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€1.00	=	US$1.264

Abbreviations and Acronyms

ACP	African, Caribbean, and Pacific countries
AGOA	Africa Growth and Opportunity Act
CARIFORUM	Caribbean Forum of the African, Caribbean and Pacific Group of States
CEMAC	Communauté Economique et Monétaire de l'Afrique Centrale (Central African Economic and Monetary Community)
CET	Common External Tariff
COMESA	Common Market for Eastern and Southern Africa
EAC	East African Community
EBA	Everything-But-Arms
EC	European Commission
ECOWAS	Economic Community of West African States
EDP	European Development Fund
EPA	Economic Partnership Agreement
ESA	Eastern and Southern Africa
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Area
GDP	Gross Domestic Product
GSP	Generalized System of Preferences
HS	Harmonized System
IPR	International Property Right
LDC	Least Developed Country
MFN	Most Favored Nation
NTB	Non-tariff barrier
REC	Regional Economic Community
RoO	Rules of Origin
RTA	Regional Trade Agreement (or Area)
SACU	Southern African Customs Union
SADC	Southern African Development Community
SSA	Sub-Saharan Africa
UEMOA	Union Economique et Monétaire Ouest-africaine (West African Economic and Monetary Union)
UNCTAD	United Nations Conference on Trade and Development
US	United States
WTO	World Trade Organization

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Abstract

Trade can play a crucial role in the development of services sectors in Africa. Services offer new dynamic opportunities for exports, especially for land-locked countries, while opening up to imports of services and foreign direct investment is a key mechanism to increase competition and drive greater efficiency in the provision of services in the domestic economy. Lower prices, higher quality and wider access to services raises productivity improves competitiveness and is critical for poverty reduction. But trade opening may need to be coordinated with regulatory reforms, to ensure efficient outcomes, while additional policies may be required to ensure that public policy objectives regarding equity are achieved. This places emphasis on the capacity to define and implement sound regulatory policies for services sectors, capacity that is limited in many African countries.

Economic Partnership Agreements are one trade option that African countries can pursue to support coordinated trade and regulatory reform in services together with unilateral, regional and multilateral reforms. An EPA is unlikely to offer much in terms of improved access to EU services markets, especially for temporary movement of unskilled workers, a key issue for African countries. Hence, the rationale for signing an EPA will be driven by African countries own domestic reform strategies. The main impacts of a services EPA for African countries would come from locking in openness to trade, providing sound precedents for regulation in key sectors, cooperation on competition policy and support for regional integration. But many of these key provisions could be pursued in a more cooperative approach with interested African countries without necessarily negotiating and signing a broad EPA agreement. A phased program of in-depth prioritized sector-by-sector regulatory reform and MFN trade liberalization is likely to be more appropriate than the current, institutionally demanding, broad and comprehensive negotiating approach with preferential liberalization.

Regulatory and trade reforms in Africa need to be supported with technical and financial assistance. Such assistance should be available to all African countries that wish to reform their services sectors, whether they negotiate and sign an EPA or not. An independently managed fund for services trade reform in Africa, organized around common priority sectors, that would allocate resources to support implementation of reforms and consultants according to expertise, not nationality, would be the most appropriate vehicle for providing technical assistance and building capacity.

Acknowledgements

This report on trade in services in Africa and Economic Partnership Agreements (EPAs) is the third in a series carried out under the World Bank's study of EPAs and related trade and development issues. A summary report titled *Economic Partnership Agreements between Africa and the European Union: What to do Now?* and the *Full Report on the Implementation of Interim EPAs* were issued in October 2008 and March 2009 respectively.

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Executive Summary

The Importance of Trade in Services

Trade can play a crucial role in the development of services sectors in Africa. Services offer new dynamic opportunities for exports while opening up to imports of services and foreign direct investment is a key mechanism to increase competition and drive greater efficiency in the provision of services in the domestic economy. Lower prices, higher quality and wider access to services raises productivity improves competitiveness and is critical for poverty reduction.

Trade in services offers new opportunities for export diversification. Too often services are overlooked as a source of export diversification and discussions and trade policies are inappropriately focused on manufactures. Considerable scope remains to expand traditional sectors such as tourism. In addition, the telecommunications revolution is making new opportunities available for export, growth and employment. The fastest growing top 100 company in Kenya in 2009 is an exporter of BPO services. It is estimated that each job in such export oriented services sectors supports an additional 3 or 4 jobs in the wider economy. Exports of services appear to be of particular importance for land-locked countries for whom opportunities to diversify into the export of manufactures are more limited by the high costs of transporting goods. Indeed, over the past 10 years exports of services from non-oil exporting land-locked countries in Africa have increased at a rate more than 3 times faster than their exports of goods.

For many African countries the available data on trade in services is limited. This restricts the information that policy makers have upon which to develop strategies for trade in services. The available data show that trade in services is a substantial share of total trade for many African countries. The EU is typically the main trading partner, although there is very little information on intra-African trade in services. Exports are dominated by travel services, reflecting the significance of the tourism sector in many African countries. However, new export activities are emerging in IT related sectors and in business services.

Africa's has not been able to increase its share of global services trade over the past two decades. Nevertheless, the available case study and anecdotal evidence suggests that there are considerable opportunities for the expansion of trade in services to the global market and between African countries from both the growth of existing flows and from increasing the range of sectors in which trade in services takes place.

Trade Liberalization and Regulation of Services sectors

Openness to trade can be an effective mechanism for increasing competition in services sectors. Competition is essential to increase efficiency in services sectors to achieve lower priced and better quality services. Competition pushes service suppliers to reduce waste, improve management and reduce operating costs. Competition then forces suppliers to pass on these cost savings to consumers in the form of lower prices. Competition also forces firms to innovate and to look for new and better products that are more closely aligned with the needs and demands of their consumers. Thus competition increases the range, variety and quality of services in the market. Finally, competition undermines costly rent-seeking activities whereby incumbent firms spend resources on lobbying officials for policies that will protect them rather than concentrating of increasing efficiency and quality.

A range of empirical studies have shown that openness to trade in services, such as telecommunications and finance, is associated with greater efficiency and faster growth. In addition, trade liberalization of services has positive impacts on trade in goods and allows developing countries to better exploit their comparative advantages in labor intensive manufactures. The gains from services liberalization are likely to be larger than those from goods liberalization and the adjustment costs that arise from service sector reforms may be lower than those arising from reducing protection of goods. This is because the dominant mode of cross-border supply in many services sectors is through commercial presence which entails that services will continue to be produced locally.

While the benefits of liberalizing trade in services are compelling, it can bring risks and potential costs that may require appropriate government intervention. This arises because of the need to regulate many services sectors to overcome market failures giving rise to concerns about both efficiency and equity. For example, when imports of services through commercial presence are liberalized, it is important that foreign entry leads to more competition and improved service, not merely to a transfer of ownership from a state monopoly to a private one or from a national monopoly to a foreign one. Reforms to establish an appropriate regulatory framework may need to precede the opening up of the sector concerned to set the rules of the game for new investors by establishing appropriate competition and pricing rules for foreign investors in services, service and access requirements when relevant, and adequate oversight and conflict resolution mechanisms.

Regulation is often a complex activity and regulators need to be able to assess the impact of regulatory decisions on relevant industry outcomes. The capacity of the regulator will be an important determinant of the nature, quality and impact of regulation. Many African countries lack the capacity to design and effectively implement appropriate regulations. Hence, technical assistance will be required to raise the capacity to design and implement appropriate regulations for services. Undertaking this simultaneously across a wide range of services will not be feasible in many countries in Africa given the human and technical resources required for successful regulation. Weak capacity of the regulator can also lead to regulatory capture, where the incumbent service provider(s)

exerts undue influence on regulators and manages to stifle attempts at reform. Moreover, existing regulatory agencies may have little or no incentive to reform unilaterally. In these cases, trade liberalization may be useful to undermine regulatory capture and catalyze the reform of regulatory agencies.

Trade opening may need to be carefully coordinated with regulatory reform. Policy makers in Africa face the challenge of getting an appropriate balance between the extent to which progressive regulatory reform initiatives exploit opportunities for external liberalization to increase competition and bring new investment, technologies and skills and the degree to which trade agreements can be leveraged to drive reform where progress has become bogged down. Since regulation is linked to technology and openness to trade is a source of new technologies it is important that flexible approaches to regulatory reform and trade opening are adopted. Inherently, this suggests a sector by sector approach in which countries target first services sectors that are priorities for their development. It also emphasizes the importance of local capacity to design and implement effective reform strategies and the need for openness, transparency and participation in discussions and decisions concerning the regulation of services. The situation is likely to vary across countries putting strong weight on flexibility in trade policy negotiations for individual countries in Africa to pursue their service sector and regulatory priorities.

Coordinating trade liberalization and regulatory reform does not necessarily entail deregulation but rather putting in place appropriate regulation; that is regulation that more effectively achieves public policy objectives while ensuring efficiently produced low cost services. Tools and procedures can be put in place to assist policy makers to assess whether existing or new regulation will achieve the sector-specific public policy objectives while contributing to competitive market outcomes. For example, the OECD principles on key market-oriented and trade-and-investment-friendly regulation and the APEC-OECD Integrated Checklist on Regulatory Reform could provide further guidance on how to undertake such a combined assessment of regulatory and competition policies, and market openness policies. More specifically, the process of capacity building could be coordinated with the increasing use of regulatory impact analysis to provide for an open, transparent and effective mechanism for the review of regulatory measures and their implementation.

Putting in place an appropriate regulatory framework can also be important in enabling firms to exploit export opportunities. For example, regulations that encourage competitive and well-functioning domestic services sectors can provide the basis for penetration of overseas markets by domestic suppliers. In Kenya, reform of the regulation of telecommunications that permitted firms to have their own satellite disk to connect to the internet and removed a previous ban on the use of VOIP (voice over internet protocol) services was critical in allowing the export of call centre services to the global market. Again, introducing the key elements of good regulatory practice are likely to be important so that transparency and openness in the design and implementation of regulations takes into account a broad range of interests, including producers that have a potential to export as well as those focused on serving the domestic market.

It may also be necessary to put in place mechanisms to ensure that social objectives regarding access to key services are not compromised by trade reform. The challenge is to achieve an appropriate balance between greater competition by improving market access for foreign providers and achieving public policy objectives. A particular concern is that increasing competition and liberalizing services will lead to a deterioration in the provision of services to the poorest or less populated areas because these are the least profitable to serve. This may arise if new competitors in formerly monopolized sectors compete away monopoly profits that were previously used to cross-subsidize unprofitable provision of services to poorer areas or regions.

There is a range of market based mechanisms that governments can use to ensure the provision of key services to poorer or under populated areas in a competitive environment. For example, the government can use an auction to attract the most efficient provider. Subsidized service can be financed by instituting a small tax on services and auctioning off the revenue to companies willing to provide services to the poor. The advantage of this approach is that a market determines who the providers will be.

Improvements in the general investment climate may be required to complement trade opening and regulatory reform. In many services sectors commercial presence through foreign direct investment is the key mode of supply. But removing restrictions on foreign direct investment may do little to encourage new inflows if there is a general climate of hostility to new investment. Countries in Africa, such as Mauritius, that have made substantial efforts to improve the investment climate have seen substantial inflows of foreign investment into services sectors. Similarly, foreign investment into Rwanda has grown enormously following reforms of the business climate that made the country the top global reformer in the World Bank's Doing Business assessment of 2009.

Implementing Trade Liberalization in Services

Many countries in Africa have, to some extent, liberalized trade in services with most of this having been implemented unilaterally. With the exception of tourism, countries in Africa have tended not to make commitments under the GATS. Countries in Africa will need to carefully assess whether further reform of applied trade policies is necessary to achieve objectives regarding investment and competition in services sectors, or whether the more pressing need is for reform of domestic regulations and domestic regulatory capacity or attention to constraints in the investment climate. This assessment needs to be undertaken on a sector by sector basis.

International trade agreements can support governments that wish to implement services reforms but which are opposed by powerful vested interests. Such agreements can help break domestic deadlocks by improving market access for the country's exporters and mobilizing export groups to support the reform effort. Trade agreements can also provide a mechanism for overcoming domestic resistance to desirable reforms by locking in the commitment to reform and enhancing the credibility of the reform

process. Evidence suggests that the GATS may not provide a strong commitment mechanism for small developing countries.

Regional approaches to services reform can bring particular benefits from exploitation of economies of scale, appropriate management of cross-border public goods, cooperation and coordination that leads to better regulations and pooling of technical skills to overcome capacity constraints that afflict regulation at the national level. Regional agreements can provide for deeper integration than agreements with rich countries or at the WTO through regulatory cooperation with neighbors who have markets with comparable demand and supply conditions and similar regulatory preferences and capacities. For example, in professional services, the mutual recognition of qualifications that is often necessary to make effective openness to temporary movement of workers, can be more easily pursued with neighboring countries than with countries at higher levels of income. Harmonizing standards with neighbors for such services will tend to be more appropriate than harmonizing with the standards of rich countries.

In general, the greatest gains from liberalizing trade in services will arise when access is provided to all suppliers on an MFN basis. By so doing a country gives its consumers and produces access to the best service-providers in the world. Sequencing preferential liberalization of trade in services before broader MFN liberalization can have adverse long-run consequences by handing a first-mover advantage to a less efficient supplier that a subsequent increase in openness cannot dislodge or force to become more efficient. Liberalization at the regional level first may be justified if there are important learning effects that local firms have not been able to exploit due to the small size of national markets or restrictive national regulatory regimes that have inhibited opportunities for growth. Preferential regional liberalization may then allow regional service providers to emerge in Africa that are then able to compete effectively when MFN liberalization is implemented. Liberalizing first on a regional basis may also allow regulators to gain experience before full opening is implemented. Hence it is important to carefully assess the potential costs and benefits of proceeding with preferential regional liberalization. Countries should also look for ways to make binding commitments to ensure that there is subsequent MFN liberalization.

Trade and Regulatory Reform of Services in Africa and Economic Partnership Agreements

An Economic Partnership Agreement with the EU is one of a number of options that African countries have to support coordinated trade and regulatory reform of services. Services EPAs are an option that may be pursued by African countries, whether they have signed an interim EPA Agreement or not. There is no legal obligation under the WTO for the African countries to include services in a trade agreement with the EU. Hence, unlike the interim agreements, which were often concluded so as to maintain trade relations for goods between the African countries and the EU, there is no such necessity for services. However, there is no guarantee that a services EPA will necessarily support pro-development outcomes in services. An EPA is one mechanism

that African countries can use to support service reform. There are other options, including unilateral liberalization, bilateral agreements, regional integration with other African countries and the multilateral GATS process. These are not exclusive and can be pursued with or without an EPA.

The main impacts of a services EPA with the EU would come from locking in openness to trade, providing sound precedents for regulation in key sectors, cooperation on competition policy and support for regional integration. Analysis of the CARIFORUM EPA suggests that an EPA could be a mechanism for locking in existing levels of openness to enhance the credibility of reform and to provide a signal to investors of the stability of the current policy stance on services. The CARIFORUM EPA also defines frameworks for the regulation of a number of specific services sectors, such as finance and telecommunications, which could provide a basis for increasing the quality and credibility of regulations in Africa. In other sectors in which Africa has offensive export interests, such as tourism and IT related services, commitments on regulations that go beyond the GATS could provide important precedents for future regional and multilateral trade agreements. Provisions in the CARIFRUM EPA for cooperation between competition authorities, especially the specific commitments in tourism, could be useful in disciplining anti-competitive behavior by EU firms in African markets and in allowing African firms to effectively compete in vertically integrated production chains. Regional regulatory cooperation and a regional preference clause could be useful for advancing regional integration in services in Africa. Putting in place structures for dialogue on mutual recognition at the EPA level may facilitate progress at the regional level.

However, an EPA is unlikely to offer much in terms of improved access for African countries to the EU market, especially for temporary movement of unskilled workers. The Caribbean EPA contains provisions for expanding employment of temporary service providers in the European Union. However, this affects professionals - business-services providers, contractual service-suppliers, and independent professionals. The CARIFORUM EPA does not address the issue of temporary movement of unskilled workers. Greater temporary access to the EU for unskilled workers, for example, through carefully crafted and managed sub-contracting schemes would have a significant economic impact in Africa. Without significant opening to temporary movement of unskilled workers by the EU, services reform will have to be driven by African countries seeking to reform their domestic services sectors.

The current GATS-style negotiation of reciprocal commitments under the EPA has given insufficient attention and resources for improving regulatory policies and strengthening regulatory institutions. Lack of attention to concerns over regulation and the ability to regulate have constrained effective participation in negotiations. Regulators will respond to substantive arguments for reform while GATS-style mercantilist bargaining over market access per se will be of little importance. This entails the need to careful analysis of the economic benefits as well as wider consequences of reform and the involvement of key stakeholders in discussions of regulatory reform.

A sector-by-sector approach to coordinated regulatory and trade reforms is likely to be the most effective approach for African countries. For countries with limited capacity to negotiate and regulate services a focus on priority services sectors from a development perspective (in most countries these are likely to include transportation, telecommunications, electricity, finance, and business services) is likely to be more effective than a broad but shallow preferential trade agreement that involves negotiations across all sectors and modes of supply.

Regulatory and MFN trade reforms in Africa need to be supported with technical and financial assistance. Such assistance should be targeted at those factors with the greatest impact on performance in the market and not solely at market access and national treatment considerations and the preparation of GATS-type schedules of commitments. Such assistance should not be directly linked to the signing of an EPA. Assistance should be available to all African countries that wish to reform their services sectors, whether they sign an EPA or not. A fund for services trade reform in Africa that would allocate resources according to need and consultants according to expertise would be the most appropriate vehicle for providing technical assistance and building capacity. With regard to an EPA, resources from this fund could be available to raise capacities in priority sectors to support implementation of commitments on trade openness and on regulation and hence enhancing the credibility of the locking in of trade openness and regulatory reform. One way to organize and coordinate such support could be through a dedicated forum (hosted where applicable in sector specific international organizations), independent of specific trade negotiations, that supports the application of economic and regulatory impact analysis, discussion of good practices and effective institutional structures. Such a forum would have to encapsulate that for services reform one size does often not fit all and that reforms and appropriate regulatory structures will often tend to be country specific.

Recommendations

For countries in Africa, drawing upon available sources of financial support and technical assistance:

- Define a strategy for trade in services that is integrated into the national development plan through the following activities (i) improving the collection and dissemination of more and better data on service sectors and trade in services; (ii) creating awareness and facilitating a dialogue among various stakeholders about the potential impact of services trade liberalization and reform; (iii) identification of priority sectors where greater competition, foreign investment and new technology can drive efficiency and growth (iv) establishing a committee for services trade and regulatory reform to champion open and transparent approaches to regulation and trade opening and oversee the use of regulatory impact analysis.
- In the priority domestic services sectors implement a trade and regulatory audit to identify the main constraints to competition and investment. Do they lie in insufficient openness to trade and investment, lack of credibility of existing

openness, inappropriate regulations, insufficient capacity to implement a sound regulatory framework, a hostile investment climate?

- In priority export sectors assess the need for improvements in the regulatory regime to support competitiveness and mobilize an export supporting approach in relevant line ministries and institutions such as the export promotion agency.
- Identify if, and how, unilateral reforms and trade agreements at the regional, EPA and multilateral level can be used to alleviate the constraints that are identified for the priority sectors and support the process of trade and regulatory reform. Explore opportunities for cooperation with the EU outside of a formal broad services agreement, for example, with regard to cooperation between competition authorities.
- Pursue more actively opportunities for regional cooperation and deeper integration of services in priority sectors of mutual interest with regional partners.

With regard to the EPAs:

- The EU and African countries should consider a more flexible approach to the EPAs that reflects the diversity of capacities and priorities across African countries in which the focus is not on a bilateral deal between the EU and regional blocks in Africa for the preferential opening of services sectors based upon a GATS type schedule but rather a country based cooperative approach to remove the constraints to the development of the sectors identified as priorities by African countries. For example, if requested by an African country or group of countries, the EU could work with these countries to facilitate cooperation between competition authorities. This could be provided even in the absence of a formal comprehensive EPA agreement. Similarly the EU could look at opportunities for mutual recognition of qualifications that are not predicated on signing a formal EPA agreement.
- The African countries and the EU should adopt an approach to services reform that enshrines a sector-by-sector approach to coordinated trade and regulatory reform rather than a broad but shallow GATS type negotiation in which priority sectors for reform are defined by each country consistent with national development plans.
- The EU should support African countries in pursuing openness to trade in services primarily through MFN liberalization especially in infrastructure sectors where preferential opening may have long-term adverse implications.
- The EU should work with other donors and international institutions to make adequate technical assistance available to all reforming countries in Africa from a fund that is independently managed and delink the provision of such funding from negotiations and agreement on an EPA. Such a fund could organize financial resources and expertise around key services sectors for Africa. Suggestions would include telecommunications, tourism, transport, finance and business services.

1. INTRODUCTION:
The Importance of Trade in Services

1.1 This report looks at the issue of opening up to trade in services and argues that this is a crucial policy issue for Africa and one that *could* be deepened in the context of the Economic Partnership Agreements that these countries are currently negotiating with the EU. The goods-only interim agreements that have been negotiated so far are unlikely to have a strong impact on development so the opportunity to negotiate appropriately designed provisions on trade in services could have more important trade impacts. Nevertheless, implementing a clear strategy for trade in services, to exploit opportunities for new dynamic exports and to drive efficiency in the provision of services to domestic consumers, should not be dependent on signing EPAs. This report, therefore, discusses ways in which EPAs could be designed to support the development of services sectors in Africa but, in doing this, also recognizes that EPAs may not be the most appropriate way to pursue services reform for all African countries.

1.2 Trade in services offers enormous opportunities for African countries to diversify their exports, pursue new opportunities for dynamic growth, increase investment and promote efficiency and widen access to services in the domestic economy. In most countries, services are now the dominant part of the economy and have been the main source of employment growth in the past decade. Reducing the cost, raising the quality and increasing access to key backbone services, such as telecommunications, electricity, and business services, can have economy wide impacts, since these services are often inputs into most productive activities, including manufacturing. A range of other services, including health, education, water and sanitation, are crucial to poverty reduction and improving the quality of life of the population as a whole.

1.3 Trade policy plays a very important role in determining the nature of competition in domestic services sectors. Countries that place restrictions on foreign service providers may limit access to the most efficient suppliers and the best technologies and, in turn, deny producers and consumers throughout the economy access to low cost services or to the types of services that are most appropriate for their needs. Similarly restrictions in overseas markets can act as a constraint on the development of services exports for which the country has a comparative advantage. Despite the importance of services and trade in services, few countries in Africa have defined a trade strategy for them.

1.4 However, liberalizing trade in services can be more complex than liberalizing trade in goods and may require considerable technical capacity, which is often in lacking in Africa. This is because many services sectors need to be regulated to ensure that they operate efficiently in the face of market failures (for example, natural monopolies or where there are information asymmetries). Failing to do so may lead to significant sub-optimal outcomes and compromise legitimate public policy objectives regarding low-cost access to key services. Opening up to trade in the absence of appropriate regulations may not necessarily increase trade or generate gains.

1.5 It is therefore important to coordinate services trade liberalization with regulatory reform. It is important to stress that regulatory reform does not necessarily entail deregulation but rather the challenge is to coordinate trade reform with the implementation of good regulations so as to allow the country to achieve its public policy objectives. There is no strict sequencing such that regulatory reform must precede trade opening or vice versa. The available evidence shows the importance of ensuring competition in the market. For example, in telecommunications performance has been stronger when the introduction of competition has preceded the privatization of state owned enterprises.[1] Many countries in Africa have benefited enormously from opening up in mobile telephony. Trade opening can also be a driver of regulatory reform. In some cases it may be necessary to pursue trade liberalization to undermine a blockage on regulatory reform when regulators are captured by incumbent producers. In many sectors regulation has to be linked to technology and opening up to trade and investment will often bring new and more advanced technologies which will require a reappraisal of the current regulatory approach.

1.6 In other cases, opening up to trade may not be the key constraint to the development of the sector and regulatory reform or improvement in the business climate may be necessary to permit investment or cross-border trade to take place. For example, some countries in Africa banned the use of voice over the internet (VOIP) which is crucial for the development of back office processing services (BPO). Opening up in this sector without addressing the regulatory constraint (the ban) would have little impact on service delivery. There are considerable opportunities for cross-border mobile banking (World Bank, 2009c) yet a number of countries in Africa do not have in place a regulatory framework to facilitate such trade. For example, in DR Congo the concept of electronic money has not yet been defined in law and regulations concerning anti-money laundering and anti-terrorism requirements relating to such banking are not yet in place.

1.7 There are a number of ways in which developing countries can implement trade policy in services: unilaterally, through bilateral agreements, regional agreements with other developing countries, regional agreements with developed countries and through the multilateral process at the WTO. Many countries in Africa have liberalized trade in services to some extent. In general, this opening up has been implemented unilaterally. This gives rise to the key issues of whether this level of openness is sufficient to ensure competitive services markets and if locking in this openness through a formal trade agreement is necessary to provide greater certainty about the continuity of policy so to encourage greater investment and trade flows.

1.8 Currently, African countries are involved in a range of negotiations on agreements that could be vehicles for greater opening to trade and investment in services and for locking in this openness to enhance credibility. A key trade policy issue facing African countries is the negotiation of Economic Partnership Agreements with the European Union which includes the opportunity to make commitments on services. In addition, many of the regional agreements in Africa are currently seeking to enhance and implement provisions on services. For example, the EAC countries have recently agreed to move to a common market with extensive commitments on trade in services. Countries in COMESA are defining sectors which will be the focus of negotiations on regional liberalization of services trade. Countries in Africa also have the

[1] Fink et al (2003)

opportunity to participate more actively at the multilateral level through the GATS process. Ensuring consistency and coordinating these negotiations with unilateral reforms is a major challenge.

1.9 This introductory chapter briefly seeks to set the scene of the rest of the report. It continues by examining in a little more detail the importance of services to Africa and the reasons why services and trade in services warrant the attention of policy makers in Africa. The chapter then introduces the EPAs defining the current state of play and the situation with regard to trade in services. The chapter also describes the key factors that appear to have stimulated policy makers in to Caribbean to pursue an agreement on services with the EU. The chapter starts by seeking to succinctly characterize services sectors stressing that in there are a large range of services with different characteristics that are necessary for the welfare of households and for competitiveness and growth. This introductory chapter then raises the issue of why services and trade in services warrants the attention of policy makers in Africa.

A Services in the Modern Economy

1.10 We start by briefly discussing the role of services. Figure A1 provides a very simple depiction of the range of sectors providing services to a modern domestic economy. The figure concentrates on services in the domestic economy but all of these services can be exported. The figure does identify services that are primarily exported such as tourism. There are a number of key 'network' or infrastructure industries such as telecommunications, transportation, electricity, water, sanitation and finance that are important for households as well as being critical inputs into the production of goods and other services. There are also 'social' services sectors traditionally based on personal contact between the consumer and the provider, such as, health and education, that provide households with the basic inputs to needed to improve their human capital and sustain their standard of living.

1.11 Both 'network' and 'social' services sectors are those that would traditionally be associated with the services part of the economy. However, an increasing range of other services have also become important inputs into production and distribution in modern economies. Professional services, such as accountancy, and logistics services, such as freight forwarding, have become essential elements determining the capacity of an economy to compete globally.

1.12 The wide range of services have differing characteristics, including the importance of scale and network effects, the nature of market failures and differing importance for social welfare. These differences in turn imply specific rationales for, and approaches to, regulation. In some services sectors, such as retail trade, there is likely to be little need for strong regulatory oversight. At the other extreme, the provision of health services might need to be carefully regulated to ensure the protection of consumers as well as access. Regulators have two broad objectives: ensuring efficiency and equity. In some cases these two objectives may conflict and government intervention may be required to ensure that public objectives regarding access to services are achieved.

1.13 There is also great diversity across Africa with regard to services, with differing sectoral priorities and differing approaches to regulation and varying levels of regulatory capacity. Take the example of Comoros, where growth is severely constrained by the high cost, poor quality and

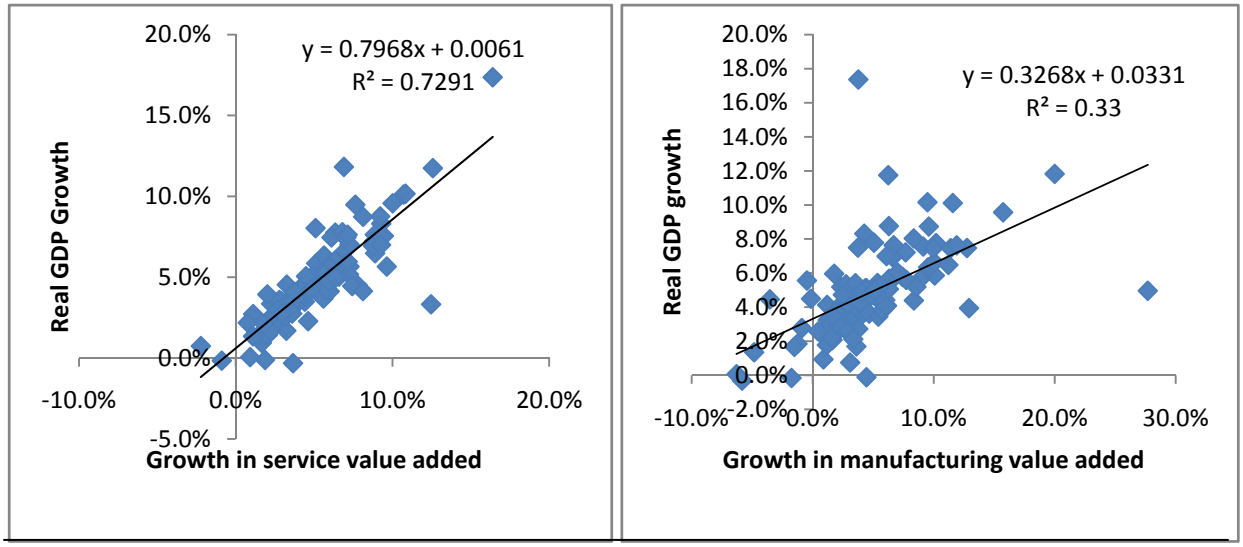
lack of availability of key services.[2] A typical small and medium sized enterprise in Comoros loses three working days per week due to power outages and faces the highest international call rates and bank charges on international transactions. Services, such as tourism, which use these inputs intensively, offer an important route to diversification and growth. National resources for investment are extremely constrained and so foreign investment will have to play an important role in financing services development. Mauritius on the other hand has made substantial progress towards becoming a modern services based economy. In contrast to these small island economies there are large coastal countries such as Kenya, Nigeria and South Africa. For these countries there are likely to be a broader range of services that can be developed and a wider set of regulatory issues that need to be addressed.

B Services and development in Africa

1.14 Services are critical to accelerating development in Africa for the following reasons:

1. *Services are a large and growing part of most economies and an important source of growth and employment*. The modern services sector dominates most economies and has become a key driver of growth in both developed and developing countries (Ghani and Kharas (2010)). Since the services sector is often the largest contributor to GDP, improvements in productivity in services have a substantial impact on overall GDP growth. Figure 1.1 compares the relationship between growth in services and GDP growth with that of growth in manufacturing and GDP growth for 136 countries during the period of 2000 to 2008.

Figure 1.1 : Growth in Services (left) and Manufacturing (right) Value Added vs. Real GDP



Updated and extended version of Figure 2 from Ghani and Kharas (2010)

- While it is not possible to infer causality it is clear that while the growth of both services and manufacturing is positively related to GDP growth, the relationship is much stronger and higher for services than for manufacturing. This reflects that in most economies

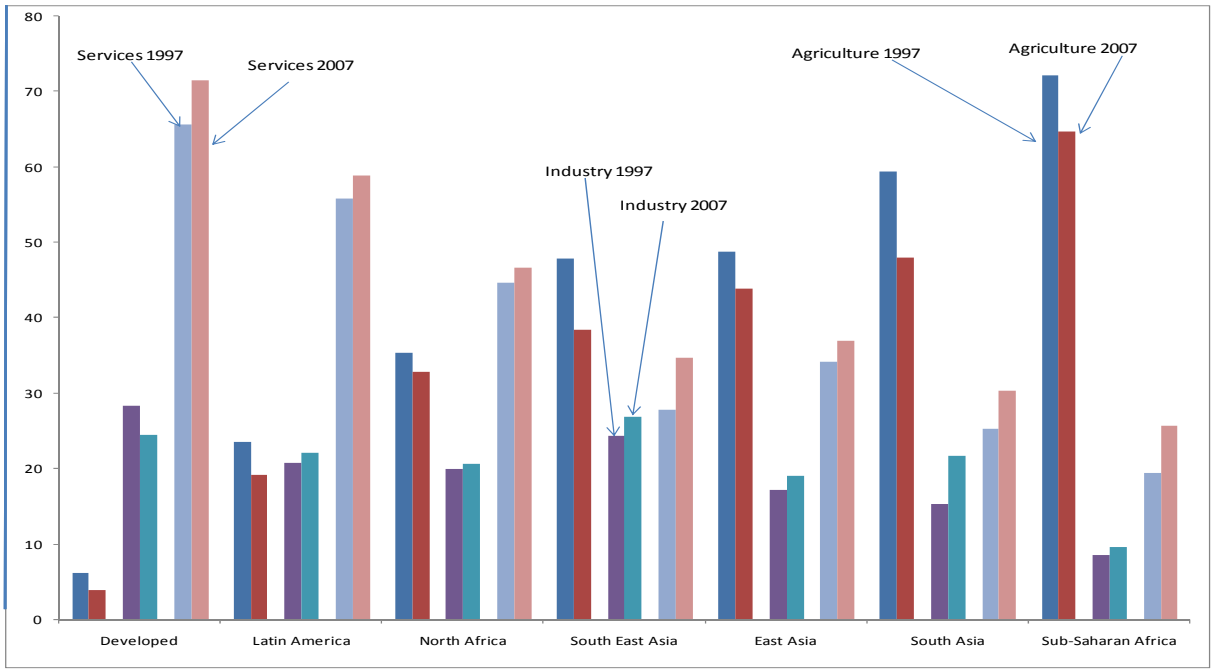
[2] See Zita (2008).

services are the largest part of the economy so that growth of services will tend to dominate overall GDP growth. Indeed, the importance of services for growth has been discussed for many years (see, for example, Inman (1985) and Riddle (1986)).

- Nevertheless, in the past services have often been put to the periphery of discussions over growth and there is still a presumption by many policy advisers and officials that growth and development can be achieved *only* through an expansion of the manufacturing sector. The fixation on manufacturing perhaps reflects old views that productivity growth in services is limited. However, the recent experience of India and a number of other Asian countries shows that labor productivity in services can be higher than that in manufacturing and that growth of productivity in services has matched growth of productivity in manufacturing in China. Experience from across the world shows that growth of the services sector contributes more to poverty reduction than does growth of agriculture or growth of manufacturing. This is because services have been the main source of employment growth and reflects that the proportion of women employed is services is typically higher than that in manufacturing and increasing employment opportunities for women is closely associated with poverty reduction.

- Figure 1.2 shows that over the 10 years from 1997 to 2007 and across all major regions, growth in employment in services has been the dominant feature of changes in the labor market. In Africa, the share of employment in agriculture has fallen quite sharply from over 72 percent of the total to less than 65 percent, although it still remains considerably higher than in other regions. Employment in industry increased by just 1 percentage point to just under 10 percent, while employment in services increased by more than 6 percentage points from around 19 to almost 26 percent.

Figure 1.2 : Shares of Employment in Agriculture, Industry and Services, 1997 and 2007



Source: ILO Global Employment Trends 2008, Appendix Table 4

- There are a number of reasons why services are becoming dynamic sources of growth in developing countries. Most important is that many services once thought to be non-tradable, such as banking, insurance, telecommunications and also business services, education and health, but can now be exchanged across international borders. Healthcare is just one example of how technology is changing the nature of the sector and its growth prospects. For many healthcare is a personal service requiring face to face interaction between care giver and patient. However, trade in healthcare services has emerged through the movement of persons to consume healthcare abroad and through the movement of professionals to provide care overseas. We are also seeing the emergence of telemedicine whereby communications and information technologies are allowing health professionals to provide advice and even consultation across borders.

- This all entails that the growth of services is becoming less constrained by domestic demand. In addition, technological change has come to play an important role in services although many developing countries remain considerably behind developed countries in the adoption and use of the most efficient technologies. The quality of access to the internet in Africa is one obvious example. Hence, there is considerable scope for catch-up in services and moving towards the technological frontier as a driver of productivity growth. A number of services also now offer broad economy-wide gains from learning and knowledge spillovers. Often these spillovers are facilitated by the clustering of firms which further fosters productivity growth. In general, it appears to be easier of services firms to cluster than manufacturing firms; they require less space and cause less congestion and pollution. Thus, the globalization of services provides new opportunities for developing countries to find niches in which they can scale up and achieve strong sustained growth so that industrialization is not the only route to development (Ghani and Kharas (2010)).

2. *Access to cost-effective services affects performance in the rest of economy and international competitiveness*. Many services are crucial inputs into other economic activities. As such, high prices combined with low quality inputs of services can undermine production throughout the economy. As shown in Figure A1 there is a wide range of infrastructure and business services that are direct inputs into productive activities. These are complemented by logistics services that facilitate the distribution of the outputs of these activities as well as the material inputs to which value is added in production. Finally, there are personal services, such as health and education, which are consumed by households but indirectly affect productivity by raising the quality of available labor.

- Arnold et al. (2006) in a study of over 1000 firms in 10 African countries show a strong positive link between the performance of the communications, electricity and financial services sectors and firm productivity. They conclude that improvements in services industries contribute to enhancing the performance of downstream economic activities, and thus are an essential element of a strategy for promoting growth. Brambilla and Porto (2006), find a significant relationship between farm productivity in Zambia and the performance of key services sectors; transportation and finance. In districts with better provision of these services farmers typically reap higher yields.

- A recent World Bank survey that covered professional associations and representative samples of firms in Kenya, Rwanda, Tanzania and Uganda found that firms that use accounting, legal and engineering services, whether externally outsourced or provided in-house, have higher average labor productivity than firms without professional services linkages. The average labor productivity of East African users of professional services is 10- 45% percent higher than that of non-users of professional services. The association between professional service usage and productivity is particularly strong for small firms (Dihel et al (2010)).

- In general, African countries tend to compare less favorably with other developing countries in terms of the cost, quality and availability of key infrastructure services, such as, electricity, water, transportation and telecommunications. Investment climate surveys regularly show that firms in Africa lack access to infrastructure services. In addition, access to the range of business and logistics services available in African countries is often limited.

3. *Provision of key services is crucial in alleviating poverty and meeting the Millennium Development Goals.* Basic infrastructure services such as electricity, water and sewerage are critical elements of household consumption bundles. If such services are produced inefficiently or are not priced competitively they may be out of the reach of poor households. Other services such as transportation and telecommunications play a critical role in linking households to markets and efficient access to these can be a route out of poverty. In addition, poor households need to be able to access finance to weather the transition out of subsistence modes of production and into the production of marketable goods and services. Empirical analysis confirms that access to roads, credit and electricity are all significantly positively linked with the chance of escaping from poverty.[3] Access to services such as transportation, finance, extension services and communication services also determines the extent to which poor households are able to respond to the opportunities created by trade reform (Aksoy and Isik-Dikmelik (2007)).

4. *Services trade can contribute to export diversification*. A key objective of many African countries is to diversify their exports away from dependence upon a narrow range of primary agricultural and/or mineral commodities, which often face volatile prices on world markets, into higher value-added production. The need for export diversification has been reinforced by the recent global downturn that has been transmitted to Africa primarily through changes in demand and prices for these basic products. Too often services are overlooked as a source of export diversification and discussions and trade policies are inappropriately focused on manufactures.

- Many African countries have been able to export tourism and related travel services, and enormous potential for their further development remains. But the scope for services exports is much broader. The telecommunications revolution through the internet is offering new opportunities. KPMG has identified call centre, Kencall, as the fastest growing top 100 company in Kenya. A company in Rwanda is exporting Computer Aided Design to the US and the UK. The spread of mobile telephony has been a success story for Africa and this is creating opportunities for exports of financial services through cross-border mobile banking (World Bank (2009)). There are enormous opportunities for

[3] See Diop et al (2005) for an application to Rwanda.

cross border trade in professional services such as accountants, lawyers and engineers as well in education and health.

- For example, Uganda's thriving education system draws students from across the region, from Kenya and Tanzania to the DRC and Sudan. In 2004-2005, education exports were estimated to be worth US$30.7 million, broken down as US$23.7 million from the secondary level and US$6.6 million from the university level.[4] The gains that are derived from a strong education system are well known, and engaging in trade in education services can help to build such a system. Exporting education services can contribute to export diversification. On the import side, countries that are net importers of education services benefit from an increase in their overall level of education. Education is a crucial input in the development of a service-based economy due to the higher skills level that many service jobs demand. And in many countries the education sector contributed to boosting employment; in Uganda, the education sector is the largest job creator in the formal economy, employing 32% of formal workers.[5]

C Services Trade Policy

1.15 Trade in services, and therefore services trade policy, affect the performance of services in the domestic economy. Competition is essential to ensure the efficient production of services in the domestic economy and openness to trade is a crucial mechanism to foster this, especially in African countries which often have small domestic markets. Openness to trade also brings with it access to more modern technologies which in turn can drive a process of technological catch-up and sustained productivity growth. A large body of empirical analysis, summarized in Chapter 3, shows that trade liberalization and the expansion of services imports can lead to lower costs, higher quality, and an increase in the variety of available services with important productivity impacts and potentially yielding larger gains for Africa than any other component of international trade.

1.16 However, trade liberalization in services is more complicated than in goods. First, because the particular characteristics of services such as their intangibility, non-storability, and proximity requirements between producers and consumers imply that the conventional definition of international merchandise trade – where a product crosses a border – does not capture all types of international services transactions. This entails a wide range of policies that can impact on trade in services. Under the definitions employed in WTO's General Agreement on Trade in Services (GATS), services trade (that is, service transactions between non-residents and residents of an economy) can be delivered in four ways or "modes":

1. Cross-border Supply (Mode 1): services supplied from the territory of one country into the territory of another country;
2. Consumption Abroad (Mode 2): services supplied in the territory of one country to the consumers of another country;

[4] Bakunda and Walusimbi-Mpanga, 2005, p. 20.
[5] Walusimbi-Mpanga, 2006, p. 24-25.

3. Commercial Presence (Mode 3): services supplied through any type of business or professional establishment of one country in the territory of another (i.e., FDI)
4. Temporary Presence of Natural Persons (Mode 4): services supplied by nationals of one country in the territory of another. This mode includes both independent service suppliers, and employees of the services supplier of another country.

1.17 In addition, effective regulation maybe necessary to realize the benefits of trade liberalization for services sectors where market failures persist. Indeed, trade opening with inappropriate regulation can result in adverse outcomes, such as replacing a domestic monopoly with a foreign one. A key element of trade opening is to grant foreign service-suppliers the same regulatory treatment as domestic suppliers. When regulations and their application are deficient then trade opening entails that foreign suppliers will face the same restrictive regime as domestic service-suppliers. Putting in place an appropriate regulatory framework can also be necessary to enable a country to exploit potential export opportunities by providing a framework that encourages competitive and well-functioning domestic services sectors to meet the requirements of overseas markets.

1.18 Effective regulation of many services sectors requires capacity within the government and regulatory bodies as well as the private sector to design and implement appropriate regulations and monitor their impact. The process of defining regulations should involve the participation of all key stakeholders while ensuring that no single stakeholder of group of stakeholders exerts undue influence and captures the regulatory process. In many African countries regulatory capacities are weak and regulatory frameworks may well not be appropriate to ensure benefits from greater openness. The situation will vary across sectors and countries and so an important aspect of regulatory reform and greater trade openness is an assessment of priority sectors and regulatory weaknesses.

1.19 In reality it is not possible to say that regulatory reform must precede trade liberalization or vice versa but rather they are both part of a dynamic process towards promoting greater efficiency while achieving public policy objectives such as efficiency and equity in the provision of services. Where domestic vested interests have captured the process of setting and implementing regulations, trade liberalization may be crucial to allow regulatory reform to take place. Regulations cannot be set independently of technology and often foreign trade and investment brings with them new technologies which require adapting regulations and their implementation.

1.20 Again, the situation will tend to be country and sector specific. What is clear is that African countries that wish to implement coordinated regulatory reform and services trade liberalization might require substantial technical and financial support to build capacity in regulatory institutions. In essence, the challenge for Africa, as elsewhere, is to implement good regulatory practice, a key element of which is regulatory impact analysis that identifies the impact of proposed regulatory changes and can highlight any potential conflicts between efficiency and equity objectives, which may require additional measures, such as subsidies to ensure provision of key social services to the poorest consumers.

1.21 Countries in Africa also have important services export interests that they can pursue through multilateral, regional and bilateral agreements. At present their services exports to the global market are dominated by tourism and related transport services but new opportunities are being exploited in telecommunications related back-office services and health services amongst others. At the regional level, there are substantial possibilities to enhance exports across a broad range of services including finance, construction, energy, education, telecommunications, and professional services.

1.22 Reform of services sectors always needs to be supported by analysis of data on services industries and services trade, information on the nature of regulatory policies and how these impinge on both trade and domestic performance, and a broad dialogue between trade policy makers, regulators, firms and other stakeholders on the policy objectives for key sectors. This must all be brought together to define a strategy for services trade which identifies key priority sectors, the role for unilateral, regional, multilateral reforms and negotiations in achieving public policy objectives for those sectors and the regulatory and capacity weaknesses that must be successfully addressed to enable trade commitments, and the regulatory reforms that may need to accompany them, to be effectively implemented. In many countries in Africa, this base for negotiating on trade in services is not yet in place and is a priority issue for technical assistance.

1.23 After seven years of discussion and negotiations, in 2007 the European Union and 19 African countries entered into "Interim" or "Framework" Economic Partnership Agreements (EPAs) that provide for WTO-compliant reciprocal, but asymmetric, liberalization of their bilateral merchandise trade and restructure the EPA-signatories' trade and development cooperation with the EU.[6] The Box below summarizes the key features of a Framework EPA for a typical African country or regional group. Subsequently, in 2009, the European Commission (EC) started dropping the adjective "interim" in describing the existing EPAs, which will, in any case, remain in effect unless and until replaced by new bilateral trade agreements between the EU and the 19 countries that have signed EPAs.

1.24 From a development perspective, the key issue regarding the interim EPAs is whether the provisions they contain will provide a mechanism to enhance trade and stimulate growth. While the focus of the interim EPAs is on goods-only and on achieving agreements that are consistent with WTO rules on preferential trade, the Cotonou Agreement, which preceded the EPAs, envisaged liberalization of trade in services but did not mandate the inclusion of services in EPAs. Although the interim EPA typically calls for negotiations of trade in services there is no legal obligation under the WTO to include services in a free trade agreement. Hence, unlike the interim agreements, which were often concluded so as to maintain trade relations for goods between the African countries and the EU, there is no such necessity for services. Hence the design of a services EPA for African countries can be determined by development considerations rather than narrow legal and commercial considerations. The WTO does provide a framework for regional agreements that do include provisions on services under the GATS.

[6] Some initialed but not yet signed. Take from email to Andrew Annex Table 1and the map on page vii show the EPA-signatories and non-signatories in Africa. This report is the third in a series carried out under a World Bank study of EPAs and related trade and development issues funded by the Multi-donor Trust Fund for Trade. A summary report titled Economic Partnership Agreements between Africa and the European Union: What to do Now? and a Full Report on Implementing Interim EPAs were issued in October 2008 and March 2009 respectively.

Box 1.1 : Key features of Interim or Framework EPA

- 100 percent duty free and quota free access to the EU.
- African countries liberalize around 80 percent of imports (in value) from EU. For example, EAC committed to 82% (64% in 2 years, 80% in 15 years, rest in 25 years).
- Less restrictive ROOs for textiles, clothing, fish and a few agricultural products.
- An MFN clause such that the signatories must extend to each other improved preferential access they grant in the future to "large" trading partners (defined as countries with a share in world merchandise exports of greater than 1 percent or regions with a share more than 1.5 percent).
- A standstill clause on new customs duties on trade between the parties
- Development assistance, or "Aid for Trade", from EDF
- Commitment to negotiations on services trade, investment, competition and government procurement

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1.26 Of the EPAs signed or initialed in 2007, only the comprehensive CARIFORUM EPA includes substantive provisions affecting trade in services.[7] Among the reasons why the CARIFORUM countries proceeded to negotiate and sign an agreement including services are[8]:

- services play a key role in the economy of CARIFORUM countries;
- substantial trade flows in services take place between the two regions;
- the region identified offensive opportunities to expand access to the EU services market;
- the region viewed the EPA as an important signaling device to confirm to potential investors the credibility of the regions commitment to opening up to trade and regulatory reform;
- expansion of services, especially knowledge based services, was seen as the key route to export and economic diversification;
- the rules on services and investment were seen as means to encourage inward investment, and with it greater access to technology, by providing a more predictable and transparent regime for investment;

[7] The CARIFORUM Agreement provides for progressive, reciprocal, and asymmetric liberalization of both trade in services and bilateral foreign direct investment; competition and trade-related regulatory reforms; and the use of trade in services to facilitate regional integration.
[8] Suave and Audet (2009)

- the negotiations offered the region the opportunity to obtain commitments from the EU of particular relevance to key sectors of interest (especially tourism) that would then provide a precedent for negotiations on this sector at the multilateral level.

1.27 This led to a strong commitment to negotiate an EPA from political leaders in the region and was backed up by a high level of technical preparation that had been developed largely in the context of the failed FTAA negotiations. This report discusses whether countries in Africa may share similar interests in negotiating commitments on trade and investment in services through an EPA and the relevance of the provisions of the CARIFORUM EPA for African countries. However, it is important to note from the start that there is much greater diversity across countries in Africa than in the Caribbean. For example, there is only one LDC, Haiti, in the Caribbean. In general, African countries do not have the same experience or capacity as the CARIFORUM countries in negotiating agreements on trade in services.

1.28 Services EPAs[9] are an option that may be pursued by African countries, whether they have signed an interim EPA Agreement or not. However, there is no guarantee that a services EPA will necessarily support pro-development outcomes in services. Much will depend upon the detail of the negotiations and the support that is provided to African countries to build capacity. An EPA is one mechanism that African countries can use to support service reform. There are other options, including unilateral liberalization, bilateral agreements, regional integration with other African countries and the multilateral GATS process. These are not exclusive and can be pursued with or without an EPA.

1.29 Regional integration can play a particular role in the development of services. Agreements between countries with similar incomes and similar capacities for regulation can allow for deeper integration of services sectors than may be possible in agreements between countries with widely differing incomes. In sectors such a professional services, many small and medium sized enterprises are unlikely to demand the services of providers from high income countries. Opening up to competition from neighboring countries is more likely to reduce costs and improve access for these firms. In many cases, standards defined in high income countries for services, such as accountancy, will not be relevant for small and medium sized firms in Africa. Hence, defining standards that reflect local demands and pursuing mutual recognition of qualifications at the regional level may be the most appropriate way to proceed with trade opening in these sectors.

1.30 A regional approach to services can encourage regulatory cooperation and coordination that can lead to better regulations and pool technical skills to overcome capacity constraints that afflict regulation and its implementation at the national level. Deeper regional integration through regulatory cooperation with neighboring partners, which have similar regulatory preferences, can thus usefully complement non-preferential liberalization. But non-preferential (MFN) liberalization will generate greater gains than trade reform that discriminates between providers of services on the basis of their nationality.

[9] We use the term services EPA to refer to an agreement containing provisions on services whether or not there are additional provisions covering issues such as intellectual property and government procurement that are envisaged for a "full EPA".

D Services and the Investment Climate

1.31 Improvements in the delivery and quality of services in Africa will necessitate investment, whether by domestic or foreign enterprises. This pushes the focus on the general business and investment climate, where many African countries rank poorly in the various ratings, such as, the World Bank's Doing Business Indicators and Investment Climate Assessments. The benefits of coordinated regulatory and trade reform in specific services sectors in increasing commercial presence and private investment will be limited if a hostile business environment constrains the investment that would otherwise take place.

1.32 Improvements are clearly occurring in Africa. Rwanda was the top reformer in the World Bank's Doing Business assessment in 2009 and the Rwanda Development Board reported a 40% increase in the value of registered investments during the year to an all time high of $1.1 billion which will create around 11,000 additional jobs.[10] Mauritius is ranked 24th in the world for ease of doing business and in recent years has implemented deep and wide-ranging measures to reduce the costs of starting and operating a business, obtaining licenses and permits and tax administration. These and other instances provide compelling examples for other governments in Africa wishing to increase competitiveness and improve the delivery of key services of steps that can quickly be taken to improve the business climate.

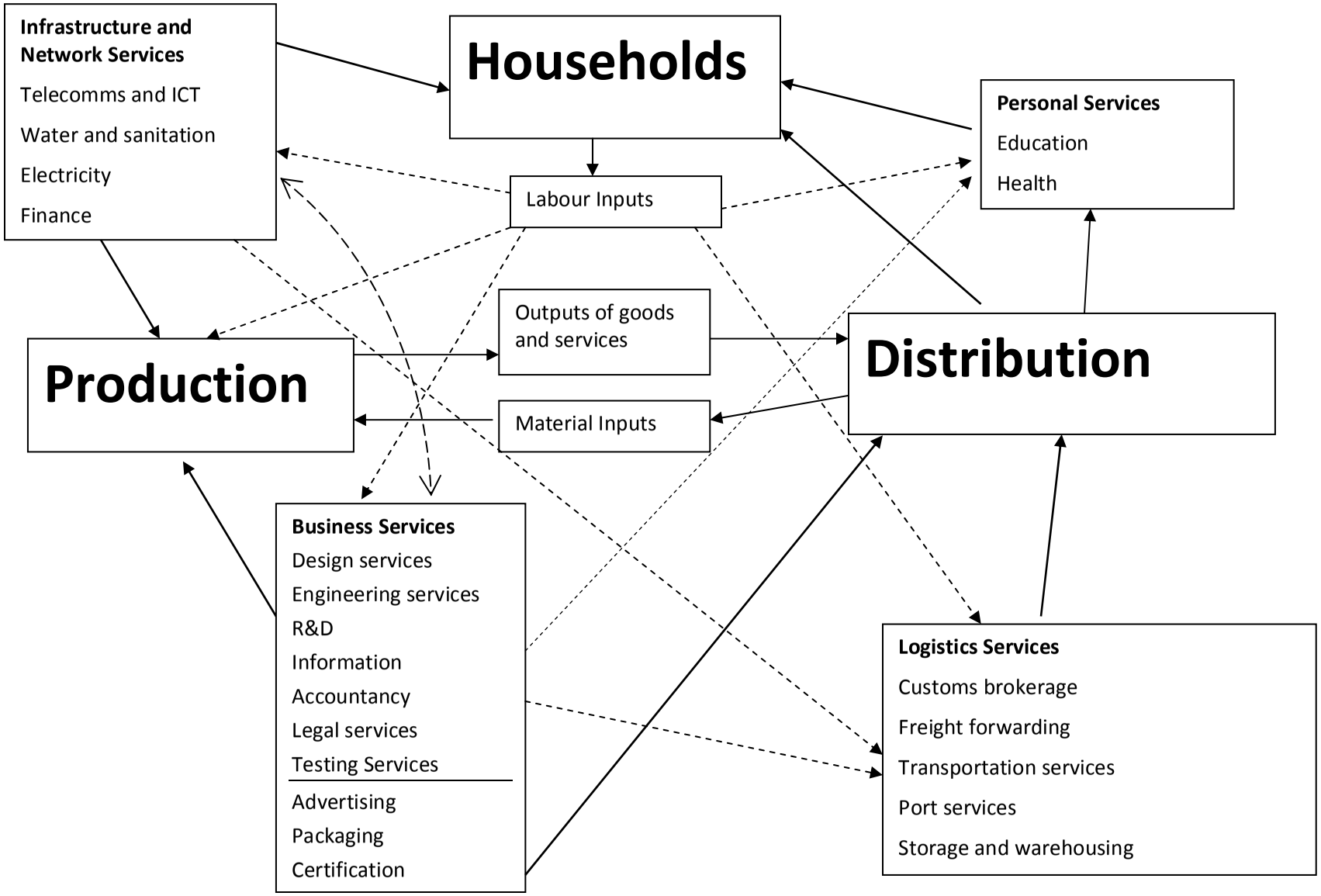
1.33 The size and importance of many services sectors can also entail that reform of these sectors acts as a powerful stimulus to broader reforms to the business climate. Efforts to reform services sectors, raise regulatory capacity and reduce trade barriers will therefore be more effective when incorporated into broad strategies to improve the business climate and increase the effectiveness of interventions by government in achieving public policy objectives.

Organization of the Report

1.34 The report proceeds in the next chapter by briefly looking at the importance of services in African countries and then by discussing the current pattern and nature of trade in services, with a focus on trade with the EU. Chapter 3 provides an overview of the literature on the role of competition in driving greater efficiency in the provision of services and how trade openness can be an effective mechanism in increasing competition. The chapter also looks at the importance of regulation in many services sectors and discusses the issue of the coordination of regulatory and trade reforms. The next chapter discusses how trade liberalization of services can be implemented starting with a review of the approach adopted in the GATS. The chapter then reviews information on services trade policies being applied by African countries and discusses what is required to prepare for and negotiate trade reform. Chapter 5 looks at the importance of regional integration and especially regional cooperation in developing services sectors in Africa. The final chapter concludes with an assessment of the issues that must be addressed for successful coordinated trade and regulatory reform of services in Africa and the extent to which an EPA can assist in making progress on these issues. Finally the report discusses a broader approach to supporting African countries in reforming their services sectors.

[10] Source: New Rwanda Times.

Figure 1.3 : Infrastructure, Business, Logistics and Personal Services



2. AFRICA AND TRADE IN SERVICES

2.1 Services matter for economic growth and development. In most non-oil producing sub-Saharan African countries, the services sector is now the largest part of the economy. As countries develop the importance of the services sector tends to rise further. In many developed countries services sectors comprise more than two-thirds of the economy. In addition to their sheer size in the economy, services matter because many, such as water and sewerage services, education, health and energy services are critical consumption products that affect welfare and poverty. Increasing the availability, affordability and quality of these services is a key policy objective in all developing countries. Other services, such as telecommunications, energy, transport and business services matter because they are important inputs into the production of goods and other services and hence influence productivity and competitiveness. Firms that have to pay more for these inputs than their rivals or have to use much lower quality services find it very difficult to compete in domestic national yet alone international markets.

2.2 Influencing this trend in the service intensity of economies has been the increase in trade in services fuelled most recently by advances in information and communication technologies that are permitting the exchange across borders of products previously deemed to be non-tradable. Trade in services has also been driven by the increasing amount of people who travel abroad to consume services such as tourism, health, and education, and to supply services ranging from professional services to construction and transportation. Global trade in services has been growing strongly and now amounts to around 20 per cent of world trade in goods. However, the share of services in global trade increases to 50% when trade is measured in value-added[11]and even further when sales by foreign affiliates of multinational firms are included (Francois and Hoekman, 2009).

2.3 This chapter briefly discusses the significance of services and trade in services for Africa so as to motivate the subsequent discussion in the report on services policies and the role that EPAs could play as part of a coordinated strategy to liberalize trade and reform services regulations. It starts by looking at services and growth and the importance of key services for households and businesses. The chapter then looks at the size of the services sector in African countries and the current magnitude of trade in services including trade with the EU. A final section discusses the extent to which African countries are participating in the global market for services in terms of shares of global imports and exports.

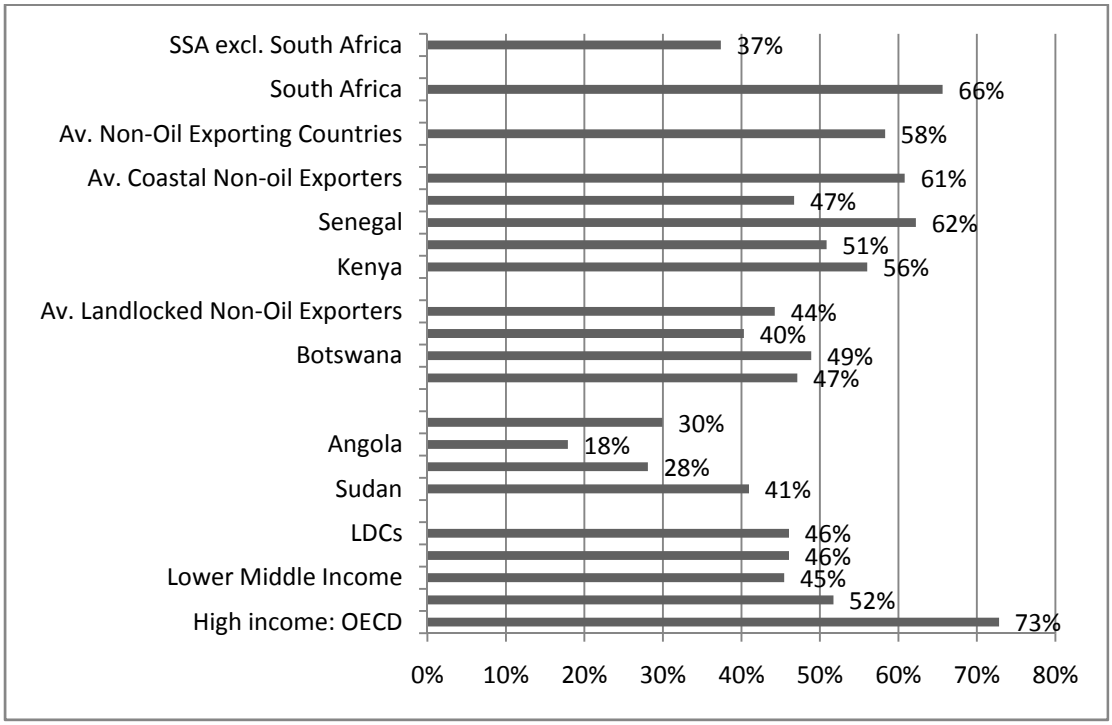
A The Services Sector in Africa

2.4 In 2007, value added in the services sector accounted for 37% of GDP in the average African country (excluding South Africa), a substantially lower level than in high income countries, where the average share of services exceeds 70%, as well as lower than the averages

[11] For many goods the splitting up of the global production chain entails that components cross many borders (each time being measured as an export/import) before, embodied in the final good, they reach the country of consumption. For example, the value-added in China of an iPod that is assembled and exported to the US is a fraction of the invoice value that is recorded by US Customs. Much of the value is due to components such as the microchip which itself is produced in a range of countries and then recorded as an export to China.

for all LDCs and low and lower middle income countries (see Figure 2.1). However, this average for Africa masks substantial differences between oil exporting countries where the share of services is very low at 30% and non-oil exporters where services contribute almost 60% of GDP, considerably above the averages for LDCs and low and middle income countries. Interestingly within the group of non-oil exporting countries, land-locked countries appear to derive proportionately less of GDP from services than coastal countries. This reflects in part that many of the land-locked African countries are LDCs and at the lowest end of the income spectrum. But there may be a causal link whereby the lack of development of services sectors in these countries is a constraint on income growth. Of importance to land-locked countries is their connectivity to global markets through road, port, air and telecommunications services. Thus, linkages to the infrastructure of neighboring countries and the degree of competition amongst service providers is often a key issue in determining the costs that producers in land-locked countries must incur when accessing external markets. As will be discussed later, regional approaches to infrastructure and the regulation of services industries may offer particular benefits to small land-locked countries.

Figure 2.1 : Value Added in Services as a Percentage of GDP in Selected African Countries and International Comparators Groups, 2007



Notes: Underlying data are in current US$. Averages are derived as the sum of the countries' value added in services divided by the sum of their GDPs which is equivalent to weighting individual value-added shares by GDP shares. Averages for SSA (excluding SA) and comparators are from DDP.
Source: National Accounts data accessed through World Bank Development Platform (DDP).

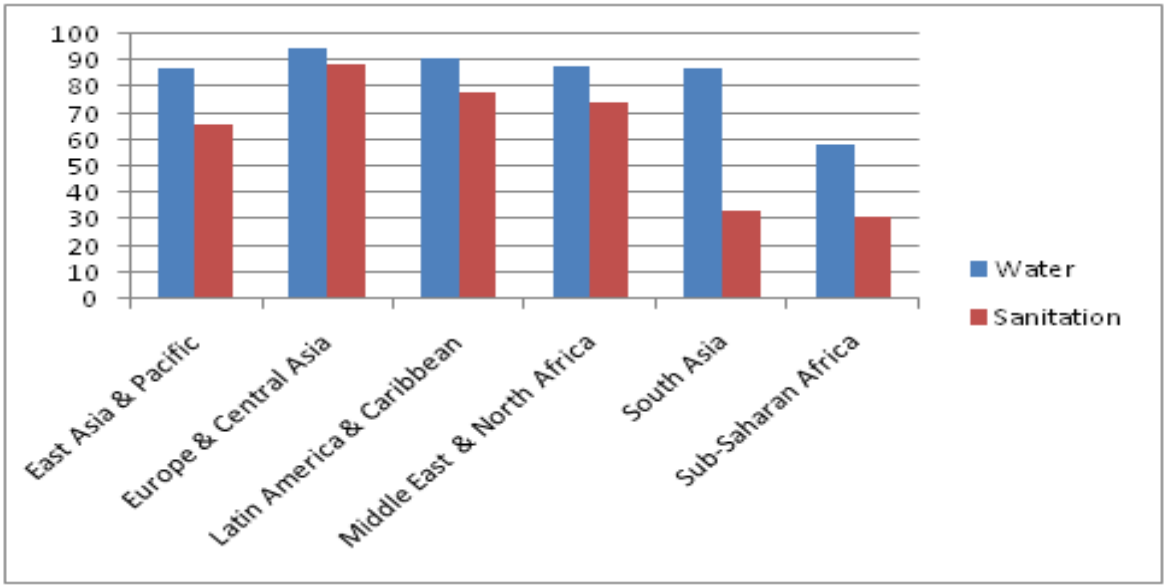
2.5 Although the services sector is growing in much of Africa, the available data suggest that in almost all African economies the increase in services mainly reflects the growth of established services such as travel and transport. These sectors account for a large relative share both in terms of contribution to GDP, as well as to employment. Only a few countries such as South

Africa, Mauritius, and Kenya are beginning to develop links to newer telecommunications-based services and the more sophisticated business services.

Access and Affordability of Basic Services for Households

2.6 Access to, and the cost and quality of, basic utilities such as electricity, water and sanitation are critical determinants of household welfare and essential to the attainment of the Millennium Development Goals (World Bank (2004)). Access to health and education services is fundamental in allowing the poor to escape from poverty. In general, African countries lag other developing countries in providing consumers reliable access to key services at low cost. Only 58 percent of the population of sub-Saharan Africa has access to safe water, the lowest of all regions, and just 31 percent has access to sanitation (Figure 2.2). Almost half of sub-Saharan African countries are not on track to meet the Millennium Development Goal for water and 85 percent may miss the goal for sanitation.[12]

Figure 2.2 : Proportion of Population with Access to Improved Water and Sanitation, 2006



2.7 Only 24 percent of the population of sub-Saharan Africa has access to electricity compared to 40 percent in other low-income countries. Even where there is access cost may be prohibitive for those not in the highest income groups. Power tariffs in most parts of the developing world range from $0.04 to $0.08 per kilowatt-hour. In East Africa, tariffs of more than $0.10 per kilowatt-hour are typical, while in West Africa, consumers in countries without hydropower can pay as much as $0.20 per kilowatt-hour. In addition, often supplies are unreliable with regular outages (World Bank (2009)).

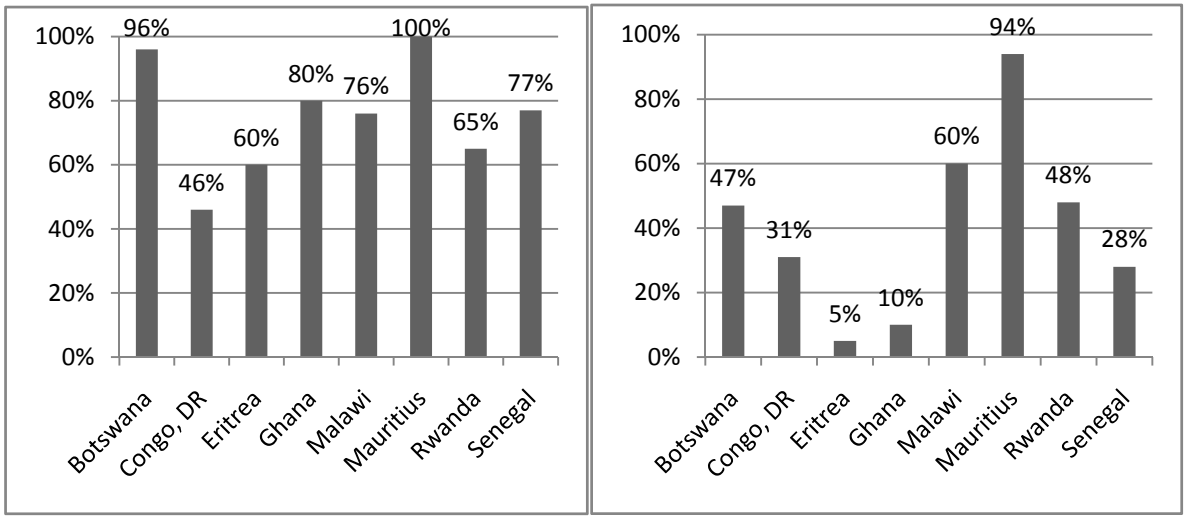
2.8 Telecommunications is the exception to the general pattern of stasis or decline. In telephone density (landlines and cellular telephones), Africa is somewhat ahead of South Asia, with 64 versus 56 subscribers per thousand people. Landline coverage increased dramatically to

[12] The MDGs require that by 2015 the proportion of people without sustainable access to safe drinking water and basic sanitation be halved.

reach more than 7 percent of households in the early 2000s, while cellular telephones came from nowhere to reach 10 percent of households today. This section provides a small snapshot of the problems facing African countries in delivering basic services.

2.9 However, there are substantial differences across countries in Africa in the extent to which basic services are being delivered. For example, over 95 percent of the population of Botswana has access to improved drinking water but only 46 percent of the population of DR Congo has access to safe water (Figure 2.3). While 80 per cent of the population of Ghana has access to improved water source only 10 per cent has access to improved sanitation. Less than half of the population of Botswana has access to improved sanitation.

Figure 2.3 : Access to Drinking Water (left) and Sanitation (right), 2008

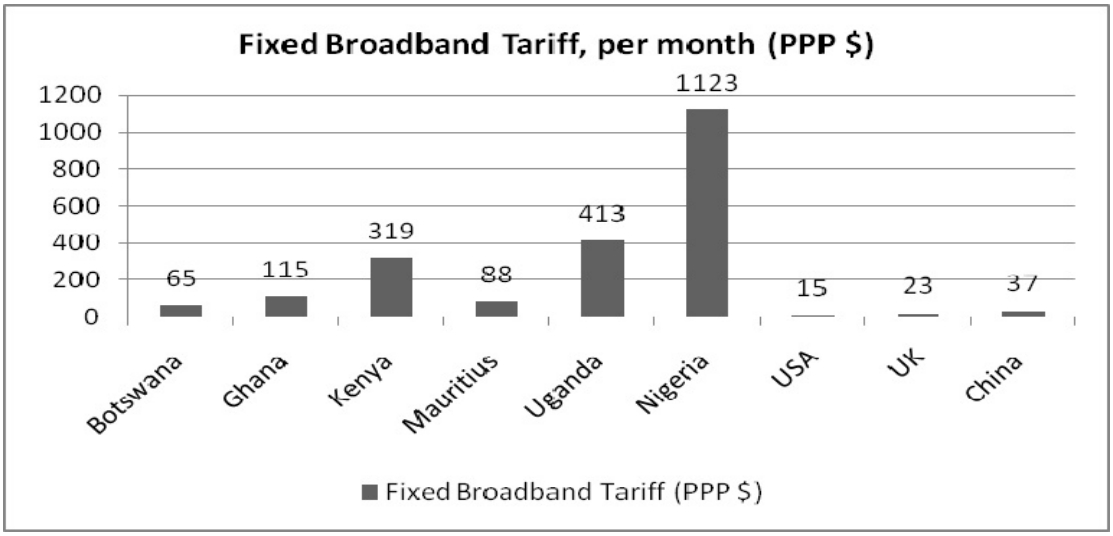


Source: World Bank DDP, accessed 2/17/2010.

Access and Cost of Business Services

2.10 In addition to their importance for households, services are also critical inputs into the production of other goods and services. Some services such as electricity, water and telecommunications are direct inputs into production. Other services, such as, health and education, have indirect effects on productivity. Increasing access, reducing costs and raising the quality of these inputs will have broad economy-wide effects on output and employment.

Figure 2.4 : The High Cost of Using the Internet in Africa



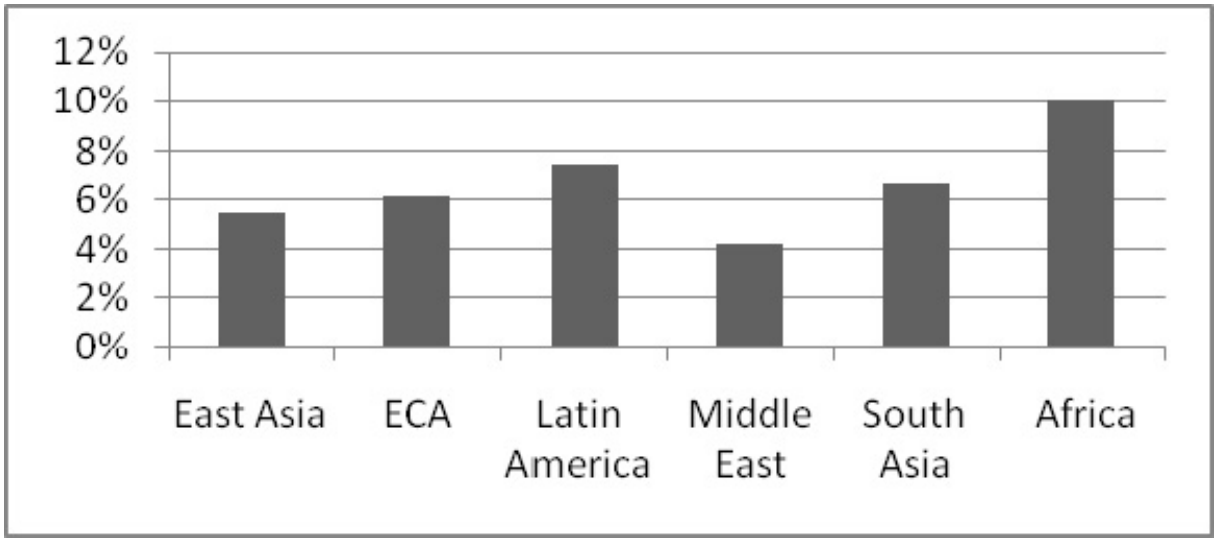
Source: Global Information Technology Report 2009-2010

2.11 The World Banks Africa Infrastructure study reports that Africa's firms report losing 5 percent of their sales as a result of frequent power outages; this rises to 20 percent for informal sector firms unable to afford backup generation facilities. Road transportation costs in Africa are higher than elsewhere. For example, prices per ton-kilometer in Central Africa on the route between Douala-N'Djamena are more than 3 times higher than in Brazil and 5 times greater than in Pakistan. However, transport costs in Africa do not appear excessive and high road freight tariffs reflect high profit margins and lack of competition (Teravaninthorn and Raballand, 2008).

2.12 While there has been a considerable increase in the use of mobile phones in Africa, which has contributed to reducing telecommunications costs for many entrepreneurs, the cost of accessing the internet remains extremely high in many African countries (Figure 2.4). In part, this reflects lack of access to fibre optic cables and the continuing reliance on satellites for connectivity. This infrastructure gap is being addressed in many parts of the continent with connection to undersea cables. Nevertheless, even when countries have access to a submarine cable prices can remain high relative to other countries if a monopoly is permitted on the international gateway.

2.13 Banking is also expensive in Africa. The difference between lending and borrowing rates offered by financial institutions in Africa is larger than in other regions (Figure 2.5). While there are high costs and high risks for financial firms in Africa, profits are also high. Subsidiaries of foreign banks in Africa obtain a return on assets and equity that is higher than that of the subsidiaries of the same banks in other regions (Beck et al (2009)). Africa appears to suffer not only from high costs in banking but also lack of competition that would reduce interest rate margins.

Figure 2.5 : Interest Rate Spread in Africa and other Regions (2007)



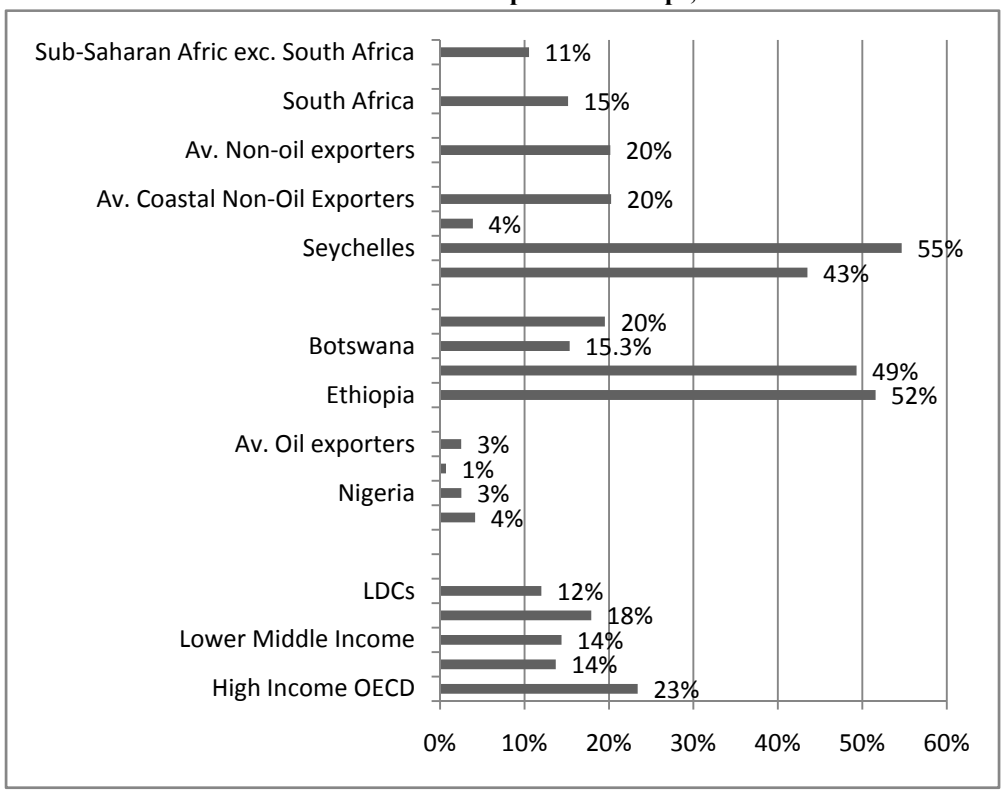
Source: World Bank DDP

B Africa's Exports of Services[13]

2.14 In the average sub-Saharan African country (excluding South Africa), recorded exports of services contribute about 11% of total exports (Figure 2.6). However, this average does not reflect the very low share of services in the exports of oil-exporting countries, just 3 percent. For non-oil exporters, services account for 20 percent of total exports. Exports of services for non-oil African countries play a more important role in total exports than in any other region, except high income countries. It is noteworthy that the importance of services in total exports is the same for both land-locked and coastal countries, while the share of services in GDP is smaller for the land-locked countries. This partly reflects that trade overall plays a smaller role in the economies of the land-locked Africa countries. There is however, wide variation across countries within each group. For example, just 4 per cent of the export revenues of Guinea come from services, while for Tanzania, over 40 percent of total exports are due to services. Trade in services accounts for around half of total exports for Rwanda and Ethiopia but only 15 percent of the exports of Botswana.

[13] The GATS definitions of service sectors and modes of delivery do not correspond directly to the definitions used in standard national accounts and balance of payments statistics. The main statistical source for measuring the magnitude of services transactions is the IMF Balance of Payments database that generally covers services traded internationally mainly via the first and second mode, and, to a limited extent, to trade via the movement of natural persons and via commercial presence. Additional sources need to be consulted for modes 3 and 4. For mode 3, Foreign Affiliates Trade in Services (FATS) statistics are an important source of information. However, such statistics are available only for a limited number of countries (mainly OECD economies). FDI statistics (flows and stocks) can be used as a complement to FATS statistics (or in the absence of FATS statistics as very imperfect proxies for trade via commercial presence). For mode 4, labor-related statistics such as compensation of employees and migrant remittances may provide some information on trade via temporary movements of people. Definitional differences and statistical issues are discussed further in Annex C on definitions of services sectors, modes of delivery, and sources of data. Because of the difficulty in capturing some types of service flows, data on recorded trade in services may significantly understate actual imports and exports, particularly for trade within Africa because of long land borders and weaknesses in recording and measurements systems.

Figure 2.6 : Exports of Services as Percentages of Total Exports (Goods and Services) in African Countries and International Comparator Groups, 2007



Notes: Data are for 33 Sub-Saharan African countries, plus South Africa. Average percentages for oil and non-oil exporting country groups have been calculated as the sum of the countries' exports of services divided by the sum of the countries' total exports of goods and services.
Source: IMF BOP data accessed through World Bank Development Data Platform (DDP) on 11/2/2009.

2.15 In balance of payment statistics, services exports are reported as commercial and non-commercial (personal and government) services. Commercial services are subdivided in transportation, travel, and other commercial services.[14] The largest component of Africa's service exports are in the travel services sector, with 50% of the total (Table 2.1). A large share of African countries' services exports is accounted for by the category "other commercial services" which includes communications, construction, computer and IT services, financial services, royalties and licenses, and other business services.[15] This catch-all category represented 29% of total services exports in 2007, with transportation services third at 21%. The weight of the travel category highlights the importance of tourism in many African economies.[16] Nearly half of African countries have significant tourism sectors (greater than 2% of GDP and greater than 5% of total exports in 2000, the definition used by the World Travel and Tourism Council WTTC).[17]

[14] See Annex C.
[15] For illustrative purposes, financial services here are listed in a separate category, but would usually be included in the "Other Services" category.
[16] Note that international carriage/travel of tourists or business travelers falls under transportation, and not travel. Only services consumed in the country of destination (accommodation, meals, in-country travel by local providers, and goods purchased by tourists) fall under the travel/tourism category.
[17] Christie, Iain, and D.E. Crompton (2001).

Table 2.1 : Composition of African Exports of Services, 2007

	Services Exp. to the World (USD million)	Exports, %
Transportation	**8640**	**21%**
Travel	**20571**	**50%**
Other	**11931**	**29%**
Financial	2057	5%
Total	**41142**	**100%**

Sources: World Bank DDP, accessed 2/25/2010, and EU Eurostat Online, accessed 2/25/2010.

The Growth of Africa's Exports of Services

2.16 Table 2.2 shows the average annual growth rate in exports of services for selected African countries over the period 1998-2007. Many countries in Africa exhibit dynamic services export sectors with average growth rates above 10 per cent, and for a number of countries exports of services have grown faster than the average of both low and high income country groups over the same period. It is interesting that the land-locked countries in Africa have seen the fastest growth of exports of services and that their exports of services have grown at a rate more than 3 times faster than the rate of growth of their exports of goods. In some cases very high growth rates are from a very low measured value in the base year and some of the growth reported in the statistics may reflect improvements in the recording of services trade. Nevertheless, this demonstrates the importance of services exports for land-locked countries whose ability to diversify into the export of manufactures is constrained by the high cost of transporting goods.

2.17 Some African countries however, have seen very sluggish services export growth rates. For example, over this period exports of services from Lesotho contracted on average by 1 percent each year. This ten year period saw rapidly rising values of goods exports for many countries in Africa, often driven by increasing commodity prices. Nevertheless, exports of services grew faster on average than exports of goods for almost half of the 35 countries in Table 2.2, and hence provided for increased diversification of exports and reduced vulnerability to the recent global downturn.

Table 2.2 : Average Annual Growth Rates of Exports of Services and Goods of Selected African Countries, 1998-2007

		Services Growth Rate	Goods Growth Rate				Services Growth Rate	Goods Growth Rate
Sudan		112.0%	139.4%		Cote d'Ivoire		6.1%	9.5%
Ghana		101.1%	18.0%		Namibia		5.8%	11.7%
Burundi		48.9%	-3.3%		Djibouti		5.2%	8.6%
Cape Verde		43.5%	8.8%		Sierra Leone		4.2%	173.8%
Swaziland		39.5%	8.1%		Kenya		4.0%	10.0%
Mali		36.4%	17.7%		Gambia, The		2.4%	2.4%
Ethiopia		25.0%	11.8%		Lesotho		-1.2%	31.0%
Rwanda		25.0%	9.8%		Sao Tome		-3.6%	4.9%
Tanzania		24.7%	21.1%		Nigeria		-4.4%	3.2%
Uganda		23.4%	23.7%		Gabon		-4.7%	10.0%
Senegal		22.3%	8.5%		Guinea		-5.6%	9.1%
Congo, Rep.		22.0%	25.0%					
Cameroon		19.9%	14.3%		Coastal Non-oil Exporters		14.0%	13.1%
Botswana		17.2%	7.9%		Landlocked Non-oil Exporters		40.8%	12.4%
Togo		16.7%	6.0%		All Non-oil Exporters		14.7%	13.9%
Benin		16.0%	14.7%		Oil Exporters		6.8%	-0.4%
South Africa		15.5%	14.3%		SSA excl. South Africa		7.2%	1.1%
Zambia		14.9%	31.4%					
Mauritius		14.6%	3.9%		Comparators			
Angola		12.4%	78.7%		LDCs		12.9%	36.0%
Niger		11.7%	14.4%		Low Income		13.5%	26.0%
Madagascar		10.4%	7.7%		Lower Middle Income		24.3%	35.0%
Seychelles		8.8%	24.8%		Upper Middle Income		18.6%	27.2%
Mozambique		6.5%	94.9%		High Income OECD		13.6%	11.1%

Source: World Bank DDP, accessed 11/5/09.

Current Comparative Advantage in Exports

2.18 Based on an index of revealed comparative advantage (RCA), Table 2.3 shows that, as expected, many countries in Africa exhibit a comparative advantage in travel services.[18] A number of African countries covered in the Table also show a comparative advantage in transport. However, revealed comparative advantage statistics give only a static picture. There are likely to be significant opportunities to export additional services, but these may not be apparent at present because of inadequate infrastructure, poor policies, or weak institutions.[19] It

[18] The index of revealed comparative advantage (RCA) can be used to assess a country's export potential. In services the RCA is a measure of services' share in the country's exports (including goods) in relation to the country's share of world trade. A value of the index greater than unity implies that a country is relatively specialized in the service concerned and has a comparative advantage in such exports compared with the world average. Conversely, a value of less than unity indicates a comparative disadvantage. At the service category level, the RCA index is defined as the ratio of exports of a service category (xij) to a country's total service exports (Xit), divided by the ratio of world exports of this service (xwj) to total world service exports (Xwt): RCAij = (xij/Xit) / (xwj/Xwt). Albeit useful, an RCA index is a crude measure of comparative advantage. For example, it does not take into consideration the presence of trade barriers; and since it is based on balance of payments (BOP) data, in the case of services trade, it does not give any indication of a country's comparative advantage in supplying services through commercial presence or the movement of individual service suppliers.

[19] For example, a recent World Bank study highlights the opportunities for Nigeria to export ICT related services. However, these are cannot be fully exploited in the absence of regulatory reform and greater competition in

is interesting to note, however, that a number of countries in Africa including Madagascar, Mauritius, Senegal, Rwanda and Kenya already show a revealed comparative advantage in ICT services.

Table 2.3 : Revealed Comparative Advantages in Services in Selected African Countries, 2007

	Transport	Travel	Finance	ICT	Total Services
Botswana	0.31	1.74	0.25	0.53	0.76
Madagascar	2.04	2.52	0.01	1.74	1.87
Mauritius	2.24	5.68	0.42	1.15	2.47
Mozambique	1.03	1.10	0.10	0.67	0.80
Senegal	1.08	3.58	0.32	2.14	2.08
South Africa	0.46	1.83	0.54	0.30	0.75
Rwanda	2.27	3.46	0.11	2.55	2.45
Kenya	3.80	2.58	0.05	1.15	1.97
Tanzania	1.94	5.10	0.31	0.96	2.16
Uganda	0.17	3.03	0.63	0.45	1.07
Zambia	0.46	0.55	0.16	0.07	0.28

Source: IMF, BOP (2008). *Notes:* [1] 2005, [2] 2004

2.19 In addition, the available data are very weak on the coverage of intra-African trade flows. There are likely to be a range of sectors, such as energy, education, and professional services where there are opportunities for African countries to exploit advantages at the regional level. For example, as discussed in more detail in Chapter 4 below, Uganda has become a successful exporter of education services to the East Africa region. In many of the professional services, providers from the developed countries are likely to be too expensive for many small and medium sized firms in Africa and local suppliers are more likely to be able to provide the level and quality of service that is attuned to local needs. Thus, the aggregate global statistics are unlikely to capture the range of advantages and opportunities that exist in Africa for developing exports of services, especially at the regional level.

Workers' Remittances

2.20 As officially recorded, workers' remittances are the second largest source (behind FDI) of external financing for developing countries world-wide and tend to be more stable than other financial flows (World Bank, 2003). They are an additional important source of foreign exchange earnings for many African countries. Data from the balance of payments on compensation of employees and workers' remittances provide some information on the magnitude of labor-related flows, although only a small part of these flows is included in the definition of Mode 4 services in WTO's General Agreement on Trade in Services (GATS).

2.21 Balance of payments statistics on labor-related flows presented in Table 2.4 show that Africa is a large net recipient of labor income -- compensation of employees and worker

telecoms and access to cheaper electricity. "Transforming Nigeria into Africa's Offshoring Hub," World Bank, January 2009.

remittances -- from (mainly) developed countries and that the total value of labor exports represents more than 30% of the value of exports of services.[20] Labor related inflows grew at a rate of 12% between 1996 and 2006, somewhat faster than total services exports which grew stood at 10% during the same period).

Table 2.4 : Labor-Related Flows and Cross-Border Services Trade in Africa, 1996-2006

Labor-Related Flows	1996	2000	2006	Average annual growth rate
Exports				
Compensation of Employees (% of Total Services Exports)	4.5	4.2	3.0	6.0
Workers' Remittances (% of Total Services Exports)	22.5	25.3	27.5	12.7
Total Receipts of Compensation and Remittances (% of Total Services Exports)	27.0	29.6	30.5	11.8
Total Receipts of Compensation and Remittances (Millions of US $)	5,592	6,837	17,121	
Imports				
Compensation of Employees (% of Total Services Imports)	2.5	3.6	2.4	7.6
Workers' Remittances (% of Total Services Imports)	3.8	4.8	1.8	0.2
Total Compensation and Remittances Payments (% of Total Services Imports)	6.3	8.4	4.2	3.8
Total Compensation and Remittances Payments (Millions of US $)	2,158	2,758	3,125	

Source: Authors' calculations based on IMF BOP Statistics

2.22 The value of officially recorded remittances is striking in some countries. The top 10 African recipients of labor remittances in 2007 were Nigeria ($3.3 billion), Kenya ($1.3 billion), Sudan ($1.2 billion), Senegal ($0.9 billion), Uganda ($0.9 billion), South Africa ($0.7 billion), Lesotho ($0.4 billion), Mauritius ($0.2 billion), Togo ($0.2 billion), and Mali ($0.2 billion). The contribution of remittances to national income is equally striking in the top 10 countries receiving the largest inflows of remittances as a percentage of GDP in 2006: Lesotho (24.5% of GDP), The Gambia (12.5%), Cape Verde (12.0%), Guinea-Bissau (9.2%), Uganda (8.7%), Togo (8.7%), Senegal (7.1%), Kenya (5.3%), Swaziland (3.7%), and Benin (3.6%).[21] Workers' remittances are thus an important additional source of foreign exchange income in many African countries, amounting exceeding 3% of GDP in one-third of the countries for which data are available.

[20] BOP statistics on labor-related cross-border flows are very imperfect proxies of services trade via mode 4. For example, the data may include flows associated with foreign born and permanent citizens and workers in sectors other than service and thus overstate (considerably) remittances from the temporary presence of foreign service-suppliers. On the other hand, the estimated total flows may be significantly understated because some countries do not report remittance information and a large share of remittances arrives through informal channels that are not recorded—such as via an individual traveling to the region (Sander and Maimbo, 2003). Additional information collected from FATS statistics (number of foreign employees in foreign affiliates) and migration statistics needs to be consulted for a more complete analysis of trade in services via the temporary presence of natural persons.

[21] The data cited in this paragraph are from http://siteresources.worldbank.org/INTPROSPECTS /Resources/ 334934-1199807908806/SSA.pdf

Africa's Exports of Services to the EU

2.23 The EU is a more important market for Africa's service exports than for its merchandise exports, absorbing 51% of Africa's nearly $21 billion in service exports in 2007 and between 32% and 76% of exports in all categories of service exports.[22] Travel and transportation services account for the bulk, 62%, of Africa's service exports to the EU. Transportation is more important in exports to the EU than in exports to the world, while travel constitutes a smaller share of exports to the EU (31%) compared to exports to the world (50%). The category "other commercial services" is more important in exports to the EU, accounting for 34% of the African countries' services exports to the EU versus 29% of their world exports. The EU data permits a greater breakdown of the other services category and shows the dominance of other business services, a category which telecommunications, postal and courier services, cross-border news-related services, and miscellaneous technical, business, and professional services.

2.24 Although no data are available on the share of workers' remittances coming from the EU, an educated guess would be that the EU is probably as an important source of the African EPA-countries' workers' remittances as of their earnings from services exports, of which the EU accounts for two thirds.[23] However, there is little statistical basis for a making a quantitative assessment of the share of Mode 4 service exports from African countries to the EU in total workers' remittances from the EU.

Table 2.5 : Africa's Exports of Services to the EU, 2007

Services Exports to the EU		
	USD million	Exports, %
Transportation	**6562**	**31%**
Travel	**6528**	**31%**
Financial	**788**	**4%**
Finance	483	2%
Insurance	305	1%
Other	**7106**	**34%**
Communication	628	3%
Computers	300	1%
Construction	1056	5%
Royalties	441	2%
Personal	156	1%
Other business	4526	22%
Total	**20983**	**100%**

Source: World Bank DDP

Intra-African Trade in Services

2.25 Few systematic data are available on intra-African trade in services and the policy barriers to expanding this trade. As noted earlier, data on recorded intra-African trade in services

[22] The comparison between African exports of services to the EU to its exports of services to the world can only approximate because the data come from different sources and there is an issue of exchange rate conversion from euros to dollars.

[23] Old estimates suggest that there were about 1.1 million African nationals in Western Europe in 2000 (Sander and Maimbo, 2003).

may significantly understate actual flows because of long land borders and weaknesses in measurement and recording systems. Formalizing and promoting this unrecorded trade is an important policy challenge. For many countries in Africa transportation services are likely to be an important feature of bilateral trade flows, particularly between land-locked countries and the neighboring countries that provide a gateway to the seas. Evidence from specific studies also indicates the importance of particular services sectors that is not reflected in available data. For example, Uganda is a significant exporter of education services to other countries in the East Africa region.

2.26 Anecdotal evidence suggests that there may be significant scope for expanding intra and inter-regional African trade in services in such areas as banking, insurance, business services (accounting, advertising, law, consulting), ground transportation, and construction. As will be discussed below in Chapter 5, export capacities in services are often best developed first on a regional basis so that economies and scale and learning effects can be exploited before tackling global markets. In a number of sectors, tastes and demands and regulatory conditions are likely to be more similar in neighboring markets than in the global market, at least compared to high income countries. This provides an opportunity for African countries to develop mutually beneficial trade and comparative advantages in particular subsectors and firms in areas where international service-suppliers are likely to be non-competitive.

2.27 Recent work by the World Bank demonstrates the potential for cross-border trade in Africa in a range of professional services, such as, accountancy, legal and engineering services (see Dihel et al (2010)). The differences in national endowments of professionals and the capacity for professional training, reflected in differences in the earnings of professionals and the costs of training across countries, suggest that there is substantive scope for trade and potentially large gains from eliminating impediments to trade. However, the current fragmentation of regional markets for professional services and professional education in East Africa by restrictive policies and regulatory heterogeneity prevents countries from exploiting gains from trade based on comparative advantage, as well as gains from enhanced competition and exploiting economies of scale. Thus, identifying and removing policy barriers to expanded intra-African trade in services are likely to be important elements of a strategy with regard to trade in services.

C Africa's Imports of Services and FDI

2.28 Many African countries do not have a strong supplier base from which to source service inputs, and the African EPA-countries are significant net importers of services. In 2007, imports of services accounted for 31% of total imports of goods and services in the average non oil-exporting country, higher than the level in other groups of similar low income developing countries (Figure 2.7). However, Africa's oil-exporting countries registered a higher average share (37%) of service imports in total imports while for non-oil exporters services comprised 20 percent of total imports. The share of services imports in total imports is similar for coastal and land-locked countries. For the non-oil countries the importance of services in total imports matches the importance of service in total exports. Since, most of the non-oil exporting countries are running substantial trade deficits the magnitude of imports of services exceeds that of exports of services. A Comparison of Tables 2.6 below and Table 2.1 shows that for Africa as a whole, imports of services are almost double the value of exports of services.

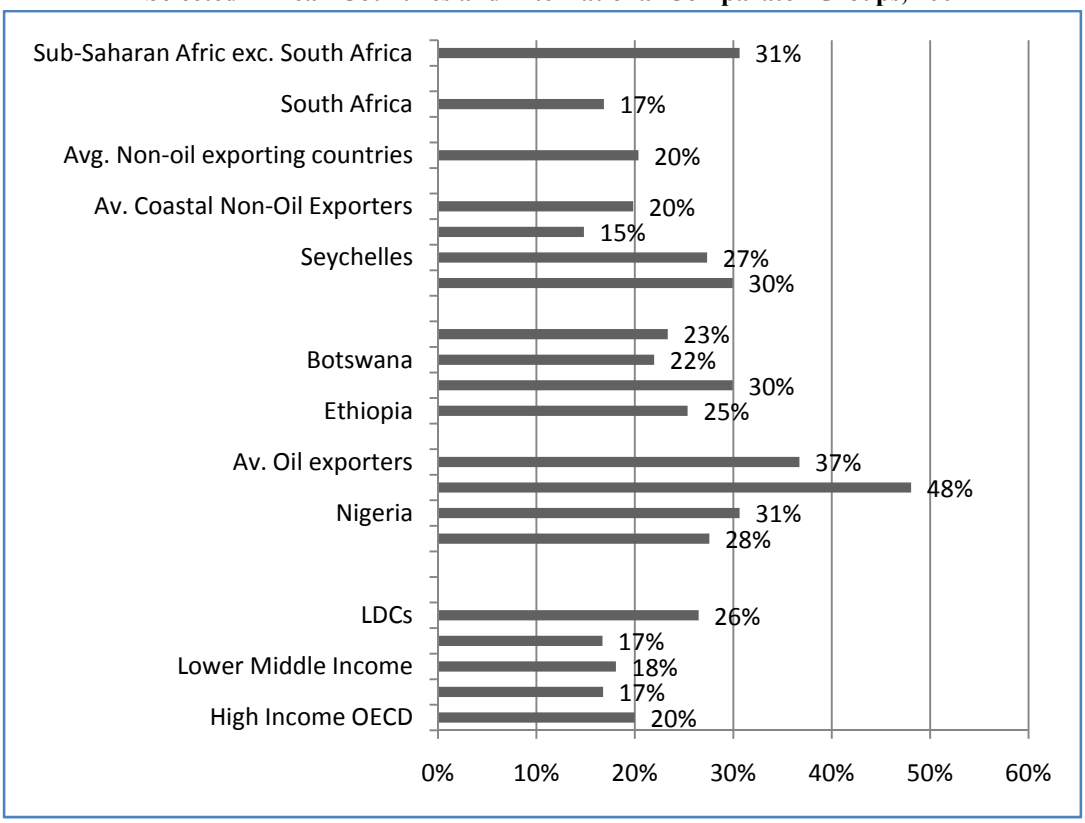
2.29 In terms of the composition of imports of services, other commercial services accounted for the largest share of Africa's services imports with 48% of the total in 2007, followed by transportation services with 39% and travel services with 17% (Table 2.6). Africa is running a substantial surplus on trade in travel services and large deficits n trade in transportation and other commercial services.

Table 2.6 : Composition of African Imports of Services, 2007

	(USD million)	% of Imports
Transportation	26680	35%
Travel	12959	17%
Other	36590	48%
Financial	3049	4%
Total	76229	100%

Sources: World Bank DDP, accessed 2/25/2010, and EU Eurostat Online, accessed 2/25/2010

Figure 2.7 : Imports of Services as Percentages of Total Imports (Goods and Services) in Selected African Countries and International Comparator Groups, 2007



Notes: Data are 33 Sub-Saharan African countries, plus South Africa. Average percentages for oil and non-oil exporting country groups have been calculated as the sum of the countries' imports of services divided by the sum of their total imports of goods and services.
Source: IMF BOP data accessed through World Bank Development Data Platform (DDP) on 11/2/2009

2.30 Of the 35 African countries shown in Table 2.7, only 16 had annual growth rates of imports of services in excess of the average for low income countries. Again, the highest figures reflect substantial growth but from a very low level of recorded base year imports of services. For many countries the growth of imports of services has been rather turgid relatively to other groups in the global economy. However, it is again the land-locked non-oil exporters than have seen the fastest growth rates of imports of services.

2.31 For 23 of the 36 African countries the growth of exports of services has exceeded the growth of imports of services over the past decade. For countries such as Nigeria, exports of services have grown on average more than three times faster than imports of services. For other countries, such as Lesotho, despite sluggish growth of imports of services, exports of services have grown at a fraction of the rate of growth of imports. In other regions, there has been a greater degree of balance in the growth of imports and exports of services. This exception is LDCs which have seen imports of services grow at a faster pace than exports of services.

Table 2.7 : Average Annual Growth Rates of Imports of Services and Goods for Selected African Countries, 1998-2007

		Services Growth Rate	Goods Growth Rate				Services Growth Rate	Goods Growth Rate
Sudan		160.1%	44.3%		Cote d'Ivoire		6.8%	13.0%
Burundi		41.0%	16.8%		Lesotho		6.3%	5.6%
Angola		40.0%	42.6%		Uganda		4.7%	18.4%
Congo, Rep.		37.1%	34.0%		Djibouti		4.0%	16.9%
Ethiopia		34.5%	41.5%		Rwanda		3.7%	12.9%
Ghana		32.5%	27.6%		Kenya		3.2%	4.3%
Cape Verde		30.8%	24.5%		Gambia, The		2.2%	5.2%
Zambia		22.4%	24.2%		Gabon		1.2%	4.0%
Senegal		21.6%	25.4%		Namibia		-0.4%	9.1%
Benin		19.0%	17.8%		Guinea		-0.8%	13.8%
South Africa		17.4%	18.2%		Nigeria		-1.9%	-0.3%
Botswana		17.1%	7.9%					
Seychelles		17.1%	17.1%		Coastal Non-oil Exporters		13.9%	13.7%
Mozambique		16.0%	31.1%		Landlocked Non-oil Exporters		22.2%	14.6%
Niger		14.1%	20.5%		All Non-oil Exporters		14.7%	13.8%
Mauritius		13.8%	7.8%		Oil Exporters		1.6%	12.5%
Mali		12.2%	23.8%		SSA excl. South Africa		10.1%	12.7%
Swaziland		10.7%	8.9%					
Sierra Leone		10.5%	45.0%		Comparators			
Cameroon		8.8%	19.0%		LDCs		21.2%	21.3%
Tanzania		8.5%	31.7%		Low Income		13.1%	24.2%
Togo		8.2%	10.2%		Lower Middle Income		20.2%	28.4%
Sao Tome		8.0%	31.6%		Upper Middle Income		16.9%	22.1%
Madagascar		7.4%	13.2%		High Income OECD		12.3%	13.2%

Source: World Bank DDP.

Table 2.8 : Ratio of Growth in Exports of Services to Growth in Imports of services 1998-2007

		Ratio of Growth of Services Exports to Growth of Services Imports				Ratio of Growth of Services Exports to Growth of Services Imports
Guinea		7.07		Niger		0.83
Rwanda		6.75		Ethiopia		0.73
Uganda		4.98		Sudan		0.70
Swaziland		3.69		Zambia		0.67
Ghana		3.11		Congo, Rep.		0.59
Mali		2.99		Seychelles		0.51
Tanzania		2.91		Mozambique		0.40
Nigeria		2.30		Sierra Leone		0.40
Cameroon		2.26		Angola		0.31
Togo		2.03				
Cape Verde		1.41		Coastal Non-oil Exporters		1.01
Madagascar		1.40		Landlocked Non-oil Exporters		1.84
Djibouti		1.29		All Non-oil Exporters		1.00
Kenya		1.24		Oil Exporters		4.29
Burundi		1.19		SSA excl. South Africa		0.71
Gambia, The		1.12				
Mauritius		1.05		Comparators		
Senegal		1.03		LDCs		0.61
Botswana		1.01		Low Income		1.03
Cote d'Ivoire		0.90		Lower Middle Income		1.20
South Africa		0.89		Upper Middle Income		1.10
Benin		0.84		High Income OECD		1.11

Source: World Bank DDP, accessed 11/5/09.
Note: The following countries were excluded from the table because of negative ratios: Lesotho, Sao Tome and Principe, Gabon, and Namibia.

Imports of Services from the EU

2.32 The EU is the largest supplier of services imports to Africa, with an overall market share of 42% in 2007 and supplies between 23% and 54% of imports in all categories of service imports. The services trade with Europe is, however, more balanced than with the rest of world with services exports to the EU covering 66% of the value of service imports from the EU whereas Africa's total world exports of services amount to 54% of its world imports of services.

Table 2.9 : Composition of African Imports of Services from the EU, 2007

Services Imports from the EU		
	USD million	**Exports, %**
Transportation	**7605**	**24%**
Travel	**2966**	**9%**
Financial	**3260**	**10%**
Finance	2599	8%
Insurance	661	2%
Other	**18116**	**57%**
Communication	709	2%
Computers	1910	6%
Construction	3367	11%
Royalties	909	3%
Personal	239	1%
Other business	10981	34%
Total	**31947**	**100%**

Sources: World Bank DDP, accessed 2/25/2010, and EU Eurostat Online, accessed 2/25/2010.

2.33 The largest component of Africa's service imports from the EU is in the "other services" category[24], with 57% of the total, larger than the share of this category in imports from the world. Transportation services imports are the second largest category, with 24% of the total, followed by travel services, with 10%. Interestingly, imports of travel services from the EU are much lower than imports of travel services from the world, while imports of other services—financial and ICT services—is much higher than compared to the world. This shows that, while African countries might procure financial, ICT, or construction services from the EU, Africans rarely travel to the EU themselves.

Commercial Presence and Foreign Direct Investment in Services

2.34 According to cross-border M&A data by sector/industry (Table 2.10), finance was the largest recipient of FDI in the services sector in 2007 and 2008. FDI in other services such as business and health services is still small. Transnational corporations (TNCs) continued to invest in infrastructure projects in areas such as electricity, telecommunications and water. Leading African firms in these services are South African TNCs such as Eskom, MTN, Vodacom, Spoornet and Transnet, although other, non-African TNCs, particularly from the EU, such as Veolia (France) that is involved in a water management project, are also active. In addition, TNCs from China, for instance, are engaged in building hydroelectric stations in African countries. The above data covers deals that involved an acquisition of an equity stake of more than 10%. "Net Sales" are net sales of companies in Africa; "Net Purchases" are net purchases by African companies worldwide.

Table 2.10: Cross-Border Mergers and Acquisitions (M&As) in Africa, by Sector/Industry, 2007-2009

	Net	Sales		Net	Purchases	
Sector/Industry	**2007**	**2008**	**2009***	**2007**	**2008**	**2009***
Total	7906	20901	3332	9914	8214	186
Primary	3837	-2055	2430	5328	-261	-36
Mining, quarrying & petroleum	3837	-2055	2430	5328	-261	-36
Secondary	1367	15639	393	810	1649	82
Wood and wood products	-1438	..	..	351	1082	..
Non-metallic mineral products	831	15469	145	466	339	..
Metals and metal products	250	104	248	55	7	44
Services	2702	7316	509	3776	6827	140
Trade	-396	32	..	-267	299	..
Transport, storage, communications	335	1665	644	250	-156	..
Finance	2595	5613	6	1099	7168	179
Business services	91	-157	-77	122	12	-39
Health and social services	..	152	5	2363	282	..

*For 2009, data is from January-June. Source: World Investment Report 2009; UNCTAD cross-border M&A database (www.unctad.org/fdistatistics)

2.35 The data in Table 2.10 also show the substantial downturn in foreign investment in Africa in 2009 following the global crisis. Investment in finance and business services dried up in the

[24] This catch-all category includes the following services: Merchanting and other trade-related services; Operational leasing services; Legal, accounting, management consulting, and public relations; Advertising, market research, and public opinion polling; Research and development; Architectural, engineering, and other technical; Agricultural, mining, and on-site processing; Personal, cultural, and recreational services.

first six months of 2009. Investment in transportation and communications, however, although slightly down proportionately compared to the level in 2008, was already close to double the amount of 2007 by the middle of the year. This perhaps reflects the continuing commitment to infrastructure projects and the longer lead times for such projects.

2.36 Information on financial flows related to cross-border mergers and acquisitions captures only one aspect of the impact of FDI on domestic services sectors. FDI in services is also an important source of new investment and a vital conduit for the transfer of technology and knowhow. For example, countries in Eastern Europe started the transition to market economies in the early 1990s with poorly developed services in many sectors. FDI in services played a major role in bringing in transforming services sectors and raising productivity throughout the economy.

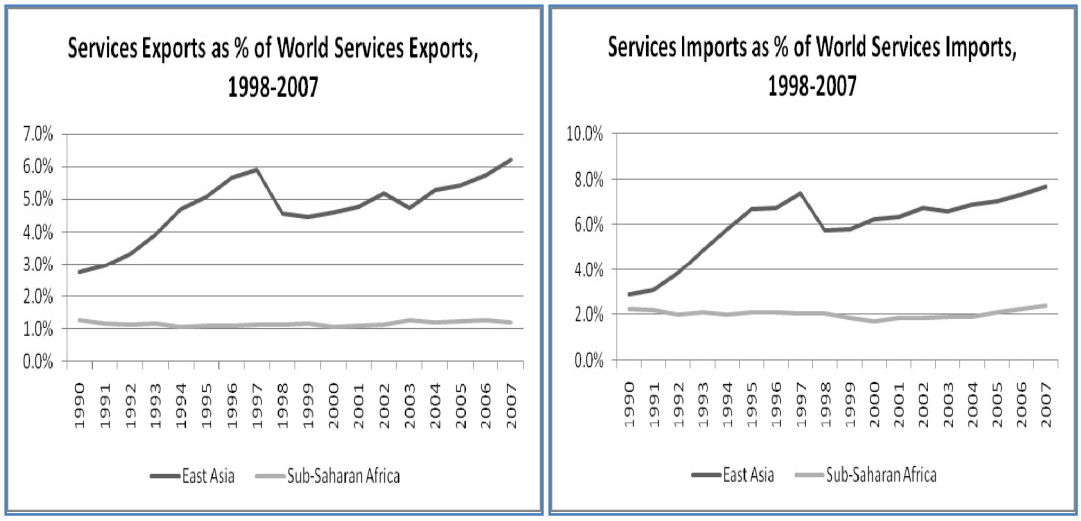
D Africa's Participation in the Global Services Economy

2.37 Despite the positive steps towards expanding its trade in services, Africa in general remains relatively isolated from the global services markets. Africa's limited engagement can be seen in individual sectors as well as in the economy as a whole. Figure 2.8 shows that Africa's shares of global services exports and imports have been roughly constant, at a low level, over the past two decades. In contrast, East Asia's share of the global services market has increased dramatically over the same period.

2.38 Looking at services sectors, Africa has had the most success in increasing exports of travel services. The share of Africa in world travel services exports has doubled in the past decade or so (figure 2.9). However, regions such as East Asia have done even better in expanding exports of travel services. Africa's share of global travel services exports is just over 2%, whereas East Asia's has a share approaching 10%. In addition to tourism, East Asia's booming economies have been successful in attracting travel for business and education purposes. It is clear that there are enormous opportunities for the further expansion of tourism and other travel services exports from Africa.

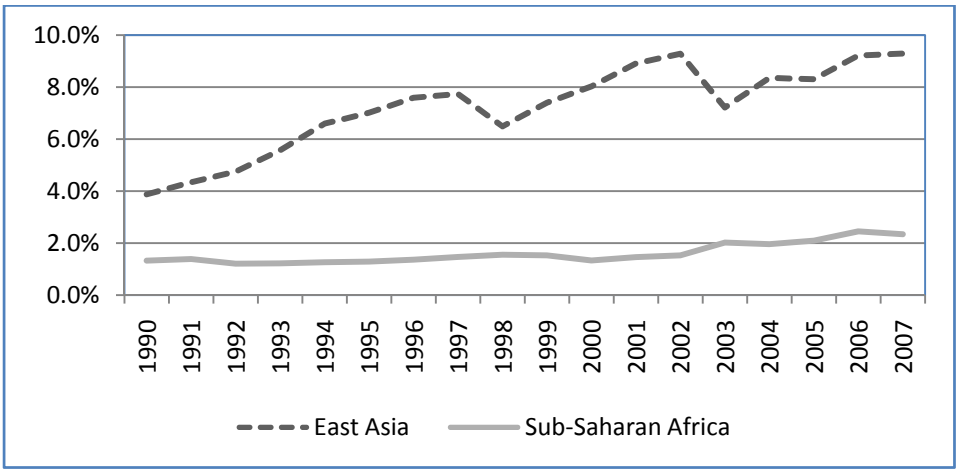
2.39 On the import side, Africa's share of the global market in most sectors has remained flat or declined, whereas we might expect that, given the lack of access and the high cost of many services, Africa would be seeking to encourage supply from abroad. The trend in the share of the global market for financial services is particularly striking, since Africa's share has decreased (Figure 2.10). In contrast, East Asia has steadily increased as a destination for world financial services, once the Asian crisis of the mid-1990s factored out.

Figure 2.8 : Share of World Services Exports and Imports: Africa and East Asia



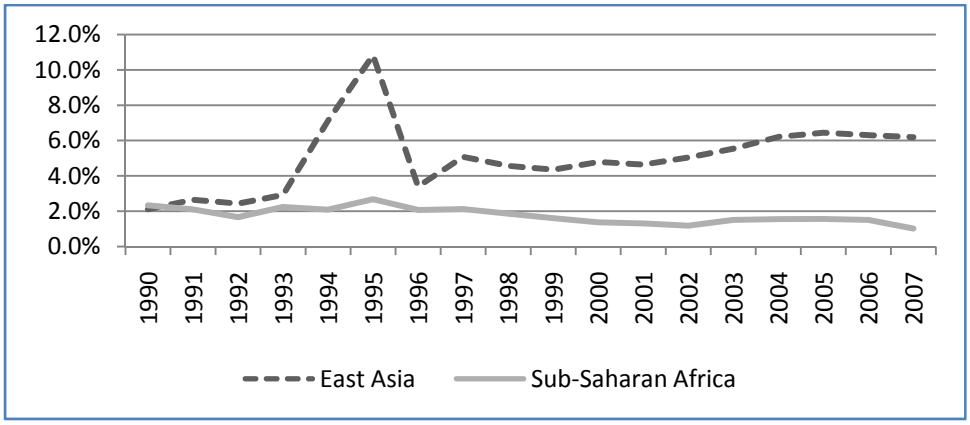
Source: World Bank DDP, accessed 3/8/2010.

Figure 2.9 : Shares of World Travel Services Exports: Africa and East Asia



Source: World Bank DDP, accessed 3/8/2010.

Figure 2.10: Shares of World Financial Services Imports: Africa and East Asia



Source: World Bank DDP, accessed 3/8/2010.

E Conclusions and Implications for Following Discussion

2.40 ***For many African countries the available data of trade in services is limited.*** Detailed sector and sub-sector breakdowns are not available and emerging services exporters will not be apparent. There is no consistent series for trade in services between African countries. This constrains the information that policy makers have upon which to develop strategies for trade in services.

2.41 The available data show that trade in services is a substantial share of total trade for many African countries and that the EU is typically the main partner. Exports are dominated by travel services, reflecting the significance of the tourism sector in many African countries. However, new export activities are emerging in IT related sectors and in business services.

2.42 ***Africa's has not been able to increase its share of global services trade over the past two decades.*** In comparison East Asia has been successful in substantially increasing its share of both global imports and exports of services.

2.43 The available case study and anecdotal evidence suggests that there are ***considerable opportunities for the expansion of trade in services between African countries*** from both the growth of existing flows and from increasing the range of sectors in which regional trade takes place.

3. TRADE LIBERALIZATION AND REGULATION OF SERVICES SECTORS

3.1 African countries are economically small and so national markets are unlikely to generate the level of competition that is needed to drive efficiency and adoption of new technologies and accumulation of skills and deliver appropriate quality and low prices to consumers. Small size and low levels of development also entail that attracting investment from overseas is often important for key infrastructure services. Hence, policies relating to openness to trade, investment and factor movements are a vital part of the approach to services reform. Africa thus needs to look beyond the liberalization of goods only when developing trade liberalization strategies and assessing their benefits. But what is the best strategy for services reform and liberalization in Africa?

3.2 As with trade in goods, economic theory provides a strong case that greater openness to trade in services will potentially be welfare improving by reducing prices and offering consumers greater quality and more variety of choice. Since many services are inputs into other activities the benefits of trade opening tends to be magnified throughout the economy. In addition to these gains from greater efficiency, trade reform can have more important impacts by increasing the rate of growth.

3.3 However, just as with goods that are subject to regulation, for example, for health and safety and for environmental reasons, the welfare benefits of trade liberalization may not arise if appropriate regulations are not implemented. This chapter discusses the contribution that trade liberalization can make to the effective reform of services sectors by stimulating greater competition and allowing for increased foreign investment, which often brings with it new and superior technologies and techniques. It also highlights the importance of coordinating trade liberalization with regulatory reform and capacity building and carefully linking reform to public policy objectives regarding services in terms of cost and access.

A Competition and Services Trade Liberalization

3.4 Competition is essential to increase efficiency in services sectors to achieve lower priced and better quality services. Competition pushes service suppliers to reduce waste, improve management and reduce operating costs. Competition then forces suppliers to pass on these cost savings to consumers in the form of lower prices. Competition also forces firms to innovate and to look for new and better products that are more closely aligned with the needs and demands of their consumers. Thus competition increases the range, variety and quality of services in the market. Finally, competition undermines costly rent-seeking activities whereby incumbent firms spend resources on lobbying officials for policies that will protect them rather than concentrating of increasing efficiency and quality.

3.5 Openness to trade is a very effective way of increasing competition in services sectors. Trade liberalization of services is concerned with reforming regulation that discriminates against foreign providers of services, so as to improve national welfare. That is, foreign suppliers should be subject to national treatment, such that they face regulations that are no less favorable than

those applied to domestic providers, and all foreign providers, regardless of country of origin or establishment, should be subject to the same barriers, if any (most-favored-nation (MFN) treatment). Annex 3.1 provides an illustrative list of discriminatory measures that can restrict trade in services. An increase in the number of service suppliers that follows trade reform will tend to provide for a wider choice of services for consumers and businesses. In many services sectors, entry by foreign firms requires establishing a commercial presence, often through direct investment. FDI is a major source of capital, technology transfer and improved managerial skill in developing economies.

3.6 Reducing discrimination may, however, not be sufficient to increase the amount of trade and competition and services trade liberalization may also require the elimination of non-discriminatory barriers that restrict trade. For example, government policies may support a monopoly and entry of both foreign and domestic firms is barred. Regulations may specify requirements regarding the conduct of firms in the market that are disproportionate relative to their objective and may intentionally or unintentionally restrict trade in services. Thus, when entry is permitted government policies may have a different impact on the operating costs of a foreign entrant compared to domestic firms. This typically leads to a distinction between policies that discriminate against foreign firms and create rents for incumbent firms and whether policies affect entry (fixed costs) and/or the operation of firms (variable costs). Table 1 summarizes these distinctions in the nature and impact of policies affecting trade in services.

Table 3.1 : A Typology of Policies Affecting Trade in Services

	Impact on entry/establishment	**Impact on operations**
Non-discriminatory	A limit of two mobile phone providers permitted to operate in the country;	All retail banks must have personnel on call to monitor and service ATMs
Discriminatory	Nationality requirements for senior managers of affiliates; maximum equity ownership limit for foreign investors;	Car and fire insurance subject to additional capital requirements; cross-border provision of insurance services subject to price regulation

Source: Hoekman (2007)

3.7 In a review of the performance of 6 developing countries including three African countries (The Gambia, Kenya and Zambia, Chandra (2008) concludes that there has been a positive correlation between employment growth and opening up of services and that expansion of services has been associated with improvements in overall efficiency. On the other hand, sector performance has not always improved which draws attention to the importance of regulations and regulatory capacity.

3.8 A range of services are inputs into other services and manufacturing activities. Hence, lower prices, improved quality and better access for these services can have substantial economy wide impacts on productivity and output. Trade liberalization that leads to greater competition in services can play an important role in growth and development.[25]

[25] See Hoekman and Mattoo (2008) for a fuller review of the links and empirical evidence regarding trade in services, trade liberalization and growth.

3.9 Financial services play a key role in economic growth and development. Claessens, Demirgüç-Kunt and Huizinga (1998) show that greater foreign presence reduces profit margins for domestic banks in the financial sectors of developing countries. Francois and Schuknecht (2000) find a strong positive relationship between openness and competition in the financial sector and between financial sector competition and growth. Their results suggest that countries that move from a closed to a relatively open financial services regime and hence a more competitive financial services sector can augment their growth rates by around 1.3 to 1.5 percent. Mattoo et al (2006) find that countries with open financial and telecommunications sectors grow faster than countries that are less open, by about 1 percentage point.

3.10 Nordas (2008) finds that greater openness to trade in services enables developing countries to better exploit their comparative advantages in labor intensive manufactures. In addition to inputs of basic infrastructure services such as energy, water and telecommunications, labor intensive manufactures and labor intensive services require an ever increasing range of supporting services, such as accounting, legal, marketing and other professional services, testing and certification services, as well as access to financial services. These supporting services may not necessarily be produced locally. Hence, trade policy in services should not only target offensive export interests and competition in key infrastructure services but also seek to ensure that local producers of goods and services have access to the range of services they need to be able to compete effectively in both the domestic and overseas markets.[26]

3.11 Blyde and Sinyavskaya (2007) provide empirical evidence that liberalization of trade in services can be beneficial for trade in goods. They find that trade in transportation and communication services generate the largest impacts on trade in goods and trade in services is important to facilitate trade in goods in all categories. Thus, trade policy in services plays a critical role in determining the extent to which countries can take advantage of opportunities to diversify away from exporting basic agricultural and mineral products and move into higher value-added manufactures and services.

3.12 An example in the manufacturing sector is clothing. A number of countries in Africa, such as Lesotho, Kenya and Swaziland have been able to establish an initial base for making-up imported textiles into clothing for export. In the main this has been stimulated by relatively low labor costs but also trade preferences in developed country markets. Most of the increase in exports from Africa over the past decade has been to the US market where non-restrictive rules of origin under AGOA have allowed for the global sourcing of inputs by African exporters. Exports of clothing to the EU under the Cotonou Agreement and under Everything but Arms have been constrained by restrictive rules of origin that prevent firms in Africa from sourcing from the most efficient suppliers.[27] This has now changed with the interim EPAs that allow similar rules of origin to those under AGOA.

[26] In the model of Nordas (2008) trade liberalization in services has a non-linear impact with initial liberalization having a limited impact relative to deeper reforms. Dihel et al (2006) come to a similar conclusion with regard to south-south trade in services; moderate liberalization may be insufficient to have a significant impact on performance in services sectors when the initial level of policy restrictiveness is high.

[27] For more discussion see Brenton (2006)

3.13 While trade preferences and relatively low labor costs give African countries an entry into the production of clothing, longer-term development is furthered by a process that moves on from simply low value-added making up activities towards more and higher value-added processes. Indeed, the global buyers that dominate much of the purchasing decisions regarding clothing imports into developed countries are increasing requiring their suppliers to take on more and more activities such as design, inventory control, sourcing decisions, transportation. Success in moving along this path requires the efficient provision of a range of trade facilitation, technical and business services as well as access to finance to enable investment in upgrading. Mauritius provides an example of an African exporter that has been able to move away from low value-added production of clothing to more sophisticated production facilities that integrate a full range of activities in the production of clothing including design and textile production.

3.14 Tourism is sector that is of particular importance for development in Africa. Indeed countries in Africa have made more commitments in the GATS under tourism and travel related services than in any other sector. This reflects the importance of the sector in many African countries and the objective to attract FDI and expand the sector. Grosso et al (2007) show how backward linkages to other services including transport services and infrastructure, accommodation, utilities and IT infrastructure, marketing and promotion, and education and training can be vital for the development of the tourism sector. Trade reforms that increase competition and improve the quality of these backbone services will therefore have additional benefits in the tourism sector and in turn on poverty through the employment of unskilled and semi-skilled workers in both urban and rural areas. Moreover, tourism can also help with the diversification of goods export (Lejarraja and Walkenhorst, 2009). Tourism can greatly support the process of information gathering, product testing, and scale-efficient establishment, and is associated with greater occurrence of new products and exports.

3.15 OECD (2006) discusses how trade barriers that prevent foreign service providers from interacting with local firms are likely to slow down technology diffusion. FDI that creates subsidiaries in the domestic economy can create both backward linkages to local suppliers and forward linkages to customers and also to competitors(horizontal linkages).This study highlights that technology is transferred not only through formal contracts, such as licensing agreements, joint ventures and strategic alliances, but also through informal channels, such as demonstration effects. In addition, movement of persons that facilitate person to person contact and on the job training can provide for the transfer of know-how and tacit knowledge that is necessary to exploit new technology. Hence, all four GATS modes of supply of services are important for transferring technology with regard to services. At the same time, openness to trade increases the capacity of the domestic economy to absorb new technologies from abroad. Hence, trade liberalization stimulates enhanced trade which facilitates more technology flows and technology leads to increased trade because it opens up new ways of doing business.

3.16 Empirical studies, such as Robinson et al (2002), find that not only are the gains from services liberalization likely to be larger than those from goods liberalization, but that the adjustment costs that arise from service sector reforms may be lower than those arising from reducing protection of goods. This is because the dominant mode of cross-border supply in many services sectors is through commercial presence which entails that services will continue to be produced locally. In practice, the positive economy-wide impacts on employment that emerge as

firms elsewhere in the economy expand as the costs of their services inputs decline and their competitiveness improves will considerably outweigh any negative employment effects on incumbent service providers as markets are opened up to competition. As illustrated by the steady increase in the share of employment in services as countries grow richer, greater contestability of services markets typically results in an expansion in the number of providers of increasingly differentiated services.

3.17 Konan and Maskus (2006) also show that liberalization of both services *and* goods tends to require less adjustment than goods liberalization alone. When just goods are liberalized the economy tends to "over-adjust" towards goods producing sectors. Thus, trade reforms in Africa that focus on goods, not services, may lead to excessive adjustment. With regard to the EPAs this supports proceeding on a broad front, and ensuring that the commitments made regarding liberalization of goods are complemented by liberalization of trade in services. Concerns that trade liberalization of services and increased competition will have a substantial negative impact on employment are thus do appear to be well founded.

B Services Trade and Regulation

3.18 While the long-term benefits for African economies of liberalizing trade in services are compelling, the liberalization of imports of services brings risks and potential costs that may require appropriate government intervention. This arises because of the need to regulate many services sectors to overcome market failures giving rise to concerns about both efficiency and equity. The unique characteristics of services sectors, including natural monopoly power, systemic risks, asymmetric information, and externalities (for example, environmental degradation from tourist activities) in the provision of services create the need for appropriate regulation. In the absence of such regulation trade liberalization can have adverse consequences for the domestic economy. For example, FDI in the tourist sector in the absence of environmental regulations may undermine future growth of the sector.

3.19 For example, network and infrastructure industries such as electricity, water and telecommunications, are highly capital intensive with long-lived assets. These are typically sunk costs since they cannot be sold or reused. There are also substantial economies of scale which can lead to natural monopolies. This is the case in electricity and water, but has been undermined in telecommunications by the development of mobile telephony.[28] The outputs of these industries are crucial to consumers and vital inputs to other economic activities. Hence, these sectors have broad economy wide impacts of output, employment and welfare. These features entail that (i) consumers may need to be protected from abuse of monopoly positions by service providers (ii) investors may need to be protected from governments acting strategically once investments have been made to keep prices at the level of operating costs. In addition, while existing users will seek to keep prices low this may come at the expense of those who are not yet connected. Hence, influential relatively prosperous urban populations in Africa usually have access to energy, water and telecommunications, while rural populations typically do not.

[28] In other infrastructure sectors competition can be introduced in segments which do not face cost constraints related to network duplication. Examples include solid waste management services and sewerage treatment. Thus in sectors that exhibit natural monopoly characteristics it is important to continue to separate those segments in which competition can develop from those segments in which natural monopoly elements remain.

3.20 Market failures can also require intervention in the markets for professional services.[29] However, as in other sectors, it is important to ensure that the regulatory measures that are implemented are not disproportionate and that standards are appropriate. The risks arise from regulations that are overly burdensome having an unwarranted impact on competition. The key issues are:

- *Information asymmetries*. Practitioners, such as lawyers, doctors, accountants, teachers, are required to have a high level of technical knowledge but consumers or clients find it difficult to judge beforehand the quality of the services they purchase. This can be addressed in the market through a reputation premium. However, in many professional services reputation may not provide the necessary information on quality to consumers; reputation may not be sufficient to avoid adverse selection whereby providers of the highest quality, who charge higher prices, are driven out of the market and overall quality deteriorates. Similarly, there may be a principal-agent problem whereby the agent (services provider) has an incentive to over-supply quality in order to charge higher prices even if the principal (consumer of services) would be better off with a lower quality service at a more reasonable price. Such information asymmetries are particularly relevant in Africa where professional services markets are rather underdeveloped and many consumers, especially small enterprises, are less frequent users of such services and may need targeted protection. Protection of consumers generally takes the form of regulation of professionals and professional services, while adverse selection issues are often addressed by (minimum) standards.
- *Externalities*. The use of professional services may bring benefits to users, but also to third parties. For example, an accurate audit can assist companies obtain the necessary credit while also helping creditors and investors make informed lending and investment decisions. However, providers and potential users in Africa, particularly small enterprises, may be unaware of the private and social benefits that the use of professional services can entail. Therefore, intervention in many professional service markets attempts to ensure that positive social externalities do occur and negative externalities are avoided. Negative externalities can be addressed through liability regulations but such an approach operates ex-post and has limited success. Ex-ante quality requirements such as standards related to education and training seem to be preferable to address externality issues.
- *Public goods.* The consumption of many professional services creates positive externalities for parties not involved in the transaction. For example, engineering services may help safeguard the liability of technical systems and guarantee public safety by preventing the construction of poor quality buildings and bridges. Legal professionals may generate important positive externalities that are of great value for society in general by defining and enforcing property rights – a critical issue in many African countries. In a free market public goods tend to be under-produced, since the producer cannot exclude non-paying beneficiaries. To guarantee that public goods are provided, states may decide to enact regulations on the provision of public goods.

[29] This discussion of professional services is based upon Dihel (2010)

- *Market power.* In certain professional services, such as accounting, leading firms (often foreign-owned) have a significant share of the market and a large gap exists between the average leading firm and other firms. For example, accounting and auditing in Kenya and Tanzania are dominated by establishments of the "Big Four" multinationals who control a significant share of the market (over 85% in Kenya). Furthermore, accounting and auditing markets as well as engineering markets seem to be heavily fragmented at the bottom in terms of organization, size, business culture and management. Such market structures may be a result of regulatory failure such as uniform standards or licensing controls at multiple levels. In such cases regulatory intervention that addresses inadequate direct or indirect regulation may be necessary to solve the problem.

3.21 The regulation of markets for professional services may also pursue public interest goals related to equity concerns. Markets can generate the exclusion of certain actors from access to relevant education or access to actual services. Therefore, governments or professional associations justify regulatory measures such as price regulation to ensure access to services for low-income consumers. But the consensus in the economic literature is that such regulatory instruments have potentially the most detrimental effect on competition, by eliminating or seriously reducing the benefits that competitive markets deliver for consumers. It is generally accepted that less restrictive mechanisms such as better information on the services provided could be put in place.

3.22 Regulation is often a complex activity and regulators need to be able to assess the impact of regulatory decisions on relevant industry outcomes. For example, in electricity the relevant outcomes that must be monitored and considered by regulators include[30]:

- *Output and consumption* - a) Household and business access levels b) Consumption levels and growth rates per head and per unit of GDP c) Levels of unsatisfied demand
- *Efficiency* - a) Productivity levels and growth rates b) Cost levels and changes c) Capacity availability and utilization; losses (technical and commercial)
- *Quality of supply* - a) Continuity of supply b) Quality of supply and customer service
- Financial performance - a) Financial surpluses and losses, achieved rates of return b) Measures of indebtedness and interest burden
- *Capacity, investment, and maintenance* - a) Capacity levels and margins b) Levels of investment and share of private and foreign investment c) Levels of maintenance expenditure
- *Prices* - a) Relationship of prices to full economic costs, including a reasonable rate of
- return on assets b) Explicitness, transparency, and efficiency of subsidies and cross-subsidies c) Tariff design that promotes technical and economic efficiency in production, fuel use, and consumption

[30] From Stern (2007)

- *Competition* - a) Well-functioning bid auction markets for concessions and IPP contracts with a sufficient number of bidders b) Well-functioning and competitive generation and supply markets
- *Social indicators* - a) Affordability of supply, particularly for low-income consumers b) Impacts on economic development

3.23 Accounting provides an example of a sector-specific monitoring mechanism. Members and associates of the International Federation of Accountants (IFAC) must participate in a Compliance Program that aims to understand whether and how IFAC's Statement of Membership Obligation requirements are being fulfilled. The program consists of three parts: Part 1, Assessment of the Regulatory and Standard-Setting Framework, was implemented in 2004. This questionnaire requires members and associates to provide information about the regulatory and standard-setting framework in their jurisdiction. Part 2 of the Compliance Program requires members and associates to complete a self-assessment questionnaire about their best endeavors to promote and incorporate international standards issued by IFAC and the IASB, quality assurance and investigation and discipline programs to monitor compliance with applicable professional standards. Part 3 of the Compliance Program requires members and associates to develop action plans, including identifying tools, resources, and regulatory changes to address areas identified through the Part 2 self-assessment.[31]

3.24 Hence the capacity of the regulator will be an important determinant of the nature, quality and impact of regulation. In many sectors and across many countries in Africa the capacity for regulation is weak relative to the EU and advanced developing countries. As will be discussed below this is a critical issue that must be reflected in the EPA negotiations and the timing and sequencing of any commitments that African countries make in international agreements such as an EPA.

C Risks from Liberalizing Services Trade

3.25 Regulation, while essential in many services sectors, in itself does not constitute a barrier to trade in services as long as domestic regulation does not discriminate against international trade in services. However, restrictions on trade may be an outcome of domestic regulations that have been adopted, and some domestic regulations that effectively restrict trade are not necessarily discriminatory. For example, despite the liberalization of the tourism sector in Zambia, the continuing high cost, in terms of both time and money, and the unpredictability of domestic licensing and administrative requirements to open and operate a business have shut some local entrepreneurs out of the tourism sector.[32]

3.26 Mattoo and Payton (2007) describe how the lack of an appropriate regulatory framework to encourage prudent risk-taking and market discipline in the banking sector undermined financial liberalization in Zambia in the early 1990s. A series of bank failures caused losses to taxpayers and depositors in the region of 7 per cent of GDP. The experience of Zambia with

[31] http://www.ifac.org/ComplianceProgram/
[32] Mattoo and Payton (2007)

liberalization of services demonstrates the importance of the nexus between trade liberalization and effective regulation, although it is important to note that there is wide variation across countries in outcomes. For example, with regard to banking while foreign banks have tended to exploit the most lucrative parts of the market, often they have not provided the financial sector deepening that was hoped for. However, this is not a common picture across all countries. In some countries this deepening process is proceeding impressively quickly, as in Kenya, reflected in increasing number of accounts and more extensive branch and ATM networks. Arora and Ferrand (2007) suggest that improved regulatory capacity was important in stimulating better financial sector performance in Kenya. Country characteristics can play an important role in explaining outcomes, as in the case of Zambia where the widely-spread, largely rural population, makes branching and traditional MFI activities less viable.

3.27 The design of services regulations and trade reforms are thus often interdependent, and the relationship between regulatory reforms is complex and interactive. For example, when imports of services through commercial presence are liberalized, it is important that foreign entry leads to more competition and improved service, not merely to a transfer of ownership from a state monopoly to a private one or from a national monopoly to a foreign one. Reforms to establish an appropriate regulatory framework may need to precede the opening up of the sector concerned to set the rules of the game for new investors by establishing appropriate competition and pricing rules for foreign investors in services, service and access requirements when relevant, and adequate oversight and conflict resolution mechanisms. Without such a regulatory framework, liberalization of commercial presence in services and privatization of former public monopolies can result in private monopolies or collusion among a few operators.

3.28 Regulation also needs to take technology into account, and openness to trade is a major source of new technologies. Since new entrants often bring new technologies and skills, it is important that there is not a rigid delineation between setting the regulatory framework and trade opening but instead an inclusive and dynamic process in which regulatory interventions are driven by empirical risks and opportunities. Hence, it is important to obtain information from not only incumbent producers but also other potential domestic and foreign investors in discussions concerning the design and implementation of regulations.

3.29 Interactions between regulatory and trade policy will, on the one hand, tend to complicate the liberalization of services but, on the other hand, will create useful synergies between liberalization of the services sector and regulatory and investment-climate reforms. Liberalization of services imports by mode 3 may also motivate progress in related policy areas such as privatizing public enterprises or improving the general legal and tax regime for foreign direct investment. In other cases, the existing regulatory framework may be adequate; and it may be sufficient just liberalize imports of services. In yet other cases, potentially large benefits from liberalization of services imports may catalyze needed regulatory reforms after commitments to liberalize imports of services have been made.

3.30 Greater openness to trade can affect governance and the quality of regulation in three key ways: first, open economies are better able to learn from successful experience elsewhere and to adapt these to local conditions to improve institutions and regulations; second, the impact of greater competition from firms in countries with better regulations and institutions may force

countries to improve domestic regulations to enable local firms to compete or face these firms going out of business; finally, rent seeking and corruption that undermines the quality and integrity of regulatory institutions becomes more difficult when openness increases the number of firms in the market.

3.31 In network industries the sequencing of privatization, competition and regulatory reform has been shown to have important impacts on economic outcomes. Zhang et al (2004) from a study of the reform of electricity generation in 25 developing countries find that when an independent regulatory authority has been established and competition introduced before privatization then there is higher electricity availability and more generating capacity. Cubbin and Stern (2005) provide evidence that the quality of regulation is positively associated with higher per capita electricity generation and that the positive impact of regulation increases with experience. In telecommunications, evidence suggests that introducing competition before privatization is associated with greater penetration of fixed lines (Fink et al, 2002) while Wallsten (2001) finds that in countries that established separate regulatory authorities before privatization telecommunications investment, fixed telephone penetration, and cellular penetration increased relative to countries that did not. In addition, investors appear to be willing pay more for telecommunications firms in countries that established a regulatory authority before privatization suggesting that where regulatory rules remain unclear investors require a premium.

3.32 Where it is necessary to establish sound regulatory policies and institutions, liberalization of trade in services will typically be more technically and politically demanding than the liberalization of merchandise trade. Before liberalizing imports of some services, many African countries first need to build capacity to regulate these services and have therefore often been reluctant to enter into any commitments to liberalize trade in services. The cost of and time required for building necessary regulatory capacity is an important consideration in determining the timing of trade liberalization and related regulatory reforms. In addition, the government agencies concerned may require significant technical and financial assistance during the initial years of regulatory and trade reforms to ensure careful design of new policies and to build up regulatory capacity.

3.33 The timing of the liberalization of different service sectors therefore needs to take into account the capacity of African countries to implement the required accompanying regulatory reforms and to take into account discussions concerning technical assistance and aid for trade. A phased approach is necessary to allow countries to focus on regulatory reform and capacity building and initially liberalize only those sectors that require little regulation or where existing regulatory policies and institutions are satisfactory, leaving remaining sectors for the future phases with a commitment to continuing negotiations over further progressive liberalization. However, flexibility is required since there may be cases where the incumbent service provider exerts undue influence on regulators, that is, regulatory capture, and manages to stifle attempts at reform. Moreover, existing regulatory agencies may have little or no incentive to reform unilaterally. In these cases, trade liberalization may be required to undermine regulatory capture and catalyze the reform of regulatory agencies.

3.34 Given the need for regulatory reform and strong competition in services sectors, policy makers in Africa face the challenge of getting an appropriate balance between the extent to

which progressive regulatory reform initiatives exploit opportunities for external liberalization to increase competition and bring new investment, technologies and skills and the degree to which trade agreements can be leveraged to drive reform where progress has become bogged down. Since regulation is linked to technology and openness to trade is a source of new technologies it is important that flexible approaches to regulatory reform and trade opening are adopted. Inherently, this suggests a sector by sector approach in which countries target first services sectors that are priorities for their development. It also emphasizes the importance of local capacity to design and implement effective reform strategies and the need for openness, transparency and participation in discussions and decisions concerning the regulation of services. The situation is likely to vary across countries putting strong weight on flexibility in trade policy negotiations for individual countries in Africa to pursue their service sector and regulatory priorities.

3.35 The key issue regarding trade liberalization and regulation is not less regulation but better regulation; that is regulation that more effectively achieves public policy objectives while ensuring efficiently produced low cost services. Tools and procedures can be put in place to assist policy makers to assess whether existing or new regulation will achieve the sector-specific public policy objectives while contributing to market openness. The OECD principles on key market-oriented and trade-and-investment-friendly regulation (see Box 3.1) offers guidance and are pertinent to the regulation of services sectors in Africa. Furthermore, the APEC-OECD Integrated Checklist on Regulatory Reform (adapted to developing countries' needs) could provide further guidance on how to undertake such a combined assessment of regulatory and competition policies, and market openness policies.[33]

3.36 As will be discussed in more detail below, an important contribution that the EPAs could make would be to refer to and support the adoption of key elements of good regulatory practice in the regulation of services in Africa, taking into account levels of development and capacity, through financial and technical support. For example, by providing for a regulatory impact assessment in priority sectors that evaluates the effectiveness of existing regulatory policies for achieving public policy objectives for that sector before trade liberalization commitments are implemented.

[33] The APEC-OECD Checklist is a voluntary tool that APEC economies may use to evaluate their respective regulatory reform efforts. The checklist is comprised of four sections including 40 specific open questions in total. The first is a horizontal questionnaire that deals with the degree of integration of regulatory, competition and market openness policies across levels of government, and on the accountability and transparency mechanisms needed to ensure their success. The second is on regulatory policies which are designed to maximize the efficiency, transparency and accountability of regulations based on an integrated rule-making approach and the application of regulatory tools and institutions. The third is on competition policies which promote economic growth and efficiency by eliminating or minimizing the distorting impact of laws, regulations and administrative policies, practices and procedures on competition, and by preventing and deterring private anti-competitive practices through effective enforcement of competition laws. The fourth is on market openness policies which aim to ensure that an economy can reap the benefits of globalization and international competition by eliminating or minimizing the distorting effects of border as well as behind-the-border regulations and practices. For more details see http://www.oecd.org/dataoecd/41/9/34989455.pdf

Box 3.1 : The Efficient Regulation Principles of the OECD

- Transparency and openness. Foreign firms, individuals and investors seeking access to a market must have adequate information on new and revised regulations so that they can base their decisions on accurate assessment of potential costs, risks and market opportunities. Excessive discretion by field-level bureaucrats should be avoided and there should be procedures whereby stakeholders can appeal the decisions of bureaucrats.
- Non-discrimination. There should be equality of competitive opportunities between like products and services irrespective of their country of origin (both national treatment and MFN treatment)
- Avoid unnecessary trade restrictiveness. Governments should use regulations that are not more trade and investment restrictive than necessary to fulfill the legitimate public policy objectives.
- Use performance based regulations (rather than design or descriptive characteristics). It is easier and less costly when firms have flexibility to meet requirements as this allows for innovation and improved efficiency.
- Use regulatory impact analysis (RIA) to provide a detailed and systematic appraisal of the potential impacts of a new regulation to assess whether it is likely to achieve the desired objectives.[34]
- Administrative simplification to minimise the administrative burdens on firms in complying with regulations, such as, simplification of licence and permit procedures; setting time limits for decision-making.
- Use internationally harmonised measures: Compliance with different standards and regulations for like products can burden firms engaged in international trade with significant costs. When appropriate and feasible, internationally harmonized measures should be used as the basis of domestic regulations.
- Streamline conformity assessment procedures. When internationally harmonized measures are not feasible, necessary or desirable, the negative effects of cross-country disparities in regulations and duplicative conformity assessment systems can be reduced by recognizing the equivalence of trading partners' regulatory measures or the results of conformity assessment performed in other countries. For example, mutual recognition of qualifications for providers of professional services and health and education services.
- Application of competition principles. Increasing competition should be recognised as a goal of regulatory reform such that there should be mechanisms to identify and correct anticompetitive practices.

3.37 In this context, it may be useful for reforming countries to establish a regulatory and trade reform committee for services -- which includes representatives of all other concerned stakeholders as well as services providers -- to oversee the process towards better regulation, greater competition, and trade liberalization. This committee would be charged with facilitating the inter-ministry and inter-agency coordination that is vital to drive effective regulatory reform and that is necessary to properly incorporate trade policy issues in the discussions. Such a committee would have the responsibility to establish the general principles of regulatory reform based on international best practice and to ensure that these are applied consistently across services sectors. The committee could comprise senior members of the concerned core and sectoral government agencies plus well respected representatives of the private sector, academic community, consumer groups, and other stakeholders. The committee would also be charged with ensuring that the discussions are open and transparent and that all interested stakeholders are able to participate.

[34] A typical RIA will include: Purpose and nature of the regulation; the consultation process; review of options for solving the problem; benefits and costs of the regulation; compliance, enforcement and monitoring; summary and recommendations

D Social Objectives and Regulatory Freedom

3.38 Concerns have been expressed that trade agreements, such as the GATS or the EPAs, will deprive regulators of the ability to achieve social objectives. This may help explain the reluctance of many countries to make new commitments or expand on existing ones under the GATS and skepticism about the impact of EPAs. The challenge is to achieve an appropriate balance between greater competition by improving market access for foreign providers and preserving the regulatory freedom that is required to achieve public policy objectives. A particular concern is that increasing competition and liberalizing services will lead to a deterioration in the provision of services to the poorest or less populated areas because these are the least profitable to serve. Existing services monopolies are often required to use part of their monopoly profits in wealthier areas to cross-subsidize unprofitable services in poorer areas or regions. Entry of new competitors into formerly monopolized service industries may erode the profits of the former monopolists and undermine their capacity to cross-subsidize unprofitable services in poorer areas.

3.39 An illustrative example is the case of water services. The experience of developing countries in liberalizing trade in this sector has been assessed by Kirkpatrick and Parker (2004). The provision of safe and reasonably prices water services is critical to development and to poverty reduction. Reforms and trade liberalization has been pursued in many developing countries to increase private participation in the water sector with the aim of increasing efficiency, expanding access and raising quality relative to public provision. The sector is characterized by network economies of scale and the scale of investment required in network assets required to provide the service often limits to scope for competition. Hence, competition takes place to win the contract or concession to provide water services, what is known as 'competition for the market'.

3.40 Kirkpatrick and Parker (2004) find that while there is evidence that privatization of water has been successful in some cases it is also apparent that regulatory weaknesses have led to adverse outcomes. For example, in Queenstown, South Africa, prices paid by the poor for water increased substantially after privatization. However, the relationship between liberalization and outcomes can be complex. For example, with regard to social objectives it is found that private utilities often raise prices but higher prices are typically accompanied by an expansion of delivery to the poor. The total cost of water to the poor may decline if previously they had only access to more expensive bottled water or water supplied by tanker.

3.41 This again draws attention to the institutional capacity required to effectively regulate private suppliers, especially when these are very large multinational firms with substantial influence. The regulator will need to address the issue of balance between provision of affordable water to the poor and allowing the company sufficient profits. Ways in which governments can intervene to encourage provision of services to the poor are discussed below. Limited regulatory capacity will constrain the ability to design and implement appropriate regulations. In addition, limited capacity may also be associated with higher levels of uncertainty and regulatory risk, which private investors will seek to cover with a higher expected return, leading to a higher cost of capital and so a lower rate of investment. A trade agreement which is carefully designed and which provides resources to increase regulatory capacity may therefore reduce these risks and stimulate investment in network service sectors. Kirkpatrick and Parker

draw attention to the role that regulatory impact analysis can play assessing the costs and benefits of changes in regulation and in improving the quality and certainty of regulation.

3.42 There are several ways the government can intervene to ensure the provision of key services to poorer or under populated areas in a competitive environment. The most efficient way is to use an auction to attract the most efficient provider (Milgrom, 1996). Subsidized service can be financed by instituting a small tax on services and auctioning off the revenue to companies willing to provide services to the poor. The advantage of this approach is that a market determines who the providers will be, as compared with traditional administrative practice, under which a regulator chooses the number and identity of the subsidized provider(s). The auction approach has worked well in some developing countries and some sectors -- from telecommunications in Chile, Peru, and India, to electricity in Guatemala -- where private providers compete for performance-based subsidies related to providing services to the poor.

3.43 For example, in environmental infrastructure services, many countries have used innovative strategies such as public-private partnerships to facilitate private participation in the sector and increase access of services to the poor. Public private partnerships can take different forms, ranging from service and management contracts, to concessions, build-operate-transfer contracts, and dispossession.[35] In addition to such large- scale contracts, there are a number of local level, small-scale independent providers which complement public authorities and large concessionaires and service consumers who are not covered by the network The experience with such contracts is mixed. In general, they have raised coverage (and sometimes prices), but have not spread the service as widely as they could have. For example, private participation in the operation of water utilities in Senegal through such a contract created financial incentives for the participating private company to serve poor households and has resulted in better services. Eight years after the signature of the contract, there has been a 20% percent increase in the amount of services supplied, and the number of connected customers has increased by 35% percent. Other case studies (for example, the water and wastewater concessions in Buenos Aires) show that most gains have accrued to already connected consumers and that results are more limited in extending coverage to the poorest. The poorest remain the most disadvantaged both in terms of access and cost. Analysts point out that the main strategic error in this case was been the award of the concession to the lowest tariff bidder, while retaining a high connection charge for the unserved (OECD and World Bank (2006).

3.44 Other policy instruments worth considering in various sectors and countries include: well-designed and targeted lines of credit to SMEs and informal enterprises, incentives to companies to expand their operations to unserved areas, and direct transfer to poor households in the form of cash or vouchers to enable them to purchase services. Conversely, countries need to

[35] *Service contracts* grant private companies, through a competitive bidding process, the right to execute technical tasks for a short period, while responsibility for investment remains with the public sector. *Management contracts* transfer responsibility for operating and maintaining government business to the private sector, while responsibility for capital investment remains with the public sector. *Concessions* transfer the responsibility to private stakeholders for operating and maintaining assets and for investment to private stakeholders. A build-operate-transfer concession is a particular form of concession whereby ownership of a constructed operating asset effectively remains with the operator for a fixed term and is then transferred to the public authority for an agreed sum. In the short to medium term, it has the character of a privatization. Finally, *dispossessions* transmit full responsibility for operations, maintenance, and investment to the private sector.

avoid using inefficient instruments such as cross-subsidization by public or private monopolies to increase access to services.

3.45 Discussion of these issues regarding provision of services has not progressed far in the multilateral negotiations at the WTO. EPAs offer an opportunity for small developing countries in Africa to influence the outcome of negotiations to address the access issue through: (i) obtaining technical and financial assistance to design and implement the types of programs discussed in the previous paragraph; (ii) by ensuring that agreement requires and supports regulatory impact analysis in key sectors where social issues are paramount to assess the potential impact of liberalization on public policy objectives prior to the implementation of commitments; (iii) to propose a dispute settlement procedure to cases where foreign service providers have not meet obligations defined in the contract or concession agreement.

E Fiscal Effects of Removing Restrictions on Imports of Services

3.46 In contrast to merchandise imports, tariffs are often difficult to levy on imports of services and are almost never used as a barrier to the import of services. The liberalization of service imports is likely to have minimal direct negative fiscal impact as the restrictions on provisions of most services, unlike tariffs on goods, do not generate government revenue. Thus, reducing barriers to trade in services does not directly require finding new sources of government funding. In fact, services liberalization may even increase tax revenues to the extent that imports of services are subject to VAT or sales tax and service provision expands.

3.47 However, in some cases the elimination of domestic monopolies in services sectors through regulatory and trade reforms that increase competition could indirectly affect the fiscal positions of the governments' undertaking these reforms. Domestic monopolies in the services sector may earn excess profits which may be partly passed on to the government, if it is a share holder, or which may be used to cross-subsidize mandated but unprofitable services provided to poorer areas. To the extent that increased competition resulting from trade and regulatory reforms leads to reduced transfers of monopoly profits to the government, alternative sources of revenue would need to be found. Similarly, if a former monopoly can no longer afford to cross-subsidize services to poorer areas as a result of regulatory and trade reforms, alternative ways of financing services to poorer areas would need to be found.

3.48 These are also issues that are difficult to deal with in the multilateral negotiations, although in principle they could be addressed by 'aid for trade'. African countries could raise this as part of the negotiations for the EPA, in a manner similar to discussions over compensation for falling tariff revenues. A compensation fund could be established to support reforming governments in designing and funding efficient strategies towards increasing access to key services such as health, water and energy where trade liberalization compromises existing strategies and undermines sources of revenue that fund these.

F Regulation and Exports of Services

3.49 Putting in place an appropriate regulatory framework can also be necessary to enable a country to exploit potential export opportunities by providing a framework that encourages competitive and well-functioning domestic services sectors to meet the requirements of overseas

markets. For example in the health sector, a good regulatory framework can enable a country to take advantage of opportunities to export health tourism services. In Kenya, reform of the regulation of telecommunications that permitted firms to have their own satellite disk to connect to the internet and removed a previous ban on the use of VOIP (voice over internet protocol) services was critical in allowing the export of call centre services to the global market.

3.50 Again, introducing the key elements of good regulatory practice are likely to be important so that transparency and openness in the design and implementation of regulations takes into account a broad range of interests, including producers that have a potential to export as well as those focused on serving the domestic market. African countries could seek to ensure that discussions over technical assistance for regulatory reform in the EPAs negotiations take into account the importance of regulatory reform for export performance in services.

G Benefits of Coordinated Regulatory and Trade Reforms

3.51 To reap the maximum benefits from services liberalization, international integration needs to be carefully managed as a part of a broader reform agenda, which emphasizes competition, sound and efficient regulation, and policies to ensure appropriate quality and widen access to services. A coordinated program of regulatory reforms and lowering of barriers to trade in services to increase competition and improve access to key inputs of services can bring substantial economy-wide benefits from:

a. improvement in the efficiency of the domestic economy and in its ability to adapt to change -- Better regulation of services and open trade policy can lead to lower costs, higher quality, and an increase in the variety of available services, thereby raising investment, innovation, and productivity. These in turn contribute to more job creation, higher growth, and an increase in the size of private sector while delivering lower prices, improved quality, and wider choice to consumers.

b. improved competitiveness in international markets -- A better regulatory and trade environment will also tend to make a country more attractive for both foreign and domestic investment to serve international markets and more competitive in producing for these.

c. more effective, efficient, and equitable achievement of public policy goals – Governments often have public policy goals in regulating services, such as ensuring the stability of the financial system, improving access to key services for low income consumers, and protecting public health and safety. Well designed regulatory reforms and open trade policies can improve the effectiveness and efficiency with which such goals are achieved while reducing the burden on firms in complying with the regulations.

3.52 Two recent country-specific analyses of regulatory reform and services liberalization in Africa show that Tanzania would gain 5% of consumption in the medium term and 14% of consumption in the long run from an across-the-board 50% reduction of inefficient regulatory barriers to business services and that Kenya would gain about 11% of consumption in the medium run (or about 10% of gross domestic product) from a full reform package that includes services liberalization and uniform tariffs. The largest gains for both countries would derive from

reduction in costly regulatory barriers that are non-discriminatory in their impacts between domestic and foreign services-providers.[36]

H Conclusions

3.53 The key messages from this chapter are:

- ***Openness to trade is a key mechanism for stimulating competition and ensuring efficiency in the provision of services.*** For many African countries the national market is insufficient to generate the level of competition and investment that is needed to drive efficiency, encourage adoption of new technologies, and accumulation of skills, and deliver appropriate quality and low prices to consumers. Expansion of imports of services can lead to greater competition, reductions in cost, improvements in quality, and increases in the variety of available services. This can have an important positive impact on productivity and growth both in the sectors producing these services and in those utilizing them as inputs.
- ***In certain sectors it may be necessary to coordinate trade liberalization with regulatory reforms.*** While liberalization of imports of services and access to new export markets are clearly important and can generate compelling long-term benefits they may need to be part of a strategy that addresses weak or inappropriate regulatory frameworks in Africa. This will be necessary in cases where trade opening is likely to exacerbate a clear market failure. At the same time the design and implementation of regulations are not independent of trade reform. Liberalization of trade in services and domestic regulatory reform constitute a dynamic and interactive process in which regulatory interventions and liberalization measures are driven by the relevant risks and opportunities. Services trade liberalization can play an important role in changing the incentive for regulatory reform, especially in sectors where there has been regulatory capture.
- Coordinated trade and regulatory reform requires substantial capacity to design and implement appropriate regulations and monitor their impact. Regulation is often a complex activity and regulators need to be able to assess the impact of regulatory decisions on relevant industry, social and economic outcomes. In many sectors and across many countries in Africa the capacity for regulation is weak and raising capacity is a key objectives. Provision of technical assistance to raise capacity to regulate services in Africa could be discussed under aid for trade and in services trade negotiations.
- ***Additional measures may be necessary to ensure consistency of services reform and social policy objectives.*** There are a range of mechanisms that the government can adopt if a conflict arises between achieving greater efficiency and objectives regarding access and cost for those in the poorest or most remote areas of the country. Issues regarding technical assistance to design such measures and development finance for their funding could be raised during discussions over trade agreements that liberalize services trade.

[36] Jensen, Jesper, Thomas F. Rutherford and David G. Tarr (2008), "Modeling Services Liberalization: The Case of Tanzania," World Bank Policy and Research Working Paper Number 4801, and Edward Balistreri, Thomas F. Rutherford and David G. Tarr (2008), "Modeling Services Liberalization: The Case of Kenya," World Bank Policy and Research Working Paper Number 4544.

Annex 3.1 : Examples of Restrictions on Trade in Services

Restrictions on market entry, including via investment

- Prohibitions and quotas on foreign services firms and/or suppliers entering the market.
- Ban on sourcing from foreign companies, e.g. advertising, accounting, management consultancy.
- Service supply reserved exclusively for domestic suppliers, e.g. internal transportation of freight and mail, voice telephony services.
- Service supply reserved exclusively for residents or citizens, e.g. education, legal practice, insurance, civil engineering and surveying, investment advice.
- Government procurement of services reserved exclusively for domestic supply.
- Prohibitions on cross-border electronic transactions and data flows.
- Requirement that cross-border transactions take place on authorized or monopoly networks.
- Quantitative limits on the amount of foreign investment permitted in a sector and/or in establishing a local presence or investing in existing local companies.
- Quantitative limits on the number of foreign companies and/or personnel permitted in a sector, and the number of its own personnel a foreign company may employ.
- Quantitative limits in air and sea transport services, e.g. on the number of passengers or volume of cargo that may be carried, landing or harbour rights.
- Quotas on foreign films, television programmes and advertising.
- Higher minimum capital requirements for foreign service companies.
- Restrictions on the legal form of the foreign service company.
- Conditions on subsequent investment.
- Conditions on location of the investment.
- Admission taxes for foreign service companies and providers.
- Non-recognition of foreign qualifications or more stringent requirements for foreign providers than for domestic providers.

Ownership and control restrictions

- Compulsory joint ventures with domestic investors, existing companies or the government.
- Limits on the number of foreign board members or government-appointed board members.
- Government approval required for certain commercial decisions.

- Restrictions on foreign shareholders' rights.
- Mandatory transfer of some ownership to locals within a specified time frame.

Operational restrictions

- Performance or local content requirements (e.g. minimum exports, minimum local employment, use of local technology or equipment).
- Restrictions on access to operational permits or licenses.
- Ceilings on royalties.
- Restrictions on repatriation of capital and profits.
- Mandatory minimum or maximum price setting, or uniform pricing requirements, regardless of relative efficiency of foreign and domestic service supplier.
- Favouring domestic suppliers in the allocation of access rights to existing distribution networks, e.g. telecommunications, water and waste treatment, transport services, marketing channels, retail outlets.

Source: OECD (2000).

4. IMPLEMENTING LIBERALIZATION OF TRADE IN SERVICES

4.1 This chapter discusses the mechanisms that are available to countries in Africa that wish to liberalize trade in services and reform the regulation of domestic services industries. Multilateral trade liberalization is governed by the rules set out in the WTO General Agreement on Trade in Services (GATS). Regional approaches to the liberalization of services trade have also typically been based on the GATS framework. While there is no legal obligation to include services in a bilateral or regional free trade agreement, GATS does provide a framework and some rules regarding preferential liberalization of restrictions on services trade. However, it is important to note that the GATS and most regional agreements, as discussed in the previous chapter, have not been effective mechanisms for liberalizing actual applied policies affecting trade in services. Policy reforms that have opened up trade in services have mostly been unilateral.[37]

4.2 A recent survey of 22 African countries by the World Bank, discussed later in this chapter, confirms that many African countries have implemented substantial liberalization in certain services sectors, although not in others. Some African countries maintain restrictive policies across a range of sectors. This liberalization of applied policies was unilateral and has not been locked-in (bound) through legal commitments at the WTO/GATS. Comprehensive information on the nature and extent of existing barriers to trade in services is not available for many African countries. This lacuna is a substantial constraint of the capacity of these countries to plan liberalizations of their applied policies and negotiate effectively at the multilateral and regional levels. Furthermore, because of minimal market-access incentives for participating in international agreements to liberalize trade in services and technical and administrative capacity constraints, most African countries have been reluctant to use these agreements either to motivate liberalizations of their applied policies or to lock-in the reforms they have already implemented.

4.3 This chapter starts with a review of the types of restrictions on imports of services and WTO/GATS rules governing trade in services to establish the international legal context for the subsequent discussion of multilateral, preferential (that is, bilateral or regional), and unilateral liberalization of the trade in services. It then considers the relative merits of non-discriminatory (multilateral) and preferential liberalizations of trade in services, examines available data on applied and bound (committed) policies affecting trade in services in Africa, and analyzes the interaction of the liberalization of applied policies, trade agreements, and capacity constraints. The chapter concludes with recommendations for overcoming capacity constraints and advancing coordinated trade liberalization and regulatory reforms.

A WTO/GATS Rules Governing Trade in Services

4.4 The following section discusses the types of restrictions on imports of services and WTO/GATS rules governing trade in services to establish the international context in which decisions about trade policy are made. Subsequent sections go on to examine the restrictions on

[37] Francois and Hoekman (2009)

trade in services imposed in Africa, the measures needed to create a more open trading environment, and the question of non-discriminatory multilateral liberalization versus preferential bilateral/regional liberalization of imports of services.

4.5 Restrictions on imports of services tend to be quite different from those on imports of goods and are usually closely linked to the specific nature of services. Foreign investment and commercial presence (mode 3) constitutes the most important method of delivery of imports of many types of services. Commercial presence abroad accounts for more than half of total trade in services worldwide. Restrictions on commercial presence can, therefore, significantly limit imports of services. Rather than protective tariffs, restrictions on imports of services typically fall into the two categories: restrictions on market access and discrimination against foreign service-suppliers.

4.6 With regard to market access importing countries may create barriers to or limits on the entry, establishment, or operation of foreign service-providers. Foreign equity ownership in some service sectors may be prohibited (by reserving entry into business entirely for nationals) or restricted through quotas or other measures (such as requiring joint ventures with nationals). Entry or employment of foreign personnel in service sectors may also be prohibited or tightly restricted.

4.7 Importing countries may discriminate against foreign service-suppliers in the design or application of domestic policies. Regulation in itself does not constitute a barrier to trade in services as long as domestic regulations do not introduce distortions that effectively discourage international trade in services. However, domestic regulations often discriminate against foreign service-providers through measures such as preferential government procurement policy, country-specific technical standards not justified by security or other valid reasons,[38] and various non-transparent regulations the practical administration of which favors domestic service-providers. The administration of taxes or subsidies may also favor domestic over foreign service-suppliers. Professional licensing and certification requirements (such as those for doctors, lawyers, and accountants) may serve dual purposes of ensuring necessary quality standards and protecting well organized domestic professionals from foreign competition.

B Standard GATS Policies for Liberalizing Imports in the Services Sector

4.8 The GATS governs trade in services at the multilateral level and also sets the ground rules for bilateral/preferential agreements on trade in services among GATS/WTO members. To deal with the types of restraints on imports of services discussed above, GATS encourages non-discrimination between domestic and foreign investors through member countries entering into commitments on market access and national treatment in multilateral or bilateral trade agreements.

4.9 ***Market Access**:* Countries may reciprocally agree to refrain from maintaining or adopting measures to limit the number of commercial firms or the total quantity of output (through numerical quotas or requirements such as economic needs tests) in specified services sectors. Limitations on the participation of foreign capital in terms of maximum percentage and measures

[38] An example of justified technical standards for trucks would be safety inspections and axle-load limits.

requiring specific types of establishment, such as joint ventures, may also be prohibited in agreed sectors.

4.10 ***National Treatment:*** Countries may also agree to grant to investors to foreign service-suppliers treatment no less favorable than they accord to domestic service-suppliers. Implementation of such a national treatment principle would curtail or eliminate many of the discriminatory practices noted above. However, even if national treatment is enforced, domestic firms may still have some advantage from some types of regulations as it may be easier and less costly for them to meet some regulatory requirements. For example, a requirement to establish a local office entails fixed costs that may exclude entry of foreign firms that might want to do only a small amount of business locally.

4.11 Market access and national treatment of foreign service-suppliers under mode 3 (commercial presence) may, by themselves, have limited impacts on competition and investment in markets that do not have appropriate regulations or weak regulators. If the national treatment of some services sectors is deficient because of restrictive or inadequate services-sector specific regulatory policies or shortcomings in the economy-wide investment climate and competitiveness, then according this same national treatment to foreign service-suppliers will still leave foreign service-suppliers to face all of the same domestic policy constraints as domestic service-suppliers. In contrast, in countries with favorable investment climates and strong agencies to define and enforce appropriate regulations, the provision of market access and national treatment to foreign service-suppliers, will likely lead to greater positive impacts on competition and efficiency.

C GATS Rules Governing *Preferential* Trade in Services

4.12 The core non-discrimination feature of the GATS, like the WTO, is the Most-Favored Nation (MFN) principle. MFN status gives to all GATS members the right to benefit from the treatment that any member gives to any another member except for explicit exceptions under GATS provided for regional and other preferential trade agreements such as the CARIFORUM EPA and other possible designs of services EPAs.[39]

4.13 The key exception to the MFN principle in the GATS is its Article V concerning economic integration agreements (EIAs), GATS terminology for regional trade agreements including customs unions, free, and preferential trade areas. Article V allows member countries to give more favorable treatment to other members who are parties to an economic integration agreement on trade in services if the agreement passes the GATS compatibility test by fulfilling two basic conditions. First, the agreement must have "*substantial sectoral coverage"* regarding the number of sectors, the modes of service delivery, and the volume of trade covered, with no a priori exclusion of any mode of supply. And, second, the agreement must provide for national treatment for service providers of parties to the agreement, eliminating "*substantially all*" discrimination, including both removing existing discriminatory measures and refraining from adopting new or more discriminatory measures. These conditions must be complied with upon entry into force of the agreement or within a reasonable mutually agreed time thereafter.

[39] MFN status confers on the nation receiving it the right to be granted all advantages that a WTO member grants to any other country.

4.14 As in other WTO agreements, GATS includes provisions for the Special and Differential Treatment (S&DT) of developing countries. Article V(3) permits flexibility in establishing the degree of substantial sectoral coverage of trade in services in agreements with developing countries "in accordance with the level of development of the countries concerned, both overall and in individual sectors and subsectors." However, the precise meaning of this S&DT provision is not clear (as is the case with some other potentially controversial WTO provisions); and the absence of an agreed understanding on its interpretation and the lack of consensus on how to move forward further complicate the situation. One can safely assume, however, that the S&DT provision would allow for a considerable degree of asymmetry in an economic integration agreement involving developed and developing nations such as the EPAs.[40]

D Non-discriminatory (Multilateral) versus Preferential Liberalization of Imports of Services

4.15 When a country (or a region) liberalizes its trade in services (or binds its liberalization), its own interests are usually served best by doing so on an MFN or non-preferential basis for imports from all foreign sources rather than just liberalizing on a preferential basis with one or a few trading partners. By doing so, a country gives its consumers and producers access to the best and most efficient service providers in the world.

4.16 Most barriers to imports of services usually distinguish between foreign and domestic firms but not between firms from different foreign countries. Thus, removal of the barriers for all foreign firms, rather than just for EU firms under EPAs, is the natural policy response for opening up services sectors to imports and will enhance the signal about the policy stance on services liberalization that is transmitted to the global economy.

4.17 Liberalization of services imports from all countries tends to increase competition among service providers and is likely to lead to greater efficiency gains and more rapid growth. A country may improve on its status quo in the short run by liberalizing on a preferential basis since this may increase the extent of competition in the market, allow economies of scale to be reaped, bring in new technologies and knowledge and opens up markets for exports. However, unlike trade in goods, barriers to trade in services are typically prohibitive and do not directly generate revenues, and so there is little risk of trade diversion[41] from their removal on a preferential basis

4.18 However, the sequencing of trade liberalization matters for services trade (Mattoo and Fink, 2002). The impact of MFN liberalization may be different if preceded by preferential liberalization. This is because preferential liberalization may grant a "first-mover advantage" to a second-best provider that can have lasting adverse consequences in its services markets. This is of particular importance in network and capital intensive services where large fixed investments are typically needed and these service sectors are imperfectly competitive even with free entry.

[40] Interesting questions for further research are whether the GATS S&DT provision makes a distinction between LDCs and non-LDCs in the same way that WTO's Enabling Clause does and, if they do, what differences in treatment this distinction permits.

[41] That is more efficient suppliers in the rest of the world being replaced by less efficient firms from the preferential partner that are no longer subject to services trade restrictions.

Large fixed investments imply that the first entrant is likely to have a permanent advantage over new entrants since the first mover's marginal cost of serving additional customers is small whereas any new competitors will have to make large fixed investments just to enter the market. For example, once the network infrastructure for fixed-line telecommunications (or electricity distribution) is in place, the marginal cost of providing service to an additional customer is quite low.[42] Potential competitors know that, if they enter such a market, the incumbent will adjust primarily by lowering prices to maintain its dominant market share. Potential competitors are thus deterred from entering. The irreversibility of investment decisions and the first-mover advantage make it wasteful not to invest in the most efficient service at the start and make it hard to replace an inefficient service provider once in place.

4.19 In cases where the first mover advantage is substantial, the competition among potential suppliers may primarily be for the first mover advantage. Because the EU is unlikely to be the most efficient provider of all network and capital intensive services, preferential liberalization of imports of these services from the EU could lead to sub-optimal development of the services sector in the EPA-countries when the first movers from the EU are not the most efficient available providers of the services concerned. Liberalization of services imports from all countries, rather than preferentially on a bi-lateral basis, is likely to increase competition among potential service providers and, as in the case of merchandise trade, to lead to greater efficiency gains and more rapid growth.

Types of Preferences for Trade in Services

4.20 The liberalization and opening of trade in services is a much more qualitative concept than the quantitative measures of tariffs for trade in goods. These issues are clarified by Fink and Jansen (2007). They classify regional trade agreements (such as the EPAs) into five different categories depending upon the degrees of trade preferences for services resulting from (a) granting of new market versus simple binding of existing policies and (b) the rules of origin for eligibility for these preference (see Table 5.1 below).

4.21 The first three of the five categories in Table 5.1 actually imply no preferential new opening of a participating country's services sector. Category 1 covers cases where a country's undertakings in a bilateral or regional trade agreement reproduce in part or full its GATS commitments. Commitments under category 2 go beyond GATS. Although such commitments do not imply liberalization beyond what has already been committed under GATS, they offer greater assurance that another party's trade policy will not become more restrictive in the future. Fink and Jansen (2007) note that such an assurance may have a positive impact in cases where existing previously unbound trade policies are fairly open, especially for infrastructure services, where foreign investors incur substantial sunk costs at the time of entry and may earn profits only after several years. By establishing a stable policy environment, such a commitment can improve a country's attractiveness to investors. (As noted below, the services provisions of the CARIFORUM full EPA appear to fall into category 2.)

[42] For mobile telephones, first-mover advantages are significant but not as large as in the case of fixed-line services cited, and additional providers appear somewhat more willing to contest a market.

Table 4.1 : Trade Preferences Created by Different Types of Commitments in Regional or Bilateral Agreements on Trade in Services

	Type of commitment	Nature of preference	Extent of "preference margin"
1	RTA commitment reproduces GATS commitments.	Parties can invoke dispute settlement mechanism of RTA to enforce the GATS commitments.	None
2	RTA binding commitments go beyond GATS commitments but do not imply actual new liberalization of services.	Reduced risk of policy reversal for service suppliers from participating countries through additional bindings.	None
3	RTA commitment implies actual new liberalization of services but implemented in a way that is non-discriminatory to third parties.	Reduced risk of policy reversal for service suppliers from participating countries through additional bindings.	None
4	RTA commitment implies actual new liberalization for parties to the agreement *only*; rules of origin are *liberal.*	Service suppliers located in the territories of the parties benefit from improved market access irrespective of the nationality of their owners.	Weak
5	RTA commitment implies actual liberalization for parties to the agreement *only*; rules of origin are restrictive.	Service suppliers located in the territories of the parties benefit from improved market access only if they are owned and controlled by their residents or nationals.	Strong

Source*:* Fink and Jansen (2007)

4.22 Services undertakings in category 3 imply new market openings, but only on a non-discriminatory basis, so that third-country service suppliers benefit equally from the new more liberal policy environment. As in category 2, the "preference margin" is limited to a reduced risk of policy reversal provided to the parties to the regional agreement through the bilateral binding of the new multilateral market opening.

4.23 The fourth and fifth categories cover cases where bilateral or regional commitments on trade in services imply new market openings which are implemented in a discriminatory way, that is, only parties to the agreement benefit from the new opening. The difference between categories 4 and 5 lies in the rule of origin governing the market opening commitments. The definition of the more liberal rule of origin (category 4) extends preferences to all companies that are incorporated in one of the parties and are engaged in substantive business operations there, irrespective of the nationality of their owners. Affiliates and subsidiaries of companies owned by nationals of non-participating third countries that are located in a participating country may thus benefit from the agreement. The more restrictive approach to rules of origin limits benefits to companies that are owned and controlled by nationals or permanent residents of one of the parties. This more restrictive rule of origin implies a greater degree of preference by preventing third countries from using a subsidiary in one party to the agreement to gain access to the market of the other party.

Advantages of Liberal Rules of Origin

4.24 A liberal approach to rules of origin may effectively open the market for a wider range of suppliers than those from countries party to the agreement. The more liberal is the rule of origin, the larger the pool of suppliers that will be permitted to compete in the preferential trade area. A

liberal approach to rules of origin is likely to be more relevant when the aim of agreement is to attract FDI from outside of the region. Liberal rules of origin will tend to be of particular importance for smaller economies. For a number of regulatory measures it may not be possible to distinguish suppliers on the basis of nationality. In some cases, the distinction between multilateral and regional liberalization of services trade may thus not be an important practical issue.

4.25 Hence, in principle rules of origin are a key issue in preferential services agreements determining the extent to which the agreement discriminates against third countries and the magnitude of costly trade and investment diversion. When levels of trade protection differ between the partners, the adoption of a liberal rule of origin in effect allows third country suppliers to establish in the least restrictive market and, from there, provide services or invest in the other markets. The demands for restrictive rules of origin are therefore likely to come from firms that dominate countries that are party to the agreement but which are not globally competitive. Some governments may also seek to use restrictive rules of origin where they perceive learning-by-doing through regional integration as an important mechanism to allow domestic firms to obtain the capacities to effectively compete globally. A more detailed discussion of the rules of origin in the CARIFORUM EPA is provided in Chapter 6.

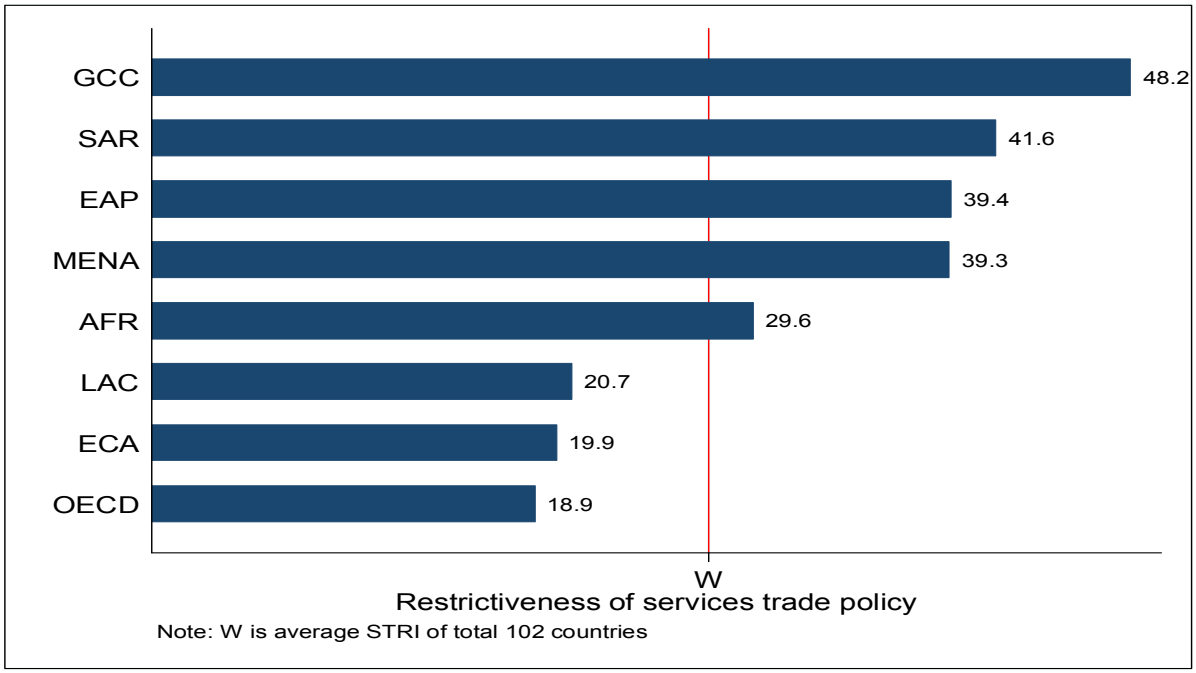
Risks of a GATS-style Bilateral Agreement on Trade in Services

4.26 GATS-type bilateral trade negotiations over services, such as those for EPAs, generally tend to focus narrowly on binding existing levels of market access and national treatment affecting different services. Annex 5.1 summarizes the nature of GATS commitments and how they are scheduled and compares this with the approach that has been adopted in the CARIFORUM EPA. A potential problem with a GATS-style negotiation is the risk that the reform effort will end up concentrating on the formal legal provisions for binding existing market access and non-discriminatory treatment of foreign investors and that attention and resources will be diverted from more fundamental issues of new market opening, reforming regulatory policies, strengthening regulatory institutions, and improving the investment climate and competitiveness.

E Restrictions on Trade in Services in Africa

4.27 To be able to effectively plan trade liberalization and negotiate agreements on trade in services bilaterally, regionally or at the multilateral level it is essential for policy makers and negotiators to have extensive information on the nature of regulation and trade restrictions in all of the sectors that are subject to discussion. Detailed information is needed about both the measures in overseas markets that constrain exports in sectors where the country has offensive interests as well as measures affecting the access and treatment of foreign service-suppliers in the domestic market. In many African countries, as well as other developing countries, comprehensive data on services sectors are not available, and they typically face great difficulties is effectively participating in trade negotiations on services.

Figure 4.1 : Restrictiveness of Applied Services Trade Policies by Region



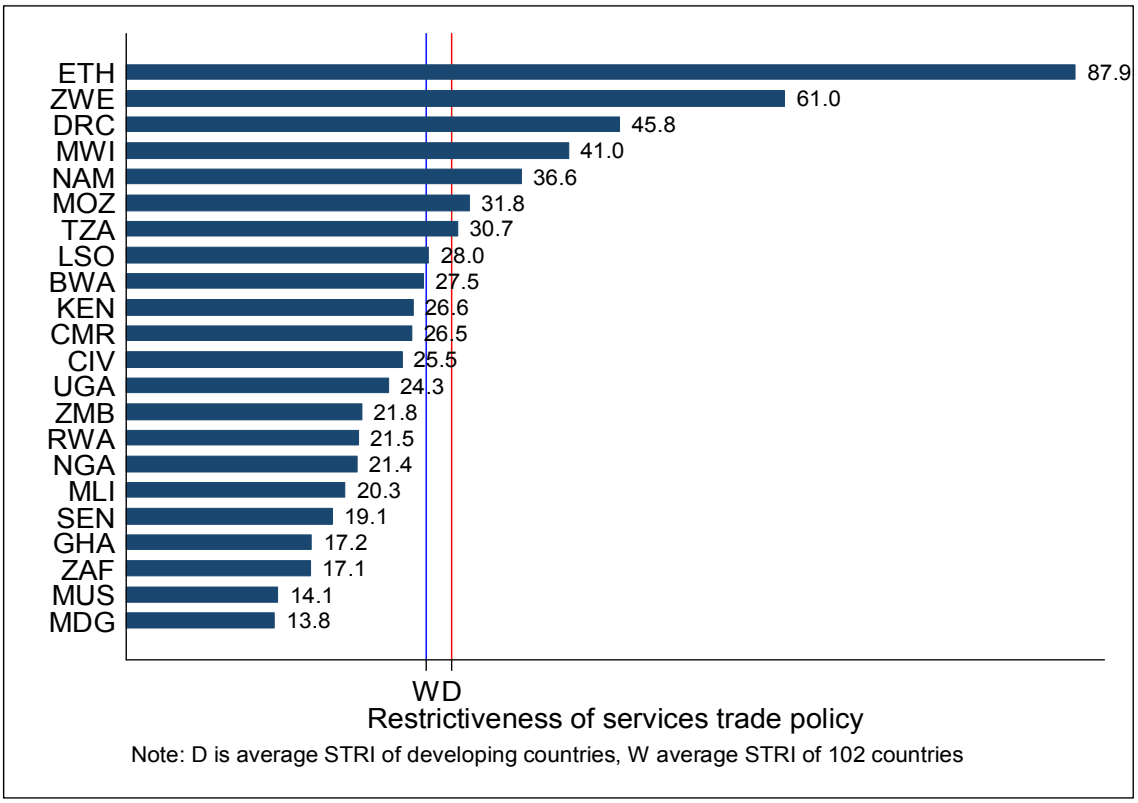
Notes: Regional abbreviations: GCC – Gulf Cooperation Council, SAR – South Asia, EAP – East Asia and Pacific, MENA – Middle East and North Africa, AFR – Sub-Saharan Africa, LAC – Latin America and Caribbean, ECA – Europe and Central Asia, OECD – Organization for Economic Co-operation and Development.
Source: Gootiiz and Mattoo (2009).

4.28 To begin to address the shortage of data on applied policies governing trade in services in developing countries, the World Bank has recently carried out a survey to assess applied (actual) trade policies in five services sectors - financial services (banking and insurance), telecommunications, retail distribution, maritime transport, and professional services – in 78 developing and transition countries and 24 developed countries in 2007 and 2008. The resulting policy summaries presented in Gootiiz and Mattoo (2009) cover only explicit market access and national treatment barriers plus discriminatory regulatory measures in the five sectors.[43] Twenty two African countries are considered in the analysis.[44]

4.29 The resulting index ranges from 0 if there are no restrictions to 100 for closed economies. The results show that, on average, African countries have relatively liberal services trade policies (Figure 5.1). For these African countries, the overall restrictiveness index of applied services polices is just above the world average and lower than the restrictiveness index in all other developing country regions except for Eastern Europe and Latin America.

[43] For example, while discriminatory licensing criteria for foreign service-providers and limits on the number of available licenses are captured in the policy summaries, restrictive domestic regulatory measures such as general licensing requirements or the public availability of licensing criteria are not included in these summaries.
[44] Botswana, Cameroon, Cote d'Ivoire, Democratic Republic of Congo, Ethiopia, Ghana, Kenya, Lesotho, Madagascar, Malawi, Mali , Mauritius, Mozambique, Namibia, Nigeria, Rwanda, Senegal, South Africa, Tanzania, Uganda, Zambia, and Zimbabwe.

Figure 4.2 : Services Trade Restrictiveness Index for African Countries

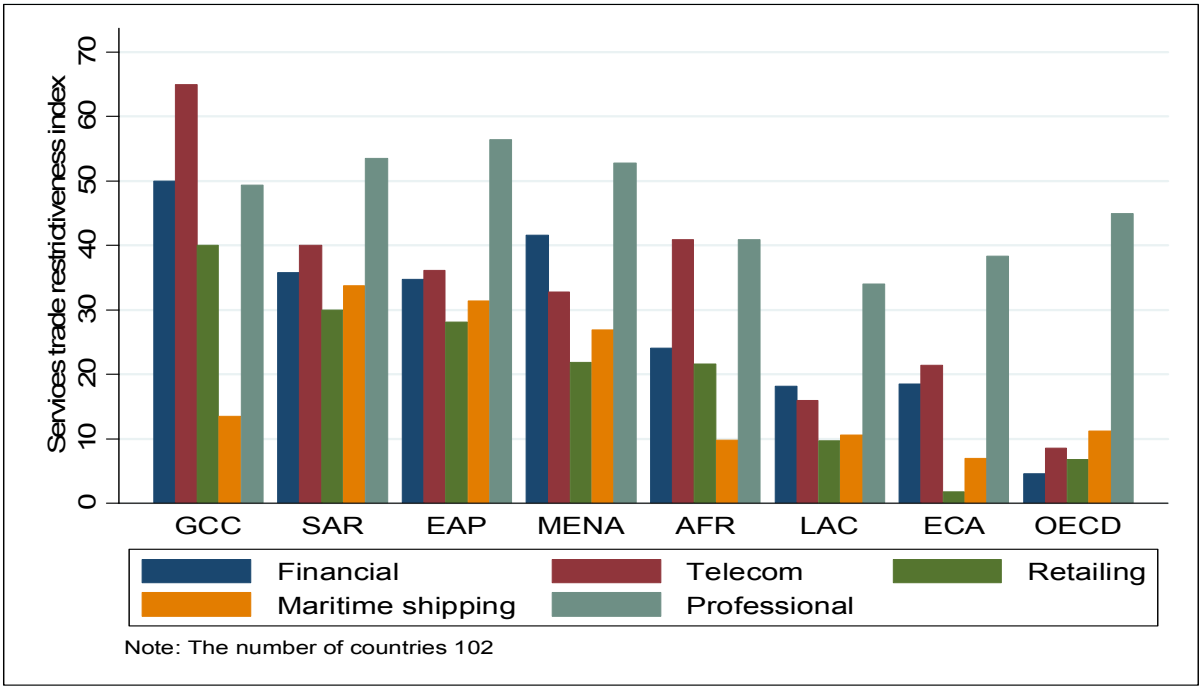


Source: Gootiiz and Mattoo (2009).

4.30 There is, however, considerable variation across countries in Africa (Figure 5.2). For example, Madagascar and Mauritius has very open policies towards trade in services with a value of the restrictiveness considerably below the world average and also below the average for OECD countries. On the other hand, the value of the index for Ethiopia is the highest score of any country in the sample. Only 7 of the 22 African countries have an overall services restrictiveness index that exceeds the world average.

4.31 Figure 5.3 shows the region averages for each of the five sectors covered. This shows substantial variation across sectors in the extent of trade restrictiveness. In most regions, professional services are the sector with the highest levels of the restrictiveness index. Africa, on average, is more liberal in maritime shipping than all regions except Eastern Europe. In financial services and retailing Africa is more open than other developing country regions. But in telecommunications the value of the index is high relative to other sectors and relative to the degree of telecommunications openness in other regions. However, again, there is substantial variation across countries in Africa and some countries have substantially liberalized trade in the telecommunications sector. For example, the value of the index for telecommunications for Tanzania is just above the global average whereas that for Zambia is more than three times the world average.

Figure 4.3 : Restrictiveness of Applied Services Trade Policies by Region and Sector



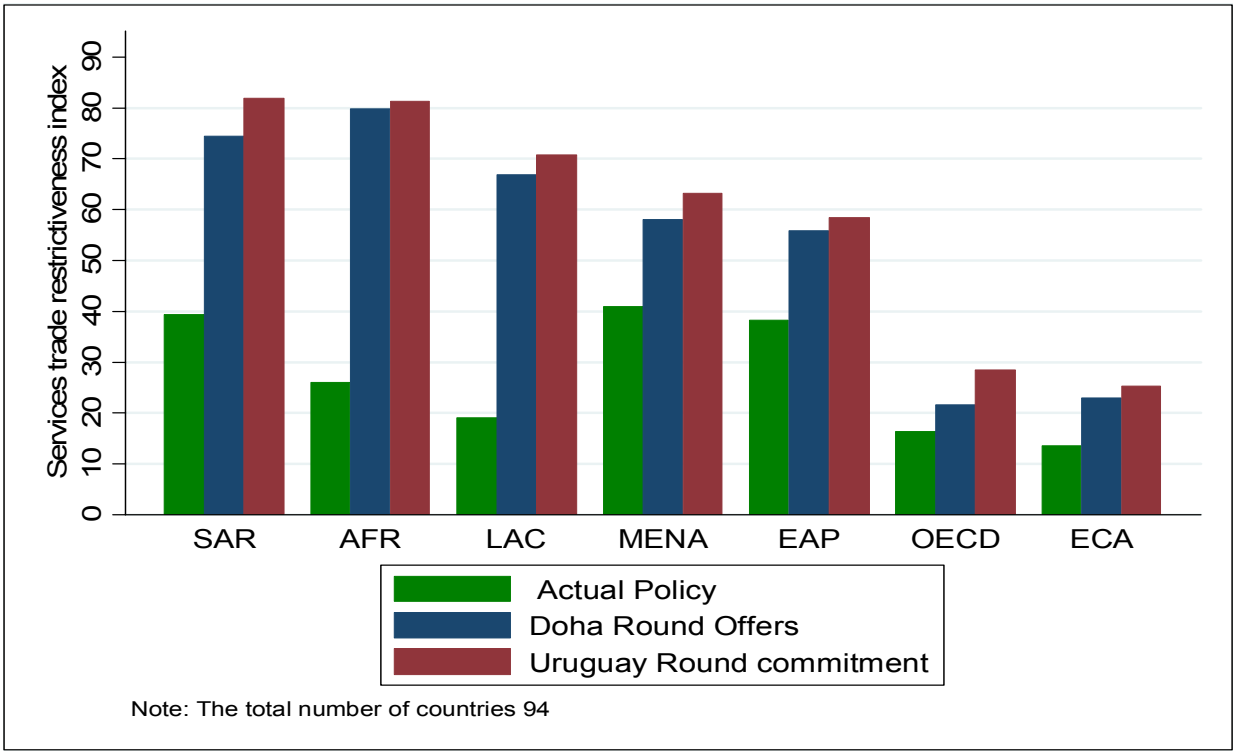
Notes: Financial services include banking and life and non-life insurance and reinsurance; telecommunications include fixed and mobile telecom; maritime shipping includes cross border and commercial presence; and professional services include accounting, auditing, and legal services. Source: Gootiiz and Mattoo (2009)

4.32 The data from the World Bank survey cited above cover only parts of five of the 12 GATS services sectors in a group of African countries. The seven omitted GATS sectors (construction and engineering; education; environment; health; tourism and travel; recreation, cultural, sport; and other services) contain a number of economically important services as do the subsectors in transportation that were not covered (air, rail, road, inland waterways, and auxiliary services for all modes of transportation) and some of the professional services not covered.[45] In addition, 25 countries in Africa are not represented in the sample. No systematic data on restrictions on trade in services are available for these regions, and some of these countries may have relatively restrictive trade regimes.

4.33 In contrast with their relatively liberal actual policies, the 22 African countries' policy commitments in the Uruguay Round and their commitment offers in the Doha Round offers are extremely limited. Several of the African countries covered by the Bank's survey did not submit Doha offers. For those countries which did submit Doha offers, the improvement over their Uruguay commitments are often minimal. The gap between applied policies and WTO/GATS services liberalization commitments and offers for Africa is shown in Figure 5.4 and is the largest in any region.[46]

[45] See Annex C for a more detailed listing of the activities included in the various GATS services sectors.

Figure 4.4 : Restrictiveness of Uruguay-Round Policy Commitments on Liberalizing Trade in Services, Doha-Round Commitment Offers, and Actual Policy by Region

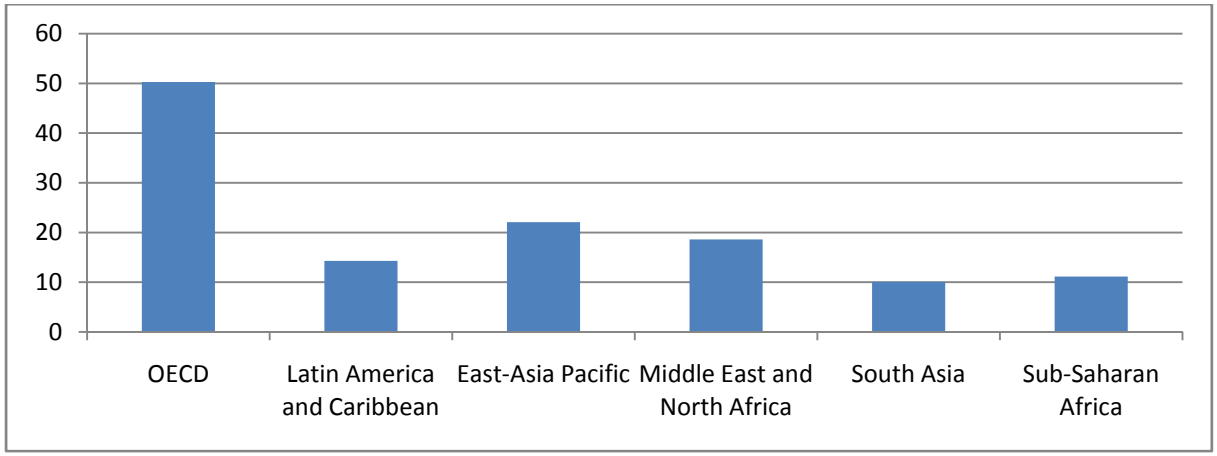


Note: Where a country did not make a Doha offer, the sector index reflects the Uruguay round commitments. Twenty one African countries are considered in the Africa group:
Ethiopia is excluded since it is not a WTO member.
Source: Gootiiz and Mattoo (2009).

4.34 A more comprehensive indicator of GATS commitments in Africa is provided by World Trade Indicators,[47] which covers commitments by 35 sub-Saharan African countries and all GATS sub-sectors. As summarized in Figure 5.5, these data confirm that on average African countries have made a relatively small number of commitments compared to OECD countries. However, it is developing countries as a group that has been reticent to make commitments in services under the GATS. Africa is similar to other developing regions in this respect.

[47]http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/TRADE/0,,contentMDK:22421950~pagePK:148956~piPK:216618~theSitePK:239071,00.html

Figure 4.5 : Index of GATS Commitments



Notes: The index measures the extent of GATS commitments for all 155 services sub-sectors as classified by the GATS and in the four modes of services delivery. The index ranges from 0 (unbound or no commitments) to 100 (completely liberalized), with an intermediate value of 50 for partial commitments. A simple average of the sub-sectoral indexes was used to generate aggregate sectoral indexes. The overall GATS commitment index is a simple average of the sectoral indexes.

Source: World Trade Indicators.

4.35 Some countries in Africa are towards the top of the ranking of countries in terms of GATS commitments. The Gambia, Lesotho and South Africa are in the top 30 countries out of 150 in the index. On the other hand, many other African countries have made few commitments, with 18 African countries in the bottom 30 of the ranking. Within regional groupings in Africa there are also wide variations in GATS commitments. For example, in SADC, Lesotho has made GATS commitments in 53% of the sub-sectors, while for Botswana the proportion is 12%, for Mozambique, less than 1%, Namibia 2% and Swaziland 6%. However, despite having made relatively extensive commitments at the GATS, Lesotho's performance in trade in services does not appear to have benefited. As shown in Chapter 2, Lesotho's exports of services have grown much less than that of more dynamic services exporters in Africa. Information on FDI by sector is limited but a recent study by the Central Bank of Lesotho shows that in 2005 FDI in services, excluding tourism, remains limited. Manufacturing accounts for 58% of investment in the sectors covered, followed by transport and communication, 24%, mining and quarrying, 11%, and wholesale and retail trade, 5%. This may partly reflect the weak enforcement mechanisms of the GATS which limit its use as a commitment mechanism. It may also reflect capacity constraints in Lesotho that have undermined the credibility of the commitments made in the GATS. These issues are now discussed in the following section.

F Liberalization of Service Trade Policies and International Trade Agreements

4.36 International trade agreements can support governments that wish to implement reforms to increase competition in services markets but which are opposed by powerful vested interests. Such agreements can help break domestic deadlocks by improving market access for the country's exporters and mobilizing export groups to support the reform effort. Binding of liberalized applied policies through trade agreements can also reinforce domestic reform efforts.

If a trade agreement can be effectively enforced, binding of applied policies can reduce the risk of policy reversals, increase the credibility of reform efforts, improve investor perceptions of the business climate, and thereby potentially contribute to a stronger supply response than unilateral liberalization alone would generate.[48]

4.37 However, the unwillingness of developed countries to negotiate on some of the key services-export interests for Africa, in particular temporary movement of persons, has given African countries little incentive in terms of improved market access to participate in WTO negotiations concerning trade in services. African export opportunities in developed countries' markets are currently concentrated on mode 4, which is subject to particularly high barriers in developed countries and for which the scope for reciprocal concessions that can motivate engagement from a political economy perspective appears limited. The small size of many developing countries' markets implies that most of them will not be of much export interest to large players in the WTO. The caution of developing countries towards global services trade liberalization thus reflects concerns that negotiated global liberalization of services trade will be largely one sided, with developed country service providers likely to gain significantly improved access to developing country service markets but with little improved access for developing-country service-providers in developed country markets. The standard mercantilist bargaining over liberalization of trade in services may, therefore, not deliver improved outcomes in many of the poorest countries (Hoekman, 2007).

4.38 In addition, enforcement mechanisms at the WTO may not be strong enough for small developing countries such that the GATS is limited as an effective commitment mechanism. Eschenbach and Hoekman (2006) find an inverse relationship between the depth of GATS commitments and a measure of the quality of applied services policies for a range of Eastern European Transition economies. This is partly a reflection of the eligibility of certain countries for EU membership, which reduces the relevance of the GATS. However, for other transition countries, it may signify that the GATS is not a powerful mechanism for locking in service reforms. The incentives to initiate a dispute settlement case against a small country that violates its GATS commitments are extremely limited. The large gap between commitments and applied policies often leaves considerable scope for policy weakening without violating GATS commitments. A key consideration then for African countries seeking in to lock-in services trade reforms is whether an EPA with the EU may provide a more effective mechanism for locking in and signaling credible commitment to reform than the GATS.

4.39 Many African countries, particularly the least developed ones, face serious technical and administrative capacity constraints in designing, negotiating, and implementing liberalizations of their trade in services and complementary regulatory reforms. The unwillingness of many African to bind current services trade policies at the WTO/GATS level may thus also reflect their inability to prepare negotiating positions, to participate meaningfully in the negotiations, and to affect the outcome.

[48] For a discussion of the importance of dispute settlement and enforcement arrangements for the credibility of trade agreements with private investors, see the World Bank's *Full Report on the Implementation of Interim EPAs*, Part I, page 82, and Part III, pages 77-84.

4.40 The policy commitments made by Lesotho in the Uruguay round illustrate the problems for low income countries with very limited capacity in negotiating trade liberalization in services. Manduna (2005) suggests that "some ministries were represented in the inter-ministerial committee by staff with a limited understanding of the prevailing policy in their respective ministries, especially as it related to the trade negotiations. Indeed, in certain instances, representatives confused practice with policy…. the MTICM itself had limited capacity and, therefore, was in a very weak position to provide the required guidance to other stakeholders." Trade negotiations in services require extensive collaboration across ministries and between the government and other stakeholders. In the absence of an effective dialogue between line ministries, regulators, the private sector and the trade ministry, the value of commitments made is likely to be limited. In the case of Lesotho, "on close scrutiny, certain commitments inscribed in the schedule contain errors. Moreover, some do not accurately reflect Government policy as it was then and even now. In certain instances domestic legislation is still to be amended to reflect what is inscribed in the commitments" (Manduna, 2005, p 18). A key issue for Lesotho, other African countries and the EU is whether these constraints that have limited the beneficial impact of GATS commitments can be overcome in an EPA? Even for the CARIFORUM EPA, the time and administrative effort required to collect the required data on existing policies was reportedly a serious obstacle to timely progress of the services negotiations.

4.41 The magnitude of the required administrative effort is compounded by the importance of regulatory reforms to successful liberalization and the need for strengthening of domestic regulatory institutions in Africa. The need for regulatory reform complicates and constrains the use of reciprocal trade concessions for services because it is difficult to design rules and commitments in a way that clearly distinguishes between measures that are protectionist and measures that have a valid domestic efficiency or social equity rationale. In addition there have been only limited discussions at the multilateral level of support to developing countries for raising regulatory capacity and the issue of protecting social objectives, which are critical for ensuring positive outcomes from services trade liberalization in Africa.

4.42 The key challenge is how to differentiate between legitimate concerns relating to quality and performance, on the one hand, and regulatory requirements that simply constitute barriers to entry, creating rents for incumbents by raising prices or needlessly raising costs for firms, on the other hand. Policy makers may be justifiably wary that market access commitments could undermine their ability to design and implement regulations that maximize national welfare (Hoekman and Francois, 2009). The challenge is to achieve a balance between greater competition by reducing barriers to market access for foreign providers and preserving desirable regulatory freedom.

4.43 Perhaps the single most important measure for overcoming capacity constraints in African countries is to adopt a series of phased, in-depth, sector-by-sector programs of coordinated regulatory and trade reforms instead of a comprehensive approach to liberalization of trade in services. The liberalization of imports of services and regulatory reforms need to be carefully coordinated and mutually supportive and substantial preparatory work is needed for these, including collection of data on existing policies and analysis of policy options. For services liberalization in Africa, particular emphasis will need to be given to capacity building for improving regulatory policies and institutions.

4.44 The magnitude of the task and the capacity constraints faced in many African countries require identifying key services-sector priorities from a development perspective (in most countries these are likely to include transportation, telecommunications, electricity, finance, and business services) and working to define reform strategies and build capacity for this limited number of sectors rather than first adopting a broad but shallow comprehensive approach to services-sector reforms. Such a strategy can optimize the use of limited reform capacity and permit both careful design and coordination of in-depth reforms and their phased implementation as the necessary regulatory capacity is developed. Countries can thus focus in an orderly way on priority regulatory reforms and building the corresponding regulatory institutions and initially liberalize only those sectors that either require little regulation or that already have satisfactory (or easily reformed) regulatory policies and institutions in place.

4.45 An important set of considerations to take into account in designing a program of coordinated trade and regulatory reforms is the linkage between different sectors and the clustering of related sectors that would benefit from interrelated or similar reforms. For example, the development of call centers and internet-based services both require a modern, efficient telecommunications system as do some manufactured exports and travel services. For this reason, regulatory reforms and the liberalization of commercial presence and foreign investment in the telecommunications sector, is likely to be a priority in countries where these are restricted.

4.46 One approach that could be used to coordinate trade liberalization and capacity building would be to formally incorporate regulatory impact analysis into a trade agreement such that commitments to change regulations and liberalize trade would be conditioned on appropriate analysis of the impact of such changes on public policy objectives regarding efficiency and equity.[49] Where such analysis highlights significant risks that liberalization will not achieve efficiency objectives and/or will undermine social objectives then implementation should be delayed until a policy framework is put in place that will protect poor consumers or other measures are available to be implemented, such as subsidies, to maintain and increase access by the poor. Ensuring better access to services post-liberalization is important both from an equity perspective and from a political economy perspective to maintain support for implementing efficiency enhancing policy reforms and sustaining them over time (Hoekman and Mattoo 2007). Hence, for trade agreements in services to effectively work as an anchor for policy reform, it is necessary that there is agreement on a framework to deal with these important issues concerning regulation and regulatory capacity.

G Preparing for and Negotiating Services Trade Reform

4.47 This section provides a summary of the key issues that will typically need to be addressed for African countries to effectively pursue trade liberalization in services to underpin the development of their services sectors. We identify three critical issues (i) improving the data on output, employment and trade in services, as well as information on applied regulatory policies and measures that distort trade; (ii) dialogue between government ministries and agencies and between the government and stakeholders that leads to a trade strategy for services with a focus

[49] For example, regulatory Impact Analysis has been mandatory for all proposed regulations in the UK since 1998. Lithuania implemented a similar requirement in 2003.

on priority sectors that carefully coordinates opening of trade with regulatory reform; (iii) capacity building to allow the first two challenges to be achieved and that enhances the ability of the regulator in priority sectors to effectively define and implement appropriate regulations.

Data and information, raising awareness and developing a service-trade strategy

4.48 Developing trade in services is a complicated process and many countries do not have an explicit policy for it. Defining such a strategy requires strong interaction and cooperation between officials in the Ministry of Trade, officials in line ministries with responsibility for services, regulators and the private sector, together with both the providers and users of services. This is necessary to carefully identify sectors with services export potential and sectors where measures are discriminating against foreign service providers, thereby limiting competition. Reform to increase trade and investment then has the potential to reduce prices and improve access in the domestic market. As part of this process it is crucial to identify and address weakness in the regulatory regime and in the capacity to effectively implement the regulatory framework.

4.49 In many African countries a first stage in this process is *raising awareness* about the role of services and trade in services in development. Often because of the complexity of issues surrounding services and because services are still considered as "non-tradable" by many policymakers and regulators or are "invisible" in trade statistics, their trade dimension tends to be overlooked. The government, with the support of external technical assistance and capacity building, can play a constructive role by:

(a) collecting and disseminating more and better data on the service sector in general and trade in services in particular;

(b) creating awareness and facilitating a dialogue among various stakeholders about the potential impact of services trade liberalization and reform by commissioning studies and convening public meetings to build a strong coalition behind services reform.

(c) presenting successful experiences from other developing countries that provide models of openness, regulatory strength, and welfare gains for consumers. In particular, showing how access to public services can be enhanced through coordinated trade and regulatory reforms.

4.50 These preparations can support the definition of a strategy for trade liberalization of services that can be integrated into the national development plan and that is driven by the domestic reform agenda. An important task will be to *identify priority sectors* that need foreign investment, but where the national market is unlikely to generate the necessary investment and competition, or sectors where technology is needed. A sensible strategy for many small countries is probably to focus first on just 2 or 3 priority sectors and then broaden the reform effort once improvements have been delivered in these sectors.

Review of Regulations and their Impact

4.51 In sectors where openness to trade has been implemented but has not delivered increased competition and lower prices or has not provided for increased access it will be necessary to

identify the reasons why these objectives are not being met: are there still measures that discriminate against foreign firms that discourage foreign investment or constrain cross-border supply of services or the temporary movement of persons; is the regulatory regime constraining entry and investment by all firms both domestic and foreign, is the capacity of the regulator too weak to perform the functions necessary to encourage investment and promote competition while achieving wider access; do the main constraints on investment lie in the broader investment climate?

4.52 In many cases it may be very apparent where the main constraints to trade and competition lie; for example, if there draconian licensing requirements that limit investment by all firms or foreign firms in particular. In general, the emphasis in the regulatory approach should be towards encouraging competition and only intervening where there are clear risks emanating from market failures and the protection of the economy from systemic risks and individuals from personal risk. This could mean taking a flexible approach to entry by small firms and only bringing regulatory discipline to bear once firms reach a certain size that entails significant risk if unregulated.

4.53 More generally, to answer these questions the government may require information on trends in investment, output and consumption, capacity utilization, prices, quality, relevant social indicators amongst others. In addition, there will need to be an open and transparent dialogue with the regulator, existing firms and representatives of users. To identify reasons for lack of foreign investment it will probably be necessary to undertake fact finding activities to gather insights from actual as well as potential investors.[50] While this task would typically be undertaken by the investment promotion agency, some African countries do not have such an agency (for example, Burundi, DRC) and often those that have been established have limited resources. Foreign embassies and commercial attaches could probably play an important role in identifying potential investors in priority sectors and discussing the constraints they perceive on investing in the country concerned.

4.54 The approach to reform in priority sectors may need to be supported by a careful review or audit of actually applied regulatory policies and regulatory capacities so as to assess the impact of these policies on trade and investment (identifying where market access and national treatment may be being denied) and the attainment of public policy objectives for the sector.[51] The key elements of an effective trade-related regulatory audit will follow the principles of good regulatory practice presented earlier in Chapter 3 and will be akin to a regulatory impact analysis of current regulations. Such a task can be demanding and again points to the need to focus on a limited number of priority sectors. A regulatory audit of all GATS sectors will often not be feasible and not relevant for small countries. While capacity limitations with regard to regulation make a strong case for proceeding on a small number of priority sectors it is also important for

[50] For example, in the case of Lesotho discussed earlier, where hoped for foreign investment in services has not materialized, information from the European Services Forum, the pan European representative body for private sector service providers, suggests that the extensive GATS commitments did not provide sufficient credibility of commitment to reform. This was compounded by a lack of prioritization of sector for reform (Charambalides (2010).

[51] See World Bank (2009d)

such a review to identify if there are constraints in the economy that are horizontal and not sector specific that are afflicting trade and investment in the particular sector(s).

4.55 Such a review should allow policy makers to address the following questions:

- Are there measures that are discriminating against foreign suppliers that may be limiting investment and competition in the sector?
  a. If the answer is no it would be worthwhile to assess whether the current degree of openness has sufficient credibility to encourage the provision of services, especially via commercial presence, by foreign firms. If not there may be a case for locking in the current degree of openness through an international agreement (and assessing whether this is most suitable at the regional, EPA or multilateral level) to send a signal to international and domestic investors of the commitment of the government to lock in existing reform and preclude future policy reversals that could undermine returns to investors.
  b. If yes the authorities could consider further trade liberalization. The recommended default level would be to implement any trade liberalization on an MFN basis to ensure maximum gains. In some sectors it may be easier to do this initially at the regional level and/or through an EPA and then subsequently sequence multilateral liberalization. There would then need to be a discussion of whether reforms in domestic regulations and regulatory capacity would be required to ensure the effectiveness of further opening. The authorities could pursue technical assistance to coordinate these trade and regulatory reforms and improve regulatory capacity. An assessment of the impact of such reform on objectives regarding access to the service will also be important and interventions may need to be designed to ensure that concerns over equity are addressed. Dialogue with development partners can then identify resources under aid for trade that can provide the necessary technical assistance and support measures to address social policy objectives. A decision would have to be made whether an EPA would be a more effective mechanism for obtaining such support.
- Are the domestic regulatory framework and the capacity of the regulator appropriate to ensure effective competition in the market and to effectively regulate priority sectors where there is a natural monopoly? Is the lack of a suitable regulatory framework the key problem affecting objectives regarding investment, efficiency and access? For example, if regulations have been defined for an old technology they may constrain investment in new technologies.
  a. If yes the authorities could pursue technical assistance to update regulations and improve regulatory capacity. A decision would have to be made whether this could be best achieved through aid for trade or through an EPA.
  b. If regulatory reform has been captured by specific producer interests then it may be necessary to consider further trade opening to propel regulatory reform and modernization of regulatory structures that increases transparency and the independence of the regulator.
- Where specific trade and regulatory reforms are identified as necessary but little progress has been achieved in moving forward it may be important to *assess and understand the political economy factors that seek to restrain efforts to increase competition and improve*

regulations. Such vested interests can often be a powerful obstacle to reform. A dialogue on reform that involves all stakeholders can provide a broad-based coalition that can support the national interest and help overcome resistance to reform by those with specific vested interests. It some cases it may be necessary to put in place policies that help to offset the losses that some stakeholders may incur as reform is implemented. For example, increasing competition through trade opening may have a negative effect on employment in inefficient domestic, often state owned, enterprises. While total employment in the sector may rise in the medium term as demand and the range of services in the sector increase, existing employees may perceive the changes as a threat and seek to prevent them. The provision of appropriate retraining and assistance in finding new employment may be help to allay these fears and facilitate the move to a more efficient sector.

- It may also important be to assess whether the implementation of a clear reform strategy for the priority services sectors is likely to flounder if the broader investment climate is hostile to investment by new firms to the market?
  a. If so it will be important to pursue broader based reforms to the investment climate and assess the extent to which the sector specific reforms can be implemented alongside the improvements to the investment climate. Again, the authorities could pursue technical assistance to improve the investment climate.
  b. If the domestic reform of the investment climate has been stalled by regulatory capture then trade opening and provisions of external technical assistance may be a useful mechanism to get past the blockages.

4.56 This should not be a static process and the sequencing is weak at best. For example, if regulatory weaknesses are identified and corrected, it may be possible to proceed with trade opening to promote more investment and competition.

4.57 A similar exercise may also be undertaken to identify and pursue offensive export interests, including those that are emerging in more dynamic services sectors by:

1. Consider if domestic regulatory policies are restricting growth prospects for the sector and if so seek technical assistance to improve regulations and regulatory capacities
2. Identify supply side weaknesses that are limiting investment and growth in the sector. For example, telecommunications infrastructure, and the costs of telecoms services, is often crucial to the development of new dynamic services.
3. Assess whether restrictions on market access and national treatment in overseas markets are inhibiting exports in key overseas markets and if so identify whether, bilateral, EPAs or multilateral negotiations are likely to be most effective in improving access.

4.58 In some countries the elements of the information base that are required to proceed are already present; see Box 7.1 for an example from Tanzania. In other countries there is a pressing need for data and studies on services sectors and their regulation.

Box 4.1 : Prioritizing Service Sectors in Tanzania

In Tanzania, the National Competitiveness Report (Bamwenda, 2008) has prioritized services sectors in terms of their *economic importance* using the following criteria: objectives and goals of national development policies defined in the strategy for growth and poverty reduction (MKUKTA 2005, MKUZA 2007), and Tanzania's National Rural Development Policy; production levels and trends; demand for given services; investment levels; sector growth rates and employment levels and trends; sector contribution to GDP; sector exports and imports as percentage of GDP. Furthermore, the *competiveness* of each sector was assessed on the basis of 27 indicators[52]. The resulting priority sectors with their corresponding rankings are listed in the first two columns of the table below.

Priority services sectors in Tanzania and their treatment in services negotiations

Prioritized Services Sectors	Ranking based on		Sectors included or proposed for inclusion in negotiations		
	Role in national development policies	Competitiveness of sector	EAC negotiations	EPA Negotiations Offers	EPA Negotiations Requests
Education	1	3	X		X
Transport	2	6	X	X	
Business services	3	4	X		X
Construction and engineering	4	5		X	
Financial	5	1	X		
Tourism	6	2	X	X	X
Environmental	7				X
Distribution	8		X		X
Communication	9		X	X	
Health	10		X		X
Recreational, cultural, and sporting services	11				X
Other services/ -- Energy	12			X	X

Source: Bamwenda (2008), Mburu and Mbithi (2007), EAC Schedules of Commitments (2009);

-- Priority services sectors in Tanzania are education, transportation, financial services, telecommunication, construction, tourism, health, and business services. These sectors have been identified by numerous LDCs as being of importance for their development. Table 6 also indicates the services sectors included in EAC negotiations and the sectors proposed to be considered for offers and requests in the EPA negotiations. It is worth noting that the majority of the priority services sectors have been considered for regional liberalization.

-- Tanzania also has a rather comprehensive information base on sectoral regulations and market access and national treatment barriers. Regulatory assessments in energy, finance, transport, communication, construction, tourism, distribution and selected business services have produced detailed inventories of domestic regulatory measures and explicit trade barriers by modes of supply. In addition, some of the studies have attempted to present sectoral performance reviews and assessments of current regulatory frameworks. In general, these studies have concluded that in many services sectors Tanzania's regulatory framework is inadequate, and have highlighted the difficulties in linking liberalization needs with the regulatory process.

Sawere (2009) notes that in Tanzania in a number of sectors such as communication, financial and selected business services, liberalization has been used to improve the performance of the sector. For example, investment liberalization policies have played an important part in Tanzania's telecom reform. By contrast, liberalization in other sectors has been postponed due to inappropriate regulation (for example, in wholesale services, storage and warehouse services). The study stresses that Tanzania lacks the institutional and regulatory capacity to design and implement effective reform in certain sectors, and recommends that prior to engaging in liberalization the country needs first to build capacity to regulate these services. Other reasons for delaying liberalization are concerns that liberalization in financial or network services may deteriorate provision of services to the poorest segments of the population and may affect disproportionately small and medium sized enterprises (SMEs), and concerns that liberalization and increasing competition from abroad will have a substantial negative impact on employment in certain business services. Finally, the study identifies several sectors such as transport services, legal services, services incidental to agriculture, forestry, hunting, and postal services, that have remained closed despite a regulatory framework that has been assessed as being adequate.

Source: Dihel (2010b)

[52]These indicators are: leadership, access to information and knowledge, education level and intellectual performance, skills and training level, human capital quality, resourcefulness and dynamism, work culture, attitude and dynamism, business sophistication, know-how and knowledge development, innovativeness and creativity, value added/ value creating ability, resource endowment, technology level and ability to indigenize, technical infrastructure, supporting physical infrastructure, supporting industrial clusters, product mix, value chain quality, market efficiency, market size, consumer sophistication, finance flow into the sector, strategic partnerships/alliances, risk level, supporting institutions and their management, policy and regulatory framework adequacy, government facilitation.

4.59 The World Bank has developed a guide that could help African countries interested in using to trade negotiations to further improve their services regime (Marconini and Sauvé, 2010). Specifically this guide assists countries in:

- *Mapping* a strategy for services in national development plans,
- *Preparing* for service negotiations, that is, developing an informed negotiating strategy or identifying the capacity needs required to do so, setting up the proper channels of communication with key stakeholders, and conducting a trade-related regulatory audit,
- *Conducting* a service negotiation, that is, acquiring a voice in debates on outstanding rule-making challenges in the service trade by pursuing offensive interests, devising strategies to deal with defensive concerns, assessing the negotiating requests of trade partners, formulating own requests and offers, and participating in collective requests and offers,
- *Implementing* negotiated outcomes, that is, addressing regulatory capacities and weaknesses and identifying implementation bottlenecks, and
- *Supplying* newly opened markets with competitive services that comply with international standards, that is, addressing the supply-side constraints on the ability to take advantage of the outcome of trade negotiations, including aid for trade in services.

4.60 For many developing countries, the administrative burden of handling and negotiating multiple trade agreements has become a serious concern, and this may hamper the opportunities available to these countries to obtain adequate market access for service exports. Acknowledging these constraints the World Bank will provide a country-specific service regulation tool that will help countries to organize, formulate, and implement reforms and/or participate in negotiations (Sáez and Vaillant, 2010).

4.61 The information and capacity requirements to define a strategy for trade liberalization in services can be substantial. In Africa, availability of high quality and objective technical and capacity building assistance for these tasks will be essential. However, the technical assistance provided thus far often appears to have focused too narrowly on understanding the GATS and on providing inventories of current trade restrictions for a GATS-style negotiation over their liberalization and has largely ignored more important trade, regulatory, and investment-climate issues.

4.62 The approach above for reforming trade in services does not lend itself well to a standard request and offer GATS style negotiation across many sectors. A services trade agreement which is driven by mercantilist market access and national treatment concerns to negotiating reciprocal commitments will not be useful if it is uncoordinated from a process that identifies clear regulatory objectives and the weaknesses of the current regulatory regime. A GATS style request and offer approach may concentrate attention on market access and national treatment and prevent attention being given to the underlying fundamental issues of new market opening, improving regulatory policies and strengthening regulatory institutions. Rather than a broad based negotiation the more effective approach will be to focus on a series of phased in-depth sector-by-sector programs of coordinated regulatory and trade reforms.

H Capacity Building for Services Trade Reform

4.63 Low income countries in Africa face substantial hurdles in building capacity to effectively regulate services and to negotiate agreements to liberalize trade in services. The quality and credibility of regulatory decisions depend on the competence of the staff of the regulator and the regulation of many sectors in many African countries is hampered by lack of qualified staff. Thus, capacity-building and high-quality, relevant training are vital for improving trade policy making and regulatory performance.

Capacity for Defining Trade Policy in Services

4.64 OECD (2001) identifies the following as essential for the design and implementation of an effective trade policy in developing countries: (i) effective mechanisms for consultation among three key sets of stakeholders: government, the private sector and civil society; (ii) effective mechanisms for intra-governmental policy coordination; (iii) a strategy for the enhanced collection, dissemination and analysis of trade related information; (iv) Strong capacity in the government supported by trade policy networks of indigenous research institutions and trade support institutions. These elements are just as relevant for services as for goods. However, in many African countries these elements are, at best, weak.

Capacity and Design for Effective Regulation of Services

4.65 Regulatory agencies need to be independent and staffed with personnel that are competent in the tasks that the regulator must undertake to be able to come to efficient decisions. In addition, stakeholders should have recourse to a neutral arbiter if they wish to contest what they deem to be an unreasonable decision by the regulator. The issues at stake are how the regulator interacts with service providers, how the regulator connects to relevant branches of the government and how the decisions of the regulator are reviewed. Kessides et al (2010) conclude that international experience suggests the following arrangements are most likely to be appropriate:

- The staff of the regulator are nonpartisan and stable such that changes in government should not lead to substantial changes in personnel
- The regulator an independent authority that takes into account the interests of all stakeholders
- The regulator operates in an open and transparent manner and is required to publicise the principles that guide its decisions
- The regulator is provided with sufficient resources to implement its mandate and is provided with the authority to compel regulated firms to provide information.
- The regulator has staff that are technically competent in the relevant economic, accounting, engineering and legal disciplines that allows for the monitoring of industry performance and analysis of cost data and firm behavior. They should also be familiar with good regulatory practice from international experience.

- There is an independent judicial process that is capable of adjudicating disputes and ensuring that the regulator is acting honestly and competently.

4.66 Clearly these requirements are absent in many small African countries and entail substantial costs if they are to be achieved. In many cases there are insufficient domestic professionals to implement an effective regulatory system. The regulator is often weak and poorly resourced and therefore can come under undue influence from politicians and/or regulated firms.

4.67 This points to the need for training and capacity building to develop the human resources necessary for good regulation. Another important approach to overcome technical weaknesses is to outsource certain regulatory functions to external contractors. Outsourcing can help enhance the effectiveness of the regulator by improving competence, independence and legitimacy. However, outsourcing requires sound contract management and effective skill transfer, and should be a complement rather than a substitute for the building of local regulatory capacity (UNCTAD (2009)).

I Conclusions: Key Policy Implications

4.68 To conclude, the key policy messages from this chapter are:

- **Many countries in Africa lack a strategy for trade in services.** Most of the liberalization of applied policies governing trade in services in Africa has been undertaken unilaterally. Countries in Africa will need to carefully assess whether further reform of applied trade policies is necessary to achieve objectives regarding investment and competition in services sectors, or whether the more pressing need is for reform of domestic regulations and domestic regulatory capacity or attention to constraints in the investment climate.

- **International trade agreements can support governments that wish to implement services reforms** to increase competition in services markets but which are opposed by powerful vested interests. Such agreements can help break domestic deadlocks by improving market access for the country's exporters and mobilizing export groups to support the reform effort. Trade agreements can also provide a mechanism for overcoming domestic resistance to desirable reforms by locking in the commitment to reform and enhancing the credibility of the reform process. Evidence suggests that the GATS may not provide a strong commitment mechanism for small developing countries.

- **Well designed and implemented liberalizations of policies affecting trade in services can be complex undertakings**, which are more technically and administratively demanding than most liberalizations of merchandise trade. Many African countries, particularly the least developed ones, face serious technical and administrative capacity constraints in designing, negotiating, and implementing liberalizations of their trade in services.

- **A phased, in depth, prioritized sector-by-sector approach to coordinated trade and regulatory reform** is the most appropriate approach to services liberalization in Africa, while efforts are made to overcome severe capacity constraints, instead of a comprehensive approach to liberalization of trade in services. Such a strategy can optimize the use of limited reform capacity and permit both careful design and coordination of in-depth reforms and their phased implementation as the necessary regulatory capacity is developed.

- **Data Requirements.** To be able to effectively plan trade liberalization and negotiate agreements on trade in services bilaterally, regionally or at the multilateral level it is essential for policy makers and negotiators to have extensive information on the nature of regulation and trade restrictions in all of the sectors that are subject to discussion. In many African countries, as well as other developing countries, comprehensive data on services sectors are not available, and they typically face great difficulties is effectively participating in trade negotiations on services. Detailed country-specific data on applied trade restrictions on a sector-by-sector basis will thus have to be collected and analyzed when formulating services-sector liberalization programs.

- **Capacity Building Assistance.** Technical assistance and financial support for capacity building can facilitate the design and implementation of coordinated programs of trade liberalization and regulatory reforms.

Annex 4.1 : Scheduling GATS Commitments

4.69 The GATS schedules are arranged by sector and sub-sector. Countries make specific commitments on market access and national treatment in these sectors for each of the four modes of trade in services: cross-border supply (Mode 1); consumption abroad (Mode 2); commercial presence (Mode 3) and temporary presence of natural persons (Mode 4). Furthermore, GATS commitments are set up in a standard format to allow for comparison. A country's GATS schedule is divided into two parts: Part I lists horizontal commitments that apply across all sectors that have been scheduled; Part II contains commitments on a sector-by-sector basis.

4.70 The GATS adopts a positive list approach to the listing of sectors: if a sector is not listed then no commitments have been made for that sector. For the listed sectors, countries can indicate any limitations on market access or national treatment for each mode of services trade. If the country has placed "NONE" besides the mode, there are no limitations on market access or national treatment for that service and mode. All commitments in a schedule are bound unless otherwise specified. Where a country wishes to maintain full discretion to introduce or maintain measures inconsistent with market access or national treatment it uses the designation "UNBOUND" for the mode concerned.

4.71 In many cases bound commitments are accompanied by descriptions which indicate limitations on market access or national treatment for the particular mode of supply. Such reservations are based on one of two approaches: (i) the entry describes the nature of the limitation, indicating the elements which make it inconsistent with market access or national treatment; (ii) the entry by describes what is being offered rather than the limitations they are maintaining. Such an approach is often used to indicate the market access opportunities for the entry of certain categories of foreign natural persons who supply services.

4.72 Example 1 shows the horizontal commitments of Kenya. Under market access, for all sectors that have been scheduled, Kenya reserves the right to require that foreign firms providing services through commercial presence are incorporated or established locally. There are no horizontal commitments on Modes 1 and 2.

Example 1: Kenya's Horizontal Commitments

Horizontal Measure	Limitations on Market Access	Limitations on National Treatment	Additional Commitments	Notes
ALL SECTORS INCLUDED IN THIS SCHEDULE	3) Commercial presence requires that foreign service providers incorporate or establish the business locally			
	4) Unbound except for measures concerning the entry and temporary stay of natural persons employed in management and expert jobs for the implementation of foreign investment. The employment of foreign natural persons for the implementation of foreign investment shall be agreed upon by the contracting parties and approved by Government			

Example 2 shows an example of the commitments with reservations made by Botswana for the specific sub sector of hotels and restaurants. Botswana has committed to maintain no measures inconsistent with market access and national treatment for mode 1, reflecting the desire to encourage tourists to come to the country. Botswana has reserved the right to apply any measures that may be inconsistent with national treatment for mode 2 and has placed a limitation on market access for this mode.

Example 2: Botswana's Chapter 9 "Tourism and Travel" GATS Commitments

Sector / Sub-sector	Limitations on Market Access		Limitations on National Treatment		Additional Commitments	Notes
09. Tourism and Travel Related Services						
A. Hotel and restaurants including catering (CPC 641-643)	1)	None	1)	None		
	2)	The amount of local and foreign currency entitled to permanent residents is limited for each trip and for the whole year by the Bank of Botswana.	2)	Unbound		
	3)	The service should be supplied through commercial presence.	3)	The service supplier should meet all residency requirements.		
	4)	Unbound except as indicated in the Horizontal Commitments.	4)	Unbound except as indicated in the Horizontal Commitments.		

4.73 A more intuitive way of understanding these restrictions is that a binding commitment puts an explicit limit to the restrictions a government can impose on a service; leaving a service unbound indicates that a country will not limit the level of restriction that it is willing to impose on a service. When making a commitment a government therefore legally binds, or locks-in, the specified level of market access and national treatment and undertakes not to impose any new measures beyond this that would (further) restrict entry into the market or constrain the operation of the service provider. Specific commitments are thus a guarantee to economic operators in other countries that the conditions of entry and operation in the market will not be changed beyond the bound level. The credibility of this process comes from the costs that countries may incur if they renege on their commitments. Such costs can include paying compensation to affected countries, if agreement with them can be achieved, or the country that reneges on its commitments can be taken to the GATS dispute settlement mechanism, which could then lead to penalties being imposed, including the removal of market access to affected countries.

4.74 While making a commitment in a particular sector may send a signal of positive intentions regarding market access and non-discriminatory behavior, GATS commitments may not always be indicative of the true state of openness and discrimination in an economy. This is because making a commitment under the GATS shows what a country *will not* do, rather than what it *will* do or *is* doing to create a level playing field for foreign economic actors. This is complicated by the fact that many countries bind their commitments at intentionally high levels, leaving open a large degree of potentially discriminatory behavior.

4.75 The down-side of locking in policy through legally binding commitments is, some critics argue, a reduction in a developing country's "policy space" for subsequently reversing the provisions that are locked-in through a trade agreement. This risk is lower the larger the gap between the commitments and actual policy. However, limiting the risk of policy reversals can be important for the credibility of reforms with private investors and for encouraging large investments that pay off over a number of years. A reduction in "policy space" may thus be the unavoidable price of establishing a competitive investment climate. Commitments that are bound substantially above actual policy may not have the desired effect.

Commitments under the CARIFORUM EPA

Example 3: CARIFORUM Commitments on Life Insurance

	LIMITATIONS ON MARKET ACCESS	LIMITATIONS ON NATIONAL TREATMENT
a) Life, accident and health insurance services (CPC 8121) ATG, DMA, DOM, JAM, VCT, TTO GUY (CPC 81211)	DMA, TTO: 1), 2) Unbound	DMA, DOM, TTO: 1), 2) Unbound
	DOM: 1), 2) Unbound for direct insurance services except for insurance of risk relating to: (i) Maritime shipping and commercial aviation and space launching and freight (including satellites), with such insurance to cover any or all of the following: the goods being transported, the vehicle transporting the goods and any liability arising there from; and (ii) Goods in international transit.	DOM: 3), 4) Unbound
	ATG, GUY, JAM, VCT: 1), 2) None	ATG, GUY, JAM, VCT: 1), 2) None
	ATG, GUY, TTO: 3) None	ATG, GUY, JAM, TTO: 3) None
	DMA: 3) Unbound. None from 1 January 2018	DMA, VCT: 3) None, except as indicated in the horizontal commitments
	DOM: 3) Unless otherwise provided in a treaty, agreement, or international agreement to which the Dominican Republic is a party, personal life and health insurance contracts sold in the Dominican Republic and all types of bonds on obligations in the Dominican Republic must be underwritten, either directly or through intermediaries, with insurers authorized to operate in the Dominican Republic. Nationality or residency requirement for obtaining a licence.	
	JAM: 3) The Financial Services Commission must be satisfied that the covers being offered by foreign companies will be supplemental to the industry in situations where there is limited capacity in the market. In addition, the relevant authority must be satisfied that adequate funds will be deposited to cover the domestic liabilities of these companies.	
	VCT: 3) None, except as indicated in the horizontal commitments	ATG: 4) None
	ATG, DMA, DOM, GUY, JAM, VCT, TTO: 4) Unbound except as indicated in the horizontal commitments	ATG, DMA, GUY, JAM, VCT, TTO: 4) Unbound except as indicated in the horizontal commitments

4.76 The EU and the CARIFORUM used different approaches to scheduling their commitments on services. The CARIFORUM followed the standard GATS format with a first section showing horizontal commitments followed by commitments on market access and national treatment for each mode of supply for each listed sector.

4.77 The EU, on the other hand, divided its commitments into four different schedules and no distinction is made between market access and national treatment. The four schedules contain horizontal and specific commitments on: (i) commercial presence (mode 3) (ii) cross-border supply (modes 1 and 2 combined) (iii) entry and admission of key personnel and graduate trainees (mode 4); (iv) entry and admission of contractual service suppliers and independent professionals (mode 4). Example 4 shows EU commitments with regard to temporary movement of contractual service suppliers and independent professionals under mode 4 for computer and related services.

Example 4: EU Commitments on Contractual Services Suppliers and Independent Professionals

Sector or sub-sector	Description of reservations
Computer and Related Services (CPC 84)	- CY, DE, EE, EL, FR, IE, LU, MT, NL, PT, SI, SE: None. - ES, IT, PL: Economic needs test for independent professionals. - LV: Economic needs test for CSS. - BE: Economic needs test, except for CSS when the annual wage is - above the amount defined by the relevant laws and regulations. - DK: Economic needs test except for CSS stays of up to three months - AT, BG, CZ, FI, HU, LT, RO, SK, UK: Economic needs test.

4.78 The EU approach identifies the restrictions maintained for specific modes (and parts of modes for mode 4) of supply across sectors. The EU approach does not allow for the simple assessment of the limitations across modes of supply for a given sector. Given the need in Africa to focus on key sectors for both domestic reform and to pursue offensive export interests, the more appropriate way for both groups to schedule commitments is probably to follow the standard GATS template to permit a clear understanding of exactly what commitments are being made for particular sectors.

5. REGIONAL INTEGRATION, REGULATORY COOPERATIONAND TRADE IN SERVICES

5.1 Regional integration can play a key role in the development of services sectors. This is particularly important in Africa where national market size is typically very small and a large number of countries are land-locked.[53] By creating larger markets, regional integration can allow firms to exploit economies of scale in production and accelerate learning processes to build supply capacities and international competitiveness. Larger regional markets can also facilitate foreign investment in services, especially in small countries that would otherwise have difficulty attracting foreign firms to service their domestic markets.

5.2 Regional initiatives can reduce the remoteness of land-locked countries by improving transport and logistics services and better link these countries to regional and global markets. Regional integration may support the development of regional infrastructure in key sectors such as transportation, communications and energy, environment protection.

5.3 Regional cooperation may also make it possible to reap scale economies in regulation and supervision, particularly where national regulatory agencies face skill constraints. Such cooperation can also reduce scope for the capture of national regulation by private sector interests. Creating regional markets may necessitate regional cooperation to effectively regulate services. Regulatory cooperation on mutual recognition or harmonization of professional qualifications, licensing certification, technical standards, competition, and provisions for labor mobility, may be important mechanisms for promoting regional trade and greater efficiency in services in Africa.

5.4 Thus, advancing regional integration and regional regulatory cooperation can be effective instruments for expanding intra-African competition and trade in services. All countries in Africa are party to one, and often more, regional trade agreements and most of these have objectives regarding integration of services markets, although there has been "very limited progress in terms of the implementation of these integration provisions" (UNCTAD (2009)). This chapter discusses the scope and policies for expanding intra-African trade in services and regional regulatory cooperation and considers how an EPA could complement and support regional integration in Africa.

5.5 Regional trade agreements can offer scope for reciprocal liberalization and regulatory cooperation in sectors of interest for all countries that can otherwise be difficult to achieve with a wider group of countries or with countries are quite different levels of development. For example, it is likely to be easier for countries with similar demands for professional services to agree to mutual recognition of qualifications to facilitate cross-border movement of people to provide services such as accountancy, legal services, engineering services and other business services.

[53] 15 of the world's 31 landlocked developing countries are in Africa.

5.6 However, sequencing can be very important in the liberalization of trade in services sectors and regional more generally preferential liberalization can give first mover advantages to second-best firms - hence MFN liberalization will typically dominate preferential opening.

A Regional Liberalization of Trade in Services

5.7 An important issue raised by many African countries in the context of the EPA and GATS negotiations is the case for sequencing preferential regional trade liberalization before removing barriers against EU firms or liberalizing on an MFN basis to allow for the strengthening of the capacity of local suppliers of services and enhancing competitiveness. In sectors where economies of scale or economies of scope are important, the small size of domestic markets in Africa and inappropriate regulations may have constrained the ability of local firms to attain the levels of efficiency necessary to effectively compete in open markets. Regional integration and regional regulatory cooperation may allow more efficient African producers to emerge before they are subject to competition from global service providers. As noted by Mattoo and Fink (2002) this can be seen as a variant of the traditional infant industry argument in which firms learn from limited exposure to competition in the regional market which then prepares them for the more intense competition in the global market.

5.8 Such an approach is justifiable if the benefits from learning at the regional level outweigh the costs from limiting access to a subset of international firms. These costs arise from: (i) limiting the choice of service supplier of consumers and firms and from higher prices as a result of less competition than under multilateral liberalization; (ii) lower prices for assets that are sold to foreign firms; and (iii) smaller revenues for the government from license fees due to a smaller number of potential bidders. As a general rule, the gains from liberalizing trade will be greatest when access is improved for all suppliers regardless of country of origin so that the most efficient firms in the global economy are able to provide services to domestic consumers and firms.

5.9 Most important is that preferential liberalization of services (with restrictive rules of origin) is typically more risky than the preferential liberalization of trade in goods. This is because, as discussed in the previous chapter, in services sectors where entry requires substantial sunk costs, the sequencing of liberalization can have more durable consequences on the nature of competition. Firms that are allowed preferential access to a market may be able to limit subsequent entry by rivals. Thus, allowing sequential entry with preferential liberalization followed by multilateral liberalization may produce quite different market outcomes, and less competitive outcomes, to a strategy of permitting simultaneous entry. The risk arises from allowing initial entry to an inferior supplier that cannot be rectified by subsequently opening up to all suppliers, although allowing acquisition by a more efficient rival can overcome the first-mover advantages of the incumbent.

5.10 However, even when subsequent opening may lead to further entry and competition or rival providers are allowed access through acquisition this may be resisted by incumbents that were granted preferential access. This is more likely if the incumbent is less efficient than rivals outside of the preferential agreement. This can be overcome by commitments to future liberalization at the WTO and, if it provides a more credible commitment, through an EPA,

especially if such liberalization is implemented in a non-discriminatory way or with liberal rules of origin.

5.11 The capacity to produce and export services is a function of endowments of factors of production, institutions and infrastructure (Hoekman and Mattoo (2008)). Hence, policy decisions that improve institutions and infrastructure may have important implications for the future structure of services sectors and the capacity of local services firms to compete with global suppliers. This places added emphasis on the pressing need for better institutions and better infrastructure in Africa to allow competitive services suppliers to emerge but also suggests the need for flexibility in trade agreements such as EPAs to allow competitive Africa services providers the chance to emerge. Again, the situation is likely to vary across sectors and countries. Countries are likely to be able to identify a wide range of service sectors in which there is little rationale for limiting competition to allow local capacity to develop.

5.12 As noted earlier, infrastructure, financial (banking/insurance), and professional services are to a significant extent inputs to other businesses. If these "intermediate" services are high-cost, low-quality, or unreliable, they act as taxes on the agricultural, industrial, and other services producers, a situation comparable to levying high customs duties on raw materials and intermediate products used by domestic industries. While protected producers for the domestic market can recover some on the excess costs of services inputs by passing these on to the local consumer through the final price of the product, the same is not true for export sectors.[54] Although in most cases exporters are authorized to import physical inputs tax-free (either through duty-free temporary admission or a draw-back system), there are no rebates for the excessive cost of uncompetitive local services and the absorption of these into the final export price can make export production uncompetitive or seriously erode their profit margins. Paradoxically, exporters who have to utilize uncompetitive inputs of domestic services may even end up with negative effective protection due to the high cost of protected domestic services, despite their governments' formal policies of export diversification.

5.13 The characteristics, the efficient scale of output, and sensitivity in national economies vary widely across services sectors which has implications for the appropriate level at which to negotiate and make commitments to liberalize trade in services. Stephenson (2002) groups sectors into four categories with regard to whether regional or multilateral liberalization is likely to be more relevant:

5.14 Infrastructure-type services: financial; telecom; energy; transport. For infrastructure and network services, which provide critical inputs to other sectors, the economies of most regional trade areas are too small to yield significant economies of scale and productivity gains just from increased market size and competition relative to their member countries. Moreover, in sectors like utilities, capital inflows and technical know-how are often critical. Potential regional suppliers usually lack the financial resources required to invest in capital-intensive infrastructure services, and foreign investment is often needed to make these sectors more competitive. The preferential liberalization of these sectors would limit the ability to attract the most efficient suppliers and would thus maintain higher-cost, less efficient provision of such critical services.

[54] However, a substantial difference between domestic and international prices encourages fraudulent imports, which can make high tariffs ineffective for protecting domestic producers.

The world or global market is the logical forum to target for the liberalization of these services. Regional negotiations and agreements can play an important role if they allow for the binding of liberalization commitments beyond those made under the GATS which are then extended to other WTO members on an MFN basis. Moreover, regional integration may be crucial to attracting the most efficient globally competitive firms who might otherwise have little interest in serving small segmented national economies. This then puts emphasis on the capacity for regional cooperation for the effective regulation of these sectors. This is discussed in more detail below.

5.15 Business-type services: distribution; professional services; other business services; tourism; construction; engineering services. This category contains services that are not produced on a network basis but that respond to commercial criteria in their production. Tourism and business services (other than professional services) are already quite open sectors in most countries and regional liberalization makes little sense, although, again, such agreements may allow for deeper commitments that could then be extended on a MFN basis. Construction, engineering and professional services, on the other hand, are typically subject to strict regulations for the determination of the equivalence of qualifications. Regional agreements can be important mechanisms for liberalization in these sectors since it will often be easier to develop common criteria for the recognition of the equivalence of standards, diplomas and educational and professional training among a smaller sub-set of member countries with similar national educational and legal systems.

5.16 Social-type services: educational; health. These are services where public policy objectives concerning consumer health and welfare are important and hence are typically more sensitive to national concerns. Very few countries have made commitments in these sectors at the WTO. In this context a strategy to liberalize these sectors may concentrate first on a small scale among countries at similar levels of development. Again, liberalization and the introduction of competition may be more feasible among countries with similar levels of income and requirements regarding these services.

5.17 Other services: recreational services; cultural services. This category contains a mixed set of services with different levels of sensitivity in different countries. Decisions regarding where to liberalize and how much will need to be carefully taken on the basis of broad and open discussions with stakeholders in each sector.

5.18 Similar arguments with regard to learning effects can be applied to regulatory capacity. Chapter 3 stressed the need to coordinate services trade liberalization with regulatory reform and capacity building. In some sectors the sequencing of regional before MFN liberalization may provide a sensible approach to increasing competition in the market at the same time as raising regulatory capacities and allowing regulators to learn from increasing openness at the regional level before having to deal with full blown MFN liberalization. This may be of particular importance in sectors where regulators in small African countries have to deal with large multinationals.

5.19 In other words, when poor regulations and limited regulatory capacity constrain broad trade liberalization there may be gains from initially increasing competition on a regional basis

as regulations are improved and capacity in increased. Again, it is important that commitments are put in place to schedule future MFN liberalization and provide incentives for additional capacity building and regulatory reform.

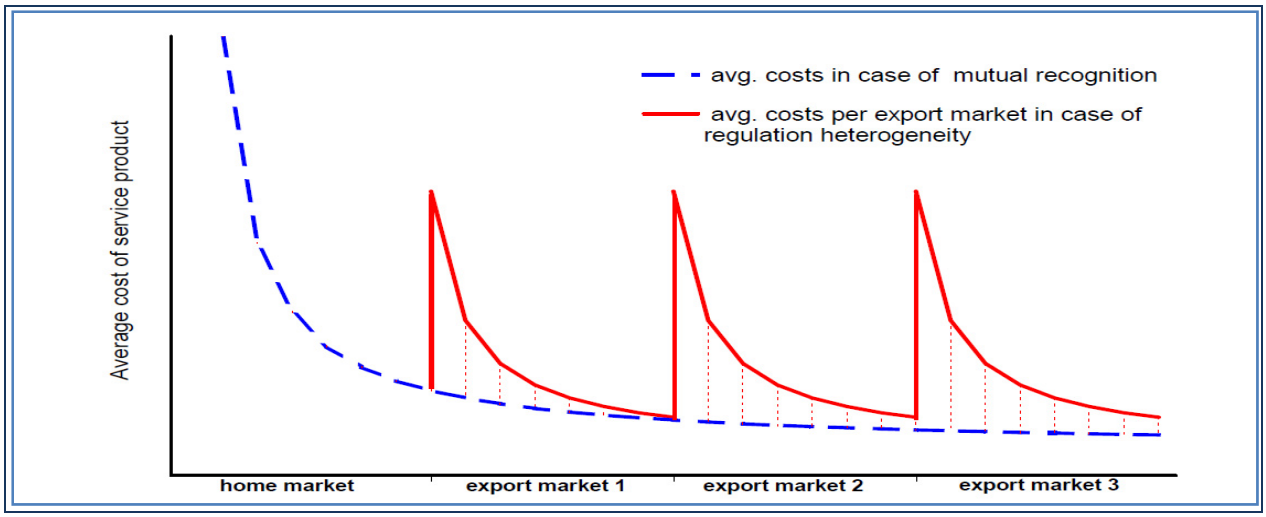
B Regional Cooperation and Coordination of Regulatory Policies and Agencies

5.20 As discussed above, there is a general presumption that the greatest gains from liberalization of services will be achieved when countries remove barriers against all countries on an MFN basis. There may be particular cases where strong learning effects may justify moving initially on a preferential basis subject to strong commitments to subsequent broad based liberalization. However, great care is required in sectors with substantial sunk costs, since preferential liberalization can give a first-mover advantage that may not be possible to undo with subsequent liberalization, leaving a country stuck with a second-best provider. Nevertheless, the importance of regulation in many sectors raises the issue of the appropriate level at which to regulate and whether cooperation between countries at a regional level may be the most appropriate and effective.

5.21 There are a range of sectors where cooperation and coordination of regulations and their enforcement across countries may be necessary for small African countries to obtain the full benefits of the integration of services sectors. However, it may be very difficult to achieve such coordination at the multilateral level or with countries at very different levels of income. This applies particularly to infrastructure sectors such as transport, water and power where regional approaches can lead to the optimal provision of public goods that spill over borders. For example, transport infrastructure does not normally end at the national border so it becomes important to cooperate to develop cross-border infrastructure and associated institutions. Coordination of cross-border and domestic transport infrastructure investment and cooperation on regulations for the services that use such infrastructure can reduce trade costs leading to increased trade and foreign direct investment (FDI). For landlocked countries it will be particularly important to coordinate with their coastal neighbors to ensure that they are effectively liked into regional infrastructure.

5.22 In addition, in sectors such as professional services, trade liberalization to permit cross-border supply and temporary movement may have little impact in practice unless accompanied by regional agreement on mutual recognition of qualifications. Costs of providing services are raised if professionals have to obtain qualifications in each of the countries in which they wish to work. The figure below demonstrates the benefits that can arise from mutual recognition. A fixed cost, such as obtaining the relevant qualification is initially incurred in the home market. Average costs then decline as these fixed costs are spread over a large number of sales or contracts. If a new overseas market is entered an additional set of fixed costs are incurred, represented by the red spikes in the figure. With mutual recognition the fixed costs of entry into overseas markets are avoided and services suppliers are better able to exploit the available economies of scale. Mutual recognition entails cost savings represented by the area under the red line in the figure.

Figure 5.1 : Costs of Regulation Heterogeneity



Source: Taken from Kox and Nordas (2006)

5.23 Achieving mutual recognition can be difficult between countries with different levels of income and wide disparities in education systems and attitudes to the temporary movement of workers. In many case, mutual recognition may be easier to agree between countries at similar stages of development with similar demands for professionals and where there is scope for all parties to enjoy gains from mutual recognition. Box 5.1 discusses the situation with regard to professional services in East Africa and the potential for regional cooperation to support cross-border trade in these services to improve access to, and use of, professional services in the region. As noted earlier, there are likely to be significant benefits in terms of higher productivity in firms that use such services.

Regional Cooperation and Regulatory Capacity

5.24 Many countries in Africa lack the regulatory capacity to effectively regulate liberalized services sectors. Attempts to reform services sectors can be undermined by regulatory capture by incumbent producers and the risk that liberalization may transfer a domestic monopoly into foreign hands and the risk that inexperienced regulators in small countries will face even greater difficulties in regulating a global multinational service provider that has a monopoly in the domestic market. Regional cooperation and coordination can allow for the pooling of scarce regulatory expertise and offers a means of overcoming regulatory weaknesses in individual countries and undermining political constraints to reform.

5.25 Cooperating on a regional approach to regulatory policy can help to reduce the vulnerability of national regulators to political and industry capture (Kessides et al, 2010). Effective regional institutions for regulating services sectors can provide greater certainty to investors, for example, with regard to expropriation of assets, by limiting the scope for arbitrary measures and decisions at the national level. Regional approaches can also limit the influence of incumbent services providers on regulators and regulations. Regulated firms are often well organized to manipulate the political process to obtain regulations and regulatory decisions that favor their own interests rather than those of consumers and producers in the wider economy. This can arise when incumbents are able to influence the choice of regulators so that the

regulatory agency does not properly take account of the interests of all groups affected by regulatory policy in terms of the price, quality and availability of the services they use or consume. Even when political influence is muted the quality of regulatory decisions can be undermined when the incumbent firm or firms has superior technical knowledge upon which the staff of the regulator come to depend and when there is less than full transparency over the data and information that is released to the regulator that is essential in effectively designing and implementing regulations.

5.26 Service reform may be more effective when it becomes part of a broader regional policy that encompasses a range of sectors and issues. Well-organized interest groups will find it harder to block reform when it is incorporated into a broader regional integration process. In addition, there will be less scope for political interference when regulatory policy is harmonized with other that of other countries. The costs of deviating from agreed commitments or cooperation are likely to be larger when reform is part of a regional agreement.

5.27 There is however, no guarantee that regional cooperation will lead to superior outcomes relative to national regulation. For example, the situation could be worse for small countries if the regional regulator is captured by the large country in the regional bloc. It is important then that regional regulation of services enshrines an open policy to trade and there is no necessity for regional regulation to be pursued through a regional trade agreement that liberalizes trade in services on a preferential basis. However, from a practical point of view, it may be necessary to ground regulatory cooperation in a regional agreement that includes a range of services sectors to provide for mutual benefits.

C Trade in Services and Regional Integration in Africa

5.28 Despite the opportunities that come from regional economic integration and cooperation in services actual experience has often been disappointing. While most regional integration communities in Africa contain provisions on trade in services and freedom of movement of persons implementation has been limited at best. In part this reflects that the membership of many African countries in more than one, often conflicting agreement, has been a major obstacle to the effective cooperation between countries in any one community. In addition, there has been limited political commitment to effective regional integration and weak regulatory capacity. Nevertheless, the situation is changing. The Tripartite approach has been established to coordinate integration between the EAC, COMESA and SADC. The EAC members have recently agreed to establish a common market by 2015 and all members have made commitments on trade in services. The following section looks at opportunities and progress in regional integration in Africa with regard to a number of illustrative services sectors and with a particular focus on professional services. In general, such analysis remains limited by lack of comprehensive data on trade in services between African countries and sparse information on regulatory policies and their application. The available studies are typically case studies of particular sectors in particular regions. Comprehensive comparisons across sectors and regions are not possible. The analysis starts with a brief look at the temporary movement of persons within certain regional groups in Africa.

Regional Integration and the Movement of Labour

5.29 One area in which regional agreements between developing countries can proceed much faster than the multilateral level and where there are significant opportunities for mutual gains is with regard to the temporary movement of labor. Intra-African movements of labor are important for achieving a wide distribution of growth benefits when members of a regional economic community differ in size and location. Firms located in the coastal and more advanced economies tend to have a competitive advantage in serving regional markets. These economies may attract much of the new investment – and generate many of the new employment opportunities -- in free trade areas and customs unions. Economies with rising incomes from exploitation of oil and other natural resources can also create employment in domestic service and non-tradable sectors. Conversely, landlocked members of RTAs often have relatively more difficulty in creating new employment opportunities, and access to work opportunities in neighboring countries can be quite important for them.

5.30 However, cross-border labor flows, even when free in principle, are often restricted in practice. The status of guest workers, when admitted, is often insecure and vulnerable to quick policy reversals when political conditions change. While free movement of labor is on the agenda of all RTAs in Africa, little progress has in general been made toward achieving this objective. Most recently, the members of the EAC have committed to create a Common Market by 2015 with freedom of movement and right of residence.

5.31 In 1979 the members of ECOWAS have agreed to a Protocol on Free Movement of Persons and the Right of Residence and Establishment of May 1979. Phase one of the Protocol guaranteeing free entry of Community citizens for ninety days without the need for visa was ratified by Member States in 1980 and immediately put into effect. The rights of entry, residence and establishment were to be implemented within fifteen years. The Protocol also bound the member states to guarantee the security and property of any person expelled. The right of residence and establishment was reconfirmed and in the 1992 revision of the ECOWAS treaty but is still not implemented The second phase (Right of Residence) of the Protocol came into force in July 1986, when all Member States ratified it, but the Right of Establishment has not been implemented. However, in 2000, further progress was made with the establishment of a joint entry visa for ECOWAS and the abolition of residency permits for ECOWAS citizens. Nevertheless, confidence in the provisions of the protocol on free movement has been undermined by a series of expulsion and deportations of foreigners, typically during economic downturns.

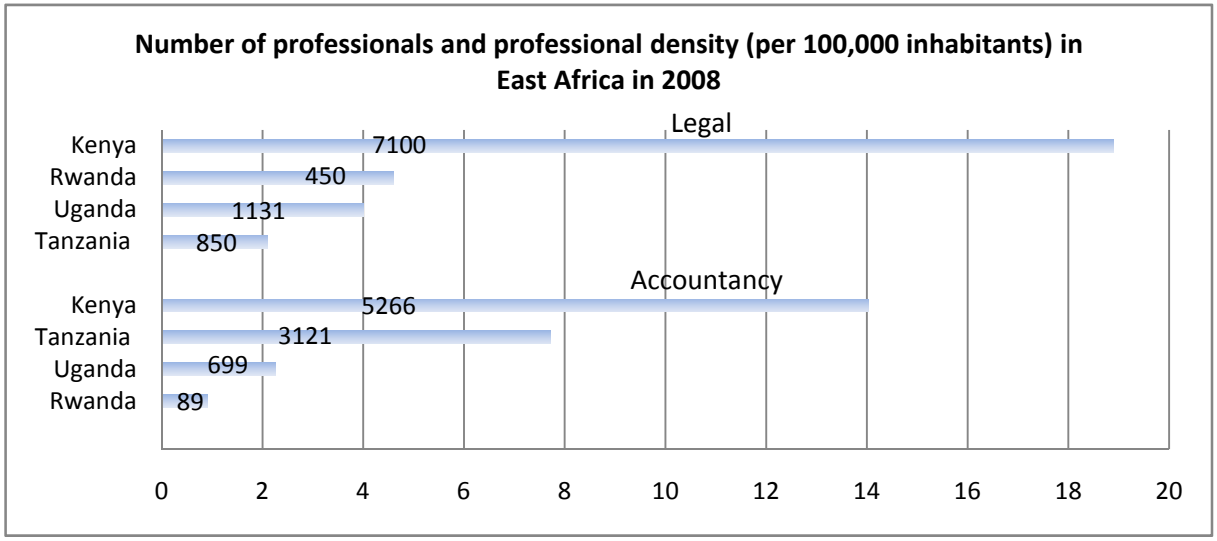
Professional Services and Regional Integration in East Africa[55]

5.32 Analysis of the market for professional services in East Africa shows that there is (i) considerable heterogeneity across countries in the numbers of accountants, lawyers and engineers (figure 1); (ii) significant differences in wages across countries; (iii) large disparities in the usage of such services by firms and especially there is limited uptake by smaller and medium sized firms. For example, severe shortages are observed in Rwanda. Both middle-level (technicians) and higher-level (certified accountants/engineers) professionals are in short supply.

[55] This section in derived from Dihel (2010)

By contrast, professional density is much higher in Kenya (Figure 1). Scarcity is noticeable in the case of experienced professionals or certain subcategories of professionals (such as aeronautical engineers or lawyers specialized in international litigation). In terms of sector-specific differences, shortages seem more severe in the engineering sector in all examined countries.

Figure 5.2 : Availability of accounting and legal professionals in East Africa

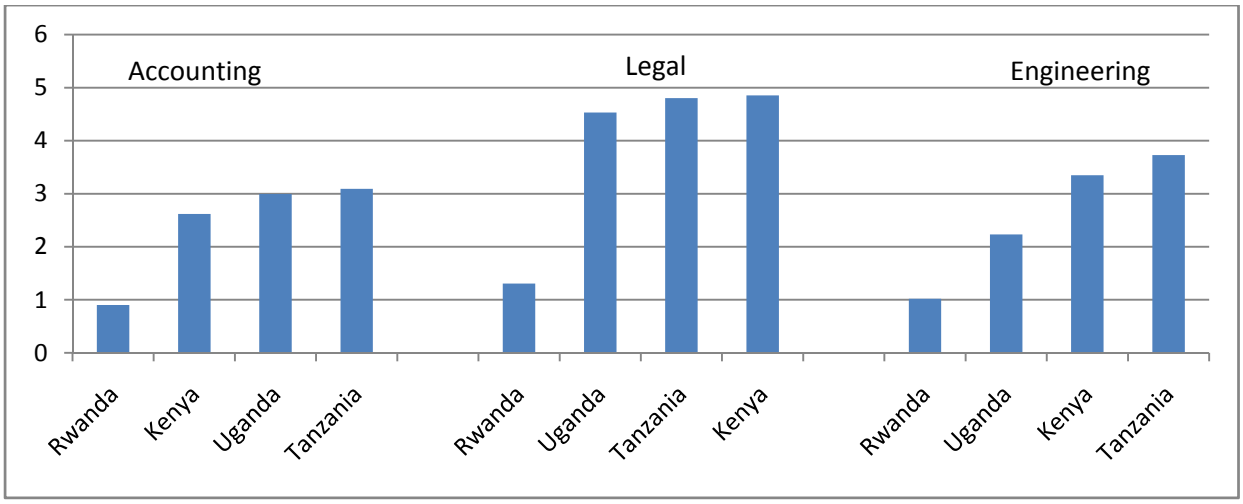


Source: World Bank Regulatory Survey in Professional Services in East Africa, 2009

5.33 The underdevelopment of professional services is the result of inadequate professional skills and regulatory barriers as well as explicit trade barriers and inappropriate migration policies. The regulatory analysis in East Africa has identified a number of disproportionate qualitative requirements to enter the professions (such as restrictions on the access to the profession, mainly due to the monopoly of professional associations over training institutions, or multiple certification requirements) as well as a number of anticompetitive measures such as regulation of fees and prices (mainly in legal and engineering services), advertising restrictions, restrictions on the business structure of professional firms and restrictions on the scope for collaboration within the profession and with other professions. Explicit barriers on foreign suppliers (firms and individuals) supplement the domestic regulatory restrictions and limit East Africa's participation in international networks and prevent these countries from tapping into the regional or global pool of skills. Figure 2 reproduces in a graphical format the aggregate regulatory indices for the examined countries and highlights the regulatory heterogeneity in professional services across the examined countries.[56]

[56] These are synthetic indices where higher numbers denote greater policy restrictiveness.

Figure 5.3 : Aggregate regulatory indices in professional services in East Africa



Source: World Bank Regulatory Surveys in East Africa, 2009.

5.34 Given these differing circumstances, policy action at the national level will differ from country to country. However, international and regional cooperation would ideally complement domestic policy measures.

Role of regional cooperation in developing professional services markets in East Africa

5.35 On the one hand, the heterogeneity of professional endowments and the sectoral earnings differentials across countries suggest that there is substantive scope for trade in professional services in East Africa. On the other hand, policy heterogeneity (in terms of both explicit barriers and domestic regulation as depicted in Figure 10) creates trade and investment costs for service firms doing business in other East African countries. Services providers have to comply with different rules in each foreign destination market and this causes fixed market-entry costs. Empirical studies point to the negative impact of regulatory heterogeneity on market entry, trade flows and export performance of firms.

5.36 Ideally, explicit trade barriers should be eliminated on an MFN or non-preferential basis. However, given the high degree of regulation in professional services, deeper regional integration that promotes trade-facilitating regulatory cooperation with neighboring partners that have similar regulatory preferences could usefully complement multilateral liberalization efforts. Regional cooperation would be particularly useful in the following areas:

- *Skill formation*: Fragmentation of the regional market for education by differences in regulation can prevent the emergence of regional hubs for higher education. The Inter-University Council for East Africa (IUCEA), a regional inter-governmental organization established in 1980 with the aim of facilitating contact between the universities of East Africa, already provides a forum for discussion on a wide range of academic and other matters relating to higher education. Deeper cooperation on maintaining comparable academic standards and linking the content of courses to labor market needs (including in professional services) could allow higher education institutions better exploit economies of scale in education and increase the number of graduates with market-relevant skills.

Furthermore, partnership for designing and administering efficient and financially viable student loan programs, and putting in place collaborative mechanisms for recovery of loans from students could enhance access to higher education in East Africa and further address some of the identified skill shortages and mismatches.

- *Development of appropriate standards* – especially for small and middle sized enterprises (SMEs). Inappropriate standards often stifle demand for services in areas such as accounting and engineering. While uniformity of standards may improve the quality, completeness and comparability of reported information, and international standards remain appropriate in specific cases, it seems that common standards applicable to big firms and SMEs prevent some smaller firms from using auditing and accounting services. For example, complying with International Financial Reporting Standards (IFRS) for corporate accounting may be excessively costly for certain types of firms, even though there is a provision for small firms to use a simplified standard. Several small and middle-sized firms – particularly in Tanzania and Uganda – noted the excessive costs of complying with international standards. Dual standards that are tailored to the specific needs of firms by size may be worth considering in East Africa. Differentiated services provided to different types of firms – say large versus SMEs - may be most efficiently delivered by different classes of accounting professionals. A framework for regional cooperation on standards already exists in the form of the Eastern Central and Southern African Federation of Accountants (ECSAFA). All countries could benefit from the development of the ECSAFA Guide on Accounting for SMEs. The ECSAFA region developed in 2005 common training standards for accounting technicians.

- *Mutual recognition of professional qualifications and professional licensing*. Regional integration can be used to reduce the scope for private interest regulation and enhance competition. A case in point is the recognition of professional qualifications and licenses at the Eastern African Community level. The five East African countries have made progress in the area of services in the context of the East African Community Common Market negotiations. The Common Market Protocol, adopted by the Multi Sector Council in 2009, includes an annex on a framework agreement on mutual recognition (MRAs) of academic and professional qualifications. The implementation of an MRA that covers areas such as education (accreditation of schools or academic programs); examinations (qualifying examinations for licensing, including alternative methods of assessment such as oral examinations and interviews); experience (length and nature of experience required for licensing); conduct and ethics (standards of professional conduct and the nature of disciplinary action for non-conformity with those standards); professional development and re-certification (continuing education and ongoing requirements to maintain professional certification); scope of practice (extent of, or limitations on, permissible activities); local knowledge (requirements for knowledge of such matters as local laws, regulations, language, geography or climate) would lead to the creation of a regional integrated market for both training of professionals and professional services.

5.37 There are potentially important gains to be derived from creating an integrated regional market in professional services in East Africa. Such gains would go beyond exploiting economies of scale in skill formation, professional services markets and regulatory institutions.

Regional integration could assist the East African countries overcome national limits in technical expertise (for example, in terms of standard setting) and minimize regulatory capture (for example, by enforcing substantive and procedural restraints on regulatory discretion through mutual recognition agreements). External assistance from more advanced partners, such as the EU, could facilitate the implementation of regulatory reform.

Regional Integration and Financial Services

5.38 Financial services in small countries tend to be more limited in scope, more expensive, and of poorer quality than services in larger systems. This is because small financial markets tend to have fewer participants and are consequently less competitive than larger markets. This leads to higher prices for financial products, more limited access to finance and less innovation than in larger financial systems. In addition, small financial systems are less efficient because firms are unable to exploit economies of scale. Small markets are also likely to provide a smaller range of products as inability to attain minimum efficient scale may prevent the provision of some financial services that are demanded by consumers. Small markets can be more volatile than larger markets since there are fewer opportunities for firms to diversify their investment and operational risks. From a regulatory point of view the regulatory infrastructure of small markets tends to be of higher cost and lower quality than in large markets. Financial supervision and regulation entails high set-up costs and requires substantial human capacity. Finally, the financial infrastructure is less complete in small markets. For example, credit information registries may not be established in small markets because it is not possible exploit the economies of scale required for cost effective operation (World Bank, 2007)).

5.39 To address these constraints a country with a small financial system can open up to flows of capital from the global market and to establishment by foreign financial services providers. This can be pursued unilaterally or by locking-in market access and national treatment commitments at the WTO. In addition countries can seek to integrate its financial system with those of other countries in the region. One form of opening should not preclude or distort the others so that, for example, regional integration should not be a substitute for the gains to be derived from opening to global international financial markets.

5.40 The benefits from regional integration can arise from scale economies from satisfying a single capital adequacy requirement in all markets, and from consolidation of management as well as back office procedures as financial firms expand or merge. A single set of rules and reporting requirements can reduce compliance costs for financial intermediaries and firms operating in several countries within a region. These lower costs and the increase in competition as intermediaries are allowed to offer services in other countries will create downward pressure on spreads and fees. The increase in competition may also encourage providers to search for new, as yet under-served, customers, thus increasing access to financial services and further contributing to growth. There will also be pressure to increase new and better financial services products more closely tailored to the needs of particular consumers.

5.41 An example of a successful approach to regional integration in financial services among developing countries is the Eastern Caribbean Currency Union (ECCU), which comprises Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, and two U.K. Overseas Territories, namely Anguilla and Montserrat. ECCU now

has over 300 financial institutions a relatively large number for a population of around 550,000. Despite the small size the financial institutions are relatively well developed and the financial system is deep. Establishment by foreign banks has been instrumental in the process of creating an open and competitive market. The Eastern Caribbean Central Bank, established in 1983, has served as a mechanism for cooperation on financial and economic issues among the ECCU members (World Bank, 2007).

Transportation Services and Regional Cooperation

5.42 Raballand et al (2008) discuss how opening up to competition and regional regulatory cooperation have enabled Zambia to enjoy relatively high transport quality and low transport prices compared to other land-locked countries in Africa. Competition has come from opening up to investment, which has come mainly from South African operators and a relatively permissive approach to regulation and the issuing of permits under bilateral agreements. This contrasts to West Africa where bilateral transport agreements typically define quotas for the fleet of each country and allow for a queuing system to allocate freight to transporters. This limits competition and incentives to increase productivity and quality of service.

5.43 Throughout Africa regional cooperation on transport services is necessary to address a number of regulatory issues that can limit competition and reduced the quality of service. Key issues are the harmonization of road user charges, the standardization of axle-load limits, consistency in rules relating to standards for transport equipment so that the same equipment can be used across countries, and third party insurance, where differences across countries raise costs and increase paperwork and delays.[57] Other important regulatory issues relate to the third country rule where a truck registered in a third country cannot transport goods between two other countries. This requires a regional approach which goes beyond the current network of bilateral agreements. Finally, there is the issue of cabotage, where a foreign transporter carries goods between two destinations within a foreign country. Currently this is prohibited in most African countries. This is an important restriction on competition in the domestic market, although the impact can be limited by an open approach to foreign investment that allows foreign operators to invest in domestic registered trucking companies.

D Conclusions

5.44 **Regional approaches to services reform can be beneficial** if they allow for the exploitation of economies of scale, ensure the appropriate management of cross-border public goods, and encourage cooperation and coordination that can lead to better regulations and pool technical skills to overcome capacity constraints that afflict regulation at the national level.

[5757] Eleven COMESA countries (Burundi, Democratic Republic of Congo, Eritrea, Ethiopia, Kenya, Malawi, Rwanda, Uganda, Tanzania, Zambia and Zimbabwe) are implementing the COMESA Yellow Card scheme which provides a single certificate of insurance that is accepted in all participating countries. It covers third-party liabilities and medical expenses for the driver of the vehicle and his passengers should they suffer any bodily injury as a result of an accident to an insured vehicle. Transporters and motorists, therefore, do not have to buy insurance cover at each border post they cross.

Deeper regional integration through regulatory cooperation with neighboring partners, which have similar regulatory preferences, can usefully complement non-preferential liberalization.

5.45 **Achieving these goals does not require the preferential liberalization of trade in services at the regional level.** In general, the greatest gains from liberalizing trade in services will arise when access is provided to all suppliers. But sequencing preferential liberalization of trade in services before broader MFN liberalization can have adverse long-run consequences by handing a first-mover advantage to a less efficient supplier that a subsequent increase in openness cannot dislodge or force to become more efficient.

5.46 **Liberalization at the regional level first may be justified if there are important learning effects** that local firms have not been able to exploit due to the small size of national markets or restrictive national regulatory regimes that have inhibited opportunities for growth. Preferential regional liberalization may then allow regional service providers to emerge in Africa that are then able to compete effectively when MFN liberalization is implemented. Relatedly, given the need to coordinate trade opening with regulatory reform and for regulators to gain experience before full opening, there may be sectors where a pragmatic approach to reform links sequential liberalization with regulatory capacity building.

5.47 **It is important to carefully assess the potential costs and benefits of proceeding with preferential regional liberalization** and pursue binding commitments to ensure subsequent MFN liberalization is actually implemented. Such an approach to services reform is likely to be most appropriate in sectors where there are substantial differences in demand and supply characteristics between regional markets and the global market.

6. LIBERALIZATION OF TRADE IN SERVICES AND INVESTMENT IN THE CARIFORUM EPA: *IMPLICATIONS FOR AFRICA*

6.1 In a context in which trade liberalization can play an important role in increasing competition and investment in services sectors to drive efficiency gains, reduce prices and increase access, this chapter looks at the key provisions of the CARIFORUM EPA as a benchmark for services EPAs between Africa and the EU. The content of this agreement is broadly relevant for the design of the liberalization of trade in services, foreign direct investment, and the trade-related regulatory framework for services EPAs in Africa. However, the design of EPAs for Africa needs to reflect the greater diversity across countries in Africa and the greater asymmetries with the EU in the level of services development and in regulatory and negotiating capacity. The aim of the chapter is to draw attention to provisions that are likely to be of particular relevance to countries in Africa that may wish to use services EPAs to increase competition and investment and drive domestic reform, while identifying issues that are likely to be problematic. The chapter concludes with the main lessons from the CARIFORUM experience in negotiating services EPAs for African countries.

6.2 The chapter begins with a brief overview of the EU's approach to liberalizing foreign investment and trade in services in its previous bilateral trade agreements with developing countries and then discusses the CARIFORUM EPA's main provisions on trade in services and foreign investment, competition and domestic regulation, regional integration, and development cooperation, and their relevance for services EPAs in Africa.

A The EU's Approach to Liberalizing Investment and Trade in Services in Previous Bilateral Trade Agreements

6.3 Provisions concerning trade in services in preferential trade agreements concluded between the EU and other countries/regions, including developing countries, differ widely with respect to coverage and depth of commitments. The EU had detailed agreements on trade in services with the former Eastern European accession countries (now members of the EU-27), including extensive cooperation on mode 4 (temporary movement of natural persons) and integration/mutual recognition of regulatory institutions affecting other modes. But the EU's bilateral trade or association agreements with other countries outside of Europe have included far fewer, or even no, specific commitments on mode 4 or other modes except for simply restating the general GATS principles.

6.4 The EU has negotiated or is negotiating services agreements with several of the developing Mediterranean countries with which it has Euro-Med or other bilateral trade agreements, such as Morocco, Algeria, Tunisia, and Israel. However, these agreements include fewer EU commitments on liberalizing mode 4 as compared with the EU's agreements with the Eastern European accession countries. For example, the EU-Moroccan agreement does not mention mode 4, and the EU-Algerian agreement extends it only for "key" personnel. In the services agreement under negotiation with Tunisia (bilateral trade in goods was fully liberalized

in January 2008), the EU has reportedly committed to permitting the entry of highly skilled personnel of service contractors and self-employed skilled professionals for a period of up to six months.[58] Israel is negotiating services agreements sector-by-sector with the EU. These negotiations have focused largely on modes 3 (commercial presence) and 2 (cross-border provision), and separate agreements on telecommunications and government procurement have been reached.

6.5 Outside of the European area, services were not included in the EU's Trade Development and Cooperation Agreement with South Africa. The EU-Mexico agreement focuses primarily on government procurement, competition, and financial services.[59]

6.6 The Cotonou Partnership Agreement (CPA) concluded in 2000 referred for the first time to the negotiation of reciprocal services agreements between the EU and ACP countries. Its Title IX on "Development of Services" includes several chapters on services. Among its key provisions are the following:

a. reaffirmation of the commitments under the General Agreement on Trade in Services (CPA art. 41.2) and extension of EPAs to encompass the liberalization of services in accordance with the GATS provisions (CPA art. 41.4);
b. need for Special and Differential Treatment (SDT) for ACP suppliers (CPA, art. 41.2 and 41.3);
c. EC support for ACP export capacity (CPA, art. 41.5); and
d. special provisions for certain sectors: Tourism (art. 24), Maritime Transport (art. 42) and ICT/Telecommunications (art. 43).

6.7 The CPA thus opened the way for negotiations in services compatible with GATS, or in the form of "GATS-plus," but it does not mandate the inclusion of services in the Economic Partnership Agreements.[60] The services content of EPAs is thus negotiable and will reflect the interest of individual countries or groups of countries in expanding trade in services.

B The Liberalization of Trade in Services and Foreign Investment in the CARIFORUM EPA

6.8 The CARIFORUM EPA reflects the EU's most recent approach to liberalizing foreign direct investment and trade in services with developing countries and may guide its approach to future trade agreements covering these.[61] The main features of the CARIFORUM EPA are:

a. Free entry, non-discriminatory (national) treatment, and MFN status of services providers and investors from the signatory countries;

[58] More favorable conditions (up to renewable two year terms) are available under the EU's "blue card" directives as discussed in Annex D.
[59] Tables B.1 and B.2 in Annex B summarize the coverage of services in previous EU trade agreements.
[60] Bilateral agreements or RTAs are permitted to go beyond the obligations contained in the GATS – an approach sometimes referred to as "GATS-plus."
[61] For a further discussion of the CARIFORUM EPA's provisions concerning the liberalization of trade in services and related issues, see also German Federal Ministry of Cooperation and Development (2008)

b. Coverage of all four GATS modes of service delivery;

c. Inclusion of foreign direct investment in production of *goods* as well as services;

d. Progressive, reciprocal, asymmetric bilateral liberalization of trade in services and investment as permitted by the GATS special and differential treatment (S&DT) clause.

e. A flexible, phased approach to implementation with separate country-by-country positive lists of sectoral liberalization commitments and initial commitments to liberalization only in a few sectors where this can be readily implemented;

f. Schedules for reviewing progress in implementation and initiating negotiations of subsequent phases of liberalization;

g. Establishment of a mechanism for settling disputes;[62] and

h. A regional preference clause extending to other members of the EPA-groups the same preferential treatment of services and investment granted to the EU.

i. An MFN clause that requires that future preferences granted to another "major trading economy" that go beyond those agreed in the EPA be extended to the parties to the EPA.

6.9 The following sections outline these provisions in a little more detail, identifying where possible implications for African countries.

General Provisions for Liberalization of Investment and Cross-Border Trade in Services

6.10 The EU's approach to liberalizing foreign direct investment in bilateral treaties is to generalize to all economic sectors provisions that were originally designed to govern the commercial presence of service sector firms (mode 3). The CARIFORUM EPA adopts this approach and covers investment in goods producing sectors as well as in services. The EPA's general provisions on commercial presence, in keeping with the EU standard approach to foreign investment in trade agreements, refer to all economic activities. Its main provisions are intended to ensure non-discrimination between domestic and EU services-providers and investors in the sectors covered through commitments on:

a. Market Access through Commercial Presence: Signatory countries are to refrain from maintaining or adopting measures to limit the number of commercial firms (through numerical quotas or other requirements such as economic needs tests) or the total quantity of output. Limitations on the participation of foreign capital in terms of maximum percentage and measures requiring specific types of establishment, such as joint ventures, are also prohibited.

b. National treatment: Signatory countries grant to investors from other signatories treatment no less favorable than that they accord to their own investors.[63]

[62] See Chapter 15 in Part III of the World Bank's *Full Report on Implementing Interim EPAs* for a discussion of dispute settlement procedures.

[63] Public enterprises are, however, exempted from this non-discrimination clause if their existing regulations are inconsistent with it.

c. Most-favored-nation treatment: Signatory countries also grant to investors from the other signatories treatment no less favorable than the most favorable that they accord to similar investors from any third country.

6.11 These broad provisions apply in principle to all goods producing and service activities, including the delivery of services by suppliers from abroad and consumption abroad (GATS Modes 1 and 2 of service delivery) as well as through commercial presence (Mode 3). Audio-visual services, national maritime, cabotage, and certain national and international air transport services are exempted from the foregoing provisions in accordance with standard GATS practice.[64]

Limitations on the Application of the General Provisions

6.12 The implementation of these broad principles governing commercial presence and foreign direct investment is, however, qualified by the following:

6.13 Actual Sectoral Coverage Determined by Positive Lists. As in the GATS, the sectors to which these principles will be applied are determined by a positive list approach, that is: the sub-sectors to be liberalized must be explicitly listed in the agreement or its annexes, and the EPA's investment provisions do not apply to any sectors that are not listed. In contrast, in a negative list approach, which, despite its name, is generally the more liberal option, investment in all sectors is automatically liberalized except for those sectors which are explicitly excluded.[65] However, a positive list approach is more appropriate for countries with limited capacity to define their interests in services negotiations and where efforts should initially focus on a limited number of priority sectors.

6.14 Separate Country-Specific Lists of Commitments. The sectors to be liberalized for commercial presence and foreign investment under the CARIFORUM EPA are identified in its annexes, which contain detailed country-by-country lists of the sectors to which its general principles are to apply. Following the approach of the GATS these schedules also contain restrictions/limitations to the application of these general principles in specific cases.

6.15 Gradual Approach to New Liberalization. The CARIFORUM EPA adopts a gradual approach to implementation and the initial coverage of the agreed principles governing the commercial presence of services-suppliers and foreign investment is limited. Initial liberalization commitments reflect largely, if not entirely, the binding of the countries' legislative provisions that are currently in effect and their pre-existing future liberalization commitments with little new liberalization. The Parties committed to further negotiations on investment and trade in services within five years with "the aim of enhancing the overall commitments undertaken."

6.16 Subsidies are Explicitly Excluded from the National Treatment Provision. The exclusion of subsidies from the national treatment provision (Article 60 (3)) is more straightforward and

[64] To the above standard GATS exceptions, the EU adds the mining, manufacturing, processing of nuclear materials, and the production of or trade in arms, munitions, and war material.
[65] A negative list approach has been adopted in the NAFTA and in agreements between countries in South America.

absolute than that found in the GATS where, in sectors that are scheduled, national treatment applies to services-related subsidies, at least until multilateral disciplines have been adopted. The EPA thus does not constrain the provision of subsidies to support domestic suppliers.

Sectoral Commitments under the EPA on Commercial Presence and Cross-Border Supply of Services

6.17 Special and differential treatment is reflected in the EPA with the EU committing to liberalize 94% of the service sectors in the GATS sectoral classification list[66] while the target shares for the LDCs and non-LDCs in the Caribbean are 65% and 75%, respectively. [67] The listings of the sectors actually liberalized for cross border supply of services (Modes 1 and 2) and for commercial presence (Mode 3) by each party to the EPA and the specific commitments in each sector are contained in an annex 4 to the agreement.

EU Commitments

6.18 For commercial presence, the EU has opened business services, communications, construction, distribution, privately funded education, environmental services, finance, privately funded health and social services, tourism and recreation services, and transport. In many areas the commitments replicate the offers made by the EU under the Doha Round, but in a number of cases the EPA commitments mark an improvement. In many sectors, the EPA commitments cover more member states and require removal of many nationality restrictions. The EU's commitments on commercial presence are limited by a number of horizontal limitations, such as those on real estate and types of establishment, some of which apply across all EU members while others are invoked by particular countries. With regard to cross-border trade in services (Modes 1 and 2), the EU made commitments in the same range of sectors in which commercial presence is liberalized. There is only one horizontal restriction on acquisition of real estate.[68]

CARIFORUM Commitments

6.19 The Caribbean Regional Negotiating Machinery (CRNM), the group that negotiated the EPA with the EU, contends that commitments by the CARIFORUM states are focused on "those sectors that have positive development impacts and in which Member States are seeking investment or new technologies as well as sectors that are important to create economic opportunities in outsourcing contracts from European firms." The sectors that most CARIFORUM states have liberalized for cross-border trade and investment under the EPA are business services, computer and related services, research and development, environmental services, management consultancy, maritime transport, entertainment, and tourism. Some of the commitments will be phased-in over time in some member states to address sensitivities at the national level.

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[66] There are 155 categories in all, grouped into 12 sectors and 56 sub-sectors.

[67] Explicitly excluded activities are: (a) mining, manufacturing, and processing of nuclear material; (b) production of or trade in arms, munitions and war material; (c) audio-visual services; (d) national maritime cabotage; and (e) national and international air transport services and services related to the exercise of traffic rights, other than a few services related to aircraft repair and maintenance and passenger services.

[68] This section and those that follow that detail the commitments made under the EPA are based on Suave and Ward (2009), Francis and Ullrich (2008) and CRNM (2008).

6.20 The EPA commitments of the CARIFORUM countries appear to entail little deepening of existing GATS commitments even if they extend the scope to more sectors. Liberalization is achieved through binding existing regulatory practices and through the constraints imposed on the ability of countries to change those practices towards more restrictive outcomes. The impact of these bindings is qualified by the reservations listed in the annex of commitments by a number of the CARIFORUM states. These reservations have led the CRNM to conclude that there will be very little need for legislative change to give effect to these commitments.[69] The issue thus is whether such an approach will lead to the outcomes that the CRNM was pursuing through the negotiations to provide a more stable and predictable environment for investment and cross border trade in services and to stimulate higher investment flows into CARIFORUM countries.

Implications for African Services-EPAs

6.21 For African countries, the challenge is to identify clearly their current policies governing trade in services and the extent of openness in priority sectors, to assess whether locking in existing openness will allow objectives regarding investment and development of services sectors to be achieved, and, if not, whether regulatory reform and possible further liberalization will be appropriate.

6.22 As noted earlier, such an analysis requires considerable information and dialogue between stakeholders in each sector to clearly establish objectives and identify the key constraints in the regulatory framework that are hindering the achievement of those objectives for the sector such as investment, competition, efficiency and access. CARIFORUM negotiators were, reportedly, hindered by lack of disaggregated statistical data on services sectors in the region.

6.23 Nevertheless, CARIFORUM had established considerable capacity to negotiate a comprehensive EPA having already acquired significant experience in negotiating on trade in services.[70] The process of negotiating the CARICOM Single Market helped to document barriers to internal trade and identify sectors with export potential. The negotiation of the CARICOM-Dominican Republic FTA also added information on the level of existing barriers to services trade within the CARIFORUM region. Finally, negotiations on the Free Trade Area of the Americas (FTAA) exposed CARIFORUM negotiators to a range of trade issues that would be relevant for the EPA negotiations. Together with experience gained at the WTO, these negotiations helped to provide an information base on offensive export interests and key barriers to services trade in the CARIFORUM region and developed the region's negotiating skills.

Schedules for Future Negotiations and Possible Further Liberalization

6.24 The CARIFORUM EPA includes schedules for reviewing progress in implementation and initiating negotiations of subsequent phases of liberalization. The legal framework for investment, the investment environment, and actual flows of investment between the parties are to be reviewed before the end of the third year and at regular intervals thereafter. There are no references to sanctions for non-compliance with agreement, and the monitoring of its

[69] From Westcott (2008)
[70] Sauve and Ward (2009)

implementation is to be part of the general review of the legal framework and environment for investment and the assessment of actual investment flows. A rendezvous clause committing the parties to entering into further negotiations on liberalizing additional sectors within five years is included in order to gradually reach the agreed targets for market access.

Importance of a Phased Approach to Liberalization in Africa

6.25 Because of the wide range of EPA-outcomes thus far in different regions of Africa and the large variations among African countries in capacity to design and implement service sector reforms, the flexible design and phased approach to the liberalization of services and investment in the CARIFORUM EPA with its built-in schedule for further progressive liberalization appear well suited for services EPAs in Africa. With this type of flexible design, reform priorities in African EPAs could reflect the interests and constraints of individual countries. The phased approach could allow countries to focus on regulatory reform and capacity building and initially liberalize only those sectors that require little regulation or where existing regulatory policies and institutions are satisfactory, leaving remaining sectors for the future phases with a commitment to continuing negotiations over further progressive liberalization.

6.26 African countries could, as CARIFORUM has, adopt a gradual phased approach to services and investment liberalization with a built-in agenda for further progressive liberalization. African services EPAs could include provisions similar to those in the CARIFORUM EPA committing the parties to review the implementation of the initial commitments a few years after the entry into force of the EPA with a view both to making any necessary adjustments and to liberalizing additional sub-sectors. The process of continual review of an EPA agreement could be designed to monitor the provision of technical assistance and the increase in regulatory capacities so as to ensure that (i) in the priority sectors where commitments have been made that public policy objectives regarding cost and access are being achieved and (ii) assess whether regulatory conditions in other sectors are such as to allow substantive commitments to be made in subsequent negotiations.

The Temporary Presence of Natural Persons to Supply Services (Mode 4)

6.27 Services EPAs could offer an opportunity to facilitate the temporary movement of natural persons for business purposes (mode 4), including intra-corporate transfers of key personnel (managers and specialists), business-services providers, contractual service-suppliers, and independent professionals. The CARIFORUM EPA has the broadest coverage of labor mobility of any agreement between the EU and developing countries (Hoekman and Ozden (2009)). An important distinction is between natural persons, who are individuals, and juridical persons, defined in the EPA as a legal entity constituted or otherwise organized under relevant law. Much of the discussion of mode 4 relates to movements of natural persons while it is juridical persons (typically firms that supply services)[71] that undertake commercial presence and cross-border trade in services.

6.28 Although the CARIFORUM EPA does not address the general issue of temporary workers, it does address the narrow GATS definition of mode 4 service delivery. The

[71] A juridical person can range from a company employing thousands of people to a single person operation.

CARIFORUM EPA covers the entry and temporary visits in the territories of the parties of the following six categories of natural persons: key business personnel, graduate trainees, business services sellers, contractual service-suppliers, independent professionals, and short term visitors for business purposes. The movement of the first 3 and the last category of natural persons are not linked to the supply of services while the temporary presence of contractual service suppliers and independent professionals is only permitted with regard to the supply of specific services. The CARIFORUM EPA is the only EU agreement to include firm commitments on temporary movement of contractual service suppliers and independent professionals.

6.29 Chapter 4 of the EPA's main text sets out the definitions, conditions of entry, duration of stay, and the arrangements for remuneration paid for each category of natural person and can be summarized as follows:

- *Key personnel and graduate trainees*. Key personnel are defined as being responsible for "the setting-up or the proper control, administration and operation of a commercial presence" (Art. 80). Graduate trainees are defined as natural persons employed by a juridical person of one of the Parties for more than one year who possess a university degree and temporarily transferred to a commercial presence of parent company in the territory of the other party for career development or training in business techniques or methods. For these two categories of natural persons the EPA requires that if there is a liberalization commitment for commercial presence, then the other Party's key personnel and graduate trainees are permitted entry without limitations or requirements for economic needs tests for up to 3 years for intra-corporate transfers,[72] 90 days in any 12 month period for business visitors[73]; and one year for graduate trainees.
- *Business service sellers*. These are defined as representatives of a services supplier that seeks temporary entry to negotiate the sale of services or to enter into agreements to sell services for that service supplier. The EPA states that whenever there is a liberalization commitment for commercial presence or cross-border supply of services, then the other Party's business service sellers are permitted temporary entry for period up to 90 days in any 12 month period.
- *Contractual service suppliers.* Contractual service suppliers are natural persons employed by a juridical person that does not have a commercial presence in the other party to the agreement and has a contract to supply service to a consumer in that party that requires the temporary presence of its employees. Contractual service suppliers of CARIFORUM countries are permitted access to the EU market in 29 sub-sectors,[74] while contractual

[72] Intra-corporate transfers can be made by natural persons who have been employed by a juridical person or have been partners in it for at least one year and who are temporarily transferred to a commercial presence in the territory of the other Party.

[73] Business visitors are defined in the EPA as natural persons working in a senior position who are responsible for setting up a commercial presence.

[74] The 29 subsectors permanently opened to contractual service-providers are: legal advisory services, in respect of international public law and foreign law (that is, non-EU law); accounting and bookkeeping services; taxation advisory services; architectural services; urban planning and landscape architecture services; engineering services; integrated engineering services; medical and dental services; veterinary services; midwives services; services provided by nurses, physiotherapists and paramedical personnel; computer and related services; research and development services; advertising services; market research and opinion polling, and management consulting services; services related to management consulting; technical testing and analysis services; related scientific and

service suppliers of the EU are allowed access in sectors and to specific CARIFORUM markets defined in the listing of Annex IV, subject to the following conditions:

- the service contract of the juridical person cannot exceed 12 months,
- the contractual service supplier has been an employee of the juridical person supplying the service for at least one year
- they have 3 years of professional experience in the sector of activity that is the subject of the contract,
- they must have a university degree of equivalent qualification[75] and the professional qualifications required by law or regulation in the Party where the service is supplied,
- the period of temporary entry is limited to six months in any 12 month period.

- *Independent professionals.* Independent professionals are self-employed services suppliers who do not have a commercial presence and have a contract to supply service that requires their presence in the overseas market. Independent professionals from CARIFORUM countries have been granted access to the EU in 11 sectors,[76] while independent professionals of the EU are allowed access in sectors and to specific CARIFORUM markets defined in the listing of Annex IV, subject to the following conditions
  - the service contract cannot exceed 12 months,
  - the independent professional has 6 years of professional experience in the sector of activity that is the subject of the contract,
  - they must have a university degree of equivalent qualification and the professional qualifications required by law or regulation in the Party where the service is supplied,
  - the period of temporary entry is limited to six months in any 12 month period.

- *Short-term visitors for business purposes*. The Parties "endeavour to facilitate" temporary entry for business reasons related to research and design, marketing, training, trade fairs, sales, purchasing and tourism conventions for a period of up to 90 days in any 12 months period.

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technical services; maintenance and repair of equipment including transport equipment services; chef de cuisine services; fashion model services; translation and interpretation services, site investigation services, higher education services (only privately-funded), environmental services; travel agencies and tour operator services; tourist guides services; and entertainment services other than audiovisual services.

[75] Except for fashion model services, chef de cuisine services and entertainment services.

[76] The 11 subsectors permanently opened to independent professionals are: legal advisory services, in respect of international public law and foreign law (that is, non-EU law); architectural services; urban planning and landscape architecture services; engineering services; integrated engineering services; computer and related services, research and development services, market research and opinion polling, management consulting services; services related to management consulting; and translation and interpretation services.

6.30 The value of these commitments is limited by a substantial number of reservations that are specified in Annex IV of the EPA. For key personnel and graduate trainees there are many requirements for economic needs tests. These typically require an assessment of local labor market conditions and demonstration that the position could not be filled by a local person with the appropriate qualifications. These tests can be applied in a non-transparent and discretionary way and can create considerable uncertainty and be a severe constraint to market access. There are also many instances of nationality and residency requirements that can prevent access. However, most of these restrictions have been placed by new members of the EU in Eastern Europe, although some of the older members have scheduled a number of nationality and residency requirements. Access for EU key personnel and graduate trainee to CARIFORUM markets is subject to an automatic economic needs test, unless otherwise indicated in Annex IV.

6.31 For contractual service suppliers and independent professionals there are a substantial number of requirements for economic needs tests for many sectors and by many countries, including older as well as new EU members. All CARIFORUM commitments are subject to economic needs test. Nevertheless, the access granted to contractual service suppliers represents a significant improvement over the EU's offer in the WTO. In return, CARIFORUM members have made quite limited temporary entry coverage for contractual service suppliers and independent professionals. The main sectors in which most CARIFORUM members have made commitments are business services, computer and related services, research and development services, environmental services, management consultancy, maritime transport, entertainment, and tourism.

6.32 In many cases it is likely that mutual recognition agreements will be necessary to allow natural persons from the CARIFORUM countries to be able to satisfy the requirements relating to professional qualifications in the EPA and benefit from the opportunities that the EPA opens for temporary movement to the EU. The does EPA goes on to establish a procedure to progressively achieve "mutual recognition" of those qualifications: "The Parties shall encourage the relevant professional bodies in their respective territories to jointly develop and provide recommendations on mutual recognition to the Joint Committee (….) of the criteria applied by each Party for the authorization, licensing, operation and certification of investors and service suppliers and, in particular, professional services." We discuss the provisions on mutual recognition in more detail below.

Implications for African Services-EPAs

6.33 Services EPAs could offer an opportunity for African countries to facilitate the temporary presence of natural persons for business purposes. Provisions similar to those in the CARIFORUM EPA could be made for expanding employment of African temporary service providers (mode 4) in the European market. However, most African countries do not have a strong comparative advantage in the sectors included in the CARIFORUM EPA. Tourism related services may be a sector worthy of attention in a number of African countries and the emerging IT sector may offer new opportunities. There is also significant scope for expanding intra-African trade in professional services, development of which could, in the longer term, create capacity for exporting similar services to the EU. Thus, African countries that enter into

negotiations on services EPAs should therefore identify if there are sectors in which there are current or potential opportunities for the temporary movement of natural persons.

6.34 While the CARIFORUM EPA shows that progress can be made on mode 4 there are also important issues that could be addressed to make an agreement more meaningful for African countries. Key issues are how to extend liberalization beyond the limited set of high-skill activities and to reduce the restrictiveness of economics needs tests. Hoekman and Ozden (2009) suggest that to exploit effectively the sector-specific approach and to allow for the discussion of less skill intensive services it will be necessary to build coalitions with EU firms operating in sectors where there are serious shortages of workers. They suggest that effective safeguard mechanisms that can be invoked if temporary movement grows "too fast" should be proposed instead of the use of economic needs tests. Finally, it will be important to allow for periods of access beyond 6 months to enable appropriate training to be provided and initial costs to be recovered.

Other Measures to Encourage Movements of Labor

6.35 The CARIFORUM EPA also includes a Protocol on Cultural Cooperation that is unique in EU agreements. This reflects the strong efforts of the CARIFORUM negotiators who pursued offensive interests in the area, especially in the music sector. The Protocol includes some provisions related to the temporary movement of persons. The EU and CARIFORUM countries endeavour to facilitate the temporary movement of artists and other cultural professionals who cannot take advantage of the commitments undertaken on mode 4 in the title on trade in services. When allowed the period of temporary entry can be extended up to 90 days in any 12 month period.

The MFN Clause

6.36 The interim EPAs signed or initialed with African countries include an MFN clause governing preferences in goods. This requires that the signatories must extend to each other any improved preferential access they grant in the future to "large" trading partners (defined as countries with a share in world merchandise exports of greater than 1 percent or regions with a share more than 1.5 percent). Hence, if African countries negotiate a trade agreement with the US or China that contains deeper preferences than those negotiated under the EPA then these additional preferences must also be offered to EU firms. This provision has proven to be very controversial and has stoked much resistance in Africa.[77] The CARIFORUM agreement contains a similar provision in services.

6.37 In strict economic terms the MFN provision cannot be disputed. The clause would be welfare enhancing since it reduces the trade diversion impact of future trade deals. The EU has recently been a strong proponent of this provision, despite arguing since the very beginning of the negotiations that its primary interests were not in securing market access in African countries (but more of WTO compatibility and development). Nevertheless it has stated that it wants to prevent itself from being "permanently disadvantaged" from any new trade deals EPA countries

[77] For a discussion of the controversy concerning the MFN clause for merchandise trade in interim EPAs, see the World Bank's *Full Report on Implementing Interim EPAs*, Part III, pages 29-31.

may sign with trading partners, and the MFN clause would be a way of ensuring this. EPA countries could also benefit as well since the MFN clause would guarantee that all the EPA groups are treated equally by the EU, so that any region or country signing an EPA now will not be worse off if another country manages to negotiate extra concessions in the future.

6.38 While the economics of the MFN clause are not problematic, the political economy implications are. The MFN clause is not required under WTO provisions governing free trade agreements. Opponents have argued that the MFN clause places an unacceptable constraint on the ability of countries to pursue deeper trade agreements with important trading partners such as the US, since they will be unable to offer any trade advantage over what they provide to the EU. This concern is particularly important for countries like South Africa, which have clear offensive interests in negotiating trade deals with other developed countries. There have also been uncertainties regarding the implementation of any such clause as to whether 'more favorable treatment' refers to a future FTA that would, on aggregate, liberalize more trade than the EPA or refers to an agreement that liberalizes at the product line and services sub-sector level goods that were excluded under the EPA. However, preferential opening of goods and services not covered under the EPA (such as excluded products or services) but extended by African countries to non-EU sources under any future bilateral trade deal could lead to some inefficient diversion of trade from low-cost EU suppliers of these goods to higher-cost non-EU suppliers.

6.39 Despite the high-level of attention paid by both the EU and African countries to the MFN clause in the EPA negotiations, the application of it may not mean much in practice. It could really only ever be relevant to large countries like China, India, Japan or the US (or regions that meet the criteria such as MEROSUR or ASEAN) that might sign an agreement with African countries at some point in the future. But even then, it seems unlikely that the sensitive products and services sub-sectors that have not been liberalized under an EPA would be included in these new trade deals.

Rules of Origin[78]

6.40 One issue that may have an important bearing on the impact of the CARIFORUM EPA agreement and any service EPAs agreed with African countries, that has received little or no attention, is the rules of origin that will affect the number of firms, and hence the degree of competition, that will benefit from the commitments on commercial presence and cross-border trade in services in the EPA. This section summarizes the provisions in the EPA that define or condition the "origin" of services providers in CARIFORUM and assess the restrictiveness of these rules and their potential impact on investment and trade in services.

Definition of Parties

6.41 The EPA defines the Parties to the agreement as follows:

- The fifteen "CARIFORUM States", of the one part, and Contracting Parties to the Treaty establishing the European Community and the Treaty on European Union, hereinafter

[78] This section was prepared by Ramesh Chaitoo.

referred to as the "Member States of the European Union", and THE EUROPEAN COMMUNITY,

6.42 This provides for individual states as well as both sets of parties acting collectively (i.e. CARIFORUM acting as a group and the European Community as a group). As in all trade agreements, the benefits to be derived from the EPA will be limited to only services suppliers and investors from the states that are parties to the agreement. And it allows for either national firms from individual CARIFORUM states or firms comprised of shareholders from more than one CARIFORUM state.

Natural Persons

6.43 Article 61 of Title II on Services, Investment and E-commerce defines a natural person from either side as:

> "natural person of the EC Party" or "natural person of the Signatory CARIFORUM States" means a national of one of the Member States of the European Union or of the Signatory CARIFORUM States according to their respective legislation;

6.44 This definition puts the full onus on national or domestic law and provides some level of flexibility since the more restrictive term "citizen" is not used. In many states, citizenship is only derived from being born in the particular states; and in some instances the parents must also be citizens of the states. To understand the importance of the use of the term "national" in the CARIFORUM EPA, consider for instance, some states may allow for what is loosely considered as economic nationality through which a natural person from a foreign territory can be legally considered as a "national". This facility can be used to attract certain kinds of investors. In the case of CARIFORUM, two states have provided for such in the recent past but it has since fallen out of fashion partly due to criticism by locals.[79]

6.45 The definition in the EPA also caters to various permutations and combinations of "nationality" as may exist in 15 plus 27 different states. Indeed, some EU states may also provide for foreigners from non-EU Member states to become nationals under their domestic law. This can only be assessed by researching the immigration laws in the different national jurisdictions. So, in terms of service suppliers that are natural persons, the CARIFORUM EPA is not very restrictive.

Juridical Persons

6.46 In the case of juridical persons, there is a different nuance and somewhat tighter definition. The EPA stipulates:

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[79] By way of comparison, the CARICOM Revised Treaty defines a "national" in a somewhat curious manner as a person who:
(a) is a citizen of a State Party; or
(b) has a connection with a State Party of a kind which entitles that person to be regarded as belonging to or, if it be so expressed, as being a native or resident of that State Party for the purposes of the laws of that State Party relating to immigration;

- "juridical person of a Party" means a juridical person of the EC Party or a Signatory CARIFORUM State set up in accordance with the laws of a Member State of the European Union or of a Signatory CARIFORUM State respectively, and having its registered office, its central administration, or its principal place of business in the territory to which the Treaty establishing the European Community applies or in the territory of a Signatory CARIFORUM State, respectively;

- Should the juridical person have only its registered office or central administration in the territory to which the Treaty establishing the European Community applies or in the territory of the Signatory CARIFORUM States respectively, it shall not be considered as a juridical person of the EC Party or of a Signatory CARIFORUM State respectively, unless it engages in substantive business operations[80] in the territory to which the Treaty establishing the European Community applies or of a Signatory CARIFORUM State, respectively;[81]

6.47 It should be noted that the negotiations over this definition lasted for a long time. Initially, the EC had first proposed the phrase "real and lasting economic links" instead of "substantive business operations". The EC also argued that this was the language in the EC Treaty with which they needed to be consistent. But CARIFORUM negotiators objected to this phrase which would have introduced too much room for interpretation by national officials in the EU, and an unacceptable level of uncertainty for third-country investors wishing to invest in the Caribbean in order to supply the EU market. Given the limited capital base in CARIFORUM, this was an important consideration in terms of market access for investors in Europe. CARIFORUM states wanted to be able to use the EPA to attract third country investors to the Caribbean.[82]

6.48 No one on the EC negotiating team could specify what was meant by "real and continuous link" and although EC negotiators referred several times to ECJ case law on this interpretation, the details were never provided to CARIFORUM negotiators. As a result, CARIFORUM insisted that the more common phrase "substantive business operations" be used instead. CARIFORUM argued that the meaning of this phrase was more well-known through

[80] In line with its notification of the EC Treaty to the WTO (WT/REG39/1), the EC Party understands that the concept of "effective and continuous link" with the economy of a Member State enshrined in Article 48 of the EC Treaty is equivalent to the concept of "substantive business operations" provided in Article V, paragraph 6, of the GATS, and in this Agreement.

[81] Note that there is a special carve-out for shipping companies that are established in non-EU or non-CARIFORUM states but their vessels must be registered in a CARIFORUM or EU state.

[82] One should recall that under the investment law of the Dominican Republic, an investor is simply "the owner of the foreign investment", and its legal forms are not limited or specifically defined. Foreign investors/investment get full national treatment. The ownership or origin of the capital of a company does not determine the kind of treatment that will be given to an investment. And commercial presence is not expressly required for receiving the status of investor or the prerogatives established in Law 16-95, although there is special legislation for certain sectors that requires such presence, as is the case of telecommunications and financial services. However, the definition of a Caricom investor under the Revised Caricom Treaty is quite restrictive. A juridical person or company must be substantially owned and effectively controlled by nationals or residents or natives of a Caricom state. Furthermore, a company or other legal entity is: (i) substantially owned if more than 50 per cent of the equity interest therein is beneficially owned by nationals; (ii) effectively controlled if nationals mentioned have the power to name a majority of its directors or otherwise legally to direct its actions.

ICSID and UNCITRAL cases and this language was used in bilateral investment treaties to which some CARIFORUM states were signatory.

6.49 It should be pointed out that the phrase ("real and continuous link") still exists in the Services and Investment text proposed by the Commission to SADC in 2008 and perhaps in other regions. This may have implications for ascertaining the origin of an investor and could be used in a manner that might lead to denial of benefits for some investors.

6.50 On their part, EC negotiators were apparently concerned about third country (non-CARIFORUM) investors using the offshore or international business sector in some CARIFORUM states to gain access to the EU market (so-called paper companies, or pigeon-hole companies or entities that were only represented by legal firms or management consulting firms in Barbados, the Bahamas, among others.

Definition of Commercial Presence

6.51 The EPA simply defines an "investor of a Party" as a natural or juridical person of the EC Party or of a Signatory CARIFORUM State that performs an economic activity through setting up a commercial presence. However, as a result of this disagreement mentioned above, the footnote to the definition of a "commercial presence" in Article 65 contains the following criteria to guide interpretation of "lasting economic links".

> The terms "constitution" and "acquisition" of a juridical person shall be understood as including capital participation in a juridical person with a view to establishing or maintaining lasting economic links. When the juridical person has the status of a company limited by shares, there is a lasting economic link where the block of shares held enables the shareholder, either pursuant to the provisions of national laws relating to companies limited by shares or otherwise, to participate effectively in the management of the company or in its control. Long-term loans of a participating nature are loans for a period of more than five years which are made for the purpose of establishing or maintaining lasting economic links; the main examples being loans granted by a company to its subsidiaries or to companies in which it has a share and loans linked with a profit-sharing arrangement.

6.52 Some may consider these conditions to be restrictive but in practical business reality they are not. They largely reflect real-world circumstances of firms operating in foreign jurisdictions but it does limit the flexibility to pursue some leaner business models. In principle, while CARIFORUM states wanted to get the broadest possible market access into the EU for companies established in their jurisdictions, irrespective of their legal form or structure, they were also cognizant that it was important to attract real investment and not paper companies in order to have development impact. CARIFORUM was also careful to avoid granting access for short term financial or portfolio investment that can lead to sudden instability in small economies. Given the fact that some CARIFORUM states may be considered micro-economies (with only 55,000 people in St. Kitts and Nevis for example), this was a critical issue.

Implications of Origin Requirements

6.53 Given the interests and concerns of the CARIFORUM states, the origin conditions for service suppliers and investments in the EPA are not overly restrictive. However, the interests of states in other EPA regions may be different. In principle, if one considers economic efficiency alone it may be best to have more liberal definitions regarding investors and investments (commercial presence) such as, for instance, in the recent Canada-Peru FTA which involves a rich, developed economy and a poor, developing country:

6.54 *Enterprise* means any entity constituted or organized under applicable law, whether or not for profit, and whether privately-owned or governmentally-owned, including any corporation, trust, partnership, sole proprietorship, joint venture or other association and a branch of any such entity;

6.55 *Enterprise of a Party* means an enterprise constituted or organized under the law of a Party, and a branch located in the territory of a Party and carrying out business activities there; [83]

6.56 But this will require that other ACP states are comfortable with such approaches since many FTAs in the Americas usually include pre-establishment in their investment provisions. There is a fair amount of sensitivity about liberal investment regimes in many ACP states. On the other hand, the EU has a very open investment regime, generally speaking. A further consideration is that when the CARIFORUM EPA was negotiated the EC did not have full competence over investment but they seem to do so now under the Lisbon Treaty. If they indeed can now negotiate market access as well as investment protection and promotion this may lead to a bolder approach in terms of investment and totally change the dynamics of the EPA negotiations.

C Competition and General Regulatory Provisions in the CARIFORUM EPA

Competition Provisions

6.57 The CARIFORUM EPA stresses the importance of free and undistorted competition in trade among the participants. The participants in the agreement acknowledge explicitly that anti-competitive practices have the potential to distort the proper functioning of markets and generally undermine the benefits of trade liberalization. More specifically, they agree that practices that prevent or substantially lessen competition and abuse of market power are incompatible with the proper functioning of the EPA. However, the EPA does not contain any binding substantive commitments to new policy actions.

6.58 The EU has longstanding legislation and powerful institutions to regulate competition within its jurisdiction. In contrast, only two of the Caribbean countries (Barbados and Jamaica) had pro-competition institutions that were operational when the EPA was signed, although most other countries had plans to establish these. Establishment of regional or sub-regional competition authorities was also under discussion. In the EPA, the Caribbean countries

[83] Chapter 1, Article 105 and Chapter 8, Article 847.

acknowledge the importance of regulatory bodies' being independent from commercial interests and indicate their intention of putting in place within five years the necessary laws and institutions to address anti-competitive practices within their jurisdictions; and the EPA provides for a review of the signatories' competition legislation and its implementation.[84]

Exchange of Information and Cooperation in Enforcement of Competition Laws

6.59 The CARIFORUM EPA provides for cooperation between competition authorities with respect to enforcement activities and for exchange of information that facilitates the application of respective competition laws. Such assistance could be of use to fledgling competition authorities in the Caribbean. The EPA allows for any competition authority to inform the other competition authorities of "any information it possesses which indicates that anticompetitive business practices falling within the scope of this Chapter are taking place in the other Party's territory." Given the relative size of the parties, this provision is most likely to imply information being provided by the EC competition authorities to their counterparts in the Caribbean.

Implications for African Services-EPAs

6.60 For African services-EPAs, it is likely that flexibility in the design of the competition provisions will be required to take into account the existing status of a country's (or a region's) competition legislation, its implementation capacity, and the effectiveness of any existing independent national or regional competition agencies. Commitments could be designed to go into effect only after the necessary implementation capacity has been created, with clear benchmarks to allow for the effective monitoring of progress.

6.61 Indeed, many countries in Africa have not enacted competition laws and of those countries that have a law on competition, many were enacted a long-time ago and may need updating and few countries have an effective competition authority to implement the legislation. Table 6.1 lists the countries in Africa that have enacted a competition law and those that have established a competition authority. African services EPAs will need to incorporate a higher degree of flexibility than the CARIFORUM EPA where the Caribbean countries must ensure that they have laws in force to address collusion and abuse of a dominant position as well as a completion authority within five years of the EPA's coming into effect.

[84] See Dawar and Evenett (2008) for further discussion of the competition provisions of the CARIFORUM EPA.

Table 6.1 : Countries in Africa with Competition Laws and Competition Authorities				
Country	Competition Law	Competition Authority	Date Law Adopted	Notes
Angola	..	..		Competition law drafted in 2004 but not in effect
Benin	X	X	1990	
Botswana	..	..		Competition rules for telecoms and industrial property, but no comprehensive competition law
Burkina Faso	X		2003	
Burundi	..	..		
Cameroon	X	..	1998	
CAR	..	..		
Congo, DR	..	..		
Cote d'Ivoire	X	X	1991, 1997	
Djibouti	..	..		
Eritrea	..	..		
Ethiopia	X	..	2003	Law overseen by the Ministry of Trade and Industry
Gabon	..	..		
Gambia	X	X	2007	
Ghana	..	..		No comprehensive competition law, but does have a "Protection Against Unfair Competition" Act, 2000
Guinea	..	..		..
Kenya	X	X	2009	
Lesotho	..	..		Competition law is being drafted
Liberia	..	..		..
Madagascar	..	..	..	..
Malawi	X	X	1998	
Mali	X	..	1992	
Mauritania	X	X	1991	Competition authority established in 1999.
Mauritius	X	X	2007	
Mozambique	..	..		A competition law was approved in 2007 but has been withdrawn and is being revised
Namibia	X	X	2003	Competition Authority launched mid-December, 2009
Niger	..	..		
Nigeria	..	..		A competition law is being drafted
Rwanda	..	..		
Sao Tome	..	..		
Senegal	X	..	1994	
Sierra Leone	..	..		
Somalia	..	..		
South Africa	X	X	1979, 1998, 2009	Competition law adopted in 1979 and 1998; an amendment was passed in September, 2009
Swaziland	..	..		In process of adopting a competition law
Tanzania	X	X	2003	
Togo	..	..		In process of adopting a competition law.
Uganda	..	..		Competition law drafted in 2004 but has not been adopted
Zambia	X	X	1994	
Zimbabwe	X	X	1996	
Total	17	12		
	43%	30%		
Notes: X = Yes, .. = No. **Sources:** www.globalcompetitionforum.org and http://www.state.gov/e/eeb/rls/othr/ics/2009/index.htm				

6.62 In some regions of Africa, a services EPA could facilitate the establishment and strengthening of regional competition agencies (with a clear definition of respective competencies vis-à-vis national competition bodies), with financial support and technical

assistance from the EC. Such agencies could take advantage of regional-level economies in regulation, ensure a level playing field for competition at the regional level, and counter-act the risk to the independence of national competition agencies from capture by national interest groups.

6.63 The EU also has considerable experience in competition and regulation and is potentially an important source of technical assistance in this area under its aid for trade and other development programs. Such assistance would be complemented by the provision of cooperation and information from EU authorities to regional competition authorities in Africa. Even more important is the tourism sector-specific agreement that obliges the EU Commission, with its well-developed powers in competition policy, to discipline the anti-competitive practices of EU tourism operators in the Caribbean and could be usefully extended to the air and maritime transport sectors in Africa as discussed in section 6.4 below.

Technical Assistance

6.64 The CARIFORUM EPA explicitly provides for technical assistance and capacity-building to ensure effective and sound competition policies and enforcement. Specifically, the EPA mentions support for the efficient functioning of the CARIFORUM Competition Authorities, assistance in drafting guidelines, manuals and legislation, the provision of independent experts and the provision of training for key personnel involved in the implementation of and enforcement of competition policy. Many countries in Africa are in the process of drafting and implementing competition policies. The EPA may then be a useful mechanism for countries that wish to accelerate this process and obtain technical assistance to achieve high quality laws and trained staff in the competition authority.

Domestic Regulation of Services Provisions in the CARIFORUM EPA

6.65 Domestic regulation refers to measures that apply to both domestic and foreign services-providers alike and include qualification requirements, licensing requirements and procedures, and universal supply obligations. Trade agreements include disciplines on domestic regulation because such measures may affect the success of foreign providers in the market. The starting point for many of the provisions on domestic regulation in the CARIFORUM EPA is existing GATS commitments and agreements.

Domestic Regulation of Services and the GATS

6.66 The GATS currently contains a few general and rather weak commitments on the domestic regulation of services. Article III, relating to transparency, requires the publication of laws and regulations affecting trade in services, notification of changes in laws and regulations and the establishment of enquiry points to respond to WTO members requests for information regarding the regulation of services. Where market access commitments have been made under GATS, members agree to administer their domestic regulations affecting trade in services in "a reasonable, objective and impartial manner" (Art VI.1). Procedures should be established for the review of administrative decisions (Art VI.2), and applicants for licenses should be informed of the decision "within a reasonable period of time" and of the status of their application "without

undue delay" (Art VI.3). Article VII of the GATS allows for mutual recognition agreements regarding qualifications of professionals, which might otherwise be in contradiction with the most-favored nation principle, but calls for other countries to be given adequate opportunity to accede to the arrangement or negotiate a comparable one. There are also sector-specific instruments at the WTO that affect regulation of services, especially for telecommunications and financial services. These will be discussed in more detail in section 6.4 below.

General Provisions on Regulation of Services in the CARIFORUM EPA

6.67 The CARIFORUM EPA contains similar provisions on transparency to the GATS but differs in that enquiry points are to make information available to investors and service suppliers of the other party and not WTO members generally as in the GATS. While this requirement will be useful for encouraging inward investment, it may entail some additional cost. For African services EPAs, the provision of up-front technical assistance for early establishment of or improvements in the enquiry points would be useful in assisting African countries in providing information to potential investors and facilitating inward investment.

6.68 While the GATS does not require members to pursue mutual recognition agreements (MRAs), the CARIFORUM EPA has elements of "soft" obligations that may lead to a dynamic which results in "hard" obligations'.[85] The EPA outlines a number of stages in a process to establish MRAs regarding requirements, qualifications, licenses, and other regulations. The process starts with encouraging professional bodies from the parties to the agreement to work together to develop recommendations for mutual recognition. The participants in the CARIFORUM EPA make a general commitment to encourage professional associations. But there is no time schedule for doing so except in four priority sub-sectors: accounting, architecture, engineering, and tourism, for which negotiations are supposed to start within three years. If recommendations on mutual recognition are agreed by the professional bodies and after review, found to be consistent with the EPA, the parties are then obliged to negotiate an MRA.

6.69 The CARIFORUM EPA's process for formulating MRAs puts a great deal of emphasis on the professional bodies in the respective countries. In many African countries, professional bodies have very limited administrative capacities and often do not exist. Hence, in practice, an obligation to encourage professional bodies in Africa to work together with bodies in the EU may be hollow.

6.70 However, commitments by the EU on market access for services providers under African services EPAs could have limited impact without recognition of professional qualifications. In certain sectors, particular countries may have offensive market access interests in the EU that could be furthered through a MRA. Tourism and health professionals may be important for a number of countries. More advanced countries such as Mauritius and Botswana are likely to have a broader array of professionals who may benefit from access to the EU market, such as health professionals. In other cases, a MRA may underpin market access commitments by African countries in sectors where there is a shortage of professionals.

[85] Schloemann and Pitschas (2008)

D Sector Specific Commitments on Regulation of Services in the CARIFORUM EPA

6.71 The chapter on regulation of services in the CARIFORUM EPA contains specific provisions for computer services, courier and postal services, financial services, international maritime transport services, telecommunications services and tourism services. In general, these provisions replicate the details of GATS agreements, although in a number of important ways, that are highlighted below, the EPA goes beyond the GATS to imply stricter discipline on domestic regulation.

Tourism

6.72 Tourism stands out as a sector in which many African countries currently possess a comparative advantage in services trade, and there is the possibility for substantial further development of the sector. The section on regulation of tourism in the CARIFORUM EPA is particularly interesting since regulatory discipline in this sector was actively pursued by the Caribbean countries, and the key provisions appear to be geared towards their interests (Schloemann and Pitschas, 2008)).

Discipline on the Competitive Behavior of EU Firms

6.73 The key obligation under the CARIFORUM EPA is the requirement for all parties to the agreement to maintain an active competition policy in tourism to prevent anti-competitive practices and abuse of dominant positions including the practices of domestic firms in the other parties market. Most important is that the agreement obliges EU Commission, with its well-developed powers in competition policy, to discipline the practices of EU tourism operators in the Caribbean. The agreement specifically mentions "tourism distribution networks" including agencies, tour operators and reservation systems and practices such as imposition of unfair prices, exclusivity clauses, refusal to deal, tied sales and quantity restrictions. The commitment by the EU Commission to discipline large EU firms is seen by the Caribbean countries as essential to protect their mainly small firms from anti-competitive practices. Such discipline may be difficult for small developing countries to exert on large global firms in the absence of a binding trade agreement. This provision certainly goes beyond the GATS, where no agreement has yet been reached on tourism, and sets an important precedent for future negotiations at the multilateral level.

Other Provisions

6.74 As noted above, tourism is specifically identified under the provisions on mutual recognition of professional qualifications, reflecting demands made by CARIFORUM during the negotiations. There are also good intentions to work towards observing environmental and quality standards in tourism and "best endeavour" obligations to encourage the commercial transfer of technology to CARIFORUM states and to facilitate the participation of SMEs in tourism. Uniquely, there is a section on development cooperation and technical assistance targeted at the tourism sector. For all other sectors such assistance is defined in a generic way. Under the agreement the EU will support the advancement of the tourism sector in the

CARIFORUM region (Article 117). A number of provisions also define specific areas for cooperation including: introducing tourism satellite accounts into national accounts systems; capacity building for environment management; development of internet-based marketing strategies for SMEs; support for CARIFORUM states to participate in international standard setting related to sustainable tourism and for tourist services suppliers to comply with sustainable tourism standards; tourism exchange programs and training for tourism services providers.

Implications for African Services-EPAs

6.75 Such discipline on the anti-competitive behavior of EU operators in the tourism sector could be of enormous relevance to African countries and might be usefully extended to the airline transport sector. Provisions for mutual recognition and development assistance could also be valuable. For example, Hansohm et al (2005) note the absence of SADC tourist suppliers in travel-originating distribution centers and lack of access to Global Distribution and Computer Reservation systems as important constraints to the development of the sector in Southern Africa.

6.76 It is worth noting that the CARIFORUM parties had articulated well defined offensive interests for the sector supported by active dialogue with regional tourism associations such as the Caribbean Tourism Organization and the Caribbean Hotel Association as well as national associations. The request for specific attention to the tourism sector was at first resisted by the EU.[86] Many countries in Africa have not yet defined comprehensive tourism strategies, and regional cooperation on tourism is in its infancy in many parts of the continent. These are clearly priority areas for technical assistance.

E-Commerce

6.77 Looking forward, a sector that may be of increasing importance to African countries is e-commerce. While a small number of countries, including Mauritius and Kenya, have developed successful exports in this area, a range of countries are developing strategies for IT-enabled services. The CARIFORUM EPA appears to reflect the multilateral discussions that have taken place. The commitments are general with agreement to develop digital trade between the parties and to ensure that e-commerce develops subject to the highest international standards of data protection. The EPA forbids the imposition of customs duties on e-commerce, a measure that has not yet been agreed at the WTO.

6.78 The EPA also contains provisions for dialogue on regulation of e-commerce, explicitly mentioning recognition of certificates of electronic signatures, liability of service providers regarding the transmission and storage of information and the protection of consumers. It also includes the commitments on the liberalization of cross-border supply of computer services and on the movement of IT-related service-suppliers. While not as advanced as agreements recently signed by the US, Suavé and Ward (2009) argue that the EPA sets important precedents for developing countries and for future multilateral negotiations. The EPA may thus have significant development impacts by providing a base for the future expansion of e-commerce.

[86] http://www.sice.oas.org/TPD/CAR_EU/Studies/CRNM_tourism_e.pdf

Maritime Transport

6.79 The CARIFORUM EPA deals in depth with regulatory issues and new liberalization in international marine transport services, a reflection of the geographic (island) characteristics of the region and the amount of prior negotiation that had taken place concerning this sector. International marine transport is the only services sector that was specifically designated for liberalization in the Cotonou Agreement. The CARIFORUM EPA provides for unrestricted market access, commercial presence, and full non-discriminatory national treatment of ships and services-suppliers from the participants in the EPA. "The EPA partners have further undertaken not to introduce cargo-sharing arrangements with third countries concerning maritime transport services and to terminate existing arrangements within a reasonable period of time and to abolish and abstain from introducing any unilateral measures and administrative, technical and other obstacles which would constitute a disguised restriction to trade in the sector" in order to foster competition and avoid cartelization (Sauvé and Ward, 2009, p. 16). The CARIFORUM EPA goes beyond the GATS where agreement on maritime transport has yet to be reached and again sets important precedents for subsequent negotiations at the multilateral level.

Implications for African Services-EPAs

6.80 It could be interesting for African countries to examine the potential benefits that would accrue from greater discipline on anti-competitive practices in maritime transport as anti-competitive behavior of European firms serving African countries has reportedly been a problem. Previous studies have shown that, while trade liberalization is important in reducing shipping prices, the impact is considerable enhanced with the break-up of private carrier agreements and discipline on restrictive business practices (Fink et al, 2002). African services EPAs could include provisions governing maritime transport similar to those agreed on tourism in the CARIFORUM EPA, with a commitment from the EU competition authorities to ensure that EU firms in the maritime transport sector do not engage in anti-competitive practices in African markets.

Telecommunications Services

6.81 The sector specific obligations on telecommunications in the CARIFORUM EPA reflect the key elements of the GATS Telecommunications Reference Paper on regulatory principles. They address key regulatory issues such as the independence of the regulator, universal service obligations, licensing, preventing anti-competitive practices, interconnectivity between suppliers and networks, and allocation of scarce resources such as frequencies and telephone numbers.

Regulatory Institutions

6.82 With regard to regulatory institutions, the CARIFORUM EPA enshrines the objectives of the Reference Paper of a regulator that is separate and independent from any supplier of telecommunications services. The EPA adds two relatively minor obligations to sufficiently empower the regulator and ensure that it functions in a transparent way. The EPA also contains provisions similar to the GATS regarding the right to appeal but stipulates independence of the appeals body (including from the regulatory authority), requires that the appeal body provide

written reasons for decisions taken (unless they are of a legal nature), and provides for independent judicial review of decisions by the appeals body.

Licensing

6.83 The provisions in the EPA regarding licensing requirements appear to go beyond those in the Reference Paper, which requires only that licensing criteria be made publicly available. In the EPA, the provision of telecommunications services "shall, as much as possible," be authorized following notification. Licensing is however, permitted for frequencies and numbers. Apart from these two issues, it appears that there is commitment towards automatic licensing with the burden on the regulatory authority to show that non-automatic licensing is necessary (Schloemann and Pitschas, 2008).

6.84 Significantly, the EPA limits the setting of license fees to cover only administrative costs and so prevents the use of telecommunications licensing to generate revenues, whereas the draft disciplines at the WTO make exceptions for the auction or other sale of licenses. This provision is clearly problematic given the substantial revenues that many EU countries earned from selling licenses and that in many African countries liberalization of market segments such as 3G mobile telephony has yet to take place.

Universal Service and Interconnection Obligations

6.85 Another key provision in the EPA relates to universal service. The CARIFORUM EPA adopts the key elements of the GATS Telecommunications Reference Paper regarding the right of governments to define the type of universal service obligations and that these will not be treated as anti-competitive if administered in a transparent, non-discriminatory way and are not more burdensome than is necessary. The EPA adds to this the right of all providers to be eligible for universal service and therefore that the regulator entertains options and make impartial choices. The Parties to the agreement are obliged to consider compensation mechanisms for universal service obligations and that these should be set to offset actual burdens incurred by the operator. While not perceived to be a concern in the Caribbean, capacity constraints in Africa are likely to be relevant and the timing of the opening up of universal service will need to be carefully coordinated with regulatory reform and raising regulatory capacity to ensure an appropriate framework is in place to monitor implementation of universal service commitments and provide for appropriate responses if commitments are not met.

6.86 The EPA also commits the parties to protect the right of every telecommunications provider to negotiate interconnection with any other provider, to ensure the confidentiality of telecommunications data. It requires the regulatory authority to intervene, if requested, to settle disputes between suppliers if they concern matters covered by the agreement, such as interconnection. Again, these are additional requirements beyond those of the Reference Paper that could add administrative burdens to fledgling regulators in Africa. Hence, transitional periods during which technical assistance is provided to build capacity will be important for such provisions to be relevant and effective.

Implications for African Services-EPAs

6.87 While many of the members of CARIFORUM have accepted the provisions of the GATS Telecommunication Reference Paper and are likely to be fairly well prepared to implement these, the situation in Africa is different. Twelve African countries have made commitments of some kind in telecommunications under the GATS, and 6 of these have incorporated the Reference Paper.[87] Despite subsequent substantial unilateral liberalization of telecoms across Africa, no African country has yet made offers on market access in telecommunications in the Doha Round.

6.88 Some of the provisions on regulation of telecommunications in the CARIFORUM EPA would entail important risks for African countries such as: the limiting of licensing fees to only cover costs with the resulting loss of potentially important sources of revenue for governments and the creating of administrative burdens that could undermine effective implementation in countries with weak regulatory capacity. On the other hand, some African countries may find certain of the provisions useful for reforming the telecommunications sector, which is necessary to support strategies for the development of IT-enabled services. For example, interconnection rates between mobile and fixed line operators can have an important impact on the degree of competition in the market. Liberalization of market access to increase competition and reduce prices may be compromised if incumbent suppliers are reluctant to negotiate interconnection agreements with new or potential entrants. In countries with limited regulatory capacity and/or regulatory capture an international agreement supported by technical assistance can be an effective instrument to improve interconnectivity and increase competition.

Financial Services

6.89 Importantly, CARIFORUM countries have undertaken a considerable number of specific commitments on financial services (83 in total, compared to 44 existing GATS commitments and offers made in the Doha Round). The provisions on regulation of financial services in the EPA apply only to these financial services in which the Parties have undertaken commitments on market access and national treatment.

6.90 The section on financial services follows closely the "Annex on Financial Services", which is a part of the GATS and hence mandatory WTO law, and the "Understanding on Commitments in Financial Services", which only applies to (mostly developed) WTO Members that have chosen to undertake their specific commitments on financial services in line with the approach adopted by the Understanding. No CARIFORUM state has adopted the Understanding and so all elements in the EPA derived from the Understanding represent "WTO plus" commitments.[88]

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[87] Seven African countries made commitments on market access for foreign suppliers in the basic telecommunications negotiations (Cote d'Ivoire, Ghana, Kenya, Mauritius, Senegal, South Africa and Uganda). All but Mauritius incorporated the reference paper. Earlier Nigeria had committed to open mobile telephony; and Lesotho, Nigeria and Zimbabwe had made commitments on value-added services (Dijofack-Zebaze and Keck, 2009).

[88] The section provides detailed definitions of financial services, financial services suppliers, and public entities (a key element of any agreement on financial services) which are identical to the corresponding definitions the Annex. There is also a legal definition of "new financial service" which does not figure in the Annex but corresponds literally to that in the Understanding.

Regulatory Provisions

6.91 The provisions of the section of financial services provides for a "prudential carve-out", a far-reaching authorization for regulators to take exceptional measures for prudential reasons to protect customers such as investors, depositors or policy holders as well as measures to ensure the integrity and stability of a country's financial system. There is also a non-disclosure rule in which ensures that authorities are not required to disclose confidential information or information relating to the affairs and accounts of individual customers. Both of these provisions replicate commitments in the Annex and do not imply any new obligations for GATS signatories.

6.92 Article 105 contains commitments to "endeavour" to provide effective and transparent regulation. The Article goes beyond the GATS by stating that planned measures should be provided in advance to all interested parties to allow them the opportunity to comment. GATS requirements only apply to measures already adopted. Small developing countries with weak regulators have resisted this prior notification at the WTO for fear it may open the door to powerful foreign providers to influence the regulator more easily during the drafting stage than later when a regulatory measure has already been adopted. The EPA does not legally obligate the parties to allow prior comment on new measures but only to make a "best endeavour" to do so. In practice, and in future EPAs, it may be useful to define that this endeavour is only relevant in countries in which the regulator has attained the capacity for independent and effective regulation.

6.93 The parties must also use their best endeavours to facilitate the implementation and application of internationally agreed standards for regulation and supervision of financial services sector, although the meaning of "internationally agreed standards" is unclear and the "best endeavour" nature of the obligation should ensure that CARIFORUM countries do not have to implement standards that are inappropriate to their level of development. Under the Agreement financial service suppliers are entitled to be informed of all of the requirements applying to the supply of financial services within the territory of a given Party. There is also a requirement to inform an applicant of the status of its application and "notify the applicant without undue delay" if the regulatory authority requires additional information on its application.

6.94 An important element of the section on financial services, given the fast pace of innovation in financial product design, is the treatment of new financial services, that is, services not yet captured by existing definitions and schedules. The issue is not dealt with in the GATS Annex on Commitments in Financial Services but does appear in the subsequent GATS Understanding. Article 106 of the EPA requires that the EU and the CARIFORUM states permit a financial services provider to provide any new financial service if it is of a type similar to that permitted by domestic providers "in like circumstances." Similar provisions in the Understanding only apply to new financial services that are offered by financial service suppliers which have a commercial presence. By contrast, the provisions in the EPA apply to new financial services supplied through any mode of supply. However, the new service can still be subjected to regulatory conditions which may entail a requirement to establish a commercial

presence in order to supply the new financial service. Hence, in practice the EPA corresponds closely to the Understanding.

6.95 The EPA also addresses data processing and follows the Understanding, and hence is – for CARIFORUM States – "GATS plus." It requires Parties to allow for the cross-border transfer of financial data if that is required in the ordinary course of business of a financial service provider. The Parties must also ensure "adequate safeguards" for the protection of data, in particular personal data. Finally, as in the Annex, the EPA allows for "specific exceptions" relating to certain financial services of a public nature, such as, public retirement plans or statutory social security systems.

6.96 The section on financial services, while it embodies a number of GATS plus obligations, does not entail the establishment of new regulatory bodies. Nevertheless, it is likely to require capacity building to allow countries to effectively implement the range of "best endeavours" regarding effective and transparent regulation.

Implications for African Services-EPAs

6.97 For African countries, commitments on the regulation of financial services could entail important risks of restricting access if they enshrine standards in western markets and fail to take into account the particular features of the market in low income countries. On the other hand, a services EPA that reflects the interests of African countries could set a useful precedent for flexibility to be provided in future multilateral agreements. For example, an important issue for many African countries is the restrictiveness of requirements that come from standards relating to anti-money laundering and combating financial terrorism with regard to identification to access banking services. These requirements are difficult to satisfy for many who live in rural areas and may constrain the development of new novel financial services such as mobile banking.[89] The EPAs could offer African countries the opportunity to introduce additional flexibility into the commitments on the regulations of financial services that reflects better the situation facing consumers and providers in much of Africa.

Implications of the CARIFORUM EPA's Sector-Specific Commitments on Domestic Regulation for African Services-EPAs

6.98 It is apparent from the CARIFORUM negotiations that an EPA offers African countries the opportunity to pursue important regulatory issues of relevance to key offensive export sectors, such as in tourism and perhaps IT-related services, and that an agreement with the EU could then set important precedents for other preferential and regional trade agreements in Africa and for its multilateral trade negotiations. Such precedents may help African countries ensure, that in these key sectors, future agreements at the multilateral level are not skewed against their interests in favor of developed countries. The services EPAs also offer African countries the opportunity to support regulatory reform programs through commitments on domestic regulation

[89] See World Bank (2009)

that clarify the role and nature of regulators, confirm requirements concerning universal service, and lock-in an open and transparent approach to regulation and competition.[90]

6.99 However, African countries need to be well-prepared to effectively pursue their interests in services in terms of having a well-defined strategy for trade in services, with a detailed approach for a limited number of priority sectors. For many African countries the asymmetry with the EU in terms of regulatory and negotiating capacity is much greater than that of the CARIFORUM countries. Hence, there is a pressing need for technical and capacity building assistance to allow African countries to clearly identify specific interests, formulate positions for negotiations on the regulation of services, and carefully consider the implications of regulatory commitments that are requested of them by the EU. In cases where regulatory commitments can be made, substantial additional technical support will subsequently be needed to raise capacities in regulatory bodies and support necessary legal reform to permit effective implementation.

E The CARIFORUM EPA and Regional Integration

6.100 A key factor underlying the CARIFORUM EPA was the acceptance by all parties on the need to facilitate regional integration (Articles 4 (general) and 60 (investment and services)) and that differences in levels of development among countries in the Caribbean necessitated "the progressive, reciprocal and asymmetric liberalization of investment and trade in services." Article 64 explicitly states that economic integration among CARIFORUM states is an objective of the Agreement and that progressive removal of remaining barriers and the provision of appropriate regulatory frameworks for trade in services and investment will contribute to the deepening of the process of regional integration in the Caribbean. Thus, the EPA clearly recognizes the importance of putting in place appropriate regulatory frameworks together with trade liberalization at the regional level.

Regional, Bi-lateral, and Multi-lateral Liberalization of Trade in Services

6.101 The phased approach to liberalization discussed above could be tailored to support the emergence of regionally competitive firms before opening up to the EU in those sectors were careful analysis suggests the opportunity for learning effects that could be important in allowing local firms to expand and compete in open markets. However, regional liberalization first is likely to be an efficient approach only in a relatively few sectors and would need to be managed with care even in those sectors. When trade in a sector is liberalized only on a regional basis the "first mover" advantage in capital intensive and network services and natural monopolies can give a permanent competitive advantage to a less efficient supplier from one of the member countries of a region just as only liberalizing trade with the EU can give a permanent competitive advantage to an EU supplier that is less efficient than some from elsewhere in the world as discussed in Chapter 5. In many sectors, it is unlikely that the phased implementation of liberalization at the regional level and then with the EU will be sufficient alone to allow regional competitive suppliers to emerge. Any relatively inefficient regional supplier will create a

[90] "Locking-in" will, however, be credible only if services-EPAs have effective dispute settlement and enforcement provisions as discussed in the World Bank's *Full Report on the Implementation of Interim EPAs*, Part I, page 82, and Part III, pages 77-84.

competitive burden for the manufacturing and services firms in all regional countries that have no choice but to utilize the services of the inefficient supplier.

6.102 Even in those few sectors where regional liberalization is an economically attractive first step, it still is likely to be important to lock-in future liberalization with the EU and simultaneous opening up on an MFN basis to ensure that the protection of regional producers is temporary and time bound. Effective "locking-in", however, will require strong enforcement provisions to ensure that the commitment to open up is actually implemented or avoiding creation of politically powerful domestic services-suppliers that will be able to block the implementation of the opening-up commitment. In addition, flexibility to advance liberalization beyond the region may be automatic if it becomes clear that learning effects in the identified sectors are not important as initially perceived or are not being exploited by local producers. Subject to appropriate regulations being in place for the sectors concerned, development needs of the region's member countries may then justify more immediate opening to the EU and global suppliers.

Regional Regulatory Cooperation

6.103 Article 64 in the CARIFORUM EPA explicitly refers to the importance of the principles set out in its Chapter 5, which covers the regulatory framework, as providing a framework for further regional liberalization of investment and trade in services. As discussed above, the agreement's Chapter 5 covers some general principles regarding regulation, such as, transparency, procedural fairness and right of review of administrative decisions, and more specific commitments regarding mutual recognition and the regulation of particular sectors. Thus, the EPA draws attention to the importance of an appropriate regulatory framework to promote regional trade and investment. Attention will also have to be given to coordinating regional trade liberalization with regulatory reform and to exploiting the opportunities for effective regulation at the regional level.

The Regional Preference Clause

6.104 The CARIFORUM EPA contains a regional preference clause under its general provisions that extends the same treatment of services and investment granted to the EU to the Caribbean countries signing the EPA.[91] Under this clause, preferential treatment provided to the EU by an individual Caribbean signatory is automatically extended to the other Caribbean signatories. The inclusion of regional preference clauses in service EPAs similar to the one in the CARIFORUM EPA could provide a stimulus to intra and inter-RTA efforts for liberalization of trade in services in Africa.

6.105 As discussed in the Chapter 5, a number of treaties establishing African regional trade areas (RTAs) define broad objectives for trade in services and provide for a "right of establishment." However, in practice the impact has been limited due to lack of actual implementation and little progress has in general been made in achieving cooperative solutions to services reform and regulation. An important recent development, however, is the agreement

[91] Part VI, General and Final Provisions, Article 6

in the EAC to develop a common market which includes explicit commitments *(to do what)* on a number of services sectors.

6.106 Inclusion of regional preference clauses in services EPAs could provide a new stimulus for the liberalization of investment and services flows within and between the regional EPA-groups more generally. Although a regional preference clause could become redundant if *all* members of an African EPA-group actually liberalize services and investment on a MFN basis, it would be helpful if some do not (particularly if effective dispute settlement arrangements are also adopted) and could also have a constructive symbolic value as a visible sign of political support for regional integration efforts.

F Development Cooperation and Technical Assistance

6.107 The CARIFORUM EPA explicitly recognizes that development cooperation is a "crucial element" of the partnership and is "an essential factor in the realization of the objectives of the Agreement" (Article 7). The EPA identifies in Article 8 a set of development priorities for assistance from the EU to the CARIFORUM states which include:

a. Technical assistance to build, human, legal and institutional capacity to facilitate implementation of the commitments of the EPA;
b. Assistance for capacity and institution building for fiscal reform to strengthen tax administration and improve the collection of tax revenues;
c. Support to promote private sector and enterprise development, in particular small economic operators, and enhance international competitiveness,
d. Support for the diversification of exports of goods and services through new investment and the development of new sectors;
e. Enhancing technological and research capabilities to facilitate development of, and compliance with, internationally recognized sanitary and phytosanitary measures and technical standards and internationally recognized labor and environmental standards;
f. The development of innovation systems, including the development of technological capacity;
g. Support for the development of infrastructure necessary for the conduct of trade.

6.108 These broad provisions for cooperation and assistance are complemented by a number of provisions that are specific to investment and trade in services. In addition to the support envisaged for the tourism sector, discussed above, Article 121 defines a range of areas for the EU to support technical assistance, training and capacity to:

a. Improve the ability of CARIFORUM service suppliers to obtain information and satisfy regulations and standards in EU markets;
b. Improve the export capacity of local service suppliers;
c. Facilitate interaction and dialogue between service suppliers of both Parties;

d. Address issues of quality and standards in those areas where the CARIFORUM states have undertaken commitments;

e. Develop and implement regulatory regimes for specific services at both the CARIFORUM level and in the CARIFORUM states;

f. Establish mechanisms for promoting investment and joint ventures between service suppliers of the Parties;

g. Enhance the capacities of investment promotion agencies in CARIFORUM states.

6.109 While the CARIFORUM EPA is explicit about the importance and possible nature of cooperation and assistance from the EU to the CARIFORUM states, the text does not contain precise language or commitments on the amount of overall development financing or the amounts for specific issues or sectors that will be provided. The non-specific nature of the EU's technical assistance commitment has proved controversial with the criticism that the agreement is unbalanced in that CARIFORUM countries have made legally binding commitments but the commitment by the EU to provide development support is not precise or legally enforceable. Actual financing will take place through the existing framework and rules defined in the Cotonou Agreement. That is, financing will be provided through the through regional and national indicative plans of the European Development Fund.

Technical Assistance Required for Services-EPAs in Africa

6.110 A key concern for African countries in negotiating services EPAs is that these actually contribute to increased investment, more competition, greater efficiency and wider access to services through coordinated reforms in trade, regulatory, and investment-climate policies and the strengthening of regulatory institutions. As discussed above, detailed analyses at the national and regional level will be needed to determine how to design and coordinate necessary regulatory and trade reforms for priority services sectors to enable negotiating positions to be formulated at the national and the regional levels, to plan the implementation of reforms, and to strengthen the institutions concerned. In general, such analyses have not yet been undertaken in many African countries.[92] Given differences in the levels of capacity and readiness to negotiate between Africa and the Caribbean, substantial technical assistance will be required before effective negotiations with the EU can take place.

6.111 Availability of high quality and objective technical and capacity building assistance for these tasks will be essential. The EU has the capacity to provide substantial technical and financial assistance for the preparation and implementation of services EPAs. However, the technical assistance provided thus far for EPA negotiations appears to have focused too narrowly on inventorying current trade restrictions for a GATS-style negotiation over their liberalization and has largely ignored more important trade, regulatory, and investment-climate issues. Some of the regional EPA-groups are now making requests for technical assistance for this purpose.

[92] Some initial background studies have already been carried out for individual countries (Zambia, Mauritius) and regions (COMESA, SADC) in Eastern and Southern Africa. These could provide a useful information base for carrying out more detailed studies to determine regulatory requirements, the sub-sectors to be initially liberalized, commitments to be made in each sector, the adjustment periods and technical assistance needed

Such technical assistance needs to be given both priority attention now and sustained attention over time in aid for trade and other development assistance programs in order to underpin efforts to make the necessary regulatory and institutional reforms.

6.112 The European Commission has substantial technical expertise on competition, regulation, and the development of unified markets and could make important technical contributions to the services-sector reform effort in Africa under its aid for trade and other development programs. For example, the EU has provided extensive effective technical and financial support for the restructuring of Tunisian industries in connection with their Euro-Med agreement that offers concrete examples of the types of programs that might be feasible in some African countries.

6.113 Although the EU is likely to be an important source of technical and capacity building assistance, it may not be the best source in all cases. Both high quality and *objective* professional expertise is needed. Thus, in cases where advisors from the EU would face conflicts of interest, it may be desirable to seek inputs from other sources. Modalities will thus need to be established that will permit EPA-countries to obtain necessary technical and capacity building assistance from the most appropriate source.

G Conclusions: Main Insights from the CARIFORUM EPA[93]

6.114 The conclusions for designing and negotiating African services-EPAs that emerge from the above assessment of the CARIFORUM EPA are:

1. **Heavy institutional demands of a comprehensive approach.** The investment and services provisions of the CARIFORUM EPA are the broadest agreement on trade in services that the EU has thus far concluded with any region of the world. The CARIFORUM EPA covers all services sectors and modes. Such a comprehensive agreement requires a substantial institutional capacity to negotiate and implement. A more selective, strategic approach to regulatory reform and liberalization of trade in services may be more cost effective in Africa than the comprehensive model adopted for the CARIFORUM EPA.

2. **A gradual and phased approach to services trade and investment liberalization.** The CARIFORUM EPA provides for flexibility in the scheduling and implementation of commitments with a built-in agenda for further reform. However, while the CARIFORUM EPA establishes a schedule for continuing discussions of possible liberalization of trade in services, the Caribbean countries do not have any strategy for doing so. Even for countries with the institutional capacity to negotiate and implement a comprehensive agreement on services, it may well be a more effective reform strategy to work out over time a phased series of in-depth sector-by-sector regulatory reform and liberalization strategies and plans for implementing these instead of first negotiating a broad but shallow comprehensive agreement.

3. **Little new liberalization of imports of services.** Although the CARIFORUM EPA's agreement on trade in services is quite broad in terms of coverage, it is also fairly shallow in terms of the depth of reforms. It largely just binds the existing level of market openness for

[93] For similar findings, see Francis and Ullrich (2008) and Suave and Audet (2008).

imports of services (the agreement falls into Category 2 in Table 5.1). This approach may increase the credibility of existing policies and reduce the risk of their being reversed which may increase investment if services imports under Mode 3 are being constrained by fears of current applied policies being made more restrictive rather than by the restrictiveness of current policies themselves. But, by itself, it does nothing to liberalize existing policies to permit expanded imports of services. An approach that targets priority sectors may be more effective in identifying if further trade opening is required to stimulate trade and greater competition and investment

4. **No Action thus far on non-preferential liberalization of services imports from all sources.** However, since the EPA only binds for imports of services from the EU the market access that currently is currently in effect for all imports of services, the market access of EU and service providers from other foreign countries will continue to be the same as it now is. Lack of MFN liberalization is thus not an immediate problem, but MFN liberalization will be needed as soon as any new access is proposed for EU service providers.

5. **Establishment of sound regulatory precedents.** The CARIFORUM EPA defines frameworks for the regulation of a number of specific services sectors. In some cases, such as finance and telecommunications, this could be useful to African countries seeking to increase the quality and credibility of their regulations. In other sectors in which Africa has offensive export interests commitments on regulations that go beyond the GATS could provide important precedents for future regional and multilateral trade agreements. The benefits of this approach are particularly apparent for tourism in the CARIFORUM EPA, but a forward looking approach could also target dynamic sectors, such as those related to IT, in which some African countries may develop a broader competitive base in the future.

6. **Cooperation in enforcement of competition laws.** The CARIFORUM EPA provides for cooperation between competition authorities with respect to enforcement activities and for exchange of information that facilitates the application of respective competition laws. Such assistance could be of use to fledgling competition authorities in the Africa. A commitment from the EU competition authorities to ensure that EU firms in the tourism, air transport, and maritime transport sectors do not engage in anticompetitive practices in Africa could be particularly helpful in disciplining behavior in these important sectors.

7. **Regional Integration in Services.** Regional regulatory cooperation and a regional preference clause are the CARIFORUM EPA's primary instruments for advancing regional integration in services and could usefully play a similar role in services EPAs in Africa. However, there are also opportunities to pursue a sequenced approach to mutual recognition of professional qualifications, first at the regional level and then with the EU. Putting in place structures for dialogue on mutual recognition at the EPA level may facilitate progress at the regional level.

8. **Improved market access for Mode 4 - but limited to professionals.** The CARIFORUM EPA contains provisions for expanding employment of temporary service providers in the European Union. However, this affects professionals - business-services providers, contractual service-suppliers, and independent professionals. The CARIFORUM EPA does not address the issue of temporary movement of unskilled workers, which is of particular relevance to African countries.

7. SERVICES TRADE LIBERALIZATION IN AFRICA AND THE EPA PROCESS

7.1 Services reform is crucial for development in Africa and trade liberalization is an important part of a services reform strategy. Trade opening in services is complex as it has to be coordinated with regulatory reform and capacity building. A services EPA is one mechanism that is available to countries in Africa as part of services reform strategy to increase efficiency and improve quality and access to services. However, international agreements have so far not been useful instruments for supporting services reform in Africa. If EPAs are to be important vehicles for development they will have to address a range of reasons why previous agreements at the regional and multilateral level have had little traction on actual reform in African countries and most importantly on outcomes. In particular, there will be a need to address the asymmetry between the African and EU parties to the negotiations and the differences across countries in Africa in terms of the number and type of priority services sectors and regulatory capacities.

7.2 Many countries in Africa currently place little emphasis on services in their industrial, trade or export promotion strategies, with the exception of tourism. The EPA negotiations, even if they do not lead to an actual agreement, could play an important role in raising the profile of trade policy in services and encouraging policy makers to give greater attention to the benefits from opening up to international competition in services and from further developing export capacities in services. As yet they do not appear to be performing this role.

7.3 This chapter discusses what a well designed services EPA could bring to Africa and seeks to place the EPA in a broader framework for liberalization of trade in services in Africa. The design and implementation of strategies for trade in services should not be dependent or solely linked to the EPA process. Such strategies and related technical assistance are equally important for those countries that decide not to pursue a services EPA. Hence, technical assistance for these activities should be provided by 'aid for trade' resources from a variety of sources. For the LDCs in Africa, funds from the Enhanced Integrated Framework could be used to support the development of a services trade strategy and finance the trade-related regulatory audit in priority sectors. A services EPA cannot therefore be viewed as a stand-alone agreement rather as a flexible mechanism that countries in Africa may use to support a process of coordinated trade opening, regulatory reform and capacity building.

A Services Reform and an EPA

7.4 The conclusion of a services EPA with many African countries is likely to be extremely difficult. The negotiation of EPAs needs to accommodate diverse situations such as those of Mauritius and Comoros, Sierra Leone and Nigeria and so on. The negotiation of interim EPAs has been far from smooth. In addition there has been substantial resistance in Africa and amongst many NGOs to negotiations on the so-called Singapore issues that includes services, investment, competition and intellectual property.

7.5 A key incentive for African countries to negotiate EPAs is ***improved access to the EU market for African services suppliers.*** The EPA offers African countries the opportunity to pursue offensive export interests that would not be possible under unilateral liberalization. A negotiation with the EU may be a more effective route to obtaining market access concessions of relevance to African countries than the WTO where many more countries are involved. For Africa, the key issue relates to Mode 4 rather than the other modes of supply. There has been little progress on the issue of temporary movement of persons at the multilateral level.

7.6 Services EPAs could offer an opportunity for African countries to facilitate the temporary presence of natural persons for business purposes. Thus, African countries that enter into negotiations on services EPAs should therefore identify if there are sectors in which there are current or potential opportunities for the temporary movement of natural persons. Tourism related services may be a sector worthy of attention in a number of African countries and the emerging IT sector may offer new opportunities as well. There is also significant scope for expanding intra-African trade in professional services, development of which could, in the longer term, create capacity for exporting similar services to the EU. Provisions similar to those in the CARIFORUM EPA on cultural issues that allows for greater access for musicians and other cultural performers will also be of relevance for many African countries. It may also be of interest for a number of countries to discuss movement of health workers.

7.7 In the CARIFORUM EPA the EU commitments on mode 4 relate mainly to movement that is linked to commercial presence of an enterprise. That is movement of business visitors, key personnel, such as managers and specialists within a company, which make intra-corporate transfers and graduate trainees. African countries currently have little scope to increase commercial presence in the EU and hence limited capacity to benefit from these forms of temporary movement of persons. Hence, African countries will probably want to push for more emphasis on access for contractual services suppliers and independent professionals, movement that is not directly linked to a commercial presence in the EU. For example, in the CARIFORUM EPA such professionals can stay in the EU for only six months in a year and there contract cannot exceed 12 months. Greater flexibility on these limitations could be an important objective for African negotiators.

7.8 However, for the EPA to have a strong impact on development in Africa it will need to extend liberalization beyond the limited set of high-skill activities and allow African countries to exploit their current comparative advantage in less skill intensive activities. The benefits to Africa of effective provisions of temporary movement are likely to vastly exceed any gains that may come from the provisions in the EPAs on goods.[94] Mechanisms need to be developed that allow for the short-term temporary stay of less skilled workers from Africa while providing EU countries with greater certainty that these workers will leave after their period of temporary employment.

7.9 Allowing for sub-contracting schemes, where companies from Africa would be contracted by EU firms to undertake certain activities using workers from the African country,

[94] In a global context, Winters et al (2003) suggest that the gains from a relatively modest opening up to temporary movement of unskilled and semi-skilled workers would be substantial and far exceed the removal of all restrictions on trade in goods.

may be the most appropriate way of allowing for temporary movement (Winters et al (2003)). A key reason is that the agreement can specify that the contract is between clearly defined entities in both countries/regions, for example, incorporated firms. This then puts the emphasis on enforcement of the conditions that are stipulated regarding the mobility of unskilled workers, such as temporariness and conditions of employment, on the firms involved. In practical examples where such schemes have been implemented, such as in Germany, instances of non-compliance, including workers who stayed on after the contract expires, led to fines being imposed on the German (hiring) company. Hence, enforcement of conditions is more straightforward in the case of sub-contracting than it is when allowing for mobility of individual workers.

7.10 Allowing increased access to the EU market for less skilled workers in Africa through the phased introduction of sub-contracting schemes would be an important factor to increase the gains from an EPA and to encourage Africa countries to participate in the EPA negotiations. Such schemes could be introduced first in sectors where EU firms identify there are shortages of workers. Hence, the EU Commission will have to work closely with EU firms and national governments in defining a strategy for sub-contracting and opening up the temporary movement of unskilled workers that can then be discussed in the EPA negotiations. Over time the scope of such schemes could then be extended to a wider range of sectors.

7.11 At present the European Commission does not appear to be in a position to offer significant new market opening for mode 4 regarding the temporary movement of unskilled workers. This clearly limits the benefits to African countries from an EPA in terms of offensive export interests and the motivation for participating in EPA negotiations. Hence the reform process would have to be African-driven and the focus solely on domestic reform in which African countries select priority sectors for reform. The key contributions of an EPA will therefore relate to the ***locking-in openness and the enhancing the credibility of reform.***

7.12 The impact of unilateral liberalization in African countries may be limited under certain conditions, for example where regulatory capacities are weak and credibility to implement reform is low. This is especially so in sectors where the dominant mode of supply is commercial presence and the anticipated investment inflows may not materialize following the removal of discriminatory measures nor an improvement in market access if considerable uncertainty remains about the commitment to reform and the stability of regulation and transparency and independence of decision by the regulator.

7.13 The multilateral process through the GATS could, in principle, support those countries wishing to reform their key services sectors. However, as discussed in Chapter 5, the GATS negotiations are not well tailored to address the interests and concerns of small low income countries and these countries have very little influence over the negotiations. Francois and Hoekman (2009) conclude that the contribution of the GATS to services reform has been negligible. With the EPAs, African countries have the opportunity to more directly influence the outcome of the negotiations and to obtain finance and technical support to improve regulatory capacities.

7.14 An EPA in coordination with deeper regional integration offers a mechanism for African countries to lock in their current de facto relative openness to entry of foreign service-providers

and foreign investment by binding these policies. Although many African countries are nominally relatively open to FDI the advantage of including CARIFORUM-type services and investment provisions in a services EPA is that they could offer foreign investors the additional security of locking-in the existing degree of services and investment liberalization under an international treaty, establishing credible dispute settlement and enforcement mechanisms, and thus reducing uncertainty about possible future reversals of existing policies contained in investment codes and other legislation through unilateral national action. This could help attract new FDI both to take advantage of improved access to the EU market and to help finance needed infrastructure and other investments in Africa.

7.15 The impact of an EPA would be greater if such openness were to be locked in on an MFN basis, for example, through comparable commitments at the GATS and explicit preferences for EU service suppliers are avoided. An EPA agreement could also enhance credibility by making clear that resources will be made available to upgrade regulatory capacities and help provide greater certainty over regulatory decisions.

7.16 The down-side of locking in reforms through legally binding commitments in EPAs or other trade agreements is, as some critics argue, a reduction in a developing country's "policy space" for subsequently reversing the provisions that are locked-in through a trade agreement. However, limiting the risk of policy reversals is important for the credibility of reforms with private investors and for encouraging large investments that pay off over a number of years. Some reduction in "policy space" is thus the unavoidable price of establishing a competitive investment climate. However, since binding commitments in trade agreements do have long-term implications for a country's trade and investment policies, it is important to analyze such commitments carefully before entering into them. This will be particularly true in sectors where uncertainty relates to a lack of regulation and the putting in place of good regulations may require new regulations.[95]

7.17 To some extent concerns over loss of policy space can be addressed in the design of an agreement. What is important is that the agreement contributes to public policy objectives regarding the provision of services, in terms of cost and access. Thus, the effective monitoring of the impact of the agreement and the linking of financial and technical assistance to outcomes, in terms of regulations and regulatory capacity, rather than to commitments to liberalize, can assuage concerns that reform and opening up could have adverse consequences for particular groups in terms of cost and access to basic services. Again, this could be achieved through an agreement that enshrines regulatory impact analysis as a critical part of the process of reform that informs the implementation of commitments and provides a degree of space for policy makers to put in place the regulations, regulatory capacity and mechanisms necessary to achieve social policy objectives in open services markets.

7.18 Also, services negotiation experience shows that countries may establish clear boundaries to the scope of negotiations and exclude particularly sensitive sectors where concerns over the loss of policy space are greatest. This has occurred in the context of North-North and North-South negotiations. For instance, in the context of NAFTA negotiations, Canada established a

[95] It is worth noting that in the CARIFORUM EPA there is a full prudential carve out for the financial services sector which preserves the freedom of the financial regulator to act to ensure stability of the financial system.

"cultural exception", whereby cultural industries were excluded from services and investment provisions of the agreement. The U.S. has not adopted commitments on maritime transport. Also, countries have excluded from the scope of the services and investment provisions of the agreement social services such as education, health and social security as well as measures that favor minority populations. The EU has also established its own exceptions in services negotiations. For instance, audiovisual services are typically not included in its bilateral trade agreements, and subsidies policies have also been left outside the scope of agreements (Sáez, 2010).

7.19 An EPA also offers African countries the opportunity to define ***provisions on regulation and anti-competitive practices*** governing important export sectors, such as in tourism and perhaps IT-related services, as well as key domestic sectors that are opened up to trade. The interests of African countries may be more easily represented in a negotiation with the EU relative to multilateral negotiations with a wider set of countries. An EPA agreement could set important precedents for multilateral negotiations that will help ensure, that in these key sectors, their interests are properly reflected in any outcome.

7.20 Services EPAs could also be designed to support regulatory reform programs in Africa through commitments on domestic regulation that clarify the role and nature of regulators, confirm requirements concerning universal service, and lock-in an open and transparent approach to regulation and competition. This could be supported by cooperation and information sharing between regulators and competition authorities.

7.21 Such provisions are likely to be relevant to many African countries. For example, the provisions on tourism in the CARIFORUM, backed up with technical assistance, may assist small and medium sized African tourism providers to integrate more effectively into global tourism chains. The commitment by the EU to discipline EU firms that are applying anti-competitive practices in the markets of CARIFORUM countries could also be of relevance to Africa in other sectors such as maritime transport.

7.22 Provisions on IT related services may also be of interest to a number of African countries as they seek to exploit export interests in these sectors. For example, regulatory rules on data protection enshrined in an EPA backed up technical assistance could provide a degree of certainty to investors seeking to locate activities and companies demanding cross border supply of data related services.

7.23 An EPA could also be designed to ***further regional integration***. Regional integration can play an important role in developing a range of services sectors in Africa. A Services EPA for Africa could play a role through a regional preferences clause similar to that in the CARIFORUM EPA that ensures that any preference granted to the EU is also granted to other members of the African regional agreement. However, given the importance of implementing services trade reform in many sectors on a non-discriminatory basis such a provision should not be of particular importance. It is in the area of mutual recognition, which is very difficult to implement on a multilateral basis, that such a clause could be relevant.

7.24 Indeed, an EPA could have a more profound effect on regional integration by providing impetus to mutual recognition at the regional level. An EPA that provides a structure for agreement on mutual agreement between the EU and members of a regional African community could encourage the establishment of national representative bodies for the different professional services, where they do not exist, and promote a dialogue between the bodies of different countries at the regional level with a view to implementing mutual recognition before or as an agreement with the EU is reached. On the other hand, there is no necessity for countries and regions to pursue mutual recognition agreements with the EU through an EPA. It should be possible to discuss these on a stand alone basis.

7.25 The EPA offers the opportunity to obtain ***technical and financial assistance*** that is necessary to support services reform. One of the key issues affecting the negotiations on services is the EU's reluctance to be specific about resources to support development outcomes outside of the envelope of commitments already made under the European Development Fund, while Africa countries are concerned about making commitments in services without a clearer understanding of the resources that will be available to address regulatory capacity building that will be critical in determining the impact of these commitments.

7.26 One way to deal with this issue is to include in the EPA agreement provisions that allow African countries to condition implementation of commitments on careful analysis of whether trade opening may exacerbate the impact of a clear market failure in the sector concerned and if so on the delivery of appropriate technical assistance and capacity building. This would help ensure the readiness of the regulatory framework and the capacity of the regulators to enable the benefits from trade liberalization to be attained and social objectives to be achieved.

B An Alternative Approach for Supporting Services Trade Reform in Africa

7.27 It appears that little substantive progress has so far been made in pushing forward the trade in services agenda through the EPA process. The negotiations on services are narrowly focused on requests and offers based on GATS type schedules. There is not enough attention to the regulatory framework and regulatory capacity and as such policy makers may not have the confidence to proceed with services trade liberalization. The current approach is not well-suited for the situation in many African countries and will probably not support the focused sector specific services reform that is required.

7.28 Thus, given the importance of services to development and of services trade, both Africa and the EU may wish to reconsider the current approach to services EPAs and seek to bring the EPAs and regional integration into a broader approach to services trade reform. Such an approach could recognize that while there are some African countries that may well wish to negotiate a services EPA in the near term, there are other countries that may in the future perceive that such an agreement could be useful to support their services reform programs while some countries may never wish to pursue a services EPA. Nevertheless, all 3 groups of countries will require support in developing their services sectors. This suggests that the EU and African countries should pursue a more flexible approach to the negotiation of EPAs and that an agreement can be negotiated with countries that are ready and willing to do so, whenever that

may arise. Hence, there should not be a specific deadline for the negotiation of EPAs and hence no final take it or leave it offer.

7.29 The problems that the EPA negotiations face reflect those that have encumbered the global negotiations on services trade liberalization under the GATS. Two key factors appear to undermine the standard mercantilist approach to trade negotiations regarding services (Hoekman and Mattoo (2007)). First, the export interests that have propelled reciprocity in trade in goods appear to be weaker for services. For developing countries the key area of export interest is temporary movement under mode 4. However, this is the most sensitive issue and one where there is little prospect of progress under the GATS or EPAs. It is an issue that will require concerted and effective cooperation between host developed and source developing countries under which source countries assist in the screening of those seeking to temporarily move abroad to work and facilitating their return to help prevent illegal migration.

7.30 Second, concerns over regulation and the ability to regulate have constrained effective participation in negotiations. Regulators will respond to substantive arguments for reform while mercantilist bargaining over market access per se will be of little importance (Feketekuty (2010)). This entails the need to careful analysis of the economic benefits as well as wider consequences of reform and the involvement of key stakeholders in discussions of regulatory reform. These inputs and dialogue are difficult to coordinate with multilateral and bilateral trade negotiations. There is also the important issue of achieving social equity objectives and putting in place mechanisms that ensure greater access to services after liberalization.

7.31 Thus, what is required is for the EU and other donors and international institutions such as the World Bank to coordinate their support for African countries that request assistance in the design and implementation of services reforms. An element of this could be an inclusive forum for services reform, independent of specific trade negotiations, that supports the application of regulatory impact analysis, discussion of good practices and effective institutional structures (Feketekuty (2010)). An important aspect of services reform is that one size does not fit all and that reforms and appropriate regulatory structures will often tend to be country specific.

7.32 The EU and the development community could then participate in a broad based dialogue on services trade reform with African countries perhaps focused on national committees for coordinating reform of services trade and regulations and regional communities in Africa. Such assistance would concentrate on priority sectors identified by the countries. Rather than bringing just trade negotiators to the table the EU and others would bring their sector and services trade experts to propel a sector based dialogue on services trade reform.

7.33 The challenge would be to find an effective host for such a forum. Should it be a multilateral development agency? Ideally, it would be located in an African institution such as the African Union or African Development Bank. But this raises the issue of whether these institutions currently have the capacity to be a successful host and whether taking on such an activity would comprise the achievement of their existing objectives. Where available, it may be effective to focus on existing UN sectoral agencies, such as the International Telecommunications Union and the World Tourism Organization, or other sector specific international institutions to provide a forum to support Africa countries that wish to implement coordinated regulatory and trade reform in Africa.

7.34 Mobile telephony is perhaps an example of the dialogue that could take place. Many African countries have opened up to competition from foreign mobile phone companies, some of which are African. This in turn has led to a substantial increase in coverage and the use of telephony in these countries. Some countries remain less open and, if they request, can be assisted in opening up. However, many of those countries that have successfully introduced competition in mobile telephony will face the issue of introducing 3G technology into the market. Of particular importance will be the way in which licenses for the provision of 3G services will be allocated. In addition to affecting the nature of competition and market outcomes in terms of prices and access to these new services there are important revenue issues at stake. In many countries the telecom regulator remains very weak and there is considerable risk that the allocation of the licenses could be distorted. Hence there is a need to raise capacity in telecoms regulators. European countries also have considerable experience in allocating licenses for 3G services which could be very useful in assisting African countries is designing methods for the sale of such licenses.

7.35 EPAs remain one policy option that would be available to African countries to pursue if they so wished to pursue a comprehensive agreement with the EU to lock-in reforms, to support regional integration and to define in an international agreement key elements of regulatory frameworks for priority sectors. In some sectors, trade opening may be the most appropriate step and commitments in the form of an EPA may be an effective way of locking in existing or additional opening and providing credibility for this policy stance. Even when there are good reasons to concentrate on improving regulations and regulatory capacity, binding commitments to future trade liberalization may be important in undermining regulatory capture, encouraging FDI and providing momentum to the reform process.

7.36 Some countries in Africa may wish to use the discipline of an EPA to provide a regulatory framework for the development of particular sectors, for example, in terms of transparency of regulatory decisions. On the other hand, in a flexible approach to support to services development countries in Africa may wish to pursue particular issues with the EU without negotiating a comprehensive EPA. Some countries may wish to pursue cooperation on competition policy, mutual recognition agreements in certain professional services or perhaps adopt the EPA approach towards the development of tourism sector but not in non-priority sectors such as postal and courier services.

7.37 Technical assistance from the EU should not be predicated on negotiating and signing a services EPA. A number of countries in Africa may not wish to pursue an agreement on services with the EU in the form of an EPA yet they may wish to implement services reform. Providing technical and financial assistance to support reform in these countries will be equally important. It is also important that such assistance be based on international best practice and experience across developing as well as developed countries. The use of the EU model of integration and reform may not necessarily be the most appropriate and assistance should not be limited to advice from EU consultants only.

7.38 The importance of services trade reform across Africa therefore suggests the establishment of a fund for assistance in services under the aid for trade umbrella, with resources

from a range of donors. Such a fund, independently managed, would be better able to respond to individual country and regional demands for assistance in implementing strategies for services trade reform based on an MFN approach to liberalization. Such a fund could also ensure that lessons and expertise learnt from the experience of those at the forefront of services reform is appropriately shared with other countries and to support a base of African consultants with relevant expertise in trade and regulation of services. Within such a fund it may therefore be worth considering developing sector specific programmes rather than the ad hoc delivery of assistance. Initially resources can be concentrated on sectors consistent with current priorities that are common across many African countries such as transportation, telecommunications, energy, water, finance and professional services.

7.39 Hence, obtaining access to technical and financial assistance should not be a driving force behind the negotiation of EPAs. Such assistance should be available to all countries in Africa. A reason for negotiating an EPA lies in the opportunity to coordinate this technical and financial assistance with specific commitments on trade opening and regulation so as to reinforce and increase the credibility of the locking in of such commitments. The appropriate technical assistance for capacity building would be accessed from the fund for service reform and amounts would not need to be specified a priori in an EPA agreement. Crucially, this then entails a non-discriminatory approach to trade liberalization locked in through an EPA to give greater credibility than the GATS.

7.40 To coordinate the reform, negotiation, and implementation process, and the use of technical assistance it may be useful for African countries to *establish and empower a regulatory and trade reform committee for services* to oversee the process towards better regulation, greater competition, and trade liberalization. This committee would be charged with facilitating the inter-ministry and inter-agency coordination that is vital to drive effective regulatory reform and that is necessary to properly incorporate trade policy issues in the discussions. Such a committee would have the responsibility to establish the general principles of regulatory reform based on international best practice and to ensure that these are applied consistently across services sectors. The committee could comprise senior members of the concerned core and sectoral government agencies plus well respected representatives of the private sector, academic community, consumer groups, and other stakeholders. The committee would also be charged with ensuring that the discussions are open and transparent and that all interested stakeholders are able to participate.

C Conclusions

- **Without significant opening to temporary movement of unskilled workers by the EU services reform will have to be driven by African countries seeking to reform their domestic services sectors.** Greater access to the EU via mode 4 for unskilled workers, for example, through carefully crafted and managed sub-contracting schemes would have a significant economic impact. However, at present there is little on the table for African countries in terms of offensive export interests. Hence, the focus will be primarily on domestic reform and the EPA, as currently configured as a demanding negotiation across all sectors that results in shallow commitments, may not be suited to support such a reform process.

- **A sector-by-sector approach to coordinated regulatory and trade reforms is likely to be the most effective approach for African countries.** The situation in many African countries suggests identifying key services sector priorities from a development perspective (in most countries these are likely to include transportation, telecommunications, electricity, finance, and business services) and working to build capacity and define reform strategies for this limited number of sectors rather than first negotiating a broad but shallow comprehensive preferential agreement. The EPA process needs to be amended to provide a forum for such a sector-by-sector approach for coordinated regulatory and trade reforms but it could equally be pursued without an EPA, unilaterally and regionally. Small least developed countries should probably concentrate first on 2 or 3 priority sectors.

- **Technical and financial support to address regulatory weaknesses and build capacity is important to support regulatory and trade reforms and Africa's integration into the global economy.** Technical assistance needs to effectively support the necessary regulatory-reform/MFN-trade-opening process. It should be targeted at those factors with the greatest impact on performance in the market and not solely at market access and national treatment considerations and the preparation of GATS-type schedules of commitments. Such assistance should not be directly linked to the signing of an EPA. Assistance should be available to all African countries that wish to reform their services sectors, whether they sign an EPA or not. A fund for services trade reform in Africa that would allocate resources according to need and consultants according to expertise, not nationality, would be the most appropriate vehicle for providing technical assistance and building capacity. With regard to an EPA, resources from this fund would be available to raise capacities in priority sectors to support implementation of trade opening commitments and hence enhancing the credibility of the locking in of trade openness.

D Recommendations

7.41 With regard to services reform, countries in Africa, drawing upon available sources of financial support and technical assistance should:

- Define a strategy for trade in services that is integrated into the national development plan through the following activities (i) improving the collection and dissemination of more and better data on service sectors and trade in services; (ii) creating awareness and facilitating a dialogue among various stakeholders about the potential impact of services trade liberalization and reform; (iii) identification of priority sectors where greater competition, foreign investment and new technology can drive efficiency and growth (iv) establishing a committee for services trade and regulatory reform to champion open and transparent approaches to regulation and trade opening and oversee the use of regulatory impact analysis.

- In the priority domestic services sectors implement a trade and regulatory audit to identify the main constraints to competition and investment. Do they lie in insufficient openness to trade and investment, lack of credibility of existing openness, inappropriate regulations, insufficient capacity to implement a sound regulatory framework, a hostile investment climate?

- In priority export sectors assess the need for improvements in the regulatory regime to support competitiveness and mobilize an export supporting approach in relevant line ministries and institutions such as the export promotion agency.

- Identify if, and how, unilateral reforms and trade agreements at the regional, EPA and multilateral level can be used to alleviate the constraints that are identified for the priority sectors and support the process of trade and regulatory reform. Explore opportunities for cooperation with the EU outside of a formal broad services agreement, for example, with regard to cooperation between competition authorities.

- Pursue more actively opportunities for regional cooperation and deeper integration of services in priority sectors of mutual interest with regional partners.

7.42 With regard to the EPAs:

- The EU and African countries should consider a more flexible approach to the EPAs that reflects the diversity of capacities and priorities across African countries in which the focus is not on a bilateral deal between the EU and regional blocks in Africa for the preferential opening of services sectors based upon a GATS type schedule but rather a country based cooperative approach to remove the constraints to the development of the sectors identified as priorities by African countries. For example, if requested by an African country or group of countries, the EU could work with these countries to facilitate cooperation between competition authorities. This could be provided even in the absence of a formal comprehensive EPA agreement. Similarly the EU could look at opportunities for mutual recognition of qualifications that are not predicated on signing a formal EPA agreement.

- The African countries and the EU should adopt an approach to services reform that enshrines a sector-by-sector approach to coordinated trade and regulatory reform rather than a broad but shallow GATS type negotiation in which priority sectors for reform are defined by each country consistent with national development plans.

- The EU should support African countries in pursuing openness to trade in services primarily through MFN liberalization especially in infrastructure sectors where preferential opening may have long-term adverse implications.

- The EU should work with other donors and international institutions to make adequate technical assistance available to all reforming countries in Africa from a fund that is independently managed and delink the provision of such funding from negotiations and agreement on an EPA. Such a fund could organize financial resources and expertise around key services sectors for Africa. Suggestions would include telecommunications, tourism, transport, finance and business services.

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Annex A: Definitions of Services Sectors, Modes of Delivery, and Sources of Data GATS Classification of Services Sectors

The Sectoral Classification List under WTO's General Agreement on Trade in Services (GATS) includes twelve core service sectors:

Table A.1 – GATS Classification of Core Services Sectors

	Core Sectors	***include (not exhaustive):***
1	Business	Professional (legal, accounting, medical etc.), computer & IT-related, real estate, rental/leasing
2	Communication	Postal, courier, telecommunications, audiovisual
3	Construction and Engineering	Buildings, civil engineering, installation and assembly
4	Distribution	Wholesale, retail, franchising
5	Education,	Primary, secondary, higher, adult
6	Environment	Sewage, refuse disposal, sanitation
7	Financial	Insurance, banking
8	Health	Hospitals, social services
9	Tourism and Travel	Hotels and restaurants, travel agencies and tour operators, tourist guides
10	Recreation, Cultural, Sport,	Entertainment, news agencies, libraries, sporting and other recreational
11	Transport	Maritime, internal waterways, air, rail, road, services auxiliary to all modes of transport
12	Other services	….

The twelve core sectors are further subdivided into 165 service sub-sectors.[96] This sectoral classification constitutes the basis used for trading partners' commitments under the ongoing GATS negotiations. Unfortunately for analytical purposes, the statistical format under which services are reported in a country's balance of payment and other statistical reports do not coincide with these twelve GATS sectors. The *Manual on Statistics of International Trade in Services* sets out an internationally agreed framework for the compilation and reporting of trade flows in services, the classification retained by this manual based on the BOP classification of services will be used for the rest of this annex. All existing data sources have significant limitations and information ideally would need to be estimated by combining different sources, entailing new problems of data coherence. For many African EPA-countries, no disaggregated data on trade in services are available (see Section B of the main text for additional discussion of this point.)

Modes of Services Delivery

Under GATS definitions, services can be delivered in four ways or "modes:"

Mode 1 - Cross-border Supply

Both provider and user stay in their respective countries, and the service crosses the borders. Cross-border provision includes both business and consumer services that can be transferred electronically or by mail (examples: purchase of insurance by correspondence or

[96] In 1991, the GATT Secretariat produced a note known as the Services Sectoral Classification list (GNS/W/120), resulting from consultations with member countries, so that specific commitments could be made and negotiated. GNS/W/120 should thus be considered as a *negotiating list* rather than as a *statistical classification*.

online, call centers, outsourced provision of professional services like accounting, computer assisted design. etc) and items sent abroad for repair (such as ships and aircraft). Mode 1 delivery usually requires reliable and (in the case of online services) cheap telecommunications.

Mode 2 – Consumption Abroad

Consumer travels abroad to consume from the service supplier. Consumption abroad involves service usage by foreigners, such as tourists, students, or patients, of services in the home country. Traditionally, the major sector characterized by Mode 2 delivery is tourism. Another example is education services. Consumption of medical services abroad is also increasing.

Mode 3 – Commercial Presence

Commercial presence refers to the provision of services by locally-established but foreign owned and controlled companies. An affiliate of the provider, such as a branch or wholly-owned subsidiary, sells services in the country of consumption (such as banking and insurance services or transport). This mode of delivery is often linked to investment.

Mode 4 – Temporary Movement of Natural Persons

An independent service provider or employees of a foreign firm temporarily move to another country to provide services. For example, foreign companies in service sectors may use home or third-country nationals on a temporary basis to provide the labor component of engineering, construction, distribution, transport, health, and other services. GATS Mode 4 delivery applies only to the services sector (as opposed to industrial and agricultural employment) and to temporary stays of personnel. It does not apply to the broader category of workers seeking to enter the labor market of a third country on a long-term or permanent basis (economic migrants). Mode 4 is of particular importance for developing country exports, especially SSA's, because the underdeveloped state of their service industries limits the scope for expansion in the medium term of most services exports other than tourism and individuals delivering services abroad under Mode 4.

In the GATS terminology, Mode 4 is defined as temporary movement of natural persons in service sectors. The scope of Mode 4 in services provision is limited by two factors. First, Mode 4 is limited to transactions between residents and non-residents in one of the twelve service sectors described above, and does not cover employment of foreign nationals in other sectors of the economy[97] like agriculture or industry. Moreover, in the context of GATS, Mode 4 commitments mostly refer to highly skilled personnel, either independent workers who offer their services abroad, or inter-corporate transfers whose presence is closely linked to provision of services through Mode 3, commercial presence. Second, Mode 4 covers only non-permanent provision of services or employment in services sectors in the country of the consumer. Although GATS provides no definition of "temporary"[98] or non-permanent, it appears implicitly understood that permanent or long-term (up to ten years) work permits or immigration of persons seeking citizenship or residency status are not covered under Mode 4.

[97] There seems to be a lot of confusion in the literature between Mode 4 on the one hand, and immigration from SSA and the importance of resulting remittances on the other.

[98] In countries' GATS commitments, the temporary status usually covers 2 – 5 years

End-Uses of Services

Besides the standard categorizations by service sector and delivery mode, it is useful to make a distinction based on the economic or "end-use category" of the service, similar to the economic classification which divides goods in capital, intermediate and consumption goods.[99] While the concept of capital goods does not apply to the services sector, the distinction between intermediate services and end-use services highlights their impact on other production sectors. Intermediate services are inputs in the production and distribution of goods (transport of goods and business travel, network infrastructure services, professional business services, etc.).[100] Whereas final use services (tourism and other recreational services, health, education, cultural services) go directly to the ultimate consumer. As always, the distinction is not water-tight, as most infrastructure services are consumed both by productive sectors and by final users.[101] But for economic analysis purposes, a service could be included in the intermediate services category to the extent that it constitutes a significant input in the production process of goods and is therefore an important determinant of a country's competitiveness. For further analysis, intermediate services could be further broken down into infrastructure services (capital intensive) and business services (skilled-labor intensive).

Sources of Data on Trade in Services

Analyzing trade in services encounters formidable problems of classification and data availability as outlined above. The widely accepted reference is the Manual on Statistics of International Trade in Services, developed jointly by the IMF, the OECD, Eurostat, WTO, UN and UNCTAD; it provides a detailed analysis of measurement issues related to services trade. Recommendations of the Manual are promoted by these six agencies and will enable countries to progressively expand and structure the information they compile in an internationally comparable way. The Manual explicitly relates to the System of National Accounts 1993 and the Fifth Edition of the IMF's Balance of Payments Manuel (BOPM5). This framework constitutes a significant improvement, but especially for African EPA- countries, major data limitations persist. The main source of information for services trade data are balance of payment (BOP) statistics. These statistics cover services traded internationally by the first and second mode (cross-border and consumption abroad) and, to a limited extent, trade by Mode 4 via the movement of natural persons in categories like computer and information services and other business services. But Mode 3 (commercial presence) coverage is limited to certain sectors with specific characteristics like construction services. The major part of foreign commercial affiliates/subsidiaries/branches are incorporated as legal entities of the host country and their business transactions within the country of establishment are therefore not captured in balance of payment trade in services statistics.[102]

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[99] The Broad Economic Category (BEC) classification is a rearrangement and aggregation of the basic headings of SITC 3 into end-use categories that are meaningful within the framework of the System of National Accounts (SNA), namely categories approximating the three basic classes of goods in the SNA: capital, intermediate and consumption goods. The BEC classification thus allows trade analysis to be integrated into macroeconomic analysis.

[100] Mattoo, A (2005), uses the expression "producer services" for service inputs into the production of goods. Browning and Singelman (1975) initiated the use of the term producer services.

[101] This is also the case with many intermediate goods. For example, sugar, considered a consumption good for households, is also a major input for the beverage and confectionary industry (although the tendency is to replace it with corn syrup for industrial use).

[102] Profit remittances would be reported in the BOP, but in the factor income category.

Given the limited coverage of BOP statistics, consultation of additional sources of information is necessary to improve the data quality. For Mode 3, Foreign Affiliates Trade in Services (FATS) statistics are an important source of information in terms of outwards FATS (majority-owned affiliates of the compiling economy established abroad) and inward FATS (majority-owned foreign establishments in the compiling economy.[103] FDI statistics are used to complement (or serve as a proxies for) FATS statistics. A relatively small part of Mode 4 transactions can be measured by companies reporting on the compensation of employees posted abroad. Migrants' remittances cannot be used even as an imperfect proxy for Mode 4, as they are neither limited to temporary movement of people nor to services trade. Annex table A11.4 gives an overview of the statistical coverage available for each mode.

In the following description and analysis of services trade of African EPA-countries, OECD-Eurostat partner-reported data (so-called mirror data) have been used for the EPA-countries trade with the EU[104] , whereas services trade with the world is based on World Bank Development Indicators and IMF Global Development Finance (i.e. BOP) databases. Using two different data sources entails additional problems of data coherence and limits strict comparability.[105]

Table A.2: Statistical Coverage of Modes of Supply

Mode	Statistical coverage
Mode 1 Cross border supply	BPM5: *transportation* (most of), *communications services, insurance services, financial services, royalties and license fees* Part of: *computer and information services, other business services,* and *personal, cultural, and recreational services*
Mode 2 Consumption abroad	BPM5: *travel* (excluding goods bought by travellers); repairs to carriers in foreign ports (goods); part of *transportation (*supporting and auxiliary services to carriers in foreign ports)
Mode 3 Commercial presence	FATS: FATS statistics, each ICFA category BPM5: part of *construction services*
Mode 4 Presence of natural persons	BPM5: part of: *computer and information services; other business services; personal, cultural and recreational services;* and *construction services* FATS (supplementary information): foreign employment in foreign affiliates BPM5 (supplementary information): labour-related flows Other sources: see Annex I

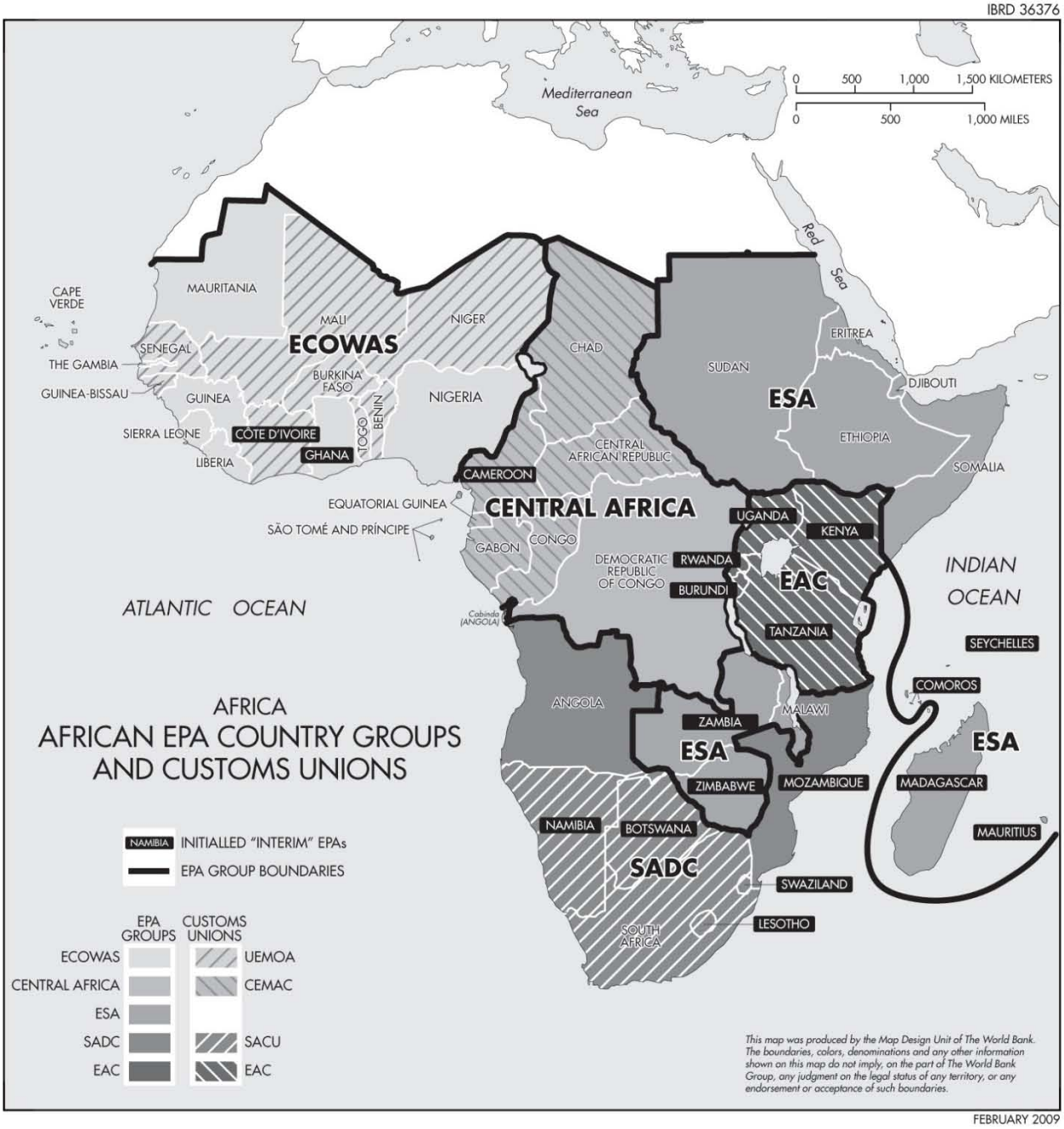
Source: United Nations, 2002.

[103] The standards for FATS statistics are set out in the Manual on International Trade in Services. Relevant information is collected by national statistical offices of OECD countries through periodic surveys of businesses identified as possessing affiliates abroad. Interpolation techniques are then used to estimate annual data. The level of return of the questionnaires (reporting is not mandatory for firms) is suboptimal and hence the quality of the data is disparate.

[104] Data refer to EU-15 countries, i.e. before the 2005 and 2007 enlargements to 25 and subsequently 27. EU-15 countries represent about 90% of the EU's goods trade with African EPA-countries and probably even more of services trade.

[105] Example of the coherence problem: In one instance, services exports to the EU for a particular year appeared to be higher than services exports to the world including the EU.

Map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0 500 1,000 MILES
Red Sea
CAPE VERDE
MAURITANIA
MALI
NIGER
ECOWAS
SENEGAL
THE GAMBIA
GUINEA-BISSAU
GUINEA
BURKINA FASO
NIGERIA
TOGO
BENIN
SIERRA LEONE
CÔTE D'IVOIRE
GHANA
LIBERIA
CHAD
SUDAN
ERITREA
DJIBOUTI
ESA
ETHIOPIA
SOMALIA
CENTRAL AFRICAN REPUBLIC
CAMEROON
EQUATORIAL GUINEA
SÃO TOMÉ AND PRÍNCIPE
CENTRAL AFRICA
GABON
CONGO
DEMOCRATIC REPUBLIC OF CONGO
UGANDA
KENYA
RWANDA
BURUNDI
EAC
TANZANIA
INDIAN OCEAN
ATLANTIC OCEAN
Cabinda (ANGOLA)
SEYCHELLES
COMOROS
ANGOLA
ZAMBIA
MALAWI
ESA
ESA
ZIMBABWE
MOZAMBIQUE
MADAGASCAR
NAMIBIA
BOTSWANA
MAURITIUS
SADC
SWAZILAND
LESOTHO
SOUTH AFRICA
AFRICA
AFRICAN EPA COUNTRY GROUPS AND CUSTOMS UNIONS
NAMIBIA INITIALLED "INTERIM" EPAs
EPA GROUP BOUNDARIES
EPA GROUPS
CUSTOMS UNIONS
ECOWAS
CENTRAL AFRICA
ESA
SADC
EAC
UEMOA
CEMAC
SACU
EAC
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