

WATER AND THE GATS: MAPPING THE TRADE – DEVELOPMENT INTERFACE

Trade and development were identified as twin goals by the leaders of the G8 nations at the Gleneagles Summit in July 2005. The G8 communiqué looked forward to successful conclusion of the Doha Round of international trade negotiations led by the World Trade Organisation (WTO) as a key vehicle for promoting economic growth and development – including expansion of trade in services under the GATS-General Agreement on Trade in Services.

Yet, in international debates on water policy, liberalisation of services trade, as a means of achieving the water supply and sanitation (WSS) targets under the Millennium Development Goals (MDGs), is contested. Concern is expressed that GATS negotiations may put developing countries under pressure to create markets in water services and open them to foreign operators in conditions and at a pace which will have negative impacts on development, particularly in poorer areas. At Gleneagles the G8 recognised that ‘least developed countries face specific problems in integrating in the international trading system’ and pledged to ‘work to ensure that there is appropriate flexibility in the Doha Development Agenda (DDA) negotiations’ in order to help Least Developed Countries (LDCs) ‘decide, plan and sequence their overall economic reforms in line with their country-led development programmes’.

But this begs the question of how far trade-oriented reforms are consistent with development and specifically ‘pro-poor’ development objectives? If, in relation to water services, pro-trade and pro-development objectives are to be compatible and convergent, it must be possible at a national level to liberalise the market according to GATS principles, or equivalent domestic rules, and to regulate so as to secure (poor) citizens’ access. But is that actually the case? Also, do GATS procedures and rules really allow for flexibility?

Mapping the pro-trade and pro-development interface

There has been little detailed empirical study of how the GATS-development relationship operates in practice, and the water sector provides a topical example with which to consider the relationship between the above twin goals. ODI has recently undertaken a study¹ in South Africa, Mexico and Senegal where existing markets in urban areas offer opportunity for analysis of ‘live’ examples of services liberalisation in the water sector. The study ‘mapped’ the trade-development interface and showed how the inclusion of water services under GATS might affect the achievement of development goals.

The nature of the interaction between trade and development depends on the existence and operation of two major areas of activity – Private Sector Participation (PSP) and Regulation – as illustrated in Figure 1.

The type and level of PSP may vary substantially, from service contracts with limited private sector functions, to full privatisation where both operation and ownership of water infrastructure is passed from the public authorities to private operators.

Modalities of regulation in the water sector are in the process of evolution in many developing countries as public authorities adapt to recent reforms, including adoption of a supervisory role over private service providers.

PSP in Water Services

Since the early 1990s development banks and donors have been supporting promotion of PSP in developing countries as a means of financing WSS service delivery and improving its performance. PSP-sceptics note, however, that subsequent experience of PSP has been mixed and they doubt the benefits which would be achieved by countries (further) opening up their water services to PSP, including foreign participation. A risk is that PSP (both domestic and foreign) may result in higher prices (for cost recovery purposes), forcing the poor and marginalised to buy water at higher rates or leaving them to be provided for by other means (e.g. state provision or stop-gap supplies by water tanker). These are important issues in relation to a basic service whose availability is essential to all, but where market failures have occurred.

The initial enthusiasm surrounding the potential of PSP has been replaced by more sober reassessment of its role; polarisation of debates around PSP was unhelpful, tending to lump together very diverse actors on both sides. The question is not whether, in the abstract, PSP is inherently good or bad, but rather under what local conditions and national contexts different modes of PSP are, or are not, likely to be appropriate.

Regulation of Water Services

Regulation plays a key role in shaping the distribution of costs and benefits of water services. The success of PSP, both domestic and foreign, in improving services depends to a great extent on the adequacy of the local policy environment and the capacity of (often decentralised) authorities to implement new policy guidelines and assume new roles and responsibilities, including partnering with, and regulating, the private sector.

Figure 1: Private Sector Participation (PSP) and Regulation

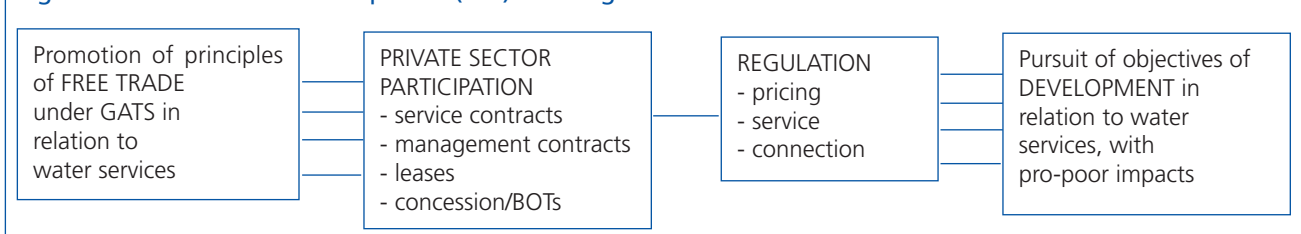


Table 1. PSP in Water Services in the Study Countries

	South Africa	Mexico	Senegal
Approach	Moderate PSP with a handful of large concessions. Cautious and gradualist approach in the face of broad opposition of unions, NGOs, civic groups in townships - effectively constraining liberalisation of water services.	Moderate level of limited PSP in the Federal District (D.F.). The scope for trade in water services is substantially circumscribed by the domestic regime under a policy of gradual introduction of PSP, in an often hostile social and political climate.	Significant level of PSP, although mainly through relatively short-term 'affermage' (lease) contracts which are preferred to longer and broader concessions of responsibility to private operators.
Pricing	National policy requirement to provide 'Free Basic Water' although responsibility for setting tariffs decentralised. Increases in prices and enforcement of cost-recovery among poor communities is controversial, e.g. number of disconnections for non-payment including in the area of 2002 cholera outbreak.	Setting of water tariffs remains in the hands of the State at decentralised levels. The tariff system in D.F. does not differentiate between domestic users and has sought to avoid controversy by setting a low water price for (all) domestic users.	Setting of tariffs remains under State control. Price of water is widely considered to be high (not least due to the geographical situation), although increases have, for social and political reasons, been capped at 3% annually. The existing 'cross-subsidy of WSS services for socially disadvantaged groups' does not cover the poorest parts of the population that depend on communal taps.
Service	Despite notable improvements in some townships, private sector is not expected to meet development objectives in poor areas where there exists rapid urban growth. Long-term concession contracts insufficiently flexible to respond to changing patterns of demand.	Principal service constraints in poor areas in D.F. arise from water resources context in the Valley of Mexico which affects bringing of 'bulk' water supply to D.F., the latter being the responsibility of public authorities.	Interviewees were all positive about the improved quality of water services since PSP, including those poor communities which are served: for example, privatisation of communal water taps is reported to have improved hygiene.
Connection	PSP is considered to have only a limited role in extending basic service provision to 'non-revenue areas', so that such provision remains largely the domain of government. Failure to extend to areas other than those specified in the PSP contract often leads to additional pressure on the existing system and illegal connections.	Decisions to construct new infrastructure are in the hands of public authorities, with private operators working on a fee basis.	An increase in household connection was one of the key aims of the water sector reforms which brought in PSP. It is estimated that 90% of urban population is now served, compared with 80% pre-PSP.

A key lesson from PSP to-date is that more, not less, regulation is needed to ensure that markets in the water sector function efficiently. Negative effects on equity are likely where effective domestic regulation is absent or underdeveloped, as is the starting point in many developing countries.

PSP in the Study Countries

The approach which public authorities in the three study countries have adopted in relation to PSP in water services is summarised in Table 1. In all three cases the conditions of market liberalisation are defined solely by the domestic regime.

Table 1 analyses PSP experience in relation to three issues which are key to achieving the development objective of improved water services for poor populations, namely:

- pricing: while payment for water use is a key economic instrument in water management, water pricing includes design and application of 'social tariffs', i.e. tariff structures which allow differential pricing and include special treatment for poor households;²
- service: improvement of the quality and regularity of water supply to poor households;
- connection: extension of coverage of piped water networks to poor districts and households.

Experience in the three study countries points to some positive results where relatively short-term contracts, with limited functions, have been preferred to longer and broader concessions of responsibility to private operators, but doubts remain as to the role of PSP in extending water provision to poorer areas.

In all three cases, because of social and political sensitivities surrounding water services, PSP has been introduced and applied in a cautious manner in the face of considerable resistance. This confirms a key point relating to water services, namely that their characteristics make them significantly different from many others. Trade specialists note that the services least frequently included by WTO country members

in their GATS commitments to-date are 'social' sectors such as education, health, and water services (sewage and sanitation), as compared with sectors where commitments have been much more common, such as telecommunications, finance and other business services.

As to the international set of principles and procedures for (multilateral) liberalisation of services trade constituted by GATS, in none of the three study countries have commitments been made in relation to water supply. An issue considered by this study was what difference a future commitment to GATS would make, a key research question being whether the 'impulse' of trade liberalisation under GATS would take effect to restrict, or to enhance, promotion of development objectives in relation to water services?

GATS Rules

Trade liberalisation under GATS essentially refers to: (i) the equal market access principle which prohibits limitations in the participation of foreign service providers (and foreign direct investment) unless specifically listed in a country's 'schedule of specific commitments'; and (ii) the national treatment principle whereby governments can elect either to treat foreign services and service suppliers in the same way as domestic services and service suppliers, or include limitations in their commitments to favour the latter. An outline of the GATS negotiating process is set out in Box 1.

Central to the anti-GATS critique are perceived threats to a country's sovereign right to regulate water services, or the alleged transfer of regulatory autonomy from national governments to the WTO. GATS rules do not dictate any specific role for the public and private sectors, and countries are free, in principle, to decide whether and how far to open such sectors to foreign competition. Members therefore have, in theory, flexibility to determine the sector coverage and substantive content of their 'schedules of specific commitments'. The reality of GATS, however, is more complex. While there

is strictly nothing which compels WTO members to open services to negotiation, there is clearly an indirect link between competition-enhancing policies reflected in the GATS (and bound by GATS rules – see the principle on ‘irreversibility’ below) and the likelihood that foreigners will invest. And in trade negotiations, developing countries may come under pressure to meet demands of more powerful WTO Members promoting those ‘foreign’ investment interests and able to exert influence through their aid programmes, i.e. via development channels.

The experience of Senegal is an example of how developing countries have come under influential pressure from donors in the past. In 1995, the World Bank, the French AfD and the German KfW pressed for greater PSP as a precondition for allocating more (and much needed) funding to national water infrastructure. Similarly in South Africa there has also been pressure from other countries to liberalise water services.

Before deciding upon their negotiating position regarding GATS, countries need to assess their strengths and weaknesses in the relevant services sector, including regulation, as well as the potential costs and benefits of liberalising those services – in local conditions. The onus is on the committing country to define clearly the extent and scope of application of GATS in terms which are effective for its own development objectives, including formulating any desired limitations to GATS rules in its schedule of commitments.

Box 1: The GATS negotiation process: requests and offers

Under the GATS negotiating process, individual countries make requests for others to make commitments in specified sectors. Countries then make offers for liberalisation based on the requests they have received.

The request process is bilateral and Members normally submit requests in the form of a letter asking a country to make commitments for a sector or to remove certain market access or national treatment limitations from a sector which has already been scheduled.

Offers can be used to respond to requests, or are made in sectors where a country would like to volunteer liberalisation. Offers take the form of a draft ‘schedule of specific commitments’. Unlike requests, offers are distributed to all Members (via the WTO Secretariat) and are subject to multilateral negotiation. Offers can generate more requests as part of the negotiation process.

Regulatory Space

Another way of expressing the above key research question is whether the regulatory ‘space’³ needed for governments to secure their citizens’ sustainable access to water services is constrained or enhanced by the trade rationale, and in particular by committing to GATS.

Figure 2 (on page 4) highlights factors which currently operate in the water services sector in South Africa and the (pro-poor) development issues which are most relevant to the regulatory authorities. It illustrates that the regulatory space is not at present constrained by GATS principles – because these do not apply – nor by trade principles – because their application is limited.

A similar situation applies in the Federal District of Mexico City which has allowed only gradual introduction of limited PSP, subject to a domestic regime. Interviews suggest that in the capital city, trade and development in water services barely meet; they are (largely) separate worlds and in present circumstances there is little or no interaction, whether compatibility or conflict.

In the three countries the research showed that the most pressing water supply development concerns operative were not in fact trade-related: PSP has proved (at least to-date) to be an insufficient (and in some cases inappropriate) response to the major challenge of the MDGs, namely outreach to poorer, low-revenue areas in LDCs. The reasons why theoretical advantages of PSP have not always been realised in practice are complex, but due largely to a combination of over-optimistic revenue modelling on the part of private sector and a lack of public sector capacity to understand business models and harness them effectively towards public policy objectives.

A key lesson from the experience of liberalisation, alluded to in the G8 communiqué, is sequencing. Problems associated with implementing major concessions in South Africa and Mexico, and elsewhere, point to a ‘crisis of regulation’ resulting from attempts to fast track liberalisation. Public authorities need to ensure adequate regulation is in place before opening up water services to PSP, including foreign access. Developing country municipalities are often ill-equipped to assess the costs and benefits of PSP, negotiate contracts with the private sector and monitor its compliance.

Application of Evolving GATS Rules

Since the purpose of the ongoing Doha Round is to encourage opening of domestic water regimes, the study also explored how the above situation may change – since GATS rules are still evolving: i.e. what GATS rules might take effect to alter the above trade-development configuration in the future?

The 1-page Insert to this Briefing describes five GATS rules and assesses how they might operate in relation to water services. The conclusions of this analysis are that, in four out of the five cases, the development of GATS rules may potentially impinge on domestic autonomy by constraining the regulatory space of public water authorities, so that the circumstances in which each of the four rules will, and will not, apply should be defined in schedules of commitments.

Ongoing social, economic and political transformation in developing countries demands flexibility at all levels of government to vary the level of public and private involvement as appropriate to different steps of development. The GATS principle of ‘irreversibility’ (sometimes also called ‘lock-in’) seems to threaten this freedom. WTO Members can modify their schedules of commitments or withdraw any commitment, but in such circumstances any Member may ask for compensation which, if agreed upon, must be extended to all Members.

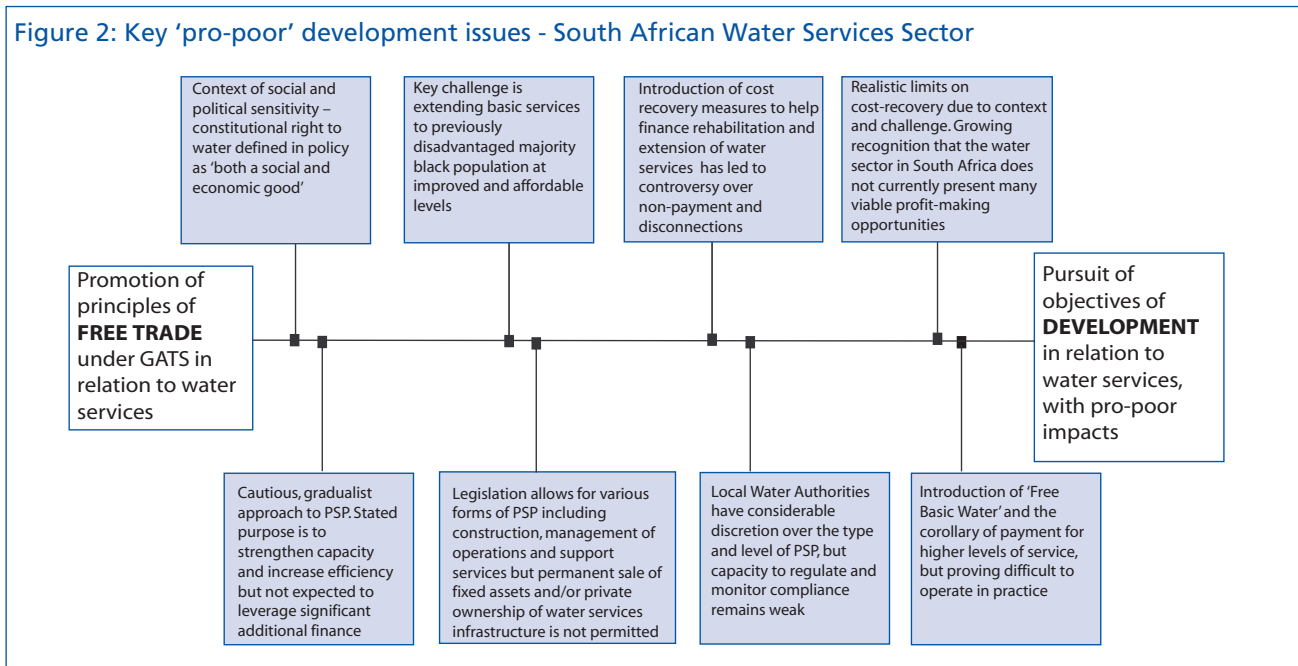
The underlying rationale for this rule is that GATS is designed to provide certainty to private investors. But, surely, for a relationship of confidence to exist, certainty should exist in equal, or at least reasonable, measure in both directions. Such reciprocity is currently in doubt. A key argument of proponents of PSP has been that it would be accompanied by substantial injections of private capital, but an important finding of a (recent) study called ‘PRINWASS’⁴ has been that private sector investment has proved to be much less substantial than expected.

Conclusions

In conclusion, this research highlights the following:

- many of the obstacles to achieving universal water coverage are not in fact trade-related, and the current scope for PSP in developing country markets, especially in poorer ‘non revenue’ areas, is in practice rather limited. This combination of factors means that there is little or no interaction (whether compatibility or conflict) between trade and development in

Figure 2: Key 'pro-poor' development issues - South African Water Services Sector



water services in the study countries;

- GATS rules currently represent a 'moving target' so that making of future GATS commitments in relation to water services involves uncertainty; there are some legitimate concerns that GATS rules might restrict the policy-making autonomy of national government, or disenfranchise progressively decentralised local governments by 'locking in' a particular set of policy choices;
- if alignment of trade-oriented reforms and development objectives is to be achieved in developing countries, a gradual approach to making market access and national treatment commitments in the water sector is advisable; regulatory authorities in developing countries which have little experience of PSP and GATS will not be able to regulate for things they do not (or cannot) foresee; a cautious step-by-step approach to making GATS commitments will increase the likelihood of anticipating correctly how they will take effect;
- the exchanges during this project, between trade and water specialists, have revealed the extent of dialogue and learning required at the GATS-water sector interface. Trade officials need to familiarise themselves with the special features of the water sector. Water officials need to build up their understanding of the content of the different GATS rules and how they are interpreted internationally under WTO procedures/auspices;
- GATS presents a particular capacity challenge for developing countries, not least their ability to negotiate GATS commitments effectively with other WTO Members.

income households [i.e. through alternative measures of 'income support'], tariff structuring is increasingly seen as a promising approach to helping those who cannot meet their most basic needs, while also reconciling environmental and affordability objectives.

3. As expressed in Mehta L. & Madsen B. (2005), 'Is the WTO after your water? GATS and poor people's right to water', *Natural Resources Forum* 29 (2005) 154-164.
4. The EU-sponsored PRINWASS survey of PSP covered 17 cities in nine countries in Africa, Europe and Latin America including both 'mature' cases of 10-15 years of PSP, 'intermediate' cases of 5-9 years of PSP and one 'incipient' case of 1 year of PSP only. The research team noted 'a consistent pattern' of very low or zero contributions of 'fresh capital' from the private operator's own capital, with revenues constituting by far the major source of funding supplemented by loans - and state subsidies (page 47 & 48). Page 50: 'The examples investigated by the PRINWASS team tend to disprove the claim that PSP contributes to the financial relief of the public sector. The evidence suggests that... WSS utilities continue to rely on public funding whether through direct subsidies or other finance'. In other words, this study has indicated that earlier projected levels of private investment in the water sector have, to-date at least, proved overly optimistic.

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Endnotes

1. This ODI study has been sponsored by the European Union (EU) under the DFID-funded EC PREP programme. The question posed was as follows: how are the 'pro-trade' and 'pro-development' objectives of EU policy in relation to the water sector consistent and coherent (if at all)? For the three longer reports of the findings of this study, including a case study of Mexico, see www.odi.org.uk/wpp/publications.
2. As a recent OECD study notes ('Social Issues in the Provision and Pricing of Water Services', OECD Paris, 2003, page 70): 'Where governments are unwilling or unable to offer financial relief to low-



Water and the GATS: application of GATS rules

The following question is raised in the accompanying Briefing Paper: How might GATS rules take effect to constrain, or enhance, the regulatory ‘space’ of government in relation to water services?

The following is a description, in outline, of five GATS rules, with an assessment of how they might take effect in the water supply sector – as summarised in the Table. This issue is pertinent to decisions by individual WTO Members as to how they draw up their ‘schedules of specific commitments’ under GATS.

The different ways commitments may be entered in those schedules are:-

- an entry of ‘none’ indicates that a Member is bound to not having or introducing any measures which restrict market access or national treatment for a sector;
- the term ‘unbound’ indicates that no commitment has been made and the Member is free to introduce market access and national treatment limitations as it chooses;
- all other entries which include commitments with limitations are known as ‘partial commitments’.

Under the GATS system, each country determines which GATS rules are likely to be conducive to its development objectives and formulates its commitments accordingly. Once partial commitments

have been entered, no additional measures restricting market access or national treatment may be introduced.

Subsidies

Although the basic rules for liberalisation of services trade via GATS were agreed during the Uruguay Round, a number of issues remained unresolved and were left for the Doha Round of the GATS negotiations, from 2000 onwards (and ongoing). For example, GATS envisages the development of rules on subsidies to eliminate trade-distorting effects which are under discussion in the current GATS 2000 negotiations. The question arises: how might water pricing subsidies be ‘trade-distorting’?

GATS sceptics are concerned that in key social sectors, such as water, GATS might constrain policymakers in providing consumer subsidies. The conclusion of this study is, however, that it is unlikely that the development of any rules on subsidies under the GATS will constrain their use in the water sector as consumer subsidies forming part of social tariffs.

First, within the GATS, subsidies are considered as ‘measures’ for which Most-favoured-nation (MFN) obligations apply and national treatment is applicable only to the extent that a GATS Member has listed a sector in its specific schedule of commitments. Most WTO Members have included limitations on national treatment that apply to all subsidies, while others (Canada, EU, Japan and US) have done so with respect to specific modes of supply and specific services sectors. Second, guidance on the subsidies issue can be taken from the WTO’s Agreement on Subsidies and Countervailing Measures (SCM). The WTO rules only concern firm- or industry-specific subsidies not economy-wide ones (e.g. subsidies for poor consumers) which are assumed not to distort trade. Subsidies are considered to be economy-wide if eligibility is determined by objective criteria, not conditional on export performance or the use of domestic inputs, and not limited to a firm or industry within a geographic region.

So, a scheme such as South Africa’s policy commitment to provide ‘Free Basic Water’ would probably not be impeded.

Irreversibility

GATS also includes a principle of irreversibility. WTO Members can modify their schedules of specific commitments or withdraw any commitment, but

Will GATS rules constrain water policy options?	
GATS Rule relating to	Status
Subsidies	WTO rules under GATS are likely to apply to firm- or industry-specific not economy-wide subsidies, i.e. not to subsidies for (poor) water consumers.
Irreversibility	Each country’s ‘schedule of commitments’ must explicitly define the circumstances in which the rule will not apply.
‘Unnecessary’ barrier to trade	<i>as above</i>
Competitive Bidding	<i>as above</i> Not clear if participation in bidding processes for PSP contracts are or are not included under GATS as ‘government procurement’.
Governmental Authority	Technically services supplied ‘in the exercise of governmental authority’ are excluded from GATS, but it is not clear whether or not that applies to water services under PSP concessions.

in such circumstances any Member may ask for compensation which, if agreed upon, must be extended to all Members. The rationale is that GATS is designed to provide certainty to private investors. So, another GATS issue is how the rule on 'irreversibility' may constrain (or enhance) the regulatory space of public water authorities?

In South Africa, for example, the process of sector reform is very much ongoing and the appropriate role of PSP in relation to social and developmental policy objectives remains undecided. If, at the end of a 25 year concession involving a substantial delegation of functions to the private sector, the public authority decided, for whatever reason, it wanted to go back to a contract with a lesser delegation of functions, would it be entitled to reduce, to return, functions delegated to PSP without paying compensation?

The answer seems to be that, if a GATS commitment had been made in the water sector with no specific limitations stipulating that freedom to reduce/return was being retained, then compensation would need to be paid (if challenged).

'Unnecessary' Barriers to Trade

Among the weakest and most undeveloped elements of GATS are the specific obligations under Article VI that domestic regulatory measures affecting services trade must be administered 'reasonably', 'objectively' and 'impartially' and should not constitute 'unnecessary' barriers to trade (unintentionally or as disguised protectionism). The reference to 'necessary' disciplines has promoted concern that WTO panels would interpret this as 'least trade restrictive'.

Since the application of these concepts will depend on future clarification, in the meantime countries will be well advised to explicitly define in their 'schedule of commitments' how they consider the rule should apply.

Competitive Bidding

A related issue is whether the right to participate in the bidding process for concession contracts amounts to granting market access, or if these would fall within the remit of government procurement (and so be excluded). This issue is potentially significant since

countries are often reluctant to reopen competitive bidding processes when a contract expires. In both Mexico and Senegal, for example, water concessions have been renewed with existing incumbents without recourse to competitive bidding processes. Such decisions are often taken when there is overall satisfaction with the performance of existing service providers, short durations of renewals and a desire to reduce transaction costs.

'Governmental Authority'

An important element in the debate is that services supplied in the exercise of governmental authority are excluded from the scope of the GATS (Article 1:3). In the case of water services, the question arises as to the extent to which water services provided by the private sector operating under concessions could be excluded as essential government services. The degree of government funding varies across countries, depending on social and political preferences over the role of the state in their provision.

Note

The participation of foreign companies in the provision of water services has raised an additional controversy – the fear that a national asset will be vulnerable under foreign influence and control. For example, under the national Water Law in Mexico (passed in April 2004), and as established by the Mexican constitution (Article 27), water is the property of the nation, a public resource. According to Article XXVIII 'supply of a service' includes the production, distribution, marketing, sale and delivery of a service and potentially, therefore, the control of the resource. Technically ownership of a natural resource is excluded from the scope of the GATS, but in practice the issue is complicated by the fact that water is a natural monopoly and water operators, including private companies, cannot provide a service without adequate access to the resource being guaranteed. Collection is certain to include the water source, and could lead to establishment of control (if not 'ownership'). In other words, on the ground, the distinction between access to water delivery services and access to the resource itself may not be as easily demarcated as some trade commentators presume.

For fuller discussion of the above GATS rules, see section 9.5 of the long Report of the findings of this study: www.odi.org.uk/wpp/publications/