legitimate in some countries that require domestic regulatory reform. However, in many countries these kinds of objections have been raised by business to challenge or stall genuine consumer protection legislation. Governments at every level would be under increased pressure to respond to these objections if WTO members amend the GATS to include new constraints on domestic regulation. Genuine consumer protections could be caught, not only unnecessary red tape.

Other broadly worded items appearing in "EXAMPLES OF MEASURES TO ADDRESSED BY DISCIPLINES UNDER GATS ARTICLE VI:4" reflect traditional business complaints about regulation. These include:

- "a great deal of documents must be submitted through several stages in order to obtain authorization",
- "authorization procedures are costly",
- "authorization requirements are cumbersome",
- "authorization may not be handled through a single point", and
- "authorization procedures take up a considerable amount of time".

The examples of regulations to be disciplined are not finalized and would not in any case determine what would be vulnerable or safe from a WTO challenge. But they do indicate the range of non-discriminatory regulation at risk. In the event of a dispute about which regulations were subject to the disciplines, a WTO panel might refer to the list as part of the negotiating history to clarify the negotiators' intent.

The list also makes the discussion of new GATS regulatory disciplines less abstract. It can be viewed as examples of WTO "disputes-in-the-making". WTO disputes are generally launched when domestic industries raise complaints with their home governments about problems they experience in overseas markets, complaints their governments agree are legitimate and can be resolved through the WTO dispute process. Therefore, the list of measures to be disciplined by new GATS rules on domestic regulation give consumers an indication of what regulations could be targeted in future WTO disputes. All the elements of a future dispute are already in place since the list was drawn from complaints businesses have with government regulations, particular WTO

members have agreed that the complaints are legitimate and have submitted them as problems to be addressed by the GATS, and an amendment to the GATS is being drafted specifically to deal with these complaints. Examples and possible consequences of such disputes are outlined in the next section.

### **Licensing Requirements**

Some of the examples on this list are very broad, such as “unduly burdensome licensing requirements”. Since fulfilling licensing requirements necessarily costs money, the business perspective on what is unduly burdensome can conflict with that of consumers. The following are just two examples of where consumers and businesses have been at odds over the importance of complying with licensing requirements:

- Nursing homes in the U.S. have been found deficient in meeting the conditions of their operating licenses. The US Consumers Union has published a guide, “Nursing Home Watch List by State”, to alert seniors to the facilities that have been cited for the most serious deficiencies. Deficiencies listed include failure to prepare food under sanitary conditions and failure to prepare comprehensive care plans.
- Utility providers often have conditions imposed on their licenses in order to protect consumers, and breaches result in frequent consumer complaints to utility watchdogs. These licensing obligations can include: giving sufficient notice and delay before services are terminated due to non-payment, prohibitions on requiring consumers to buy related services, limitations on telemarketing, and requirements to provide pricing information in a clear and comparable way.

Since service suppliers violate existing licensing requirements and their industry associations lobby for less stringent ones, it would be unrealistic to think they would not try to use WTO disciplines on “unduly burdensome licensing requirements” to advantage. Governments could be asked to take up formal WTO challenges against other governments’ licensing requirements. Or it is perhaps more likely that a government’s GATS obligations could be used domestically to buttress arguments that governments should pursue the least burdensome alternative to regulation, such as industry self-regulation, government incentives, or consumer education. Consumer advocates encounter all of these arguments routinely in their efforts to obtain strong consumer protection legislation.

#### *Indemnity insurance*

Some specific regulations included on the examples list are ones that provide recourse for consumers of substandard services, such as the requirement that the “applicant must possess indemnity insurance or be bonded prior to licensing.” It should be remembered that if higher insurance or bonding requirements are imposed on foreign suppliers these can already be challenged in the GATS wherever governments have made national treatment commitments. The cost of indemnity insurance does create a barrier to entry for professionals in fields like medicine, but given the consequences for patients of

professional errors, indemnity insurance is an important safeguard of patients' interests and it is hard to determine what is "more burdensome than necessary".

Where communities have experienced particular problems with the reliability of construction contractors' work, bonding requirements may be very stringent and appear unnecessarily burdensome by international standards. On the west coast of Canada for example, a commission of inquiry recommended strict bonding requirements after 50,000 purchasers of poorly constructed condominiums were left with an estimated \$800 million in repair bills. The contractors they might have sued in many cases simply dissolved their corporate identity and re-established themselves under different names.<sup>32</sup>

### *Environmental regulation*

The examples of regulatory complaints listed in "EXAMPLES OF MEASURES TO ADDRESSED BY DISCIPLINES UNDER GATS ARTICLE VI:4" are often raised in relation to environmental regulations. Although it may not be as obvious as it is for goods, services have significant environmental impacts, so GATS constraints on domestic regulation could conflict with consumer concerns about sustainability. Pesticide spraying, the construction of logging roads, toxic waste disposal, pipeline construction, and services related to mining and agriculture are just some of the services that can be heavily regulated for environmental reasons. In these areas, it is common for industry to object to costly or lengthy authorization procedures, having to seek authorization from a number of agencies, and requirements to participate in environmental assessments. The risk for environmental regulation under the GATS is particularly serious because, in contrast with WTO agreements that deal with goods, the GATS allows no exceptions for governments who violate the agreement but do so in order to conserve natural resources.

### **Licensing Requirements and Access to Services**

Opening up markets to foreign competition can lower prices and/or increase the range of services available, but liberalizing markets does not mean that everyone in a society will have access to these services. In exchange for closing a market to competition, governments can insist that monopoly service providers meet the basic needs of the poor and people living in expensive-to-serve rural areas. With liberalization, companies experiencing stiff competition tend to argue that they can no longer afford to meet universal service obligations.

Some economists say that universal service obligations and cross-subsidization - using one aspect of an operation to subsidize another - within a particular sector are not efficient ways to meet social goals. If GATS disciplines to limit domestic regulation on licensing are introduced, a dispute panel might agree with this perspective. Panel members might support a government's objective of providing universal access to a service, but they could rule that access to services should be ensured through means that would be less of a burden on particular industries, such as through direct government subsidies funded out of general revenue.

## *Health services*

At a March 2002 World Bank/OECD conference on the proposed GATS regulatory disciplines<sup>33</sup>, Professor David Luff gave examples of health care licensing requirements designed to ensure universal access that could fall foul of the requirement to be "no more trade restrictive than necessary":

- Ensuring universal access by imposing it rather than granting government incentives to service providers;
- Restricting fees rather than increasing social security payments to enable patients to afford the fee that is charged;
- Requiring facilities to operate on a non-profit basis rather than setting conditions on how for-profits operate.

Luff points out<sup>34</sup> that the exemption in the GATS for "services supplied in the exercise of governmental authority" would be unlikely to protect public health care services from a GATS challenge since so little of health care is provided anywhere in the absence of competition - a requirement to qualify for the exemption.

But even in the mostly private system that exists in the US, health facilities are required through licensing requirements to provide certain services that they would likely drop if they were allowed to operate on a purely market basis. Federal law requires hospitals to provide emergency care even for those who lack health insurance or other means of payment. State laws can require hospitals to provide particular kinds of services, such as obstetrics care. While these services may be comparatively poor investments from a strictly business standpoint, they are critical from the perspective of maintaining the health of the general population.

Although the objective of maintaining public health would not likely be challenged, the particular means a government adopted to pursue its universal access objective could be. To impose across-the-board disciplines of the type being considered in the GATS negotiations would necessarily make WTO rules a critical factor to be weighed in the determination of domestic policies to achieve universal service access.

Whether WTO dispute panels would agree that these kinds of regulations are violations of the proposed GATS disciplines on domestic regulation would be guided by how they determined whether a regulation was "necessary." The considerations they would take into account are reviewed below.

### **Regulatory Standards**

Listed in "EXAMPLES OF MEASURES TO ADDRESSED BY DISCIPLINED UNDER GATS ARTICLE VI:4" as potential problems are "National standards which diverge from international standards". In light of the fact that the GATS covers measures that "affect" services trade, the scope of these regulations could be very broad indeed.

For example, food labelling done on a fee or contract basis is a service covered by the GATS<sup>35</sup>, as are food wholesale and retail services, transportation, and storage. Consumer organisations campaigning for the labelling and traceability of genetically modified foods may want to consider how new constraints on domestic regulation would affect their work.

### *Marketing and advertising*

Other examples of regulations considered problems are some which were originally raised during the GATS negotiations on regulation of professional services. In discussions on professional services, limitations on marketing and advertising were regarded as hampering international firms of lawyers, architects, and accountants from being able to compete in foreign markets.

Disciplining limitations/prohibitions on market and advertising generally could have profound ramifications for consumers. Some examples are:

- Rather than responding to consumer requests for strong regulations to deal with “spam” (unsolicited commercial emails), under the proposed GATS disciplines regulators could be limited to less burdensome approaches such as “opt-out” provisions requiring consumers to notify advertisers if they do not want these emails. BEUC, the European Consumers’ Organization, has supported the European Parliament’s tougher stand that consumers should receive spam only if they expressly “opt in” by agreeing to let commercial advertizers use their addresses;
- Rather than banning direct-to-consumer advertizing for prescription drugs, a key consumer demand to restrain escalating health care costs, governments could be required to choose the less burdensome approach of allowing the industry to self-regulate (as is done in New Zealand), or abide by government-imposed standards (as is done in the US);
- Rather than prohibitions on broadcast advertizing directed at children (as is done in the province of Quebec, Canada), advertizers could be requested to adopt voluntary codes.

With the potential threat of a WTO challenge using new provisions in the GATS, it would become that much harder for consumer groups to convince regulators that outright bans or strong restrictions are the approach to take.

As with licensing requirements, it is reasonable to expect business firms would make use of GATS disciplines on regulatory standards given the opportunity. Dean O’Hare, Chair of the US Coalition of Service Industries, in his testimony<sup>36</sup> to Congress on the GATS said his Coalition wanted to see across-the-board disciplines so that “onerous” regulations could be challenged if they were “more burdensome than necessary.” Among the standards he identified as problems were “Excessive privacy and confidentiality regulations” in the health care field.

#### **iv. How Would a WTO Dispute Panel Rule on Proposed GATS Regulatory Disciplines?**

The proposals for new GATS disciplines on regulation would confer considerable authority on WTO panels to decide in the event of a dispute which regulations and procedures are overly burdensome. Many countries have instituted guidelines to reduce regulatory burdens, but this is not the same as making it an obligation that is binding under international law. GATS negotiators have already decided against providing guidance to panels through a mechanism that is included in other WTO agreements - a list to illustrate what kinds of regulatory objectives dispute panels should accept as legitimate.

The European Commission initially proposed that the expression suggested in the agreement - “not more burdensome than necessary to ensure the quality of the service” - should be broadened to include a list of other legitimate objectives. “Ensuring the quality of the service” does not capture a whole range of public policy concerns, such as access to services, environmental protection and cultural diversity. But after criticism of its proposal, the European delegation decided against development of a list of legitimate objectives on the basis that “the result was likely to be either overly restrictive or too broad to be of much guidance.”<sup>37</sup>

Direct challenges to regulatory objectives, however, would probably not be the biggest threat the new disciplines would present to the right to regulate. When consumer groups campaign for stronger consumer protections, they rarely face opposition that says their underlying objectives are wrong. Whether it is a campaign to get spam regulated through “opt in” provisions, a ban on advertizing to children, or tough new standards for the accounting industry, consumer organizations are told that the objectives they seek have merit but should be achieved through less burdensome means.

Which regulations would violate the proposed GATS regulatory disciplines can be anticipated by reviewing WTO dispute decisions made on the basis of existing necessity clauses in other WTO agreements. WTO rulings on what is required to prove a measure is “necessary” indicate that in order to meet this test, governments need to:

- 1) Have an objective for their regulations that will be accepted as legitimate.
- 2) Choose the least trade restrictive means of achieving their objective that is “reasonably available” to them. A WTO dispute body has already ruled that the fact that an alternative means costs a government more is not a compelling enough reason against having to adopt it if it is less trade restrictive<sup>38</sup>. This ruling could have important ramifications for how governments meet universal service objectives under a GATS necessity test. It also has significance for developing countries whose resources limit their policy options.
- 3) Ensure the measures taken and the objectives they are supposed to meet are an appropriate fit in the sense that measures have to be “effective” ways to achieve their stated objectives.

The WTO Appellate Body has interpreted “necessary” as tending to mean “indispensable.” In the event of a challenge, a regulation that fell short of being indispensable would involve WTO panels weighing how effective they thought the regulations were and whether the objective they served was important enough to justify their severity. In its 2000 ruling in the Korea Beef case, the Appellate Body stated:

*“In sum, determination of whether a measure, which is not ‘indispensable’, may nevertheless be ‘necessary’ within the contemplation of Article XX(d)[a necessity clause in the GATT], involves in every case a process of weighing and balancing a series of factors which prominently include the contribution made by the compliance measure to the enforcement of the law or regulation at issue, the importance of the common interests or values protected by that law or regulation, and the accompanying impact of the law or regulation on imports or exports.”* (Emphasis added.)<sup>39</sup>

Professor Joel Trachtman of Tufts University, in his analysis of the GATS and necessity tests in other WTO agreements, said this statement could be viewed as “breathtaking” because “it constitutes a significant shift toward a greater role of the Appellate Body in weighing regulatory values against trade values.”<sup>40</sup> Trachtman said the Appellate Body appeared to be providing guidance on how all WTO necessity tests should be interpreted.

In its May 2001 paper on the GATS and domestic regulation, the European Commission stated that the introduction of new GATS disciplines should not mean that a government's underlying regulatory objectives should be questioned. However, necessity tests have proven to have far-reaching implications. In a case involving the French ban on asbestos, the Appellate Body repeated that they saw it within their authority to judge whether a regulation was necessary in terms of whether the government's objective was important enough: “In this case, the objective pursued by the measure is the preservation of human life and health through the elimination, or reduction of the well-known, and life-threatening, health risks posed by asbestos fibres. The value pursued is both vital and important in the highest degree.”<sup>41</sup> As a consequence, very strict regulations that serve less than life-and-death goals, such as a total ban on particular kinds of advertizing to children, would not likely fare as well as the asbestos ban did if challenged under a necessity test.

WTO rulings indicate that panels do get involved in passing judgement on the worthiness of a government's underlying objectives in deciding whether the means used are too restrictive. And the new necessity test being proposed for the GATS would apply not to regulations that violate provisions in the agreement, but to ones that fully comply. It could not help but restrict a government's right to regulate.

## IV The GATS and Accounting Regulation

### i. Hard Lessons on the Value of Regulation

*“Let's also be honest with ourselves. Every profession in every country has its problems -- its cases of failure, malpractice, fraud and the like - in spite of well-intended regulatory protections. And each of those protections, no matter how effective, imposes a cost. But ultimately, the best guarantees of high-quality professional performance are not restrictive regulations, the erection of trade barriers and the absence of competition.... After all, nothing focuses the mind like the threat of losing your assets, the threat of losing your means of livelihood, and the threat of becoming irrelevant to the needs of society.”* Charles Heeter, Andersen managing partner, at the Third OECD Workshop on Professional Services, February 20-21, 1997

GATS draft disciplines in the accounting sector provide an example of why imposing permanent constraints on regulation of services is not in the interests of consumers, since it is impossible to predict when experiments with deregulation will go wrong. Up until recently, Andersen partners could make dismissive speeches about “well-intended” regulatory protections<sup>42</sup>, and such remarks did not spark any controversy.

Although the hazards of relying on market disciplines to protect consumers may seem obvious in hindsight, stricter regulation in the accounting sector did not have much support before scandals were exposed at the world’s largest companies. What might draw headlines and stiff new regulatory penalties with today’s heightened public awareness rated barely a mention just a couple of years ago. For example, an investigation in 2000 revealed that, in violation of professional guidelines, half of the US partners of the “Big Five” accounting firm PricewaterhouseCoopers had investments in companies they audited.<sup>43</sup>

The US Consumers Union is backing the strongest regulatory reforms now being proposed, in particular ones drafted by California state legislators and U.S. Senator Paul Sarbanes. Frank Torres, Legislative Counsel for Consumers Union, has stated:

*“The accounting system is plagued with problems that have compromised audits and left people robbed of their savings. The problems don't begin and end with Enron and Arthur Andersen. There are systematic problems in the accounting profession involving conflicts of interest and lax oversight that can only be solved with tough new standards.”<sup>44</sup>*

In the US, legislators have started to reverse a decade long trend of deregulation of the accounting profession. In the UK, the accountancy regulator is considering whether new rules are needed to prevent accounting firms from obtaining consulting work by offering discounts on their audit fees.<sup>45</sup> Internationally, the International Accounting Standards Board is reviewing “special purpose entities”, the ones Enron is accused of using as a

technique to move losses off its balance sheet. The IASB's chair, David Tweedie, has warned against "it couldn't happen here" thinking and promised the international body would learn from the problems the US was experiencing.<sup>46</sup>

The current accounting crisis will hurt consumers in direct and indirect ways. Stock markets around the world have fallen precipitously. Half of American households are invested in stocks, and they are seeing their retirement and college savings accounts decimated. Becoming an informed investor can seem an impossible task when arguably legal accounting practices allow companies to vastly inflate numbers in their financial reports. In the case of Merck & Company, \$12 billion of prescription copayments they never actually received were counted as revenue.<sup>47</sup> Critical information about how much executives are paid in stock options is buried in many companies' footnotes. The US Financial Accounting Standards Board approved this practice in 1993 after a fierce lobbying effort against the tighter rules the Board had proposed.<sup>48</sup> The UK's Centre for Economic and Business Research Ltd. calculated that the profits leading US companies reported for 2001 would have been 27% lower if they had followed less "aggressive" accounting approaches.<sup>49</sup>

Even if consumers do not have stock market holdings, they may still suffer when insurance firms that invest heavily in the stock market increase their rates to compensate for losses. Businesses that contribute to employee pension funds will have to raise revenues to cover the decline in pension fund investments, and this may also translate into higher prices to consumers.

Representatives of the accounting profession in the US, though, are strenuously resisting government attempts to exert authority over what has been a largely self-regulating profession. The American Institute of Certified Public Accountants objected to both the US Securities and Exchange Commission's and the Senate's reform packages. The Institute's lobby group has contacted US accountants to urge them to get in touch with legislators and oppose what they call "a de facto government takeover of the accounting profession".<sup>50</sup> Senator Paul Sarbanes, who initiated the Senate's accounting reform bill, said the pressure he had been subjected to by the accounting profession had been "over the top".<sup>51</sup>

In language reminiscent of a necessity test, accounting lobbyists have criticized the new rules as being more burdensome than required and as ineffective to insure the reliability of financial reporting. Researchers from the accounting sector have already produced papers attempting to prove quantitatively that particular attempts to regulate the profession will not have their desired effect. An example is provided in Appendix C, which analyzes how the GATS draft disciplines could be used to challenge the Sarbanes-Oxley Act.

## **ii. Accounting Firm Involvement in Drafting GATS Disciplines**

Strict regulation of the accounting profession of the kinds proposed could come into conflict with a country's WTO obligations. In 1998, the WTO's Council for Trade in

Services adopted "DISCIPLINES ON DOMESTIC REGULATION IN THE ACCOUNTANCY SECTOR", and agreed that these would become binding in 2005. The disciplines impose a "necessity test" - regulations would be WTO violations if they restrict trade more than is necessary. While the agreement does recognize that preserving the integrity of the profession and protecting consumers are legitimate objectives, in doing this governments cannot "prepare, adopt, or apply" rules that either intentionally or inadvertently create "unnecessary barriers to trade in accountancy services." The "DISCIPLINES ON DOMESTIC REGULATION IN THE ACCOUNTANCY SECTOR" are attached as Appendix D.

A representative of the accounting firm Andersen Worldwide revealed to the New York Times <sup>52</sup> that his firm was part of an international accounting group that helped to draft the GATS disciplines on accounting. Andersen representatives claim responsibility for getting the original WTO decision to work on domestic regulation of professional services, with accounting services put first on the agenda.<sup>53</sup> Andersen was consulted on the GATS negotiations through their seat on the Department of Commerce's Industry Sector Advisory Committee on Services and through their active participation in the US Services Industries Coalition, the European Services Forum, and the Global Services Network.

In his April, 1998 testimony to the United States International Trade Commission, senior Andersen partner Charles Heeter said the company had taken an interest in trade negotiations for over a decade.<sup>54</sup> A survey of their global partners on trade issues revealed regulations were preventing the firm from providing "seamless services" worldwide and these rules were more of a problem than traditional trade barriers. Heeter said that Andersen's initial objective with the GATS was to get as many countries as possible to make commitments on accounting, even if this just locked in existing levels of liberalization, because then the GATS disciplines on domestic regulation would apply to the sector. GATS commitments prevented "regulatory backsliding" and the agreement had already been used "to stop regulatory reversals" in the accounting sector.

Accounting firms' interests in being able to provide a full range of services became reflected in WTO work on the sector. The WTO Secretariat characterized "Compartmentalization/scope of practice limitations/incompatibilities" as one of the "most significant barriers to international trade in accountancy services".<sup>55</sup> The US delegation asked in its paper on the issues to be addressed in the accounting disciplines whether it should be considered "overly burdensome or restrictive to limit the activities or combinations of services that can be performed by companies".<sup>56</sup> The US negotiating position on accounting legitimizes the broad range of services accounting firms provide. It states: "international accounting firms are engaged in a variety of activities. In addition to auditing, these include: management consulting, computer and information technology, advice on mergers and acquisitions, and tax preparation."<sup>57</sup>

However, limiting the range of services accounting firms can sell is a key component of proposals to reform the industry. Providing consulting and other kinds of services is far more lucrative (worth \$11 billion annually in the US) to accounting firms than doing

audits. The concern is that auditors may not want to endanger their firm's consulting contracts by being too critical in their audits of a client's financial statements.

### **iii. Likelihood of Accounting Challenges**

It may seem unlikely in a context like the current crisis of confidence in financial reporting that any country would turn to the GATS to challenge regulatory reform. But even with public attention being focused in an unprecedented way on the profession, the accounting lobby has mounted a fierce campaign against reform. If the GATS draft disciplines on accounting had already been in force lobbyists could have used these as part of the anti-reform campaign. The arguments they make already parallel what might be said in a WTO challenge<sup>58</sup>, not that the government's objectives are illegitimate, but that they are overly burdensome and will unnecessarily impede economic activity. While they could not take a challenge under the GATS against their own government, American firms could work through their overseas affiliates to encourage foreign governments to launch a challenge.

Until the draft accounting disciplines come into force in 2005, the US and all WTO members are not supposed to make any changes to their regulations that might conflict with the disciplines. US trade negotiators are committed in the meantime to get tougher constraints on accounting regulation. Representatives of the accounting profession intervened forcefully in 1998 with the US Trade Representative to argue that too many compromises had been made in the negotiations leading up to the agreement and the draft disciplines were too watered down. They wanted the period before the draft becomes legally binding to be used to insert stricter constraints.

The time before 2005 though could be used instead to re-examine whether accounting regulations that are transparent and do not discriminate in any way against foreign companies really need to be "disciplined" by the WTO. Rather than imposing a necessity test, it would be far better for negotiators to explore whether multilateral rules can be developed to address conflicts of interest within the profession. Imposition of a necessity test cannot make weak regulation stronger. It can only expose governments to WTO sanctions if they regulate in a way that might be considered "more trade restrictive than necessary." The current crisis in US accounting regulation provides a strong case for why governments need to retain a broader regulatory flexibility than would be possible under the proposed GATS disciplines on domestic regulation.

## **V. Requiring Regulations To Be "Pro-Competitive"**

### **i. Proposals to Apply Pro-competitive Regulation to All Services**

The Global Services Network, the private sector group established to lobby for expansion of the GATS, identified promotion of "pro-competitive" regulation in an across-the-board fashion as one of its key goals at its founding meeting in 1998.<sup>59</sup> The model the GSN recommended for pro-competitive regulation is the one provided by the Basic Telecommunications Reference Paper, a set of regulatory obligations countries agree to fulfill when they make GATS telecom commitments. The Reference Paper is attached as

Appendix E. Some WTO delegations have taken up the GSN recommendations and are advocating the pro-competitive model should be extended to all service sectors. The EC has suggested pro-competitive principles might be a litmus test to determine which regulations are “no more burdensome than necessary”.<sup>60</sup>

Practices that violate the GATS telecom “pro-competitive” obligations are ones that:

- ? Cross-subsidize. One of the anti-competitive safeguards in the obligations is the prevention of suppliers from "engaging in anti-competitive cross-subsidization". This means a service provider cannot use revenue from one part of their operations to subsidize another.
- Discriminate in providing access to essential infrastructure. Owners of essential infrastructure are required to provide access to it on a “non-discriminatory” basis, at the same rates and quality that they provide to their own affiliated suppliers. Specifically they have to provide access:  
“in a timely fashion, on terms, conditions (including technical standards and specifications) and cost-oriented rates that are transparent, reasonable, having regard to economic feasibility, and sufficiently unbundled so that the supplier need not pay for network components or facilities that it does not require for the service to be provided.”
- Allow regulators to give preference to particular suppliers.

Pro-competitive regulation is said to ensure general public benefits from liberalization and privatization by breaking the hold monopoly incumbents have over access to infrastructure. According to Pierre Sauve with the OECD’s Trade Directorate: “the absence of pro-competitive regulatory policies may substantially reduce the social payoff to privatisation if it merely results in rent transfers from the public purse to the new private owners of the firms, be they domestic or foreign.”<sup>61</sup> Pro-competitive rules according to this theory will relieve governments of the need to directly regulate in the public interest – setting up a competitive market with non-discriminatory access to basic infrastructure supposedly will do this on its own.

## **ii. Pro-Competitive Regulation and Water Services**

The UK Consumers’ Association has recommended taking a pragmatic approach to this model of regulation rather than assuming it can work in all sectors. In its papers<sup>62</sup> responding to the British government’s proposal to restructure water services, CA identified potential problems in having building and maintaining water supply infrastructure “unbundled” from other water services. Rather than benefiting consumers, the CA reports suggest “this form of competition could potentially lead to increases in water bills, particularly for households in rural areas.” “Cost-oriented” rates, of the type required by the GATS telecom reference paper, would mean cross-subsidies for rural and poor consumers would be lost. CA says it would not be easy for governments to ensure universal access to basic service would continue.

Profit margins in Britain's water industry are low, particularly after imposition in 1997 of the tax on windfall profits. Companies that CA surveyed could not anticipate net cost savings to be gained from the restructuring. Additional competition introduced through pro-competitive rules would increase the pressure on companies to focus on the more lucrative rather than expensive-to-serve aspects of the market, and foster increased resistance to Britain's high regulatory standards. "Pro-competitive" restructuring could also have negative effects for consumer choice, since water from different sources would be mixed if the infrastructure service was "unbundled" from water abstraction and retailing. CA recommended that "If a question mark remains over what is the most appropriate form of competition in the sector, it may be worth considering afresh whether competition is really more effective than regulation in this sector." CA's papers on the water sector provide a compelling explanation of the rationale for universal access to water services, saying that it is "clearly a prerequisite for economic and social participation."

The British government decided in the spring of 2002 not to extend competition for water supply to individuals, with the Environment Minister Michael Meacher explaining his decision in terms strikingly similar to the points CA had made: that water is essential to life, that there is no national grid to distribute it, that rural consumers benefit from being cross-subsidized through averaging of costs across regions, that the intensive regulatory changes needed to ensure that extended competition would work for everyone might outweigh the benefits.<sup>63</sup>

While they may not be efficient according to some economic models, forms of cross-subsidization within a sector such as cost averaging for water or risk pooling for health insurance may be the socially preferred and most politically feasible way to provide universal access to a service. Legally binding, pro-competitive obligations implemented through across-the-board GATS disciplines would threaten these policies.

The GATS Basic Telecommunications Reference Paper does allow a country to regulate for universal access to services. Article 3 states: "Any Member has the right to define the kind of universal service obligation it wishes to maintain." But this is not an unqualified right. The article also states these obligations can be maintained but only if 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" (emphasis added). These qualifications beg the question again of how a WTO dispute panel would define "more burdensome than necessary". As has been discussed above, governments could be challenged on what methods they use to ensure universal access to services. The fact that less burdensome options cost governments more would not be a decisive defence in the event of a dispute.

Universal service requirements have already been challenged on the basis of the GATS Basic Telecommunications Reference Paper, although a case has not yet proceeded as far as the panel stage. For example, the US, in response to a complaint from AT & T, intervened in 2000 with the Canadian government to object to Canada's program that required long-distance carriers to subsidize local phone service in remote areas. Citing

the terms of the Reference Paper, Trade Representative Charlene Barshefsky stated that Canada's program needed to be administered "in a manner that is more transparent, non-discriminatory and competitively neutral."<sup>64</sup> Canada subsequently restructured the subsidy program, and the USTR reported its concerns had been resolved.<sup>65</sup>

### **iii. Pro-Competitive Regulation and the Telecom Sector**

The US GATS position on energy calls for development of a reference paper creating the same kinds of obligations as are contained in the GATS telecom reference paper, saying national treatment and market access commitments under the GATS are not enough to open up energy markets.<sup>66</sup> The US argues that the same model to combat "anti-competitive practices" that was applied in the telecom sector would benefit the energy sector in every country worldwide.

This GATS negotiating proposal to expand the telecom model to energy is being made at the same time analysts are saying the US experiment with pro-competitive restructuring of the American telecom industry may be coming to an end. An overview of the crisis in the sector is provided in Appendix F.

Can conclusions be drawn about the pro-competitive regulatory model since one of the most dramatic collapses in U.S. corporate history occurred during the time the GATS telecom obligations and the US Telecommunications Act of 1996 were in place? Is the current crisis attributable in any way to the model, such as the lack of integrated planning of infrastructure under competitive rules? Before deregulation, the FCC used to require companies to justify capital expenditures in order to ensure consumers did not pay for unnecessary infrastructure investments.

Or are the problems instead a result of failures to enforce the model vigorously enough? Incumbent phone service suppliers have been very successful in hanging on to their original customer base, and some argue that it is because they have been inventive in keeping competitors from using their infrastructure regardless of what the rules say.

From a consumer standpoint, what is a disaster for telecom companies has, at least in the short term, produced some very good deals. Consumers have enjoyed low long distance rates under deregulation. However, according to the Consumers Union, low volume consumers have ended up paying relatively more than high volume consumers as companies tried to compensate for fiercely competitive long distance rates by raising their flat charges. Because there has been little, if any, competitive incursions into the "local loop", consumers are paying considerably more for their monthly service than they did prior to the advent of deregulation.

In Canada, consumer groups have asked whether the consumer should be expected to foot the bill for market competition. Former monopoly telecom providers are telling Canada's regulator that with competition, they are having trouble meeting universal access obligations such as service to remote areas and provision of pay phones. Their competitors are saying the cap on local phone rates has to be raised in order for them to

stay in business and take on market incumbents. The risk of bankruptcy to these firms is real enough; the “mortuary atmosphere” dominating the telecom sector globally is pervasive in Canada as well, with former stars of the stock exchange disappearing.

Consumer representatives have questioned whether local phone service competition is feasible in a country like Canada where the cost of serving vast areas is high. Phillippa Lawson, counsel for the Public Interest Advocacy Centre, made the argument for a pragmatic approach to competition policy when she presented at recent regulatory hearings on local phone rates:

*“Competition is a preferred means to an end. It is not an end in itself. The end is a healthy, efficient industry with low prices and high quality of service throughout the country. If competition merely leads to higher prices, less reliable service and customer confusion, it will have been a failure.*

*Consumers have asked us to tell you that greater choice is not worth higher prices to them. It is your job to ensure that competition is allowed to develop where it is economic, at rates that meet public policy objectives, and at a pace that reflects the reality of this highly capital intensive, technology dependent industry... The public interest will not be served by efforts to prematurely kick start competition where it cannot be sustained in the long term.”<sup>67</sup>*

Developing countries have pressed for an assessment of the impacts of existing liberalization under the GATS before negotiations to expand the agreement proceed. Although a broad assessment is opposed by industrialized countries, there is provision in the agreement under Article XIX to conduct such an assessment. Rather than having the telecom pro-competitive model be a prescription for GATS disciplines over other sectors, the diverse experience with this model could be analyzed to determine what conditions are necessary to provide benefits to consumers.

The Public Interest Advocacy Centre’s recommendations on local long distance phone services provide some useful criteria to evaluate competitive regulatory changes. PIAC raises a very interesting question relevant to the current crisis in the telecom sector about the point of fostering competition that is not sustainable. Their recommendations echo those made by the UK Consumers’ Association in relation to water: that competition is generally positive for consumers but governments should not impose it where consumers, particularly the most vulnerable, would be harmed. This perspective on competition argues against GATS pro-competitive disciplines being applied in a “one-size-fits-all” way in all countries and to all services.

#### **iv. Pro-Competitive Regulation and the Energy Sector**

In 1999, the WTO Energy Services Coalition was founded to promote GATS negotiations on energy and was co-chaired by E. Joseph Hillings, a vice-president of

Enron, and Donald A. Deline, a director of Halliburton. Hillings gave a speech in November, 2000 to the European Services Forum saying there should be a new classification for energy services created under the GATS.<sup>68</sup>

Only a narrow range of energy services currently appears in the GATS classification. But Hillings argued that because the sector was being opened to foreign competition, it was imperative to have energy on the GATS classification list that countries use to make their market access commitments. Hillings underlined that while getting new market access commitments under the GATS was important, creating a pro-competitive regulatory environment was just as important. He suggested there be a GATS reference paper for energy modelled on the Basic Telecommunications Reference Paper to allow for access to energy grids, establishment of an independent regulator, and to discipline practices like cross-subsidization.

The subsequent US position paper on energy services, submitted in December 2000, made the same arguments the WTO Energy Services Coalition did that energy should be treated as a service subject to the GATS and that it should have a reference paper with pro-competitive regulatory disciplines. Under the new classification, “electricity generation” along with every other aspect of the energy sector would be services covered by the GATS.

The importance attached to achieving international regulatory changes in the energy sector is reflected in the May, 2001 policy statement issued by the US administration: “National Energy Policy: Report of the National Energy Policy Development Group”. The report describes the US objective at the GATS negotiations as getting WTO members “to open markets eligible for private participation in the entire range of energy services, from exploration to the final customer.” But the aspect of the US proposal that the authors describe as “equally important” is that consideration be given on “how to best create a pro-competitive regulatory environment for energy services.”

In an analysis of how proposed pro-competitive changes impact the electricity sector, economist Marjorie Griffin-Cohen contrasts the two major approaches to electricity regulation:

*“Under systems that have been characterized by large-scale, vertically integrated natural monopolies, the supply, distribution, and prices of electricity are regulated by public entities. The regulator would normally oversee long-term planning for supply, and monitor all price changes. Through these measures, both the supply and price of electricity is guaranteed for specific long-term periods. Under a deregulated system, this role of the regulator is removed and the market acts as the adjudicator of both supply and pricing decisions. This means no collective long-term oversight ensures building for an adequate supply in the future, and prices to consumers shift from reflecting costs of production to reflecting what the market will bear.”<sup>69</sup>*

The argument made for pro-competitive regulation is that companies respond better to market forces than to government rules. Regulators are almost always under-resourced in comparison with the companies they are supposed to monitor. With so much riding on their decisions, regulators can end up being “captured” by industry and behave as though they are its employees rather than public servants.

But the costs of implementing the pro-competitive model in particular sectors like energy may ironically be paid through higher prices and less reliability for consumers. In addition, the California experience with energy restructuring suggests creating rules that ensure markets have genuine competition and are immune from manipulation is an extremely challenging task, even for the world’s wealthiest country. The California experience is described in Appendix G. Developing countries, in any pro-competitive restructuring experiment, will often deal with the same trans-national energy corporations that seem to have got the better of US regulators. Negotiating to make the “pro-competitive” model a binding obligation on WTO members seems particularly unwise given that Enron, one of the main champions of getting pro-competitive energy disciplines implemented through the GATS, appears to have been a master at manipulating exactly these kinds of rules.

## VI Conclusion

This paper has attempted to assess risks for consumers that may result from proposed GATS disciplines on domestic regulation of services. As the March 3, 2003 deadline approaches for WTO members to respond to bilateral requests for liberalization in trade in services, we would like the U.S. and EC negotiators to discuss with TACD representatives:

- ? **The document “Examples of Measures To Be Addressed By Disciplines Under GATS Article VI.4”** (Appendix B) **in relation to its implications for consumers**. This document lists complaints about regulation drawn from service industry input to governments. It serves to highlight concerns TACD has raised in the past about the development of new GATS disciplines on domestic regulation. Some of the “Examples” of domestic regulations targeted for WTO disciplines are regulations that consumer organizations have helped to create in order to protect consumers.
- ? **Improved transparency**. The transparency measures demanded by WTO members on behalf of their service industries contrast with the transparency provided to civil society regarding the GATS negotiations. Whereas proposals regarding enhanced GATS transparency obligations would require advance notice of regulatory proposals, documents be made public, and opportunity for comment these elements have not been provided to civil society in the case of the GATS negotiations. The U.S. and EC GATS negotiators should propose a mechanism by which consumer organizations and other sectors of civil society may review and comment on draft documents, such as **“Examples of Measures To Be Addressed By Disciplines Under GATS Article VI.4”** which are now only

available if they are leaked. TACD members would be pleased to assist in the development of such a mechanism.

- ? **An assessment of the experience with the GATS pro-competitive regulatory model.** Given problems that have emerged in the telecommunications sector, it seems ill-advised without a thorough assessment of what went wrong in this sector to extend the GATS "pro-competitive" model developed for telecom to other services. Consistent with GATS Article XIX. 3 which requires an assessment of services liberalization, U.S. and EC negotiators should urge the Council on Trade in Services to commission a study that would review current problems in the telecom sector. This study could address the regulatory capacity issues developing countries in particular might face in the implementation of "pro-competitive" rules. WTO members should make a draft version of the study available for public comment in advance of finalizing the study.

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<sup>1</sup> WTO, *"The United States of America - Schedule of Specific Commitments"*, WTO Document Symbol: GATS/SC/90, 15 April 1994

<sup>2</sup> GATS 2000, *"Request from the EC and Its Members States to the United States of America"*, 30 June 2002

<sup>3</sup> World Trade Organization, Council for Trade in Services, *"Recent Developments in Services Trade - Background Note by the Secretariat"*, WTO Document Symbol: S/C/W/94, 9 February 1999

<sup>4</sup> Dean O'Hare, President and Chief Executive Officer, Chubb Corporation and Chairman, Coalition of Service Industries, Testimony Before the Subcommittee on Trade of the House Committee on Ways and Means Hearing on the United States Negotiating Objectives for the WTO Seattle Ministerial Meeting, 5 August 1999

<sup>5</sup> GATS Article XXI "Modification of Schedules".

<sup>6</sup> Dean O'Hare, *op. cit.*

<sup>7</sup> WTO, *"Decision on Domestic Regulation"*, WTO Document Symbol: S/L/70, 28 April 1999

<sup>8</sup> The Secretariat wrote: "The necessity test -- especially the requirement that regulatory measures be no more trade restrictive than necessary -- is the means by which an effort is made to balance between two potentially conflicting priorities: promoting trade expansion versus protecting the regulatory rights of governments.", WTO, Working Party on Domestic Regulation, *"Application of the Necessity Test: Issues for Consideration Informal Note by the Secretariat"* WTO Job No. 5929, 2 May 2000

<sup>9</sup> Joseph de Pencier, Counsel for the Attorney General of Canada, paragraphs 37 - 40 of *"RESPONDENT OUTLINE OF ARGUMENT OF INTERVENOR ATTORNEY GENERAL OF CANADA"* in the 2001 BC Supreme Court review of the NAFTA Metalclad case, No. L002904 -Vancouver Registry

<sup>10</sup> GATS Article III:1, "Transparency"

<sup>11</sup> GATS Article III:2

<sup>12</sup> GATS Article VI:1(a) "Domestic Regulation"

<sup>13</sup> GATS Article VI:2(a) "Domestic Regulation"

<sup>14</sup> GATS Article II "Most-favoured Nation"

<sup>15</sup> GATS Article XVII "National Treatment"

<sup>16</sup> WTO, Council for Trade in Services, *"Construction and Related Engineering Services - Background Note by the Secretariat"*, WTO Document Symbol: S/C/W/38, 8 June 1998

<sup>17</sup> WTO, Working Party on Professional Services, "The Relevance of the Disciplines of the Agreements on Technical Barriers to Trade and on Import Licensing to Article VI.4 of the GATS", WTO Document Symbol: S/WPPS/W/9, 11 September 1999

<sup>18</sup> Tony Warren and Christopher Findlay, *"How Significant are the Barriers? Measuring Impediments to Trade in Services"*, paper presented at the "Services 2000: New Directions in Services Trade Liberalization" Conference, Washington, D.C., 1-2 June 1999

<sup>19</sup> It is important to note that market access obligations apply to non-discriminatory measures. The WTO Secretariat has stated: "Another confusion that sometimes arises is the idea that only discriminatory measures should be scheduled under Article XVI. This is not the case. Article XVI covers all measures that fall within the six categories listed, whether they are discriminatory or not." See the Committee on Specific Commitments, *"REVISION OF SCHEDULING GUIDELINES - Note by the Secretariat"*, WTO Document Symbol: S/CSC/W/19, 5 March 1999

<sup>20</sup> Office of the United States Trade Representative, "U.S. Proposals for Liberalizing Trade in Services Executive Summary", 1 July 2002

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<sup>21</sup> OECD-WORLD Bank Conference on Regulatory Reform and Trade Liberalization in Services, OECD, Paris, 4-5 March 2002. Drafts of the papers presented are available from the World Bank Internet site: [www1.worldbank.org/wbiep/trade](http://www1.worldbank.org/wbiep/trade)

<sup>22</sup> p. 17, Peter Evans, "*Energy Services, Domestic Regulation and the WTO*", paper presented 5 March 2002 to the OECD World Bank conference on Regulatory Reform and Trade Liberalization in Services.

<sup>23</sup> GATS Article XIV imposes a necessity test when countries try to defend themselves from challenges that they have violated the agreement. The current negotiations on domestic regulation would impose a necessity test on regulations that fully conform with the existing provisions of the GATS.

<sup>24</sup> "14. It was noted that Article XIV of the GATS (General Exceptions) applies, *inter alia*, to the protection of privacy and public morals and the prevention of fraud, and there was agreement that measures taken by Members must not be more trade restrictive than necessary to fulfill such objectives. They also must not constitute a means of arbitrary or unjustifiable discrimination, or a disguised restriction on trade in services. It was also noted that, as Article XIV constitutes an exception provision, it should be interpreted narrowly, and its scope cannot be expanded to cover other regulatory objectives than those listed therein."

WTO, "*Work Programme on Electronic Commerce*", WTO Document Symbol:S/L/74, 27 July 1999

<sup>25</sup> "He [the US delegate] noted that the Article VI:4 mandate to develop any necessary disciplines was itself a necessity test." Working Party on Domestic Regulation, "*Report on the Meeting Held on 12 March 2002*", WTO Document Symbol: S/WPDR/M/15, 10 April 2002

<sup>26</sup> WTO, Working Party on Professional Services, "*The Relevance of the Disciplines of the Agreements on Technical Barriers to Trade and on Import Licensing to Article VI.4 of the GATS - Note by the Secretariat*", WTO Document Symbol: S/WPPS/W/9, 11 September 1996

<sup>27</sup> WTO, Working Party on Domestic Regulation, "*Report on the Meeting Held on 29 November 2001*", S/WPDR/M/14, 29 January 2002

<sup>28</sup> In defending its policies in the bananas case, the European Union tried to argue for a limited application of the GATS. But the dispute panel rejected the EU's argument, stating: "The scope of the GATS encompasses any measure of a Member to the extent it affects the supply of a service regardless of whether such measure directly governs the supply of a service or whether it regulates other matters but nevertheless affects trade in services."

<sup>29</sup> WTO, Working Party on Domestic Regulation, "*Report on the Meeting Held on 12 March 2002*", WTO Document Symbol:S/WPDR/M/15, 10 April 2002

<sup>30</sup> In its paper on the GATS and domestic regulation, the European Union stated: "A measure should be considered not more trade-restrictive/not more burdensome than necessary if it is not disproportionate to the objective[s] pursued. This means that the degree of trade-restrictiveness meeting the requirements of necessity will depend on, and be assessed against, the specific objective[s] pursued, while the validity, or rationale, of the policy objective[s] must not be assessed." Working Party on Domestic Regulation, "*Communication from the European Communities and Their Member States – Domestic Regulation, Necessity and Transparency*", WTO Document Symbol:S/WPDR/W/14, 1 May 2001

<sup>31</sup> p. 14, Claude Trollet and John Hegarty, "*Regulatory Reform and Trade Liberalisation in Services: The Benefits and Limitations of Strengthened GATS Rules -Accountancy Services*", OECD-World Bank Conference, 4-5 March 2002

<sup>32</sup> Commission of Inquiry into the Quality of Construction in British Columbia Dave Barrett, Commissioner March 2000

<sup>33</sup> pp. 32-33, David Luff, "*Regulation of Health Services and International Trade Law*", OECD-World Bank Conference, 4-5 March 2002. Note that while Luff raises these possible impacts of a

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necessity test on access to health care, he argues overall that governments can protect themselves from challenges by not taking commitments in the health sector.

<sup>34</sup> David Luff, *op. cit.* p. 15

<sup>35</sup> United Nations Statistics Division. See CPCprov code 87600 at <http://unstats.un.org/unsd/cr/registry/regcs.asp?Cl=9&Lg=1&Co=87600>

<sup>36</sup> Dean O'Hare, *op. cit.*

<sup>37</sup> WTO, Working Party on Domestic Regulation, "*Report on the Meeting Held on 3 July 2001*", WTO Document Symbol:S/WPDR/M/12, 16 August 2001

<sup>38</sup> WTO Appellate Body Report, Korea—Measures Affecting Imports of Fresh, Chilled and Frozen Beef, WTO Document Symbol: WT/DS/161,169/AB/R, paras. 180, 181 adopted 10 January 2001.

<sup>39</sup> *Ibid*, para 164

<sup>40</sup> Joel P. Trachtman, "*Lessons for GATS Article VI from the SPS, TBT and GATT Treatment of Domestic Regulation*", Internet-posted paper, The Fletcher School of Law and Diplomacy, Tufts University, 20 January 2002

<sup>41</sup> WTO Appellate Body Report: European Communities—Measures Affecting Asbestos and Asbestos-Containing Products, WTO Document Symbol: WT/DS135/AB/R, adopted 5 April 2001

<sup>42</sup> Andersen partner Charles Heeter was scheduled to be a speaker at the March 2002 World Bank/OECD conference on the GATS and domestic regulation.

<sup>43</sup> The Globe and Mail, "*CPAs Propose New Rules*", 7 February 2000

<sup>44</sup> Consumers Union, News Release, "*Senate Banking Committee Oks Accounting Reform Bill*", 18 June 2002

<sup>45</sup> Financial Times, "*Accountancy profession clashes with regulator over attack on 'low balling'*" 30 June 2002

<sup>46</sup> International Accounting Standards Board, Chairman's Statement, 28 March 2002.

By 2005, all European companies will be required to follow IASB accounting standards.

<sup>47</sup> The Wall Street Journal, "*Bristol-Myers Faces SEC Probe*", 11 July 2002

<sup>48</sup> The New York Times, "*Is True Reform Possible Here?*" 14 July 2002

<sup>49</sup> Toronto Star, "*Cooked Books Burn Investors*", 28 February 2002

<sup>50</sup> Washington Post, "*Rules Full of Loopholes*", 20 May 2002

<sup>51</sup> The New York Times, "*Senate Committee Approves Measure on Audit Industry*", 19 June 2002

<sup>52</sup> The New York Times, "*W.T.O. Pact Would Set Global Accounting Rules*", 1 March 2002

<sup>53</sup> In his description of Andersen's role, managing partner Robert F. Kelley says that an Andersen group he headed "developed the strategies to involve the worldwide organization in the process of enhancing global trade in services. This effort resulted in the Ministerial Decision on Professional Services to be implemented by the World Trade Organization." "Hall of Distinction 1997, Senior Member Robert F. Kelley, Biography, Louisiana State University

<sup>54</sup> Andersen Worldwide, Written testimony in connection with Investigation No. 332-385, "General Agreement on Trade in Services", 22 April 1998.

<sup>55</sup> WTO, Council for Trade in Services, "*Accountancy Services - Background Note by the Secretariat*", WTO Document Symbol:S/C/W/73, 4 December 1998

<sup>56</sup> WTO, Working Party on Professional Services, "*Elements to Be Addressed in Developing Disciplines for Professional Services: Accountancy Sector, Implementing GATS Article VI:4 Communication from the United States*", WTO Document Symbol:S/WPPS/W/15 20 June 1997

<sup>57</sup> WTO, Council for Trade in Services Special Session, "*Communication from the United States – Accounting Services*", WTO Document Symbol:S/CSS/W/20, 18 December 2000

<sup>58</sup> The American Institute of Certified Public Accountants criticized Senator Paul Sarbanes' bill by saying: "The Sarbanes proposal does not help auditors do a better job for investors; rather it

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punishes companies and auditors alike while making it more difficult to serve investors. In adding onerous burdens of cost and inefficiency, the proposal would make it more difficult for companies to prosper and grow.” The New York Times, “*GOP Fights Proposed Rules on Auditors*” 18 May 2002

<sup>59</sup> Hong Kong Coalition of Service Industries, “*Preparing for Services 2000*”, The Bulletin, , June 1998

<sup>60</sup> David Price, Allyson Pollock, “*Rewriting the Regulations: how the WTO could accelerate privatisation in health-care systems*”, *The Lancet*, Vol. 356, December 9, 2000 p. 5

<sup>61</sup> Pierre Sauve, “*Open Services Markets Matter*” Working Party of the Trade Committee, OECD, 11 December 2001, para. 46

<sup>62</sup> Consumers’ Associations, “*Water Competition - Pipe Dreams*”, June 2000, “*Under Pressure - the Future of the Water Industry*” August 2001

<sup>63</sup> The Guardian, “*Meacher Cautious on Water Deregulation*”, 20 March 2002

<sup>64</sup> News Release, “*Annual Review of Telecommunications Trade Agreements*”, Office of the United State Trade Representative, 4 April 2000

<sup>65</sup> Although Canada revised its subsidy program after the US complaint, it is not clear that Canada did this to address to US concerns or for other reasons.

<sup>66</sup> WTO, Council for Trade in Services Special Session, “*Communication from the United States – Energy Services*”, WTO Document Symbol: S/CSS/W/24, 18 December 2000

<sup>67</sup> Public Interest Advocacy Centre, Oral Argument to the CRTC Hearings on Price Cap Review, Ottawa, Canada, 22 October 2002

<sup>68</sup> ESF Conference, op. cit.

<sup>69</sup> Marjorie Griffin Cohen, “*From Public Good to Private Exploitation: Electricity Deregulation, Privatization, and Continental Integration*”, Canadian Centre for Policy Alternatives, July 2002, p. 4