BMZ Federal Ministry for Economic Cooperation and Development

The Trade Perspective in Services Regulation Workshop

23th – 25th October 2013

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The Trade Perspective in Services Regulation Workshop

23th – 25th October 2013

Mandela Institute, School of Law, University of Witwatersrand Johannesburg, South Africa

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Foreword

by Leonor von Limburg

There is hardly an event on trade in services that does not conclude that bottlenecks in regulatory capacities are significant barriers for more meaningful trade liberalization in developing countries. This is not surprising given that trade in services liberalization is basically a process of domestic regulatory reform, and a sensitive one. At the same time, services regulators often criticize the pace and scope of regulatory demands deriving from services trade agreements, some of which are not quite foreseen at the onset of negotiations.

This makes evident that, besides building capacities to regulate services or to negotiate services trade agreements, what is needed is a better common understanding of these two sides of a coin. Trade policy makers and regulators have after all common objectives: to improve upon the provision of services and to maximize the leverage that services sectors can bring for development. When liberalizing services sectors governments are usually seeking to improve upon their efficiency, access and coverage. An adequate regulatory framework is a necessary prerequisite to achieve this goal. Trade in services negotiations often provide a good opportunity to revise and improve upon existing regulation.

GIZ, on behalf of the German Federal Ministry for Economic Cooperation and Development, organized this workshop in South Africa with the intention of bringing together trade in services negotiators and services regulators from East and South Africa. Although negotiators and regulators in the region communicate sporadically, this is done mostly ad-hoc and around negotiation deadlines. A more systematic form of cooperation and networking seemed necessary to promote a better mutual understanding.

The initiative was highly welcomed. Besides providing a platform for more productive networking, the workshop served to highlight the interplay between liberalization and regulation in services. The fact that there are often (albeit not always) alternatives – some more trade restrictive than others – to achieve key regulatory objectives was discussed from the perspective of two different sectors: financial and transport services. A methodology to conduct a regulatory audit was introduced. New developments around trade in service liberalization were debated, such as the plurilateral Trade in Services Agreement (TISA) and the WTO initiative to allow for unilateral preferences for services providers from least developed countries.

We want to thank all the very engaged participants and trust to keep on working closely together in realizing the potential in services sectors.

Programme of the Workshop

Wed, Oct 23th	
12:00 – 14:00	Arrival and registration
14:00 – 14:30	**Opening and welcoming remarks** Prof. Marylyn Christianson, Acting Director, Mandela Institute – Witwatersrand University and Anja Gomm, Head GIZ Sector Project Trade Policy
14:30 – 16:00	**Session 1: Setting the scene – Regulating services across borders** Regulators often have a choice of instruments to attain their legitimate policy goals. Some are more trade restrictive than others. In some cases priorities need to be established among potentially conflicting policy objectives. The session was dedicated to review key policy objectives of regulation, analyze typical instruments of economic regulation including network regulation, discuss what the potential conflicts are and reflect on when and how minimizing trade restrictions contributes to attaining those objectives and to strengthening services sectors. The aim is to allow regulators and negotiators to see trade agreements as an opportunity for regulatory reform rather than instruments of unregulated liberalization and market opening. Speakers: Prof. Pierre Sauvé, World Trade Institute, University of Bern and Prof. Markus Krajewski, Erlangen-Nuernberg University
16:00 – 16:30	Coffee break
16:30 – 18:00	**Section 2: Conducting a regulatory audit – Introducing a methodology** Regulatory audits help not only to have a better understanding of the institutional and regulatory landscape of a sector, and are hence a first step to optimize it, but also help to systematically evaluate the potential benefits and risks of services trade liberalization and the concomitant changes to domestic regulatory practices that may come in its wake. The session introduced a simple methodology to conduct a trade-related regulatory audit in service industries and discuss the good governance and other uses to which the preparation of such an audit may be put. Participants were asked to perform an exercise analyzing regulatory measures applying in a specific sector in their country or in a country they could be potentially negotiating with. Lecturer: Prof. Pierre Sauvé
18:00 – 21:00	Networking Cocktails & Dinner

Thu, Oct 24th	
09:00 – 10:45	**Session 3: Regulatory audit – Guided group work and debriefing** Participants were guided by Prof. Sauvé and Prof. Krajewski on the regulatory audit methodology introduced in the previous session.
10:45 – 11:15	Coffee break
11:15 – 13:00	**Session 4: Presentations and discussion of guided group work** Participants presented and discussed with the group the results of the guided exercise on conducting a trade-related regulatory audit in service industries.
13:00 – 14:30	Lunch
14:30 – 16:00	**Session 5: Frontiers of Regulation Part 1 – Financial Services** History has shown that lessons from financial crises are rapidly forgotten once recovery sets-in. This session explored the role of effective pro-competitive, regulatory frameworks in safeguarding financial market stability and user interests. The session also explored whether and how the recent crisis and its regulator fallout affect the case for continued trade and investment liberalization in financial services. In particular, the impact of existing rules on financial services trade (Annex on Financial Services, Understanding on Commitments and similar provisions found in many preferential trade agreements) on regulatory reform in financial services were analyzed and critically discussed. Speaker/Discussant: Raul Saez Contreras, Interamerican Development Bank Sudhir Sooklal, Department Trade & Industry South Africa Matthew Stern, DNA Economics Moderators: Pierre Sauvé & Markus Krajewski
16:00 – 16:30	Coffee break
16:30 – 17:30	**Session 6: Discussion on Financial Market Regulation**
18:00 – 19:00	Networking Cocktail
19:30 – 21:00	Dinner & Keynote Address: Competition Policy in Service Sectors – Prof. David Unterhalter, Witwatersrand University

Fri, Oct 25th	
09:00 – 10:45	**Session 7: Frontiers of Regulation Part II – Transport Services** Infrastructure reform since the 90s has been designed along three main axes: introduction of competition, promotion of private sector participation and separation of regulation from service provision and sector policies. Greater efficiency in the provision of services and infrastructure can be seen as the common objectives behind these elements. These elements of infrastructure regulation are particularly relevant in the case of transport. Transport costs are a substantial part of trade costs, in many cases higher than tariffs. This session explored the way in which regulators in the sector use entry, tariffs, quality, investment and access to ensure their objectives and how different trade-offs affect the choice of an optimal instrument mix. Speaker/Discussant: Martin Rodriguez Pardina, Macroconsulting Demetria Mudenda, Road Transport and Safety Agency Matthew Stern
10:45 – 11:15	Coffee break
11:15 – 12:30	**Session 8: New developments in services trade and their regulatory implications** Despite the stalled Doha Development Agenda negotiations which have curtailed forward movement under the GATS, the services (both liberalization and rule-making) agenda is moving forward in different parts of the world and in various institutional settings. A large number of preferential agreements covering services are being negotiated. These include, but are not limited to, efforts at deeper services market integration in various regions in African (EAC, COMESA, SADC, etc.), as well, on the external front, ongoing discussions towards the conclusion of Economic Partnership Agreements with the European Union or the newly launched talks on a US-EU Transatlantic Trade and Investment Partnership (TTIP). Meanwhile, a plurilateral Trade in Services Agreement (TISA) among countries that account for close to 70% of global services flows is moving ahead. This session reviewed these initiatives; the advances made in them (or the lack thereof) and discussed their implications. Discussants: Pierre Sauvé, Markus Krajewski, Raul Saez, Martin Rodriguez Pardina and Matthew Stern
12:30 – 14:00	Lunch
14:30 – 16:00	**Session 9: Looking Ahead – A view from the Region** Closing panel discussion involving selected speakers on what they consider their forward looking priorities in services regulation and market opening.
16:00 – 16:15	**Closing** – Prof. Tumai Murombo, Witwatersrand University and Anja Gomm

Summary of the Workshop

by Johannes Schwarzer

Background

It has long been recognized that service sector development plays a key role for the functioning of the broader economy. Inefficient provision of key services such as transport, telecommunications and financial services are major obstacles to economic growth in developing countries. Often, the underlying cause of such underperformance is inefficient regulation.

Technological developments and greater international economic interconnectivity have significantly altered the landscape in which service sector regulators operate. On the one hand, many previously untradeable services are today being imported from foreign providers. On the other hand – and consequentially – international trade negotiations increasingly deal with services. As a result, the work of service sector regulators (domestic) and trade negotiators (international) increasingly interacts with one another, often in the absence of explicit and informed communication between them.

The workshop brought together trade negotiators and regulators from the East and Southern African subregions to shed light on this interplay. Through a combination of lectures and workshops, participants were introduced to the regulatory audit methodology to identify potentially non-conforming regulatory measures in their countries and the policy rationales underpinning them and to learn about best practice regulatory approaches in finance and transportation. The workshop aimed at proposing sensible steps forward to improve capacities and networking in the area of services regulation and trade.

Outcomes of the workshop

The workshop proceeded in three stages. The first stage provided participants with a comprehensive background on the interaction between international trade negotiations, agreements and domestic service regulation. The regulatory audit methodology was introduced and later applied to identify potentially non-conforming domestic regulatory measures, discuss the likely policy goals to be achieved by the measure in question and propose, where available, alternative, less trade- or investment-restrictive measures to achieve the same objective. The second stage involved in-depth discussions on best regulatory practices in the financial and transport sector, both internationally and in the regional context. The third stage centered on new developments in services trade and their regulatory implications, as well as next steps to tackle the resulting challenges.

First stage
In the first stage, Professors Krajewski and Sauvé set the scene for the workshop, recalling the objectives and instruments of regulation, as well as their interplay with provisions to be found in major services trade agreements such as the WTO General Agreement on Trade in Services (GATS) and key preferential trade agreements covering services. The session underlined that services trade negotiations – by their very nature – necessarily deal with domestic services regulation and should hence be viewed as an opportunity for countries to benchmark and review their existing regulatory regimes. Such a review can be undertaken using the regulatory audit methodology, which implies a thorough inventory of existing and potentially non-conforming regulatory measures. The identified measures should be discussed along a set of guiding questions pertaining to relevant characteristics (such as e.g. whether they are the least trade restrictive form of achieving a certain policy goal) and can finally be ranked in terms of their desirability for each country. Such an exercise has multiple benefits, including better insight on the alignment of the regulatory regime with policy objectives, helping define a clearer services trade negotiation agenda and fostering communication between trade negotiators and the relevant sectoral regulators, rationalizing and aligning both trade and domestic regulatory policy. Participants were then given the opportunity to perform such a regulatory audit in small groups, identifying a range of trade- or investment-restrictive measures across Sub-Saharan Africa in sectors like finance, transport and energy, with the bulk of measures being restrictions on foreign ownership.

Second stage

The second stage kicked off with a presentation by Dr. Raul Saez on frontiers in financial service regulation. Dr. Saez used the case of Chile to illustrate benefits and risks associated with financial market liberalization and stressed the need to have a solid regulatory structure in place, with credible financial regulators whose roles are clearly defined, before any liberalization should take place. Dr. Saez also pointed out a few best practices, notably that countries should allow the operation of foreign-owned financial institutions through establishment in domestic markets under host-country regulation. Countries should also not discriminate between foreign-owned and domestically-owned institutions, when under similar (like) circumstances, refrain from quantitative restrictions on the number of providers and establish clear and objective criteria for licensing, in particular fit-and-proper tests, and eliminating "economic necessity" tests. Dr. Saez further pointed out that developing countries should be conscious of retaining policy space with respect to the (temporary) enactment of short-term capital controls for balance of payments purposes when engaging in negotiations on financial service liberalization. Dr. Saez did not believe that new financial services pose an inherent threat to developing countries. He recalled that while innovations in securitization and derivatives were responsible for the 2008 financial crisis in developed economies, the crisis spread to the developing world only through resulting reduced liquidity shocks, which could only be managed through appropriate supervision and regulation of financial institutions operating in the domestic market. The subsequent discussion focused on the state of financial regulation in SADC countries. In his discussion of Dr. Saez's presentation, Dr. Matthew Stern noted that across SADC countries access to finance remained extremely low, while the cost of banking was unusually high. To broaden access to financial services in SADC would seem to require the entry of more innovative financial service providers and products able to reach poor and disparate consumers at reasonable cost. He suggested that the removal of restrictions on cross-border trade in financial services should be of top priority in regional services trade negotiations, since most countries had already a quite liberal stance on foreign ownership of financial institutions. Mr. Sudhir Sooklal picked up on the high costs of banking in South Africa and emphasized that credit is increasingly being provided by non-financial institutions that operate in an unregulated market. He considered the risks this represents in terms of market stability to be of major concern and also mentioned that – from a SADC perspective – the payments system was unduly cumbersome and expensive, needing urgent reform.

Dr. Martin Pardina highlighted the important role of transport on economic growth and pointed out that Sub-Saharan Africa and SADC fared quite poorly in international comparisons in terms of quality of infrastructure, costs and logistics performance indices. Although some progress has been made in transport regulation in the region in recent years, daunting challenges lie ahead. Regulatory regimes in Africa confront, as in many other countries, the challenge of finding a proper balance that squares incentives for cost minimization with the objective of economic sustainability of enterprises. The subsequent discussion focused on solutions to tackle the challenges arising in the SADC region's transport sector. Ms. Demetria Hatoongo-Mudenda examined road transport liberalization under the SADC legal regulatory framework. She observed that while several initiatives had been pursued to liberalize road transportation in SADC, there still existed a number of barriers to the free entry of foreign operators into the regional market. She suggested that effective service sector liberalization could address some of the challenges faced in the transport sector in the SADC region such as high transport costs and fragmented markets. Negotiations within the SADC Trade in Services Protocol should center on the harmonization of standards and the adoption of transparent rules for cross-cutting issues that affect cross-border road transport operations in the region for visa issuance, security rules or insurance regulation. In his comment, Dr. Matthew Stern pointed out that intra-regional transport costs were particularly problematic, which made that it is easier for African countries to trade with the rest of the world rather than between themselves. Numerous agreements exist at different levels to harmonize specific standards and regulations, but implementation at the national levels has been and remains weak.

Third stage

The third stage of the workshop kicked off with a presentation by Prof. Krajewski on new developments in services trade. Professor Krajewski presented the current state of the negotiations on the Trade in Services Agreement (TiSA), as well as its history and the rationale for it. He pointed out that while being a preferential trade agreement negotiated outside the WTO, it will still compete with GATS, which has both advantages and disadvantages. On the one hand, it may provide for the necessary momentum to achieve a universal agreement. On the other hand, countries not involved in the negotiations (e.g. all African countries and the majority of other WTO Members) are likely to find themselves sooner or later confronted to the possible need of adhering to an agreement negotiated by others. Mr. Krajewski also briefly touched upon the recent Transatlantic Trade and Investment Partnership (TTIP), launched in July 2013 between the EU and the US.

Mr. Julian Mukiibi presented details on the LDC waiver for services, an enabling clause for services to be made available for LDC members of the WTO established through a Ministerial decision in 2011. Mr. Mukiibi's observation that not a single WTO Member had to date made use of the waiver sparked a vivid debate among the participants over the reasons for such inertia. Mr. Mukiibi argued that it was chiefly a question of trade facilitation and capacity building, as LDCs need to better understand the services sector in order to be able to formulate specific, development-enhancing requests in areas of export interest. Others found that the waiver was of no real value for LDCs, because LDC service providers tend to be more interested in regional markets. The mode of supplying services of primary interest to most LDCs would be Mode 4 (temporary movement of natural persons), which is a form of trade that developed countries (and perhaps more advanced developing countries as well) were generally unwilling to liberalize. Still others disagreed with this latter view and pointed to the EU CARIFORUM EPA, where an innovative agreement on Mode 4 issues has been found, albeit not in an explicit LDC context per se and on a bilateral basis. In this vein, African LDCs would need to be more specific in their requests for Mode 4 liberalization, since developed economies are less likely to liberalize the temporary movement of natural persons across the board.

In a closing session, participants were asked to provide feedback and to reflect on what should follow from this workshop. In general, participants were very pleased with the format and content of the workshop. The regulatory audit exercise and the presentations on the financial and the transport sector were considered useful across the board and especially regulators used the term “eye-opening” several times when referring to the trade dimension that was conveyed in this workshop. Several regulators noted that they have been increasingly confronted with trade-related issues in the recent past, but lacked sufficient understanding to clearly see links with their work. On the other hand, trade negotiators mentioned that their frustration has traditionally been the lack of implementation of negotiated outcomes in their countries. Their hope was that this workshop setup would help build greater awareness on the crucial importance of implementation in trade policy formulation. Participants were divided on the ideal sectoral focus of the workshop. A number of participants found the intersectoral nature of the discussions very enriching, pointing out that a number of regulatory issues actually involve the need for regulatory dialogue and collaboration across sectors (e.g. transport and insurance). Nevertheless, it was recognized that deeper sectoral focus could enhance the quality of discussions and involve a more knowledgeable target group of participants. One proposal was to define sectors in a broader way that covers more substantive ground than traditional sectoral definitions (e.g. mobile banking instead of telecommunications and finance). Other suggestions concerned focusing on regional value chains or transportation corridors. With respect to the geographic scope of such workshops, participants tended to agree on the need to pursue the dialogue first on the national and perhaps even sectoral level. Then, once the links with other sectors and countries have been identified, such discussions could be expanded. Regarding the target group of possible future workshops, many participants felt that other stakeholders should also be invited to participate. Regulators in particular felt that policy and law makers needed to be more centrally involved in these discussions. Moreover, some participants suggested that service providers (industry associations) should be better represented, as they are the ones faced with the barriers in practice. Finally, participants enjoyed the networking opportunity and found it very useful to have contact points in different institutions across countries.

Opening Session: Background

by Anja Gomm

The importance of the services sector for development has long been recognized. Services are essential in countless economic activities and determinants of productivity and competitiveness. Efficient transport, telecommunication and financial services are known to promote economic growth. Beyond their indirect contribution to development via economic growth, efficient services directly contribute to improving living standards. Better access to basic services such as health, education, water and energy is thus at the core of the poverty reduction agenda.

Services trade is growing around the globe. A number of developing countries are increasingly exporting services in sectors other than tourism and transport, their traditional strongholds, and moving up in services value chains in fields such as business professional and medical services, among others. Well regulated, open services markets should foster competition and enable the large investments required to upgrade many sectors, especially in infrastructure. Although further liberalization of trade in services remains high in the international agenda, there has been limited progress in services negotiations. Concerns among developing countries about their ability to comply with regulatory demands in services agreements, are among the reasons for this lack of progress.

Opening services sectors to foreign providers may require important adjustments in domestic regulation. Since access to services is such an important and sensitive issue, regulators need to strike a balance between opening markets to attract efficiency-triggering competition and crafting an appropriate legal framework to ensure universal access and fair pricing.

Although trade policy makers and services regulators in many African countries sporadically communicate, there is rarely systematic networking between them in the region. Trade negotiators are often not fully aware of the regulatory implications of trade agreements. Regulators in turn, do not always fully take into account the potential of services trade liberalization in reaching their ultimate goal of improving services provision. Opening services markets can only contribute to development if aligned with other policies and oriented not only to promoting services exports but to improving services supply through the presence of effectively regulated foreign providers.

GIZ, on behalf of the Federal Ministry for Economic Cooperation and Development (BMZ), organized this event to provide the opportunity to discuss these issues, bring together trade policy makers and regulating authorities on a regional basis, and propose sensible steps forward to improve capacities and networking in the area of services regulation and trade.

Session 1: Setting the scene – Regulating services across borders

by Pierre Sauvé and Markus Krajewski

1. Introduction

The lack of mutual consultation at the interface of service liberalization and domestic regulation is paradoxical, as services negotiations and reforms really are all about domestic regulation. Unlike for goods, international services flows do not face tariffs or other impediments at the border. In fact, borders are often immaterial to services flows. Hence negotiations in services are more to be likened to negotiations of non-tariff barriers to trade or behind-the-border impediments in goods.

Experience tells us that regulatory issues are very hard to tackle and negotiations are slow moving affairs. This has several reasons. For once, regulatory issues are subject to complex political economy and governments are good at finding alternative ways of protecting vested interests. Second, regulation is deeply rooted in country-specific contexts like geography, history, religion, culture, attitudes towards risk and uncertainty, etc. Third, regulation is very complex as it responds to various types of market failures specific to very heterogeneous service sub-sectors.

As such, there is no one-size-fits-all approach to regulation, both across sectors and across countries. Such domestic and sectoral heterogeneity can run counter to the traditional DNA of trade agreements, which tend to push towards more universal, horizontal approaches. This is true for negotiations on the global level, but also holds for regional arrangements and perhaps the European Union is the only construct that has found some balance in this matter through a complex set of institutions.

In any case, services liberalization rarely occurs at negotiation tables. Most agreements consolidate recently enacted domestic reforms, while the commitments countries took under the General Agreement on Trade in Services (GATS) often offer less than the regulatory status quo, such that they have little impact on domestic conduct. Trade agreements rarely are as powerful drivers of domestic reform as we like to think. Change in domestic regulation occurs more from autonomous decisions to liberalize. So it is only after that that negotiation will happen such a sequence needs to be kept in mind. Nevertheless, negotiations offer a good opportunity for countries to revaluate the status of domestic regulation.

Hence, this workshop aims to look at trade agreements through a regulator's lens and also to look at regulation through a trade negotiator's lens, so as to improve mutual understanding about regulation and trade in services and thereby enable better services regulation and more informed trade negotiations.

2. Three presumptions on trade in services negotiations and services regulation

First, agreements about liberalizing services trade are really agreements about services regulation and are hence fundamentally different than traditional agreements on trade in goods. This is because barriers to trade often come in the form of restrictive services regulations, which trade agreements will seek to remove or prevent for the future. Second, the actual impact of liberalization commitments in services trade on investment and growth of services trade is empirically unclear. On the one hand, the lack of such an empirical link may be explained by the relative dearth of available data on services trade, but it may as well be that gains from trade agreements in services are simply overstated. Nevertheless, the third presumption posits that trade agreements in services still play a vital role in service sector performance by providing a template for good regulation. Regulatory standards usually found in trade agreements, such as objectivity, impartiality, transparency requirements etc. benefit foreign and domestic providers alike. Therefore, the potential of trade negotiations to reassess current regulatory practices should not be underestimated as they provide an opportunity to have a fresh look the adequacy of the current regulatory regime, in terms of meeting policy objectives as well as their efficiency and sufficiency in doing so.

3. Objectives of regulation

We will define regulation as the process of influencing, controlling and guiding economic activities through various instruments in pursuit of different policies. With this definition in mind, the objectives of regulation can roughly be divided into economic and non-economic goals. Economic goals include the correction of various market failures. A classic example of such a market failure is the case of a monopolistic or oligopolistic market structure. Whenever there is excessive concentration of economic activity in a certain market, regulatory goals include e.g. price regulation, the prevention of abuse of dominant positions and ensuring universal access to the relevant service in question. But market failures can also arise in the presence of externalities. Whenever the social costs of an economic activity are higher than the private costs accruing to the provider, the objective of regulation is to internalize these costs. Conversely, positive externalities imply that social benefits are higher than private ones, which leads to underprovision of a socially beneficial public good. In this case, it becomes the government's task to provide such a good. Another market failure that is particularly relevant to the services sector is the case of information deficits and asymmetries. Such market failures are particularly frequent in financial and professional services, where either consumers a priori cannot accurately assess the quality of the service provider, or service providers cannot a priori assess e.g. the solvability of the client. Further economic objectives include reducing transaction costs, addressing coordination problems (e.g. when investments becomes profitable only when a number of independent agents chose to invest), as well as macroeconomic goals such as economic growth, monetary stability, employment and regional development. Of course regulatory objectives can also be non-economic in nature and pursue social goals (income distribution, universal access to certain services, consumer and workers' protection), community goals (cultural diversity, biodiversity) as well as strategic interests (energy security).

4. Instruments of regulations

Governments have a number of regulatory instruments at their disposal, which can be to some extent ranked according to the level of government intervention. Economic incentives such as subsidies, grants, taxes and charges (as well as tax breaks), as well as government procurement practices are widely regarded to be the least intrusive instruments governments may employ for regulatory purposes. Behavioural control mechanisms present a stronger form of government intervention as they influence market mechanisms more immediately. An example of such a behavioural control measure are various types of standards, which usually define requirements a supplier must fulfil to operate legally. Price controls also fall under this category and so do measures that regulate information, such as labelling and mandatory disclosure requirements. The most interventionist form of regulatory instruments comes in the form of entry controls, which determine who is allowed to provide a certain service. Such controls can be qualitative, such as when prior approvals to provide a service are based e.g. on a certain level of education or on demonstrated skills or knowledge. But there can also be quantitative limitations to entry, regulated by a limited number of licenses that governments give out to operators. An extreme case of a quantitative entry control is a public monopoly.

5. Juxtaposing regulatory instruments and principles of services trade agreements

Economic incentives are typically not subject to specific obligations in traditional services agreements as long as they are applied in a non-discriminatory manner, as they would not violate national treatment or most favoured nation treatment obligations. Non-discriminatory subsidies may nevertheless have a trade-distortive effect and hence there is a mandate to negotiate disciplines on such subsidies in article XV GATS. Article XIII GATS mandates "negotiations on government procurement in services", which is an area hitherto mostly absent in traditional agreements on trade in services. Recently negotiated PTAs, such as the EU-Canada free trade agreement, include government procurement and more generally, public procurement in services is also subject to the plurilateral Agreement on Government Procurement.

Behavioural control measures, even if non-discriminatory, may be subject to disciplines on domestic regulation under Article VI GATS. These include technical standards, which would cover all types of behavioural regulation. In this context, the central question will be whether the measures are too burdensome or more trade-restrictive than necessary. In addition, transparency requirements may be applicable.

Entry controls, when qualitative, can be subject to disciplines on domestic regulation as these cover licensing requirements and qualification requirements. Issues of burdensomeness or trade-restrictiveness as well as transparency would also be relevant in this context. It should be noted that a restriction based on qualitative aspects, i.e. aspects, which can be fulfilled by most, if not all, economic actors, seems in any event less burdensome than quantitative restrictions. Quantitative entry controls are subject to typical market access requirements (e.g. Article XVI GATS). Monopolies, exclusive service suppliers, economic needs tests and quotas are usually prohibited in services trade agreements unless exceptions are allowed.

In general, the level of trade-restrictiveness coincides with the degree of government intervention. As a consequence, measures with a lower degree of intervention are less likely to violate the principles of the trade agreement. This is why assessing regulatory measures in the light of these principles may also help governments to perform regulatory audits and decide which regulatory instruments are most suitable for their respective policy objectives.

Session 2: Conducting a trade-related regulatory audit in services

by Pierre Sauvé

1. Introduction

Trade agreements offer important moments to take stock of a country's regulatory infrastructure and to benchmark domestic regulatory practices, to benchmark enforcement cultures, to identify gaps in regulation that will need to be addressed and that should be a part of the calculus of what countries are prepared to negotiate on and to commit to. Doing an audit is a periodic exercise that with or without a trade negotiation should be something countries engage in. The very design of domestic regulation should be made in such a way as to make necessary the periodic revision of laws and regulations. E.g. in Canada there are sunset clauses in most federal laws. They expire after a given period of time and the prospect of a regulatory regime expiring is a very scary prospect for economic agents who need certainty, who need to know what the rules are. This process sets in motion a natural process of regulatory review, reform and impact assessment that has made Canada alongside Australia and New Zealand one of the best practice countries when it comes to the making and the assessing of domestic regulation.

For the purpose of this workshop, the methodology that is going to be introduced will very much focus on the trade dimension of domestic regulation. Hence, we will focus on those regulations that are pertinent in a trade law context, i.e. the subset of measures at the nexus of trade liberalization and domestic regulation.

Negotiations in services are all about domestic regulation. The currency of trade negotiation is domestic laws and regulations. So for countries to master intricacies of services negotiations, the negotiation team must have information that raises the knowledge level about how it regulates, why it regulates, what regulatory objectives are being pursued by potentially restrictive forms of regulations and whether or not the objectives of the regulations are being met. Trade anchored negotiations should thus be viewed as an opportunity to benchmark the domestic regulatory regime, to link those two processes, which are very different in character.

2. Why a regulatory audit?

The very conduct of services negotiations requires an adequate architecture of interagency coordination. Sectors are so diverse that the lead ministry in charge of the negotiations cannot know of every regulation and the rationale for every regulation in place. A regulatory audit can hence help promote a healthy dialogue between officials involved in domestic and external policy matters. If trade negotiators work in opposition to sectoral ministries, there may be jealousy, trust issues and general mutual antagonism. After a trade deal is struck, the implementation burden is shifted to sectoral ministries. If these have not been sufficiently involved in the design of negotiated outcomes, there will be little commitment to enforce these results. Moreover, trade officials do not speak the language of port regulation, financial regulation etc. They need to be taught that language and are only able to learn it if they interact and work with sectoral ministries. The same holds the other way round, e.g. a central banker does not typically worry about trade issues. Meanwhile, dialogue between the domestic and the international sphere is gaining importance in an increasingly interconnected world. Finally, trade agreements often result in the codification of the status quo. If that result flows from the conviction that there is no other way to achieve a particular regulatory objective other than through those regulations in place, then this is entirely legitimate. Here again, a regulatory audit helps to get a clearer sense of the rationale for regulations and the need to at times maintain potentially trade and investment-restrictive measures.

3. Objectives of regulatory audit

The purpose of trade negotiations has over the years been to make sure that regulations in place achieve their objectives in an economically most efficient, or resource-saving manner. In that sense, regulatory audits also help to identify antiquated or inefficient regulations that have no bearing to current economic reality. Once this is done, countries can adopt or converge towards international or regional best practice, which tends to be informed by the degree to which regulation is pro-competitive. Given the very dynamic global economic landscape, it is an ongoing quest to pursue market-friendlier forms of regulation.

4. Potential uses of an audit

An inventory or trade-related audit of domestic regulatory measures "affecting services and trade in services" should be compiled on the basis of existing legislation and regulations. It entails the provision of a comprehensive overview of the trade- and investment-restrictive components of a country's regulatory regime and can hence help identify regulations in need of reform and possible elimination. Such a ranking of regulations can yield useful negotiation currency, in that it offers a clearer view of the issues a country can offer in turn for the requests it faces at the negotiation table. It may also help countries anticipate the likely requests they will get from trading partner and better prepare for them. The exercise also helps to confirm the legitimacy and continued need for restrictive regulations, which in turn equips them with a much stronger case for defending these measures in negotiations. A good starting point for a regulatory audit may be to look at the Office of the United States Trade Representative's National Trade Estimate Report. These report lists, country by country, the measures the US would like to see removed. In a sense, the USTR has hence already done a lot of work for other countries, which will either likely want to address the same measures when entering into negotiations with another country. At the same time, it is for each country a first summary of the measures that it is likely going to have to defend against requests of partner countries.

5. Methodology

Unlike what has been adopted in GATS, the methodology for a regulatory audit takes a negative list approach, in that it assumes that all sectors are liberalized and it then singles out those measures and sectors that are to be subject to reservations. For each measure, one specifies the sector and the sub-sector to which it applies, the industry classification and the type of reservation (What is the legal provision that you are seeking exception from? E.g. national treatment, most favoured nation, market access etc.). Then one goes on to specify the level of government that is concerned with the measure and an accurate description of the measure itself, including its legal character. Finally one determines what is the nature of the non-conforming characteristic of the measure. In what ways does it deviate from the norm embedded in the principles from the relevant trade agreement? Finally, it is instructive to note whether the measure has provisions for a phase-out or not.

Once the list of relevant regulations is drawn up, a number of key questions should guide the discussion in a regulatory audit:

1) What is the policy objective pursued by the relevant regulatory measure?

2) Is the policy objective pursued by the specific measure still consistent with overall government policy?

3) How transparent is the measure and the process to adopt and amend it?

4) Are private sector stakeholders, domestic and foreign, consulted prior to the enactment or reform of new policy measures?

5) When was the measure, law or regulation enacted?

6) When was the measure last invoked?

7) Is it periodically reviewed?

8) Is the government satisfied that the policy objective is being achieved and has it developed a framework to assess the effectiveness of its regulatory regime?

9) Can the policy measure be achieved in a manner that might lessen its restrictive impact on trade and investment?

Session 3 & 4: Guided group work on regulatory audit and presentation and discussion of results

Participants split up into smaller groups and identified regulations in countries of their choice, using the regulatory audit methodology introduced in the earlier session. Subsequently, the results of the group work were discussed in the plenary in the framework of the guiding questions presented during the introduction to the methodology. Participants identified a number of trade- or investment-restrictive measures, of which we list a small selection below:

The Kenyan 1994 Insurance Act limits foreign insurers to a maximum of 75% capital participation, which is likely to violate national treatment provisions in Kenyan treaty obligations. The Act does not have a clear phase out, but specifies that it shall remain in force until sufficient competition exists in the domestic market and Kenya has more experience in supervising the sector. A likely policy objective of the measure in question is the prevention of excessive concentration of economic power, as well as the prevention of repatriation of profits. Both objectives can likely be met by less intrusive regulatory instruments. Similar considerations may have been the reason for enactment oft he Mauritius Independent Broadcasting Authority Act, which requires that individuals working in that sector have to be a citizen of Mauritius or ordinary residents. For corporate bodies, more than 80% of the directors must be resident in Mauritius. Moreover, foreign cross ownership with printing press and news or magazines is restricted to less than 20%. South Africa maintains a public monopoly in the construction and management of ports, as of sections 10 and 11 of the Port Act. The stated objective of the Act is to ensure their efficient and economic functioning. The Ugandan Veterinary Practice Acts stipulates that licensing is limited to only those professionals trained in the universities listed in the schedule (three East African universities and some commonwealth universities). While this measure is extremely restrictive, it is not uncommon. For example Singapore maintains similar restrictions in allowing US graduates from a very select list of universities to practice law in Singapore. Finally, measure involving economic need tests have been identified, which give discretion to relevant authorities to grant licenses. For example, the German Law on the Transport of Persons stipulates that licenses will not be issued if local transportation interests are negatively affected (determined by demand for taxi services, number of existing taxis, development of taxi businesses). The stated objective here is to maintain an orderly market structure and to prevent ruinous competition

Session 5: Frontiers of Regulation Part I – Financial Services

by Paul Saez Contreras

1. Negotiating financial services in PTA: market opening and prudential regulation

Financial services is a heavily regulated industry for a number of reasons. Public faith and confidence in the financial system are very important in this industry that is characterized by high levels of information asymmetries. High risks of failure and contagion may provide for situations in which loss of confidence in one institution can lead to a run against otherwise solvent institutions. Financial crises are some of the most costly crises in economics. Large amounts of public funds are required to restore the functioning of financial institutions, for public goods reasons. Even when deposit insurance is not explicit, it is usually the taxpayers that end up footing the bill, often paying for regulators' mistakes. Increasingly, regulators need to look beyond individual risk and adopt macro-prudential regulation to deal with systemic risk. This type of risk is especially widespread when there are substantial amounts of cross borrowing and lending, where shocks can put the whole system in peril. Rules can be imposed on capital adequacy, liquidity and rules on how especially long term investors invest.

There are various models of how financial institutions are regulated worldwide and there may be one or several financial authorities as well as separation of activities, such that e.g. banks may not own insurance companies or get involved in securities. But there can also be different banking models, such that e.g. retail and investment banking may be separated.

Chile decided to unilaterally open its financial system to foreign competition. Following the general arguments in favour of financial liberalization, the idea was to improve the financial system in terms of greater competition, improving access to financial services, improving financial and economic performance, hoping that foreign institutions would bring greater financial stability, lower the costs of financial intermediation, achieve higher savings and introduce new financial products and transfer of technology. Of course there are risks as well. In the case of banks, there is the possibility of transmission of funding or liquidity shocks that occur in the home country of the parent. This was an important channel in the 2008 crisis, as there was a transmission of the liquidity freeze from developed countries to developing countries. Another issue pertaining notably to emerging markets is the potential for destabilizing inflows and outflows of capital flows when opening up the capital account, which is closely related to the opening of the financial system to foreign competition.

There are several approaches to liberalization, all depending on country-specific contexts. Openness can be done unilaterally or through commitments in multilateral (GATS) and/or preferential negotiations. Whatever the strategy, however, a key point to make is that countries should already have a solid regulatory structure in place, with credible financial regulators whose roles are clearly defined. Recent research confirms that the positive empirical link between trade in financial services and growth is only significant if you control for the quality of institutions.

When thinking about liberalizing trade in financial services, history teaches us a number of best practices. Following these will help to facilitate negotiations by circumscribing them to certain key points and then to really move the negotiations to the non-conforming measures.

Countries should allow the operation of foreign-owned financial institutions through establishment in domestic markets under host-country regulation. This is something that would never be objected in negotiations. In that case, countries should decide if they are going to allow direct branching as well as subsidiaries. This is a very important issue today. Direct branching means that the bank is not actually incorporated in the host market and has its own capital and liquidity ratios based on the home country rules. But there is not a single type of branches, as the way they are regulated is very different depending on the markets. In some cases countries allow branches, but require them to have their own capital and their liquidity ratios, based not on their global, but on their local capital. This is what is happening in Latin America, where branches are not direct branches. For all practical purposes they are treated as subsidiaries, with the sole exception of not being incorporated in the host country. Countries should also not discriminate between foreign-owned and domestically-owned institutions, when under similar circumstances. National treatment is a basic principle. Anything that you have in your legislation in terms of a major issue of national treatment should to the extent possible be removed. However, in some case they cannot be removed. In the Chilean case, residency requirements were needed in some cases for legal purposes, such that representatives of a financial institution could e.g. be summoned to court. Further, quantitative restrictions on the number of providers authorized to supply financial services should be removed. Countries should also establish clear and objective criteria for licensing, in particular fit-and-proper tests (what is the quality of the owners of the institution and their capacity to operate), eliminating "economic necessity" tests. The adoption of international standards on regulation should also be pursued, as greater adherence to these standards will make negotiations easier, since the demands of the partner are going to be less difficult to comply with.

There are certain areas in which allowing for cross-border trade is easier than in others. One case is when financial services are already being purchased abroad, which is due to the nature and size of the global market. This holds true in sectors like Maritime and Air Transport insurance, where the size of that type of insurance and the practice, which is normally related to international trade, is such that exporters are already buying insurance from foreign providers, as the domestic market is too small for that. Keeping the market closed does not make sense in such a case. Another case is where the cost of effectively enforcing the prohibition is very high. For example, foreign banks in Chile that are not established there cannot offer bank deposits outside of Chile, because that is solicitation, which is not allowed. But any Chilean can buy insurance or can open an account anywhere else in the world under her/his own responsibility. If the bank fails it is not the Chilean regulator's fault, depositors assume the costs themselves. Trying to avoid that is so costly that you may as well allow it. Of course if you have problems with capital flows, you have to combine that with macro-prudential issues to prevent capital flight, but that is a different issue. "Sophisticated" consumers should be allowed to purchase financial services cross-border, as there is really no need to e.g. prevent big companies from buying insurance abroad. The same holds true for cross-border provision of certain financial services that do not involve transfers and hence do not need to be classified as risky. For example insurance risk assessment, actuarial services, financial consultancy services, data processing etc. do not pose any risk in terms of capital outflows. The only reason to restrict these sectors is for industrial policy purposes.

2. Models of inclusion of financial services in PTAs

There are essentially two approaches that appear as different models, but are actually not that different. One is to follow the GATS model, where commitments in financial services are negotiated as part of all commitments in cross-border trade in services in all modes of supply, with added provisions specific to financial services, notably the prudential carve-out. This is the approach followed by EU. Then there is what can be called the NAFTA model, where financial services are addressed in a stand-alone chapter with only disciplines related to financial services included. This is the approach followed by the US. Nevertheless, the two models can be combined. The Chile-EU Association agreement is an example, where the general GATS approach of positive listing was followed, but financial services were addressed in a standalone chapter. So what are the advantages of a standalone chapter on financial services? First, if the Finance Ministry is the negotiator of financial services, a stand alone chapter is preferable, as it does not cause conflicts within a country's team. Second, disciplines and commitments that apply to financial services are confined to those that are specific to this highly regulated industry. Third, some disciplines that are applied to services are just not applicable to financial services, such as for example performance requirements. Performance requirements are the very nature of a lot of financial service regulation. For example, pension funds have limitations on where and how to invest, which is nothing other than a performance requirement. Fourth, there may simply be political economy reasons. In Chile, the only way to convince the central bank to sit down and negotiate was to ensure that there would be a separate chapter in which the negotiations would be restricted to financial services and there would be no trade off with market access in other sectors. While in the end there was some trade-off, negotiating a separate chapter did somewhat narrow the scope of those. Fifth, a standalone chapter allows for a specific investor-state dispute settlement mechanism and circumscribes the grounds for such disputes, effectively reducing the reasons to resort to an investor-state dispute.

However, any financial services chapter will always have a "prudential carve-out", which posits that measures considered being of a prudential nature are considered to be an exception to the obligations. These measures are usually very broadly defined but are still subject to the dispute settlement procedure.

3. Rules on investment and financial services

Special dispute settlement procedures
In the case of a standalone chapter, both state-to-state and investor-state disputes are applicable to financial services, but differ in important ways from those in other areas. In state-to-state disputes membership of the panel is restricted to financial services experts only and in the particular case of the US, there may be no cross-retaliation when an inconsistent measure is found. In the case of an investor-state dispute, the foreign investor may trigger a dispute for breaches of articles from the investment chapter, which are brought into the financial services chapter. This happens particularly from chapters like transfers, expropriation etc. Normally this would go directly to a tribunal that is set up specifically for that purpose but in the case of financial services the responding country may invoke that it is not meeting its obligation because it applied a prudential measure as defence. In that case, the dispute goes first to a committee on financial services, which occurs prior to any other type of legal proceedings. The committee may decide that the measure in question is indeed a prudential measure, which is then binding on the panel and thus the end of the dispute. But even if the committee does not decide on the issue within a specified period of time, the issue does not automatically become a fully fledged investor-state dispute. The committee's report is first submitted to a panel, if requested, and becomes more of a state-to-state dispute.

Regulation of capital flows
Measures relating to capital flows were the hardest nut to crack in the negotiations between Chile and the US. Chile applied restrictions on short-term capital flows in the 1990s, to counter potential volatility in capital flows induced by much higher interest rates in Chile than in the rest of the world. There is a consensus today that these measures were indeed helpful in lengthening the structure of Chile's foreign debt, while not affecting FDI, as it addressed only short term capital flows. In the early, 2000s the restrictions were removed as the gap in interest rates narrowed, but the Central Bank Act reserves the right to apply it again if the Board of Governors so decides. Therefore, Chile's position in all its PTAs has been that the ability to impose such measures on capital inflows (transfers) should not be affected. Under pressure from the negotiating partners, Chile did have to accept limitations on the rate and duration of the measure in the PTA with Canada in 1997. From then on, Chile introduced a reservation to the application of the transfer's article in all its PTAs, consolidating the rate and duration of the restriction as negotiated with Canada. In the EU agreement there is also a safeguard that allows for the imposition of one year of safeguard measures to capital movements between the Parties when they threaten serious difficulties for the operation of monetary policy or exchange rate policy. Another measure was a safeguard measure from the GATS, which tackles capital outflows in case of balance of payments difficulty, which has subsequently incorporated in other PTAs as well. While the EU accepted both limitations of inflows as well as outflows, the US was more sceptical and its negotiation position was that no provisions to safeguard the balance of payments should be allowed. Secondly, in the view of the US, the short term capital measure in place did not constitute a prudential measure or a "non-discriminatory measure of general application taken by any public entity in pursuit of monetary and related credit policies or exchange rate policies" in the article of exceptions in the chapter on Financial Services. Hence, the US was not prepared to accept a reservation by Chile as other partners such as Canada and the EU had done. Finally an agreement was reached in the form of an annex to the investment chapter on "Special Dispute Settlement Provisions", which holds that when an investor from the US claims that Chile has breached an obligation as a result of its imposition of restrictive measures with regard to payments and transfers, then a dispute settlement process can be triggered. Hence the issue has not entirely been solved, but has been subject to dispute settlement, albeit under certain limitations. Moreover, transfer of proceeds of FDI (long-term investment) and debt issued in a foreign market are accepted from this provision, while Chile was not able to insert a GATS-like safeguard article in the Chile-US PTA. The latter is a serious concern, as Chile's policy

space in case of BoP difficulties is seriously circumscribed. Politically and economically, the value of this PTA for Chile is very high. But when push comes to shove and you face the risk of a balance of payments crisis, it is unclear to what extent the agreement can really be honoured. In November 2012, the IMF for the first time in its history, issued an official institutional position concerning capital flow management measures (i. e. capital controls) in which it is accepted that, under certain circumstances, capital controls (on inflows and outflows) are acceptable as a measure to preserve economic and financial stability and even as a tool for macro-prudential reasons. In the same document, the IMF recognizes that a number of emerging economies have already taken commitments within various PTAs, which do not allow them to impose such capital controls.

4. The challenge of new financial services

The origin of the article on "new financial services" in PTAs is the Understanding on Financial Services of the WTO. It reads: "A Member shall permit financial service suppliers of any other Member established in its territory to offer in its territory any new financial service." Various versions of this text can be found in several PTAs and were usually pushed for by developed countries. The basic problem with this minimalist formulation is that it does not take into consideration the regulatory framework of a country or the framework of commitments taken. For example, in some countries that follow the Latin law tradition, financial institutions can only offer financial services that the law expressly authorizes. Second, it does not take into consideration issues of prudential regulations. There might be good reasons to reject the provision of a certain new financial service. Therefore, more recent agreement take these factors into account by including:

1) The possibility that the authorization (when needed) to provide a new financial service can be rejected for prudential reasons.

2) The host country may determine the institutional and juridical form through which the new financial service may be provided.

3) The obligation to authorize a new financial service as if the regulator would authorize a domestic institution to provide it, under similar circumstances.

Could the obligation to accept any new financial service lead to the spread of financial crises to emerging economies? Probably not. The financial crisis of 2007 – 2008 was caused by innovations in securitization and derivatives in certain developed countries (not even in all) and such new products did not spread to emerging economies, as there has never been a market for them. The crisis did spread through reduced liquidity shocks through banks. So negotiations can serve to put conditions in the text of the article and the best safeguard is appropriate supervision and regulation of financial institutions (domestically and foreign owned) operating in the domestic market.

Session 6:
Discussion on Financial Market Regulation

1. Financial Services in SADC

by Matthew Stern

In SADC the level of foreign competition in the financial sector is reasonably high, while access to finance is low. Four out of ten SADC countries included in the WEF Africa Competitiveness Report ranked access to finance as the single biggest problem in doing business. In fact, there is a clear negative relationship between the percentage of the population with access to formal banking and the number of foreign banks as a percentage of total banks. The costs of banking are unusually high in Sub-Saharan Africa, which suggest that there are substantial gains to be reaped from liberalization and integration. SADC countries are involved in multiple liberalization/integration initiatives, among which the SADC Trade in Services Agreement, Economic Partnership Agreements, the Tripartite Free Trade Agreement, as well as the WTO process. Nevertheless, to date, just half of the 14 SADC members have made any commitments in financial services at the WTO. The presentation of Saez gives us an idea of assessing the likelihood of success, or impact, of such negotiations. In particular, Saez has pointed out two preconditions that need to be in place:

1) The industry should already be open to cross-border trade.

2) The regulatory framework should 'be adequate' to allow access to foreign financial services both in the domestic market and cross-border.

Levels of foreign ownership are quite high in SADC countries and there are generally few limitations on national treatment or establishment. Existing laws and regulations are predominantly prudential. In all SADC countries, banks are permitted to operate subsidiaries and representative offices, though direct branch banking is not permitted in most countries, except in South Africa and Mauritius. The only country that currently imposes an explicit limit on the participation of foreign capital in banking-sector investments is Zimbabwe, though this may change in the near future. South Africa is the only SADC country to specify a national treatment limitation in its WTO schedule.

With respect to cross-border trade, however, the situation is different. Cross-border trade is generally not encouraged and is often effectively prohibited. Many SADC countries still impose foreign exchange controls or restrict the ability of local consumers to access financial services (cross border) from abroad. Severe residency and in some cases citizenship requirements are imposed on many key positions across the banking sector (over and above general work permit requirements). For example, in Tanzania, the number of non-Tanzanians in financial institutions may not exceed five at any time. In most countries there are restrictions on the ability of local consumers to access insurance services (cross border) from foreign providers located outside the country and in four SADC member states legislation prescribes that insurers are to cede a certain amount of their business with a predetermined (local) reinsurer.

To broaden access to financial services in SADC would seem to require the entry of more innovative financial service providers and products, which are able to reach poor and disparate consumers at reasonable cost. According to Saez (2013), it would seem that regional Trade in Services negotiations could support this process. To do so, the following questions would need to be addressed:

- Most of the barriers (and opportunities) to trade revolve around the cross-border provision of financial services. Is SADC ready to take a major step forward in facilitating such trade in some sub-sectors?

- How will negotiators deal with prudential regulations (most notably exchange controls) and how will they determine what is fair and necessary, and what is costly and discriminatory?

- And how can this be achieved in such a way that does not destabilise national financial systems or increase the risk of regional contagion?

2. Financial Sector in South Africa

by Sudhir Sooklal

The financial services sector is by far the largest sector in the economy. According to UNCTAD, the financial sector makes up 5 – 7% of GDP in Africa. In South Africa, this figure is at 15% in a strict definition and in a broader definition around 20%. Some argue that the South African economy is excessively financialized. There are tendencies within the government that push towards re-industrializing manufacturing and there is a widespread perception that the financial sector has been the culprit for the loss of the manufacturing sector. At the same time, the vital role of the sector for the entire economy cannot be denied. The sector has grown at an annual rate of 9.1%, compared to 3.6% overall. The financial sector is the largest employer as a sector, employing roughly 1.8 million people. In employment terms, the rate of growth recently increased by 24.5%, whereas other sectors shed jobs. Nevertheless, the financial sector seems not to be adequately recognized, despite that role. With regard to regulation, the reserve bank is in charge of banking sector regulation and the non-banking sector is regulated by the financial services board (FSB), which covers pensions, asset management, equity markets etc. Various initiatives are under way to promote access to finance. The cost of banking in South Africa is extremely high, in fact among the highest in the world. Initiatives to redress this are underway, but there is a long way to go. The Finance Minister recently called for a panel to look at the source of these unusually high costs, and so does the competition commission. However, banks are resisting this and they are powerful players in South Africa. Meanwhile, credit is increasingly provided by non-financial institutions, which operate in an unsecured market. This development has sparked serious concerns by the authorities that fear that it might destabilize entire financial system. So national credit regulator is currently looking at measures trying to curb this risk, but nevertheless institutional responsibilities remain unclear as of yet.

From a SADC perspective, payment systems are very cumbersome and expensive and again improvements are under way. This risks being a lengthy process, as various national regulators work closely together to promote greater harmonization of regulatory regimes.

Dinner Speech: Competition Policy in Services Sectors

by David Unterhalter

1. Introduction

The multilateral project is important but stalled. There are no quick gains to be expected from multilateral engagement. In the context of services, the GATS was predicated on progressive negotiations. Hence, the very premise of the services agreement has not been realized. It is thus not surprising that countries are increasingly focusing on RTAs and BTAs. This is not good or bad, but it is a reality, and especially for African countries it is becoming more and more important. The world is dividing up in different kinds of trading blocs and arrangements and Africa should not lose its foothold in those developments. It used to be that any credible country should adopt a competition law in order to attract investments. Many national jurisdictions have adopted different kinds of competition laws ever since with all sorts of challenges and opportunities.

2. A few reflections on the South African case

Competition law has body of law that should respond to two sometimes conflicting imperatives:

On the one hand it should be understandable by those who invest, and so apart from rivalry among the EU and the US as to which model should be adopted, the first imperative should be that it is cognizable by major jurisdictions, because investments used to come from there. This has changed in a world where there are increasing flows of South-South investments (China in Africa). The Chinese model is by no means a model of simple adoption of EU and US competition law. On the other hand, the greater congruence that there is in principle and identity of content, the easier will integration be. There may be differences in application, but as long as the pool of principles is fundamentally the same, supranatural or regional institutions that deal with competition will function better. In South Africa, modern competition law was created only recently and much of it has been borrowed from EU and Canadian competition law. The second imperative is a form of domestic, local nationalism, which is not meant in a pejorative sense. The area of competition law that has most local bearing is the question of merger law. In general, merger law has an element that responds to national imperatives, be it national security, national interest or simply the desire not to have certain assets under foreign control.

The frictions these two imperatives create played out most forcibly, when Wal-Mart wanted to enter the South African market and made an offer for control of a large local retailer, called Massmart. Massmart was a major retailer in the country and was also chosen as Wal-Mart's springboard for African expansion. However, this move drew a fierce response; first from the trade union movement and second from Ministers and Ministries. There were a number of complaints and apprehensions against Wal-Mart, who is the single biggest employer in the world and has an enormous reach. Its supply chain has tentacles across the globe. Wal-Mart employs massive logistics to source goods from all over the world at very low prices. In markets that it entered, it had major impact on local retailing, even on large domestic retailers. Challenges came to two grounds of public policy: first employment, what would procurement by Wal-Mart do to the ability of local production to supply retail trade? How far can a major retailer in South Africa potentially affect domestic manufacturers and would they become displaced, with consequential employment effects? Second, small business would have to compete globally with manufacturers from China, Thailand etc. So the issue of industrial policy was at the heart of a debate that continues to go on: South Africa is a mid sized developing economy, fairly remote from other markets, exports depend on minerals and there has been a lot of attrition to the industrial base through integration into global markets after 1994, when it was liberated from its pariah status. So the industrial policy question is still: how do you maintain an open economy without hollowing out your industrial capabilities? The invocation by the Minster was essentially saying that Wal-Mart cannot be allowed into South Africa without local content requirements. Even though it happened in South Africa, the story is emblematic for developing countries that need to balance their priorities in being attractive for investments on the one hand, but on the other hand countering the threat of putting their already underdeveloped industrial base in peril. So how did South African competition law handle the situation?

In other jurisdictions, there is a ministerial override in terms of mergers that do not work for the country (US, UK and the EU). South Africa in turn judicialized the question of public policy. It is not a question of ministerial fiat or decision-making, but an issue for consideration and determination in every merger. How public policy plays out is eventually an issue to be determined in institutions, namely the competition tribunal (adjudicator of first instance) and thereafter the competition appeal court. South Africa has judicialized and made subject to adjudication the question of public policy, which is ordinarily subject to executive authorities in many other countries.

Although unusual, there is a provision that says: is the merger justified on public policy grounds? There are three particular fields that need to be considered when answering this question: Employment, small businesses' ability to engage in exports (international competitiveness) and regional development. Interestingly, even if a merger is uncontroversial on standard competition criteria, it is possible to disallow the merger explicitly on public policy grounds. The concept is interesting, but the application, especially in the case of Wal-Mart, perhaps even more.

So Wal-Mart entered and in terms of traditional competition criteria everything went well. But how about the public policy questions of employment and small businesses? Wal-Mart claimed that they would benefit the country by lowering prices. So two concepts of welfare had to be sorted out: Wal-Mart was arguing in terms of a consumer welfare claim, but there was also the issue of total welfare analysis, where other concepts of welfare beyond consumer welfare played in. Courts had to grapple with it, ask how to weigh them up? In addition, there was the question of whether Wal-Mart was not actually offering opportunities for South African industries to enter Wal-Mart procurement system. So it was complicated for the courts. The tribunal and the appeal courts finally were not able to make a clear determination on the contested question what the effect would be. What did happen, though, is that although questions of law were never determined, Wal-Mart put up a fund to encourage local suppliers to integrate into its logistical chain. With that fund, the merger could finally take place.

The story illustrates a few things. The basic dilemma in developing economies to weigh gains from openness and consequences of not being able to compete is live and real. Competition law can be a framework for tackling this. Judicializing this question is not necessarily the right way to deal with it, but it is an interesting experience in South Africa that other countries may contemplate.

3. The services context

The concept of services grew quickly over recent years. Developments in transport and information technology have made more services tradable than previously thought, while other services used to be subject to government control or monopolistic provisions. So regulation of services was always the stepchild of international trade regulations. Moreover, trade in services was long largely unidirectional; in the developed countries thought that developing countries are fruitful place to provide those services. This is now changing, because in many areas developing economies are taking the fight back to developed economies in many areas of service provisions. Service centers in India are but one example of this trend. So on the clear fracturing in ability in services sectors is disappearing. As such, services are becoming a matter of industrial policy as well. Competition law must reflect this, which in turn needs to be reflected in forms of how to perform regional integration. Competition law should be designed in a way that facilitates regional integration. Again, it is not sure whether the South African model is the right one, as its focus is specific to South Africa and it would need to be adapted to a regional context.

Obviously, such industrial policy would be difficult to square with international obligations, notably in the WTO context. As such, these obligations do circumscribe developing countries' policy space and there is not really a way to square this circle. South Africa and other developing countries have embraced the Uruguay Round out of a political will that was there at the time, but the enthusiasm is dissipating, as reflected in the stalled Doha negotiations. Sooner or later, Wal-Mart may want to expand into other countries in the area. Here are three pieces of advice to those countries. First, Wal-Mart is well resourced, but understands it needs to keep a low profile. So countries should be clear about what is negotiable and what not, thinking clearly about potential gains and losses in terms of country welfare of such a move. Second, in South Africa the Minister of economic development was pursuing negotiations with Wal-Mart at same time as the competition process was taking place, which did not lend coherence to what was going on. It is hence important to figure out what channels should be used and not to use them interchangeably. Work out the sequence in which things are to be done. A Minister cannot be a broker and a litigant at the same time. Third, if one gets into fight as a last resort, one has to be realistic about what is the right fight to have. Which fight is winnable and at what costs. Overblown ambitions can lead to very meagre outcomes.

Session 7: Frontiers of Regulation Part II – Transport Services

1. Infrastructure regulation – Common Challenges across sectors

by Martin Rodriguez Pardina

Economic rationale for regulation

Infrastructure is a sector characterized by market failures as previously discussed. In particular, it is an industry where average costs are minimised when there is only one firm, a so called natural monopoly. This characteristic is due to the interaction of scale economies and demand and usually occurs when there are high fixed costs relative to variable costs. As a consequence, the presence of a single firm creates conflict between productive and allocative efficiency, which gives rise to the need for regulation. Such regulation should be structural, restricting market entry to maintain productive efficiency. On the other hand, it should focus on conduct, such as through price controls, so as to prevent abuse of dominant position by the monopolist. For the purpose of this presentation, the term "regulation" is defined as the "combination of institutions, laws, and processes that, taken together, enable a government to exercise formal and informal control over the operating and investment decisions of enterprises that supply infrastructure services". Although different approaches to the institutional organization of the regulator exist the autonomous regulator model has been the prevailing paradigm since the early 90s. The economic rationale for an "autonomous" regulator is to try to isolate infrastructure sectors from short term political pressures by entrusting the long term objectives to a separate body with a clear legal mandate.

Regulatory objectives and instruments

Regulation has various objectives that sometimes stand in conflict with each other. One regulatory objective is sustainability of the activity, which implies that the firm must generate revenue to cover economic costs. At the same time, the objective of allocative efficiency requires that prices reflect the marginal cost of providing the service. This can create frictions, as under a natural monopoly, marginal costs are lower than average costs. A further goal of regulation is to achieve productive efficiency, which requires the establishment of incentives to minimize costs. This turn may conflict with measure to ensure allocative efficiency, e.g. the levelling of tariffs and costs can reduce incentives to minimize costs. Last but not least, regulation should strive to ensure equity in terms of access and affordability. So considerations of fairness give rise to another type trade-offs with other regulatory objectives. For example, price discrimination may be efficient in some cases, but may as well be unfair. Tariff levels are the most apt instruments to ensure sustainability, while the tariff structure will decide about allocative efficiency and fairness. The tariff regime in turn will most likely determine incentives for productive efficiency.

Given the presence of trade-offs in regulatory objectives, countries will have to rank their objectives in a certain order, attaching weights to each. One problem that has been observed is that some LDCs attach the same weights to the various objectives that OECD countries do, but there are persistent differences in the initial situation these countries build from. Coverage in LDCs is usually very low, while being universal in OECD countries. LDCs are usually in a deficitary financial situation, requiring them to raise tariff levels to efficient rates, while the opposite holds in OECD countries. As such, the challenges LDCs face are quite different.

Relevance of transport infrastructure

Empirically, there is a clear correlation between infrastructure development and economic growth and development more broadly. There are a number of reasons for that. Transport infrastructure has a direct impact on the ability of countries to trade as it represents a large part of logistics costs. Emerging economies usually suffer from inefficient transport infrastructure that is too expensive and too little developed. Sub-Saharan Africa and SADC fare quite bad in international comparisons in terms of quality of infrastructure and logistic performance indices. In 2003, UNCTAD estimated that transport cost as a percentage of the delivered value of exports stood at 12.6% for Africa, compared to a 6.1% world average. Nevertheless, some surveys find evidence for recent improvements, albeit at lesser rates than elsewhere.

Role of regulation: Ports

Despite regional differences, the costs for ports in Africa are substantially higher (sometimes double) than in the rest of the world. Investment needs are also very high, the ratio of demand to reported capacity in general cargo and container traffic exceeds 75% in several African ports and 100% in some. Meanwhile, African ports also suffer from productive inefficiency, according to a study by Trujillo et al, the average technical efficiency (which can somewhat proxy for productive efficiency) was 30% for the period 1998 – 2007.

Although some progress has been made in transport regulation in the region in recent years, still there are daunting challenges ahead as it need to deal with high costs, low efficiency levels and the need for large investments The challenge lies in finding a balance that squares incentives for cost minimization with the sustainability objective will providing conditions which are attractive to investors.

2. Examining road transport liberalisation under the SADC legal regulatory framework

by Demetria Hatoongo-Mudenda

Background

The road transport service is critical in the SADC region. Around 90% of the cargo flow into and out of the region is estimated to be carried by road transport. The sector traditionally falls under the SADC Protocol on Transport, Communications, and Meteorology (SADC TCM) and most recently the SADC Protocol on Trade in Services (SADC TIS) has been agreed to by member states to govern services. The SADC Treaty envisions the conclusion of several protocols for the liberalization of the services sector and for harmonizing regulatory regimes. SADC countries have concluded several protocols to cooperate on a number of services, including transport under the SADC TCM. Generally the intention to liberalise trade in services in the SADC can be traced to the SADC protocol on trade. Under Article 23 of the SADC protocol on trade a mandate for negotiating trade in services is provided. The SADC TIS is a product of the said Article 23. Member states are to adopt policies and implement measures in accordance with their obligations in terms of the GATS with a view to liberalising services sectors within the SADC.

Road transport liberalisation under SADC TCM

The first initiative at liberalising road transportation in the SADC region has been under the SADC TCM. The SADC TCM envisages that road transport will be liberalised by countries entering into bilateral or multilateral road transport agreements as a means of allowing foreign road transport operators from one member state access to the transport sector of another member state. The obligation on member states to liberalise road transport is under Article 5.1 of the SADC TCM where member states are to facilitate the unimpeded flow of goods and passengers between and across their respective territories by promoting the development of a strong and competitive commercial road transport industry which provides effective transport services to consumers. Member states are to progressively introduce measures to liberalise their market access policies. Under Article 5.3 liberalisation of market access policies is to be undertaken in a phased approach although two or more member states which are in the position to implement the provisions of this Article ahead of other member states may agree to liberalise their policies on the basis envisaged in the phased approach by concluding appropriate bilateral agreements. The SADC TCM further envisages that member states will achieve the same levels of liberalisation by concluding a multilateral agreement to govern the operations of transport operators from various member states. There has been slow progress with regard to the liberalisation of road transport mainly due to the protective stance taken by most member states which have been slow to allow market access for cross-border traffic through prohibition of cabotage.

Road transport liberalisation under SADC TIS

The SADC TIS sets out the framework for the liberalisation of trade in services between SADC member states. The main objectives of the SADC TIS include progressive liberalisation of intra-regional trade in services with a view to create a single market for services trade as well as enhance capacity and competition of the services sector of state parties. Negotiations under the SADC TIS will start with six core services sectors (construction, communication, transport, energy, tourism and financial), and it is hoped that liberalisation will eventually cover almost all sectors and modes of supply. The SADC TCM and SADC TIS should be seen as complementing the efforts of services liberalisation. However, conflict may also exist in the provisions.

Complementary provisions under the SADC TCM and SADC TIS

Bilateral or multilateral agreements addressing the harmonisation of administrative procedures, documentation etc. concluded under the SADC TCM would complement the provisions of Article 18 of the SADC TIS which urges member states to promote an attractive and stable environment for the supply of services through, inter alia, the development of simplified administrative procedures. Article 5.3 of the SADC TCM which emphasises reciprocity in terms of market access may be inconsistent with the non-discriminatory general obligation of MFN treatment under the SADC TIS. MFN exemptions may be sought under the SADC TIS. Alternatively a member state could list those countries that it accords reciprocity to under the SADC TCM so that preferential treatment can be accorded to some members over others. Further, Article 5.4 of the SADC TCM provides that members may maintain quota and capacity management systems. Member states, when negotiating their commitments under the SADC TIS need to be mindful of this provision, such that in the event that they agree to liberalise road transport (which would in principle have to be done on an MFN basis), then members might have to consider either doing away with quota or capacity conditions or listing specific limitations in order to be consistent with Article 14 of the SADC TIS provisions on market access.

Recommendations

While several initiatives have been pursued to liberalise road transportation in SADC, there still exist a number of barriers to the free entry of foreign operators in the SADC market. Some member states have adopted legislation that water down guaranteed market access to transport markets under the SADC TCM e.g. prohibition of cabotage. Effective service sector liberalisation could address some of the challenges faced in the transport sector in the SADC region such as high transport costs and fragmented markets. It may contribute to increased competition within the SADC member states which in turn could generate increased investment, lower prices and improve output in services with spin-off benefits for the wider domestic and regional economy. As SADC member states prepare to begin the trade in services negotiations under the SADC TIS, it is most important that they take advantage of the opportunity for capacity building in institutional and human capacity which is available through the implementation of the LDC modalities under the Doha round under the auspices of the WTO. Similarly landlocked developing countries and LDC countries in the SADC region need to place particular emphasis on developing their internal transportation infrastructure. Trade is significantly affected by transportation costs, so investments in railways and roads both construction and maintenance are crucial for keeping these costs down. Harmonization of standards and adoption of transparent rules for cross-cutting issues that affect cross-border road transport operations in the region for visa issuance, security rules or insurance regulation. If the countries were to harmonize or recognize insurance cover such as the Yellow card under the COMESA, this would reduce the cost for the operator of having to buy a third party insurance cover before being allowed entry and to transit in the other members states. As regards the commitments that member states may make to open their markets in the road transport sector, member states may restrict the entry of foreign road transport operators into their markets only through the permissible limitations under market access or national treatment conditions in accordance with the stipulated modes of supply recognized under the SADC TIS.

3. Discussant

by Matthew Stern

One of the key messages transmitted by Rodriguez Pardia was that "transport is a key sector for trade and general economic development". We also saw that in Africa logistics costs are high and quality is generally poor. Intra-regional transport costs are particularly problematic, which makes that it is easier for African countries to trade with the rest of the world rather than between themselves. Nevertheless, transport and travel services account for a large proportion of overall, recorded services trade in the SADC region, which could be due to a relatively mature level of development or relatively high associated costs. Gains from liberalizing the sector should in any case be strong in view of reducing the extraordinarily high costs.

Africa is home to 12% of the world's people, but it accounts for less than 1% of the global air service market. 20 percent of Africa's tourism-related jobs are supported by visitors arriving by air, compared with only four percent in North America. In Africa there is a preponderance of small, costly, unsafe and protected national carriers. Road freight is regulated by a multitude of bilateral agreements, but there are strong differences in standards and domestic regulations, providing for severe limitations on routes, especially on secondary routes. Cabotage is generally prohibited and it is very expensive to obtain permits. The 'third country rule' prevents foreign transport operators from picking up cargo in one country and delivering it to a third country, unless the operator transits its country of origin. Road user charges apply and drivers are required to possess work permits for entering foreign countries.

Several initiatives have been initiated and are still underway to tackle these issues. The Yamoussoukro Declaration of 1988 commits 44 African countries to deregulate air services and promote transnational competition in the aviation sector. The SADC Protocol on Transport, Communications and Meteorology commits member states to the progressive liberalization of market access in the road freight sector. Meanwhile, numerous additional agreements have been developed by SADC to harmonise specific road standards and regulations, but implementation at the national level has been weak. The ongoing SADC Trade in Services negotiations may offer yet another avenue to improve the sector's performance.

Session 8: New developments in services trade and their regulatory implications

by Markus Krajewski

1. Plurilateral Trade in Services Agreement (TiSA)

The launch of TiSA grew out of a frustration with the lack of progress in the Doha Development Agenda in services and the acknowledgement that the proliferation of PTAs with services chapters is a reality. The text of Chairman's Statement at the eighth WTO Ministerial Conference (December 2011,) reads: "advance negotiations, where progress can be achieved (...), including focusing on the elements of the Doha Declaration that allow Members to reach provisional or definitive agreements based on consensus earlier than the full conclusion of the single undertaking." The group of countries involved in the initiative is called the "really good friends of services", which include Australia, Canada, Chile, Columbia, Costa Rica, EU, Hong Kong, Island, Israel, Japan, Korea, Mexico, New Zealand, Norway, Pakistan, Panama, Paraguay, Peru, Switzerland, Taiwan, Turkey, US. Together, these countries cover around 68% of world trade in services, while not a single BRICS country is involved yet.

Potential contents of agreement include general provisions (scope, definitions, main principles, exceptions), which will likely "copy and paste" from GATS. In terms of specific commitments, the agreement will likely be a hybrid positive/negative list-approach. Rules and Disciplines need to be agreed upon, but will likely cover domestic regulations. The EU is pushing for a regulatory framework for certain sectors such as postal and courier services, information and communication technology and financial services and Switzerland would like to see rules and disciplines on export subsidies. Government procurement is also likely to fall under this category. The TiSA will likely also have institutional provisions (institutions, dispute settlement, entry into force and accession). Commitments on national treatment will likely follow a negative list approach with a ratchet mechanism that provides for locking in autonomous liberalization.

A stand-still clause will ensure that non-conforming measures will be listed at actual levels of liberalization. Market access provisions will likely follow a positive list approach. An EU proposal calls for additional commitments, such as the prohibition of localisation requirements for commercial presence, in terms of residency or local agents etc. Further, the EU would like to see a prohibition of discriminatory economic needs tests, foreign shareholding and joint venture systems.

TiSA will be an instrument that competes with WTO GATS. It's just a PTA negotiation, but gives the illusion of WTO conformity because it is being negotiated in Geneva. Nevertheless it would still be a path breaking agreement, as it may provide for a critical mass to come to a universal agreement. If China joins, this would represent 73% of world services trade, which will also induce India and others to join. What is important here is that this is a serious challenge to the WTO system. No African country is involved in TiSA negotiations, while services are an important element of African export diversification. So ultimately, African countries will have to join the initiative, but will have to do so on terms that others have been negotiating.

2. Transatlantic Trade and Investment Partnership (TTIP)

The TTIP is a very recent initiative, negotiations between US and EU began in July 2013. The TTIP is set to be a comprehensive agreement on trade and investment with the overall objective of establishing a Transatlantic Free Trade Area and to consolidate the US-EU approach towards trade, investment, competition etc. vis-a-vis other countries. An agreement is hoped to be reached in two years from now.

While it is still very early to tell what exactly the content of the agreement will be, there are already certain indications of what the substance of the negotiations will be. The EU proposal on services, investment and e-commerce foresees investment liberalization in terms of market access and national treatment, based on positive-list as well as the prohibition of discriminatory economic needs tests, joint ventures and limitation of foreign capital. It also contains provisions on investment protection, as is usually the case in bilateral investment treaties. Concerning cross-border trade in Services (Modes 1 and 2), the proposal also mentions market access and national treatment based on positive-list. Specific commitments are also put forth with respect to the temporary presence of natural persons for business purposes. A proposed regulatory framework for domestic regulation contains a binding set of disciplines for qualification and licensing, including proportionality. Specific frameworks for computer services, postal and courier services, electronic communications, financial services, international maritime transportation services and e-commerce are also forwarded. Initial EU position papers shed light on other issues that are likely to be the substance of negotiations, such as anti-trust & mergers, government influences and subsidies. The overall objective for the EU here is to articulate shared values and affirm existing practices. With respect to anti-trust & mergers the EU would like to state general principles and define the basis for institutional cooperation of competition agencies. Regarding government influence, the EU is concerned with state-owned enterprises and enterprises with special rights. It would like to address questions of anti-discriminatory behaviour, the prohibition of cross-subsidization, transparency and narrow exceptions for public services. Important issues to address on the topic of subsidies include transparency, consultations regarding harmful substances ad addressing most distortive forms of subsidies. In the field of government procurement, the EU's objective is to reach a GPA Plus to bilaterally improve regulatory disciplines to set higher standards for future GPA revisions. An agreement should provide for improved market access both regionally and on the local level and include Public Private Partnerships. There should be cross-cutting disciplines on regulatory coherence for goods and services.

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