BRIEFING PAPER
trade and investment series

CCPA
CANADIAN CENTRE for POLICY ALTERNATIVES
CENTRE CANADIEN de POLITIQUES ALTERNATIVES

Volume 9, Number 3 • March 2008

There They Go Again
GATS Negotiators Work to Limit Domestic Regulation

By Ellen Gould

At the end of January, the chair of the GATS Working Party on Domestic Regulation Peter Govindasamy issued his latest draft of proposed WTO "disciplines" to constrain government regulation of the service sector (see http://tinyurl.com/368b2t). His proposal appeared just as the global economy was reeling from two spectacular regulatory failures in this sector—the US subprime mortgage fiasco, requiring the world's largest banks and investment firms to write down an estimated $400 US billion of their assets, and the losses by the French bank Societe Generale due to $73.3 US billion in unauthorized trades. The sums involved are larger than the entire GDP's of many developing countries.

The draft GATS disciplines, if implemented, would limit what governments can do to prevent and resolve such crises. They would hamstring regulators and further bias the regulatory process in favour of commercial interests.

Changes from the Previous Draft

Key changes from the April 2007 draft of the disciplines (see http://tinyurl.com/35y747) are:

- Deletion of a critical footnote that would have recognized the right to regulate to meet sub-national, as well as national, objectives **(paragraph 3)**. This deletion means if local governments have different objectives than those pursued at the national level—think Canadian cities and how their Kyoto goals can contrast with those of the Harper government—they will be on weak ground if their regulations are challenged at the WTO.
- Imposition of very onerous requirements to publish "detailed information" on regulations, **(paragraph 13)** including ten specific details on every measure relating to licensing requirements and procedures, qualification requirements and procedures, and technical standards for committed sectors. A measure is defined in the GATS as including a "law, regulation, rule, procedure, decision, administrative action" or any other form of government initiative. No consideration is given to the administrative burden compiling all this information would impose, especially for local governments.
- Giving a commercial bias to input on proposed regulations. The previous draft stated governments should endeavour to give "interested persons" reasonable opportunities to comment, but the current draft restricts this to just "service suppliers" **(paragraph 15)**.

Govindasamy described his revised draft as containing compromise language where agreement has been reached as well as elements where there are "persistent divergences" and further negotiations are needed. But because the Working Party decided in April 2007 to keep its discussions secret, it is impossible to tell what has been agreed and what is still being contested. The secrecy of the negotiations (even the draft disciplines had to be obtained through leaks) contrasts sharply with the onerous transparency requirements negotiators would impose on governments.

Necessity tests—that government regulatory measures cannot be more burdensome than necessary or trade restrictive than necessary—do not appear in the current draft. Some delegations such as Australia's have insisted necessity tests are an essential part of the disciplines and had proposed the April 2007 draft be changed to include them. The debate over explicit inclusion of necessity tests might be one of the "persistent divergences" the Chair was unable to reconcile.

Alternatively, the first sentence of the draft disciplines, stating the disciplines were agreed **"pursuant to Article VI:4 of the GATS"**, may be compromise text to resolve this issue because it might be interpreted as rooting the disciplines in Article VI:4's necessity language. The previous draft said the disciplines were agreed **"having regard to"** Article VI:4, which might suggest a weaker connection.

Compliance with the GATS necessity test is already being pursued at the Asia-Pacific Economic Forum through a working group on telecommunications regulation. Their reports reveal how APEC countries are restricting their regulations to what is "no more burdensome than necessary", and how different elements listed in the draft disciplines contribute to this aim (see http://tinyurl.com/3b8rdt).

In regards to **licensing fees**, developing countries have been unable to get a clause modified that **would restrict these fees to the costs incurred by competent authorities (paragraph 26)**. The EU in particular has insisted on this restriction. Together with the reduction in their tariffs resulting from other aspects of the Doha negotiations, governments of some developing countries would see their revenues significantly reduced.

A Yellow Light for the Right to Regulate

Overall, the disciplines in the current draft would weaken the regulatory authority of governments, particularly subnational governments, and create many new grounds for challenging non-discriminatory regulations.

In a 2007 presentation to APEC (see http://tinyurl.com/3328zp), the WTO Secretariat likened the proposed GATS disciplines on domestic regulation to a yellow traffic light, creating rules somewhere between the clear prohibitions and the general exceptions in the agreement. It is an apt metaphor for the uncertainty the disciplines will create for governments. In some jurisdictions it is acceptable to run a yellow light whereas in others it is a violation. By moving non-discriminatory regulation from its current green light status under the GATS to a yellow light, and creating disciplines that are open to a wide range of interpretation, negotiators are adding the threat of WTO dispute challenges to what is already a difficult environment for regulation.

Added in the form of an annex to the GATS, the disciplines will require an amendment to the agreement. The Secretariat has explained that the disciplines would apply to "nondiscriminatory qualitative requirements" and subject regulatory autonomy to "rules aimed at minimizing trade restrictive effects." In the context of the GATS, which covers investment as a form of trade, the disciplines create a new obligation to minimize the effects of regulation on commercial activity within a country's borders.

Although the draft disciplines include recognition of "the right to regulate and to introduce new regulations" **(paragraph 3)**, that right inevitably would be curtailed by the new disciplines.

Potential Disputes Under the Draft Disciplines

While the Secretariat claims in their presentations that the WTO has no "direct role" in determining the content of domestic regulations, the disciplines as drafted create opportunities for regulatory systems to be challenged if they do not conform with WTO rules in terms of both content and process.

The draft disciplines require that measures relating to services regulations have to:

- **Be "based on objective and transparent criteria" (paragraphs 2 and 11)**—This discipline threatens a wide range of regulations that are based on necessarily subjective judgments such as scenic value and public interest. "Competence and the ability to supply the service" are given as examples of objective and transparent criteria, so this discipline could be used to challenge regulatory criteria designed to achieve broad social

or environmental benefits unrelated to customer satisfaction with a service.

- **Not constitute "a disguised restriction on trade" (paragraph 2).** The Appellate Body stated in the US-Gasoline case that a "concealed or unannounced restriction or discrimination in international trade does *not* exhaust the meaning of 'disguised restriction'." The panel in the Brazil-Tyres case took this AB ruling to mean "that a restriction need not be formally 'hidden' or 'dissimulated' in order to constitute a disguised restriction on international trade…" These rulings suggest that even a measure that is completely transparent could still be found to be a "disguised restriction on trade." For example, if the cost of complying with regulations was high, this could be a violation of the disciplines as a restriction on trade, even though the regulations were publicly available and not concealed in any way.
- **Be "pre-established" (paragraph 11)**—This discipline threatens the discretionary authority of regulators to make tradeoffs and set criteria that are reasonable given particular circumstances. The discipline also begs the question—established prior to what? For example, if capital requirements for already chartered banks are changed in the midst of a banking crisis, does this violate the "pre-established" rule? Another discipline states members have to endeavour to **"publish in advance"** any measure of general application relating to matters covered by the disciplines before it is adopted **(paragraph 15).**
- **Be "relevant to the supply of the services to which they apply" (paragraph 11)**—This discipline threatens all requirements that might be considered external considerations to the supply of a service, such as the impact of a shopping centre on a residential neighbourhood or the environmental impacts of a pipeline development.

Under the draft disciplines, members would have **"to ensure"** licensing and qualification procedures were **"as simple as possible" (paragraphs 17 and 31**). This is an extreme requirement, and it is left to a panel to determine what level of simplification is possible. It is also a questionable goal, serving as it does exclusively the interests of service suppliers and not the general interest in setting the appropriate level of complexity necessary to achieve regulatory objectives. Why, for example, should the licensing of financial institutions be made "as simple as possible" given the complexity of the services being supplied?

In service sectors such as construction, submission of archeological assessments, habitat impact studies, and surveys of community opinion can make licensing procedures complicated in a way that panels might rule does not pass the simplicity test. This discipline could end up effectively restraining the content of regulations as well as the procedures involved.

Another proposed discipline stipulates that applicants can only be required "in principle" to approach **"one competent authority" (paragraphs 19 and 32).** Limiting the approvals needed to just one government department would be another way the disciplines would tend to narrow the range of concerns that can be addressed through the licensing process.

These procedural disciplines, along with the **deletion of the previous reference to subnational objectives in paragraph 3**, fundamentally conflict with federal systems where applications need to be made in each province or state to fulfill different regional requirements. The jurisdictions of local, state, and federal governments would be jeopardized by a process limited to what is as "simple as possible" and handled by "one competent authority".

Regulatory diversity is also targeted by a discipline stating WTO members **should take international standards into account** when they are formulating their own technical standards **(paragraph 41).** In the event of a dispute, the presumption would be in favour of international standards, although governments could argue using the wording in the discipline that international standards were "ineffective or inappropriate means for the fulfillment of national policy objectives." This bias toward imposition of international standards could discourage leadership in strengthening standards, as California has done with its environmental regulations.

Establishing New Standards of Treatment for Business

The disciplines stipulate that authorities ***shall*** begin processing licensing and qualification applications, notify applicants if their application is rejected,

and ensure that approved applicants are allowed to begin supplying a service all **"without undue delay" (paragraphs 20, 23, 30, 33, and 37).** Other disciplines oblige regulatory authorities to inform applicants of insufficiencies in their application and to finish processing completed applications **"within a reasonable timeframe" (paragraphs 21, 24, 35, and 38).** These disciplines essentially establish new, legally binding standards of treatment for foreign investors and professionals. They will enable challenges in key sectors like mining, where delays in licensing are a constant source of complaint from industry.

Countries with significant mining development like Canada, Mongolia and South Africa have made GATS commitments for mining-related services, such as "tunnelling, overburden removal and other development and preparation work of mineral properties and sites". Under the disciplines, foreign mining companies would have to have their applications for this work handled "without undue delay" and "within a reasonable timeframe". Since mining projects are frequently held up by community opposition, imposition of these GATS disciplines would tend to place communities at a disadvantage in the regulatory process.

The current draft disciplines state that governments have to endeavour to provide "service suppliers" (not the broader category of "interested persons" specified in the previous draft) with **reasonable opportunities to comment** before measures are adopted **(paragraph 15).** Paragraph 15 also states governments should endeavour to respond in writing to these comments. Although these disciplines are written as "best endeavour" provisions, they still mean governments have to establish some process whereby commercial interests can intervene and have their interventions responded to before measures are adopted.

This WTO-enforced commercial bias to the regulatory process links transparency to necessity disciplines. At the APEC workshops on the GATS disciplines, the Singapore representative explained that one of the ways his government ensured their technical standards did not constitute an "unnecessary barrier to trade" was to "involve private sector/industry participants at the outset" (see http://tinyurl.com/3b8rdt).

Wide Scope of the Disciplines

The current draft maintains definitions that give wide scope to the disciplines. They cover not only "licensing requirements and procedures, qualification requirements and procedures, and technical standards" but also "**measures relating to**" these categories of regulations **(paragraph 2)**. The definitions of each regulatory category **(paragraphs 6, 7, 8, and 9)** have also not changed, despite strong disagreement within the Working Party on Domestic Regulation about what they cover.

China, in support of a paper by Columbia on applying the disciplines to visas, has stated "that visa criteria and procedures were tantamount to licensing criteria and procedures." The US and the EC have objected to this view, with the US saying delegations were giving "lofty interpretations" to the text of Article VI.4. But without clarification in the text of the disciplines it is conceivable a panel could share China's perspective.

In terms of the scope of the licenses covered by the disciplines, China and Pakistan have suggested language that would exclude, "authorization, permit or permission relating to the use of natural resources." The US has objected in the past that licensing has been defined so broadly that the disciplines could apply to building permits. These concerns about narrowing the definitions of what is covered are not reflected in the current draft.

Ambiguous Wording

The draft continues with previous language limiting the application of the disciplines to measures affecting trade "in sectors where specific commitments are undertaken." It is not clear from this wording if application of the disciplines is triggered for a whole sector by a commitment in any mode of supply in a sector. For example, South Africa's commitments for commercial presence in financial services may mean the disciplines would apply to cross-border trade in financial services as well, even though South Africa made no commitments for the cross-border mode of trade in this sector.

The draft also attempts to draw a line between the measures the disciplines cover and what is covered by the market access and national treatment provisions

of the GATS: "They do not apply to measures to the extent that they constitute limitations subject to scheduling under Article XVI or XVII" **(paragraph 10)**. The previous draft had stated the disciplines would not apply to measures "which constitute limitations…." This change appears to broaden the scope of the disciplines. The new wording would apply the disciplines to those aspects of a measure that are not covered under market access and national treatment, even if the measure is listed as a limitation.

The lack of clarity between what is actually covered by market access and national treatment means the scope of the disciplines is also unclear, and may be far different from what negotiators intend. In a March 1999 paper, the Secretariat identified 1420 mistakes in scheduling market access limitations out of a total of 7040 listed. Presumably the disciplines would apply to limitations if they had been improperly scheduled, with the result that their coverage may be far broader than is contemplated. The potential for scheduling errors increased when the Appellate Body ruled in the US-Gambling case that market access covers regulatory bans, treading on areas that might be considered to be qualitative rather than the quantitative restrictions GATS market access rules are supposed to apply to.

De facto discrimination under GATS national treatment increases the uncertainty in what limitations should be scheduled. The national treatment rules stipulate that governments have to give foreign services and suppliers no less favourable treatment than they give their own. But what constitutes a "like" service or service supplier cannot be known for certain until ruled on in an actual dispute. Since it is very hard for governments to anticipate what panels might rule to be de facto discrimination, they inevitably make mistakes when they schedule their commitments.

National treatment rules already allow challenges to qualification and licensing requirements that are "excessive" (see Mattoo, 2004 at http://tinyurl.com/2l3vhh). For example, if a foreign doctor was required to completely requalify in order to practice, such an excessive requirement would be a national treatment violation. Language and residency requirements could also be found to be national treatment violations if the foreign service being supplied was deemed "like" a domestic one. So despite negotiators' efforts, it seems likely that the domestic regulation disciplines will overlap with market access and national treatment rules, creating even more potential for GATS disputes.

The Sleeper in the Doha Round

Public controversy about the Doha Round of WTO negotiations largely focuses on two issues—the extent to which the US and Europe will cut their agricultural subsidies and how much developing countries will open their markets to foreign industrial goods. The GATS domestic regulation disciplines will come into force at the end of the overall round, and have the potential to significantly affect everyday life on questions as important as what kind of development is to be permitted in a neighbourhood. But negotiations in this area get no media coverage, and are likely to be treated as a minor consideration when a Doha deal is ready to be signed. Once GATS negotiators have a draft they can agree on, the disciplines will probably receive no further notice until they come into force and the inevitable disputes emerge. In other words, the ideal time to raise objections about this secretive WTO's committee's work is now, before the disciplines become yet another WTO obstacle to governments' right to regulate.