

Services and Investment Liberalization in the Euro-Mediterranean Region

Questions and answers

1. Why is services and investment liberalisation on the Euro-Mediterranean agenda ?

- Trade is an essential component of the Euro-Mediterranean Partnership, ultimately aiming to deepen regional integration across the Mediterranean region through the liberalisation and facilitation of trade, and the creation of a genuine **Euro-Mediterranean Free Trade Area** by the year 2010. The objective to extend the scope of Euro-Mediterranean trade relations to the liberalisation of trade in services and investment was foreseen in each of the Association Agreements concluded between the EU and its Mediterranean partners.
- This objective was further confirmed at the Barcelona Summit of November 2005, which marked the 10th anniversary of the Euro-Mediterranean Partnership, and the negotiations are scheduled to start between a first wave of willing partners on 24 March 2006 in Marrakech.

2. What is the legal framework for such negotiations ?

- The **Euro-Mediterranean Association Agreements** all provide for the future widening of the scope of the agreements to cover the liberalisation of services and the right of establishment. Therefore, a few years after the entry into force of the agreements (5 at the latest), it is foreseen that the relevant Association Councils examine the situation and make recommendations in this respect. In a number of cases, this deadline has already elapsed or is about to lapse (e.g. Tunisia, Morocco, Israel, Lebanon).
- **Articles II and V of GATS** are the most relevant **WTO**-related provisions.
- Article II is the “most favoured nation clause” of the GATS. It reflects the fundamental WTO principle that one cannot discriminate between foreigners, notably through the attribution of preferential treatments.
- GATS Article V (which is the mirror of the famous article XXIV of GATT) provides for an exception to this fundamental rule, but under strict conditions: In order to remain compatible with WTO rules, preferential agreements concluded under Article V should be “economic integration agreements”. In particular, this means that they must provide for:
 - **substantial sectoral coverage** measured in terms of number of sectors, volume of trade and modes of supply. Furthermore, the agreement should not *a priori* exclude any mode of supply;

- **the elimination of substantially all discrimination between the parties**, i.e. measures that discriminate against service suppliers of other countries within the group will be eliminated, and/or new or more discriminatory measures prohibited;
- **development-related flexibilities** (e.g. asymmetry in commitments, transition periods) in case developing countries are parties.

In clear, WTO legal conditions imply that the negotiations – and therefore the future agreements – are **bound to be ambitious**.

3. Why should MPs be interested in this negotiation ?

Simply, because there are considerable benefits from liberalisation of trade in services and investments¹.

Benefits from liberalising trade in services

In general, services sector is one of the **most dynamic sectors** and is growing faster than any other sector. Services correspond to around 75% of employment and GDP in the EU, and around 60% of the GDP in the MED-countries.

- **No economy of today can prosper without an efficient services industry.** Competitive services (particularly communication, transport, professional or financial) are essential inputs for all sectors, for services as well as for industrial production, and are therefore an important **prerequisite for the attraction of investors and successful economic performance**.
- Liberalisation will enable **access to world-class services** which facilitates exporters and producers to capitalize on their competitive strength. Indeed, backbone services such as e.g. financial and telecommunication services play an important role in the production of goods and of other services.
- Services liberalisation leads to **dynamic gains** such as knowledge spill-over, faster innovation, and transfer of technology including access to efficient technologies and production methods.
- There is also strong evidence in many services that liberalisation leads to **consumer savings** in terms of lower prices, better quality and wider choice for consumers. These benefits, in turn, influence positively supply conditions of other products and services.

Benefits from liberalising investments

- The inter-dependence and complementarities between trade and investment are widely recognised.²

¹ See particularly: OCDE, The Development dimensions of trade, 2001; B. Hoekman, A. Mattoo, P. English, Development, trade and the WTO- a handbook, World Bank, 2002.

- Foreign direct investment (FDI) is defined as the acquisition of means of production and is a key means in promoting development and economic and social growth. While there is a direct link between the rate of investment and GDP growth, investment rates in the MPs remain relatively low (around 5-15% of GDP) compared with many other countries (e.g. in the EU roughly 20%).
- International rules on FDI contribute to improving the business climate by increasing legal certainty for investors and by reducing the perceived risk to invest. It is clear that FDI flows also depend on a whole range of other factors such as political and macroeconomic conditions, infrastructure and human capital, domestic policies, and the bureaucratic environment.
- However, domestic reforms are crucial in contributing to attract FDI, and their effectiveness can be enhanced if backed by international rules ensuring that the regulatory framework will remain stable, transparent and non-discriminatory.
- Furthermore, due to inter-dependence and complementarities between investment and trade it is important that they are addressed together. This is particularly important in the case of trade in services since over 60% of worldwide FDI goes into the services sector. The joint liberalisation of trade in services and investment is therefore an essential step for the Mediterranean countries' integration into the global economy.

4. What is the Istanbul Framework Protocol about ?

- This Framework Protocol was adopted by Euro-Mediterranean partners during the Trade Ministerial Conference of Istanbul in July 2004. It is not a binding agreement but a general framework that is meant to be used as a basis for the liberalisation of trade in services.
- Many of its provisions are inspired by the language of the GATS, the two main exceptions being the articles dealing with the regional MFN clause and with the further integration of services markets (articles III and XX, respectively).
- Since the Istanbul Protocol does not address the right of establishment, it will need to be complemented during the negotiations (as the future agreements are meant to cover both services and the right of establishment).

5. Would the future agreements go beyond WTO commitments ?

- Yes. These agreements would be preferential “economic integration” agreements in the sense of GATS Article V. They would therefore have to go beyond WTO commitments (see question 2 above).

² See notably UNCTAD's 2003 World Investment Report, on 'FDI policies for development'.

6. *How does the EU envisage the negotiations on the right of establishment ?*

As regards the right of establishment, the EU is in favour of an approach which is both ambitious and flexible.

The EU approach to the right of establishment is meant to be complementary vis-à-vis the bilateral investment treaties (BITs), which a number of Mediterranean countries have concluded with some EU Member States. While BITs focus on the protection of investors once they are established, the EU objective is to develop a complementary instrument which would bring value-added to these agreements. The EU approach can therefore be summarized as a **transposition of the logic of GATS ‘Mode 3’ negotiations to the primary and secondary sectors** (i.e. agriculture and manufacturing).³ It can also be described as follows:

- It focuses on long-term FDI (i.e. productive investment that generates employment and growth) and does not cover short-term capital movement such a portfolio investment;
- It fosters **transparency** by clarifying regulatory framework, and ensures that host and home countries fully retain their **right to regulate** by following a positive list approach of commitments for sectoral coverage, and creates in that way a **predictable** business-friendly environment, itself a basis for increased investment;
- It improves market access and provides for national treatment in accordance with the laws and regulations of the host country;
- It aims at freeing the flow payments and investment-related capital movements, while preserving the possibility to take safeguard measures in exceptional circumstances;
- It seeks to facilitate the movement of investment-related natural persons (‘key personnel’).

7. *Why is regionalism so important ?*

- Regional integration serves as a **first step towards the integration into the world economy**, as can be illustrated by the EU’s post WWII experience. Simply put, if Mediterranean partners are not able to trade with their neighbours on the local market it is likely that they will not be in a good position to compete at the global level.
- Regional integration, because it allows a restricted group of dedicated partners to go further in their cooperation that is possible in the WTO, can actually contribute to reinforce the multilateral trading system – notably by showing the way and offering

³ One should not forget that the GATS deals with the right of establishment in services sectors, as so-called ‘Mode 3’ commitments relate to the liberalization of commercial presence (i.e. investment) of services suppliers in the territory of the WTO Members.

successful examples of what can realistically be done internationally between committed partners.

- Regional integration is a **huge incentive to invest** as the size of the market may become sufficient to justify setting up a local supplier. By contrast, the conclusion of bilateral agreements with individual countries is of much lesser value, because it opens relatively small markets, instead of opening a whole region.
- There are also significant – though difficult to measure – **dynamic effects** in regionalism: Opening markets at the regional level increases competition and efficiency of companies, and gives a boost to FDI. **Intra-regional integration therefore spurs growth.** Economically, intra-regional trade is the most powerful source of growth, more so than inter-regional trade – this is a lesson that can be drawn from the EU’s own experience (in 2002, the effect of the internal market was estimated at 1,8% of the GDP of the Union, which is enormous), but also from recent economic studies (notably from the World Bank) on the Mediterranean region. The effect of a “deep integration” process including trade in services could be between 4 to 20% of growth of GDP⁴.

In short: Regional agreements can be used as **building blocks for integration into the global trading system.**

8. *What does the regional MFN clause mean ?*

- This clause comes from the Istanbul Framework Protocol on the liberalisation of trade in services. It means that each Mediterranean partner should eventually grant other Mediterranean partners a preferential treatment that should not be *less favourable* than the one granted to the EU. Derogation from this principle would normally only happen in two cases:
 - In the case Mediterranean partners have not signed an agreement between them. In this case, the regional MFN would not apply. This is a very important exception: it preserves the right of each country to decide not to integrate with another country. However, once an agreement has been signed, the clause starts to apply.
 - In the case of South-South vs. North-South agreements. In clear, MPs can still grant each other a more favourable treatment than the one they are willing to grant the EU. This is an important element, which is interesting since it has been inserted at the initiative of the EU. In clear, regional integration between the Mediterranean partners is important enough for the EU to be ready to renounce the right to request the benefit of some of the provisions of the South-South agreements which will eventually be concluded. Therefore, MPs can go further in their own regional integration than vis-à-vis the EU.

⁴ D. Müller-Jentsch, Economic prospects for the Euro-Mediterranean partnership: deeper integration and trade in services, World Bank –European Commission, 2003.

9. Will all the Mediterranean partners start negotiations at the same time ?

- Not if they do not feel ready to do so. While they have all been invited to start negotiations on 24 March in Marrakech, nobody is forced to do so. The reason is also that the deadlines for examining the situation as to the widening of the scope of the agreements to trade in services and right to establishment are elapsing at different times for different countries.
- This approach will therefore allow those countries that are willing to start the negotiations right away to do so, and not to be hindered by those who may wish for any reason to wait a bit longer.

10. How will negotiations be organised: regionally or bilaterally ?

- The negotiations will be conducted through a combination of methods, at both regional and bilateral level.
- With a view to ensuring coherence of the regulatory framework across the Euro-Mediterranean region, the general provisions on both services liberalisation and the right of establishment should be virtually identical in all the future agreements. They should therefore best be negotiated jointly, among all the participants to the first wave of negotiations (one can thus think of those as ‘plurilateral’ negotiations).
- As differentiation among the Mediterranean partners is however necessary to tailor the future agreements to the specific needs and level of development of every country, the negotiation of specific commitments will be conducted on a bilateral basis.

11. How will the future agreements take into account the specificities of the various MPs ?

- In many ways. First of all, their **level of development will be taken into account** in the negotiation of the specific commitments that will complement the plurilateral negotiations on the general provisions. As most Mediterranean partners are developing countries, they will enjoy a more favourable treatment than the EU. Therefore, developing Mediterranean partners will benefit from a better access into the EU markets than the EU will do into their own markets.
- Both in services and investment, using a **positive list approach** is a possibility. This means that only sectors which have been included in the list are committed according to the commitments and restrictions mentioned. The main advantage of this approach is that the parties can tailor the commitments according to their specific needs. For example, a sector can be liberalised in general with limitations nevertheless remaining in those sub-sectors that the partner concerned still wishes to protect from foreign competition.

- Also, in case domestic operators would need time to adapt to foreign competition, the market opening can take place gradually, with transition periods agreed on a case-by-case basis.

12. Will the negotiations lead to deregulation and privatisation of public services ?

- Liberalisation is neither about privatisation nor about deregulation. Trade and investment negotiations are only about progressive facilitation of trade and investment, with a view to provide equal opportunities for economic operators from different countries. Regardless of whether the market is open or closed, governments will retain the right to regulate, and e.g. to impose requirements that must be met for the providers to supply the service. In fact, openness often requires more regulation to be put in place.
- In EU countries, public services are often subject to strict official regulation aimed at guaranteeing affordable and quality services to the entire population. In line with this approach, the agreements will **preserve the parties' right to regulate** economic and non-economic activities within their territory and to guarantee the achievement of legitimate public policy objectives.
- In addition, both the GATS and the Istanbul Framework Protocol exclude from their scope any service which is supplied in the exercise of governmental authority (i.e. neither supplied on a commercial basis nor in competition). This exclusion ensures the preservation of the public authorities' prerogatives to exclude a specific activity from competition.
- Finally, the parties will remain free to **decide on the level of opening of their market** to foreign suppliers, and will keep their right to maintain and develop **the regulatory framework they deem appropriate for the organisation of each services sector**. With respect to public services, for instance, the parties will retain the right to maintain services as a monopoly; open them to competition but restricting access to national competing suppliers; or to take GATS commitments covering the right of foreign operators to supply services, in addition to national ones. This will however certainly be issues that would be addressed during the negotiations.

13. Integrating trade and development instruments

As important an element as it may be to ensure the sustainable development of any economy, trade and investment liberalisation is merely a means that should not be confused with the end. Therefore, this negotiating process will not be only about trade liberalisation. It will also be about using all available development tools to make sure that they complement and support the objectives that are to be achieved through the opening of trade in services and investment.

- The EU is well aware that the creation of a free trade area by 2010 and the overall success of the Barcelona Process require substantial financial assistance, and therefore it will continue to provide financial support to the Mediterranean partners.
- Since 1995, the EU has earmarked a total of €8.8 billion for MEDA bilateral and regional projects that support the implementation of the Association Agreements and the

adoption of key social and economic reforms in the Mediterranean countries.. The funds were divided between the MEDA I programme, from 1995 to 1999, which accounted for €3,435 million, and the MEDA II programme, from 2000 to 2006, representing €5,350 million.

- From 2007 onwards, the new European Neighbourhood Partnership Instrument (ENPI) will replace MEDA. ENPI-financed programmes will continue to support economic reforms related to the implementation of the Association Agreements and the ENP Action Plans. They will also provide the possibility to finance activities related to the liberalisation of trade in services. The economic chapters in the Action Plans focus on regulatory harmonisation between the Neighbours and the EU, thereby overcoming regulatory barriers and facilitating trade, including trade in services.

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