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TRADE NOTES

LINKING THE GENERAL AGREEMENT ON TRADE IN SERVICES (GATS), TO NATIONAL DEVELOPMENT GOALS AND POVERTY REDUCTION

The World Trade Organization (WTO) agreement covers goods (The General Agreement in Trade and Tariff, GATT), services (The General Agreement on Trade in Services, GATS) and Intellectual Property (Trade Related Intellectual Property, TRIPS). These agreements map out the principles of liberalization and the permitted exceptions. Goods have a service component that is reflected in their relative prices. This implies that there is great opportunity for trade in services given that it is cross cutting. After signing these agreements at the international level, it is important that they are integrated into the national development strategies in order to provide mechanisms for development and poverty reduction. The Institute of Economic Affairs-Kenya organized a policy round table on *28th June 2007* to discuss the coherence between trade rules and development policies in Kenya with particular reference to the General Agreement on Trade in Services. The objective of this meeting was to obtain professional views from stakeholders in order to inform policy makers of the significant issues under trade liberalization, development and poverty reduction.

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THE GENERAL AGREEMENT ON TRADE IN SERVICES (GATS) - BACKGROUND

The GATS was first introduced into the Multilateral Trading System during the Uruguay Round (1986-1994) and was one of the key agreements that came into being with the creation of the World Trade Organization (WTO) in 1995. Until this time, no multilateral agreement was in existence on the rules for trade in service and the rules and disciplines contained in the GATS agreement marked the first step towards a longer term process of service liberalization. The services sector has been characterized by very strong government involvement which has included natural monopolies, public service delivery and a focus on infrastructure and security interests of the country. This sector can also be described as intangible meaning that the criteria for quality is the service provider rather than the product and is also characterized by the presence of no tariffs which means that market access conditions are determined by regulators and not tariffs.

The rising importance of services trade has been followed by an expansion of the share of commercial services in total world exports of goods and services from 15 per cent in 2000 to 19.3 per cent in 2004 (WTO International Trade Statistics 2005). In developing countries, the services sector now accounts for the largest share of total economic output. Trade in services has accounted for 57 per cent of GDP in middle-income economies and 45 per cent of GDP for low-income economies (World Bank 2001). It had also been observed that the service sector GDP is the fastest-growing component in both low- and middle-income economies and also that service sector GDP in such economies is growing faster than the world average. The services sector in Kenya is a major foreign exchange earner and contributes around 54% to GDP (WTO, 2000), and this is mainly in the tourism, financial and communication sectors.

GATS defines "Trade in Services" as the supply of services through any of the 4 modes:

Mode 1: Cross Border Supply

This is the supply of a service from the territory of one member into the territory of any other member independent of the supplier or the consumer. For example through telecommunication or postal infrastructure, there is no physical movement of the service provider but the service itself.

Mode 2: Consumption Abroad

This happens when the consumer crosses into the territory of another country and buys services there e.g. tourism or a ship and other equipment sent abroad for repairs. The consumer is non-resident in the country where the service is consumed.

Mode 3: Commercial Presence

This involves a direct investment in the export market through the establishment of a business locally for the purpose of providing a service e.g. the establishment of a subsidiary of an insurance company or a bank or local offices of multinational services firms which may employ local personnel and can be incorporated under local laws.

Mode 4: Movement of Natural Persons

This means the temporary entry of an individual in the territory of another member for the purpose of providing a service. It should be noted that this movement is temporary and so the supplier remains a non resident. Examples here include independent services suppliers such as individual consultants or health workers.

Scope and Coverage of GATS

GATS coverage is divided into twelve sectors and these are further divided into over 150 sub sectors excluding services offered by the government:

- Business sector
- Communication
- Construction and Engineering related
- Distribution
- Education
- Environment
- Health related services
- Financial services
- Tourism and travel related
- Recreation, Culture and Sport
- Transport
- Other services

WTO NEGOTIATIONS UNDER GATS

Cancun to the July 2004 Framework

After the collapse of the 5th WTO conference in Cancun Mexico in 2003, consultations were held with the aim of reviving the negotiations. In effect a breakthrough was achieved with the adoption of the July 2004 Framework which brought the negotiations back on track. The July Framework was established in May 2005 as the benchmark for the submission of revised offers and the following recommendations on services were made:-

- Submission of initial offers by those members who had not done so
- Members should try to ensure a high quality of offers mainly in sectors and modes of supply of export interest to developing countries. Offers are bilateral bargaining between governments to improve market access opportunities
- Reaffirmation of the interest of members particularly developing countries in Mode 4
- Provision of targeted technical assistance

By July 2005, 24 revised and 68 initial offers remained outstanding from the July 2004 Framework.

Hong Kong Ministerial Conference

During the Hong Kong Ministerial Conference, the following declarations were made under Services:

- Under Mode 1 commitments were made at existing levels of market access on a non-discriminatory basis on areas of interest to the Member countries
- Under Mode 2 commitments were made at existing levels of market access on a non-discriminatory basis in areas of interest to Member countries and on Mode 2 where commitments on Mode 1 exist.
- Under Mode 3 commitments were made on enhanced levels of foreign equity participation, removal or substantial reduction of Economic Needs Tests (ENTs), and allowing greater flexibility on the types of legal entity permitted.
- Under Mode 4 commitments were made on new or improved commitments on the categories of Contractual Services Supplier, Independent Professionals and Others delinked from commercial presence and new or improved commitments on the categories of Intra-corporate Transferees and Business Visitors
- Under the Most Favoured Nation (MFN) exemptions, commitments were made on the removal and substantial reduction of exemption from MFN treatment and clarification of remaining MFN exemptions in terms of scope of application and duration
- Under the scheduling of commitments, declarations we made on ensuring clarity, and certainty in scheduling of commitments and ensuring that scheduling of any ENTs is according to the scheduling guidelines.

Certain timelines were then put into place including:

- Enabling any outstanding initial offers to be submitted as soon as possible
- Submission of plurilateral requests by 28th February 2006 or as soon as possible
- Mechanisms for according special priority to sectors and modes of supply of interest to LDCs before 31st July 2006
- Second round of revised offers to be submitted by 31st July 2006
- Final draft schedules of commitments shall be submitted by 31st October 2006
- Development dimensions which included flexibility for individual developing countries, in regard to the size of their economies and the implementation of LCD modalities.

The Hong Kong Ministerial meeting injected momentum into the negotiations and as a result 22 collective requests were made under the plurilateral approach as the bilateral process continued alongside the plurilateral process. The lack of progress was linked to lack of progress in the Non Agricultural Market Access (NAMA) and Agriculture processes and the talks were suspended before the deadline for a second round of offers on 31st July 2006.

THE COHERENCE BETWEEN KENYA'S NATIONAL DEVELOPMENT GOALS AND TRADE POLICIES

Post independence period

During the post independence period the main policy thrust and national development goals were based on the fight against poverty, illiteracy and diseases as detailed in Sessional Paper No. 1 of 1965. The trade policy in place then was that of import substitution accompanied by public sector marketing boards and trade support institutions to handle production, and both domestic and export marketing. Additionally, production and trade was based on self sufficiency and prohibitive tariffs were in place. This period in time registered economic prosperity based on expanded agriculture and there was an elaborate public sector administrative arrangement to support industry and trade, by way of licenses, permits etc. During this time there existed heavy public sector involvement in the productive and services sectors since there was no private sector to undertake the activities and this was also a functional centrally planned economy.

As much as there were milestones in this era, there existed various handicaps which included;

- Lack of competitiveness
- Diminishing markets with the collapse of the EAC in 1977
- Lack of diversification of export products and dependence on trade in primary agriculture products to sustain the economy
- Concentration of budgetary resources on production with little emphasis on trade
- Little emphasis on trade as a tool to spur the well being of the people
- Limited linkages to external markets
- Lack of preparedness for external/internal shocks e.g. oil shocks, shrinking markets, product substitution
- Narrow trade options
- Limited attention to the services sector
- Limited stakeholder involvement
- Little emphasis on taking advantage of new export opportunities.

The Structural Adjustment Programmes Period

During the Structural Adjustment Programmes period, while maintaining the post independence thrust, there was a focus on improved governance and export orientation as a way of improving the well being of the people. The main features of trade policy during this period centered on liberalization and privatization with reduction of government involvement in productive sectors. Milestones during this era in time included price liberalization/decontrols in most sectors of the economy including exchange in interest rates with the eventual effect of prices coming down. New players with new products came into the market, an effort was made to rationalize tariffs and new initiatives were adopted to improve competitiveness e.g. Export Processing Zone (EPZ). This era was also positively characterized by the establishment of the Kenya Revenue Authority (KRA) to operate outside treasury, success stories of privatization in Kenya Airways, diversification into the horticulture sector with limited public sector involvement and improved policy stability and predictability.

There existed various handicaps during this era and these included:

- Closures of business and the lack of preparedness of the business community for the new policy environment
- Lack of re-alignment of business support institutions to new policy, this meant retaining

institutional structures operating under import substitution

- Ineffective legal and regulatory frameworks
- Inadequate involvement and sensitization of the public
- Lack of market analysis on changing market requirements, including new traded products and substitution of existing product ranges
- Lack of strategic preparedness for new and niche products/services
- Frequent policy reversals
- Widening gap between the poor and the rich
- Maintaining the status quo on what is traded

The Globalization/Regionalization period (1990s and beyond)

During the globalization/regionalization period (1990s and beyond) the national development goals built on Sessional Paper No. 1 of 1986 "*Economic Management for Renewed Growth*". The main trade policy of this period related to globalization and wider and deeper regional integration within the context of further liberalization, restructuring, reforms and new institutions being set up. Milestones reached during this time included the creation of new markets in particular, the Common Market for East and Central Africa (COMESA), the East African Community (EAC), African Growth and Opportunities Act (AGOA) and new traded products. There existed a wider private sector involvement at policy, production and trade levels, further liberalization of the energy generation and communication sectors, deepening of regional integration and realigning of budgets and plans. Other positive features of the globalization era were the devolution of limited budget resources to the community level, the establishment of youth and enterprise funds, increased involvement of stakeholders in trade negotiations supported by analytical work, diversifying trade negotiations to include services and involvement of the president in the business sector through the National Economic Social Council (NESC).

The various handicaps that existed during this period included;

- Limited dissemination and promotion of new preferential markets and products to the business community
- Lack of complementary national policies to benefit from multilateral/regional and bilateral agreements
- Lack of legal and regulatory frameworks in support of new trade polices
- Disparity of knowledge within both the public and private sector on trade related issues
- Continued monopoly in a number of service sectors e.g. power transmission
- Limited participation of youth and women in economic activities
- Capacity constraints in negotiations
- Inadequate funding of trade facilitating institutions
- Delayed privatization/reforms in key trade supporting service sectors
- Continued fragmented trade policy making processes and implementation
- Lack of impact assessment studies on trade policy
- Limited policy analysis to trade policies and overall national development goals
- Continued limited attention to the services sector

Taking into account the various periods, there has been a lack of harmony between trade policies and overall national policies. There is need to strengthen and institutionalize the national analytical capacities and cross over into value addition. This area is in need of a wider involvement of stakeholders in the policy making process and negotiations, comprehensive trade policy analysis, monitoring and evaluation and investment in business support institutions, infrastructure and the services sector with a wider involvement of the private sector. Other ways to strengthen this link would be to enhance the legal and regulatory frameworks, move into partnerships and invest more in technical education.

LINKING GATS TO NATIONAL DEVELOPMENT GOALS AND POVERTY REDUCTION

The purpose of trade rules system is to provide predictability and stability for market players which then facilitate positive development and poverty outcomes. Trade can play a powerful role in reducing poverty if the national and international policies which can facilitate this are rooted in a development-driven approach to trade rather than a trade-driven approach to development. It is important to acknowledge that integration into the global economy in itself is not a mechanism for poverty reduction. The long term effects of trade liberalization such as increased productive capacities, higher incomes and increased human freedom are key to poverty reduction. Trade liberalization is a very important part of the development process and a very important policy issue. National policies which support poverty reduction should therefore have an integration component which gives strategies on how to create and sustain dynamic processes that result in increased productive capacities. Development should therefore include all groups such as the marginalized. Further, in order to better manage integration within the global economy trade strategies should include external trade and finances and technology acquisition.

It would be important for developing countries like Kenya to make certain that the multilateral trading system and the commitments on trade in services give rise to economically rational policies at the national level. An important condition for benefiting from the multilateral trading system or WTO agreements is the development of a national strategy for the liberalization of domestic markets, practical efforts to open foreign markets for services and the promotion of multilateral rules that encourage development prospects. Trade liberalization has the potential to contribute to development and poverty reduction. Current globalization of world markets is mainly due to the internationalization of the services sector. Most of the time services cannot be seen by the policy makers but it plays an important role in facilitating all facets of economic activity. Services such as financial services, communication and transportation give support to various businesses around the country. Education, health and recreational services have a say in the quality of labour available to firms and professional services avail expertise to increase firms' competitiveness. Government services determine the efficiency of the economic environment in which firms need to operate in. In the production of goods, a percentage of value addition comes from the input of services. Service industries are becoming increasingly important in many developing countries like Kenya and contribute greatly to GDP.

There exists a link between GATS development and poverty reduction. This can be done by looking at the role of services in development from three major types of services. First, the telecommunication services which act as a medium through which the majority of transactions occur, is important for all sectors of the economy. Telecommunication linkages and a cross-cutting range of value-added services ensure that local companies are linked to the global market. Second, the presence of professional services and specialized businesses defines one of the differences between developing and developed countries and being able to outsource business services can have a tremendous impact on the structure of a firm. When business services are not available externally, employees would have to be hired from within and leads to an increase in operating costs. If it were purchased from a domestic source it would reduce price competitiveness and if it was procured from a foreign supplier it would end up increasing imports. With the availability of business services firms are able to dictate the amount of service they need and can choose from a wide range of specialized services. Third, education and training services continually ensure the availability of a skilled labour force. Workers in the services industry need not only technical skills but also skills in information technology, interpersonal communication and problem-solving skills that allow them to provide quality services. Trade in services brings out a range of national development benefits which have a link to poverty reduction. It brings in first and foremost foreign exchange which is important to an economy, but more importantly world class services are available locally and this prevents local firms from importing services.

The Kenya government in its paper "Investment Programme for Economic Strategy for Wealth and Employment Creation" postulated several ways of addressing issues of equity and poverty reduction: first is investing in human capital through free primary education and strengthening the education system; provision of basic health services; improved labour market policies for strong employment growth while taking care of special groups such as women and children. Second, focus on agriculture, livestock and environment initiatives that will raise the productivity of farmers through improved agricultural research and extension, financial services, improved input distribution, commercialization, market and value addition.

Lastly, poverty targeted programmes such as the social action fund to support and finance implementation of productive community-driven development programmes. In addition, Arid and Semi arid lands programmes to cater for geographical areas with high incidence of poverty which have been traditionally excluded in public resource allocation. All these measures fall under development of productive capacities which encompass three processes: first, the accumulation of physical, human and organizational capital; second, structural transformation and third, technological progress. Trade affects the development of these productive capacities which in turn affect poverty. Further, the Private Sector Development Strategy Paper (PSDS), which builds on the strategic framework already laid in the Economic Strategy for Wealth and Employment Creation paper (2003-2007) has its third goal as facilitating economic growth through greater expansion of trade through finalizing the trade and industrial development policy, revitalizing trade facilitation and increasing access to trade finance. These policy documents have made tremendous efforts in addressing the supply side issues associated with trade.

Opportunities and Challenges of Services Liberalization

Worldwide liberalization of trade in services started two decades ago or earlier and the economic benefits have been proven by practice with income gains from services liberalization being greater than the gains from trade in goods and agriculture. Challenges to this sector have resulted from higher trade barriers in services than in goods, a lack of transparency and the effects of the protection of the economy in general. Benefits to consumers have been those similar to the benefits of open trade in goods, price and quality competition, better choice of supply, access to better quality, competitive and cost effective services and the improvement of consumer purchasing power and standards of living. Other opportunities in the area of service liberalization have been in attracting Foreign Direct Investment (FDI), improving the competitiveness of manufacturing and exporting industries and contributing to sustainable development through employment and poverty alleviation. The liberalization of trade in services does not mean deregulation but it requires appropriate regulation to ensure national policy objectives like consumer protection, proper functioning of financial markets, traffic safety, pro-competitive regulation in telecommunication and other infrastructure services, universal access requirements in health and education, safe-guarding cultural and audio-visual services. GATS guarantees national sovereignty and flexibility to regulate domestic services markets.

Conclusion

The major hindrances to service development in Kenya have been the poor state of infrastructure and inadequate access to capital for emerging businesses which is important for further liberalization of the services sector. On the whole it is clear that Kenya's scope for geographic, sectoral and volume of services export expansion is substantial but there is need to address regulatory and promotional issues for the service firms to exploit the ready business opportunities in the region and beyond. It would be practical for policy makers to make the development of services a priority.

At the policy level for Kenya, it is clear that there has been minimal coherence between trade policies and overall national policies. While the government has adopted a bottom-up approach in implementing trade policies that facilitate increased trade, it is not clear how trade agreements negotiated at international /regional level are integrated (Top-Bottom) into national development polices in order to have a development –driven approach to trade. It is important to put in mechanisms to monitor the integration of international trade policies as they can impact negatively on productive capacities which in turn affect poverty.

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