Cambridge

International Trade and Economic Law

Preferential Services Liberalization

The Case of the European Union and Federal States

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Cambridge

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IV Preferentialism in Services: Are Services Special?

i Particularities of Going Preferential in Services

The share of trade in services in global cross-border trade is approximately 20 per cent. This is in stark contrast to the importance of the service sector in national economies.[55] The discrepancy reflects the difficulties in trading services across borders.[56] It is noteworthy that Mode 3 (commercial presence) covers approximately 50 per cent of international trade in services.[57] Trade in services is therefore, in practice, much about foreign investment. As pointed out by Fink and Jansen, this is one of the reasons why the perceived wisdom about regional integration coming from traditional trade literature does not necessarily apply to preferentialism in services.[58]

In general, the study of services liberalization can be considered more challenging than the study of trade in goods. Whereas goods trade is liberalized primarily through tariff cuts and elimination of goods-specific regulatory barriers, deep liberalization of services involves a scrutiny of the entire national regulatory framework. Given the broad modal coverage of the GATS, which extends, *inter alia*, to factor movements, i.e. capital and labour, services trade touches upon more complicated issues than goods trade. This complexity is reflected in the lack of coherent theory of services trade liberalization in academic research.

Trade diversion is usually considered to be significant if participating countries have had a high level of external protection prior to the establishment of a PTA. For PTAs concerning goods this concern has become less topical in the post-Uruguay Round era when the level of duties has, for most products, been reduced to low levels.[59] For trade in services, however, the concern is still very valid. The level of liberalization reached since the conclusion of the GATS in 1995 is modest and the barriers to trade in services are still high. There are big differences between the different modes under which services are traded. Therefore, the motivations of

[55] Services represent about two-thirds of global GDP and over 70 per cent of GDP in most developed countries. World Bank data on services, available at http://data.worldbank.org/indicator/NV.SRV.TETC.ZS (last accessed on 15 July 2018).

[56] Fink, C. & Jansen, M. (2009), at 224.

[57] Magdeleine, J. & Maurer, A. (2008) Measuring GATS Mode 4 Trade Flows. *WTO Staff Working Paper*, ERSD-2008-05.

[58] Fink & Jansen (2009), at 224.

[59] Mavroidis, P. C., Bermann, G. A. & Wu, M. (2013) *The Law of the World Trade Organization (WTO): Documents, Cases & Analysis*. St. Paul, MN: Thomson/West, at 155–6.

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countries to liberalize services trade also vary between the modes. Incentives to grant better access to foreign investment under Mode 3 are not necessarily similar to the incentives that an enhanced movement of service suppliers under Mode 4 may offer, or a better access for online services for example. Moreover, the applicable regulations tend to vary greatly depending on the mode of delivery.

Many scholars and practitioners consider that preferentialism in the field of services is likely to be less harmful than in the field of goods. Fink and Molinuevo summarize three basic reasons for this. First, there is the issue of domestic stocktaking. Second, services regulations are often applied in a non-discriminatory manner. The third reason is the liberal rules of origin that are set out in Art. V GATS and also typically applied in EIAs.[60]

The first reason, domestic stocktaking, refers to the positive spillover effects from PTA to WTO negotiations. According to Fink and Molinuevo, such effects may be more important in services than in goods. Services negotiations require a resource-intensive stock-take of all such domestic laws and regulations that might be considered to affect trade in services. Governments that have carried out a comprehensive analysis of their domestic regulatory framework may be better prepared for services negotiations also in other contexts, particularly in the WTO. EIAs may therefore 'play a useful role in overcoming "informational" obstacles to further multilateral integration'.[61]

The second reason behind the less dangerous character of service preferentialism lies in the way regulations are typically applied in practice. Behind-the-border regulations are relevant in goods and services trade alike. In the field of services, however, regulations are the only form of protection. The lack of tariffs means that a central, discriminatory means of protection is completely absent in trade in services. This has important implications for the liberalization of services considering that origin-based discrimination is often hard or at least unpractical to implement through domestic regulation. Adapting one's internal service-related regulation depending on the origin of the service supplier is more difficult to accomplish and can be welfare-reducing as a whole.[62]

[60] Fink & Molinuevo (2008), East Asian Preferential Trade Agreements in Services: Liberalization Content and WTO Rules. *World Trade Review*, 7(4), 641–673, at 641–73.

[61] Ibid., at 668.

[62] With this type of legislation we mean all generally applicable regulation that applies to service suppliers in the territory of a country (to nationals and foreigners alike). Whereas MA limitations are quantitative, this type of regulation is qualitative in nature. Generally,

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As is noted by Miroudot et al., such a practice can create economic distortions that can further translate into productivity losses.[63]

Miroudot and Shepherd note that overall the concept of preferences is not easy to tackle in the context of services trade considering that many service-related measures are not really prone to discrimination between domestic and foreign suppliers. They give the examples of market regulations introducing rules on prices, access to networks or increasing the powers of a competition authority. Such regulations equally benefit domestic and foreign services suppliers. As they note, it is not possible to create a more competitive market for domestic suppliers only. Foreign suppliers would have to be totally excluded from such a market.[64]

Countries therefore often apply the same rules to services and service suppliers of all countries without differentiating between their MFN and PTA partners.[65] Naturally, domestic suppliers may be treated more favourably *de jure* or *de facto* as many service-related rules require nationality, residency or country-specific qualifications. For foreign service suppliers, they often prove equally burdensome for all of them.

Nevertheless, discriminatory application of domestic regulation to service suppliers of different origins is not impossible. Even if governments typically abstain from applying different sets of regulation depending on the origin of the service supplier, some of the most restrictive measures are applied on a preferential basis only. Such restrictive preferential measures

genuine liberalization of internal service-related regulation often happens through unilateral reforms and not through trade negotiations. The preferential treatment of service suppliers of any specific country is thus not usually in a central role when new service-related regulations and reforms are put in place. See Bosworth, M. & Trewin, R. (2008) The Domestic Dynamics of Preferential Services Liberalization: The Experience of Australia and Thailand, in Marchetti, J. & Roy, M. (eds.), *Opening Markets for Trade in Services: Countries and Sectors in Bilateral and WTO Negotiations*. Cambridge: Cambridge University Press, at 633–66.

[63] See Miroudot, S., Sauvage, J. & Sudreau, M. (2010) Multilateralising Regionalism: How Preferential Are Services Commitments in Regional Trade Agreements?, *OECD Trade Policy Papers*, No. 106, 6 December 2010, OECD Publishing, Paris. http://dx.doi.org/10.1787/5km362n24t8n-en, at 9. As an example they mention the promotion of a competitive market in telecoms where the facilitation of new entrants through regulation will benefit all companies.

[64] Miroudot, S. & Shepherd, B. (2014) The Paradox of 'Preferences': Regional Trade Agreements and Trade Costs in Services. *The World Economy*, 37(12), 1751–72, at 16.

[65] This is different under the so-called Mode 4 of the GATS, which involves the cross-border movement of natural persons supplying services. Different conditions are generally applied to nationals of different states. The analysis of liberalization of Mode 4 requires methods somewhat different from other modes of delivery under the GATS. Chapter 8 in Part III (methodology) deals with this problem.

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are most easily applied under Modes 3 and 4. Miroudot and Shepherd note that discriminatory measures usually appear in the form of foreign equity restrictions, labour market tests for the entry of natural persons and the recognition of qualifications. But, as they note, even in these areas, not all countries introduce discriminatory measures.[66]

Undertakings originating in EIA partners may sometimes be allowed to benefit from preferential, and often earlier, access to the market. In such a case, preferential liberalization may exert more durable effects on competition than in the case of goods. For instance, if second-best suppliers obtain a first-mover advantage, it may result in the country being stuck with such suppliers even if liberalization was subsequently carried out on an MFN basis. The establishment of preferences may thus result in entry by inferior suppliers.[67] As noted by Sauvé and Shingal, in the field of services, the sequence of liberalization matters more than in goods.[68]

EIAs sometimes include certain harmonization or coordination of regulatory measures, which may benefit their service suppliers in comparison to service suppliers originating in countries with differing regulatory standards. However, regulatory coordination between EIA partners may have positive effects as well. Sometimes regulatory changes may create schemes that benefit not just the preferential partners but all foreign suppliers.[69]

In addition to the benefits of domestic stocktaking and the non-discriminatory application of services regulation, the third essential element in the less-risky character of EIAs are the liberal rules of origin. Such rules are necessitated by Art. V:6 GATS that requires service suppliers also from countries outside the EIA to benefit from the agreement as long as they are established in one of the parties and engage in substantive business operations in their territories.[70] Rules of origin

[66] Miroudot & Shepherd (2014), at 16.

[67] Winters, A. L. (2008) Preferential Liberalization of Services Trade: Economic Considerations, in Mattoo, A., Stern, R. M. & Zanini, G. (eds.), *A Handbook of International Trade in Services*, Oxford University Press, Oxford and New York, at 223–4. For economic considerations on services preferentialism, see especially Mattoo, A. & Fink, C. (2004) *Journal of Economic Integration*, 19(4), 742–79 and Hoekman, B. & Sauvé, P. (1994) Regional and Multilateral Liberalization of Service Markets: Complements or Substitutes? *Journal of Common Market Studies*, 32(3), 283–318.

[68] Sauvé, P. & Shingal, A. (2011) Reflections on the Preferential Liberalization of Services Trade. *Journal of World Trade*, 45(5), 953–63, at 954.

[69] WTO, *World Trade Report 2011 – The WTO and Preferential Trade Agreements: From Co-Existence to Coherence*, at 54.

[70] In accordance with Art. V:6 GATS, service suppliers of other Members constituted as juridical persons under the laws of a party to an EIA must be entitled to treatment granted

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formed in accordance with Art. V:6 help to attenuate the so-called 'stumbling block' effect of PTAs.[71]

In the case of goods trade, rules of origin are typically based on a value-added criterion. Only goods which have sufficient value added within a specific territory (thus are sufficiently transformed) are eligible for preferential treatment. The design of rules of origin for services trade is essentially different. Instead of targeting the service and its transformation within the relevant territory, they focus on the characteristics of the service supplier. Jansen points at two reasons behind the differences in rules of origin in manufacturing and services. First, the nature of services trade significantly differs from goods trade and thus the rules of origin for services make references to issues such as place of incorporation, particular ownership or control and the level of business operations within a specific territory. Value-added rules are inappropriate for services where only under Mode 1 the service alone is crossing the border. Secondly, the rules of origin in manufacturing and services do not always serve the same purpose. In services, rules of origin similarly delimit the extent to which non-members may benefit from the EIA but they also pursue goals that are more related to regulatory issues than economic interests. Therefore, rules of origin are sometimes constructed in a way that allows for more regulatory oversight within the EIA or domestically.[72]

ii The Lack of Market Access Discipline in Art. V GATS

EIAs tend to follow the disciplines of the GATS in their design: they generally include provisions similar to at least Art. II (MFN), Art. III (Transparency), Art. VI (Domestic regulation), Art. XVI (MA), Art. XVII (NT) and Art. XIV and XIV bis (general and security exceptions)

under such agreement, provided that they engage in substantive business operations in the territory of the parties to such agreement.

[71] Fink & Jansen (2009), at 248.

[72] Jansen, M. (2008) Comment: Is Services Trade Like or Unlike Manufacturing Trade?, in Panizzon, M., Pohl, N. & Sauvé, P. (eds.), *GATS and the Regulation of International Trade in Services*. Cambridge; New York: Cambridge University Press, 139–42, at 139–40. Jansen notes that in a number of sectors, such as the financial sector and telecommunications, regulation plays a crucial role in guaranteeing the efficient functioning of the markets. The policy-makers must therefore make sure that trade liberalization does not jeopardize the regulation of relevant markets. In some cases, rules of origin are designed for protectionist purposes. For example, the condition that owners or managers of foreign companies are domestic may reflect the intention to ensure that their decisions reflect the interest of the domestic establishment and not those of holding companies situated outside the EIA territory.

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of the GATS. Similarly to the GATS, Members typically undertake their EIA commitments in respect of both MA and NT. It is, however, noteworthy that Art. V GATS does not include any MA discipline: it does not require any specific level of liberalization as regards the various, mostly quantitative, limitations included in Art. XVI GATS.

This is reflected in the wording of Art. V that places the emphasis in a specific EIA's analysis to the level of non-discrimination granted to one's partners. Requiring MA commitments from EIA partners would not be desirable, as countries would in that case be incentivized to apply different MA conditions to different trading partners. Relaxed quotas and other quantitative limitations in EIAs could lead to a more restrictive trading environment towards countries outside the EIA. Service suppliers from EIA partner countries would have less restrained access to each other's markets whereas outsiders would be subject to stricter requirements in the form of a higher number of discriminatory quotas and other quantitative restrictions. As a consequence, service suppliers from MFN countries would suffer while EIA service suppliers would enjoy a more favourable operating environment through more open MA conditions.

As Fink and Jansen note, preferential liberalization of services may create a long-term trade diversion effect.[73] In service markets, high location-specific sunk costs and network externalities can give first-movers a durable advantage. Second-best service suppliers may thus take over the market and will not be replaced by first-best suppliers from outside the EIA when trade is eventually liberalized on an MFN basis. Even short-term preferences can thus be detrimental as they have long-term effects.[74]

Preferential MA conditions can take the form of bigger quotas and more relaxed conditions as to the types of legal entities. They may also waive otherwise applicable economic needs tests. Also, a limited number of licences may be made more easily available to preferential partners and the numbers of their personnel may be unlimited.[75] The creation of

[73] 'Trade diversion' is a term originally coined by Jacob Viner. In his groundbreaking work of 1950 Viner analyzed the effects of PTA on economic welfare. He labelled those conflicting forces as 'trade creation' and 'trade diversion'. See Viner, J. (1950) *The Customs Union Issue*. New York: Carnegie Endowment for International Peace.

[74] Fink & Jansen (2009), at 230. The authors point out that the potential for trade diversion effects greatly depends on the rules of origin adopted by an EIA.

[75] Especially self-regulated industries tend to have *numerus fixus* constraints on new entry (certain professions). See Hoekman, B. (1995) Tentative First Steps: An Assessment of the Uruguay Round Agreement on Services, Volume 1. *World Bank Policy Research Working Paper*, No. 1455, at 30.

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preferential MA conditions can thus significantly alter the conditions of competition to the benefit of service suppliers from an EIA partner country as others may in practice be blocked from the market due to later arrival. The problems relating to preferential MA conditions makes us propose that Art. V deliberately omits the requirement to address MA limitations.

In contrast, the requirement of elimination of discrimination towards one's EIA partner is potentially less harmful as it is more likely to benefit also those service suppliers who come from countries outside the EIA. Differentiation among foreign suppliers is more easily carried out with regard to MA conditions as various limitations on the number of services suppliers, economic needs tests and other MA requirements usually involve some type of case-specific discretion.

Considering that MA limitations tend to be the most harmful types of limitations, it can nevertheless be asked why Art. V does not include any discipline on MA at all. If the discipline existed, it could require the elimination of substantially all MA limitations (in addition to the requirement to eliminate substantially all discrimination). Such a requirement could be seen as a counterpart to the requirement of elimination of duties with respect to substantially all the trade between parties to CUs and FTAs under Art. XXIV:8 GATT. The negotiation background of Art. V does not reveal any specific reason for this – actually, we have not identified any clear reason for the neglect of an MA discipline in Art. V either in literature or through various discussions with specialists who were observing the GATS negotiations. As to the MA discipline in Art. XVI of the GATS, there is a wide array of opinions as to its reach and dimensions, especially as a result of the *US–Gambling* dispute.[76]

A close observer of the GATS negotiations has noted that, in his view, one of the underlying and also explicit purposes of Art. XVI was to reform domestic service markets. At least for such countries that were expecting the GATS to induce domestic liberalization, and not just trade liberalization, Art. XVI clearly covered not only discriminatory but also non-discriminatory MA measures.[77]

[76] *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, Report of the Appellate Body, WT/DS285/AB/R, circulated 7 April 2005. For a discussion on the scope of Art. XVI GATS (the GATS discipline on MA), see Pauwelyn, J. (2005) Rien ne Va Plus? Distinguishing Domestic Regulation from Market Access in GATT and GATS. *World Trade Review*, 4(2), 131–70, and Mavroidis, P. C. (2007) Highway XVI ReVisited: The Road from Non-Discrimination to Market Access in GATS. *World Trade Review*, 6(1), 1–23.

[77] Interview with Hamid Mamdouh, Director, Trade in Service Division, WTO Secretariat, 31 January 2013.

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One option is thus to consider whether the lack of an MA discipline in Art. V is related to the perceived function of Art. XVI as a vehicle of domestic liberalization. In such a case there would be less reason to include an MA discipline in the rules on EIAs, which are primarily targeted to ensure a high level of non-discrimination between the participating countries. As we already proposed above, an explicit encouragement towards taking commitments on quantitative limitations in the form of an MA discipline could lead to quotas and other numerical limitations being taken on a preferential basis. That type of preferentialism can be considered especially harmful in the field of services.

Due to the absence of a specific MA discipline in Art. V, Members appear free to include MA limitations in their EIAs. They are, however, restricted by the requirement to eliminate discrimination in the sense of NT as that requirement applies to such MA limitations that are prescribed or implemented in a discriminatory manner.[78] Already this has a restrictive effect on the use of MA limitations, as Members may be reluctant to formulate MA limitations that they would have to extend also to their own service suppliers.[79]

Some commentators have argued that Art. XVI should encompass discriminatory MA limitations only.[80] If this was the case, the reason for the lack of a MA discipline in Art. V could be quite straightforward: since Art. V requires the elimination of discrimination there would be no reason for it to include specific rules for the scheduling of discriminatory MA limitations. The majority opinion, however, appears to be that Art. XVI covers discriminatory and non-discriminatory measures alike. This is also the WTO Secretariat's view[81] and, most importantly, it has been

[78] It should be noted that subsection (f) of Art. XVI:2 refers to limitations that are by their nature discriminatory (limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment).

[79] In light of the *US–Gambling*, Art. XVI covers also non-discriminatory measures that are in conflict with a Member's MA commitments. A Member may, however, choose to formulate its commitments in a discriminatory way or leave a specific sector completely unbound. Under Art. V, however, Members are restricted as the EIA should have a wide sectoral coverage and eliminate 'substantially all' discrimination.

[80] See especially Mavroidis (2007).

[81] See page 4 of the 2001 Scheduling Guidelines (S/L/92, 28 March 2001). The guidelines have been prepared by the WTO Secretariat and adopted by the Council on Trade in Services.

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confirmed by the result in *US–Gambling*.[82] However, when the negotiation history of Art. V is considered, it cannot be ruled out that some Members might have understood Art. XVI to cover discriminatory measures only.

The following chapter analyzes the core requirements of Art. V GATS. The purpose is to address the lack of comprehension over the rules on PTAs and provide a legal interpretation of the GATS rules in light of the wider understanding of preferentialism in services that has been introduced in this chapter. The interpretation is then used as the basis for the empirical analysis of EIAs, covering Parts III and IV of the book. The underlying idea is that new proposals for the interpretation and analysis of PTAs should actively be put forward to avoid a situation where the international trade community simply stops caring about the WTO rules and their enforcement altogether. The move to the so-called 'mega-regionals' is already a reality. Even if the risks relating to preferential treatment in services are lower than in the field of goods, it is still important to keep track of the current developments and analyze to what extent new agreements open up trade in services. One of the key areas worth tracking is services regulation applied by sub-central levels of government in federal countries and free trade areas such as the EU. The issue of federalism in services regulation and liberalization is dealt with in Part II.

[82] The AB did not deal with this question explicitly but since the zero-quota was applied also to domestic service suppliers, the AB must have considered Art. XVI to cover non-discriminatory measures as well. The issue of discrimination came up only under the analysis of the availability of general exceptions (Art. XIV GATS).

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2

The GATS Rules on Economic Integration Agreements (EIAs)

I Background of Art. V GATS

The international regulation of services trade was not born at the advent of the GATS. Rule-setting on services had started on a bilateral and a regional level already prior to the initiation of the talks on a multilateral services agreement, the GATS, during the Uruguay Round. In addition to the EU,[1] where detailed provisions on regional services liberalization existed since the EEC Treaty, the USA pioneered by including specific service disciplines in its FTA with Canada, concluded in 1987. The US–Canada FTA contained provisions on trade and investment in services and even covered temporary movement of business persons.[2]

In addition to bilateral and regional initiatives, industry-specific standard setting contributed to the increasing service flows already prior to the GATS. For example, the International Telecommunications Union, the Basel Committee on Banking Supervision and the International Aviation Organization established standards and administered agreements concerning the services provision in their respective fields. Moreover, specific schemes existed with respect to certain services. The USA, for example, had been active in concluding treaties of Friendship, Commerce and Navigation (FCN) that regulated, among other issues, aviation, shipping and communications services.[3]

[1] The term EU refers to all historical denominations (EEC, EC) of the European integration process.

[2] Marchetti, J. A. & Mavroidis, P. C. (2011) The Genesis of the GATS (General Agreement on Trade in Services). *European Journal of International Law*, 22(3), 689–721, at 690.

[3] Ibid.

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The Uruguay Round, however, marked the debut of comprehensive trade negotiations across a wide spectrum of services sectors. Since then, trade in services has become an indispensable element of bilateral, regional and multilateral efforts of trade liberalization.[4] A significant phenomenon in the development of world trade since the establishment of the WTO in the mid-1990s is that the number of PTAs has rapidly multiplied. Today, the majority of PTAs include rules on services.[5] The stalled state of multilateral trade negotiations has driven countries to seek further opening of goods and services trade also through more innovative arrangements. In the area of services, the negotiations for a plurilateral services agreement, the TiSA, started in 2013. If a critical mass of participants is achieved, TiSA will possibly be applied on an MFN-basis.[6] At the moment the negotiations are, however, at a halt. The increasing number of EIAs, as well as the TiSA project, nevertheless show the willingness of WTO Members to engage in the liberalization of services where very little has happened in the multilateral scene since the first commitments taken upon the entry into force of the GATS in 1995.

Whereas the US demand was crucial in putting services on the multilateral negotiation agenda, the EU's role was instrumental in shaping the final agreement.[7] The EU's own example was also essential in the

[4] Marchetti, J. A. & Roy, M. (2008) *Opening Markets for Trade in Services: Countries and Sectors in Bilateral and WTO Negotiations*. Cambridge; New York: Cambridge University Press, at 1.

[5] According to the WTO's RTA database, over 150 EIAs (based on Art. V GATS) and over 290 PTAs (based on Art. XXIV GATT, Art. V GATS and/or the enabling clause) in total were notified and in force as of 31 January 2019. See www.wto.org/english/tratop_e/region_e/region_e.htm (last accessed on 10 February 2019). The numbers do not include accessions to existing PTAs.

[6] The economic case for a plurilateral agreement on services is clear. Lee-Makiyama notes that neither is such an idea a novelty. The GATS itself started as a plurilateral agreement that was created by a group of countries that chipped in their commitments until the collective offer was good enough to be extended to all members of the WTO on the principle of MFN. See Lee-Makiyama, H. (2012) The International Services Agreement (ISA) – from the European Vantage Point. *ECIPE Policy Brief*, No 3/2012, at 3. For possible alternatives for the final legal form of TiSA, see Giødesen Thystrup, A., *Legal Forms of Negotiated Trade in Services Agreement (TiSA) Outcomes – Perspectives on Trade Integration and an Incrementalist Approach to Quasi-Multilateralization,* CTEI Working Papers, CTEI-2016–03, 29 September 2016.

[7] According to Marchetti and Mavroidis, the USA conditioned its participation in the Uruguay Round upon the inclusion of services trade in the negotiation agenda. The EU's priority was to defend its Common Agricultural Policy and only gradually it became a key participant in the services liberalization and drafting of the GATS. See Marchetti & Mavroidis (2011), at 694–5 and 716.

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formulation of the GATS rules on EIAs. The EEC Member States had detailed provisions for the liberalization of services trade in place; they needed to be taken into account in the formulation of the GATS provisions. Since preferential liberalization of trade in services was already a reality during the negotiations of the GATS, the agreement had to provide a possibility for their existence. According to Stephenson, during the Uruguay Round negotiations, a draft provision on preferential trade for services was introduced by the EU and supported by Switzerland, Australia and New Zealand. The proposed draft was included in the 'Dunkel text' of December 1991. At the end of 1991, the footnote to Art. V:1(a) was added. The final version of Art. V found in the GATS is almost identical to that set out in the Dunkel draft.[8]

The GATS allows the conclusion of EIAs that ensure comprehensive trade liberalization in trade in services. In contrast to the two strict forms of PTAs allowed under the GATT (CUs and FTAs), the drafters of the GATS opted for a broader term of 'economic integration'. The more open-ended formulation made it possible to abstain from specifying the exact type of liberalization required from EIAs.[9] Nevertheless, Art. V GATS includes a set of legal criteria that all EIAs should respect.

Since few border measures are applied in the field of services, the concept of discrimination, or rather non-discrimination, forms the core of services liberalization. As will be shown in this chapter, the requirement of non-discrimination with respect to domestic policies is the very essence of Art. V GATS.

Assessing the level of elimination of discriminatory measures is necessarily more qualitative in nature than assessing the level of duties. Notwithstanding the most blatant violations of MFN and NT, determining what constitutes discrimination requires discretion. This normally involves a value judgement. If one is to avoid empirical results being skewed by personal judgement, one has to take a relatively restrictive approach to the concept of discrimination or at least be very clear in defining one's methodology and its consistent application the deeper to the sphere of *de facto* discrimination one is willing to venture.

[8] Stephenson, S. (2000) Regional Agreements on Services in Multilateral Disciplines: Interpreting and Applying GATS Art. V, in Stephenson, S. (ed.), *Services Trade in the Western Hemisphere: Liberalization, Integration and Reform*. Washington, DC: Brookings Institution Press and Organization of American States, 86–104, at 88.

[9] Munin, N. (2010) *Legal Guide to GATS*. Alphen aan den Rijn: Kluwer Law International, at 26.

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The present chapter interprets the various elements of Art. V. The methodology for the empirical analysis of EIAs (Part III) is designed based on the understanding of Art. V proposed here. As we argue that the rules on EIAs cannot be interpreted in a vacuum, an overall understanding of Art. V must necessarily be inspired by empirical findings. Any empirical analysis of existing agreements shows the challenges and limitations present in a legal interpretation of the GATS rules on EIAs, and in the interpretation of the EIAs themselves.

As the external effects of EIAs are outside the scope of this book and its empirical analysis, our interpretation of Art. V is focused on the first two paragraphs of Art. V: the so-called internal trade requirement and the possibility to take into account a wider process of economic integration or trade liberalization between the EIA partners. The concept of non-discrimination is dealt with in detail, as it is the fundamental building block of Art. V:1. In addition to engaging with the fundamental criterion of non-discrimination, the book provides new tools to analyze services commitments of federal entities. In addressing federal entities' commitments, we also pay attention to the internal differentiation in a specific Member's (in our empirical analysis the EU's) services commitments and argue that such differentiation, which is due to the Member's regional subdivision, must be considered under the Art. V criteria.

II The Legal Criteria for EIAs

i The Main Ingredients of Art. V

The GATS discipline on EIAs is almost five decades younger than the corresponding discipline for CUs and FTAs under the GATT. However, the two disciplines share common elements. Similarly to Art. XXIV GATT, Art. V GATS includes an internal requirement (facilitation of trade between the parties to the EIA), an external requirement (prohibition to raise the level of barriers applicable to outsiders) and a notification requirement.[10] In addition, Art. V includes features that are specific to EIAs only. This is arguably due to the different nature of preferentialism

[10] Since the CRTA has *de facto* been restricted to a mere transparency exercise, the notification requirement now mainly serves for transparency purposes. Those who believe that the requirements of Art. V have not been met, have the possibility to challenge the consistency of the notified EIA with the multilateral rules before a WTO Panel. Mavroidis, P. C., Bermann, G. A. & Wu, M. (2013) *The Law of the World Trade Organization (WTO): Documents, Cases & Analysis*. St. Paul: Thomson/West, at 781.

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in goods and services, as well as to changes in Members' opinions towards PTAs in general. When the GATS was negotiated, PTAs were already part of the everyday practice of the Members. This was likely to call for more flexibility in the design of the discipline. In addition, as viewed in the previous chapter, services preferentialism can be considered less harmful than preferentialism in the field of goods. This may have encouraged a looser attitude to be reflected in Art. V GATS.

The flexibility is especially present in the provision of Art. V:2, which allows the EIA's contribution to the wider economic integration between its participants to be taken into account. Even more leeway is available to developing countries. Under the provision of Art. V:3, in EIAs involving developing countries, the condition regarding the elimination of discrimination is more flexible in accordance with the level of development of the countries concerned, both overall and in individual sectors and subsectors.[11]

Unlike Art. XXIV GATT, Art. V also includes a specific rule regarding the origin of the service suppliers. Suppliers originating in Members outside the agreement will still benefit from the EIA if they have substantive business operations within the territory of one of the members to the agreement. As discussed in the previous chapter, this potentially greatly extends the field of application of EIAs.

The entire provision of our centre of focus, Art. V:1 (including footnote (1)), reads as follows:

> *Art. V: Economic Integration*
>
> *1. This Agreement shall not prevent any of its Members from being a party to or entering into an agreement liberalizing trade in services between or among the parties to such an agreement, provided that such an agreement:*
>
> *(a) has substantial sectoral coverage (1), and*
>
> *(b) provides for the absence or elimination of substantially all discrimination, in the sense of Art. XVII, between or among the parties, in the sectors covered under subparagraph (a), through:*
>
> *(i) elimination of existing discriminatory measures, and/or*
>
> *(ii) prohibition of new or more discriminatory measures,*
>
> *either at the entry into force of that agreement or on the basis of a reasonable time-frame, except for measures permitted under Arts. XI, XII, XIV and XIV bis.*

[11] For a detailed discussion of the nature and degree of flexibilities given to developing countries in Art. V, see Sieber-Gasser, C. (2016) *Developing Countries and Preferential Services Trade*. Cambridge: Cambridge University Press.

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(1) This condition is understood in terms of number of sectors, volume of trade affected and modes of supply. In order to meet this condition, agreements should not provide for the a priori exclusion of any mode of supply.

The first paragraph, the *chapeau* of Art. V, gives reason to conclude that EIAs may take the form of either a bilateral or a plurilateral trade agreement between two or more countries and within one or more regions. The same provision implies that Art. V applies to both current and future EIAs. Further, the reference to 'parties' as participants to the agreements implies that the scope of the provision is not limited to agreements between Members but applies also to agreements between Members and non-Members.

To qualify as an EIA under Art. V, the agreement must satisfy three main requirements.[12] First, an EIA must have substantial sectoral coverage (paragraph 1(a)). Second, it must provide for the absence or elimination of substantially all discrimination between or among the parties and in the sectors covered under the first requirement (paragraph 1(b)). Finally, in addition to these two requirements designed to facilitate trade between the parties to the agreement (often referred to as the 'internal requirement'), an EIA must satisfy an external requirement (paragraph 4): it must not raise the overall level of barriers to trade in services with regard to any Member outside the agreement.

It is sometimes proposed that in order to be in line with Art. V, EIA commitments should go further (deeper) than the same parties' GATS commitments. However, the language of Art. V does not appear to support this interpretation. In practical terms, such an expectation is of course reasonable considering that the general level of liberalization in the original GATS commitments is low. But strictly legally we can more securely say that the respective concessions in EIAs must be at least at the level of the parties' GATS commitments. As pointed out by Adlung, it is hardly conceivable that an agreement aimed at 'liberalizing trade in services', and required to provide for 'the absence or elimination of substantially all discrimination' between its parties, would allow for the introduction of new discriminatory measures at the regional level.[13]

[12] EIAs liberalizing trade in services are admitted 'provided that' the conditions of the first paragraph are met. The language makes clear that the conditions are mandatory. Cottier, T. & Molinuevo, M. (2008) Article V GATS, in Wolfrum, R., Stoll, P.-T. & Feinäugle, C. (eds.), *WTO – Trade in Services*. Leiden; Boston: Martinus Nijhoff Publishers, 125–64, at 130.

[13] In practice, this however happens. See Adlung, R. (2015) The Trade in Services Agreement (TISA) and Its Compatibility with GATS: An Assessment Based on Current Evidence, *World Trade Review*, 14(4), 617–41.

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The AB has not yet had the occasion, or desire, to interpret Art. V. The only reference to Art. V so far has been in the Panel Report of *Canada–Autos*. The case dealt mostly with measures relating to trade in goods, but the Panel concluded that a specific measure was inconsistent also under Art. V:1(b) since it accorded an advantage to US firms and excluded other firms in another party to the EIA.[14]

In *Turkey–Textiles*, the AB indicated that the words 'shall not prevent' in the opening paragraph of Art. XXIV:5 GATT mean that the GATT does not make impossible the formation of a customs union. The same, presumably, applies to FTAs under Art. XXIV GATT. It is noteworthy that Art. V GATS employs the same words 'shall not prevent' in its *chapeau*. Since the context of Art. XXIV GATT and Art. V GATS is identical (both provisions justify an exception to certain WTO obligations for Members engaged in deep economic integration with their preferential trading partners), one may assume that the AB's reasoning in *Turkey–Textiles* is in this respect applicable also to EIAs concluded under Art. V GATS.

There is, however, a certain difference between Art. XXIV GATT and Art. V GATS regarding the legal effects of a PTA. Both disciplines include a notification requirement, but Art. XXIV contains stronger language than Art. V on the 'conditionality' attached to the time-frame for implementation. If a Working Party were to find that the plan or schedule for an interim agreement for a PTA is not likely to result in a GATT-consistent CU or FTA, its members 'shall not maintain or put into force [an] agreement if they are not prepared to modify it in accordance with . . . the recommendations'. No such provision exists in Article V.[15] This difference has, however, become redundant as practically no multilateral control of PTAs exists any longer. The formal discussions on legal consistency of PTAs have been replaced by the Transparency Mechanism of 14 December 2006.

There are commentaries on Art. V in a number of textbooks and articles dealing with services trade. Their analysis, however, typically stays on a relatively general level. A deeper discussion is provided by Cottier and Molinuevo who go through possible interpretations for each provision of Art. V.[16] Also Stephenson and Sieber-Gasser provide useful

[14] Panel Report in *Canada–Automotive Industry, Canada – Certain Measures Affecting the Automotive Industry*, WT/DS139/R, circulated 11 February 2000, paras. 10.265–10.272.

[15] Hoekman, B. & Sauvé, P. (1994) Liberalizing Trade in Services. *World Bank Discussion Papers*, WDP243, at 60.

[16] Cottier, T. & Molinuevo, M. (2008) Article V GATS, in Wolfrum, R., Stoll, P.-T. & Feinäugle, C. (eds.), *WTO – Trade in Services*. Leiden; Boston: Martinus Nijhoff Publishers, 125–64.

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analyses and point out a number of challenges in effectively applying these disciplines.[17]

Art. V is explored at some length also in Hoekman and Sauvé. They consider Art. V conditions to be weaker than those applying in the GATT context and stress that the weakness of the discipline on EIAs implies only a limited constraint on 'strategic' violations of the MFN obligation.[18]

We will now proceed to a more detailed analysis of the two core requirements of Art. V:1: the requirement of 'substantial sectoral coverage' and the elimination of 'substantially all discrimination'. In addition, we will shortly go through the other principal criteria of Art. V: the possibility to pay attention to 'a wider process of economic integration or trade liberalization' (Art. V:2), the flexibility provided for developing countries (Art. V:3), the external requirement (Art. V:4) and the criteria for rules of origin in EIAs (Art. V:6). Even if the focus in the book and especially in the empirical analysis is on the first paragraph of Art. V, these other criteria are essential elements in services preferentialism and they inform the overall interpretation of Art. V.[19] Art. V:5 (renegotiation of commitments) and Art. V:8 (lack of compensation for trade benefits accruing from the EIA to non-parties) are not dealt with as they are not essential elements in a compliance analysis. Art. V:7 (notification and examination procedure) has been taken up in the previous chapter.

ii Substantial Sectoral Coverage (Art. V:1(a))

The term 'substantial' in Art. V defines sufficient coverage in terms of sectors covered as well as non-discrimination provided. It appears in two different forms: 'substantial' (Art. V:1(a)) and 'substantially' (Art. V:1(b)).

According to Art. V:1(a), an EIA must have substantial sectoral coverage. The requirement is designed to prevent the conclusion of numerous sector-specific agreements that would pick and choose from areas of mutual interest. The goal is trade promotion while containing trade

[17] Stephenson (2000). See also Stephenson, S. M. (2000) GATS and Regional Integration, in Sauvé, P. & Stern, R. M. (eds.), *GATS 2000: New Directions in Services Trade Liberalization*. Washington, DC: Center for Business and Government Brookings Institution Press, 509–29, and Sieber-Gasser (2016).

[18] Hoekman & Sauvé (1994), at 71.

[19] The basic parameters for the empirical analysis are built on Art. V:1. However, elements arguably belonging under 'a wider process of economic integration' in line with Art. V:2 are also included in the analysis.

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diversion to which randomly concluded sectoral agreements are likely to contribute.[20]

The use of the word 'substantial' gives reason to conclude that EIA partners are never under an obligation to liberalize trade in all service sectors. The requirement can be compared to Art. XXIV:8 GATT. In that context, in *Turkey–Textiles*, the AB noted that 'substantially all the trade' as mentioned under Art. XXIV:8 GATT is 'something considerably more than merely *some* of the trade'.[21] Mitchell and Lockhart conclude that the relevant amount of trade must, therefore, fall somewhere between *some* and *all* trade among the parties to the PTA. However, since there is no clear definition or agreement about the meaning of the word 'substantial' under the GATT, the practice under the GATT does not shed light on the word's definition either in the context of the GATS.[22]

Similarly to Art. XXIV:8 GATT, Art. V:1(a) GATS focuses on the level of liberalization rather than the type of trade affected.[23] Unlike paragraph 8 of Art. XXIV, Art. V:1(a) GATS, nevertheless, gives some further guidance for its interpretation. It includes the following footnote:

> *This condition is understood in terms of number of sectors, volume of trade affected and modes of supply. In order to meet this condition, agreements should not provide for the a priori exclusion of any mode of supply.*

However, the precise application of these additional elements remains unclear. Fink and Molinuevo point out several essential questions. First, how to understand 'volume' of services trade. Is it opposed to the 'value' of such trade? At what level of disaggregation should the count of sectors

[20] Cottier & Molinuevo (2008), at 132. Ortino and Sheppard cite the WTO Secretariat and conclude that the 'substantial sectoral coverage' appears to have been designed to prevent Members from using the Art. V exception for economic agreements that are limited to one specific mode of supply, such as cross-border services (Mode 1) or foreign direct investment (Mode 3). See Sheppard, A. & Ortino, F. (2006) International Agreements Covering Foreign Investment in Services: Patterns and Linkages, in Bartels, L. & Ortino, F. (eds.), *Regional Trade Agreements and the WTO Legal System*. Oxford; New York: Oxford University Press, 201–14, at 211. On governments' incentives to exclude certain economic sectors from liberalization in FTAs, see Grossman, G. M. & Helpman, E. (1995) The Politics of Free-Trade Agreements. *The American Economic Review*, 85(4), 667–90.

[21] *Turkey – Restrictions on Imports of Textile and Clothing Products*, WT/DS34/AB/R, Report of the Appellate Body, circulated 22 October 1999, para. 48 (original emphasis).

[22] Mitchell, A. D. & Lockhart, N. J. S. (2009), Legal Requirements for PTAs under the WTO. in Lester, S. & Mercurio, B. (eds.), *Bilateral and Regional Trade Agreements: Commentary and Analysis*. Cambridge and New York: Cambridge University Press, 96 and 111.

[23] Ibid., 89.

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be made? And, moreover, can entire sectors be excluded from the agreement? If so, at which point would an exclusion of a sector reduce the volume of trade to a non-substantial level? As noted by the authors, the lack of sufficiently disaggregated data on trade in services further complicates the determination of volumes and value of trade covered by a specific EIA.[24]

Under the GATT, various suggestions regarding 'substantially all the trade' have been made, also among the Members. According to one of such propositions, a threshold could be set at 95 per cent of all tariff lines at the six-digit level. That starting point could then be complemented by an assessment of trade flows at various stages of the implementation of the PTA.[25] The proposal did not receive enough support.[26]

With regard to Art. V, there has been a variety of opinions regarding the scope of 'substantial sectoral coverage' among the Members. Because of the wording 'number of sectors' in the footnote to paragraph 1(a), it has been suggested that not all sectors need to be covered under an EIA to meet this criterion. Otherwise the text would have clarified that all, and not a 'number of', sectors had to be covered.[27] Some Members have argued that the exclusion of certain sectors and volume of trade would be permissible, given that the footnote to Article V.1(a) only condemns the *a priori* exclusion of a mode of supply, not specific sectors. Some have emphasized that the number of exclusions to the sectoral coverage must be restricted and not further limited by the volume of affected trade and the modes of supply.[28]

According to another line of argumentation, the word 'substantial' does not allow any, or at least any essential, sector to be excluded from an EIA. If a major sector were excluded, it would need to be considered in conjunction with the modes of supply and the volume of trade involved.[29]

[24] Fink, C. & Molinuevo, M. (2008), East Asian Preferential Trade Agreements in Services: Liberalization Content and WTO Rules. *World Trade Review*, 7(4), 641–673, at 660.

[25] Australia, WT/REG/W/22/Add.1, paras. 9–10.

[26] For the Members' views regarding the 'substantially all the trade' (SAT) requirement in Art. XXIV GATT, see Mavroidis, P. C. (2016) *The Regulation of International Trade: GATT*. Cambridge: MIT Press, at 302–3.

[27] EC, WT/REG50-52/M/2, para. 16; New Zealand, WT/REG/W/22, para. 17. The opinions presented here have been expressed within the Committee on Regional Trade Agreements. A synopsis of such systemic issues is included in WTO Committee on Regional Trade Agreements, *Synopsis of 'systemic' issues related to regional trade agreements*, Note by the Secretariat, WT/REG/W/37, 2 March 2000.

[28] New Zealand, WT/REG/M/22, para. 17.

[29] Argentina, WT/REG/M/22, para. 16.

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Other issues brought up by the Members include the degree of detail in the examination of EIAs and the coverage of modes of supply. The first issue relates to the correct level of examination: it can be done either sector-by-sector, sub-sector-by-sub-sector or on a disaggregated basis. The coverage in terms of modes is seen to relate especially to Modes 3 and 4. For some Members, both investment and the movement of natural persons need to be included. At least one delegation has proposed that certain aspects exempted from the GATS through the GATS Annex on Movement of Natural Persons Supplying Services under the Agreement[30] need to be included in an EIA for consistency with the GATS.[31]

Whereas certain rough or approximate values for 'substantial' may be given, it is hard to see how to settle on any specific value. Such a set value may be even harder to conceive in respect of sectoral coverage than in respect of elimination of discrimination. The requirement to achieve substantial sectoral coverage presumes that we know the overall number of service sectors that exist. This is not really the case.

The GATS does not impose any specific set or list of sectors on the Members but they are free to use their own categorizations. Most Members have opted to use the WTO's Sectoral Classification List that is used as a basis of our empirical analysis.[32] However, they are not required to do so. And even if the Members typically do use the recommended list, they sometimes combine or divide certain sectors or sub-sectors to their own choosing. As witnessed by our analysis, also the EU Member States do this in certain instances even though generally they tend to follow the Secretariat's list.

Another issue relates to the emergence of new services sectors. Technological progress brings about challenges in the classification of new services. Should completely new services, or services that used to be delivered under a specific mode only, count towards the overall number of sectors towards which the 'substantial' sectoral coverage of a specific EIA should be compared? In this respect EIAs following the so-called negative listing model do better as they automatically extend all relevant

[30] Art. XXIX GATS provides that the Annexes, including the mentioned Annex, are an integral part of the Agreement. The said Annex provides, among other things, that the GATS 'shall not apply to measures affecting natural persons seeking access to the employment market of a Member, nor shall it apply to measures regarding citizenship, residence or employment on a permanent basis'.

[31] Japan, WT/REG/M/22, para. 18.

[32] Services sectoral classification list, Note by the Secretariat, WTO document MTN.GNS/W/120, 10 July 1991.

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disciplines to new services that were not yet developed or commercialized at the time of the conclusion of the agreement. Only such current or future measures or policy areas that have been specifically excluded from liberalization would remain outside the scope of liberalization in such new services sectors.[33]

In the present book the EU's EIAs are analyzed on the basis of the Sectoral Classification List. This makes it possible to compare the EU's EIA commitments to most other Members' commitments as the majority of them use the same list both in their EIAs as well as under the GATS. However, it should be kept in mind that the overall number of sectors may, and is likely, to rise in the future and methodologies should be adapted to take them into account. The methodological challenges relating to different organization of sectors, and modes, are addressed in Chapter 9 of Part III of the book.

iii Absence or Elimination of Substantially All Discrimination (Art. V:1b)

The second sub-paragraph of Art. V:1 requires that an EIA provides for the absence or elimination of substantially all discrimination in the sectors covered by the agreement. This is to be attained either through '(i) elimination of existing discriminatory measures, and/or (ii) through prohibition of new or more discriminatory measures'. There are two interlinked issues that complicate the interpretation of the provision.

First, there is no common understanding of the link between 'substantial sectoral coverage' (sub-paragraph 1(a)) and 'substantially all discrimination' (sub-paragraph 1(b)). One view is that a sector would not be considered covered unless it satisfied also the requirements under Art. V:1(b). Another view holds that the two tests need to be distinguished. According to this view, the requirement of substantial sectoral coverage merely determines the proportion of sectors or sub-sectors subject to liberalization. Art. V:1(b), on the other hand, would apply as a separate requirement by determining the general degree of discrimination that is allowed in the liberalized sectors. It would seek to determine

[33] Robert, M. & Stephenson, S. (2008) Opening Services Markets at the Regional Level under the CAFTA-DR: The Cases of Costa Rica and the Dominican Republic, in Marchetti, J. & Roy, M. (eds.), *Opening Markets for Trade in Services: Countries and Sectors in Bilateral and WTO Negotiations*. Cambridge; New York: Cambridge University Press, 537–72, at 562.

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to what extent policy measures retaining a degree of discrimination in the liberalized sectors and modes are acceptable.[34]

The fact that Art. V:1(b) calls for the absence or elimination of discrimination in the sectors covered under sub-paragraph (a), would give reason to conclude that a sector should be considered covered only if it provides for full non-discrimination. However, in light of the Member's practice where hardly any service sector in any EIA provides for full (or even close to full) non-discrimination, we suggest that the two requirements could be treated separately. At least such an approach would be more informative than disregarding each sector where discrimination is not eliminated. Thus, each EIA could be given two separate scores under Art. V:1: one for sectoral coverage and another one for the level of non-discrimination (in the sectors covered). This is the approach in our empirical analysis on the EU's EIAs. Each sector and sub-sector gets two scores: one for being included with at least some level of commitments (coverage) and another one for the elimination of discrimination.[35] Both scores are expressed as percentage values depending on how many EU Member States have bound themselves.

The second challenge of interpretation relates to the question of whether the parties to an EIA must indeed eliminate substantially all discrimination or whether a mere standstill agreement could be considered sufficient. Hoekman and Sauvé have argued that a standstill is enough. They consider that the drafting of such a minimalistic requirement was linked to the outcome of the 1989 Canada–US FTA which largely consisted of a standstill agreement applied to a finite list of covered services.[36]

Cottier and Molinuevo, on the other hand, argue that the answer should be 'no', because the introductory sentence of Art. V:1(b) specifically calls for the 'absence or elimination' of discrimination between the EIA parties. The options of (i) and (ii) are informed by this main obligation and need to be construed accordingly. In order to live up to the obligation, EIAs must abolish discriminatory measures where they exist and prohibit the future introduction of discriminatory policies in

[34] WTO Committee on Regional Trade Agreements, *Synopsis of 'systemic' issues related to regional trade agreements*, Note by the Secretariat, WT/REG/W/37, 2 March 2000, at 20.

[35] See the review sheets in Appendix 3. The types of discrimination counted for in the analysis are explained later in this chapter. A detailed explanation of the methods of the empirical study is provided in Part III.

[36] Hoekman & Sauvé (1994), at 62.

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those sectors or sub-sectors where no discriminatory policies are maintained at the time of the conclusion of the EIA.[37]

We agree with the interpretation of Cottier and Molinuevo and consider that Art. V goes beyond a standstill and requires EIA parties to achieve a sufficient degree of rollback of protective measures. The provision of Art. V:1(b) needs to be read as a whole and in light of its opening sentence that sets the required degree of liberalization, which is the *absence* or *elimination* of substantially all discrimination. We consider that the conjunction 'or' has been inserted in Art. V:1(b)(i) for such cases where parties have already prior to the EIA eliminated substantially all discrimination between them at least in certain sectors. In such a case, the parties are requested not to introduce any new or more discriminatory measures. As noted by Cottier and Molinuevo, the standstill obligation also ensures that the absence of discrimination will be maintained in sectors and modes that have previously been subject to unilateral liberalization.[38]

The absence of substantially all discrimination does not need to be provided at once. Art. V:b includes the possibility of eliminating discrimination on the basis of a reasonable time-frame. Therefore, discrimination does not have to be eliminated on day one but a time-frame must be set. In the discussions of the CRTA, Members have suggested periods ranging from five to ten years.[39] In any case, we consider that keeping in mind the purpose of Art. V:1, any open-ended undertaking to eliminate discrimination at a later stage should not suffice but a specific, 'reasonable' time-frame should be set.

[37] Cottier & Molinuevo (2008), at 136. In general, the majority view in literature does not seem to support the existence of a mere standstill obligation. With regard to NAFTA, there was an interesting debate on this issue between the EU, USA and Mexico. The USA supports the view of Hoekman and Sauvé (1994) while the EU is behind the view put forward in here. Mexico appears to aim at a compromise by suggesting that the EU and US delegations were speaking about the same thing – 'that the result of the negotiations was to comply with the requirements of Art. XVII in substantially all the sectors'. See 'Examination of the North American Free Trade Agreement', Note on the meeting of 24 February 1997, WT/REG4/M/4, CRTA, 16 April 1997, paras. 19–23.

[38] Ibid., 137. But even if one were to adopt the interpretation proposed by Hoekman and Sauvé, Art. V would create the obligation to 'freeze' the situation across services sectors. Thus, a 'standstill' would need to have substantial sectoral coverage.

[39] WTO Committee on Regional Trade Agreements, *Synopsis of 'systemic' issues related to regional trade agreements*, Note by the Secretariat, WT/REG/W/37, 2 March 2000, para. 84. Some Members have supported a ten-year period since it would coincide with that provided for integration in the area of goods set out in Art. XXIV:5 and as explained in paragraph 3 of the Understanding on the Interpretation of Art. XXIV GATT 1994. Para. 3 of the Understanding specifies that the period should exceed ten years only in exceptional cases and subject to the provision of full explanation to the Council for Trade in Goods.

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In addition to these more technical issues, a central element in Art:1(b) relates to the meaning of 'discrimination'. Discrimination in WTO law covers two concepts: MFN treatment and national treatment (NT). With regard to the first, it is unclear what type of MFN treatment is required by the provision. Does the provision allow for an EIA to include a conditional MFN provision or different degrees of MFN treatment depending on the parties? Is gradual implementation of MFN treatment possible?[40] As an example, in the EU–CARIFORUM Economic Partnership Agreement ('EPA'), the commitments related to the presence of natural persons are not covered by the MFN clause at all. Compulsory provision of MFN could mitigate the possible harmful effects of proliferating PTAs. However, since Art. V requires the elimination of discrimination in the sense of NT only, we conclude that MFN as regards other EIAs is not expected from partners to an EIA. The existence of a general MFN discipline in the EU's EIAs is nevertheless noted in our empirical analysis as it tells about the overall depth of integration between the partners to the agreement.

With regard to the second aspect of discrimination, or rather non-discrimination, Art. V is clearer. It makes an explicit reference to the NT discipline of Art. XVII. Even though one could argue that it is not entirely clear whether exactly similar treatment is required under both provisions, such an argument is in our opinion far-fetched. There could hardly be any clearer indication of equivalence in interpretation than the specification that the discrimination should be eliminated 'in the sense of' Art. XVII.

Art. XVII requires that subject to any conditions and qualifications set in a Member's Schedule, 'each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers'. The second paragraph specifies that the requirement may be met by according either formally identical or formally different treatment to that accorded to the Member's own like services and service suppliers. This implies prohibition of both *de jure* as well as *de facto* discrimination.[41]

[40] Munin (2010), at 231.

[41] Ibid., 160. The coverage of *de facto* discrimination was confirmed by the AB in *EC–Bananas III*. See *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, Report of the Appellate Body, WT/DS27/AB/R, 9 September 1997. Defining *de facto* discrimination is challenging, as well as understanding what type of measures count as *de facto* discrimination. This issue is taken up below as well as in Chapter 8 of Part III on methodology.

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Some EIAs go beyond the obligations entailed in Art. XVII and engage in deeper forms of economic integration. The objective of deeper liberalization of services trade can be advanced through various regulatory cooperation instruments such as agreements on mutual recognition (MRAs) and harmonization.[42] Since the liberalization of services is primarily concerned with regulatory issues, the deeper the integration, the more issues there are that tend to fall outside NT and instead enter the sphere of non-discriminatory domestic regulation. Deep regulatory cooperation typically ends up eliminating discrimination but may, in addition, lead into an acceptance of certain parts of the service supplier's domestic regulatory framework as sufficiently adequate for the receiving Member's regulatory purposes. Our view is that because of the direct reference to Art. XVII, Art. V does not require more than elimination of discrimination in the sense of NT. Art V. nevertheless duly recognizes deeper integration: the second paragraph gives the possibility to take a wider process of economic integration into account in the analysis of EIAs. However, since the possibility is tied to evaluating whether the conditions under paragraph 1(b) are met, it would seem that Art. V:2 is recognizing elements that fall *short* of non-discrimination, not elements that go *further* than the provision of NT. The provision is thus giving leeway to EIAs that do *not* eliminate discrimination as extensively as required by Art. V:1.

A possible interpretation is that Art. V:2 simply recognizes the overall aim of deeper economic integration in a specific EIA. While such an agreement may contain regulatory elements of deep, non-discriminatory integration in certain sectors (e.g. through MRAs or even through harmonization), the agreement may still fall short of NT in some other sectors. Therefore, we consider that the mapping of instruments of

[42] As Trachtman notes, for mutual recognition to succeed, a satisfactory level of essential harmonization must have already taken place. Only then can countries agree on a minimum level of regulation. See Trachtman, J. P. (2014) Mutual Recognition of Services Regulation at the WTO, in Lim, A. H. & De Meester, B. (eds.), *WTO Domestic Regulation and Services Trade: Putting Principles into Practice*. New York: Cambridge University Press, at 110. Instead of mutual recognition, we can also talk about mutual acceptance of 'equivalence'. A MRA or mutual acceptance of 'equivalence' may be possible without straightforward harmonization but such outcomes are possible only once the parties are satisfied that at least the minimum requirements of domestic regulation are fulfilled, in a different but equivalent way, by the other party's regulation. Beviglia-Zampetti, A. (2000) Mutual Recognition in the Transatlantic Context: Some Reflections on Future Negotiations, in Cottier, T., Mavroidis, P. C. & Blatter, P. (eds.), *Regulatory Barriers and the Principle of Non-Discrimination in World Trade Law*. Ann Arbor: University of Michigan Press, 303–28, at 308.

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deep economic integration, such as MRAs and harmonization that go beyond the requirement of non-discrimination, is in any case relevant as they might affect the overall discrimination analysis of an EIA.[43]

An EIA that does not reach the threshold of 'substantiality' may still be considered to respect the requirements of Art. V if its overall purpose is to engage in a deeper economic integration over time. Therefore, Art. V:2 must necessarily allow for a certain time-frame during which the wider process of economic integration or trade liberalization can take place. The possibility for a 'time-frame' is mentioned also under Art. V:1. The elimination of substantially all discrimination should take place either at the entry into force of that agreement or on the basis of 'a reasonable time-frame'. Since Art. V:2 allows for additional elements to be taken into account in evaluating the fulfilment of conditions under Art. V:1, the 'wider process' should be interpreted to allow for economic integration or trade liberalization to take place over a time period that is more extensive than 'a reasonable time-frame' that is available already under the conditions of Art. V:1.

Another unclear issue relates to the list of exceptions included in Art. V:1(b). Measures permitted under Articles XI, XII, XIV and XIV bis are excluded from the requirement of elimination and prohibition of discriminatory measures. Emergency safeguard measures (Art. X), on the contrary, are not mentioned in the list. A question often put forward thus is whether EIA partners retain the right to maintain them.[44] As these provisions act as exceptions, a Member is exempted from its obligations under a specific commitment in case it successfully invokes one of the provisions.

Let us assume that a Member in an EIA with another Member has prescribed a specific commitment in the field of professional services,

[43] A separate issue is whether MRAs concluded in the context of EIAs should still be notified to the WTO in accordance with the procedure of Art. VII and whether they should provide adequate opportunity to any other Member to indicate their interest in participating in the arrangement. Since Art. V does not require Members to engage in any MRAs or other deep regulatory instruments, a possible interpretation is that the independent obligations under Art. VII still apply. As noted by Mathis, to the extent that Art. V notifications incorporate recognition instruments falling within the meaning of Art. VII, it is up to the Members affected by them to bring cases to dispute settlement accordingly. See Mathis, J. H. (2006) Regional Trade Agreements and Domestic Regulation: What Reach for 'Other Restrictive Regulations of Commerce'?, in Bartels, L. & Ortino, F. (eds.), *Regional Trade Agreements and the WTO Legal System*. Oxford; New York: Oxford University Press, 79–108, at 98.

[44] See similar discussion on Art. XXIV:8 GATT in Mitchell & Lockhart (2009), at 98–9.

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more specifically concerning medical doctors. In the commitment, in respect of Modes 3 and 4, the Member has included a language requirement (complete fluency in the local language). In such a scenario it could possibly be argued that such a strict language requirement should be considered as a measure that is *de facto* discriminatory (at least if applicable across the board with no possibility for exemptions) and thus subject to elimination under the criteria of Art. V. However, in this specific case, the Member might be able to invoke Art. XIV lit. b and claim that the language requirement is necessary to protect human health since patients must be able to communicate with their doctor in their own language. An additional justifying argument could be that doctors must be able to effortlessly communicate with pharmacies and medical authorities. Assuming that the Member's claim was considered legitimate and it would satisfy all the requirements under one of the justifications of Art. XIV, and the *chapeau*, the language requirement would, in that specific case, not affect the Member's compliance with Art. V:1(b).[45]

The obvious problem is that an abstract, *ex ante* analysis cannot take such situations into account. The general exceptions, as well as security exceptions and restrictions to safeguard the balance of payments, are available as exceptions and thus do not need to be anticipated in one's schedule. Certain commitments falling short of NT may thus lower the 'compliance score' of the EIA even if they were in an *ex poste* situation (in dispute settlement) considered justified under one of the general exceptions. Since the consideration of EIA commitments in this light is purely speculative, any compliance analysis is necessarily somewhat skewed in this regard.[46]

Munin argues that Art. XVI (market access) restrictions are not covered by the requirement to eliminate substantially all discrimination since Art. V:1(b) requires elimination in the sense of Art. XVII only. Therefore, according to this interpretation, the depth of MA concessions

[45] In order to comply with the requirements of Art. XIV, the measure would have to satisfy the necessity test, which requires, among other criteria, the Member to demonstrate that no other reasonably available alternative measure were at the Member's disposal. In this specific example of a language requirement for medical doctors, a possible alternative, less trade-restrictive measure could be cooperation with local doctors or the requirement of intermediate language skills instead of complete fluency. On the criteria of Art. XIV GATS, see Cottier, T., Delimatsis, P. & Diebold, N. (2008) Article XIV GATS General Exceptions, in Wolfrum, R., Stoll, P.-T. & Feinäugle, C. (eds.), *WTO – Trade in Services*. Leiden; Boston: Martinus Nijhoff Publishers, 287–328.

[46] The same applies to Art. XXIV:8 GATT since duties and other restrictive regulations of commerce must be eliminated *except*, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX.

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is left to the discretion of the parties and only a wide scope of coverage of an EIA in terms of sectors is required. As has already been discussed above, we share this opinion and argue that Art. V is only concerned with the elimination of discrimination. This issue, however, invokes an important interpretative question relating to certain MA limitations: should discriminatory measures listed under Art. XVI:2 (joint venture requirements and foreign equity ceilings) be considered as measures 'in the sense of Art. XVII' to which the provision applies?[47] In our opinion, that should definitely be the case considering that in addition to being MA limitations, such measures clearly discriminate against foreign services suppliers when they limit the amount of foreign investment (but not domestic investment) and impose an obligation of cooperation with local companies (when they, on the contrary, can operate freely).

Among the Members, the central issue with regard to Art. V:1(b) has been the extent to which discriminatory measures are allowed. Most remarks have been made on the scope of the list of exceptions included in the provision. At least three Members have argued that the list is not exhaustive.[48] Divergent views have been expressed especially on safeguard measures. Some Members have argued that they can be applied on an MFN basis also between parties to an EIA, whereas some consider that safeguard measures should not be applied at all. A relevant question is also what other discriminatory measures, besides those falling under the enumerated Articles, should be allowed under an EIA.[49]

Some Members have paid attention to the difficulty of developing elaborate interpretations or formulas to clarify the requirements relating to EIAs, referring especially to the difficulty in arriving at a percentage-type test for quantitatively measuring 'substantially all discrimination', similar to the test used in defining 'substantially all the trade' in goods PTAs. As a result, it has been suggested that each EIA needs to be examined on its own merit.[50]

[47] Munin (2010), at 233.

[48] Argentina, Japan and Korea, WT/REG/M/22, paras. 16, 18 and 20.

[49] Hong Kong, China, non-paper entitled Systemic Issues arising from Article V of the GATS, Section 2.

[50] New Zealand, WT/REG/M/22, para. 17 and WTO Committee on Regional Trade Agreements, *Synopsis of 'systemic' issues related to regional trade agreements*, Note by the Secretariat, WT/REG/W/37, 2 March 2000, at 34.

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iv Wider Process of Economic Integration (Art. V:2)

According to Art. V:2, the relationship of the EIA to a wider process of economic integration or trade liberalization may be considered. The provision allows for an overall assessment of the agreement. One could consider a situation where a new Member State joins the EU. Under Art. V:2, the final result and the essence of the economic integration could possibly be taken into account.[51] It is important to note that such a wider process may only be considered in evaluating whether the EIA provides for the absence or elimination of substantially all discrimination, but not in regard to the requirement of substantial sectoral coverage.

The Members themselves have proposed the 'wider process of economic integration' could be construed as one involving the elimination of barriers also in goods; the drafting history of this paragraph is said to support such an argument. The harmonization of domestic regulation among parties to an EIA could also contribute to such a process.[52] The meaning of the provision has been also been perceived as relating to the interpretation of 'substantially all the trade' under Art. XXIV GATT and that of a 'reasonable time-frame' in prohibiting new or more discriminatory measures under Art. V:1(b).[53]

As already discussed above with regard to the requirement of elimination of discrimination, the provision of paragraph 2 may allow for consideration to be given to economic integration going beyond non-discrimination. One example of such deeper integration is recognition agreements, which we consider to be one demonstration of a wider process of economic integration to be taking place and thus relevant for the analysis of an EIA under Art. V. A different angle to this question is possible as well. Trachtman considers that Art. V does not provide an exception for agreements on equivalence or harmonization from other GATS requirements. He argues that in light of the *Turkey–Textiles* case, the exception of Art. V is, similarly to the exception of Art. XXIV GATT, only available with respect to measures that are *necessary* in order to form an EIA, or a FTA/CU.[54] On the other hand, as argued by Klamert, the

[51] Munin (2010), at 235.

[52] WTO (2000) Committee on Regional Trade Agreements, *Synopsis of 'systemic' issues related to regional trade agreements*, para. 11; Japan, WT/REG/M/23, para. 31; EC, WT/REG/W/35, para. 11.

[53] Korea, WT/REG/M/21, para. 20.

[54] Trachtman (2014), at 122. A similar view with regard to recognition agreements is put forward by Marchetti, J. & Mavroidis, P. C. (2012) I Now Recognize You (and Only You) as Equal: An Anatomy of (Mutual) Recognition Agreements in the GATS, in Lianos, I. &

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broad wording of Art. V supports a more extensive interpretation of this provision than Art. XXIV that was at issue in *Turkey–Textiles*. Art. V is not limited to any specific integration model but seems to encourage flexibility in the design of EIAs through the provision of Art. V:2. We agree with Klamert who considers that the strict standard applicable to CUs and FTAs would not make much sense under Art. V as it would have the effect of blocking many measures under deep EIAs from the start.[55] Thus, MRAs and harmonization should be possible through an EIA even if such arrangements were not strictly necessary for the formation of the EIA. In our view, the notification requirement (together or separately with the EIA), as well as the offering of adequate opportunity to outsiders to participate to any recognition measures under Art. VII still apply. In this sense, we agree with Marchetti and Mavroidis who argue that the establishment of an EIA cannot provide legal shelter from requests of extension of recognition agreements from Members outside the EIA.[56]

v Special and Differential Treatment (Art. V:3)

In the GATS, developing countries do not benefit from an 'enabling clause' but are subject to the same requirements under Art. V as developed countries. However, Art. V:3 allows for flexibility in the application of the substantive liberalization requirements when developing countries are parties to EIAs, 'in accordance with the level of development of the countries concerned, both overall and in individual sectors and subsectors'. Unlike the flexibility provision of Art. V:2, flexibility for developing

Odudu, O. (eds.), *Regulating Trade in Services in the EU and the WTO*. Cambridge: Cambridge University Press, 415–43, at 425–7.

[55] Klamert, M. (2015) *Services Liberalization in the EU and the WTO: Concepts, Standards and Regulatory Approaches*. Cambridge: Cambridge University Press, at 62. It should be noted that the 'necessity' test formulated in *Turkey–Textiles* to determine the legitimacy of a CU/FTA still requires further clarification. The language and approach of the AB are strongly reminiscent of the more famous necessity test under Art. XX GATT. However, as noted by Bartels, any analogy to the Art. XX necessity test includes various complications in the application of the Art. XXIV defence. The most striking complication is the absence of any catalogue of objectives for the achievement of which a trade measure taken in the context of forming a PTA might be 'necessary'. In *Turkey–Textiles*, the AB assumed that it was permissible for the European Communities to seek to avoid trade diversion while concluding a PTA with Turkey but the AB did not explain why precisely this objective was considered legitimate. See Bartels, L. (2004) WTO Dispute Settlement Practice on Article XXIV of the GATT, in Ortino, F. & Petersmann, E.-U. (eds), *The WTO Dispute Settlement System, 1995–2003*. The Hague; New York: Kluwer Law International, 263–74, at 269.

[56] Marchetti & Mavroidis (2012), at 427.

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countries is allowed also in regard to sectoral coverage. However, it could be argued that there is a higher degree of flexibility available towards Art. V:1(b) than Art. V:1(a) since Art. V:3(a) states that 'flexibility shall be provided . . . particularly with reference to subparagraph b'.

In addition, Art. V:3(b) allows developing countries concluding EIAs among themselves to give more favourable treatment to firms that originate in parties to the agreement. It therefore allows for discrimination against undertakings originating in countries outside the agreement, even if they were established within the territory of one of the parties.

Unlike under the Enabling Clause, Art. V:3 is not limited to EIAs among developing countries. Flexibility also applies to EIAs between developed and developing countries and operates as a limitation on the principle of reciprocity present in Art. V:1(b).[57]

vi The External Requirement (Art. V:4)

The so-called external requirement of Art. V is set in paragraph 4. It provides that EIAs must not 'raise the overall level of barriers' to trade in services with respect to third parties. The assessment is made in comparison to the level applicable prior to such an agreement and in respect of each sector and sub-sector covered by the agreement. The provision builds upon the tradition of Art. XXIV:5 GATT and aims to prevent parties from embarking on so-called 'fortress' economic integration.[58] The coverage of 'barriers' is not defined and it is therefore unclear whether the provision covers measures subject to the general disciplines of the GATS (e.g. MFN, domestic regulation and transparency), or merely specific commitments under Articles XVI and XVII.[59]

The interpretation of the external requirement includes similar challenges to the quantification of the internal requirement. As noted by Stephenson, the difficulty of calculating the overall level of barriers to

[57] Cottier & Molinuevo (2008), at 141. The authors remark that some Members have suggested that the flexibility would extend to developed countries too when they participate in EIAs with developing countries. As the authors note, such an interpretation would lead to the awkward result that developed countries were required to provide for greater liberalization in agreements among themselves and maintain more restrictions towards their developing EIA partners. For an extensive treatment of special and differential treatment under Art. V, see Sieber-Gasser (2016).

[58] Cottier & Molinuevo (2008), at 144. In 'fortress' integration, countries liberalize their internal trade but do so to the detriment of third parties by raising compensatory protection in relation to services/service suppliers from countries outside the EIA.

[59] Ibid.

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services trade in effect before and after the formation of an EIA makes it almost impossible to translate this requirement in practice.[60] Therefore, other approaches would need to be developed. Among the Members, there has been a proposition to require that an EIA did not reduce either the level, or growth, of trade in any sector or sub-sector below a historical trend.[61]

One way to analyze at least perceived changes to the overall level of barriers towards third parties is to review how many negotiations based on Art. XXI ('Modification of schedules') have been initiated between third parties and the EIA parties. The modification of schedules has been topical between the EU and third countries after the accessions of new Member States to the Union.[62]

vii Rules of Origin (Art. V:6)

Art. V:6 includes the requirement to establish a liberal rule of origin for EIAs. The benefits of the EIA must be extended to any service supplier of any Member that is a 'juridical person constituted under the laws of a party', provided that such a service supplier 'engages in substantive business operations in the territory of the parties to such agreement'. As has already been discussed in Chapter 1, this feature of Art. V is unparalleled in the area of goods trade and is one of the reasons why preferentialism in services is potentially less harmful for outsiders than preferentialism in goods.

However, rules of origin are by no means clear in the area of services. Actually, the origin rules of services, particularly those for Mode 3, are one of the most complicated issues in the GATS.[63] Moreover, while rules of origin for goods have been thoroughly discussed, much less attention has been attached to the increasingly important issue of rules of origin in services. Rules of origin in services can be distilled from Art. XXVIII GATS ('Definitions'), but arguably in a defective way. The GATS-based

[60] Stephenson, S. (2000) Regional Agreements on Services in Multilateral Disciplines: Interpreting and Applying GATS Art. V, at 96.

[61] Hong Kong, WT/REG/W/34, para. 13.

[62] See e.g. the Commission proposal COM/2013/0689/final where the Commission explains the changes relating to the modification of commitments in the schedules of the Republic of Bulgaria and Romania in the course of their accession to the European Union and asks the Council to authorize agreements in the form of an Exchange of Letters between the European Union and third countries who had submitted claims of interest.

[63] Zdouc, W. (1999) WTO Dispute Settlement Practice Relating to the GATS, *Journal of International Economic Law*, 2(2), 295–346.

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origin rules tend to consider only the legal criteria (e.g. place of incorporation) rather than economic ones (e.g. where value is added). Most EIAs follow the same approach as the one developed in GATS with the same defects and limitations.[64]

The combined criteria of Art. V:6 – constitution of a juridical person and substantive business operations – would at first sight appear relatively clear.[65] However, also there the question of what exactly constitutes a 'substantive' business operation is open to many interpretations, especially in light of today's commercial realities where services, and not only goods, are built along complicated value chains.[66]

III What Benchmark for EIAs?

The internal and external requirements set out the principal intent behind Art. V. They express the desirability of increasing trade by voluntary agreements between willing partners. Similarly to Art. XXIV GATT, they recognize that the purpose of an EIA should be to facilitate trade between the parties and not to raise barriers towards those remaining outside the agreement.[67] As in Art. XXIV, there is, however, a clear tension between the two requirements: the deeper the integration, the more dramatic are typically the effects on outsiders. This seeming irrationality was already brought up by Viner who noted the paradox of demanding a 100 per cent preference, 'which suddenly turns to a maximum evil at 99 per cent . . . ' In Viner's view, a completed customs union was still preferable since in that case the removal of duties is non-

[64] Gomez-Altamirano, D., Re-Thinking Rules of Origin in Services: Moving from a Legal Definition to an Economic One through a Determination of Value Addition in Global Value Chains (a paper presented at the conference of the Society of International Economic Law, 13 July 2018, Washington, DC). See also Wang, H. (2010) WTO Origin Rules for Services and the Defects: Substantial Input Test as One Way Out, *Journal of World Trade*, 44(5), 1083–108, at 1083.

[65] On both criteria, see Cottier & Molinuevo (2008), at 146–8.

[66] Moreover, services are an important part of value chains in manufacturing. Cernat and Kutlina-Dimitrova have drawn attention to the growing importance of services inputs in manufacturing sectors' exports. They argue that the existing four modes of supply of the GATS do not adequately cover this type of indirect services value-added trade. Hence, theoretically, they make the case for a new indirect mode of services supply – 'Mode 5'. See Cernat L. and Kutlina-Dimitrova, Z., Thinking in a Box: a 'Mode 5' Approach to Services Trade, Chief Economist Note, European Commission, Issue 1, March 2014. Available at: http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc_152237.pdf (last accessed on 15 September 2018).

[67] Mathis (2006), at 79–80.

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selective by its very nature and the 'beneficial preferences are established along with the injurious ones, the trade-creating ones along with the trade-diverting ones'.[68]

This very tension is maybe behind what has become a systemic disregard of the basic principles of Art. XXIV GATT and Art. V GATS. Moreover, it is now practically impossible to know how far or close PTAs come to fulfilling the requirements, as there is no longer any comprehensive multilateral review system. There has also been a shift in the analysis of PTAs in literature. Today, most studies focus on systemic issues stemming from PTAs as well as on reviewing the so-called WTO+ elements included in them. Even when presenting observations on a specific PTA's consistency with the WTO criteria, scholars avoid drawing any dramatic conclusions based on such observations.

Especially in the context of EIAs this is understandable considering the vagueness of the terms 'substantial' and 'substantially', as well as the complex modalities of liberalizing services. We lack a clear benchmark as to the level of liberalization that EIAs are required to attain. In addition, an objective analysis is close-to an impossible task to carry out. Because of difficulties in measuring services liberalization, assessing the fulfilment of the Art. V criteria necessarily includes a great deal of subjectivity.[69] Another challenge is that Art. V gives some room to the so-called 'living agreements'. First, the absence/elimination of discrimination can be attained on the basis of a reasonable time-frame and second, Art. V:2 allows consideration to be given to a wider process of integration. In deep economic integration projects, such as the EU, higher level of liberalization is being attained in a continuous, slow process with occasional setbacks.[70]

To propose some structure to the legal analysis of EIAs, we propose to concentrate on the first paragraph of GATS Art. V. That provision puts

[68] Viner, J. (1950) *The Customs Union Issue*. New York: Carnegie Endowment for International Peace, at 44 and 51.

[69] The USA has argued that since there is no objective data to base conclusion on, an assessment requires looking at 'the sum of the parts'. According to the view expressed by its representative in one of the meetings of the CRTA, we should not wait for more numbers, but rather draw some subjective conclusions according to the elements of Art. V. See 'Examination of the North American Free Trade Agreement', Note on the meeting of 24 February 1997, WT/REG4/M/4, CRTA, 16 April 1997, para. 18.

[70] In the NAFTA debate the representative of Mexico claimed that NAFTA was planned as a living agreement; it did not represent the end of a process of negotiations, but rather was an instrument moving all elements towards greater liberalization. The representative added that the EC, too, had developed in this manner. Ibid., para. 20.

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forward the clearest requirement which is to eliminate, or at least aim at eliminating, substantially all discrimination across a substantial number of service sectors. Even if Art. V allows for other aspects in an EIA to be taken into account, the starting point should be in analyzing the extent of non-discrimination provided. This is the key requirement that we study in more detail in the chapter that follows.

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3

Elimination of Discrimination in EIAs

I Non-Discrimination in EIAs

i The Key Obligation: Non-Discrimination

The essence of Art. V is the requirement of elimination of discrimination.[1] This is in contrast to the multilateral liberalization of services under the GATS. The Preamble to the GATS does not mention elimination of discrimination but merely calls, among other objectives, for progressive liberalization of services trade. The framework for such liberalization to take place over time is provided in Part IV of the GATS: under Art. XIX GATS, Members should enter into successive rounds of negotiations of specific commitments with a view to achieving a progressively higher level of liberalization. The GATS Preamble can be compared to the Preamble of the GATT 1994, which calls for the 'elimination of discriminatory treatment in international commerce'. Elimination of discrimination is thus one of the GATT's long-term objectives but a similar statement is lacking in the GATS.

There is thus a principal difference in the way multilateral and bilateral services negotiations should be conducted. The fact that non-discrimination has a key role to play in the GATS discipline on EIAs may give reason to suspect that GATS-compliant EIAs are possible between very trusting partners only. At least a certain level of similarity in cultural, political and economic backgrounds of the participating

[1] Similarly, Cottier, T., Delimatsis, P. & Diebold, N. (2008), Article XIV GATS (General Exceptions), in Wolfrum, W., Stoll, P.–T. & Feinäugle, C. (eds.) *WTO – Trade in Services*. Leiden: Martinus Nijhoff Publishers, at 317–18.

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countries seems to contribute to a deeper integration in the field of services.[2]

The obligation to provide for a high level of non-discrimination (a 'substantial' level) brings with itself a certain challenge for any compliance analysis. Under the GATS, discrimination can exist only in a situation where the services and/or service suppliers under comparison are 'like'. The determination of the existence of discrimination thus requires a comparison of specific services and/or service suppliers to each other. This cannot be done in an abstract analysis of an EIA, and thus no completely accurate compliance analysis under Art. V can be concluded.

The question of likeness is only the first step in a discrimination analysis under Art. XXIV GATS. The finding of discrimination also requires a finding of 'a treatment no less favourable' than that accorded to one's own like services and/or service suppliers. The question of treatment, however, becomes topical only after likeness has been established.[3] In the field of services, the establishment of likeness and less favourable treatment can be a daunting task because governments can always invoke difference in treatment due to various regulatory distinctions. In the lack of any real-life service or service suppliers, we lack the means to carry out a full discrimination analysis. In the following sub-section, we explain how to approach this problem in an abstract, legal analysis of EIAs.

ii Discrimination Analysis in the EIA Context

Non-discrimination entails the idea of a level playing field between domestic and foreign like products and services. The legal framework for the creation

[2] On the relevance of the 'trust theory of economic integration' in the EU and the WTO, see Lianos, I. & Odudu, O. (2012) *Regulating Trade in Services in the EU and the WTO: Trust, Distrust and Economic Integration*. Cambridge: Cambridge University Press. One form of economic integration are mutual recognition agreements (MRAs). Marchetti and Mavroidis argue that MRAs in the WTO are frequently concluded between countries having a similar cultural background. Moreover, the majority have so far been signed across geographically proximate partners who usually also share the same language. See Marchetti, J. & Mavroidis, P. C. (2012) I Now Recognize You (and Only You) as Equal: An Anatomy of (Mutual) Recognition Agreements in the GATS, in Lianos, I. & Odudu O. (eds.), *Regulating Trade in Services in the EU and the WTO*, Cambridge: Cambridge University Press, 415–443.

[3] For an analysis of the 'less favourable treatment' obligation, see Ortino, F. (2008) The Principle of Non-Discrimination and Its Exception in GATS: Selected Legal Issues, in Alexander, K. & Andenæs, M. T. (eds.), *The World Trade Organization and Trade in Services*. Leiden: Brill, 173–204, at 174 and onwards. See also Krajewski, M. & Engelke, M. (2008) Article XVII GATS, in Wolfrum, R., Stoll, P.-T. & Feinäugle, C. (eds.), *WTO – Trade in Services*. Leiden; Boston: Martinus Nijhoff Publishers, 396–420, at 409–16.

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of such a playing field is set in Art. XVII GATS. Based on the rulings of the Panel and the AB in *EC–Bananas III*, we know that the following four cumulative elements need to be present in a successful NT violation claim:

1) First, there needs to be a specific commitment in the relevant sector and mode of supply;
2) Second, there must be a measure *affecting* the supply of services in the sector and mode of supply concerned;
3) Third, the measure is applied to foreign and domestic *like* services and/or service suppliers; and
4) Fourth, the measure accords to foreign services and/or service suppliers *treatment less favourable* than that accorded to their domestic counterpart.

There is thus a four-prong test to establish inconsistency of a particular measure with Art. XVII GATS.[4] The existence of a specific commitment in a given sector is a factual issue. Even though interpretative problems are always present, in an *ex ante* analysis of services commitments we have to take the existence of a commitment as taken. We also have to assume that the scheduled measure is meant to affect the supply of services in the sector and mode concerned. If that were not the purpose, the measure would not have been prescribed. The two final elements, however, pose more difficulties for an abstract analysis of services commitments. We do not have any real-life services/service suppliers to compare to each other and we typically have very few details on the measure to estimate whether it accords less favourable treatment or not. This is a genuine problem because a conclusion one way or another may result in a false finding of discrimination or non-discrimination.[5]

As noted by Mattoo, the narrower the definition of likeness, the more likely is the possibility that measures will escape the Article XVII net.[6]

[4] Mavroidis, P. C., Bermann, G. A. & Wu, M. (2013) *The Law of the World Trade Organization (WTO): Documents, Cases & Analysis*. St. Paul: Thomson/West, at 829.

[5] The establishment of likeness and less favourable treatment require a case-by-case analysis. In *Japan–Alcoholic Beverages II*, regarding Art. III:2 GATT, the AB came to the conclusion that 'the interpretation of the term [likeness] should be examined on a case-by-case basis'. According to the AB, this allows a fair assessment in each case of the different elements that constitute a 'similar' product. See *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, Report of the Appellate Body, circulated 4 October 1996.

[6] Mattoo, A. (1997) National Treatment in the GATS: Corner-Stone or Pandora's Box? *Journal of World Trade*, 31(1), 107–35, at 122, and Mattoo, A. (2000) MFN and the GATS, in Cottier, T., Mavroidis, P. C. & Blatter, P. (eds.), *Regulatory Barriers and the Principle of Non-Discrimination in World Trade Law*. Ann Arbor: University of Michigan Press, at 55.

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This issue was dealt with in a recent WTO dispute settlement case concerning services, in the case *Argentina – Financial Services*. The dispute concerned eight financial, taxation, foreign exchange and registration measures imposed by Argentina mostly on services and service suppliers from jurisdictions that did not, at the time, exchange information with Argentina for the purposes of fiscal transparency. In its ruling, the Panel found that the relevant services and service suppliers were 'like' under both Art. II:1 and Art. XVII of the GATS, because the eight challenged measures provided for differential treatment on the basis of the origin of the services and service suppliers at issue. The AB, in its ruling, pointed out that likeness may indeed be presumed where a measure provides for differential treatment based exclusively on the origin of the services and service suppliers concerned. The AB, however, found that in its analysis under Art. II:1, the Panel did not make a finding that the distinction between cooperative and non-cooperative countries in the measures at issue was based exclusively on origin, and that the Panel erred in finding likeness 'by reason of origin' in the absence of such a finding. Instead, the Panel should have undertaken an analysis of likeness on the basis of various criteria relevant for an assessment of the competitive relationship of the services and service suppliers of cooperative and non-cooperative countries. Because the Panel's finding of likeness under Art. XVII was based on its finding of likeness under Art. II:1, the AB found that the Panel erred also in its analysis under Art. XVII. Consequently, the Panel's findings of likeness of the services and service suppliers at issue under Articles II:1 and XVII of the GATS were reversed.[7]

Because the AB did not draw any conclusions on the question of whether the services and service suppliers of cooperative and non-cooperative countries were like or not, it was left unclear to what extent

For a comprehensive analysis in the literature, see Diebold, N. F. (2010) *Non-Discrimination in International Trade in Services: 'Likeness' in WTO/GATS*. Cambridge; New York: Cambridge University Press.

[7] *Argentina – Measures Relating to Trade in Goods and Services*, WT/DS453/AB/R, Report of the Appellate Body, circulated 14 April 2016. In the same report, the AB concluded that, where a measure is inconsistent with the non-discrimination provisions of the GATS, regulatory aspects or concerns that could potentially justify such a measure are more appropriately addressed in the context of the relevant exceptions and not in the context of the analysis of 'treatment no less favourable' under Art. II:1 and Art. XVII. Likeness in the services context has also been dealt with in *EC–Bananas III* (para. 7.322) and *China–Publications and Audiovisual Products* (paras. 7.975–7.976). See *China – Measures Affecting Trading Rights and Distribution Services for Certain Publication and Audiovisual Entertainment Products*, WT/DS363/AB/R, Report of the Appellate Body, circulated 21 December 2009.

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a country's cooperation with other countries on tax matters may affect the position of its services and service suppliers in a discrimination analysis. What the AB said was that the differing treatment between cooperative and non-cooperative countries inherent in the eight measures at issue was origin-related; however, it is not origin in itself that determines which countries are on the 'cooperative' list but rather those countries' respective regulatory frameworks. The AB thus left the door open to the possibility of taking certain regulations, or rather the lack of such regulations, of the country of origin into account in the determination of 'likeness'. In this case, such regulations did not even relate to the quality of the services or the service suppliers but rather to their operating environment. However, the AB abstained from explaining how 'likeness' should be defined.[8]

As a result of differences between goods and services, WTO-compliant, unilateral and extra territorial application of one's regulations may be more feasible in the field of services than in the field of goods. One could, for example, ask if two service suppliers are like if one of them respects the rules of the core ILO Conventions with respect to employed personnel supplying services and the other one does not.[9] Could the service supplier in another Member be considered 'unlike' to one's domestic supplier if the foreign supplier's employees had working

[8] The AB and panels have abstained from taking a clear stand on 'likeness' in the services context also in earlier instances. In *EC–Bananas III*, the panel accepted that foreign and domestic services and services suppliers were like without justifying its decision in detail. Its restraint is obvious in its infamous conclusion of likeness according to which '. . . to the extent that entities provide these like services, they are like service suppliers' (Panel Report, para. 7.322). In *Canada–Autos* the same conclusion (this time with respect to Art. II GATS) was repeated with the addition that it was applied for 'the purpose of the case' (*Canada – Certain Measures Affecting the Automotive Industry*, WT/DS139/R, WT/DS142/R, Report of the Panel, circulated 11 February 2000, para. 10.248). In the same case, the Panel also introduced the concept of 'likeness across modes' (Panel Report, para. 10.307). The Panel also found that in the absence of 'like' domestic service suppliers, a measure by Canada could not be found to be inconsistent with the NT obligation (Panel Report, paras. 10.283–10.289). The Panel thus seemed to assume that the absence of like suppliers implied the absence of like services. The correlation between the likeness of services and service suppliers is one of the key questions in the likeness analysis. In general it appears that the determination of likeness, as well as the application of the NT principle as a whole, gives rise to a wider range of questions and uncertainties under the GATS than under the GATT. See Cossy, M. (2006) Determining 'Likeness' under the GATS: Squaring the Circle? *WTO Staff Working Paper* (ERSD-2006–08), at 2.

[9] The question addresses a situation where the foreign service supplier's employees do not access the employment market of the other Member. In such a situation, the employment laws of the home state usually apply. Under Mode 4, the receiving state may in certain cases require the application of its core labor laws to the employees of a foreign service supplier (especially in the case of contractual service suppliers).

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conditions considered degrading in the other Member? One may also ask to what extent the 'method' of achieving one's professional capacity, such as the quality of one's educational institute, may affect the evaluation of 'likeness'.[10]

The liberalization of services has an important particularity. In contrast to the GATT whose disciplines are confined to the cross-border flow of goods, the GATS extends to measures affecting both the services (i.e. the product) and the service supplier (i.e. the producer). The extension of coverage to service suppliers is significant considering that many typically national regulations, such as quality standards, are based on the characteristics of the supplier.[11] This is in contrast to goods where the AB has, at least so far, drawn a line between the methods of production and the product itself. In simple terms, the basic method of differentiation has been that only such methods of production that leave a trace on the product can be taken into account in the discrimination analysis.[12] In the field of services, the competence and the performance of the 'producer',

[10] There is discussion of more meaning to be given to non-product related production methods and to the production environment also in the field of goods. For example, Cottier and Oesch argue that it is only a matter of time before human rights will inform the basis of definition for a like product, and 'thus will relevantly and explicitly shape the operation of non-discriminatory treatment'. See Cottier, T. & Oesch, M. (2011) Direct and Indirect Discrimination in WTO Law and EU Law. *NCCR Trade Regulation Working Paper*, No. 2011/16, at 12.

[11] Lim, A. H. & De Meester, B. (2014) *WTO Domestic Regulation and Services Trade: Putting Principles into Practice*. New York: Cambridge University Press, at 1–2. See also Cossy (2006).

[12] So far, the AB has considered that the method of production cannot affect the analysis of 'likeness', unless the method affects the product itself. However, the placement of import controls on products produced according to a specific method of production may be allowed if justified under one of the general exceptions of Art. XX GATT. In *US–Shrimp/Turtle* the AB made clear that Members have the right to take trade action to protect the environment (in particular, relating to the conservation of exhaustible natural resources). According to the ruling, measures relating to the method of harvesting sea turtles could be considered legitimate under Art. XX(g). The USA, however, lost the case, not because it sought to protect the environment but because it discriminated between Members by violating the chapeau of Art. XX. See *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, Report of the Appellate Body, WT/DS58/AB/R, circulated 12 October 1998. On the notions of non-product related and product related processes and production methods ('PPMs'), see Joshi, M. (2004) Are Eco-Labels Consistent with World Trade Organization Agreements? *Journal of World Trade*, 38(1), 69–92, at 69 and 73–4. Joshi defines non-product related PPMs as 'measures that relate to processes that do not impart any distinguishing characteristics to the final product'. See also Kudryavtsev, A. (2013) The TBT Agreement in context, in Epps, T. & Trebilcock, M. J. (eds.), *Research Handbook on the WTO and Technical Barriers to Trade*. Cheltehnham; Northampton: Edward Elgar, 17–80, at 40–7.

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the service supplier, are inherently linked with the result of the 'production' – the service. This means that there is possibly a wide scope for differentiation of like services and service suppliers based on characteristics attributable to the service supplier and the methods that the supplier employs while supplying the traded service.[13]

Mattoo explains the great role played by regulatory distinctions.[14] Even if cross-price elasticity, consumer choice and other case law-established factors would point towards likeness, nothing prevents a government from intervening and imposing a regulatory component on a given service or service supplier and thus differentiating the foreign supplier from a domestic one. Moreover, likeness is of course not the sole ground for regulatory distinction; 'less favourable treatment' is the other one. The finding of discrimination between like services/service suppliers similarly requires a case-by-case analysis of the treatment granted.[15] In addition, as we have discussed above, there is also the possibility of recourse to one of the justifications under Articles XI, XII, XIV and XIV bis. No matter where the burden of proof is placed, getting a final answer in an unclear situation is possible through dispute settlement only.[16]

iii Analyzing Discriminatory Measures in Specific Commitments

Because of the above-mentioned problems in an abstract, empirical analysis of EIAs, we consider that the most legitimate way to conduct

[13] According to Krajewski, the extension of the NT obligation to service suppliers can be interpreted as allowing for a certain degree of differentiation according to the production process methods (PPMs) of the service in regulatory measures. See Krajewski, M. (2003) *National Regulation and Trade Liberalization in Services: The Legal Impact of the General Agreement on Trade in Services (GATS) on National Regulatory Autonomy*. The Hague: Kluwer Law International, at 97.

[14] Mattoo (2000), at 73–5. Mattoo writes on likeness in the context of Art. II (MFN) but similar conclusions on likeness can be drawn under Art. XVII. See also Mavroidis, Bermann & Wu (2013), at 833–4.

[15] In this regard, Mattoo notes that the sequential procedure of first determining likeness and then less favourable treatment is actually not ideal in the services context but leads into a legal cul-de-sac. Instead, he proposes simultaneous consideration of the degree of unlikeness and differences in treatment. See Mattoo (2000), at 73.

[16] Discussing likeness under Art. II (MFN), Mattoo argues that in case a Member refuses access to another Member's service or service supplier the burden of proof should be placed on that Member. The Member would thus be requested to demonstrate why the foreign and domestic services/service suppliers are not like. See Mattoo (2000), at 75. As to seeking clarity through dispute settlement, a certain reservation is warranted. As the scant case law (most recently in *Argentina – Financial Services*) on 'likeness' under the GATS demonstrates, the meaning and scope of the concept remains largely unresolved.

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such an analysis is to focus on explicitly discriminatory measures only.[17] Measures constituting *de facto* discrimination have to be largely omitted in an *ex ante* analysis of an EIA. Instead, the focus must be on the most detrimental types of discrimination, those constituting direct (or nearly direct) discrimination.[18] For the analysis to be possible, a likeness between foreign and domestic services and/or service suppliers in the scheduled commitments must be assumed. We consider this reasonable as otherwise no discrimination analysis is possible to carry out. In any case, legal analyses of commitments under trade agreements always include a certain margin of error since they remain on an abstract level.

In this type of abstract discrimination analysis, we divide the clearest, most explicit types of discriminatory measures in services trade into four different groups. These four groups consist of the type of measures that are taken into account in our empirical analysis.[19]

[17] Other methodologies are, of course, available, in other types of approaches (e.g. econometric analyses). However, since our approach is legal and our intention is to analyze EIA commitments directly in light of the Art. V criteria, a strict methodology is required.

[18] This can be equated to *de jure* discrimination. A measure that openly links a difference in treatment to the origin of the service or services and therefore modifies the conditions of competition in favour of domestic services and services suppliers is generally considered *de jure* discrimination. See Krajewski & Engelke, at 410. As for *de facto* discrimination, there is no positive concept for its determination and various views have been put forward in the literature. However, it can be considered to cover measures which do not distinguish services/services suppliers based on their origin but which with respect to a 'neutral' criterion modify the conditions of competition in favour of domestic services and/or service suppliers. Ibid., at 411. See also Krajewski (2003), at 113, where he argues that only those measures which can at least theoretically be scheduled should be seen as discriminatory. This is because the possibility to schedule a *de facto* discriminatory measure only exists if the adverse effect on foreign services/service suppliers is foreseeable or can reasonably be expected.

[19] Our analysis of the types of measures to be considered as limitations to national treatment is close to that of Miroudot and Shepherd (2014). In their analysis of existing EIAs, they map commitments that are either 'full' (no limitation), 'partial' (some limitations listed), or 'unbound' (no commitment). 'Partial' commitments are broken down into nine different types of trade restrictive measures, four for market access and five for national treatments. See the 'Typology of Limitations in Partial Market Access and National Treatment Commitments' in Miroudot, S. & Shepherd, B. (2014) The Paradox of 'Preferences': Regional Trade Agreements and Trade Costs in Services. *The World Economy*, 37(12), 1751–72, at 1770. The authors use a database developed at the OECD that covers all services agreements where an OECD economy, China or India is a party (Miroudot, S., Sauvage, J. & Sudreau, M. (2010) Multilateralising Regionalism: How Preferential Are Services Commitments in Regional Trade Agreements?, *OECD Trade Policy Working Papers*, No. 106.). The database includes a similar analysis for commitments taken under the GATS. See also the illustrative list of frequently occurring limitations to the NT obligation published by the WTO Secretariat. It is included as Attachment 1 in the Scheduling Guidelines (S/L/92, 28 March 2001). The list gives examples of

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The first group covers all commitments that prescribe an 'unbound' in a specific sector or sub-sector. In substance, an 'unbound' means that the Member takes no commitment at all. It is the most straightforward limitation to NT as it entails the widest possible scope of discretion in the treatment of foreign services and service suppliers. Outside the general obligations that may apply across the sectors even when no specific commitments are undertaken, specific commitments that are left 'unbound' do not grant any guarantee of non-discrimination. Such 'empty' commitments are thus always considered discriminatory.

The second group consists of measures that are discriminatory in the clearest sense of the word: they are applied to foreigners only. This category of measures is directly discriminatory as the basis for the application of the measures lies solely in the foreign origin of the service supplier. Naturally, measures that grant more positive treatment to foreigners than to one's own nationals are not of relevance here but only the type of measures that restrict trade in services.[20] Typical measures under this first category are discriminatory market access restrictions such as the requirement of a specific legal entity, limitations to numbers of foreign services suppliers and such economic needs tests (ENTs) that are applied to foreigners only. Other clearly discriminatory measures are foreigners' non-eligibility for subsidies, prohibition to acquire real estate, discriminatory taxes and discriminatory licensing and qualification requirements. With the last types of requirements, we refer to cases where licensing is required from foreigners only and cases where foreigners are required to have higher qualifications than one's own nationals.

The third group covers measures that relate to nationality. Such measures are also based on one's origin and can thus be seen as a subgroup of the second category of measures. However, they differ from the second group in the sense that they concern measures, which are not applied only to foreigners, but include a requirement concerning one's nationality. For example, a specific commitment under professional services may prescribe that companies acting in the field of auditing services must have in their board at least one person with the nationality of the Member in question. In contrast to the second group of measures,

measures Members consider as possible violations of NT. Some of the measures discriminate overtly, while others appear to amount to *de facto* discrimination.

[20] Essentially, states have a sovereign right to treat their own products and nationals less favourably than imported products and foreign nationals (reverse discrimination, discrimination à rebours). See Cottier & Oesch (2011), at 8.

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the measures belonging to this category are applied indistinctively to all service suppliers, but since they are based on nationality, they are clearly discriminatory.

The fourth group of considered NT limitations forms an exception to our otherwise strict approach. It consists of measures concerning one's residency. In trade law, residency requirements are typically considered to form a type of indirect, or covert, discrimination as they are not directly based on one's nationality.[21] However, because of how the GATS is structured, we consider residency requirements to be discriminatory but *only* with regard to Modes 1, 2 and 4. This is because the essence of these three modes is in that they enable the supply of services *without* residency. The requirement of residency would thus often strip a commitment under any of these three modes of its liberalization content. Although the measure does not formally distinguish service suppliers on the basis of national origin, it *de facto* offers less favourable treatment to foreign service suppliers because they are less likely to be able to meet a prior residency requirement than like service suppliers of national origin.[22] With regard to this group of measures, our analysis includes a certain margin of error but we consider that the margin of error would be more significant if residency requirements under Modes 1, 2 and 4 were not taken into account.

We do not take note of residency requirements under Mode 3 even if such requirements could potentially be considered discriminatory at least when they do not apply to the legal entity but to its personnel. For example, foreign companies established in the receiving Member may have board members or members of personnel that have their permanent residence in their country of origin. Requiring such persons to change their residence to the receiving Member may thus be seen as a restriction to the supply of services under Mode 3. However, if a similar residency requirement is applied also to legal entities of national origin, it is not directly based on the origin/nationality of the service supplier. Even though such requirement may potentially constitute a violation of the NT obligation (in case the requirement modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service

[21] Klamert, M. (2015) *Services Liberalization in the EU and the WTO: Concepts, Standards and Regulatory Approaches*. Cambridge: Cambridge University Press, at 274–5.

[22] See the WTO Secretariat's Scheduling Guidelines, S/L/92, at 6. In the Scheduling Guidelines it is explained that the need to schedule residency requirements should be decided on a case-by-case basis, and in relation to the activity concerned. For example, a residency requirement may be considered discriminatory when there is no justified need to live in the country as opposed to having a bare mailing address in the country.

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suppliers of any other Member), such a conclusion is not straightforward and arguably based on a case-specific analysis. Under Mode 3, the service supplier has a commercial presence in the receiving Member and, therefore, the local regulatory framework typically applies in its entirety (in the case of juridical person constituted under local laws) or at least to a larger degree than in respect of the other modes (in the case of branches and representative offices).[23] Thus, there is more leeway for residency-based measures under Mode 3 than under the other modes.

Notwithstanding the residency requirements (which are arguably a form of *de facto* discrimination), our analysis is thus limited to *de jure* discrimination. These types of discrimination can be considered to constitute the clearest violations of the NT obligation. Outside such direct forms of discrimination, we enter a far less certain ground. The more hidden types of discrimination are revealed only when reviewed in the context of a specific case.[24] Taking the example of qualification requirements, the requirement of a local qualification (such as a professional degree in the receiving state) may be considered discriminatory or non-discriminatory depending on whether service suppliers with and without the qualification can be considered like. In addition, the qualification requirement must modify the conditions of competition in favour of the Member's own services or service suppliers.[25]

[23] We advance the argument that one constitutive element of service supply under Mode 4 is that the service supplier (a natural or a juridical person) remains largely subject to the regulatory framework of the state of origin. Under Mode 3, the establishment of a commercial presence in the receiving state brings the service supplier deeper, or completely (depending on the legislation that is applied to different types of commercial presence), within the regulatory framework of the receiving state. Nevertheless, the discrimination analysis of residency requirements needs to be case-specific. Certain services may be practically impossible to provide without residence (e.g. daily postal delivery services), whereas certain others may require no residency or residency of a certain type of personnel only. In addition, in many occasions public policy concerns may justify the need of a local representative. Since it is often not possible to conclude whether such justified concerns are present in a residency requirement under a specific commitment, we have opted to disregard all residency requirements under Mode 3 (unless it is obvious that they are applied on a discriminatory basis).

[24] The situation can be contrasted to an analysis of a goods agreement in light of Art. XXIV GATT. Even though Art. XXIV requires the elimination of duties and other restrictive regulations of commerce on substantially all the trade between the parties, the analysis is, in practice, to a large extent limited to the elimination of duties. If there is an extensive amount of restrictive regulations of commerce left in place, such a situation is typically revealed only in practice.

[25] Members sometimes include in their schedules also measures that cannot easily be considered discriminatory. This is probably a sign of lack of clarity over the borderlines between national treatment and domestic regulation. However, such over-scheduling

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The problems relating to the analysis of discriminatory measures in a schedule of specific commitments are taken up in more detail in Part II of the book concerning the methodology to study EIAs.

Finally, it should be noted that the absence of 'substantially' all discrimination depends not only on sectoral commitments but also on crosscutting horizontal commitments. They pose an additional challenge for any empirical analysis as they often include discriminatory limitations that are applied to all or a significant part of services sectors (e.g. subsidies available only to one's own nationals). This issue is taken up in more detail in Chapter 8 of Part III concerning the methodology of the empirical study.

II The Level of Non-Discrimination Required by GATS Art. V

The biggest challenge in the analysis of EIAs under the Art. V criteria is that we do not have a clear benchmark for the requirements of sectoral coverage and elimination of discrimination. There is no unequivocal answer to the question of what 'substantial' and 'substantially' really mean. This forces one to ask whether the negotiators' purpose has been to avoid any clear-cut interpretations from being made. The diversity in the Members' positions as to the correct interpretation of 'substantiality' confirms that no common understanding exists.

In addition, an empirical analysis of the level of discrimination in EIAs includes two other significant challenges. First, because only the most blatant forms of discrimination can be taken into account, the results of an abstract empirical analysis (to which we also refer as *ex ante* analysis) are likely to show less discrimination than the agreement in reality entails. The second challenge, on the other hand, relates to the possible event of finding discrimination there where it could potentially be permitted under Articles XI, XII, XIV and XIV bis.

The measurement and assessment of 'substantial coverage' and 'substantially all discrimination' in quantitative and qualitative terms inevitably entails a case-by-case analysis on the level of specific commitments under each sector. However, the review procedure under the Transparency Mechanism of 2006 is limited to the preparation of

may also be a smart policy as some of the measures that do not at first glance appear discriminatory between domestic and foreign service suppliers can be that in practice, depending on the way they are applied. Therefore the inclusion of such measures in a schedule releases the Member from its responsibility and gives it more leeway in the application of the measure.

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a simple factual presentation that only gives an overall assessment of the agreement. A more specific examination may only take place in dispute settlement where Panels and the AB would be called upon to examine the WTO-compatibility of a specific domestic measure based upon an EIA. In such a case, the compatibility of the agreement with Art. V may be examined as a preliminary matter.[26]

Dispute settlement on PTA-related issues is extremely rare and we are not likely to receive much clarity on the WTO-compliance of EIAs through that route. While the number of PTAs is growing, it would, however, be important to keep some track of their relationship to the legal discipline. Due to the modesty of the Transparency Mechanism, it is mainly left to scholars to propose alternative methods for the analysis of PTAs and to inform decision-makers of the results of such analyses. In this book, we propose one approach that pays due respect to the flexibility and complexity depicted in the discipline while providing concrete means to assess EIAs and compare them to each other.

The emphasis is on analyzing the EU's EIAs in light of the internal requirement of Art. V:1. The aim is to show how far the EU comes in eliminating discrimination across the services sectors. The purpose is not to reach a conclusion on the legality of the EU's EIAs. Some suggestions on their compliance with Art. V can, however, be made. They are made on two different grounds. First, it is suggested that if an EIA provides for non-discrimination in less than 50 per cent of the coverage of the agreement, an *a priori* assumption of the agreement falling short of Art. V requirements can be made. That is because under no circumstances can 'substantial' be considered to be less than 50 per cent of coverage. Such a low level of liberalization cannot, in our view, be saved even by the possibility of taking any wider process of integration into account. In the case of the EU, our results do not show the overall level of coverage but the percentage of Member States providing for non-discrimination. The implications of this are discussed in Chapter 12 in Part IV of the book.

The second ground for conclusions as to the liberalization level of a specific EIA in relation to the Art. V criteria relates to the Members' practice. Considering the intentional flexibility built in Art. V, the Members' practice becomes more relevant than in a situation where a clear interpretation of the wording of Art. V was available. We do not

[26] Cottier, T. & Molinuevo, M. (2008), Article V GATS, in Wolfrum, W., Stoll, P.–T. & Feinäugle, C. (eds.), *WTO – Trade in Services*. Leiden: Martinus Nijhoff Publishers, 138–9.

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suggest the establishment of subsequent practice in the sense of Art. 31:3 (b) of the Vienna Convention on the Law of Treaties as that would require going through a much bigger sample (if not all) of EIAs with a rigorous methodology. Such a methodology is hardly available for the analysis of EIAs. Instead, we suggest a more modest comparison of the Members' EIAs to each other. In such a comparison, the overall purpose of the agreement should be taken into account. An EIA aiming to create a common market should be viewed somewhat differently from an EIA aiming at simple commercial market opening. Such comparisons should be made also between the different agreements of any single Member. The average level of liberalization in both types of comparison gives us some scope of realistic expectations to be made about the liberalization levels of various EIAs.

In the present book, the EU's EIAs are compared to each other keeping this purpose in mind. Each agreement's numerical scores on sectoral coverage and non-discrimination provide the tool for comparison, between the agreements themselves as well as to the criteria of Art. V:1. In addition, the scores show the internal differences that are present in the services commitments of individual EU Member States. The detailed methodology is applied to the EU agreements only but for the purpose of comparing the EU's EIAs with agreements made by other federal entities, the US and Canadian commitments in CETA and NAFTA are reviewed. So far, EIAs concluded by federal states have been left to little attention even though federal states are among the most active states in preferential services liberalization. Part II of the book aims to fill this gap in literature by focusing on federalism in the international liberalization of services.

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