GATS and the Liberalisation of Water Supply Services
Diese Studie wurde auf Veranlassung des Bundesministeriums für wirtschaftliche Zusammenarbeit und Entwicklung von dem Beratungsunternehmen "Stone & Webster Consultants" erarbeitet. Sie stellt die Bedeutung der GATS-Verhandlungen für die Dienstleistungen der Wasserversorgung, die Position der Europäischen Union hierzu und die laufende Diskussion in der Zivilgesellschaft dar. BMZ und GTZ stellen diese Studie der Öffentlichkeit zur Verfügung, um zu mehr Transparenz beizutragen.


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PN 98.2003.6 – PPP im Infrastrukturbereich
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Nummer 8 – Februar 2003
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1 Introduction and executive summary

The possible liberalisation of trade in water supply services under the General Agreement on Trade in Services (GATS) entered public debate during the course of 2002. Under the current round of negotiations, the European Union as the representative body of EU Member States, submitted a request to some Members of the WTO calling for the liberalisation of a range of services including water supply services. This proposal, strongly supported by the main players in the European water industry, has given rise to concerns that water services will also be subject to GATS negotiations. Critics of this proposal have argued that “water [may] become subject to enforced liberalisation under the […] General Agreement on Trade in Services Agreement [and that] the new EU strategy will give a decisive impetus to water privatisation across the developing world”.

The objective of this study is to take a closer look at some of these issues and to discuss the implications of the GATS agreement on the liberalisation of water services in WTO member states. In doing so, it particularly takes into account the specific situation of developing countries. More specifically, the study seeks to address the following main questions:

- first, whether water services, which are traditionally considered a public service, are covered by GATS and thus subject to liberalisation;
- secondly, potential options for constrained liberalisation under GATS; and
- thirdly, potential risks of water sector liberalisation from the perspective of developing countries.

To provide some understanding of the background the first two parts of the study provide a brief overview of the way in which the GATS Agreement operates as well as background to the EU proposal.

Our findings in relation to these key issues may be summarised as follows:

- In the debate as to whether water and sanitation services would be covered under the GATS no final conclusion has been reached. It may be argued that water services are excluded from GATS as a service provided under public authority. Others argue that in a number of countries user charges are levied for water services and water services are operated as a commercial business even under government ownership would thus fall within the scope of GATS. The EU appears to indicate that water services should fall within the classification of environmental services (and thus be subject to GATS regulations).
- If water services were to fall within the scope of GATS, Member States would not, however, be obliged to open their markets to foreign service providers. This is because for services covered under GATS there is only a obligation of transparency in relation to market access arrangements.

1 Watkins, K.: Money talks, The Guardian April 24, 20002 in www.guardian.co.uk/Archive/Article/0,4273,4399856,00.html
If member states were to decide to go a step further and make liberalisation commitments under GATS, they would still have significant flexibility in terms of the extent to which access is liberalised. Options for constrained liberalisation include implementing restrictions on:

- the number of services operators;
- the value of services transactions or assets;
- the number of natural (foreign) persons supplying a service;
- the type of the legal entity; and/or
- the participation of foreign capital.

In addition, country signatories are allowed to intervene in a market to protect or promote national policy objectives. Governments are specifically allowed: to maintain and designate monopolies and exclusive service suppliers; to regulate, and to introduce new regulations, on the supply of services in accordance with national policy objectives; and to subsidise certain activities or service providing entities. All of these activities are obviously highly relevant to the water sector.

The political economy of the negotiation process has to be taken into account. This is because weaker Member States, given the bargaining strength of the EU and other stronger WTO Member States, may be pushed to accept commitments to liberalise their water supply and wastewater service sectors in return for market opening concessions in other services sectors of other WTO Member States.

While liberalisation may be a chance to significantly improve the existing water supply situation in a number of countries it has to be recognised that there are risks involved. These risks relate to the limits of private sector participation, the market dominance of a few competitive service providers and the regulatory, institutional and legal capacity of developing countries.

The paper recognises the limits of private sector participation in the water sector. Instead of ownership issues, however, it is recommended to focus on the promotion of key elements of efficient provision of water supply that apply for publicly and privately managed companies alike. These include transparency, sufficient incentives for staff and consumers, and a strong institutional and regulatory framework.

The paper also points out to the limits of competition for the market through the dominance of few international service providers in the sector and briefly outlines some of the remedies that are currently discussed concerning this matter.

The study concludes that where Governments seek to liberalise trade in water supply services it is vital to strengthen the regulatory and institutional capacity of weaker member states to achieve a maximum of benefits for consumers.
2 The General Agreement on Trade in Services (GATS)

This section provides a brief overview of GATS. It describes the developments leading to the current discussions on trade in services, sets out some of the characteristics of trade in services that differentiates it from trade in goods, and discusses the key principles underlying GATS. The purpose of this section is to provide the necessary background information for the assessment of the implications of GATS for water supply services that is provided in Section 4.

2.1 Development of GATS

GATS is a set of multilateral rules governing international trade in services. It was developed by WTO Members in response to the significant increase in the size of service industries over the past twenty years, their increasing importance in international trade, and the specific characteristics of trade in services compared to trade in goods. GATS forms Annex 1 of the Marrakech Agreement, which also established the World Trade Organisation, and came into effect on 1 January 1995.

The GATS Agreement mandates ongoing rounds of negotiations to further liberalise international trade in services (Article XIX). The current round of negotiations, which commenced in 2000 is the first full round of negotiations since the signing of the agreement in 1995.

In March 2001, the Council for Trade in Services established the negotiation guidelines and procedures for the current negotiating round. These require Members to submit requests (or proposals) for specific commitments on market access to other Members by 30 June 2002 and to present initial offers of market access by 31 March 2003. It is in this context that the EU, in July 2002, submitted its proposal for the liberalisation of certain service sectors, including water supply services.

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2 The Council for Trade in Services is established under the GATS Agreement (Article XXIV) and acts as an executive body of the WTO responsible for trade in services. It is open to participation by representatives of all Members, and the Chairman is elected by the Members.

3 By June 2002, 55 WTO member governments had tabled written proposals, either individually or jointly (EU, Andean Community, Mercosur). Of these governments, a majority (32) are governments representing developing countries which also expressed strong demand for technical assistance for conducting negotiations in trade in services. Proposals include professional services, tourism, telecommunications and transport services, financial services and distribution. Medical and health services have not been mentioned at all while very few proposals (3) deal with the education sector WTO, Press Release/300, 28 June.
2.2 Characteristics of international trade in services

International trade in services has a number of significant differences from international trade in goods. These differences explain the need for a separate international agreement that specifically covers services separately from the international trade in goods (which is covered by the General Agreement on Tariffs and Trade - GATT).

The main characteristics of trade in services may be summarised as follows:

- Services are non-visible, sometimes non-tangible and extremely heterogeneous.
- Services can neither be stored nor easily framed into a clear concept of geographical origin. In addition, services cannot always be easily separated from goods (e.g. an electronically downloadable book might be regarded as a good or a service).

In contrast to trade in goods, border measures against trade in services are rare while domestic regulations against foreign suppliers predominate. Thus, it is the broader market access issue rather than the narrow trade liberalisation issue which dominates negotiations.

Services may often be politically sensitive for cultural and moral reasons (e.g. resistance to liberalisation of audio-visual services by the EU and other states).

The unique characteristics of trade in services, compared to trade in goods, has resulted in the identification of four so-called ‘modes of supply’ for internationally traded services. These are:

- Mode 1: cross-border supply, i.e. no movement of either consumer or supplier.
- Mode 2: consumption abroad, i.e. the consumer moves to the producer.
- Mode 3: commercial presence i.e. producers locate in the consuming country.
- Mode 4: temporary movement of natural persons (who are service suppliers) to the consuming country.

For many sectors more than one classification applies. In telecommunications, for example, Mode 1 (international phone calls), Mode 3 (foreign direct investment in telephony), Mode 4 (management of an acquired telecommunications company by foreign nationals) may all apply.

This classification system is important as it is one of the instruments by which a Member may tailor restrictions to the liberalisation of a sector or sub-sector. (This is discussed further in Section 2.3 below.)
2.3 Key principles underlying GATS

An understanding of how GATS functions is critical to assessing how GATS might impact on water supply services. There are a number of key principles that underlie the GATS Agreement. These are as follows:

- GATS applies to all services with only limited exceptions;
- Members have substantial flexibility in how services are liberalised under GATS;
- there is a general obligation to provide Most Favoured Nation treatment to other Members;
- GATS has a significant focus on domestic regulations rather than border measures;
- Members have flexibility to protect national policy objectives under GATS;
- Members are obliged to be transparent in their commitments; and
- GATS provides for ongoing negotiations to further liberalise international trade in services.

The remainder of this section separately discusses each of these principles in more detail.

GATS applies to all services

The GATS Agreement applies to all services in Member countries. The only exception are services which are provided to the public in the exercise of government authority on a non-commercial basis and not in competition with one or more service providers. Coverage of a service sector by GATS does not, however, oblige a Member to liberalise market access in that sector. It only places a minimal transparency requirement on a Member in relation to these sectors (see below). In effect, GATS coverage sets the boundaries around those service sectors which might potentially be liberalised as a result of the negotiation process.

Flexible Liberalisation

Members have significant flexibility in terms of how, and to what extent, a service sector is liberalised. For example, a Member may liberalise a service sector through providing foreign suppliers with market access. However, the scope of market access that is afforded to foreign suppliers may be restricted through the application of one or more of a limited number of market access restrictions identified in the GATS agreement. The forms of market access restrictions that may be applied to a partially liberalised sector under GATS are:

- limits to the number of services operations;
- limits to the value of services transactions or assets;
- limits to the number of operations or quantity of output;
- limits to the number of natural persons supplying a service;
- limits to the type of legal entity; and
- limits to the participation of foreign capital.
These limitations may be applied differentially to the four modes of supply that were identified in the previous section.

Alternatively, or in addition, a Member may apply the ‘national treatment’ principle whereby foreign suppliers are accorded the same status and treatment as domestic suppliers. This does not, however, mean that the market itself is fully liberalised – it simply means that domestic and foreign suppliers have access to a particular market under equitable conditions.\(^4\)

This scope for flexible liberalisation means that a Member might, for example, choose to liberalise access to a particular service sector while continuing to provide subsidies to a domestic supplier (i.e. not commit itself to national treatment of foreign suppliers). Alternatively, it could choose to adopt the national treatment principle in relation to suppliers of a particular service, but maintain restrictions on access to the market which may be applied to both local and foreign suppliers, or only to foreign suppliers (provided that the restrictions applied to foreign suppliers are consistent with the types of restrictions identified in the list above).

<table>
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<tr>
<th>Matrix of options for constraining service sector liberalisation</th>
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<td><strong>Mode of supply</strong></td>
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<td><strong>Cross-sector commitments</strong></td>
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| **Sectoral commitments** | Cross-border supply | According to GATS provisions | According to GATS provisions |
| | Consumption abroad | | |
| | Commercial presence | | |
| | Temporary entry of natural persons | | |


\(^4\) Domestic and foreign suppliers will not necessarily have identical treatment, but the treatment of foreign suppliers should be no less favourable than that afforded to domestic suppliers.
A further option for a Member country is to restrict the mode of supply by foreign service providers independently of the sector involved. An example of this may be a law that stipulates a general approval requirement for the establishment of a commercial presence by all foreign service providers.

As a result, each GATS Member has significant flexibility and variation in terms of how the services sector as a whole, or individual service sectors, is opened to foreign suppliers. The matrix of options available to GATS members in terms of liberalising the services sector is illustrated in the table above. This flexibility is also known as the ‘a la carte’ principle.

**Most Favoured Nation treatment**

Most Favoured Nation (MFN) treatment is a general obligation under GATS that applies to all service sectors. According to this, Members must grant each other the most favourable treatment accorded to any of their trading partners (regardless of whether the nation receiving favourable treatment is a WTO Member) immediately and unconditionally. That said, certain measures may be exempted from MFN. A common use of the MFN exemption is to allow for preferential regional trading arrangements.

**Focus on Domestic Regulation**

As discussed previously, constraints on international trade in services more usually take the form of domestic regulations rather than border measures. As a result, under GATS Members commit to applying domestic regulations reasonably, objectively and impartially.

**Protection of national policy objectives**

GATS allows Members to intervene in service sectors in accordance with national policy objectives. GATS specifically allows Members to:

- maintain and designate monopolies and exclusive service suppliers;
- regulate, and to introduce new regulations, on the supply of services in accordance with national policy objectives; and
- to subsidise certain activities or service providing entities.

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5 According to Article VIII the provision of any service as a monopoly or under an exclusivity arrangement is in conformity with GATS provided that MFN and any specific commitments in the service sector are observed and the service supplier does not abuse its monopoly position.

6 Governments are free to subsidise a national supplier in service sector where it has not made commitment or which appear on the list of national treatment exemptions where market access has been generally granted.
• While it is broadly recognised that governments should have sufficient
decision making power to follow national policy objectives, it is also
recognised that domestic regulation and strong incumbent monopolies
may adversely affect trade in services. As a result, mechanisms for
ensuring that monopolistic suppliers do not undermine market access
commitments are currently being discussed (recognising that the relevant
provisions in GATS (Article VIII) dealing with monopolies and subsidies
are limited in scope).7

Transparency

A further key principle underlying GATS is transparency. Members must
specify those sectors where market access is, or is not, liberalised, and where
liberalisation is only partial, the limitations to market access that are being
applied must also be specified.

In addition, given the impact that domestic laws and regulations can have on
trade in services, Members are obliged to inform the Council of Trade in
Services of the introduction of any new laws or changes to existing laws or
regulations which significantly affect those service sectors in which trade has
been fully or partially liberalised.

Ongoing negotiations

As mentioned previously, GATS includes provisions for pre-scheduled
negotiations, which are held irrespective of whether or not an all-
encompassing round of multilateral trade negotiations is opened. This seeks
to ensure an ongoing process of liberalisation.

7 In relation to subsidies, for example, the consequences of pursuing rules and policies that contradict
GATS requirements are limited. Under Article XV of GATS it is stated that a “Member State that is
adversely affected by a subsidy of another Member may request consultation with that Member on
such matter.” In relation to criticism concerning provision on monopolies see Mattoo, A. (2000):
3 Liberalisation of water supply services: the EU proposal and reactions

3.1 The EU proposal

3.1.1 Background

Since 1999, the European Commission has had an exclusive mandate to represent its fifteen Member States in trade negotiations, including GATS. In this function, the EU has commissioned a number of studies to assist in developing its position and submitted various documents to the Council of Trade in Services to set out its position in relation to the liberalisation of trade in services.

In April 2002 an EU proposal for the liberalisation of a range of services, including water supply services, became public following a leak of confidential documents. We would note that at this stage this is simply a proposal and has no substantive effect, and will not do so unless individual Member countries agree to it during the negotiation process.

3.1.2 General approach to trade in services

The EU, in general, is a strong supporter of reductions in barriers to trade in services. This position is based on the expected growth in services as well as the strong position of EU companies in service industries. The EU's broad objectives are defined in various documents submitted to the WTO, and are made particularly clear in the request submitted to the WTO on 1 July this year. In summary, the following points usefully illustrate the EU's negotiating position:

- Elimination of entry barriers, such as limitations on the number of services suppliers, limits on foreign ownership or shareholdings, restrictions on the type of legal entity, compulsory joint-ventures or numerical quotas.

- Requiring comprehensive negotiating rounds to decrease the imbalance of services commitments across different countries.

- Emphasising the importance of regulatory disciplines to underpin market access and national treatment commitments as well as introduction of pro-competitive principles.

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8 As part of the negotiation process each Member State is requested to submit a request to other Member States on market access. At a later stage, in response to the requests received from other countries, Members are required to make an offer concerning the liberalisation of services in their own country.
“To facilitate increased participation by developing countries in world trade in services by duly taking into account national policy objectives and levels of development, both overall and in individual sectors.”

In relation to public services the EU has stated that “as far as government-owned undertakings are concerned, the EC has no intention to promote or request their privatisation during the course of these negotiations irrespective of whether they are entrusted with the provision of public services or not. However, public undertakings can coexist with private competitors. In fact a gradual opening to competition will enhance the quality of the services provided and afford lower the prices for consumers.”

3.1.3 EU proposal for liberalising trade in water supply services

The EU has requested that a number of WTO members liberalise trade in water supply services. This request forms part of its broader proposal for liberalising trade in environmental services. This request was specifically directed to a number of developed and developing countries, including India, the Philippines, Colombia, Pakistan, China, Paraguay, Uruguay, South Africa and Venezuela.

Environmental services, as defined by the EU, includes water supply services, wastewater management and solid and hazardous waste management. The EU estimates that world-wide the environmental services market is worth US$280 billion and expects it to increase to the same size as the pharmaceuticals or information technology industries (currently US$640 billion) in 2010.

The EC has emphasised the importance of reducing trade barriers in this sector in the trade negotiations. In the EC’s trade liberalisation request, it states that “overall, we believe that WTO Members should aim to substantially reduce barriers to trade in services. For example, typical obstacles to trade in environmental services include monopolies and exclusive providers issues, restrictions on legal forms of doing business, equity limitations, restrictions on foreign investment, unspecified licensing and approval requirements, financial participation in enterprises, and local content obligations.”

9 Summary of the EC’s Initial Requests to Third Countries in the GATS negotiations, 1 July 2002, section III. http://europa.eu.int/comm/trade/services/gats_sum.htm

10 Summary of the EC’s Initial Requests to Third Countries in the GATS negotiations, 1 July 2002, section IV. http://europa.eu.int/comm/trade/services/gats_sum.htm


12 Other service industries covered in the EU’s definition include the protection of biodiversity and landscape, noise, air and climate protection, other environmental and ancillary services, business, remediation and clean-up of soil and water, business consulting, construction, engineering, distribution, transport and other services with an environmental component. The current WTO definition for environmental services, however, does not specifically include water supply services.

unspecified economic needs tests, residency and nationality requirements, restrictions to the movement of key personnel etc. This list is not exhaustive, and other restrictions are also maintained by WTO Members.”

3.2 Reaction to the EU proposal

The leaking of the EU’s trade in services liberalisation request in April 2002 (and its subsequent official publication) has evoked considerable criticism from a number of non-government organisations (NGOs) world-wide. While the objectives, point of view and quality of these criticisms vary from one source to another there are a number of common arguments regarding the EU’s request that WTO members provide market access to water supply service providers. This section presents and summarises these arguments.

Concerns regarding the application of GATS to water supply services

A major concern of WTO critics is that once water supply is covered by GATS it will quickly become subject to liberalisation negotiations. This concern is based on the view that there is some scope for interpretation as to whether GATS applies to water supply. As discussed above, while GATS covers all service sectors, it does not cover government services providing on a non-commercial basis.

It is feared that if water supply services are covered by GATS “water [may] become subject to enforced liberalisation under the […] General Agreement on Trade in Services Agreement [and that] the new EU strategy will give a decisive impetus to water privatisation across the developing world”. It is pointed out that “observers can see for themselves the services in named countries that have been targeted by the EC for GATS coverage [including water delivery and energy services]”.

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14 Other market barriers in relation to the water sector may include indirect subsidies. It has recently been argued, for example, that many water intensive industries sectors in developing countries (e.g. agriculture) benefit from the low level of cost-recovery. It has further been argued that these indirect subsidies constitute market barriers for products from other countries where water is charged at cost-recovery levels. [But don’t these barriers relate to goods or services production where water is a production input rather than to trade in water supply services itself?] Some of the barriers are mentioned in: GATS 2000: Environmental Services Proposal from the EC and their Member States, December 2000. http://europa.eu.int/comm/trade/services/nspw06.htm

15 Watkins, K.: Money talks, The Guardian April 24, 20002 in www.guardian.co.uk/Archive/Article/0,4273,4399856,00.html

General doubts about benefits of liberalisation

It is argued, that there is little evidence of the benefits of liberalisation in a sector characterised by monopoly structures, including the water sector. As a result, there are doubts regarding the extent to which opening of access to these markets will contribute to a country’s economic development.

It is argued that failed reform programmes in combination with the preponderance of natural monopolies “… has lead to an increase in market power among a few multinationals, rather than increased competition”\(^\text{17}\) and that “foreign corporations can use their power to limit competition.”\(^\text{18}\)

A New Zealand NGO has argued that it was “high time to come down from 30,000 feet and ordinary people are made aware that free trade (or ‘trade liberalisation’) = privatisation.”\(^\text{19}\)

Interference in a country’s internal rules and regulations

Since the scope of services as defined by GATS covers not only cross border trades but a large share of services inside national economies WTO critics argue that the most important target for services liberalisation are likely to be a Member States’ existing rules and regulations on the administrative level. It is argued that through Article VI (domestic regulations) “GATS interferes substantially in WTO Members’ home policy and is likely to affect crucial and sensitive areas of a country’s sovereignty.”\(^\text{20}\)

Flexibility not applicable in reality due to political pressure

WTO critics have pointed out that GATS may not provide for sufficient flexibility for Member countries to chose both the sectors and the extent to which they liberalise\(^\text{21}\). It is argued that the argument that developing countries have the choice whether to liberalise in reality lacks political realism: “during the next two years of GATS negotiations, the pressure on developing countries to liberalise their services will be immense. While this is not caused by GATS itself, it is the political context in which GATS negotiations are taking place.”\(^\text{22}\)


\(^{19}\) Water Pressure Group: European Water Multinationals are already in NZ, 22 April 2002 in Scoop Media. www.scoop.co.nz/mason/stories/PO0204/S00147.htm

\(^{20}\) Position paper AG Handel des Forums fuer Umwelt und Entwicklung: die WTO Verhandlungen zum Dienstleistungsabkommen GATS. [own translation from German to English] www.forumue.de/forumaktuell/positionspapiere/00000001d.html

\(^{21}\) Art. II.1.GATS and Annex on Art. II Exemptions

Irreversibility of specific commitments

It is often argued that Member States’ specific commitments are irreversible. An example is given of the privatisation of a water company in Cochabamba, Bolivia where a considerable increase in tariffs reportedly caused riots, the contract with the private operator was subsequently cancelled and responsibility for water supply was given back to the local authority.

It has been argued that if “Bolivia had been locked in to such commitments [i.e. under GATS], the ability to reach a political solution would have been effectively eliminated […], it would have had to give at least three months notice of its intentions and waited through a period of negotiations before it could take action […] it would have had to compensate all WTO members with no guarantee that anything it offered as a substitute commitment would have been regarded as acceptable.”23

Lack of capacity in developing countries

It has been argued that the low institutional and regulatory capacity in developing countries means that it is questionable if Member Governments in developing countries have a clear understanding of the impact (where they have made unlimited commitments) and in case that they have limited their commitments if they are able to enforce those limitations against powerful multinational corporations.

According to WTO critics, provision of technical assistance to address these capacity problems under the WTO Trade Related Technical Assistance and Capacity Building funding is likely to be driven by the EC negotiating interest and agenda rather than driven by the demand of the recipient, based on their country situation.24

“Dictate of big business”’ interests

Another criticism is that that the development of GATS in general, and the EU negotiating proposal in particular, has been deeply influenced by multinational corporations (e.g. French, German and British water utilities), which are expected to benefit most from the agreement at the cost of consumers and the interests of developing countries.

When the leaked EU documents were released and the wider public informed about the EU request list many NGOs pointed out to the lack of transparency: “despite the public interest in GATS [the EU] has conducted negotiations behind closed doors with an unacceptable level of industry involvement […] with parliaments also in the dark, we are deeply concerned that important…


negotiating proposals are being decided by the Commission Member State trade expert [...] and industry lobby groups [...] with little transparency and public oversight.”

It has been pointed out that an EC official stated at the beginning of April in an email to a NGO representative that EU proposals “can and will not be made public.”

4 Relevance and implications of GATS for water supply services

This section discusses the relevance of GATS to water supply services and the implications of liberalising water supply services under the GATS framework. We found that there is no clear evidence if water supply services which are traditionally considered a public service, are covered by GATS and thus subject to liberalisation.

Nevertheless, even if water supply services were covered by GATS it may be argued that implications for member countries are limited. This is because GATS provides for sufficient flexibility to restrain liberalisation in specific service areas to the extent that a member state wishes to do so. In addition, full liberalisation of water services (if a government wishes to pursue this route) would need to go further than GATS requirements.

From a developing or transition country perspective however, there are risks associated with liberalisation of water services if some of the issues are not properly addressed at an early stage of the process. We therefore present in this section:

- first, whether water services are covered within the scope of GATS;
- second, options for flexible liberalisation of water markets under GATS;
- third, a discussion of risks associated with water market liberalisation from the perspective of developing and transition countries.


27 Liberalisation usually describes the opening of a market to a larger number of competing service providers. Given the monopolistic character of the water industry, liberalisation of water services under GATS is limited to the opening of markets to foreign providers by a competitive tender process. Opening of water markets may result in a range of different contract types with the private sector including concessions, lease, BOT or management contracts. Privatisation as the full sale of assets to a private investor is the exception and has only been used in England and Wales. Partly sale of assets under a public private partnership model have occurred in some Central and Eastern European Countries including the Czech Republic, in Belize and Chile.
4.1 GATS coverage

The first step in considering the implications of GATS for water supply services is to assess whether water supply services fall under the scope of GATS. As discussed in Section 2, all services fall within the scope of GATS other than those “services supplied in the exercise of governmental authority”, i.e. “a service which is supplied neither on a commercial basis nor in competition with one or more service suppliers”.\(^{28}\)

There is some uncertainty amongst trade experts as to whether or not water supply services fall within the scope of this exclusion. For example, in those countries where water is financed through general taxation revenue rather than user charges (e.g. Ireland) or where water utilities are highly subsidised, it could be argued that it is a service that is not being supplied on a commercial basis. However, in many other countries water is supplied along commercial lines by charging fees for usage, even where water supply utilities remain in public ownership and under public management and full cost recovery is not achieved. In addition, it may be argued that even if water supply services are currently provided on a non-commercial basis it could potentially be supplied on a commercial basis or in competition with one or more service suppliers (e.g. by introducing competition in a contract tender process).

The inclusion of water supply services in the proposal submitted by the EU is indicative of its view that water supply services fall within the range of services that might potentially be liberalised under GATS. Further, the WTO has recently stated that “every government has the right to exclude public services – including health, education and water distribution – from the negotiations … Government services supplied on a non-commercial basis by each of the 144 WTO Member Governments are explicitly excluded from the scope of the negotiations”.\(^{29}\) The specific reference could imply that the WTO considers water distribution not to be automatically excluded from GATS coverage. It can be excluded, however, if it was provided on a non-commercial basis.

However, it may be argued that once water supply services are put on the agenda the decision by Member Governments as to whether water supply services should be liberalised under GATS will be driven by the dynamics of the negotiation process and governments responding to the liberalisation requests and offers of other Members. Some observers, would therefore take the view that some countries are disadvantaged by the negotiation process and may end up liberalising access to their own market without gaining sufficient concessions in return. For this reason the political economy of the bargaining process under GATS needs to be taken into account to determine the relevance of GATS on water supply services.

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\(^{28}\) Art I, 3 b-c GATS.

\(^{29}\) Press release, WTO news: Director-general of WTO and chairman of WTO services negotiations reject misguided claims that public services are under threat. [www.wto.org/english/news_e/pr299_e.htm](http://www.wto.org/english/news_e/pr299_e.htm)
In summary, the coverage of water supply services under GATS is not the predominant factor for determining to what extent water services will actually be liberalised. The implications of GATS on water services rather appear to depend on members states’ choice of options to restrain liberalisation (or to open the water market) as well as bargaining power and institutional and regulatory capacity of individual member states (which we will discuss further below).

4.2 Options for flexible liberalisation of water supply services under GATS

In Section 2.3, the capacity for flexible liberalisation under GATS was discussed. At this stage it is worth considering how mechanisms for constrained liberalisation under GATS could be applied to water supply services if a Government wishes to liberalise access to water supply services, but still impose restrictions in some areas.

The first step would be to identify the specific water supply services or sub-services which would be liberalised. A number of countries, for example have chosen to liberalise bulk water services (e.g. by a build-operate-transfer contract) before (if at all) opening access to water distribution services. Following this, decisions would be needed on the extent to which restraining measures would be maintained or introduced for each of the four modes of supply for the particular service in question.

As with other services, there is more than one mode of supply for water supply services. The following table sets out different types of water supply services for each of the modes of supply identified under GATS. It can be seen from this that Mode 3 (commercial presence) and Mode 4 (temporary entry of foreign nationals) are likely to be the most relevant to international trade in water supply services.

<table>
<thead>
<tr>
<th>Modes of Water Supply Services under GATS</th>
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<tbody>
<tr>
<td><strong>Mode of supply</strong></td>
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<tr>
<td>Mode 1: Cross Border Supply</td>
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<tr>
<td>Mode 2: Consumption Abroad</td>
</tr>
<tr>
<td>Mode 3: Commercial Presence</td>
</tr>
<tr>
<td>Mode 4: Temporary Entry of Natural Persons</td>
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<td></td>
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</tbody>
</table>

Source: Stone & Webster Consultants
Member countries could constrain liberalisation of the water supply services market through the application of cross-sector or sector specific restraints related to each of these Modes of Supply (as discussed in Section 2). Alternatively, Members could constrain the liberalisation of this market by application of the national treatment principle, which would provide equitable access to foreign and domestic service providers, but would not necessarily involve the full liberalisation of the market. Finally, as discussed in Section 2, a Member has the right to establish specific limitations on market access.

As a result of limitations to market access, foreign operators would, for example, not be allowed to establish a specific type of legal entity (e.g. a joint venture), their shareholding could be limited (perhaps to a minority level), and the outsourcing to local companies could be requested.

As discussed in Section 2, GATS allows governments to intervene in service sectors in accordance with national policy objectives. In relation to water supply services, this would mean that Governments are allowed to:

- maintain and designate monopolies and exclusive service suppliers;\textsuperscript{30}
- regulate water supply services; and
- subsidise certain activities.

In summary, according to the provisions of GATS there are a range of mechanisms that would allow Members to tailor or limit any liberalisation of the water supply services market.

Despite the reassurance from WTO officials and other GATS advocates that water services are not covered under GATS and if so, liberalisation was voluntarily and flexible the EU proposal to request access to water markets from some other states has evoked concerns with GATS opponents around the world (as presented in section 3.2). We will discuss some of the risks associated with water market liberalisation in the following section.

### 4.3 Risks associated with water sector liberalisation in developing and transition countries

For many countries liberalisation of the domestic water market (accompanied by private sector participation) is a chance of significantly improving the existing water supply and sanitation situation. Water services under the operational responsibility of government often lack capital for investment and are relatively inefficient. Moreover, a majority of the population in Africa, Asia and Latin America still does not have access to the formal network. It is often the poor of a society who are most disadvantaged by the lack of access and high costs for alternative water sources.

\textsuperscript{30} The EU and its Member States, for example have included in their schedule that services considered as public utilities at a national or local level may be subject to public monopolies or to exclusive rights granted to private operators. Turkey’s schedule until recently has indicated that areas provided by public monopolies are closed to private investment.
However, it has to be recognised that the involvement of the private sector is not a panacea in itself. In this section we argue that some of the concerns expressed in relation to the liberalisation of water services need to be taken seriously. It has been argued, for example that:

- benefits from increased competition in the sector may be limited due to the market dominance of few important players;
- private sector participation may not be appropriate for the delivery of a common good such as water services;
- regulatory and institutional capacity in some developing countries may be too weak to enforce and restrain private water companies;

We discuss each of these concerns below by outlining some of the recent experience regarding these issues.

**Market dominance**

The water and sanitation sector is mostly considered as a monopoly industry due to its unique technical and economic characteristics. That is the scope for competition in the market and thus for market access of various service suppliers is limited thereby potentially leading to high prices and/or low quality of services.

Given the limited scope for competition it is often sought to introduce competition for the market to achieve better performance and lower prices. Under this model, operators compete against each other for permission to exclusively operate a water (and sanitation) system in a specific area for a certain duration.

The international water business is dominated by a relatively small number of few European water companies. As a consequence, even if a government decides to fully liberalise its water market, there is likely to be a few foreign corporations to compete for the contract. The lack of competition may result in higher prices and lower quality of service at the cost of consumers.

Currently, there is an important debate amongst decision-makers, governments and donor agencies concerning ways to address market dominance issues in the water sector. Proposals to increase competition include the following areas:

- Restructuring of service areas: by splitting up a service area and awarding contracts to different service suppliers the market dominance of a single service provider in a country (or a major city) will be reduced.\(^\text{31}\)

\(^{31}\) For the Manila service area in the Philippines, for example, concessions were awarded to two different consortia.
- Contract duration: water contracts including long-terms concessions are awarded for a predetermined period of time. Management contracts, for example, are usually only designed for five to seven years with the perspective of re-tendering the contract. The shorter the duration of the contract, the more frequent the competitive tendering process. In addition, most contracts include early termination clauses.

- Shared responsibility with a local partner: the international operator could be requested to subcontract some of its activities to a local partner in a competitive tender process (e.g. meter reading, invoicing). In addition, in a number of countries arrangements between the international private operator and private small scale water vendors have been implemented.

- Entry of new market players: Governments in both developing and developed countries may seek to strengthen their own infant water industry to try to compete against other dominant market players.

However, governments in developing countries often have to strike a fine balance between attempts to limit market dominance (which reduces the attractiveness of the market from the perspective of private investors) and the wish to attract private interest for long term and exclusive arrangements.

**Limits of private sector participation**

Globally only 8 percent of the population are served by private service suppliers. Even in the EU and USA, Canada, Japan, Australia and New Zealand water supply is mainly managed by government institutions. That means that despite an increasing degree of private sector involvement, the majority of the population in developed countries is still served by public service providers.

With a few exceptions, private sector participation in the water sector in less developed countries is also a very recent phenomena. It is therefore too early to give a final judgement on the outcomes and impacts of these contracts. Until now, however, the results of private sector participation have been mixed. In some cases, for example, the performance of the private operator did not meet expectations, important gaps in the early contracts were identified, the regulatory and institutional design and capacity turned out to be too weak to restrain the service provider and finally, some projects were

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32 In France, for example, legislation has been enacted which places a duration limited on concession contracts.

33 The effectiveness of this approach will, of course, depend on the availability of competent local service providers in this area or, the willingness of governments and donor agencies to support the development of these skills.

34 For example, in Western Europe there are only 42 percent and in North America 22 percent of the population connected to a privately managed network. In countries like Germany, Denmark, Netherlands, Luxemburg and Austria private sector participation is an exception with the majority being managed by the Government. Masons Water Yearbook 2002-2002 (Delegation Pack), p. 8
cancelled because there was important political resistance. Finally, it has to be noted, that private investors may not be expected to enter water markets in developing countries at any price. This is because the investors’ return on investment in developing countries is subject to significant political and regulatory risk.

One may therefore argue in favour of public management of water services. We would argue, however, that while opening of water markets to private investors is not a panacea for all countries in all circumstances, it would not be in the interest of any government to ignore it as an alternative option to publicly owned and managed utilities. This is for the following reasons:

- the involvement of the private sector often follows only after a series of unsuccessful attempts to reform the public sector.
- properly designed and implemented private sector participation can result in important benefits to consumers in terms of access and improvement of quality of services.

It may be useful, however, to move beyond the debate of public versus private provision of water services. Experience suggests that for publicly or privately managed water services alike, successful water services are a combination of the following elements:

- appropriate incentives for both the staff of the operator as well as consumers for efficient management and use of a scarce resource;
- clear and transparent rules about processes, responsibilities, prices setting mechanisms and services standards;
- capacity to monitor and willingness of governments to enforce rules.

As a result, it is therefore recommendable for developing countries to develop these key elements of efficient provision water supply that apply for publicly and privately managed companies.

**Limited institutional, legal and regulatory capacity**

It is often argued that liberalisation of water services under GATS may interfere with government’s responsibilities and that the government will lose control of a basic public services to the private sector.

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35 However, a recent study found that 3.5 percent of all private sector participation projects in the water sector were cancelled most of them over price increase controversies. See Harris, C. et al. (January 2003): a review of cancelled private projects in Viewpoint, Public Policy for the Private Sector World Bank, Washington D.C.

36 This position is represented, for example, by Public Services International, a global federation of public sector unions on [www.psu.org](http://www.psu.org)
It is true, that GATS does seek to ensure that qualification and licensing requirements, procedures and technical standards do not constitute unnecessary barriers to market entry. It is, however, vital to understand that under increased liberalisation of water services the control of the government would not become less but different in terms of responsibilities and obligations. This is because even if a country wishes to fully liberalise (and privatise) its water markets it is ultimately the government who is responsible (and will be held responsible by the population) for the provision of water services.

Given the monopoly structure of the industry there is a significant need for the government to prevent any abuse of the monopoly position of the main services provider be it public or private e.g. by overcharging consumers or providing an insufficient level of services. Hence the importance of setting up an appropriate institutional and regulatory framework to monitor, supervise and regulate the activities of the water services operator. In addition, it is often underestimated that publicly owned and managed companies also require a strong institutional, legal and regulatory framework to be effective service providers.

In reality, however, due to limited institutional, legal and regulatory capacity in some countries governments may be unable to establish and enforce restrictions against powerful private water companies and to achieve a maximum of benefits for consumers. As a result of a country’s weak capacity in this area, there is a risk that operators may take advantage of the gap (or are forced to withdraw from the contract).

As a result, for any model of service provision it is crucial to recognise the need to assist weaker member states in setting up appropriate regulatory structures for the water industry. Doing so at an early stage is particularly crucial for countries that consider opening their water markets to foreign investor. This is to ensure that member states attract private investor’s interest and improve their position in the negotiations with the private investor.

However, given the time required for the establishment of appropriate regulatory, institutional and legal structures it may be advisable for some countries to delay the involvement of an international private investor (if at all) to ensure that appropriate structures are put in place.
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