

# Privatization and GATS: A Threat to Development?

A focused dialogue

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## Introduction

THE RHETORIC IN THE debate surrounding privatization has often been heated or evasive (and sometimes both), with participants accusing one another of bad faith or naiveté about the facts of the case. These tendencies have made it more difficult to identify correctly the true nature of the disagreements—and hence the evidence and argumentation that could be relevant to resolving them. This forum, which examined the relationship between development and privatization and explored different approaches to the reform of public services, presented an opportunity for market skeptics and privatization proponents to come together to discuss and debate their views on privatization and development in a more constructive way.

This report structures the dialogue from the forum into two sections: Part I represents the debate about the costs, benefits, and trade-offs of privatization. With a primarily economic focus, it includes theoretical arguments and evidence about the impact of privatization. Part II examines important political and institutional questions surrounding the General Agreement on Trade in Services (GATS)—the WTO agreement that liberalizes foreign participation and investment in a wide range of services.

Ten years ago, as the communist regimes collapsed and market-oriented economies began a lengthy period of robust growth, the wisdom of open trade, capital market liberalization, and privatization went largely unquestioned. A decade later however, there is widespread concern that economic liberalization has failed to deliver its promised results. Sagging economic growth and corporate scandals in the United States and Europe, in addition to the recent financial crises in Latin America, Russia, and Asia, have only intensified these concerns. Moreover, the privatization of state-owned enterprises—once thought to be a crucial measure for promoting development—has delivered mixed results. While privatization of traditionally competitive sectors shows evidence of increased productivity and profitability, the privatization of natural monopolies, especially water and electricity services, has engendered more disturbing outcomes. Indeed, while many representatives of trade and development organizations continue to maintain that the overall results of privatization have been positive, the observation that privatization has often led to soaring prices, denial of access, and mismanagement cannot plausibly be denied. The fact that privatization of infrastructure services has often been riddled with corruption—with political insiders winning control of some of the developing countries' most important assets through shady deals—makes the questions raised by critics of privatization all the more difficult to dismiss.

Nevertheless, even the harshest critics of economic liberalization are unlikely to conclude that privatization is a categorical threat to development. Few would deny that the private sector has an extremely important role to play in development, and that the state is not necessarily the best provider of all goods and services. The key question, then, is how the provision of services, whether public or private, can be better designed and managed in order to better serve development goals, such as alleviating poverty and promoting social equity.

Heated resistance to GATS among many civil society groups stems not from a categorical rejection of the role of the private sector, but from the perception that multi-

lateral trade rules threaten to impose a single model of corporate-led development upon all WTO members. Even more fundamental are concerns about democracy and national sovereignty. There is increasing concern that the form and content of liberalization in developing countries is largely determined by external lending institutions, which serve the interests of those countries that shape the agenda at the WTO.

The fear is that subjecting the choice and governance of privatization to WTO rules will result in a double standard that harms poor countries. Rich countries that can best “afford” the costs of liberalization, in terms of adjusting quickly and compensating losers, maintain protection and government regulation wherever it is politically convenient. Examples of this double standard under WTO rules include the application of agricultural tariffs and subsidies, textile quotas, export subsidies for the high-tech sector (which are often misleadingly represented as public research and development programs for space exploration, national defense, and health care), and restrictions on the migration of workers. Indeed, a recent and embarrassing instance of double standards concerns privatization. In response to outcries from their citizens, the European Union countries have categorically rejected accepting any “requests” to open up essential services under GATS negotiations, while at the same time making precisely such requests to developing countries.

Proponents of privatization in general, and GATS in particular, have maintained their support of these policies by drawing attention to the dismal state of government-provided services throughout the developing world. No one can deny that enormous numbers of people lack access to even the most basic services. The costs of these failures go beyond the immiseration of the poor. Services are the largest part of the economy in all but the poorest countries. Inefficiencies in service sectors thus thwart economic growth and restrict opportunities in other productive sectors that depend on good services. Moreover, calls for protection often provide political cover for rent-seekers striving to protect their wealth.

Pragmatic advocates of privatization argue, in effect, that perfection shouldn't be the enemy of improvement. While they acknowledge that privatization can be messy, nontransparent, and subject to some market failures, they stress its dynamic benefits. Over time, they argue, countries can develop their potential to promote competition and implement regulation. Without privatization, however, corrupt and incompetent governments will continue to deliver failing services indefinitely. Despite its flaws, then, privatization is still preferable to leaving matters in the hands of states that often appear incapable or unwilling to serve the public interest.

The issue of organized labor is especially divisive in the context of privatization. Critics of government services, particularly those suspicious of unions, routinely argue that public utility employment functions primarily as a patronage mechanism. They maintain that job reductions resulting from privatization may not only improve productivity, but also promote public welfare by freeing up scarce resources. However, this argument is bitterly contested by trade unions, as well as citizen advocates and some academics, who maintain that massive layoffs in public sector employment have led to the deterioration of services. The assertion that downsizing the public workforce increases service efficiency, they argue, is simply unwarranted.

The diverse and contending views presented here reflect the discord among participants at the dialogue itself, as well as the significant disagreement across many of the institutions involved in privatization and GATS debates. It seems rather unlikely that either free trade advocates, including those in the multilateral institutions, or civil society skeptics will change their minds in a dramatic way. Nevertheless, we hope that careful consideration of the broad range of views represented in this report will both promote further debate and help to inform policymakers.

We would especially like to thank the UN Financing for Development Office, DESA, for cooperation in organizing the forum; Tim Kessler from the Citizens' Network on Essential Services for his careful and thoughtful preparation of this report; Frank Schroeder for his help in conceiving and organizing the forum; and Geoffrey G. O'Brien, Morgan Stoffregen, and Lydia Tomitova for their skilful assistance with editing.

—*Manfred Bardeleben and Christian Barry*

## **Part I: Perspectives on Private and Public Provision of Services in Developing Countries**

### **Why Is Privatization So Controversial?<sup>1</sup>**

Privatization is a relatively new phenomenon. From the end of World War II through the end of the 1970s, the world saw an expansion of the public sector. Some of the reasons were political: in the aftermath of the Great Depression and the devastation of war, public ownership of the means of production was considered necessary for ensuring social protection and the provision of basic needs. In addition, the notion that public investment contributed to full employment enjoyed a great deal of public support.

Public ownership was also endorsed by economic analysis. In cases of natural monopoly, such as a water system or electrical grid, economists argued that private firms would extract rents through high prices and neglect poor consumers who were unable to pay. There were also concerns over negative externalities resulting from profit-maximizing behavior and from environmental damage to consumer safety. Generally speaking, Europe dealt with the problem of market failure through direct public ownership in contrast to the United States, which used adversarial government regulation of the private sector.

The 1980s, dominated by the doctrines promoted by Ronald Reagan and Margaret Thatcher, saw the rise of privatization, especially of public services. One reason for this development was dissatisfaction with government-provided services, many of which were regarded as inefficient, bureaucratic, and unresponsive to consumers. Moreover, loss-making services caused serious problems for the domestic economy. In addition, technological changes began to allow for real competition in some traditionally monopolistic sectors, especially telecommunications. A common slogan of market advocates was “public provision, but not public production.” Under this new vision, public services were outsourced to private firms that competed for contracts, while the state assumed the role of monitor and regulator.

Defenders of government-provided services have long argued that the economic justifications for privatization masked an aggressive political agenda that promoted corporate interests and eroded the power of organized labor. They argue that as governments cut budgets for public services, the quality and reputation of those services suffered. (Public sector unions are fond of calling this process “defund, defame, and privatize.”) As a result, consumers came to favor private alternatives. In many cases, however, these private providers neglected vulnerable consumers, charged much higher prices, or further contributed to the diminishing of public budgets through obtaining tax breaks, incentives, and even government bailouts.

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<sup>1</sup> This section is based primarily on the paper, “The Economics of Privatization,” presented by Tom Palley, Director, Globalization Reform Project, Open Society Institute.



### *Divergent Perceptions of Privatization*

Many economists, especially those employed by multilateral lending institutions, have a positive view of privatization. They also have data to back it up. For example, economists that have examined network industries in Latin America, including water, electricity, and telecommunications, find that privatization has a positive effect on profitability, labor productivity, the growth of firms, and their market valuation. In addition, evidence suggests that privatization is good for household welfare, generating more connections, shorter waiting periods, and, in some cases, even lower prices. Finally, privatization is viewed as providing macroeconomic benefits: in addition to lump sum revenues gained through sale, taking a loss-making public enterprise off the books improves overall fiscal discipline.

Notwithstanding these data, public opinion about privatization is quite negative, and becoming more so. A Latinobarómetro survey of seven Latin American countries—including the region's three largest—asks people to respond to the statement, "The privatization of state companies has been beneficial to the country." In 1998, somewhat less than half of respondents disagreed (or strongly disagreed). Just two years later, well *over* half disagreed. In particular, countries associated with deeper liberalization showed the highest increase in public dissatisfaction with privatization: in Mexico, from 39% to 56%, in Chile from 41% to 58%, and in Argentina from 49% to 68%.

How can this growing dissatisfaction be explained? According to privatization advocates, this is a clear case of public misperception. The Inter-American Development Bank Research Department reported that "the [privatization] boom is viewed as a bust by the majority of Latin Americans. As these numbers show, there appears to be a gap between perception and reality. Hopefully better communication of the benefits of privatization can narrow this gap."<sup>2</sup> Straying somewhat from the usual "rational actor" model that drives most economic analysis, the conclusion seems to suggest that people don't know what's good for them.

### *The Darker Side of Privatization*

The survey data become much less puzzling when short-term problems of privatization are taken into account. For example, many perceive the privatization process itself as unfair, involving corrupt officials selling off the country's crown jewels on the cheap. Because a tiny minority now controls these important assets, inequality increases and becomes more visible to the public, and the distribution of power tilts sharply toward the new owners. Privatization is also associated with job losses and weakened trade unions. In addition, when well-paid public sector jobs in basic services are eliminated through privatization, part of the economy moves underground.

Claims of improved productivity and quality under private provision can also be called into question. In telecommunications, for example, gains in efficiency often

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<sup>2</sup> Inter-American Development Bank Research Department, "The Privatization Boom in Latin America," *Latin America Economic Policies* 18 (2002), p. 2; available at [www.iadb.org/res/publications/pubfiles/pubN-18-2002.pdf](http://www.iadb.org/res/publications/pubfiles/pubN-18-2002.pdf).

disproportionately benefit the wealthy since international calls become cheaper while fixed rates increase. Indeed, improvements in the quality of services may be largely irrelevant to the poor, who simply want access to a basic service at an affordable price. Moreover, while ending illicit consumption is an unambiguous success story from a profit-making perspective, it can bring significant social costs, since there is often no alternative for people who are suddenly cut off from unauthorized connections. With regard to social services such as health care and education, claims about greater efficiency must be assessed with great caution. There is considerable evidence that privatization often does not provide real cost savings for equivalent service, but instead increases prices for consumers, or provides an inferior or more limited service. In the United States and Canada, for instance, privatization of public services during the 1980s and 1990s often produced little cost savings and no quality improvement.<sup>3</sup> In Latin America, the privatization of telephone, electricity, and water utilities has produced widely varying outcomes for residential, commercial, and industrial users.<sup>4</sup>

In addition to these short-term concerns, privatization is often characterized by a number of longer-term and structural shortcomings. Claims that privatization leads to macroeconomic discipline are vastly overstated.<sup>5</sup> Sudden capital inflows can cause currencies to appreciate, making the economy less competitive over time and leading to increased trade deficits. Moreover, governments do not always use one-time revenue gains “rationally,” but rather increase spending to create an unsustainable public deficit.

The international lending institutions often seek to transfer the “U.S. model” of private service provision to developing countries. In this model, a well-funded, highly professional, and autonomous regulator closely monitors the behavior of firms and ensures they comply with rules to protect public welfare. (Other private provision models tend to rely more on cooperation and negotiation between the regulator and the firms.) However, in most of these countries, the administrative capacity for regulating private firms is lacking. (And, as the recent experiences with California’s energy sector and the Northeast blackout suggest, this problem is not limited to developing countries.) Moreover, in small countries, a limited domestic market makes competition in some sectors unlikely. Where domestic producers lack technical expertise, they are unable to create the kind of dynamic, deregulated industry envisioned by market enthusiasts.

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<sup>3</sup> Elliot Sclar, *You Don’t Always Get What You Pay For: The Economics of Privatization* (Ithaca: Cornell University Press, 2001), chs. 2–4.

<sup>4</sup> Santiago M. Pinto and Huberto M. Ennis, “Privatization and Income Distribution in Argentina” (paper prepared for the project “The Effects of Privatization on Income Distribution in Latin America,” Inter-American Development Bank, November 29, 2002); available at [www.cgdev.org/events/privatization/EnnisPinto\\_Argentina\\_paper.pdf](http://www.cgdev.org/events/privatization/EnnisPinto_Argentina_paper.pdf).

<sup>5</sup> For instance, there were no improvements in the structural budget deficits in Argentina, Brazil, or Bolivia (at least judged by the IMF’s claims that recent crises in these countries are due to fiscal irresponsibility). Furthermore, if privatization does, in fact, contribute to macroeconomic discipline, one would expect that the governments that have undertaken the most extensive privatization would have the best fiscal discipline—a claim that even a casual look at Latin America and Eastern Europe would dismiss.

Skeptics have also illustrated the “privatization paradox.” Privatization is claimed to be necessary because governments are incompetent or corrupt—or both. Yet successful private provision of basic public services depends on highly capable, properly funded, neutral regulators. Somehow, these important public servants must be found in precisely the same backward and unaccountable government that could not deliver services in the first place.

Another systemic limitation of privatization is that it lacks, almost by definition, a social redistribution dimension. Public service subsidies—especially cross-subsidies, through which wealthier consumers help to cover costs for the poor—have been important mechanisms for ensuring basic necessities for citizens of all income levels. Public sector jobs have also provided adequate and stable incomes that support extended families. Privatization can therefore lead to regressive social redistribution.

Finally, privatization appears to be faltering even where the economic justification has been the strongest: capital investment. The surge in privatization during the 1990s was an impressive result of plentiful capital, but is probably not a sustainable condition. The world is currently mired in a relatively lengthy economic downturn, which does not bode well for investment in infrastructure. While investment needs for this decade will only become larger as populations and major urban centers continue to grow, industry may soon find itself starved for funds. Particularly in the area of water, where private ventures have turned into financial and political disasters, multinational firms have been scaling back their investment plans. The head of SAUR, a transnational water firm, has publicly stated that privatized water in developing countries will work only through generous corporate subsidies.

Multilateral lenders thus face an awkward policy problem: how to support privatization in the absence of private companies. They have responded by creating a panoply of new mechanisms to provide corporations with guarantees and subsidies that ensure profitability. Indeed, the World Panel on Financing Water Infrastructure, headed by former IMF managing director Michel Camdessus, recently concluded that private financing of water required much greater use of such mechanisms.<sup>6</sup> The situation is ironic: the world’s foremost defenders of markets using governmental organizations to create incentives that distort existing markets.

Multilateral institutions defend the use of such mechanisms by claiming that they reduce poverty and protect public health. It remains unclear, however, whether private firms—now using scarce public resources—are the most appropriate organizations to achieve these goals. Some critics have identified what appears to be an ideologically based double standard in development assistance: multilateral lenders regard public subsidies for infrastructure services as bad policy that erodes budgets for more legitimate social priorities. Yet these same institutions promote subsidies—as well as potentially costly public guarantees—when they are associated with private provision.

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<sup>6</sup> James Winpenny, “Financing Water for All” (report of the World Panel on Financing Water Infrastructure, March 2003); available at [www.gwpforum.org/gwp/library/FinPanRep.MainRep.pdf](http://www.gwpforum.org/gwp/library/FinPanRep.MainRep.pdf).

The debate over financing mechanisms has important implications for the policy of cost recovery, which is frequently advocated by multilateral institutions as the only way to run utilities on a sustainable basis. When user fees (and external aid) are not sufficient to cover operation, maintenance, and investment costs, the only alternative is tax revenue. But providing subsidies through general taxes can be a reasonable policy if the revenues are channeled back to the public, not to private companies. If access to safe water does not merit budgetary resources, what does? Moreover, given the reluctance of large water firms to invest in poor areas without significant financial incentives, bringing water to low-income people will require public subsidies in some form or another.

#### Focus 1: Common Pitfalls of Privatization\*

*Lack of competition.* An obvious problem with privatizing infrastructure services is that these are usually natural monopolies. Promises of superior private provision are largely based on the benefits of competition. When the service in question is a single water system or electrical grid, these considerations become meaningless. Indeed, privatization of such services typically transfers public monopolies into private hands. Because of profit-maximization and uncertainty, providers demand considerable flexibility in setting tariffs. Moreover, even bidding itself is uncompetitive. In water, a small cartel shares the market for exclusive contracts that can last up to 30 years.

*Cherry-picking.* Customers must be profitable for private provision to work. When private providers win long-term contracts, they have incentives to ignore lower-income users who cannot afford commercially priced services. In Ghana, a private water company actually redrew its service boundaries to exclude the poor. This leaves the government to provide services to the poor, invariably with insufficient resources, or to pay firms to provide affordably priced services. But this begs the question: Why use scarce government resources to subsidize private profits?

*Corruption.* To secure long-term profit opportunities, private firms routinely engage in bribery and collusion. Suez and Vivendi (now Veolia), the two largest water firms, have a long rap sheet of corruption in numerous countries. Even the World Bank has admitted that transnational firms headquartered abroad are more likely than other firms to pay public procurement kickbacks.† Moreover, while a transparent and accountable bidding process is essential, corrupt governments routinely preside over rigged auctions. As a result, many in the global South believe that their own governments often give preferential treatment to foreign companies because benefits go to economic elites, to whom they are politically responsive.

*Shifting risk.* Private provision is supposed to shift risk away from governments and onto firms. In practice, it works the other way around. Many contracts include a guaranteed rate of return. Companies entering uncertain economic environments routinely demand protection from fluctuations in currency and local demand. In the energy sector, power-purchasing agreements commit government utilities to pay for 100% of private production in hard currency, regardless of changes in the exchange rate or level of use. Such contracts have plunged huge utilities to the brink of financial collapse. The World Bank supports this trend by expanding the use of commercial and sovereign guarantees to induce private companies to invest in public services. In one remarkable episode, the Multilateral Investment Guarantee Agency (MIGA), the World Bank's investment guarantee division, reimbursed Enron \$15 million after the government of Indonesia pulled out of an energy deal following the 1997 financial crisis and massive devaluation. While recognizing the unviability of the project under severe economic depression, MIGA's general counsel stated that "international law dictated that the cancellation be compensated." Indonesia's taxpayers then had to pay back this penalty to MIGA.

*Contracts and volatility.* Contrary to naive portrayals, privatization contracts are not one-time events that commit companies to strict standards of performance. They are evolving relationships that change with events and circumstances, and are constantly being renegotiated. In this process,

governments—and citizens—often find themselves at a great disadvantage, for several reasons. First, they lack information that large and sophisticated firms possess. Second, multinational companies can use political connections or bribery to secure regulatory decisions that reflect their demands to increase tariffs or alter performance requirements. Finally, there are serious risks for terminating contracts. When governments have inadequate alternatives available on short notice, they are more likely to cede to corporate demands.

\* Drawn from the paper, “Private Problems, Public Solutions,” presented by David Hall, Public Services International Research Unit.

† Joel Hellman, Greaint Jones, and Daniel Kaufmann, “Are Foreign Investors and Multinationals Engaging in Corrupt Practices in Transition Economies?” *Transition* (May/June/July 2000), p. 5; available at [www.worldbank.org/wbi/governance/pdf/fdi\\_trans\\_o800.pdf](http://www.worldbank.org/wbi/governance/pdf/fdi_trans_o800.pdf).

### *The Challenge: Perfecting Markets . . . and Governments*

Despite the pitfalls highlighted above, privatization should not be rejected as a legitimate option for reform. Indeed, it can make good sense for private industries in competitive sectors, which may be the majority of a country’s firms. Especially when barriers to entry are low and competition is feasible, private provision can be preferable to public provision. Even for these sectors, however, it can be very hard to make privatization work in developing countries. If public regulation does not prevent collusion and monopolistic behavior, private provision can degenerate into a rent-seeking racket every bit as corrosive as government corruption itself.

Privatization is less suited to network industries and basic social services. Gains in productivity and quality are more than offset by losses in equity and poverty reduction, while corruption and the creation of an economic oligarchy have been the rule, not the exception, throughout the global South. The challenge, then, is to improve public production. This will require the generation of adequate resources and innovative approaches in improving accountability to citizens.

### **The Record of Privatization in the Global South<sup>7</sup>**

One of the most pervasive myths about services in developing countries is that there is a public sector monopoly. The truth is that many of the poor are denied public service, and must resort to either self-provision or privately provided substitutes. These are typically of poorer quality and/or more expensive than publicly provided goods. While people without access to publicly provided services tend to be the poorest, they also pay higher per unit prices than those with access.

Why has the public sector failed to extend services to everyone? A central reason is the gap in financing. Governments often use profits from lucrative services—public telecommunications, for instance—to subsidize loss-making services such as water and energy. In developing countries, natural gas revenues cover about 80% of operating and maintenance costs, electricity only about 60%, while water revenues cover

<sup>7</sup> This section is based primarily on the paper, “The Private Provision of Infrastructure: Impacts and Evidence,” presented by Clive Harris, Manager, Private Sector Advisory Services, World Bank.

barely one-third of costs. According to the 2004 *World Development Report*, in the early 1990s mispriced services cost developing countries \$123 billion annually, while technical inefficiency cost \$55 billion.

There is no evidence that public providers have a better record than private ones in serving the poor. This arises partly from basic inefficiencies in the public model: for example, in Delhi, a lot of electricity is stolen. Yet most of the theft is perpetrated by industry, not poor people. A politically convenient myth is that electricity boards do not collect bills because the users are small farmers trying to get by. In reality, the agriculture sector uses relatively little electricity, while manufacturers use a great deal. Public enterprises often don't act in the public interest.

Another common misperception in the privatization debate is that keeping services public solves the problem of regulation. Privatization skeptics are right to argue that privatizing without proper regulation might produce bad outcomes. Yet in cases of natural monopoly, these concerns remain, *regardless* of whether the service is delivered publicly or privately. Moreover, governmental self-regulation can create deep conflicts of interest.

One way or another, effective regulation is necessary. The World Bank has created regional forums to address this need. Regulatory capacity can often be increased through training programs, technical assistance, or the development of professional standards. In other cases, regulation can be contracted out to third parties. While effective regulatory capacity cannot be created overnight, this should not serve as a justification to retain public provision, which is often regulated incompetently and controlled by officials with political and financial incentives to ignore the public interests.

### ***Impacts of Private Provision***

Most arguments about the performance of privatized firms relate to employment, price, quality, and access. Fewer arguments relate to technical efficiency. In general, data suggest that when performance risk can be shifted to the private sector, the results of private provision are superior to those of public provision.

Making private provision deliver results, however, depends on creating the right incentives and options. For example, poorly designed contracts—such as those adopting high connection fees—can discourage access, especially for the poorest users. In addition, an overemphasis on improving quality can provide disproportionate benefits for the middle class, and mean little to users who lack sufficient income to pay for better services. Options that reduce cost—for example, condominal sanitation—may be less attractive to more affluent users, but can provide adequate service to populations that have long been deprived of any access. While both public and private providers can potentially come up with such alternatives, the public sector has not shown much interest in innovation.

While access is more urgent than quality for achieving poverty reduction, private provision has resulted in significant service improvements that include the poor. Certain improvements, such as stronger water pressure and longer hours of availability, make life easier or free up time for productive or leisure activities, especially for women and girls. One study in Argentina documents a drop from 9% to 5% in child

deaths in water-borne illness in municipalities that have switched to private provision.<sup>8</sup> These impacts are greatest in the poorest areas.

The impact of privatization on price varies significantly. While increases are not inevitable, in many cases subsidy levels have been so high that increased prices are required in order to finance more investment. In other cases, prices have actually dropped. One study found that five of ten cases of private provision in Latin America in the utilities sectors resulted in price decreases.<sup>9</sup>

### *Prices and the Poor*

It is generally agreed that prices should not be so high as to exclude the poor. This applies to all basic services, regardless of who delivers them. Traditionally, governments have sought to finance poor people's connections through cross-subsidies—especially through higher prices for industry. However, when large users can opt out of the system in search of cheaper substitutes, this strategy is not sustainable.

While there is a wide variety of pro-poor interventions, experience shows that even well-intentioned interventions can be poorly implemented or result in negative unintended consequences. For example, increasing bloc tariffs for water usage—in which price per unit increases at higher consumption levels—can hurt households with shared connections. Similarly, lifeline electricity tariffs, which are intended to ensure service for the poor, are typically set so high that the middle class enjoys most of the benefits. In order to make targeted interventions benefit the poor, it is important to have a better understanding of poor people's present level of access, as well as their preferences in terms of service options.

Many effective pro-poor interventions simply allow for greater flexibility in the delivery of services. For example, allowing small-scale providers entry into the market can generate competition and encourage entrepreneurs to cater to lower-income customers. In addition, allowing for different levels of services can help to stimulate appropriate and affordable technologies in poor areas. Access for the poor can be promoted through several kinds of interventions. "Smoothing" connection payments, such as through installment plans, can help poor users to pay for large lump sum investments. Promoting investments that utilize consumers' own labor can also cut the costs of connections. In addition, private concession contracts can include explicit connection targets. In terms of using aid to promote access, subsidizing connections is a direct way to increase coverage, but should be adopted only when performance risk is shifted to the operator.

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<sup>8</sup> Sebastian Galiani, Paul Gertler, and Ernesto Schargrodsky, "Water for Life: The Impact of the Privatization of Water Services on Child Mortality" (paper presented at the conference "Spatial Inequality and Development," London School of Economics, London, June 28–30, 2002); available at [www.wider.unu.edu/conference/conference-2002-5/conference-2002-5-papers/galiani-gertler-schargrodsky.pdf](http://www.wider.unu.edu/conference/conference-2002-5/conference-2002-5-papers/galiani-gertler-schargrodsky.pdf).

<sup>9</sup> David McKenzie and Dilip Mookherjee, "Distributive Impact of Privatization in Latin America: An Overview of Evidence from Four Countries" (paper prepared for the Inter-American Development Bank and Universidad de las Américas-Puebla, October 31, 2002); available at [www.stanford.edu/~mcken.idbover.pdf](http://www.stanford.edu/~mcken.idbover.pdf).

### *The Challenge Ahead*

The significance of effectively reforming the delivery of public services cannot be overstated. Over a billion people currently lack access to safe water. Improved access to modern infrastructure will help to achieve higher economic growth, improved health, and increased access to education (for instance, many girls from low-income families cannot attend school because they walk long distances to transport water).

Whether public or private, essential service providers cannot do an effective job without being financially viable. Private investment in infrastructure has been declining since its peak in 1996. While the public sector will continue to provide the bulk of infrastructure financing, it cannot do its job if services are financially unsustainable. In terms of covering costs, what is needed is the right combination of user fees and general tax revenues to pay for operation, maintenance, and expansion. In terms of assigning responsibility for delivering services, the task at hand is to determine where the private sector can take on costs by itself, and how it can assume risks that are currently borne by the government.

### **Why Public Services?<sup>10</sup>**

Privatization advocates paint a bleak picture of the public sector, portraying government-provided services as dismal failures that deny access to the poor, operate inefficiently, and reward rent-seeking politicians, labor groups, and other special interests. Yet developed and developing countries alike continue to rely on the public sector to provide the majority of basic services.

Despite arguments that private providers deliver services more effectively, the public sector is often preferable for many reasons. First, governments can have cost advantages; the costs of capital are usually lower, since loans are ultimately guaranteed by tax receipts and are therefore considered low risk. Lower profit requirements also allow for lower pricing. In addition, governments may be more likely to ensure competitive tender (and therefore lowest prices) in construction projects, since they do not distribute contracts to subsidiaries, as multinationals routinely do. While accountability has been a serious problem in both public and private provision, the potential for improving it is greater when governments provide services because political leaders respond to citizen demands and votes, while corporate leaders respond only to shareholders. Moreover, when the service in question is a monopoly, governments have no incentive to engage in monopolistic pricing—they are not profit-maximizing organizations and their goal is to secure wide political support, which would only be undermined by charging excessive prices.

Finally, the public sector promotes social solidarity in a way that companies cannot. For example, through cross-subsidies and lifeline tariffs, governments can ensure that all people have access to basic services, regardless of income level. Critics may respond that the failure of governments to do precisely this justifies private provi-

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<sup>10</sup> This section is based on the paper, “Private Problems, Public Solutions,” presented by David Hall, Director, Public Services International Research Unit (PSIRU).



sion. But the awkward fact remains that, regardless of who supplies the service, only an accountable government concerned with equity can create distributional arrangements that promote social solidarity.

While systematic data are unavailable, several telling comparisons reveal the weakness of the argument that government services perform worse than private ones. For example, in France, public water service is 15% cheaper than private water service. In a comparison of five countries with public (U.S., Japan, and the Netherlands) and private (France, England) water provision, the number of utility staff per 1,000 connections is considerably lower in public countries than private ones. Moreover, the level of “unaccounted for” water is far higher in the private-provision countries.

There are also examples of highly successful public programs to extend the number of connections. For example, in São Paulo, Brazil, the public utility SABESP increased water connections from 4 million to 5 million between 1994 and 1998, and sewage connections from 2.8 million to 3.6 million during the same period. Even in the area of revenue collection, where private providers might be supposed to have greater incentives, the public sector has proven itself highly innovative and capable. While many point to the 95% revenue collection rate achieved by the privately controlled Aguas Argentinas, similar improvements have been achieved by public utilities in Trinidad, Burkina Faso, and Honduras. In Trinidad, the public utility WASA doubled revenue in 1995 compared to 1994. In Burkina Faso, the public utility ONEA used computer upgrades and monthly meter reading to achieve 95% collection rates in the 1990s. In Honduras, the 1994 restructuring of the utility SANAA included decentralized management, computerized billing, and increased tariffs (hence revenue). These reforms led to a reduction in leaks and more reliable water service for most users.

### *Improving Public Provision*

Indeed, many of the benefits of privatization can be achieved through the corporatization of public enterprises, increasing transparency and accountability, and upgrading technology.

Greater international cooperation can become an important stimulus for improving public sector performance. Recent experience with capacity building through “twinning” has shown how well-established public sector companies can assist those seeking to become more efficient with technical and managerial support. The building of “public-public partnerships” promotes global solidarity among government organizations and a collective international commitment to outcomes.<sup>11</sup>

Government, of course, does not always perform better than companies. However, by relying on innovations such as computerization, decentralization, and internal organizational incentives, government organizations can become as nimble and responsive as the most efficient companies. The most important question, then, is not whether private or public provision is superior, but rather which kinds of reforms will be feasible and sustainable over the long run.

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<sup>11</sup> David Hall, “Water Partnerships: Public-public Partnerships and ‘Twinning’ in Water and Sanitation” (PSIRU Report, University of Greenwich, U.K., July 2000); available at [www.psiru.org/reports/2000-07-W-PUPs.doc](http://www.psiru.org/reports/2000-07-W-PUPs.doc).

## De-linking Service Provision from Universal Problems<sup>12</sup>

In many cases the challenges facing public and private providers are quite similar, if not identical. Many solutions associated with private provision could be applied to government-provided service as well, and vice versa. Several issues that emerged from the conference could be addressed more effectively if they were decoupled from the more politically divisive issue of provider competence.

*Private financing.* When services lack investment, they deteriorate. Adequate financing is essential for providing good services, especially for large investments common in infrastructure, and for upgrading technology. There have been great innovations in private capital markets, including municipal bonds, securitization, and loan guarantees. These instruments can be used to let more capital flow to both the private and public sector. Just as public financing does not automatically necessitate public delivery, neither does tapping private financial markets for long-term investment require privatization or contracting-out.

*Subsidies.* Most agree that some form of subsidy should be used to ensure that the poor are not excluded from basic services. Two well-documented problems with subsidies relate to feasibility and politics. First, targeted subsidies in particular can be administratively complex and require significant resources to implement. Inaccurate information about users can lead to exclusion of the poor and inclusion of the non-poor. Second, subsidies are often designed to benefit the middle class. For example, income levels required to qualify for lifeline tariffs for electricity can be set so high that even well-off households do not benefit from them.

*Regulation.* Both publicly and privately-delivered services require regulation. In many cases, governments may not have either the capacity or political will to regulate any provider, whether public or private. In such circumstances it is important to ask what kind of regulatory capacity can be created in the short term, and how sustainable that regulatory capacity will be over time.

*Corruption.* Advocates of both public and private provision of services tend to invoke the problem of corruption in justifying their stance. Privatization is notorious for inducing bribery and benefiting politically well-connected elites. Yet public organizations also often engage in rent-seeking behavior that is pernicious and deeply entrenched. There is growing consensus that the keys to fighting corruption, regardless of the service provider, are promoting greater transparency and ensuring that citizens play an active role in monitoring the provider.

### ***Recent Initiatives***

Recent initiatives to enable citizens to play a more active monitoring role in both public and private provision of service include the World Bank's Report Card and its Participatory Public Expenditure Review as well as NGO-led initiatives. According to the World Bank,

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<sup>12</sup> Analysis provided by Tim Kessler, Citizens' Network on Essential Services.

Report Cards are instruments to exact public accountability. Modeled on a private sector practice of conducting client satisfaction surveys, report cards solicit user perceptions on the quality, efficiency, and adequacy of the various public services that are funded by taxpayers. Qualitative user opinions are aggregated to create a 'score card' that rates the performance of service providers. The findings present a quantitative measure of overall satisfaction and perceived levels of corruption among an array of other indicators. By systematically gathering and disseminating public feedback, report cards can serve as a "surrogate for competition" for monopolies—usually government owned—that lack the incentive to be as responsive as the private enterprises to their client's needs.<sup>13</sup>

Recent case studies include the *Filipino Report Card on Pro-Poor Services*<sup>14</sup> and *Benchmarking Urban Services: The Second Report on Public Services in Bangalore*.<sup>15</sup>

The Bank's Participatory Public Expenditure Review is a tool described in the organization's "A User's Guide to Poverty and Social Impact Analysis," a compilation of techniques to be used for *ex ante* analysis and design of adjustment lending operations. Since these two initiatives are relatively new, it is difficult to assess their impact thus far.

These initiatives also include the participatory budgeting process of Porto Alegre, Brazil, which directly involves citizens in the budget-making process. Although the process does not involve the monitoring of service performance itself, it contributes to priority-setting as to which public services to fund and how much. The Porto Alegre model has been studied by numerous local governments, and the multilateral lenders are financing initiatives to replicate it among other borrowing countries. It is cited as "best practice" by UNESCO.<sup>16</sup>

Furthermore, NGOs have made efforts to involve entire communities in the monitoring and governance of service delivery. Organizations such as Water Aid in the U.K. have been doing participatory water projects for years. Specific cases of community-centered water projects include water services in the township of Savelugu, Ghana, and the provision of community water taps in low-income communities in Dhaka, Bangladesh (a project run by the NGO Dushthya Shasthya Kendra). Evidence of the social impact of such initiatives is extremely positive.<sup>17</sup>

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<sup>13</sup> Swamim Waglé and Parmesh Shah, "Report Cards: A General Note on Methodology," World Bank, p. 1; available at [www.worldbank.org/participation/webfiles/NoteCARDS.pdf](http://www.worldbank.org/participation/webfiles/NoteCARDS.pdf).

<sup>14</sup> World Bank, *Filipino Report Card on Pro-Poor Services*, Report No. 22181-PH; summary available at [www.worldbank.org/participation/FilipinoReportCard-Summary.pdf](http://www.worldbank.org/participation/FilipinoReportCard-Summary.pdf).

<sup>15</sup> Samuel Paul and Sita Sekhar, *Benchmarking Urban Services: The Second Report on Public Services in Bangalore* (Bangalore: Public Affairs Centre, 2000).

<sup>16</sup> William W. Goldsmith, "Participatory Budgeting in Porto Alegre, Brazil," *PN Magazine* (March/April 2000); available at [www.plannersnetwork.org/htm/pub/archives/140/goldsmith.htm](http://www.plannersnetwork.org/htm/pub/archives/140/goldsmith.htm).

<sup>17</sup> Both of these will be described in an upcoming collection of public sector reform case studies commissioned by the Commonwealth Foundation.

## Part II: The Impact of GATS on Social Services

### The Link between Privatization and GATS<sup>17</sup>

Part I of the dialogue focused on the conceptual and empirical issues concerning the economic impacts of privatization. Part II will address the institutional mechanisms through which private provision is promoted and controlled, by focusing on two *political* questions: First, how does GATS affect the ability of governments to pursue social and developmental objectives? Second, what pressures are pushing developing countries into institutional arrangements that promote foreign participation in key service sectors?

The link between privatization and GATS is a highly contested issue. On the one hand, GATS does not force any country to privatize services. Any WTO member is free to keep any service sector closed. On the other hand, the stated purpose of GATS is the “progressive liberalization” of services, and national commitments to include new sectors under GATS expand and protect private provision of services by foreign corporations.

According to its advocates, GATS is a transparent and flexible institutional mechanism that promotes efficiency and reduces opportunities for rent-seeking. Even many who are critical of privatization of services support GATS, arguing that it preserves the government’s ability to regulate socially sensitive sectors while bringing the benefits of foreign capital and expertise to developing economies. Critics of GATS, however, question the real extent of the flexibility that countries have to shape or even exclude themselves from GATS provisions in the most basic public services. To the extent that private provision expands in services under GATS disciplines, these critics argue that there is insufficient room for modifying commitments, much less reversing them.

### *Background of GATS*

In order to situate the debate over the impact of GATS on private provision of services, it is helpful to understand the Agreement’s basic purpose and provisions.<sup>18</sup>

GATS went into effect as part of the World Trade Organization on January 1, 1995. Its purpose is the progressive liberalization of trade in services under four distinct “modes”:

- *Cross-border supply*. Ability of nonresidents to supply services within another member’s territory.
- *Consumption abroad*. Freedom to purchase services in the territory of another member.

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<sup>17</sup> Background is provided by Tim Kessler, Citizens’ Network on Essential Services.

<sup>18</sup> Information about GATS provisions is adapted from Scott Sinclair and Jim Grieshaber-Otto, *Facing the Facts: A Guide to the GATS Debate* (Ottawa: Canadian Centre for Policy Alternatives, 2002); available at [www.policyalternatives.ca/publications/facing-the-facts.pdf](http://www.policyalternatives.ca/publications/facing-the-facts.pdf). Elizabeth Drake contributed important technical clarifications for this section.

- *Commercial presence.* Opportunity for foreign suppliers to establish, operate, or expand a commercial entity in a member's territory, such as a branch, agency, or wholly owned subsidiary.
- *Presence of natural persons.* Permission for entry and temporary stay in the member's territory of foreign individuals in order to supply a service.

The Agreement calls for successive rounds of negotiation to extend GATS coverage into new service sectors, and to specify rules that affect governments' ability to regulate or participate in those sectors. GATS applies to all WTO members who are thus subject to legally binding dispute settlement decisions.

GATS has potentially far-reaching effects, since a wide range of services may fall under its jurisdiction. The Agreement excludes services that are "provided in the exercise of government authority," which means that the service must be provided on *neither* a commercial *nor* a competitive basis. Currently, however, it is difficult to determine the precise scope of the Agreement, since there is a great deal of controversy over these important qualifications.

Once a government has made a commitment under GATS, it can be very hard to reverse. If a government does choose to withdraw from a previous commitment, it must compensate other members whose service suppliers may be adversely affected.

GATS protects foreign service suppliers and investors through several basic rules. Some of these rules apply only when approved by members for specific service sectors.

- *Most favored nation.* A government must extend any regulation or financial measure that benefits one foreign service provider to all foreign providers. Most favored nation (MFN) treatment applies automatically to all sectors unless a member explicitly excludes that sector from the MFN rule.
- *National treatment.* A government must offer "best treatment" of domestic service providers to foreign providers. If competition is altered to favor domestic providers, even as an unintended consequence of promoting domestic social goals, a measure can be ruled as discriminatory. National treatment provisions apply only to sectors in which a country affirmatively lists commitments.
- *Market access.* A government may not restrict the number of service suppliers or employees in a sector, the value of transactions, or the types of legal entities that may supply a service. Like national treatment, market access provisions only apply when a country explicitly makes this commitment in a sector.
- *Monopolies and exclusive providers.* A government may exercise monopoly for a service sector, but can only do so by listing the sector as a country-specific exception. A government that makes commitments in this area cannot use its power in a way that violates MFN, national treatment, or market access commitments.
- *Domestic regulation.* Still under negotiation in Geneva, these provisions could create some form of "necessity test" to be applied to regulations such as professional qualification, technical standards, and licensing procedures. Regulations deter-

mined to pursue nonlegitimate objectives or to be “more trade restrictive than necessary” by a dispute settlement panel would not be permitted.

### **Protecting People, Promoting Development<sup>19</sup>**

Conference panelists from official development organizations were concerned with two related questions about developing country participation in the WTO and GATS. First, how can developing countries best promote their service industries? Second, and more fundamentally, how can the progressive liberalization of trade in services promote social and development objectives? The challenge lies in identifying the conditions under which increased trade and investment in services can promote the interests of developing countries.

One useful way to determine whether and to what extent GATS supports development is to examine the specific components of the Agreement. The principles, rules, and language of GATS provide considerable flexibility for developing countries to pursue their own path to growth and poverty reduction. Features such as the doctrine of the preamble, the capacity building platform (Article IV.1), Negotiation of Specific Commitments (Article XIX), and mandatory provisions relating to progressive liberalization demonstrate a recognition of due respect for national policy objectives, the right of members to promote those objectives through regulation, and the special needs of developing countries.

With respect to the most politically sensitive service sectors—such as water, energy, health care, and education—GATS does not require either privatization or deregulation. For example, WTO member governments are free to impose universal provision regulations that require providers to offer service to low income or geographically remote households. Many proponents of GATS agree with civil society critics about the potentially adverse effects of privatization of essential services, and have distanced themselves from positions that promote private provision. At the same time, they argue that developing countries must assess costs and benefits of continued protection as they negotiate GATS. When protection only serves the interests of rent-seeking groups, society (including the poor) does not benefit. It is important, then, to distinguish between protection of services that has broader social benefits from protection that serves only narrow organized interests. This analysis will help governments to shape their GATS negotiations, since they should be more willing to expose pure rent-seekers to competition, which would benefit consumers through greater choice, better quality, or lower price.

The unfolding of GATS negotiations will have significant impact on developing countries. In particular, the implementation of “development friendly” GATS rules can ensure the policy flexibility needed to respond to changing conditions and information. (See the section, *Preserving Policy Autonomy under GATS*, below.) These include rules on Domestic Regulation (Article VI), Emergency Safeguard Measures (Article X), Government Procurement (Article XIII), and Subsidies (Article XV). Also

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<sup>19</sup> Analysis provided by the author, Tim Kessler, Citizens’ Network on Essential Services.

important is the adoption of mechanisms to implement the capacity building platform (Article IV.1), which includes liberalization of markets and modes of supply with export potential for developing countries, as well as facilitation of service market information. Finally, it is important that negotiations provide for adequate treatment of movement of workers (Mode 4), a key issue for citizens in developing countries who confront immigration restrictions that limit professional opportunities.

### *Market Failure and Social Goals*<sup>20</sup>

A useful point of departure for thinking about the impact of GATS is the failure of the status quo—too many people lack access to essential services. Most would agree that services should be delivered efficiently and equitably. Yet some might argue that there is a trade-off between efficiency and equity. An important question to ask, then, is whether GATS will promote private provision of services at the expense of social equity and poverty reduction.

The market will not necessarily take care of the poor. Private providers are not normally obliged to make society more equitable. In economic terms, even when price equals marginal cost, those without enough income get left behind. This makes progressive and effective regulation necessary. Moreover, research suggests that ownership, whether public or private, has much less impact on the performance of providers than does competition. Accordingly, neither governments nor markets alone will promote both efficiency and equity (although some altruistic providers may do well on both counts); competition and regulation are the main determinants.

In some cases, a well-run public monopoly—such as Canada’s public health system—may best serve the goals of efficiency and equity. In other cases, innovative regulatory mechanisms directed at private service providers offer a more appropriate solution. For example, the Chilean government, operating under the assumption that providers have a natural incentive to overstate costs in poor areas, created an incentive for providers to report true costs. The government awards and renews contracts by comparing prices reported at similar water utilities. Firms that overstate costs therefore run the risk of losing the contract altogether.

Will GATS lead to market failures or help to control them? Could the Agreement prevent the use of innovative regulatory mechanisms that promote both efficiency and equity? Even more importantly, could GATS deprive governments of the ability to pursue pro-poor policies, such as subsidies or universal service requirements?

While the Agreement does limit the scope for implementing regulations, it is not necessarily detrimental to important social and poverty reduction priorities. GATS targets regulations that arbitrarily provide advantages for certain service providers over others. In addition, it does not outlaw subsidies, which are permitted as long as they are provided on a nondiscriminatory basis.

In terms of efficiency, GATS itself does not cause market failures, but current negotiations within the Agreement could contribute to market failures and worsen existing ones. In particular, there is potential for services negotiations to lead to par-

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<sup>20</sup> This section is based primarily on the presentation by Aadiya Mattoo, Lead Economist, World Bank.

tial or poorly sequenced reforms. It is therefore important to ensure that GATS negotiations do not run ahead of necessary institutional conditions, such as appropriate regulatory capacities, that can ensure efficient private sector behavior.

Ensuring that GATS does not increase the risk of market failure requires a better understanding of why successful services perform well. Rushing GATS through the negotiating process without sufficient reflection may lead to the unleashing of perverse market forces that many countries are not prepared to contain. Thus, it is important to have valid generalizations about what works under different conditions, rather than disconnected case studies that support one position or another. At the same time, there is a need for greater development assistance—programs that increase technical and administrative capacity of regulators, as well as resources for strengthening universal access policies—to help countries manage liberalization of services.

#### *Preserving Policy Autonomy under GATS*<sup>21</sup>

GATS contains provisions to help countries maintain policy flexibility and autonomy. The most basic is the right to reject any request to include new sectors under GATS for any reason. GATS also includes mechanisms to develop approaches to regulatory transparency that address the concerns of different countries. In the case of domestic regulation, Article XI allows countries to negotiate consensus over the meaning of “no more burdensome than necessary.” (So far this has been developed only for accounting.)

Some advocates of GATS argue that policy flexibility should be even greater, especially for developing countries. Their proposals focus on institutional innovations. For example, GATS could be amended to enable developing countries to establish safeguards for essential services. If there was evidence of negative social impacts resulting from liberalization, safeguards could allow countries to impose limits on foreign investment on trade in services, or perhaps subsidy arrangements that would be otherwise WTO—inconsistent. This could be permitted through the creation of a general rule that allows countries to violate or reverse a commitment without having to compensate others in certain sectors or under certain extreme circumstances.<sup>22</sup>

#### Focus 2: Multilateralism vs. Bilateralism

*The policy challenge.* One important policy challenge concerns the appropriateness of the WTO as a forum for service sector negotiations. It may be that some problems cannot be solved fairly or effectively in a multilateral forum. For tradable goods, it makes sense that countries choose the coordination of a multilateral forum. Uneven tariff levels among different countries cause distortions that seriously hamper trade. But when it comes to trade in services—which is largely about rules governing foreign investment—why should countries not be able to undertake liberalization

<sup>21</sup> This section is derived from comments made by David Diaz, Erika Mann, and Elizabeth Drake. The author would like to thank Elisabeth Tuerk for offering technical clarifications on several points.

<sup>22</sup> Under existing rules, GATS allows countries to include within specific commitments the right to reverse or amend the commitment under some limited emergency circumstances. The U.S. prefers this sector-by-sector option, which clearly requires more detailed knowledge and analysis from negotiators in developing countries.



bilaterally or even unilaterally? If the liberalization of trade in services is really beneficial to all, then why not pursue it through a bilateral agreement? What specific problem is being solved by a multilateral approach, especially given the many concerns about the virtual irreversibility of making GATS commitments?

*The response.* Trade economists commonly argue that multilateral trade agreements cause the fewest market distortions. Bilateral agreements can still leave domestic service providers with extensive protection that benefits rent-seekers and hurts consumers. A more political rationale addresses power relations. A multilateral forum can help to prevent strong nations from taking advantage of weaker ones. It not only provides a consistent level of transparency about negotiations, but also may allow far more citizen input than bilateral processes. Precisely because the WTO attracts so much attention, much of it critical, multilateral negotiations generate civic activism and circulate information to diverse stakeholders. Bilateral negotiations are more likely to take place in relative obscurity, leaving citizens out of the loop and forcing trade ministries of weaker countries to go it alone.

*The counter-argument.* The degree of transparency in WTO negotiations is limited, with the real deal-making occurring behind closed doors. Moreover, it is naive to suggest that powerful countries cannot threaten or intimidate weak ones in a multilateral venue. For example, by using backdoor channels they can make it known that major concessions will be required in exchange for aid. As for economic outcomes, preventing market distortions may not be as important an objective as building up the domestic sector. Bilateral agreements can help governments to sequence liberalization and improve competitiveness gradually, so that struggling national firms are not suddenly wiped out by an onslaught of foreign corporations.

Another option might be to attach universal service obligations to GATS commitments. These could ensure governments' ability to adopt regulations that promote equity, such as requirements for serving a certain proportion of "unprofitable" or geographically remote customers. Developing countries might also wish to liberalize only certain segments of a market, thereby avoiding total liberalization of a sensitive sector. For example, they may invite foreign participation only for billing or management of electrical grid maintenance. Creating such provisions would not only require enhanced trade negotiating capacity within developing country governments, but also a less rigid negotiating posture among major WTO members.

Opponents of GATS have also focused on the need for greater policy autonomy.<sup>23</sup> Their proposals tend to include more sweeping institutional changes and political action to slow down negotiations. GATS skeptics agree that developing countries should utilize the "no commitments" option in sensitive sectors. However, they note that this is a limited strategy for most developing countries, which are under tremendous pressure to make concessions in order to gain benefits in other WTO negotiations (for example, agriculture, TRIPS). In addition, because negotiations are perpetual and liberalization is "progressive," countries that resist requests today will be under pressure to give in during the next round. Thus, for poor countries that already have too few bargaining chips in trade negotiations, a better approach would simply be a broad and explicit GATS exemption for basic public services.

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<sup>23</sup> For a critical assessment of GATS flexibility, see Peter Hardstaff, "The 'Flexibility' Myth: Why GATS Is a Bad Model for a New WTO Investment Agreement" (paper presented at a seminar on WTO Investment Agreement, Geneva, March 20, 2003); available at [www.wdm.org.uk/cambriefs/wto/flexmyth/flex5.htm](http://www.wdm.org.uk/cambriefs/wto/flexmyth/flex5.htm).

In the short term, developing countries can use a number of tactics to defend their interests in GATS negotiations. They can demand that the WTO conduct a long overdue economic assessment of the impact of liberalizing services. Countries with limited analytical capacity can insist that negotiations be put on hold until all members have more information upon which to base crucial decisions. They can also act collectively to negotiate proposed rules affecting domestic regulation, since coordination may help them to identify and exploit differences between Northern countries. Finally, developing countries can explicitly link GATS to conditions of development assistance that compel countries to liberalize service sectors unilaterally.

It will be no small feat to ensure that the concerns of developing countries will be adequately addressed in ongoing GATS negotiations. In addition to the political disposition of dominant Northern WTO members, the contribution of GATS to development will depend on the capacities of the developing countries themselves. The shape of GATS will be affected by their ability to negotiate effectively, and the effects of liberalization will depend on their success in building supply capacity, physical infrastructure, and strong public institutions. Governments need to reconcile key social policy objectives with economic efficiency and international competitiveness. Striking a balance between these priorities will require Southern governments to exercise good judgment and Northern governments to ensure both market access and flexibility.

### **Myths, Realities, and Potential Threats from GATS**

Trade in services is not an area in which the facts “speak for themselves.” While basing their claims on virtually identical data, both supporters and critics of GATS disagree over the significance and likely effects of the Agreement. What is revealing is not only the arguments used by opposing sides, but also the manner in which they interpret the evidence. This section presents a debate between participants in the dialogue about the effects of GATS on policies and people.

#### *Myths and Realities about GATS*<sup>24</sup>

A strong anti-GATS coalition has been formed by a number of transnational NGOs that view the Agreement as a threat to development. They are currently mounting campaigns and using listserves to distribute information that frightens citizen groups about the impact of extending the Agreement in the Doha Round. The anti-GATS coalition focuses especially on countries in the global South. WTO officials, national negotiators, and many private observers view this campaign as misinformed and inaccurate, arguing that it either ignores the elements of the Agreement that preserve policy flexibility or interprets them in the most sinister manner possible.

Yet transnational NGOs are not alone in their concern regarding the impact of GATS on developing countries. Citizens and leaders from developing countries have expressed concern that GATS will limit governments’ ability to control foreign direct

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<sup>24</sup> This section is based on the presentation by Richard Self, former U.S. Deputy Assistant Trade Representative for Services.

investment. Indeed, when a government accepts the commercial presence of foreign suppliers (such as foreign banks), GATS restricts its ability to regulate these entities.

It is important to note, however, that developing countries retain a great deal of flexibility to maintain policy autonomy and the kind of regulatory system they wish. Two central features of GATS protect this autonomy: first, the scope of GATS does not extend to those sectors “supplied in the exercise of government authority”; second, and even more fundamentally, no government anywhere is forced to accept any request.

It is therefore misleading to characterize liberalization by developing countries as the result of external pressure. Indeed, when developing countries accept GATS requests, it is often because they have already decided to liberalize unilaterally, and merely wish to codify the opening under a multilateral framework. In these cases, GATS simply catalogues decisions that were made prior to negotiations. While political pressures will always play a role in countries’ decisions, each country ultimately decides for itself which sectors it wants to liberalize under GATS, and to what degree. The Agreement can be shaped to reflect what each country wants to gain from liberalization.

It is also misleading to characterize large countries as wanting to deregulate all services in developing countries. The United States provides a good example. In order to understand how the U.S. Trade Representative approaches GATS negotiations, it is important to keep in mind the priorities and lobbying efforts of influential constituencies. The United States’s participation in GATS (as in all trade agreements) is shaped by domestic interest groups. (This explains why finance, telecommunications, and audio-visual services consume most of Washington’s political and negotiating capital in GATS talks.) As of today, firms in the social services sectors, such as health care and education, have not figured prominently in the process. The battleground sectors do include some services traditionally provided by government, such as telecommunications, express mail delivery, and energy (electricity and gas). However, because the medical and technical education industries have not expressed interest in liberalization, these sectors are not high on the U.S. agenda for GATS.

### Focus 3: European Politics of “No Offers”\*

As Erika Mann explained in her presentation, GATS is among the most divisive economic issues within the European Union. The European Parliament is sharply divided on the right approach, how far to liberalize or in what sectors, and how much to ask other countries—especially developing ones—to open up their service sectors. Many leaders who believe that trade generally contributes to development want to slow down the liberalization process, because issues of sovereignty and regulation are not yet resolved.

Under pressure from its citizens, the EU will not make any offers on health care or education, and wants to continue its exemption on cultural (audio-visual) trade. Even though the EU governments have taken a categorical “no offers” position on sensitive services, such as water supply and distribution, they are still asking developing countries to liberalize those services. Some Europeans characterize their governments’ position as “Do as I say, not as I do.” They are asking: If we are protecting our services because of concerns about social impact, how can we ask other countries to liberalize?

While the apparently hypocritical position of the EU governments might be cause for some embarrassment, it is not a self-evident argument that developing countries should keep their infrastructure services closed to foreign participation. EU citizens have used the democratic process to express their concerns—justified or not—about opening up social services. But Europe’s anti-GATS mobilization is focused primarily on what is best for Europe, and not what is best for developing countries. (Some argue that what is bad for Europe is bad for everyone, an intellectual position hardly more convincing than the argument that liberalization is always good for everyone.)

There are substantive reasons why Southern countries may wish to accept EU requests for opening up water and other socially important service sectors, regardless of Europe’s refusal to do the same. EU companies have a great deal of knowledge and technical expertise. In many cases they have far greater capacity to manage water than existing public service providers. In this sense, one should not arbitrarily discount the possibility of a win-win situation, in which both Southern consumers and European firms benefit from trade liberalization.

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\* These observations are drawn from a presentation by Erika Mann, Member of the European Parliament; Member of the Committee on Industry, External Trade, Research and Energy.

The challenge for many developing countries is to determine which new sectors to open up to foreign investment and participation—a decision that requires resources and analytical capacity. While much of the controversy over GATS centers on a few social sectors that may not even be subject to GATS disciplines, there are many other privately driven, competitive sectors whose liberalization could have important beneficial effects on the overall economy, which is largely dependent on the efficiency of services. In many developing countries, foreign presence may be necessary for creating a truly modern service sector.

#### *Existing and Potential Threats from GATS<sup>25</sup>*

It is important to be clear about who supports GATS. The Agreement is not the brainchild of neoliberal economists seeking to prove their theories (although these are often reliable cheerleaders). Rather, powerful constituencies in the European Union and the United States are driving GATS. While developing countries have a strong interest in promoting Mode 4 (movement of people) and specific sectors such as tourism, the economic heart of GATS—the foreign investment provisions—is being pushed by corporations based in the global North. These firms have a straightforward goal: to gain or increase access to lucrative foreign markets in services.

Defenders of GATS often respond to this political reality by pointing out that the Agreement does not privatize services. Technically, this is true. However, GATS does provide an important forum for developed countries to pressure developing ones to liberalize services. In the context of the give-and-take of negotiations, GATS can provide rewards for privatizing; governments may win long-sought increases in market access by deregulating and opening up coveted service sectors to foreign participation. And once privatization takes place, GATS virtually locks it in.

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<sup>25</sup> This section is based on the presentation by Elizabeth Drake, International Policy Analyst, Public Policy Department, AFL-CIO.

GATS makes its impact by limiting a government's flexibility to adopt regulation. Indeed, this is its purpose. According to one observer, GATS is not an agreement about trade, but rather a catalogue of things that governments may not do. GATS constrains regulation in ways that could directly undermine public priorities related to equity, safety, and environmental protection.

For example, GATS rules forbid governments from limiting the size or number of service providers. They also prohibit governments from imposing hiring requirements or performance requirements that promote equity or community development. In the United States, some hospitals can be established only by gaining "certificates of need," a regulation that minimizes "cherry-picking" and ensures that hospitals serve lower-income patients. However, requirements for reserving a certain number of beds for poor people would be a market access barrier under GATS.

The national treatment provision of GATS requires governments to accord foreign service providers treatment that is at least as good as the treatment accorded to domestic suppliers. Critically, national treatment makes no distinction between public and private providers. Public subsidies that support government programs are especially at risk. These may include preferences for socially or economically disadvantaged groups and small businesses, research and development grants, and educational scholarships.

GATS supporters respond that the national treatment provision of GATS does not prohibit the use of public subsidies to pursue social objectives. It only prohibits governments from discriminating against foreign service providers in the allocation of those subsidies. As long as the subsidy has its intended effect on improving welfare or equity, the public interest is served. GATS skeptics, however, argue that it is often appropriate to discriminate against foreign providers, especially in pursuing economic *development* objectives. For example, while banks make decisions that affect domestic investment potential, there is some evidence that foreign banks offer less credit to small borrowers than local ones. More broadly, it may be impossible to build up a domestic service industry in the long term if sophisticated (and often predatory) multinational providers are allowed to compete on an equal footing in the short term.

It is possible to specify "exceptions" for socially oriented public programs in GATS commitments. The United States, for example, has been careful to retain regulatory flexibility in these areas, especially for states and localities. However, it is doubtful that trade ministries in many developing countries will have sufficient technical staff and resources to exercise such foresight in their own GATS negotiations. Once commitments have been made, turning back is virtually impossible—governments that discover that GATS rules are undermining important domestic objectives can reverse their commitments only by negotiating compensation with all affected members.

Rules covering domestic regulation on licensing requirements, technical standards, or qualification requirements are still being negotiated.<sup>26</sup> The general goal is to develop a necessity test, so that any regulation would be "no more burdensome than necessary" to

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<sup>26</sup> For an extensive discussion of the implications of rules covering proposed domestic regulation, see Ellen Gould, "Background Paper on Trade in Services" (Trans Atlantic Consumer Dialogue, October 2002); available at [www.tacd.org/cgi-bin/db.cgi?page=view&config=admin/docs.cfg&id=190](http://www.tacd.org/cgi-bin/db.cgi?page=view&config=admin/docs.cfg&id=190).

provide the same quality of services. If ongoing negotiations become binding commitments, foreign suppliers seeking to export their services or invest in domestic services would have a powerful tool to challenge federal and local laws. In future disputes over how “necessary” a regulation needs to be to ensure service quality, decisions would be made by dispute settlement panels comprised of trade lawyers, with no expertise or mandate to consider the noneconomic consequences of their decisions. (Historically, such panels have issued very broad interpretations about government actions that discriminate.)

Regulations potentially subject to review (and a negative judgment) include those protecting workers’ rights, public health, consumer safety, universal access, and the environment. Because such laws impose burdens on private companies in order to serve social ends, they could be challenged under GATS domestic regulation rules as not being “necessary” to ensure the quality of the service being provided.

The implications for regulatory flexibility go beyond what is decided by trade lawyers in actual disputes. Just as overly intrusive liability laws can have a “chilling effect” on a free press, so might GATS rules induce governments to modify their regulatory behavior—and lower their social goals—to avoid being hauled before a dispute settlement panel. Developing country governments often face budget crises, and even those that have a strong case for adopting a particular regulation under GATS rules may find the enormous costs of WTO litigation too high to risk inviting a challenge from Northern governments.

### **Policy Coherence and Its Impact on National Governments<sup>27</sup>**

Many government officials and economists talk about GATS as though it exists in an institutional and political vacuum. Yet one cannot separate the conditions of international financial institutions (IFIs)—especially the World Bank, regional development banks, and the IMF—from multilateral trade commitments. There is growing evidence of a “policy convergence” between the agendas of development assistance organizations and the WTO.

The issue is timely. On May 13, 2003, the heads of the World Bank, IMF, and WTO met in Geneva to issue a joint statement in support of global trade liberalization.<sup>28</sup> While calling upon developed countries to increase market access for poor countries (for example, in agriculture and textiles), they also declared in a joint statement that “developing countries need to place trade integration as a central plank of their development and poverty-reduction strategies.” Given the World Bank’s new trade division and frequent trade-related conditions in its loans, there is increasing concern among advocacy NGOs and others that development assistance will be used to promote the trade interests of the countries that dominate the WTO.<sup>29</sup>

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<sup>27</sup> This section is based on the presentation by Nancy Alexander, Director, Citizens’ Network on Essential Services.

<sup>28</sup> This event took place after the dialogue. The information is added to illustrate the evolution of policy convergence among the multilateral organizations.

<sup>29</sup> For NGO reaction to the multilateral agenda on policy coherence, see Center of Concern, “IMF-World Bank-WTO Close Ranks Around Flawed Economic Policies,” Press Release, May 12, 2003; available at [www.coc.org/resources/articles/print.html?ID=537](http://www.coc.org/resources/articles/print.html?ID=537). For a critical perspective on the process leading up to policy convergence, see Rick Rowden, “The IMF, World Bank and WTO: Synthesizing Trade Liberalization Goals,” *Issue Briefings*, September 2001; available at [www.bicusa.org/ptoc/pdf/rowden\\_trade.pdf](http://www.bicusa.org/ptoc/pdf/rowden_trade.pdf).

In a very limited, technical sense, the decision to liberalize service sectors is a national choice. However, there is significant evidence that IFIs are making these decisions for borrowing countries through detailed conditions attached to adjustment and investment loans. In particular, low-income countries and high-level debtors have little room to maneuver.<sup>30</sup>

IFI loans affecting basic services not only apply external pressure with the leverage of money but often interfere directly with domestic political processes. In some cases loan conditions mandate that policy progress be achieved through decrees from the executive branch of government, thus circumventing debate (and possible opposition) in the legislature.<sup>31</sup> In a new communications toolkit, the World Bank's External Affairs Department managers market privatization to the public and to decision-makers. The toolkit recommends building a legislative support base that will ensure approval of privatization reforms.<sup>32</sup> IFI efforts to impose liberalization and privatization reforms are nothing new. What is recent, however, is that the multilateral institutions are pushing these policies at the same time that developing countries are negotiating a multilateral trade round in which services are on the table. While Northern governments claim that Southern countries always have a free choice over adopting GATS rules, the financial institutions that they control seem to be making that choice by themselves. Moreover, because of the irreversible nature of GATS commitments, those choices may be permanent.

The IMF promotes the liberalization of services indirectly by starving them of public resources. Governments facing budget shortfalls that seriously erode the quality and access of services may opt for deregulation and private sector participation. Even advocates of privatization, such as former World Bank economist John Nellis, have recognized the IMF's influence in reducing or eliminating public subsidies.<sup>33</sup> For example, the IMF routinely imposes hard-budget constraints on local governments, especially by limiting fiscal transfers from the national treasury.<sup>34</sup> Even as decentralization gives local governments greater responsibility for delivering basic services, their resources can be severely cut and their ability to borrow highly constrained. In

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<sup>30</sup> There was a surprising level of agreement among participants in the dialogue with the argument over trade-development policy convergence—even among panelists who were generally supportive of GATS. During discussion, one GATS enthusiast responded that fiscal policy affecting public services “is a pressure point imposed by the [International Monetary] Fund . . . . That's a fact.” Another panelist, reacting to the practice of forcing unilateral liberalization in sectors that could later be included under GATS commitments, responded: “I'm sure it's true.”

<sup>31</sup> Guillermo Perry and Javed Burki, former World Bank Chief Economist and Vice President for Latin America respectively, have argued that governments can best pursue public sector reform when there is an “unassailable presidential veto” and executives can make policy decisions by decree. See Shahid Javed Burki, Willia Dillinger, and Guillermo E. Perry, eds., *Beyond the Center: Decentralizing the State* (Washington, D.C.: World Bank, 1999).

<sup>32</sup> World Bank, *Public Communications Programs for Privatization Projects: A Toolkit for Task Team Leaders and Clients* (World Bank External Affairs Vice Presidency, 2003); available at [www.worldbank.org/developmentcommunications/Publications/wb%20toolkit%20book%203.6.02.pdf](http://www.worldbank.org/developmentcommunications/Publications/wb%20toolkit%20book%203.6.02.pdf).

<sup>33</sup> John Nellis, “Privatization in Africa: What has happened? What is to be done?” Center for Global Development, *Working Paper Number 25*, February 2003.

<sup>34</sup> The IMF can also allow creditors to “intercept” payments from central governments.

Bolivia, for instance, municipal fiscal responsibility laws coincided with reduced federal transfers, resulting in massive public sector layoffs and cuts in services.

#### Focus 4: International Organization Structures Supporting Privatization\*

The IFIs have created and strengthened a wide range of mechanisms to leverage support for privatization. World Bank structures include loan resources, sector strategies, guarantees, and research.

*Private Sector Development Strategy.* (Approved February 2002.) The PSDS calls for the acceleration of private (and NGO) provision of basic services on a commercial basis. Target sectors include health care, education, water, and energy.

*Water Resources Sector Strategy.* The WRSS promotes increased private participation in water and sanitation services, as well as a return to “big hydro” projects like dams. It supports shifting water from “low-value” to “high-value” use (for example, from subsistence farming to agro-business and industry).

*World Development Report.* The 2004 *World Development Report: Making Services Work for Poor People*, proposes a range of private sector solutions for failing government services, while paying scant attention to options for reforming public services themselves.

*Private Sector Advisory Service.* PSAS is a sophisticated and well-funded marketing division for privatization policies.

*International Development Association.* The IDA is the soft lending division of the World Bank, providing low-interest loans to very poor countries. The IDA increasingly attaches conditions that promote privatization and commercialization of services. In addition, the PSDS recommends using IDA resources to complement International Finance Corporation financing of privatization, specifically to offset costs of commercial pricing for low-income users.

*International Finance Corporation.* The IFC is the World Bank Group’s branch that lends directly to the private sector. It also provides commercial guarantees. Under the PSDS, the IFC has become increasingly active in financing the private provision of water, energy, and health-care services.

*Multilateral Investment Guarantee Corporation.* MIGA is the World Bank Group’s branch that insulates private investment from political risk.

*Trade capacity building.* The World Bank’s new Trade Division carries out capacity building for borrowing countries. Its director is on record as supporting unilateral trade liberalization for developing countries.

*Strategic communications programs.* The World Bank actively markets privatization programs by using loan resources to fund consultants and public ad campaigns.

World Bank privatization structures are complemented by other international institutions. These are:

*International Monetary Fund.* The IMF uses fiscal conditionalities to restrict governments’ ability to fund public services. It has also insisted on service privatization as a condition for approving poverty reduction strategies in very poor countries.

*UN Commission on Trade and Development.* UNCTAD has adopted a largely uncritical position in support of foreign direct investment in services. It has largely ignored the problem of private monopolies and the corporate practice of using in-house subsidiaries for sub-contracting.

*World Panel on Financing Water Infrastructure.* Headed by former IMF managing director Michel Camdessus, the panel recommends dramatically increasing the use of subsidies and guarantees to attract private investment in water and sanitation services.

*World Health Organization.* WHO works with the World Bank and the Academy for International Health Studies. Notwithstanding its name, AIHS is a private U.S. health-care business association that pursues global market opportunities in health-care provision.

*Energy Charter Treaty.* Enforces the right of private firms to export profits from investment in the energy sector, and adopts WTO rules framework for trade.

\* Compiled from the presentations by David Hall, Director, Public Services International Research Unit (PSIRU), and Nancy Alexander, Director, Citizens’ Network on Essential Services.



While the IMF uses fiscal conditions to move borrowing countries toward privatization, the World Bank is often more direct. Its loan conditions actually detail the mechanism of private provision. Loan documents routinely include deadlines by which progress toward privatization must occur, and can even identify which firm gets control of a concession. Minutes of Bank meetings reveal Executive Board members' insistence that debtor countries become WTO-compliant, especially in sectors that compete with high-value added goods produced in the North. In the case of low-income countries, especially those qualifying for debt relief under the Highly Indebted Poor Countries initiative, the World Bank and IMF have frequently made aid contingent upon progress toward privatization or commercialization.

Assurances that GATS does not apply to services supplied "in the exercise of government authority" must be qualified by the WTO's own definition of such services, which it defines as those that are supplied *neither* competitively *nor* on a commercial basis. The "exception" for such services is thus quite narrow. It is difficult to determine which public services actually satisfy these criteria, which could be interpreted to apply only to exclusive government monopolies without market-based user fees. Yet, in developed and developing countries alike, most basic services have at least some competition, and many have cost-recovery pricing mechanisms.

If liberalizing a sector even partially can make it subject to broader GATS rules, World Bank and IMF lending conditions will intrude even more deeply into decision-making in developing countries. Such conditions routinely include deregulation to allow or increase private participation, as well as commercial pricing. These reforms move public services away from the WTO's definition of "government authority." Moreover, this critical link between development assistance and GATS is never discussed in public deliberations. Trade ministers, parliaments, and citizens of borrowing countries need to know what their finance ministers may be "giving away" unilaterally in loan agreements.

WTO officials often respond that these fears are unfounded. However, to date, the WTO has not been able to provide legal grounds for dismissing concerns regarding the potential consequences of opening the door to services. It may be true that the WTO's leaders are not seeking to privatize key public services in developing countries. However, neither they nor national governments will determine what constitutes a legitimate exception under the "government authority" clause—which still remains undefined. Efforts to give the exception the narrowest possible interpretation may be initiated by member governments representing the interests of corporations seeking new markets. Such disputes would then be decided by nonelected WTO dispute settlement panelists.

## **Conclusion: Linking Debates about Policy and Institutions**

WHILE THE PARTICIPANTS in the dialogue differed over many substantive points, their very presence indicated agreement on something fundamental: the need to discuss policy processes and policy impacts together. Too often, debates over reform alternatives are carried out in the abstract. Theories about social and economic impacts are needed, of course, but they will be more useful when grounded in the realities of the specific constraints and opportunities that international institutions are creating.

Similarly, some who oppose or advocate the expansion of global economic governance often do so without carefully considering the likely impacts of specific policies. In the case of trade, the least helpful interlocutors are those who see any progress toward liberalization as always for the best—or for the worst.

This dialogue has not resolved the debates over the policy of privatization or the trade rules of GATS. However, it has demonstrated the usefulness of linking debates over these two issues to create a rich public discourse about costs, risks, and trade-offs of different policy alternatives. This insight has implications beyond the trade in services. One can easily imagine such a dialogue for other agreements within the “single undertaking” of the World Trade Organization, especially those related to intellectual property and investment. Moreover, as the multilateral lending organizations increasingly condition financial assistance on fundamental changes in national governance, there is a greater need for *ex ante* analysis of how institutional reforms will affect policy outcomes.

International agreements that affect policy are not always multilateral. On one side of the Atlantic, the proposed Free Trade Area of the Americas (FTAA), if eventually adopted, will have far-reaching economic implications for the hemisphere. While proponents maintain that dropping regional trade barriers will “lift all boats,” opponents argue that FTAA’s likely investment provisions will ensure that benefits go disproportionately to large corporations. On the other side of the Atlantic, the European Union will soon include ten new members, most of which are small and relatively undeveloped compared to their western neighbors. Theories about economic competitiveness, technology transfer, and investment will be tested within the complex rules and resource allocation mechanisms underlying the EU.

The present dialogue about trade in services will surely be revisited. GATS negotiations are not a one-off event, but rather a continual process that will be repeated in subsequent WTO rounds. To the extent that the current round succeeds in liberalizing service sectors around the world, future debates will include more specific and more accurate information about what institutions do to policies, and what policies do to people.

## About the Organizers

The **Carnegie Council on Ethics and International Affairs** is an independent, non-partisan, nonsectarian, tax-exempt organization founded in 1914 by Andrew Carnegie. Since its beginnings, the Carnegie Council has asserted its strong belief that ethics, as informed by the world's principal moral and religious traditions, is an inevitable and integral component of all policy decisions, whether in the realm of economics, politics, or national security. The interrelationship of ethics and foreign policy is thus the unifying theme of all Carnegie Council programs. By promoting a greater understanding of the values and conditions that ensure peaceful relations among nations, the Carnegie Council hopes to contribute to a better life for people everywhere.

The **Friedrich Ebert Stiftung** is a nonprofit, public interest organization committed to the principles and basic values of social democracy in its educational and policy-oriented work. The Foundation holds seminars and conferences on a wide range of political, economic, social, and historical issues, with international cooperation and development being one of the main fields of its activity. To pursue its worldwide activities, the Foundation has branch offices in more than 70 countries and carries out activities in more than 100 countries. More than half of the annual budget is devoted to development projects, ranging from training programs to applied research and expert consulting services. In the interest of peace and international cooperation, the Friedrich Ebert Stiftung acts as a platform for dialogue in the spirit for the reduction of political tension at the international level. The Foundation also seeks to raise awareness of development issues among political decision-makers in the North, and to promote cooperation among countries in the South.

CARNEGIE COUNCIL ON ETHICS AND INTERNATIONAL AFFAIRS

FRIEDRICH EBERT FOUNDATION

in cooperation with

UN FINANCING FOR DEVELOPMENT OFFICE, DESA

Invite you to a focused dialogue in the context of the  
Financing for Development Process

on the theme:

**Privatization and GATS—a threat to development?**

Date: April 7, 2003  
United Nations, New York  
Conference Room 5

THIS DIALOGUE WILL bring together experts on development, trade, and social services to discuss important concerns about privatization, trade, and the financing of basic social services with government representatives and other members of the United Nations community.

The Monterrey Consensus has emphasized the importance to developing countries of attracting increased foreign investment within a regulatory framework that promotes and protects private-sector participation. In addition, as a result of policy initiatives led by the international financial institutions (IFIs), social services in the developing world have increasingly been provided by the private sector. Moreover, industrial countries are pushing for increased liberalization of social services through trade negotiations on services (GATS) in the run-up to the WTO Ministerial Round in Cancun.

Many development experts, trade unionists, and civil society activists, however, argue that permitting unlimited rights for private investors, and especially foreign corporations, to control basic services sectors in developing countries can significantly harm their most vulnerable citizens. They argue that the provision of vital services, such as health care, education, energy, and water is too important to be left to private enterprises.

The discussion will examine the relationship between development and privatization and explore different approaches to the reform of public services. Of particular interest will be the policy objectives of the GATS within the WTO which is currently under negotiation in the run-up to the Ministerial Round in Cancun.

## AGENDA

9.30 a.m. *Welcome Remarks*  
*Oscar de Rojas*, Head, UN Financing for Development  
Office, DESA

9.45 a.m. – 11.15 a.m. *1<sup>st</sup> Morning Panel*  
Public sector reform or private provision of social  
services: What works best for developing countries?

Many people living in the developing world have very limited access to educational opportunities, health care, and clean water. Because developing countries often lack the financial resources to improve the performance of such public sector utilities, some experts argue that the public monopoly on the delivery of services should be abandoned as part of a development strategy. They argue that private investment in the provision of services will lead to more efficient and effective results. Critics of this approach reply that even when the poor suffer from the inefficiencies of government-run utilities and institutions, private solutions do not ensure service access for those who cannot pay. They claim, moreover, that poor countries usually lack the capacity to regulate effectively the delivery of public services by private firms. Which approach to the provision of social services is most promising for developing countries? Is there a general answer that can be given to this question, or do different countries require different solutions?

*Speakers:* *David Hall*, Director, Public Services International  
Research Unit (PSIRU)  
*Clive Harris*, Manager, Private Sector Advisory  
Services, World Bank  
*Tom Palley*, Director, Globalization Reform Project,  
Open Society Institute

*Chair:* *Manfred Bardeleben*, Director, Friedrich Ebert  
Foundation, New York Office

11.30 a.m. – 1.15 p.m. *2<sup>nd</sup> Morning Panel*  
The General Agreement on Trade in Services  
(GATS) and its impact on social services

This panel will discuss why the WTO is expanding its mandate into service sectors and will provide an overview of the current status of the negotiations on GATS, which is one of the contentious issues in the upcoming WTO Ministerial Round in Cancun. The current GATS contains rules governing the trade of services. A new and expanded GATS could contain new and broader definition of “services” covered by

the agreement as well as other new provisions. And, while some developed countries and free trade advocates have claimed that an expanded GATS will boost development, others have voiced concerns about the potential impact of GATS on local, national, and regional policies. They argue that developing countries' citizens must not be deprived of their right to demand public services and that GATS rules should not be allowed to weaken the capabilities of states and municipalities to deliver these public services. Moreover, many have claimed that GATS negotiations are being held under unnecessary levels of secrecy and without adequate democratic oversight. Will the GATS benefit developing countries, or will it threaten to limit their peoples' capabilities to exercise meaningful control over political decisions that affect them? How should these claims be assessed?

*Speakers:* *David Diaz Benavides*, Chief, Trade in Services, Division on International Trade in Goods and Services and Commodities, UNCTAD  
*Erika Mann*, Member of the European Parliament; Member of the Committee on Industry, External Trade, Research and Energy  
*Richard Self*, former U.S. Deputy Assistant Trade Representative for Services

*Chair:* *Christian Barry*, Senior Program Officer, Carnegie Council on Ethics and International Affairs

3.00 p.m. – 4.45 p.m. *Afternoon Panel*

How should developing countries promote investment in basic social services?

Effective provision of social services can significantly contribute to social cohesion in developing countries. How should private investment in the provision of services be regulated to ensure that they do not undermine social standards, employment safeguards, and wages? How should WTO rules and agreements on trade in services be formulated to promote social equity and protect national sovereignty and workers' rights? This panel will discuss and explore the kinds of alternative strategies that can be adopted to address these issues by drawing on the experience of different developing countries.

*Speakers:* *Nancy Alexander*, Director, Citizens' Network on Essential Services

*Elizabeth Drake*, International Policy Analyst, Public Policy Department, AFL-CIO

*Aaditya Mattoo*, Lead Economist, World Bank

*Chair:* *John Langmore*, Director, International Labour Organization (ILO), New York Office