

## Trade in Services and EPAs: The Way forward for the EAC

### Introduction

With an interim Economic Partnership Agreement (EPA) on trade in goods having been agreed between the European Union (EU) and the countries of the East African Community (EAC), attention in the current phase of negotiations has turned to the remaining issues in the negotiations to conclude a comprehensive agreement that include services liberalisation.

The EU is the most competitive services exporter in the global economy. It understands its strength and competitiveness in the area of services trade, thus agreeing to terms on services is high up on their agenda. On the other hand, EAC services sectors are still weak (the EAC's share of global services exports is even less than its share of global goods exports). The region is ill prepared in terms of in-depth studies needed to explore the implications of a services liberalisation for their economies. Hence, negotiating terms on services with the EU poses major challenges.

Furthermore, a free trade agreement (FTA) suggest that parties make more significant commitments than they have in the multilateral framework under the authority of the World Trade Organisation (WTO). In this regard, the EU, the world's most competitive services exporter, will be eagerly looking to gain substantial new opportunities in the EAC services sector than the EAC countries have committed at the WTO.

This paper explores what is at stake for the EAC in negotiating services with the EU, the current state of play in EU-EAC services negotiation, and the options for moving forward in these negotiations.

### Importance of the Services Sector in the EAC

According to the World Bank's estimate, services contribution in the Eastern and Southern African (ESA) region averages 50 percent of the gross domestic

**Table 1: Importance of Services to EAC Economies**

Country	Services as percent of GDP		
	2000	2005	2006
Burundi	40.8	45.1	-
Kenya	50.7	54.4	54.1
Rwanda	38.1	37.3	37.8
Tanzania	39.2	37.0	37.3
Uganda	42.4	48.4	49.2

*Source: World Bank, World Development Indicators*

product (GDP) of many countries<sup>1</sup>. As can be seen in the table 1, services are also very important to the economies of all the EAC countries, especially in Burundi, Kenya and Uganda where they contribute over 45 percent of the GDP and have been growing in recent years.

In Kenya, the services sector has been the most important sector since independence contributing significantly to trade in goods, employment, GDP, backward and forward linkages with other sectors of the economy, foreign exchange earnings from exports and remittances, and attracting foreign direct investment (FDI).

In Uganda, the sector is the main contributor to the country's GDP. On occasions when there was negative growth (usually attributable to falling growth in the agricultural sector), the growth of services offset some of the decline experienced in the country's economy.

The importance of the services sector to exports is significant in three of the EAC countries where services exports were above US\$200mn in 2005 (see table 2).

**Table 2: Main Services Exports of EAC Countries**

Country	Total services exports	Main (worth more than US\$30mn) commercial services exports besides travel and transport (by core sector)
Kenya	2000: US\$993mn	-
	2005: US\$1,886mn	Communications (US\$178mn)
Tanzania	2000: US\$6128mn	Other business (US\$97mn)
	2006: US\$1,483mn	Other business (US\$110mn), Communications (US\$32mn)
Uganda	2000: US\$213mn	-
	2006: US\$464mn	Other business (US\$33mn), Computer/info (US\$32mn)

*Source: UNCTAD statistical handbook*

The primary sectors responsible for these exports were business and communications. Uganda also had exports in computer and information services.

### Is the EAC Services Sector Prepared for Liberalisation?<sup>2</sup>

More than ever, EAC countries need accessible and affordable infrastructural services like water, transportation, energy and Information and Communication Technology (ICT) services as well as education and health to improve their productivity, generate new jobs and increase earnings. Services are thus essential for the improvement of human welfare, which is central need in achieving the Millennium Development Goals (MDGs). However, most social and economic services remain inaccessible, prohibitively expensive, or when accessible, are of low quality and unsuited to the needs of consumers (World Bank, 2003).

#### *Regulatory and Institutional Constraints*

The aim of liberalisation of the services sector is to contribute to economic gains by promoting competition, which, in turn, promotes efficiency and lower prices from which consumers gain and markets expand. However, for EAC countries the gains from past liberalisation over the last two to three decades have been stifled due to lack of suitable regulatory and institutional arrangements. Markets have not been disciplined and the private sector has not delivered on its potential. For these reasons competitiveness has not been developed in most EAC services sector and most public monopolies which were privatised have simply turned into private monopolies.

Secondly, there has not been adequate legal protection to give the private investors the confidence to invest even after the last waves of liberalisation. As Mattoo and Zanini (2007) also state, even if liberalisation were to promote private investments, but without provisions for consumer protection, such investments may simply

end up harming consumers through production of unsafe goods. Without access widening policies liberalisation may end up creating a dual services sector where private markets only serve an elite/affluent section of the society and not the more marginalised.

The necessity of such complementary reforms and the delicate challenge of creating effectively functioning and equitable markets mean that services market opening in EAC should be undertaken gradually, sequenced with other necessary reforms and informed by knowledge of legal gaps that need to be addressed. This highlights the importance of undertaking comprehensive assessments of the services sector to identify what their capacities are and what regulatory and institutional measures will best support their development.

Recent analysis of the regulatory framework in the EAC partner states illustrate that the EAC countries have some relevant regulatory frameworks in place. However, many of these are inadequate even in sectors that have already been liberalised [Regional Trade Facilitation Programme (RTFP) 2009]. It is also clear that there are still significant regulatory gaps in the EAC countries, which pose challenges for moving ahead on liberalisation.

Research by the RPTF (2009) and CUTS (2006) indicates that competition regimes in the EAC countries are non-existent or where they exist have limited capacity to protect competition. Consumer protection laws and systems are also still weak, and need to be strengthened if the private sector is to be disciplined appropriately.

#### *Infrastructural, Technological and Human Resource Constraints*

A cursory look at the level of infrastructure, human resource and technological development of many services sector in the EAC countries suggests that local

producers face huge challenges. This highlights the important need for governments and donors to provide the support required in order to improve the competitiveness of local producers as they open up to Foreign Service providers.

#### *Lack of knowledge on existing capacities, levels of competitiveness and challenges*

Little is known about the EAC service sector's level of competitiveness and the measures that are required to support them to prosper. This technical work still needs to be done and should be the pre-requisite of any serious consideration of negotiation with the EU. In addition, the legal parameters and implications of the services negotiations need to be fully understood by the EAC since the resulting commitments will have serious implications for the future of their services sectors.

The EAC also face other challenges that include: high regulation restricting market access of interest to EAC in European markets; unfair competition from EU-based multinational services providers; inadequate skills in ICT industry; limited skills in international business consulting; low penetration of EAC-owned companies; lack of venture capital finance service investment targeting export market; high logistics costs; cumbersome documentation; and variations in regulations and laws across EAC countries affecting trade in services.

It is, therefore, important that further work is to be done to explore all the challenges facing EAC services sectors and that any decisions on market opening are taken on the basis of such analysis suggesting it is suitable (RTFP 2009). It will also be important for the East African markets to harmonise regulations and build capacities before venturing into serious negotiations with the EU on opening the services sector. A development-oriented EPA would be that which lays emphasis on improving EAC's infrastructure development, regulatory framework, access to finance and credit access to market and training (Janet Abila).

All in all the EAC are not as well prepared for services liberalisation at present. Significant investments in regulatory and competitiveness development will need to be undertaken upfront for the promised benefits of liberalisation to be realised.

#### **GATS Framework and What EPAs Commitments will Involve<sup>3</sup>**

The EAC does not need to negotiate and agree on any terms on services in an EPA in order for their trade with the EU to be WTO-compatible. Therefore, unlike the EPAs negotiations on goods, the EAC could walk away

from any services negotiations with the EU without contravening WTO law.

However, because the parties have committed to include services in their EPAs, provisions of the WTO's General Agreement on Trade in Services (GATS) have to be invoked to govern such agreement. Accordingly, liberalisation of services between the EAC and the EU must include "substantial sectoral coverage" regarding the number of sectors included, the modes of supply and the volume of trade affected (Article V of the GATS)<sup>4</sup>. The EAC would also be obliged to extend national treatment to Foreign Service suppliers from the EU by eliminating "substantially all discrimination". If agreed, the agreement must be implemented "either at the entry into force of that agreement or on the basis of a reasonable time-frame".

Generally, the GATS cover all services delivered through four modes of supply (see Box 1) and all measures affecting trade in services. Its most important principles include non-discrimination, i.e. most favoured nation (Article II), national treatment (Article XVII), transparency in market access (Article III), provides rules on domestic regulation (Article VI), mutual recognition (Article VII), general exceptions (Article XIV), guiding principles on progressive liberalisation (Article XIX), specific commitments in schedules (Article XX), compensatory adjustment in cases of withdrawal of concessions (Article XXI), dispute settlement provisions (Article XXIII), and denial of benefits (Article XXVII). For developing countries, the objective of GATS (as stated in Article IV) is to ensure that the countries (especially the least developed) secure a better share of the growth in international trade.

The implications of the GATS provisions, are therefore, substantial and challenging for the EAC countries. If they agree to negotiate services they will have to engage in substantial market opening with the EU across all modes and sectors. However, EAC could make use of the flexibility provided by Article XX by deciding the sectors to offer and the levels of such offers. They should be allowed to progressively extend market access to the EU in line with their development situation; attach conditions aimed at achieving their increased participation in international trade<sup>5</sup>; and policy space to regulate in the public interest, and in line with national policy objectives<sup>6</sup>.

Such flexibilities were taken advantage of by Caribbean Community of African, Caribbean and Pacific States (CARIFORUM) in their services agreement with the EU. The CARIFORUM signatories notified a range of sectoral limitations especially in relation to modes 3 and 4, with a much lower level of limitations notified for modes 1

### Box 1: Four Modes of Supplying Services

#### Mode 1: Cross-border

In mode 1, it is the service, not its supplier or its consumer, that moves from the territory of one WTO Member into the territory of another. For example, an EU stock-broking firm buying or selling shares for a Kenyan resident over the Internet. The EU is, therefore, exporting financial services across the border to Kenya and Kenya is importing the same from the EU.

#### Mode 2: Consumption abroad

In this case, the consumer moves from his country to the territory of another WTO Member and gets service in that territory. For instance, a Kenyan fee-paying student may travel to EU to study at a European university. Thus, the EU is exporting its education services to Kenya and Kenya is importing education services from the EU.

#### Mode 3: Commercial presence

Under this mode, the service is traded by a service supplier who moves his capital and sets up a commercial presence typically through FDI in the territory of another WTO Member. For example, a Kenyan financial company setting up a company in the EU and providing financial services there.

#### Mode 4: Presence of natural persons (or movement of people)

Under this mode, the service is provided by a services supplier of one WTO Member through presence of natural persons into the territory of another Member. For example, provision of a service by Kenyan contractual service suppliers in EU territory on the basis of a pre-gained contract constitutes a part of Kenyan exports of professional services to EU or equivalently EU imports of the same from Kenya. It may also involve employees of a company temporarily entering the territory of another WTO Member to work in the company's subsidiary.

and 2. Interestingly, limitations ranged from notifying modes that were unbound to notifying phase-in schedules (including delaying implementation until 2022, in some sectors).

The GATS, however, does not cover services which are supplied in the exercise of governmental authority, i.e. neither on a commercial basis nor in competition with one or more service suppliers, are excluded from the scope of the Agreement [Article I (3) (b) and (c) of the GATS]. Typical examples of services that are provided in the exercise of governmental authority are *police services, and the monetary operations of central banks*.

It may be argued that this exclusion precludes, in many instances, the GATS' application to the health sector, since most health services are provided by governments. However, increasingly, health services are provided by private entities as well, arguably in competition with government in some cases. In such cases, the exemption would not apply. It is also true that many public services (including health), have since been unilaterally liberalised through privatisation processes, owing to developing country responses to the International Monetary Fund's (IMF) structural adjustment programmes (SAPs).

#### **State of Play in the EAC-EC EPA Negotiations**

Negotiations on services between the EAC and the EC are continuing, with all options still on the table. The EC has already submitted a text which outlined its interests in services negotiations with the EAC partner

states. The EC in its text has identified areas for negotiations in trade in services which include: *Movement of Natural Persons; Computer Services; Postal and Courier services; Telecommunication Services; Financial Services; Maritime Transport Services; Electronic Commerce; and Technical Cooperation*

In the services sector mentioned above, the EC wants EAC states to eliminate measures affecting trade in services and also offer national treatment to European companies supplying services locally.

The EAC have made a counter text in response to the EC text. At the 7<sup>th</sup> EAC-EC EPA technical officials' negotiations held on March 06, 2009 in Kigali, Rwanda, it was agreed that the EAC states should submit a joint request to the EC highlighting their interests in services negotiations. However, in the case of offers, it was agreed that each EAC states would have their own schedules of services commitments to the EC consistent with their individual levels of development and national development goals (a flexibility granted by GATS Article XX).

It was also noted that the EAC states have limited export interests in market access in services due to capacity constraints. It was, therefore, recommended that EAC-EC negotiations in services should ensure effective support from the EC to address supply-side constraints and the establishment and strengthening of regulatory legal frameworks and institutions. The sectors that have

been analysed to inform Kenyan positions in services include: *Distribution, Transport, Tourism, Environmental, Banking and Insurance, Energy, Education and ICT.*

### **Conclusion and the Way Forward**

Given the state of development of the services sector in the EAC countries, the developmental and competitiveness challenges of EAC services sector, the **competitiveness** of the EU in services, the extensive commitments a services agreement will involve and the limited value of concessions they can hope to extract in services, the EAC need to approach the EPA negotiations very carefully. For these reasons the EU also need to show maximum flexibility to the EAC in any services negotiations that occur in line with the flexibility given in the GATS Article XX to all developing countries.

#### **Way forward for the EAC**

- Explore all options available to the EAC in negotiating services with the EU, including the option of an agreement simply on development cooperation and not rules.
  - Scale-up efforts to assess the capacity and competitiveness of their services sectors; the potential legal implications and opportunities in signing a services agreement with the EC; and identify their negotiating priorities.
  - Present a united front in demanding maximum flexibility in all aspects of the negotiations from the EC.
  - Demand that the EC makes clear and accountable commitments in relation to development assistance and cooperation in any agreement.
  - Focus on what it wants from the EC first and then define its market access requests.
  - Relate its negotiations to all national and regional development plans or policy statements and sectoral plans.
  - As a strategy, no EAC country should schedule an entire sub-sector unless it is entirely sure that it is prepared to open to competition any new services that may evolve in that sub-sector. This strategy can be implemented by checking that all scheduling has been done only at the three digit level or beyond.
  - Exhaustively review laws to ensure that they find ALL or any restrictions on market access or national treatment that exist. Should any country chose to open a sector in which there is no domestic legislation or regulations or inadequate regulations, it would need to set the date for liberalisation of that service in the future with the aim of getting the regulatory regime effectively in place by then. Such offers would need to be complemented by commitment from the EC to provide funding to support the development of regulatory regimes.
- The GATS Article V would be critical for any consideration in deciding the level of liberalisation to settle for. This means that the EC will most likely want a standstill clause or guarantee that new barriers will not be introduced in sectors that have not been committed or opened in the EAC EPA and would push EAC to go beyond their WTO commitments. A good example is in the CARIFORUM EPA where small states made very light commitments in the EPA (between 50-60 percent sectoral coverage in terms of CPC listing) and had to include a standstill clause. The EAC countries will have to figure out what they can get away with, and what meets EC bottom line. It is likely, that smaller EAC economies may get off easy in terms of what EC would request from them. The little they offer will have to be safeguarded by a standstill close as EC pushes to get more offers from the bigger EAC economies that provide attractive market and big returns for EU businesses/companies.
  - The EC is interested in large infrastructural services. Its requests to Kenya include a wide range of business services, telecom, transport, maritime, financial, construction, distribution, etc. Although Kenya may escape in most other areas, it will be required under the EPA to offer what can be defended to definition or concept of “substantial sectoral coverage,” notwithstanding the developing country flexibilities in the GATS Article V. But scheduling should not be done only on a defensive basis. One must target sectors where there is high export potential to open which require foreign investment (mode 3) or competition to increase efficiency and lower the cost of inputs to services and manufacturing, etc. One must also identify those that are non-sensitive and with relatively low export potential and dangle them for liberalisation in exchange for better concessions from the EC.
  - GATS Article V says that in principle one should not exclude any modes, but EAC countries should be witty enough in deciding how they calibrate their offer terms of the different modes to fine tune their market access commitment.

- Finally, the EAC should not make offers in a vacuum as offers should be linked to requests. The EAC would have to be entirely sure what they want from the EC and hold out on offers in areas of interest to EC until they get clear concessions of interest to them. But the EAC should not forget that the EC wants all ESA and Southern African Development Community (SADC) states to come on board with full EPAs. So, the strategy of holding out on what EC is interested in may be of some value for them in the negotiations because EC is likely to concede.
  - Allow the EAC sufficient time frames to explore the implications of a services agreement for their economies, develop suitable strategies, and negotiate terms that will promote their development.
  - Offer clear and accountable commitments in relation to development assistance and cooperation in any services agreement.
  - Allow any African, Caribbean and Pacific (ACP) country that does not want to negotiate a full services agreement to conclude an EPA without such terms and access development assistance to support the development of their services sector.
- Way forward for the EU**
- Ensure that development and poverty reduction objectives stay central to the negotiations, as demanded by the Cotonou Partnership Agreement.
  - Extend maximum flexibilities to the EAC in relation to services, in recognition of the terms of GATS Article V and the limited levels of development of these countries.

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## ENDNOTES

- 1 World Bank WDI 2005, online available <http://www.worldbank.org>.
- 2 This section is mostly drawn from RTFP (2009)
- 3 This section is drawn mostly from ComSec (2008)
- 4 The "substantial coverage" is qualified by a footnote to GATS Article V:1(a) which states that "agreements should not provide for the a priori exclusion of any mode of supply"
- 5 See Article XIX (2) and Article IV of the GATS
- 6 See Preamble to the GATS

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