

Services

1. **A practical trade law problem**

Prize-winning architectural firm Construct has created considerable worldwide interest through its buildings in its home country of Country A, a member of the World Trade Organisation (WTO). Construct was invited to submit drafts to an architectural competition in Country B and subsequently won the competition. However, before signing the contract, Country B's investor wants details from Construct on its submission of the plans and supervision of the building site.

Country B is a member of the WTO and has listed sector "CPC 8671 architectural services" in its schedule, with no limitations on market access. A border tax on temporary entry of professionals is listed under Country B's horizontal commitments as a limitation on national treatment under Mode 4, presence of natural persons. Country B's law requires architects to have local offices; only architects from neighbouring Country C, also a WTO member, are exempt from this requirement. However, all architects, whether domestic or foreign, are forbidden from sending plans to customers in Country B by email or post. In addition, Country B allows only 20 architectural firms to operate within its territory, as the government feels that it can better regulate the industry with a limited number.

Construct feels that these requirements are threatening its performance of the contract resulting from the architectural competition. How would one advise Construct in world trade law?

2. **Services and GATS**

During the Uruguay Round, services were included for the first time in the scope of the world trade negotiations. The General Agreement on Tariffs and Trade (GATT), concerned with international trade in goods, has existed since 1947, but it was only in January 1995, with the creation of the WTO, that the General Agreement on Trade in Services (GATS) was concluded. GATS is part of the WTO's Single Undertaking of the Uruguay Round, and all WTO members are therefore signatories to it and bound by the obligations it contains.

2.1 **To what does GATS apply?**

GATS applies to "measures by Members affecting trade in services". Measures include laws, regulations, rules, procedures, decisions and administrative action, and may be taken by any level of government as well as by non-governmental bodies exercising delegated powers. For a measure to affect trade in a service, it must have an effect on

trade between two members in the service according to one of the four modes of supply. Governmental services “in the exercise of governmental authority” are excluded from the definition of ‘services’.

2.2 What are services?

Services can be considered as intangible commodities satisfying human needs. Production and consumption of services generally occur simultaneously. Indeed, one classic definition of a service is “anything that you cannot drop on your foot”! In fact, services include many different categories and are traditionally separated into 12 core service sectors:¹

- business services (including professional services and computer services);
- communication services;
- construction and related engineering services;
- distribution services;
- educational services;
- environmental services;
- financial services (including insurance and banking);
- health-related and social services;
- tourism and travel-related services;
- recreational, cultural and sporting services;
- transport services; and
- other services not included elsewhere.

These main sectors are then broken down into around 160 sub-sectors – some quite specific, such as ‘maintenance and repair of vessels’, and others relatively broad, such as ‘entertainment services’.

2.3 What are modes of supply?

Goods are traded between countries in essentially one way: they are physically transported from one country to another. Services, on the other hand, can be traded in four different ways, called ‘the four modes of supply’:

- Cross-border supply – services supplied from the territory of one WTO member to the territory of another member. Examples include providing banking or legal services from one country to another via telephone or post;
- Consumption abroad – services consumed by a person in the territory of another member. Examples include tourism, education and healthcare services;
- Commercial presence – services provided by a company via a business presence (eg, an office) in another member’s territory. Examples include domestic subsidiaries of foreign companies such as banks or hotel chains; and
- Presence of natural persons – services provided by persons temporarily entering another member’s territory. Examples include the practices of professionals such as doctors, architects, accountants and teachers.

1 WTO doc MTN.GNS/W/120.

2.4 What is the structure of GATS? What are annexes and schedules?

GATS contains 29 articles that essentially set out the obligations of WTO members and the scope of those obligations, as well as some formalities and procedural issues. It also contains various annexes dealing with particular sectors and exemptions. Added to this is each member's schedule, which details the specific commitments the member makes in each sector.² The schedules use a positive list approach, meaning that a member assumes obligations for only those sectors inscribed into its schedule. This can be contrasted with a negative list approach, in which all service sectors would be automatically liberalised unless they were listed in a schedule. Once a sector is inscribed in a schedule, members can nevertheless place limitations on the obligations they wish to assume for that sector: these limitations are discussed below. There are also some obligations under GATS that are automatically imposed on members for all sectors, whether listed in their schedule or not: most favoured nation is one example.

Schedules are in fact composed of two sections: one for horizontal commitments and one for sector-specific commitments. Horizontal commitments set out limitations that apply across all sectors, while the sector-specific commitments contain limitations that apply only to the specified sector. Therefore, limitations might apply to a particular sector by virtue of a horizontal commitment in a member's schedule, even though no limitation is listed for that sector itself.

2.5 What are the basic obligations under GATS?

(a) *Most favoured nation*

The most favoured nation principle, a longstanding element of international trade in goods, is also a key principle in trade in services under GATS. It provides that any privileges in services trade granted by one member to another must be automatically extended to all other members. Under GATS, the obligation is unconditional, meaning that it applies to all members, to all sectors – whether listed in the member's schedule or not – and for all modes of supply. Therefore, if Country A negotiates bilaterally to grant Country B preferential access in accounting services, this preferential access must immediately be granted to all other countries as well, even though Country A may not have listed accounting services in its GATS schedule. Other countries will be able to challenge Country A under GATS if it does not grant access to them.

At the time of signing GATS, members were allowed to submit exemptions from the most favoured nation principle in an annex on Article II. These were intended to last only 10 years (and thus should now have expired), but may be extended in time if members desire. The most favoured nation principle will not apply to any exemption listed in this annex, allowing members to maintain specific measures that favour one country over others. Countries' existing most favoured nation exemptions can be found in the WTO Services Database at <http://tsdb.wto.org/wto/WTOHomepublic.htm>.

2 The schedules are searchable online in the WTO Services Database at <http://tsdb.wto.org/wto/WTOHomepublic.htm> (June 2006).

(b) National treatment

The national treatment principle requires countries to treat both foreign and domestic service providers equally. Strictly speaking, foreign providers must be given treatment that is “no less favourable” than that given to domestic providers. This obligation implies the absence of all discriminatory measures that may modify the conditions of competition to the detriment of foreign services or service providers. It does not matter whether the treatment provided to foreign and domestic services and service providers is formally different or formally identical – what counts is the practical result of the treatment.

National treatment under GATS is a conditional obligation, meaning that it applies only to sectors specifically listed by a member in its GATS schedule. In addition, members may list limitations on how far they will guarantee national treatment. For instance, a member might impose certain conditions on foreign banks (but not domestic banks) wishing to operate in their territory. If these conditions were not inscribed as limitations on national treatment in the banking services sector in the member’s schedule, they would be violations of the principle and liable to challenge. On the other hand, if banking services were not inscribed in the member’s schedule at all, no challenge to the discriminatory conditions could be brought by other members.

Note that no new limitations on national treatment should be inscribed into a member’s schedule; this opportunity passed after a member initially signed GATS. Since the goal of GATS is to produce ever-higher levels of service liberalisation, limitations inscribed by members can be added to or modified only if compensation is paid to adversely affected members. Article XXI sets out the procedures for modification of schedules.

(c) Market access

Once a specific sector is inscribed in a WTO member’s schedule, there are certain restrictions on market access that the member is not permitted to impose. These include restrictions on:

- the number of service suppliers in the sector;
- the value of service transactions in the sector;
- the number of service operations or quantity of output in the sector;
- the number of persons employed in the sector;
- the type of legal entity or joint venture that may supply services in the sector; and
- the participation of foreign capital (eg, a maximum percentage limit on foreign shareholding).

As with national treatment, the market access obligation is conditional since it applies only once a sector is listed in a member’s schedule. Members are similarly permitted to inscribe limitations to market access in their schedules. For example, a member might impose a limitation on market access by restricting the number of workers employed in the tourist guide services sector, with a view to reducing the human impact of tourism on an environmentally significant site.

Provided that this limitation is inscribed in the tourist guide services sector in the member's schedule, or if the sector as a whole is not contained at all in the schedule, then no challenge can be brought by other members against the limitation.

While new sectors may be added to a WTO member's schedule at any time, since this serves to open up the market of that particular member to further services liberalisation, removing a sector or modifying or adding to limitations imposed in a sector may result in compensation being paid to other adversely affected members. This also explains why the current Doha Round negotiations focus only on liberalisation of services.

2.6 What are the major exceptions allowed under GATS?

(a) *General exceptions*

GATS includes Article XIV, which was drafted based on the language of Article XX of GATT. It allows members to take any measures necessary to protect human, animal or plant life or health, as long as these measures do not result in arbitrary or unjustifiable discrimination, or operate as a disguised restriction on trade in services. Measures necessary to protect public morals or to maintain public order are also permitted, as well as other measures relating to safety, privacy, fraud, tax collection and double taxation.

Measures taken under these exceptions are not required to be listed anywhere in a member's schedule or in a GATS annex. Essentially, a member may take such measures unilaterally and would then rely on an exception if challenged by another member. The burden of proof falls on the member seeking to rely on the exception to show that:

- the measure is necessary to achieve the public goal sought (public order, human health, etc); and
- the measure does not result in arbitrary or unjustifiable discrimination or operate as a disguised restriction on trade.

For a measure to be necessary, it ordinarily must be the least trade-restrictive or least GATS-inconsistent measure available to the member (although the member does not have to demonstrate that every other possible measure is more trade restrictive than that taken).

Under Article XIV*bis*, members are allowed take measures that they consider "necessary for the protection of [their] essential security interests . . . in time of war or other emergency in international relations". As with the analogous exception in GATT, this is a largely self-judging exception, since it is again left to individual members to decide for themselves what constitutes their essential security interests or an emergency in international relations.

In this case, members must keep the GATS Council of Trade in Services informed of any measures taken under Article XIV*bis*. If challenged, the burden of proof still rests with the member taking the measures to demonstrate that they conform to the requirements of the exception.

(b) *Governmental services*

Any services provided “in the exercise of governmental authority” are excluded entirely from GATS, meaning that members make no commitments at all to other members regarding such services. This relates to services “supplied neither on a commercial basis, nor in competition with one or more service suppliers” and would include services such as police, fire brigade and tax collection.

In light of recent trends towards privatisation of many traditionally public services such as water, electricity and even prisons, there are suggestions that the governmental authority exception is much smaller than it appears. Where a fee is charged for these services above their cost, for instance, this may indicate that the service is being provided on a commercial basis (regardless of the margin involved) and would thus be included in the scope of GATS. Also, in cases where a private provider supplies a service alongside a governmental provider (eg, public and private schools operating in the same environment), it is possible that the government will then be ‘in competition’ with the private service provider, with the result that the sector is not covered by the governmental authority exception and must comply with all general GATS obligations. The scope of this exception is therefore somewhat unclear.

(c) *Bilateral or regional trade agreements*

In certain circumstances, members are exempted from the most favoured nation principle where they have concluded bilateral or multilateral/regional agreements on services trade liberalisation. The agreement must have “substantial sectoral coverage” and must remove “substantially all discrimination” between the parties. The history and context of trade liberalisation and economic integration between the parties may be considered in determining whether these conditions have been met. These requirements are also relaxed slightly where the parties are developing countries.

This means in practical terms that if, for instance, Member A has concluded a treaty with Member B granting certain services trade privileges to Member B, and that treaty meets the conditions on sectoral coverage and discrimination, then the most favoured nation principle will not apply to Member A. No other member could challenge Member A claiming that it has breached its most favoured nation obligations under GATS by not extending the privilege granted to Member B to all other members.

(d) *Other specific exceptions*

The maritime transport sector is excluded entirely from GATS, unless members decide to make specific commitments in the sector themselves. Measures affecting air traffic rights and directly related services are also excluded, as they are considered to be covered already under the Chicago Convention. Three other services in the air transport industry – aircraft repair and maintenance, the selling and marketing of air transport services and computer reservation systems – are nevertheless included.

Trade in services may also be restricted in cases of “serious balance-of-payments and external financial difficulties”. This allows a member to restrict services trade in appropriate cases in order to maintain domestic financial reserves. The restrictions

must not discriminate among members, must be only those necessary to deal with the circumstances and must avoid unnecessary damage to other members' interests.

2.7 Why are financial services, transport and telecommunications services different?

Services such as banks, train companies and telecommunications operators are commonly required to perform other services: for example, to allow service providers to travel to or contact their customers, and to transport goods necessary to perform services. These services have gained special recognition in several annexes to GATS covering financial services, transport services and telecommunications services.

3. NAFTA and services

Chapter 12 of the North American Free Trade Agreement (NAFTA) imposes obligations on its three parties in the field of services broadly similar to those imposed under GATS. The major difference is that NAFTA takes a negative list approach, meaning that all service sectors are automatically covered, except for financial services, air transportation services and government procurement. However, NAFTA parties can choose to opt out of coverage for other services by listing them in the annexes to NAFTA. When considering a case under NAFTA, complainants must therefore check that the service sector in question is not one of the generally excluded sectors and, further, has not been specifically excluded by the party against which the complaint is made. Otherwise, NAFTA cannot apply.

Whereas GATS applies in covered sectors to measures affecting trade in services, NAFTA applies to five measures, affecting:

- the production, marketing, distribution, sale and delivery of a service;
- the purchase or use of a service;
- the access to and use of distribution or transportation systems in connection with the provision of a service;
- the presence of a foreign service provider in a party's territory; and
- the provision of financial security as a condition for providing a service.

For NAFTA to apply, the measures must relate to three of GATS's four modes of supply: consumption abroad, presence of natural persons and cross-border supply. The fourth mode of supply, commercial presence, is covered by a NAFTA provision that prevents a party from requiring that foreign service providers establish a domestic office or residence before they may provide their service in that party's territory.

The basic two obligations of national treatment and most favoured nation apply under NAFTA as under GATS. NAFTA requires parties to provide whichever treatment is better, flowing from these two obligations. NAFTA does not grant any rights of entry or employment to one party's citizens in respect of other parties. It also does not prevent each party's government from providing public services in a manner "not inconsistent" with NAFTA.

There are specific provisions in NAFTA relating to telecommunications services and financial services. Chapter 13 sets out obligations allowing for reasonable and non-discriminatory conditions of access to telecommunications in order to provide

cross-border services, while Chapter 14 grants certain rights (including national treatment and most favoured nation) to financial institutions to operate in the territory of foreign NAFTA parties.

4. The European Union and services

The freedom to provide cross-border services within the European Union is one of the fundamental freedoms contained in the EC Treaty and is “central to the effective functioning of the EU Internal Market”.³ The scope of the freedom has been comprehensively examined by the European Court of Justice in its jurisprudence, a guide to which is available from the EU website.⁴ A new attempt was recently undertaken to liberalise services with the Services Directive. One of the key elements – to legislate a country of origin principle according to which service providers would have to comply only with their own domestic services legislation – was rejected. New initiatives focus on making provisions more transparent and facilitating compliance through online information and applications.

As regards non-EU service providers wishing to operate within the European Union, there is no particular European regime. EU law has implemented the obligations established under GATS by which each EU member state is bound.

5. A world trade law solution to the practical problem

Four particular circumstances are threatening Construct:

- the border tax on temporary professional entry into Country B;
- the requirement for architects (except those from Country C) to maintain a local office;
- the prohibition on sending architectural plans by email or post; and
- the restriction on the number of architects operating in Country B.

Construct would like to remove all of these problems, and GATS is potentially the tool to allow it to do that.

5.1 Does GATS apply?

GATS applies to “measures affecting trade in services”. The four problems are all laws of Country B, which is enough to define them as ‘measures’. The laws all affect the supply of architectural services from one country to another according to one or more modes of supply:

- The first problem relates to Mode 4, presence of natural persons;
- The second problem relates to Mode 3, commercial presence;
- The third problem relates to Mode 1, cross-border supply; and
- The fourth problem relates to Modes 1 and 3.

Therefore, the problems are all “measures affecting trade in services” and GATS will apply.

3 http://europa.eu.int/comm/internal_market/services/principles_en.htm.

4 http://ec.europa.eu/internal_market/services/index_en.htm.

5.2 What are Country B's GATS commitments?

Country B is a WTO member and is therefore bound by all the general obligations in GATS, including the most favoured nation principle across all sectors. It has not listed any exemptions to the most favoured nation principle in an Article II annex, so any benefits that it grants to one member must be automatically extended to all other members. It also has no bilateral or regional services trade arrangements in place under Article V that might lessen its most favoured nation commitments.

Country B has listed "CPC 8671 architectural services" in its GATS schedule, with the result that the sector is bound by the conditional obligations of GATS, including national treatment and market access. These obligations are decreased by one factor: the limitation on national treatment that Country B has listed as a horizontal commitment. The limitation thus applies across all sectors, to allow Country B to impose a border tax on any professionals, including architects, entering its territory temporarily in order to provide a service.

5.3 Do any of Country B's measures violate its GATS commitments?

There are several likely violations of GATS commitments arising from Country B's measures.

As noted above, Country B is under a most favoured nation obligation to extend any benefits granted in favour of one country to all other countries. The exemption for Country C architects from the local office requirement must therefore be extended so that all other members, including Country A, are exempt from the local office requirement. In other words, the requirement must be removed entirely, as it violates the most favoured nation obligation under GATS.

The prohibition on sending architectural plans by email or post applies to both domestic and foreign architects, and so appears to be non-discriminatory and permissible, since all providers are being treated equally. However, on closer inspection, the prohibition serves to modify the conditions of competition between foreign and domestic providers. The only method of delivery permitted by the law is physical delivery by the architect to the client, which is clearly easier for a Country B-an architect to achieve than a foreign one in light of problems such as geographical location, transport costs and immigration and customs issues. The result is that foreign architects are left less competitive than domestic architects, a situation not permitted under GATS. The prohibition is not listed as a limitation on national treatment in Country B's GATS schedule, and so it violates Country B's national treatment commitments.

Under the market access provisions of GATS, members are not permitted to maintain restrictions on the number of service suppliers in any sector inscribed in their schedule. Since the architectural services sector is inscribed in Country B's schedule, the restriction on the number of architects operating in Country B is not permitted by GATS. To be allowed to maintain this measure, Country B would need to list it as a limitation on market access for this sector.

The border tax on temporary professional entry would ordinarily violate the principle of national treatment, since it discriminates between domestic and foreign service providers by imposing an additional cost on foreign providers and making

them less competitive than domestic providers. Country B has not listed any limitations on national treatment specifically for the architectural services sector. However, because the limitation is listed as a horizontal commitment in Country B's schedule, it applies across all sectors in the schedule (including "CPC 8671 architectural services"). Hence this violation is permitted and cannot be challenged by Construct.

5.4 **What is the likely outcome for Construct?**

Given that private companies or firms cannot bring claims against WTO member governments, Construct should first contact the trade department in the Country A government and explain the situation. Following the WTO dispute resolution process, Country A would then request consultations with Country B on the matter. If no mutually acceptable solution can be found, Country A may choose to request the establishment of a WTO panel to hear the case. However, although dispute resolution in the WTO operates according to relatively strict timelines, Construct may prefer not to wait for the panel process, finding alternative solutions such as opening an office in Country B, delivering the plans in person, paying the tax imposed as an additional cost to its business or partnering with an architectural firm from Country B to avoid the numerical restriction.

If the dispute were to proceed to a panel then, based on the discussion above, the panel would likely find that the local office requirement, the email/post prohibition and the numerical restriction are all violations of GATS and must be repealed by Country B. The border tax would be allowed to stand, but Construct may accept this and choose not to send representatives to Country B in person to supervise the building site, perhaps hiring Country B's workers instead.

6. **The US – Gambling dispute: a case study**

The United States maintained a collection of laws at federal, state and local levels of government that addressed online gambling. In March 2003 Antigua and Barbuda requested consultations with the United States regarding these laws, claiming that they amounted to a prohibition on the cross-border supply (ie, via the Internet) of gambling and betting services contrary to the GATS commitments made in the sector by the United States. Specifically, Antigua and Barbuda argued (among other things) that the US prohibitions amounted to a limitation on the number of service suppliers using the cross-border mode of supply by effectively imposing a quota of zero. The United States claimed in response that the measures were justified by the general exceptions to GATS in Article XIV, as being measures necessary for the protection of public morals.

A panel was established to hear the case in July 2003. The panel's report was delivered in November 2004, following an extension of time and a suspension of proceedings (later resumed) while the parties again attempted negotiations for a mutually acceptable solution. The panel largely agreed with Antigua and Barbuda, finding that the United States had breached its market access commitments. The panel also held that the laws in question did relate to public morals, but were not necessary to protect public morals; the United States therefore could not rely on the general exception.

Both parties appealed various aspects of the decision to the Appellate Body, which gave its judgment in April 2005. The Appellate Body agreed with the panel that the United States had breached its market access commitments, but found that the measures were to be considered necessary to protect public morals. However, the Appellate Body also found that the United States had not shown on the evidence that the measures were applied to domestic as well as foreign gambling service suppliers. This meant that the measures were being applied in a manner constituting arbitrary or unjustified discrimination between countries. Therefore, the Appellate Body decided that the general exception did not apply and that the United States was in violation of its GATS obligations.

Following arbitration, it was determined that the United States would have until April 3 2006 to implement the Appellate Body's decision by amending its laws as necessary. In May 2006 Antigua and Barbuda prepared to challenge the steps towards implementation taken by the United States and the disagreement continued.⁵

7. **Recommended resources**

For further information on services and GATS, certain publications are particularly useful, including the following:

- WTO Secretariat, *Guide to GATS, An Overview of Issues for Further Liberalization* (The Hague: Kluwer Law International, 2000).
- International Trade Centre, *Business Guide to the General Agreement on Trade in Services* (Geneva: ITC, 2001).
- M Krajewski, *National Regulation and Trade Liberalization in Services* (The Hague: Kluwer Law International, 2003).

5 *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/DS285