

ANALYSIS OF DRAFT WAIVER DECISION ON SERVICES AND SERVICES SUPPLIERS OF LDCs

SYNOPSIS

On 29 November 2011, the Chairman of the CTS submitted a proposal for a draft waiver decision to be submitted to Ministers for adoption at the 8th Ministerial Conference.¹ This is essentially a waiver from the most-favoured nation treatment clause (Article II. 1) in GATS to allow Members to provide preferential and more favourable treatment to services and services suppliers of LDCs.

This Note is an analysis of the draft waiver decision. Two main issues have arisen in the draft waiver text. Firstly the types of preferences covered by the waiver, in order to be effective, needs to go beyond market access measures. The second issue is that of rules of origin. There is need to clarify the meaning of rules of origin in the waiver.

It concludes that in order for the services waiver to be beneficial for the LDCs, it has to deliver on market access in sectors and modes of supply (in particular, mode 4) of interest to LDCs; improve access of LDCs services suppliers to global distribution channels and information networks. LDCs want operationalization of priority market access. Yet in as much as the waiver remains the unilateral decision of WTO Members to grant this preferential treatment; then there remains a weak link.

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ANALYSIS OF DRAFT WAIVER DECISION ON SERVICES AND SERVICES SUPPLIERS OF LDCs

I. INTRODUCTION

- 1) For most LDCs the ability to marshal internal resources in the form of domestic savings and to produce a meaningful exportable surplus remains a distant prospect. These problems are exacerbated by other factors such as external debt burden. Official Development Assistance (ODA) -- the long-established source of development finance which has annually accounted for a sizable percentage of the development budgets for many LDCs has declined in real terms since the 2007 following a series of austerity budgets in many donor countries. Given the ever-increasing demand for aid from various competing sources around the world, it is fair to say that the future prospects of ODA are uncertain. Reversing these trends requires a reinvigorated effort by the international community to provide comprehensive assistance to LDCs, of which increased participation in services trade forms but one part.
- 2) The service sector covers a wide spectrum of activities, which range from traditional sectors like communications, transport, finance, energy and tourism; to new and dynamic sectors like software development, environmental and educational services. Services satisfy both commercial (e.g. banking), and social needs (e.g. health and education services). The latter, in most, if not all countries, are viewed as key government responsibilities, subject to close regulation and control, with governments in many cases also acting as the main suppliers in order to ensure universal access and equity.
- 3) In order to understand the constraints on what is achievable in trade in services for LDCs, it is necessary to mention at the outset some of the challenges facing the LDCs today. Most visibly LDCs face the challenge of overcoming extreme poverty. UNCTAD's Least Developed Countries Report 2011 indicates that the continuing marginalization of LDCs in the global economy is apparent in a number of dimensions. While LDCs represent a significant and increasing share of world population (12 per cent in 2009), their contribution to global output remains below 0.9 per cent, considerably lower than what it was in the mid-1970s. In other words, one eighth of the world's population produces less than one 100th of the world total GDP. With regard to international trade, the LDCs' share of world merchandise exports hovered around 0.6 per cent between the 1980s and the early 2000s, and has climbed to 1 per cent more recently. The bulk of the recent improvements, however, is accounted for by fuels; excluding that product line, LDCs accounted for only 0.53 per cent of world exports in 2009.¹ All these pose major challenges for unilateral efforts by LDCs to stimulate economic growth and development.

¹ UNCTAD Doc., *The Least Developed Countries Report 2011* at page iii

II. STATISTICS ON SERVICES TRADE

- 4) A few trade statistics can serve to illustrate the growing importance of trade in services and also highlight the differences between LDCs and other countries. In developed countries, services account for roughly 70 per cent of production, employing nearly 80 per cent of workers in OECD countries. In some developing countries, services now feature more prominently than traditional sectors such as agriculture; and account for more than 50 per cent of economic activity. Some developing countries, such as India have established themselves in outsourcing and as leading exporters of IT services. But the story is different for the LDCs. The table below shows the share of LDCs in global trade in commercial services, share in world imports, share in world exports, and import to export ratio. The average share of LDCs for trade in services between the years 2007-2009 was 2.40 per cent. Share in world imports stood at 3.74 per cent while exports were 1.15 per cent

Most LDCs import more services than they export

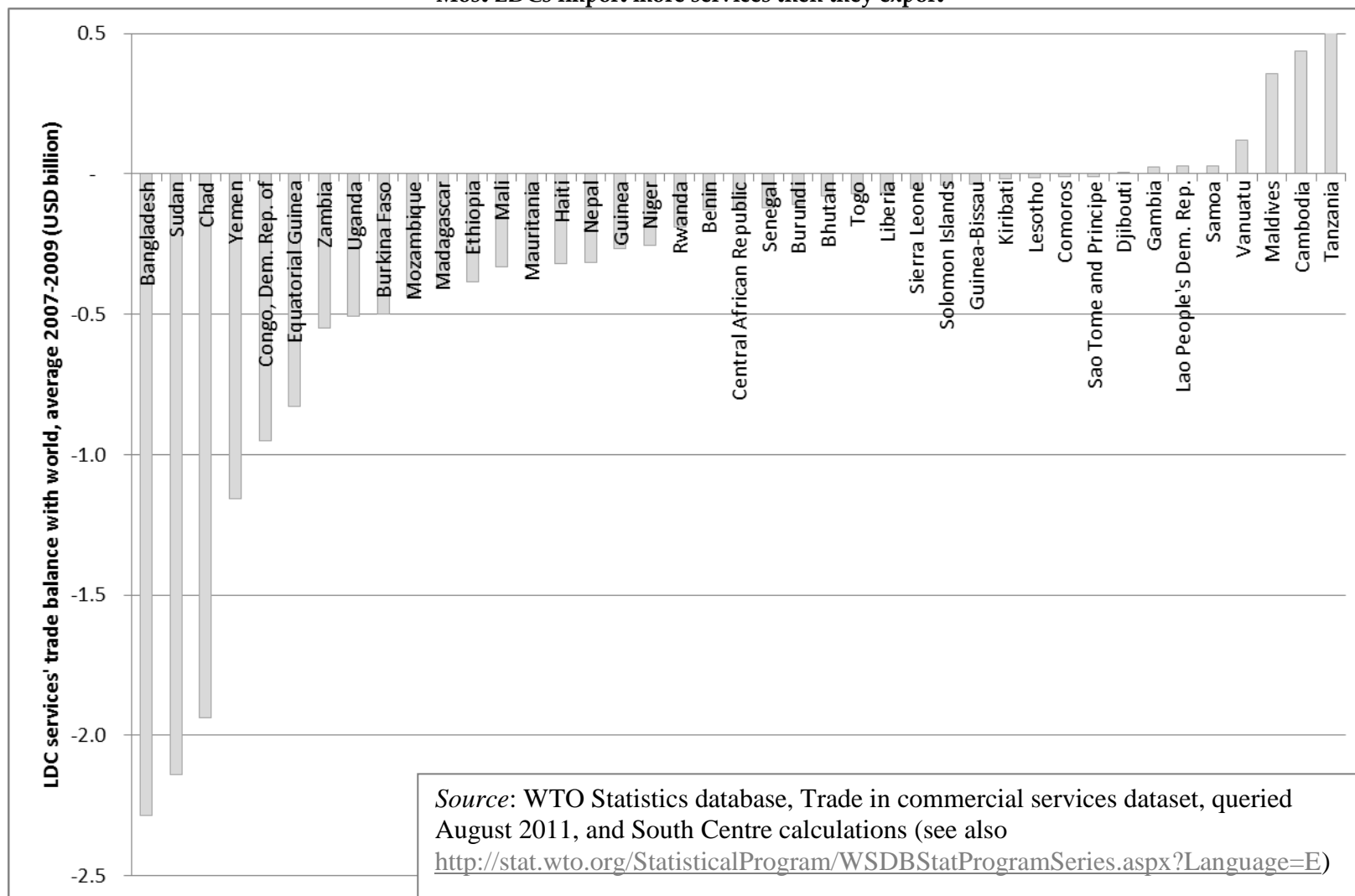


Table: LDCs' share in services trade

LDC	Share in world trade	Share in world imports	Share in world exports	Ratio imports / exports
Angola	0.64%	1.30%	0.03%	48.7
Bangladesh	0.17%	0.29%	0.07%	4.0
Tanzania	0.16%	0.14%	0.18%	0.8
Yemen	0.13%	0.19%	0.08%	2.5
Sudan	0.13%	0.23%	0.03%	7.0
Ethiopia	0.10%	0.12%	0.08%	1.5
Chad	0.09%	0.19%	0.01%	24.7
Madagascar	0.09%	0.11%	0.07%	1.6
Uganda	0.08%	0.11%	0.06%	1.8
Senegal	0.08%	0.09%	0.07%	1.2
Cambodia	0.07%	0.05%	0.09%	0.6
Congo, Dem. Rep.	0.07%	0.11%	0.03%	4.4
Mozambique	0.06%	0.08%	0.04%	2.1
Nepal	0.05%	0.07%	0.04%	1.8
Zambia	0.05%	0.07%	0.02%	3.3
Maldives	0.04%	0.03%	0.06%	0.5
Haiti	0.04%	0.05%	0.02%	2.3
Equatorial Guinea	0.04%	0.08%	0.00%	46.4
Mali	0.04%	0.05%	0.02%	2.4
Burkina Faso	0.03%	0.06%	0.01%	5.7
Rwanda	0.03%	0.04%	0.02%	2.0
Benin	0.02%	0.03%	0.02%	1.8
Mauritania	0.02%	0.04%	0.01%	4.7
Guinea	0.02%	0.03%	0.01%	5.2
Lao People's Dem.R	0.02%	0.02%	0.02%	0.9
Niger	0.02%	0.03%	0.01%	5.1
Togo	0.02%	0.02%	0.01%	1.6
Vanuatu	0.01%	0.01%	0.02%	0.4
Liberia	0.01%	0.02%	0.01%	1.7
Bhutan	0.01%	0.01%	0.00%	2.5
Central African Republic	0.01%	0.01%	0.00%	5.9
Solomon Islands	0.01%	0.01%	0.01%	1.8
Sierra Leone	0.01%	0.01%	0.00%	2.1
Djibouti	0.01%	0.01%	0.01%	1.1
Gambia	0.01%	0.01%	0.01%	0.7
Guinea-Bissau	0.01%	0.01%	0.00%	2.0
Burundi	0.01%	0.01%	0.00%	36.7
Lesotho	0.00%	0.01%	0.00%	1.5
Comoros	0.00%	0.00%	0.00%	1.4
Samoa	0.00%	0.00%	0.00%	0.4
Kiribati	0.00%	0.00%	0.00%	3.4
Sao Tome and Principe	0.00%	0.00%	0.00%	2.1
All LDCs	2.40%	3.74%	1.15%	3.2

- 5) The story is that the vast majority of LDCs import more services than they export. The chart shows that only Tanzania, Cambodia, Maldives, Vanuatu, Samoa, Lao People's Dem. Rep and Gambia have surpluses in their global trade in services (500 million for the case of Tanzanian). These gains mostly come from the tourism and transport sectors.
- 6) Looking at the table and chart above, we can conclude that in terms of global services trade; LDCs as a group are net importers of services and therefore important as destination markets and less important as exporters. However, for individual LDCs, the importance of services trade is varied, and some countries have a relatively significant share of services exports as part of their overall trade. This observation should guide some of the negotiating interests of LDCs.

III. MANDATES FOR ACCORDING SPECIAL PRIORITY

- 7) The **Preamble** to the GATS reflects the 3 objectives that guide the negotiations on services, namely: (i) to establish a multilateral framework or principles and rules with a view to progressively liberalize trade in services as a means to promote global economic development; (ii) recognizing that WTO members, in particular, developing country members still need to regulate the supply of services in line with national policy objectives; and (iii) the need to assist developing countries to strengthen their domestic services capacity, efficiency and competitiveness, such that they may expand their services exports and participation in the multilateral trading system.
- 8) **Article IV** is at the heart of special and differential treatment (S&D) provisions for LDCs under the GATS. Article IV.1 provides for increasing the participation of developing countries through the 'negotiation of specific commitments' by other members in order to: (i) strengthen their domestic capacity, efficiency and competitiveness; (ii) improve their access to distribution channels, information networks and technology; and (iii) liberalize sectors and modes of supply of interest to developing countries. Article IV: 3 provides that in implementing the aforementioned provisions, special priority shall be given to LDCs. In particular, non-LDC members should take into account the serious difficulties LDCs face in accepting negotiated specific commitments due to their 'special economic situation and their development, trade and financial needs'.
- 9) Article IV should be read together with the Modalities for the Special Treatment for LDCs in the Negotiations on Trade in Services² (see Annex 1 of this paper) and the Guidelines and Procedures for the Negotiations on Trade in Services.³

² WTO Document TN/S/13

³ WTO Document S/L/93

- 10) The modalities contain useful provisions and practical examples of activities aimed at achieving full implementation of GATS Article IV and increasing the participation of LDCs in trade in services. These include, a call for programmes that promote investment in services sectors in LDCs, promoting development of LDCs' infrastructure and services export capacity with a focus on training; technology transfer; enterprise level schemes; intergovernmental cooperation; and where feasible, financial resources. Targeted and coordinated technical assistance and capacity building programmes shall continue to be provided to LDCs to strengthen their domestic capacity, develop institution and human capacity and assist them to undertake necessary regulatory reforms. Technical assistance shall also be provided to assist LDCs to conduct an assessment The Modalities recognise Mode 4 as being of special interest to LDCs and call on members to consider, to the extent possible, undertaking commitments to provide access in mode 4, taking into account the categories of natural persons identified by LDCs in their requests. Lastly, the modalities provide that in the negotiations on rules under the GATS, that is, dealing with subsidies, emergency safeguard measures, domestic regulation and government procurement, members shall take into account the special interests and difficulties faced by LDCs.
- 11) In addition, **the Hong Kong Ministerial Declaration** in its paragraph 47 calls on Members to implement the LDC modalities and give priority to the sectors and modes of supply of export interest to LDCs, particularly with regard to movement of services providers under mode 4.
- 12) **Paragraph 3; Annex C, Hong Kong Declaration** calls for full and effective implementation of the LDC Modalities. Paragraph 9 requires members to develop methods for the full and effective implementation of the LDC Modalities, including expeditiously:
 - (a) Developing appropriate mechanisms for according special priority including to sectors and modes of supply of interest to LDCs in accordance with Article IV:3 of the GATS and paragraph 7 of the LDC Modalities.
 - (b) Undertaking commitments, to the extent possible, in such sectors and modes of supply identified, or to be identified, by LDCs that represent priority in their development policies in accordance with paragraphs 6 and 9 of the LDC Modalities.
 - (c) Assisting LDCs to enable them to identify sectors and modes of supply that represent development priorities.
 - (d) Providing targeted and effective technical assistance and capacity building for LDCs in accordance with the LDC Modalities, particularly paragraphs 8 and 12.
 - (e) Developing a reporting mechanism to facilitate the review requirement in paragraph 13 of the LDC Modalities.
- 13) In light of the various mandates for special priority for the LDCs outlined above, the question that arises is how do the LDCs transform these mandates

into concrete measures? It is in order to achieve this aim that WTO members are currently seeking a Services Waiver for the LDCs. But facilitating exports requires strengthening their domestic services capacity. LDCs need to identify their existing services capacity and sectors and the types of transactions of export interest. These require an assessment of LDCs services sectors. This assessment is in fact a mandate in the services negotiations.

IV. AN ASSESSMENT ON TRADE IN SERVICES

- 14) One issue of vital importance to LDCs in the current negotiations is the assessment on trade in services. Article XIX:3 of the GATS and Paragraphs 14 and 15 of the Negotiating Guidelines provide that the CTS in special sessions shall carry out an assessment of trade in services for each new round of negotiations, both generally and on a sector by sector basis, to see whether the objectives of Article IV are being realized
- 15) According to Paragraph 14 of the Guidelines, the negotiations shall be adjusted in light of the results of the assessment, with reference to the objectives of GATS Art IV. In theory, this means that the findings of the assessment, in respect of LDCs, can be used to adjust the negotiations to ensure that the objectives of GATS Article IV are being met (increasing the participation of developing countries).
- 16) An assessment is invaluable for LDCs because essentially it should be a judgment on the effect of the GATS on their services trade. They can use it as a basis to develop their development and negotiating objectives -- draw conclusions from it in order to identify sectors where opportunities exist; where they are strong and have an exporting interest and those where they are weak.
- 17) Without the reassurance of a sound assessment many LDCs might not be able to take advantage of any preferential market access that will come with the services waiver. An analysis of current data needs to look at the economic objectives of the GATS and how they relate to LDCs. This is in terms of promoting economic growth, increasing participation in trade in services, and liberalization of modes of supply and sectors of interest to LDCs. It appears logical that LDC Members would also conduct their own individual assessments independently from that mandated by the GATS in order to develop their negotiating objectives and to respond to changes in domestic trade policy.
- 18) An assessment of individual LDCs and their services sectors is therefore essential. An assessment is needed to examine the participation of LDCs in trade in services, including, existing liberalization commitments by developed and developing members, in sectors and modes of supply of interest to LDCs. The assessment should examine whether the objectives of the GATS Preamble and Article IV have been achieved, and if not, what are the causes. The CTS can use the assessment to evaluate the quality of offers and commitments by

developed and developing countries in those sectors of interest to LDCs. In making offers, non-LDC members should focus on those sectors, transactions and modes indicated by LDCs as being of export interest to them.

V. THE LDC SERVICES WAIVER – KEY ELEMENTS

- 19) On 29 November 2011, the Chairman of the CTS submitted a proposal for a draft waiver decision to be submitted to Ministers for adoption at the 8th Ministerial Conference.⁴ This is essentially a waiver from the most-favoured nation treatment clause (Article II. 1) in GATS to allow Members to provide preferential and more favourable treatment to services and services suppliers of LDCs.
- 20) The waiver's cornerstone lies in its paragraph 1, wherein MFN obligations of the GATS are hereby waived to the extent necessary to permit members to provide preferential treatment to services and services suppliers of LDCs without according the same treatment to like services and service suppliers of all other members. The waiver is designed to promote the trade of LDCs in sectors and modes of supply that are of particular export interest to them. Paragraph 7 proposes the termination date of the waiver to be 15 years from the date it is granted. In each of its annual reviews, the General Council shall examine whether the exceptional circumstances justifying the waiver still exist and whether the terms and conditions attached to the waiver have been met.
- 21) Paragraph 5 provides that for the purpose of preferential treatment, a service supplier of a least developed country is (a) a natural person of a least developed country, or (b) a juridical person which is either (i) constituted or otherwise organized under the law of a least-developed country and, if it is owned or controlled by natural persons of a non-least-developed country Member or juridical persons constituted or otherwise organized under the law of a non-least-developed country Member, is engaged in substantive business operations in the territory of any least-developed country; or (ii) in the case of the supply of a service through commercial presence, owned or controlled by (1) natural persons of least-developed countries; or (2) juridical persons of least-developed countries.
- 22) Two main issues have arisen in the draft waiver text. Firstly the types of preferences covered by the waiver, in order to be effective, needs to go beyond market access measures. The second issue is that of rules of origin. There is need to clarify the meaning of rules of origin in the waiver.

⁴ WTO Doc. TN/S/37 *Preferential Treatment to Services and Service Suppliers of Least-Developed Countries*

A. The scope of the waiver

- 23) The draft waiver decision limits the scope to the application of measures described in GATS Article XVI (market access). Preferential treatment with respect to the application of measures other than those described in Article XVI, is subject to approval by the Council for Trade in Services in accordance with its procedures and will be annexed to the waiver.
- 24) Therefore any measures which discriminate against services and services suppliers of LDCs in developed countries will have to be negotiated and is subject to the approval of the Council for Trade in Services. What this means in practice is that developed countries can still keep economic needs texts and nationality/residency requirements even in sectors where they might have granted preferential access to LDC services and services suppliers. This paragraph is thus an empty shell with no effective and actual access really granted to the LDCs.

Economic Needs Tests

- 25) Developed countries often use economic needs test (ENT) in their liberalization commitments as means of protecting sensitive sectors. An ENT can generally be characterized as a provision in national regulations, legislation or administrative guidelines imposing a test which has the effect of restricting the entry of service suppliers, based on an assessment of "needs" in the domestic market. Such measures operate to restrict access for foreign suppliers to a market. Examples of these in the context of the movement of natural persons may be: the protection of the local work force in certain sectors through residency and nationality requirements. In terms of services supplied through a commercial presence (foreign investments), application of ENTs are designed to "safeguard" particular sectors in favour of domestic suppliers.
- 26) The policy justification behind these ENTs is that it would be socially and economically undesirable to allow foreign suppliers to enter the market when there are local suppliers who could meet demand. For example, in the hospital services sector, France indicates that service suppliers with access to management functions must receive prior authorisation; one of the criteria to be taken into account being "the availability of local managers". In the EU's GATS schedule of commitments, Spain and Italy indicate that an ENT applies to the establishment of new pharmacies, the main criteria for which include "the population, the number of existing pharmacies and their geographical density". This illustrates the protection accorded to domestic suppliers against foreign suppliers in the allocation of approvals or permits to establish new pharmacies.
- 27) The ENTs in financial services in the EU's GATS schedules relate in most cases to the establishment of branches and subsidiaries in the market. In some cases, they address the expansion of activities of already-established service suppliers. The criteria listed for the ENTs are generally very vague. They make market access dependent on "public interest" "public benefit", such as whether "current

and future conditions of the market permit satisfactory operation of the company to be set up"; or "in accordance with the economic conditions and needs"; or the "need to control the number of companies operating in the country".

- 28) In transport services, criteria listed include "the adequacy of current levels of service"; "the effect of new entrants on public convenience, including the continuity and quality of service"; "number of service suppliers in the local geographic area"; "existing public transport on the route concerned"; "traffic criterion"; "need to provide protection to investment of operators in unserved areas/developmental routes"; and "the route measured capacity test for numbers of vehicles". In distribution services, the tests concern mainly the establishment of department stores. Relevant criteria include "the number of and impact on existing stores, population density, geographic spread, impact on traffic conditions and creation of new employment."
- 29) The current obstacles to mode 4 trade are also considerable. These include vague definitions for the categories of persons included in schedules, the limited number of commitments for categories de-linked from commercial presence, the bias in favour of highly skilled persons; the lack of recognition of certain qualifications.

B. Rules of origin

- 30) Rules of origin are meant to ensure that services and services suppliers from non-LDCs do not free-ride on the concessions granted to the LDCs. For example, suppose the US gives preferential market access of business services to Bangladesh; how can the US prevent Indian companies from supplying these services through an affiliated or unaffiliated company in Bangladesh? A further issue is what level of 'service transformation' would need to take place for these business services imported into Bangladesh to qualify for trade preferences? The choice of rule of origin determines *who* will benefit from the preferential treatment.
- 31) Defining rules of origin in services trade is different and more complex than for goods. Services being intangible, it is difficult or nearly impossible to measure domestic value addition. And transformation of services is not as clear as might be the case in goods to distinguish processing.
- 32) The central question is whether LDCs would prefer a restrictive rule of origin or a liberal/broader one. If service suppliers take the form of firms (juridical persons), a restrictive rule of origin would limit export to national suppliers (or, more broadly, already established suppliers). On the other hand, liberal rules extend benefits to third party service suppliers.
- 33) Adopting restrictive rules of origin could be disadvantageous for LDCs in terms of potential access to foreign markets. Most LDCs are small economies and not

globally competitive in most sectors, partnerships and joint ventures could enhance their ability to enter foreign markets.

34) Paragraph 5 of the draft waiver decision provides that:

For the purpose of preferential treatment granted pursuant to paragraph 1, a service supplier of a least-developed country is:

a natural person of a least-developed country; or

a juridical person which is either:

constituted or otherwise organized under the law of a least-developed country and, if it is owned or controlled by natural persons of a non-least-developed country Member or juridical persons constituted or otherwise organized under the law of a non-least-developed country Member, is engaged in substantive business operations in the territory of any least-developed country; or

in the case of the supply of a service through commercial presence, owned or controlled by:

1. natural persons of least-developed countries; or
2. juridical persons of least-developed countries identified under subparagraph (i).

35) The problem with this proposal is that the phrases '*substantive business operations*' and '*owned or controlled*' are not defined. If our aim is to adopt broader and more liberal rules of origin, then it makes sense to see what the norm is in other trade agreements. Fink's analysis of services agreements involving ASEAN countries shows that they have adopted a rule requiring only '*substantial business operations*' in the territory of a party.⁵ The second criteria in the waiver above which is the element of ownership and control is absent. In other words, a non-party service supplier which engages in substantial business operations may also benefit from the preferential agreement. It should be noted, however, that even though this broader rule of origin extends trade preferences to third-party service suppliers; it still discriminates between party and non-party suppliers in that the latter can be denied benefits in the absence of proof of substantial business operation. While the former is entitled to the benefit regardless of the size of its business operation in territory of the party. For example, a subsidiary of a South African company operating in Zambia may also benefit from the preferential treatment given to Zambia under the services waiver.

36) The criteria for determining substantive business operation are (a) the nature and scope of business and (b) years of operation required. For example in the China-Macao Closer Economic Partnership Agreement, a service supplier should be engaged in substantive business operations for 3 years or more.

⁵ Fink and Molinuevo, 'East Asian Free Trade Agreements in Services: Key Architectural Elements' *Journal of International Economic Law* 11(2), 263-311 (2008)

- 37) In the China - Hong Kong Closer Economic Partnership Agreement, to qualify for the benefits of the CEPA, the Hong Kong company must be engaged in 'substantive business operations. 'Substantive business operations' are assessed on the basis of the following criteria:
- The company must be incorporated under the laws of Hong Kong
 - The company must be liable to pay profits tax in Hong Kong
 - The minimum period of the company's substantive business operations in Hong Kong is 3 years, but for construction and real estate, banking and insurance industries, the requirement is 5 years;
 - The company should own or rent premises in Hong Kong to engage in substantive business operations. The scale of its business premises should commensurate with the scope and the scale of its business; and
 - The company must employ in Hong Kong 50% or more of its total staff.
- 38) The above is in line with the spirit of Article V.6 of the GATS Agreement which requires WTO members to extend the benefits of preferential agreements to foreign owned and controlled service suppliers that engage in substantial business operations in the territory of a member.
- 39) Therefore a rule of origin that expressly includes the domestic ownership and control criteria leads to a marked reduction in the number of service providers eligible for preferential treatment benefits. Eligibility for preferences will be confined to firms that are owned and/or controlled by persons of the exporting LDC country.

VI. PROBLEMS POSED BY PARALLEL NEGOTIATIONS IN OTHER FORA

- 40) There is no doubt that developments in other negotiating fora, which run parallel to the WTO negotiations, can erode the potential gains of LDCs within the WTO. Indeed, the EU exploits parallel negotiations to obtain results in their favour, by locking in certain countries into a specific negotiating position, or by separating certain countries from their coalition partners. Furthermore, for LDCs, the multiplicity of negotiations in various fora, which may not necessarily be coherent, can over-stretch already limited negotiating capacity. High benchmarks in other fora can limit the room for maneuver available to LDCs in the WTO. Therefore, LDCs need to ensure their negotiators and policy makers in different fora are coordinating effectively.
- 41) Perhaps the most significant parallel forum for LDCs at the moment is the negotiations with the EU. Most LDCs are also part of the African, Caribbean and Pacific (ACP) group of countries, currently negotiating the reciprocal Economic Partnership Agreements (EPAs). Most LDCs, especially from East Africa have expressed their opposition to the "WTO Plus" approach favoured by the EU. Most notably, the EU is in favour of opening up trade in services and investments on a reciprocal basis in the EPAs. These contrast sharply with the preferential treatment LDCs are currently seeking in the services waiver.

CONCLUSION

- 42) In order for the services waiver to be beneficial for the LDCs, it has to deliver on market access in sectors and modes of supply (in particular, mode 4) of interest to LDCs; improve access of LDCs services suppliers to global distribution channels and information networks. Its scope has to go beyond market access to make sure that regulations applied in developed countries do not act as barriers to LDC services exports.
- 43) The objective of the LDCs is to access markets on a priority basis. LDCs want operationalization of priority market access. Yet in as much as the waiver remains the unilateral decision of WTO Members to grant this preferential treatment, then there remains a weak link.

READERSHIP SURVEY QUESTIONNAIRE
South Centre Analytical Note

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