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MILE 7

**THEORETICAL CHALLENGES AND PRACTICAL
DIFFICULTIES FOR THE DEVELOPMENT OF
SUBSIDIES DISCIPLINES IN THE GENERAL
AGREEMENT ON TRADE IN SERVICES**

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LIST OF ACRONYMS

ANZCERTA	Australia-New Zealand Closer Economic Relations Trade Agreement
AoA	Agreement on Agriculture
ASCM	Agreement on Subsidies and Countervailing Measures
CARICOM	Caribbean Community
CVD	Countervailing Duty
EC	European Community
EEA	European Economic Area
EFTA	European Free Trade Association
FTAA	Free Trade Area of the Americas
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
MERCOSUR	Mercado Común del Sur
TPR	Trade Policy Review
RTA	Regional Trade Agreement
UNCTAD	United Nations Conference on Trade and Development
WPG	Working Party on GATS Rules
WTO	World Trade Organisation
WTR	World Trade Report

ABSTRACT

The thesis takes stock of the developments at the multilateral level in developing subsidies disciplines for services to date and assesses the problems in developing multilateral disciplines on the use of trade distortive subsidies in services. Consideration is given to the appropriateness of the concepts derived from other World Trade Organisation (WTO) rules on subsidies for transposition into the area of services. The study also represents an interrogation into whether the existing disciplines are sufficient to deal with the issue of trade distortive subsidies and whether any insights for the creation of a multilateral framework can be gleaned from the existing legal instruments found in regional trade agreements. Finally, the study examines alternative proposals for the creation of subsidies rules at the multilateral level.

KEYWORDS: SUBSIDIES DISCIPLINES; TRADE IN SERVICES.

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INTRODUCTION

RATIONALE

The development of subsidies disciplines for services is a complex issue and not fully addressed by the General Agreement on Trade in Services (GATS) framework. In the post-Washington Consensus environment, there seems to be less enthusiasm for the negotiation of subsidies disciplines at a multilateral level as agreed by the WTO Members during the Uruguay Round. Such reluctance perhaps reflects the recognition that subsidies in services sectors are critical for developing countries to attain economic policy goals as well as to pursue other social goals which are key to their future development. In addition, subsidies continue to play an important social and economic role in developed economies not only for distributional and environmental purposes, but also as a strategic trade policy tool.¹

In this context, it must be recalled that from an economic perspective, while a subsidy can cause distortion, it is often the first best option to pursue policy goals as it only directly affects one side of the consumption/production balance. Nevertheless, some subsidies have the potential to distort resource allocations beyond the domestic market and hence negatively impact on international trade. The key issues for the multilateral system are the extent to which disciplines on subsidies are warranted, the strength of these future disciplines and the form they should take. It is important to note at the outset, however, that the multilateral system is not completely devoid of rules for addressing the effects of trade distortive subsidies. While the GATS does not contain a specific instrument which governs the use of subsidies, some provisions within the agreement do exert a disciplinary effect. Nonetheless, there is some doubt as to the efficacy of these rules to cope with the negative international effects arising from subsidisation practices among WTO Members.

BACKGROUND

Thirteen years after the completion of the Uruguay Round, a number of the rules and disciplines of the GATS remain unfinished. The mandated creation of rules on subsidies, emergency

¹ UNCTAD, *Subsidies for Services Sectors: Neo-Protectionism or a Useful Development Tool?* UNCTAD/DITC/TNCD/MISC/2003/7 (Geneva: UNCTAD, 2005), 39.

safeguards, government procurement and domestic regulation are yet to be completed.² In this regard, Cottier and Oesch have commented that “the GATS is comparable to the GATT 1947 days.”³ Lack of progress on the completion of the rule-making agenda represents a challenge to the fulfilment of the mandate of progressive liberalisation of trade in services contained in GATS Article XIX as Members find themselves negotiating concessions without the benefit of understanding how these commitments will interact with the rules.⁴ Sauvé has highlighted the importance of making progress on and/or bringing closure to the unfinished business from the Uruguay Round as Members “turn their attention to new rule-making and market opening challenges in the GATS.”⁵ In specific relation to the mandated negotiations on subsidies the World Trade Report (WTR) 2006 indicates that they have not progressed significantly since 1995 and this has been the cause for some concern.⁶

AIMS

The thesis seeks to take stock of the developments at the multilateral level in developing subsidies rules for services and to assess the problems involved in developing multilateral disciplines on the use of trade distortive subsidies in services. It also attempts to determine the appropriateness of the concepts derived from other WTO rules on subsidies for transposition into the area of services. In addition, the study aims to examine whether the existing disciplines are sufficient to deal with the issue of trade distortive subsidies and whether any insights for the creation of a multilateral framework can be gleaned from the existing legal instruments found in regional trade agreements. Finally, the thesis undertakes a review of the alternative proposals for the creation of subsidies rules at the multilateral level.

RESEARCH QUESTIONS

This thesis will be guided by the following research questions:

- Who are the main *demandeurs* for subsidies disciplines?
- What are the major difficulties in developing services disciplines?

² The mandates for the creation of rules on domestic regulations, emergency safeguards, government procurement and subsidies are to be found in GATS Articles VI: 4, X: 1, XIII: 2 and XV: 1 respectively.

³ Thomas Cottier and Matthais Oesch, *International Trade Regulation: Law and Policy in the WTO, the European Union and Switzerland* (London: Cameron May, 2005), 1001.

⁴ South Centre, “State of Play of the GATS Negotiations: Are Developing Countries Benefiting?” *T.R.A.D.E. Policy Brief*, no.4 (November 2005): 2.

⁵ Pierre Sauvé, *Developing Countries and the GATS 2000 Round. Trade Rules: Behind Borders: Essays on Services, Investment and the New Trade Agenda* (London: Cameron May, 2003), 75.

⁶ WTO, *World Trade Report 2006* (Geneva: WTO, 2006), xli.

- Are there more problems in developing disciplines in subsidies for services at the international level or at the regional level?
- Can regional trade agreements (RTAs) be useful for developing disciplines on the use of subsidies at the international level?
- Is the lack of regional disciplines a boon or a stumbling block?
- Are horizontal subsidies disciplines appropriate for services?
- What are the implications of not having subsidies disciplines for services?

RESEARCH APPROACH AND DESIGN

This thesis is intended to be primarily qualitative in nature and will reflect a multidisciplinary approach. It will draw on the disciplines of law, economics and international political economy. The study first reviews the developments at the international level in relation to the creation of subsidies disciplines for services. This is followed by an analysis of the existing legal instruments for disciplining subsidies within other multilateral trade agreements. The next step involves an assessment of the efficacy of existing provisions within the GATS to address the trade effects of distortive subsidies and an examination of capacity of a number of RTAs to deal with this problem. It is estimated that there are currently some 380 RTAs in existence.⁷ Of the RTAs that relate to services trade, the majority specifically exclude subsidies from the scope of the agreements. By virtue of this fact, the sample of RTAs to be examined is limited as very few agreements contain provisions which seek to discipline subsidies for services. Consequently, the following agreements were selected for analysis:

- European Community (EC);
- European Economic Area Agreement (EEA);
- Free Trade Agreements entered into by the European Free Trade Association (EFTA);
- Australia- New Zealand Closer Economic Relations Trade Agreement (ANZCERTA);
- Caribbean Community (CARICOM);
- Mercado Común del Sur (MERCOSUR);
- Andean Community; and
- Free Trade Area of the Americas (FTAA).

⁷ WTO, "Regional Trade Agreements," [database online]; available from http://www.wto.org/english/tratop_e/region_e/region_e.htm; accessed August 30, 2007.

Finally, consideration is given to the alternative proposals found in the literature for developing multilateral disciplines for services subsidies. The study does not discuss the issue of the development of countervailing measures to remedy the effects of services subsidies as there is a strong consensus in the literature that such a mechanism is not feasible for service sectors due to a number of problems, the main ones being the lack of statistical data and problems of measurement peculiar to trade in services.

DATA

Data for the study is drawn from primary sources as well as secondary sources. Primary data is drawn from international agreements including multilateral trade agreements and regional trade agreements. Secondary sources include, but are not limited to articles in journals and on the internet, books, publications of international organisations, minutes of meetings of specialised WTO bodies for the development of services rules as well as WTO jurisprudence.

CHAPTER ONE

Multilateral Efforts to Develop Subsidies Disciplines for Services

1.1 The Mandate

GATS Article XV recognises that “in certain circumstances, subsidies may have distortive effects on trade in services” and thus commits Members to enter into negotiations to develop the necessary multilateral disciplines to avoid such trade distortive effects.”⁸ Such negotiations are to recognise the role of subsidies in relation to the development programmes of developing countries and take into account the needs of Members, particularly developing country Members, for flexibility in this area. For the purposes of the negotiations, Members were mandated to exchange information concerning all subsidies related to trade in services that they provide to their domestic service suppliers.

1.2 Work Agenda of the Working Party on GATS Rules (WPGR)

In 2001, the Special Session of the Council of Trade in Services mandated that “Members shall aim to complete negotiations under Articles VI:4 (Domestic Regulations), XIII (Government Procurement) and XV (Subsidies) prior to the conclusion of negotiations on specific commitments.”⁹ Clearly, the envisioned sequencing for rule-making and progressive services liberalisation has not materialised.

On the question of subsidies rules for services, the Hong Kong Ministerial in December 2005 instructed that “Members should intensify their efforts to expedite and fulfil the information exchange required for the purpose of such negotiations, and should engage in more focused discussions on proposals by Members, including the development of a possible working definition of subsidies in services.”¹⁰

While the deadline for the completion of negotiations on an emergency safeguard mechanism and subsidies disciplines remained open, the Ministers mandated that negotiations on government

⁸ WTO, *The Legal Texts: Results of the Uruguay Round of Multilateral Trade Negotiations* (Geneva: WTO, 2002), 298.

⁹ WTO, “Guidelines and Procedures for the Negotiations on Trade in Services,” March 29, 2001, S/L/93, paragraph 7.

¹⁰ WTO, “Doha Work Programme: Ministerial Declaration,” WT/MIN(05)/DEC, adopted on December 18, 2005, Annex C, paragraph 4 (c).

procurement be completed by the end of the Doha Development Round (DDR). As Adlung has commented “creating subsidies disciplines in the current round is possibly not the prime concern of trade ministers who may find it difficult enough to persuade other ministers to help improve current services schedules. If the non-existence of a safeguard mechanism already complicates such efforts, it is certainly not tempting to open an additional front.”¹¹

Progress in the WPGR on the development of subsidies disciplines has been particularly protracted. The main issues of discussion include “the definition of a subsidy in services; evidence of trade-distorting subsidies; the extent to which existing GATS rules already discipline services subsidies or provide the means to do so; a wider role for subsidies in meeting public policy objectives and the development aspirations of developing countries; and the appropriateness of including countervailing procedures in the disciplines.”¹²

This lack of progress has been attributed to “Members’ qualms about revealing information on their services subsidisation practices as well as their reluctance to enter a *terra incognita* of trade rules.”¹³ In addition, it has been suggested that “one reason for this lacklustre interest in the outcome of these negotiations may be the fact that members can protect their essential interests, even at present.”¹⁴

The issue of information exchange is key to the entire process of developing disciplines. To date, only five countries have complied with the information exchange mandate, namely, Norway; New Zealand; Hong Kong, China; Poland and Switzerland.¹⁵ Members are currently considering issues such as definitions and applicability of legal provisions from other frameworks; however, the lack of information hinders Members from clearly identifying the

¹¹ Rudolf Adlung, “Negotiations on Safeguards and Subsidies in Services,” *Journal of International Economic Law* 10, no. 2 (2007): 262.

¹² B.K. Zutshi, “Services Sector Negotiations: Issues and State of Play,” [database online]; available from http://www.unescap.org/tid/publication/chap4_2278.pdf; accessed May 20, 2007, 49.

¹³ Marc Benitah, *Subsidies, Services and Sustainable Development* (Geneva: International Centre for Trade and Sustainable Development, 2004), 1.

¹⁴ Zutshi, “Services Sector Negotiations: Issues and State of Play,” 50.

¹⁵ The submissions of Norway; New Zealand; Hong Kong, China; Poland and Switzerland are contained in the documents S/WPGR/W/16/Add.1, S/WPGR/W/16/Add.2, S/WPGR/W/16/Add.3, S/WPGR/W/16/Add.4, and S/WPGR/W/16/Add.5 respectively.

nature of the problem which they are trying to tackle. The quality of the discussion therefore has been undermined by the lack of information.

Some Members have argued that it is necessary for a definition of a subsidy to services to be developed in order for them to comply with the mandate to supply information. The membership appears to have differing views on the exact scope of the mandate. There is some debate on whether the mandate is an obligation to exchange information on *all* subsidies in services or merely the trade-distortionary ones.¹⁶ However, as observed by a member of the Swiss delegation, the lack of a definition has not prevented the identification of the subsidies which are found in Trade Policy Reviews.¹⁷ In addition, the WTO Secretariat clarified that the intention at the drafting stage of Article XV was to cast the net on the exchange of information as wide as possible. The drafters intended that Members would look into their own subsidy programmes and notify them on the basis of their own definition of a subsidy.¹⁸

Hong Kong, China and Mexico proposed a provisional definition very similar to that found in the Agreement on Subsidies and Countervailing Measures (ASCM) to be used by Member States to identify and exchange information on subsidies they provide to their domestic suppliers in five selected sectors of their own choice and that such information be provided by November 2005.¹⁹ It was further suggested that such information include, but not be limited to: the form of the subsidy; the policy objective and/or purpose of the subsidy; eligibility criteria for the subsidy; the amount or budgetary outlay of the subsidy, if available; the calculation methodology of the subsidy payable, if applicable; the duration of the subsidy and/or any other time-limits attached, if applicable; and statistical data permitting an assessment of the trade effects of a subsidy, if available.

Despite the efforts by Hong Kong, China and Mexico to drive the negotiations forward, the exchange of information did not take place since some Members, mainly developed country Members, felt that the ASCM did not provide an appropriate basis for creating rules for services,

¹⁶ WPGR, "Report of the Meeting of 21 June 2006: Note by the Secretariat," S/WPGR/M56, July 4, 2006, paragraph 35, 9.

¹⁷ WPGR, "Report of the Meeting of 19 April 2007: Note by the Secretariat," S/WPGR/M57, May 9, 2007, paragraph 43, 10.

¹⁸ WPGR, "Report of the Meeting of 21 June 2006: Note by the Secretariat," S/WPGR/M56, paragraph 36, 9.

¹⁹ WPGR, "Communication from Hong Kong, China and Mexico," 15.

that there was a need for further clarification and providing subsidy information for five sectors was too burdensome given the short time frame before the Sixth Ministerial.²⁰ This lack of progress has been attributed to a fear by the Members that their revealed subsidies may be later defined as being trade distortive and hence subject to discipline.

In the face of the apparent stalemate, the Chairman of the WPGR engaged in consultations to ascertain the reasons delaying the fulfilment of the information exchange requirement.²¹ He found that there was an issue among the membership as to 'who goes first'. Some Members felt that the *demandeurs* themselves should provide information first. Other delegations believed that the Members with the largest shares in services trade or the highest incidence of subsidy use in service sectors should go first. In addition, since only a few Members had provided information, the incentive for other Members to comply with the mandate was low. A second set of reasons related to the lack of resources to gather and prepare the information, especially for some developing countries, and competing priorities, including more pressing negotiating topics. Thirdly, some delegations seemed to have concerns about how the information provided would be used and that their efforts might be criticised as being incomplete.

Against this background, it was suggested that a possible way forward was to utilise and build on the information gleaned from TPRs. Members could update the information contained in their own TPR reports and provide additional details on the programmes mentioned.

1.3 The Need for Subsidies Disciplines

The rationale for the need for subsidies disciplines for services from the economic perspective is much the same as the rationale for subsidies disciplines for goods. Firstly, subsidies can negate or undermine market access commitments by importing nations as they trade one form of protection for another.²² As noted in *WTR 2006*, "a country can undermine its market access commitments by providing subsidies to import-competing industries. In addition, subsidies given to competing exporters in third countries can divert trade away from a country that had relied on negotiated market access to another market."²³ The latter reasons were precisely what inspired

²⁰ South Centre, "State of Play of the GATS Negotiations," 4.

²¹ WPGR, "Report of the Meeting of 19 April 2007: Note by the Secretariat," S/WPGR/M57, paragraph 43, 10.

²² Alan Sykes, "The Economics of WTO Rules on Subsidies and Countervailing Measures," *John M. Olin Program in Law & Economics Working Papers*, no. 186 (2003): 2.

²³ WTO, *World Trade Report 2006*, 47.

the Uruguay Round negotiators to develop “more stringent disciplines on subsidies than those initially provided for under the GATT (1947).”²⁴

Secondly, subsidies can skew the direction of trade flows as consumers are enticed away from one exporting nation to another. Consequently, the expected benefits from negotiated market access are “threatened just as much by subsidies to competing exporters in third countries as by subsidies to import-competing industries in the nations that make commitments.”²⁵ Thirdly, there is the concern that subsidies can distort comparative advantage and produce a less efficient global division of labour which results in a lower economic welfare.

In the context of the multilateral trade negotiations, developing countries may be reluctant to make further concessions in the absence of increased transparency and disciplines on subsidies programmes provided by developed countries.²⁶ Consequently, disciplines on services subsidies could have a beneficial impact on the negotiations by promoting a level playing field.²⁷ Poretti provides two compelling reasons for the creation of subsidies disciplines. In the first instance, the creation of a legal instrument to prohibit or circumscribe the use of trade distortive subsidies would render markets more contestable and thereby increase the value of negotiated market access commitments. In the second instance, the creation of disciplines would help Members who are making new commitments in sectors where they offer subsidies to clarify the WTO compatibility of such support measures.

Many commentators fear that developed countries could potentially restrict access to their markets and diminish the value of liberalisation commitments by applying trade distortive subsidies. For example, Celli argues that “the absence of a multilateral definition of disciplines on services subsidies is unfavourable to DCS [developing countries] in the request-offer process. DCS are in a very disadvantageous position as they are unable to properly assess the competitiveness or market prospects of domestic providers in the face of potentially subsidized

²⁴ WTO, *World Trade Report 2006*, 47.

²⁵ Skyes, “The Economics of WTO Rules on Subsidies and Countervailing Measures,” 2.

²⁶ Marc Benitah, *Subsidies, Services and Sustainable Development*, 4.

²⁷ Pietro Poretti, “Waiting for Godot: Subsidies Disciplines in Services Trade,” paper prepared for the World Trade Forum, World Trade Institute, Berne, Switzerland, September 8-9, 2006, 13.

foreign providers.”²⁸ Moreover, the potential for trade distortion by the more developed economies is exacerbated by the limited capacity of developing countries to grant extensive subsidies.²⁹ Consequently, the impact of any subsidies granted by developing countries could be reduced or even reversed by the subsidies provided by developed countries to their services industries.

1.4 The Potential Universe of Measures to which Subsidies Disciplines Could Apply

It is worth bearing in mind that the mandate in Article XV relates to trade distortive subsidies *only*. While there is no firm agreement on which subsidies are to be considered to have a distortionary effect on international trade, most of the literature points to export-enhancing subsidies, investment-diverting subsidies and import-displacing subsidies as likely candidates for multilateral disciplines.³⁰ It should be noted that much of the following discussion is conceptual in nature.

It is considered to be important to identify the ways in which these main types of subsidies are applied within the four modes of supply through which trade in services takes place: from the territory of one Member into the territory of any other Member; in the territory of one Member to the service consumers of any other Member; by a service supplier of one Member, through commercial presence in the territory of any other Member; and by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member.

Export-Enhancing Subsidies

An export-enhancing subsidy would allow the exporting Member to attain a larger market share than would have been possible in the absence of subsidies.³¹ This situation is similar to the case of export subsidies in goods. In the case of Mode 1, an export subsidy could include any benefit granted to service suppliers of a Member that increases their competitive edge in the importing market. For example, a benefit granted by country A which allows its service providers to supply the service at a lower cost of production and, therefore, compete more effectively in the market of

²⁸ Umberto Celli Jr., “Services in a Development Round: What is at Stake for Developing Countries,” paper presented at the Asian Regional Dialogue on Trade in Services, Boracay, Philippines, February 28- March 1, 2006, 4.

²⁹ Benitah, *Subsidies, Services and Sustainable Development*, 4.

³⁰ This broad categorisation of trade distortive subsidies and the following discussion draws on the analysis of Luis Abugattas. See Luis Majluf Abugattas, *Towards Disciplines on Subsidies on Agreements to Liberalise Trade in Services*, report prepared for the CRNM/IDB Project, August 2002, 11.

³¹ *Ibid.*, 11.

country B. An even more concrete example could be an Indian firm selling web design services via the internet receiving a subsidy from the Indian government.³²

In terms of Mode 2, any measure which confers a benefit to domestic suppliers of a Member generating as a result of such a measure “run away business” from another Member could be considered an export subsidy. To illustrate, country A may provide a benefit to its service provider enabling it to attract increased numbers of consumers from traditional markets as well consumers from new markets. Some of this growth of services exports will be at the expense of other Members. An example could be a hotel with mainly a tourist clientele which is located in territory A being subsidised by the government of A.³³

For Mode 3, an export subsidy would be any measure which provides a benefit to service suppliers of a Member to establish a presence abroad or once the supplier is established to support its operations in another Member’s territory. An example for Mode 3 could be a subsidiary company from country B that establishes a commercial presence in country A while receiving a benefit from country A which is unavailable in country B. Some commentators are of the view that such subsidisation is unlikely since a government would scarcely provide a subsidy to a firm that is considering relocating or establishing a commercial presence in another jurisdiction.³⁴

For Mode 4, an export subsidy would include any measure, which provides a benefit to natural persons of a Member, temporarily supplying a service in another Member’s territory. An example of an export subsidy in Mode 4 could be the case of an Indian programmer travelling to the US to sell his services and receiving a subsidy from the Indian government not available on the Indian market or the US market.³⁵

³² Benitah, *Subsidies, Services and Sustainable Development*, 17.

³³ Ibid., 17.

³⁴ Giles Gauthier with Erin O’Brien and Susan Spencer, “Déjà Vu, or New Beginnings for Safeguards and Subsidies Rules in Services Trade?” *GATS 2000: New Directions in Services Trade Liberalisation*, ed. Pierre Sauvé and Robert Stern (Cambridge: Harvard University Centre for Business and Government, Washington DC: Brookings Institution Press, 2000), 179.

³⁵ Benitah, *Subsidies, Services and Sustainable Development*, 17.

Import-Displacing Subsidies

An import-displacing subsidy would be any measure granting benefits to service suppliers of a Member that impairs market entry, or business expansion, of service suppliers of other Members in that Member's territory through any mode of delivery.

In the case of Mode 1, an import-displacing subsidy could include any benefit granted to the service suppliers of a Member that increases their competitive edge by giving them an advantage in the domestic market. In terms of Mode 2, any measure which confers a benefit to the service suppliers of a Member generating as a result of such a measure "run away business" of *domestic consumers* from *foreign suppliers* located in their respective territories could be considered an import-displacing subsidy. For example, country A provides a subsidy to its services suppliers enabling them to offer cheaper services to the residents of country A thereby displacing the imports from service suppliers from countries B and C.

For Mode 3, an import-displacing subsidy would be any measure which provides a benefit to domestic service suppliers as opposed to foreign service suppliers of a Member to establish a presence domestically or once the supplier is established to support its operations. For Mode 4, an import subsidy would include any measure, which provides a benefit to the natural persons of the Member thereby conferring a benefit over the foreign supplier.

While import-displacing subsidies might have the same effect as other regulatory barriers of impeding access to markets by the service suppliers of other Members, the potential adverse effects of other regulatory barriers should be dealt with under GATS Articles VI (domestic regulation), VII (recognition) or VIII (monopolies and exclusive service providers) which may more appropriately address the different circumstances which give rise to such effects.³⁶

Investment-Diverting Subsidies

Finally, an investment-diverting subsidy would be any measure which grants an incentive for service suppliers to locate in the particular territory. These types of subsidies represent a challenge to trade policy officials since they relate to overall investment incentive policies and

³⁶ Abugattas, *Towards Disciplines on Subsidies*, 12.

the use of these instruments is pervasive.³⁷ A primary anticipated benefit from undertaking market access commitments, particularly for developing countries, is increased inward foreign direct investment flows; however, investment-diverting subsidies can serve to minimise or cancel out such benefits as other Members entice investors with more tempting investment packages. For Mode 3, an investment-diverting subsidy would provide the foreign service supplier with a benefit for locating within a Member's territory.

1.5 The Prevalence of Subsidies in Services

Comprehensive information is not available on the existence of subsidies in services trade. However, it would seem that subsidies are found in the whole range of services sectors, but mainly in audiovisual services, tourism, financial services and transport, especially maritime transport.³⁸ In a 2005 study, UNCTAD revealed that the bulk of non-agricultural subsidies worldwide is channelled towards the services sectors- energy, water distribution and (mainly road) transport.³⁹ The WTO's TPRs have turned out to be an important though imperfect source of information on the use of subsidies in services. The information contained in the TPRs is seen as only an approximation for a number of reasons.⁴⁰ Firstly, the information presented sometimes included services provided in the exercise of governmental authority or services excluded through the Annex on Air Transport Services. Secondly, since the TPR reports tend to focus on sectors as financial services, tourism, telecommunications and transport, other sectors might be under-represented in the compilation because they were not typically covered in TPR reports. Thirdly, the information is compiled on the basis of concepts drawn from the definition contained in the ASCM. It should also be considered that the vast array of trade distortive subsidies remain hidden as Members' schedules do not reveal the full extent of support measures since the entry 'unbound' potentially cloaks a variety of protective measures including subsidies.

However, in general, it can be concluded that WTO Members rely more on tax incentives than on direct grants and developing country Members also often use duty-free inputs as part of free zone incentives.⁴¹ The reliance on tax incentives as a mechanism to provide subsidies may be

³⁷ Abugattas, *Towards Disciplines on Subsidies*, 12.

³⁸ WTO, "Subsidies for Services Sectors: Information Contained in WTO Trade Policy Reviews," S/W/TPGR/25/Add. 5, March 27, 2007, 2.

³⁹ UNCTAD, *Subsidies for Services Sectors*, 24.

⁴⁰ WTO, "Subsidies for Services Sectors," S/W/TPGR/25/Add. 5, 1.

⁴¹ *Ibid.*, 2.

explained by the political preference for less obvious and less costly forms of support.⁴² Developing and developed countries tend to use different forms of export subsidies and while the subsidy programmes of the former relied more on a selective approach, the latter manifested a preference for the use of, *inter alia*, export promotion regimes, export financing and export guarantees.⁴³ Masheyaki and Kidane note that “studies have found evidence that in many cases countries provide export support to their services suppliers, both companies and natural persons. Export support in services is either granted in general to all services exports, or is granted to some specific services.”⁴⁴ The increasing subsidisation of services sectors is explained by the trend adopted by many countries to extend existing support measures available for trade in goods to services activities, as well as the implementation of programmes specifically aimed at supporting services exports.

1.6 Major Difficulties in Developing Services Disciplines

The initial discussions on subsidies in services were forced to confront a number of problematic issues. To a large extent, many of these issues continue to linger in the background of the deliberations of the WPGR. Firstly, the lack of statistics, which plagues other services related issues makes conceptualisation of effective rules particularly difficult.⁴⁵ Secondly, the classification of services in budgetary appropriations differs from the classification found in the Central Product Classification (CPC) or MTN/GNS/W/120. The Members’ classification systems frequently differ significantly from the existing classification systems in services. Thirdly, the budget appropriations often capture several broad economic activities that do not differentiate between goods and services. Fourthly, there are problems in measuring accurately the effect of the subsidy on the price of the final service. Fifthly, the inseparability of services from goods makes discussions on disciplining subsidies in services particularly difficult.

1.7 The Dynamics of the Subsidies Disciplines Negotiations

Generally, countries seem to desire to maintain the flexibility to offer measures of support. Such a conclusion finds support in Sauv e’s observation that there are some doubts about the existence

⁴² Benitah, *Subsidies, Services and Sustainable Development*, 3.

⁴³ Mina Mashekayi and Martine Julsaint-Kidaine, “Integrating Developing Countries in the Global Services Economy,” paper presented at the Asia Regional Dialogue on Services and Sustainable Development, Boracay, Philippines, February 28- March 1, 2006, 29.

⁴⁴ *Ibid.*, 29

⁴⁵ David Vivas Eugui, *Negotiations in WTO on the Rules of the General Agreement on Trade in Services: the Case of Venezuela*, UNCTAD/DITC/TNCD/6, February 2001, 23.

of political will to curtail regulatory sovereignty in this area.⁴⁶ He notes that this lack of political will may be acutely exhibited in countries characterised by federal political systems where responsibility for financing and/or administering support programmes is at the sub-federal level. Perhaps Switzerland's response to the WPGR questionnaire on subsidies provided to services sectors reflects the particular dilemma faced by these states. Switzerland was not in a position to report on subsidies provided for environmental services, educational services, health and related services as responsibility for these services rests with the cantons and communities.⁴⁷

Chinese Taipei, Hong Kong; China, Chile, Mexico, Peru, Switzerland are in the forefront of pressing for subsidies disciplines. Switzerland in particular contends that export subsidies should be addressed in the current round of negotiations and that Members should agree to progressively phase them out.⁴⁸ On the other hand, the Quad has taken a more cautious approach to the development of subsidies disciplines.⁴⁹ The US has adopted a critical posture in the negotiations and has continually called for a more cautious approach to the issue. Canada has urged Members to consider whether there is really a problem that needs to be addressed. The EU remains unconvinced that export subsidies are trade distortive *per se* and could not be justified by public policy objectives. In contrast to the debates on export-enhancing support measures, there has been little discussion of investment-diverting incentives. With regard to the latter the multilateral system seems to manifest a "repeated revealed preference for regulatory inaction, especially in federal states."⁵⁰

In reviewing the reports of the meeting of the WPGR one is struck by the absence of enthusiasm among all but a small minority of the membership on this issue. Many developing countries do not appear to be persuaded of the need for specific subsidies disciplines. In fact, many seem to have defensive interests on the issue. This notion is captured in Brazil's perspective that any eventual disciplines must recognise the role of subsidies in the development programmes of

⁴⁶ Pierre Sauv , "Completing the GATS Framework: Addressing Uruguay Round Leftovers," *Aussenwirtschaft* 3, no. 57 (2002): 333.

⁴⁷ WTO. "Communication from Switzerland: Response to the Questions Relevant to the Information Exchange Required Under the Subsidies Negotiating Mandate." S/WPGR/W/16/Add.5. December 22, 2005, paragraph 7, 3.

⁴⁸ International Trade Centre, *Doha Development Agenda: Challenges for Business and Government, WTO Services Negotiations Progress Report*, September 2005, 24.

⁴⁹ *Ibid.*, 23- 24.

⁵⁰ Pierre Sauv , "Waiting for Godot? The Troubled Prospects for a Multilateral Framework on Investment," paper presented at the World Trade Institute, Berne [database online]; available from http://www.unescap.org/tid/artnet/mtg/tipc_s6sauve.pdf; accessed August 28, 2007.

developing countries.⁵¹ It remains far from clear whether the Members' inability to fulfil the mandate of GATS Article XV is due to genuine difficulties or lack of political will or perhaps both.

⁵¹ International Trade Centre, *Doha Development Agenda*, 24.

CHAPTER TWO

Subsidies Disciplines in Services versus Subsidies Disciplines in Goods & Agriculture

2.1 Multilateral Disciplines on Subsidies

2.1.1 Agreement on Agriculture (AoA) Model

Although the AoA does not provide a definition of a subsidy, the Appellate Body in *Canada-Dairy* looked to the definition found in the ASCM.⁵² The AoA identifies a general set of agricultural subsidies to be disciplined- export subsidies and domestic support measures. The Agreement imposes reduction commitments on the most trade-distorting support while imposing a greater measure of discipline on the use of other support measures than that which had existed in the pre-Uruguay Round period.⁵³ There is no need to directly show that the measures have adverse trade effects, rather “adverse trade effects play only an implicit role in the general identification of certain subsets of measures.”⁵⁴

Export subsidies are simply defined as subsidies contingent upon exports, under Article 1(e). Article 9 of the Agreement does, however, identify a number of measures which are considered to be export subsidies under the AoA. These measures are stock disposal at non-commercial prices, marketing subsidies, subsidies to transport charges, and subsidies on agricultural products that are inputs to exported products. It should be noted that some of these support measures are in fact subsidies for services which are inputs into the production of agricultural goods.

Domestic support commitments are classified according to the degree to which they are deemed to distort markets.⁵⁵ Amber Box subsidies are those that are regarded as the most directly trade-distorting. Beyond a certain *de minimis* level, these measures are subject to reduction commitments which are expressed as Aggregate Measures of Support (AMS). There are also a number of support measures that are not subject to reduction commitments. Firstly, there are the Green Box Measures, which have no, or at most minimal, trade-distorting effects on production. Secondly, there are the Blue Box Measures, which are considered to be trade-distorting, but are contingent on limitations in production. Thirdly, there are Article 6.2 Measures (Development

⁵² Report of the Appellate Body, *Canada- Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/R, WT/DS113/AB/R, October 13, 1999, paragraph 87, 22.

⁵³ WTO, *World Trade Report 2006*, 123.

⁵⁴ Benitah, *Subsidies, Services and Sustainable Development*, 22.

⁵⁵ WTO, *World Trade Report 2006*, 123.

Programmes) which are direct or indirect measures of assistance to encourage agricultural and rural development.

In terms of remedies, agricultural subsidies may be challenged multilaterally (dispute settlement) or unilaterally (countervailing duties). Export subsidies which fully comply with the AoA are not prohibited by the ASCM, but they are countervailable.⁵⁶ Before the expiration of the AoA's 'Peace Clause' (Article 13), domestic supports which were in full conformity with the AoA were not actionable multilaterally, but may have been subject to countervailing duties. Similarly, Green Box Measures were not actionable multilaterally nor were they subject to countervailing measures. However, with the expiration of the 'Peace Clause' the ASCM applies to subsidies for agricultural products subject to the provisions of the AoA, as set forth in Article 21 of the latter Agreement.

2.1.2 Agreement on Subsidies and Countervailing Measures (ASCM) Model

The term 'subsidy' was defined for the first time in the multilateral system in the ASCM. According to the Agreement, there is a subsidy when there is "a financial contribution by a government or any public body..." and "a benefit is thereby conferred." For a subsidy to be subject to the disciplines of the ASCM, it must also be specific.

The definition in the ASCM is generic and unrelated to the concept of trade distortion; rather the level of trade distortion is reflected in the ASCM's categorisation of subsidies. Subsidies are categorised as prohibited, actionable or non-actionable, the so-called traffic light approach. All prohibited subsidies are presumed to be specific. Prohibited subsidies are those which are in law or in fact based on export performance or those contingent upon the use of domestic over imported goods. Annex I to the ASCM contains an Illustrative List of Export Subsidies. Actionable subsidies are those specific subsidies which cause adverse effects to the interests of other Members, by injuring their domestic industry, nullifying or impairing their benefits under the GATT or causing them serious prejudice. All non-specific subsidies are non-actionable. Before the expiration of the provisions of Article 8 in 2000, subsidies granted for research and

⁵⁶ United Nations Conference on Trade and Development, "Module 3.15: Agriculture," *Handbook on Dispute Settlement* (Geneva: UNCTAD, 2003), 39 [database online]; available from http://www.unctad.org/en/docs/edmmisc232add32_en.pdf; accessed September 1, 2007.

development (R&D), disadvantaged regions and encouraging environmental upgrading of existing facilities were also non-actionable.

The ASCM has made the link between the subsidy measure and trade distortion through the notion of specificity.⁵⁷ This notion of specificity is derived from US countervailing practice. The rationale for the specificity test was that it provided a practical limit to the number of countervailing duty actions, combats economic distortion and it brings fairness to international trade.⁵⁸ However, in operation, the test only serves the first goal well.

The ASCM sets forth the conditions for determining specificity. Only those subsidies that are specific are considered to be trade-distortive and liable for action under certain conditions. Article 2 establishes the criteria by which a subsidy can be deemed to be specific. These criteria are as follows: if access to the subsidy is limited by the granting authority or if the legislation under which the authority operates limits access to certain enterprises; if the criteria or conditions used by the granting authority or legislation for determining eligibility are not objective. Even if the subsidy appears to be *de jure* non-specific, the measure may be considered specific if the programme is used by a limited number of certain enterprises, if there is predominant use by certain enterprises, if disproportionately large amounts of the subsidy are granted to certain enterprises. The manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy may also be taken into account in determining specificity. If the programme is limited to certain enterprises located within a designated geographical region or it is a prohibited subsidy, it is deemed to be specific.

The ASCM provides two tracks for affected Members to seek remedies for the negative impact arising from the use of subsidies- the unilateral track and the multilateral track.

⁵⁷ Rajeev Ahuja, *Towards Developing Subsidies Disciplines under GATS*, Working Paper no. 174 (New Delhi: Indian Council for Research on International Economic Relations, 2005), 16.

⁵⁸ James Southwick, "The Lingering Problem with the Specificity Test in United States Countervailing Duty Law," 72 *Minnesota Law Review* 1159 (1988): 6 [database online]; available from Westlaw.

2.2 Applicability of Models to Services

General Approach

The AoA approach to services may offer a less stringent way of disciplining subsidies for services. Given the practical difficulties in developing subsidies disciplines, the AoA model could provide a way of testing the disciplinary waters since no measure of support would be prohibited. Moreover, this approach responds partially to the need to control some of the trade distortive effects of support measures.⁵⁹ Also, as there is no need to demonstrate adverse trade effects, complex considerations involved in calculating injury can be avoided. On the other hand, difficulties may be encountered in setting negotiated ceilings. If complementary reductions and disciplines are not attached to the categories, Members may find the flexibility to relocate support measures within the categories overly tempting.

While some trade experts consider that the use of the ASCM model would be consistent with the existing WTO legal framework based on the similarity and differences between goods and services, others are of the view that attempting to categorise subsidies as in the ASCM might not be the best approach.⁶⁰ Abugattas has suggested that a preferred approach would be to have a basic test to determine the existence of a subsidy and then to establish the casual link between the subsidy and the trade distortion.⁶¹ Such an approach requires the development of quantifiable indicators of adverse effects. For example, the criteria of injury, impairment or nullification of benefits and serious prejudice could be incorporated as the indicators of trade distortion. The next step would be for the affected Member to prove that there is a casual link between the subsidy and the distortive effects. Nevertheless, the continual problem of inadequacy of data remains.

Elements of the Definition

The primary task for negotiators will be to find a definition or qualifying criteria to establish the difference between subsidies and other forms of regulation.⁶² Indeed, much of the discussion on the issue of subsidies disciplines has revolved around this very question of defining a subsidy in services. One of the key questions arising from the discussion within the WPGR is how does the

⁵⁹ Benitah, *Subsidies, Services and Sustainable Development*, 35.

⁶⁰ Benitah, *Subsidies, Services and Sustainable Development*, 35 and Abugattas, *Towards Disciplines on Subsidies*, 19.

⁶¹ Abugattas, *Towards Disciplines on Subsidies*, 19.

⁶² *Ibid.*, 16.

existence of different modes of supply affect the definition of a service subsidy. Another question is whether there are aspects of the definition contained in ASCM that need to be refined to make them more applicable to the services context.⁶³ The following section seeks to consider such questions.

In 2005 Chile; Hong Kong, China; Mexico; Peru and Switzerland submitted an informal paper proposing that a provisional definition of subsidies in services could be formulated drawing on elements from the ASCM.⁶⁴ The definition reflects the concepts in the ASCM definition, but with some notable modifications. (These are discussed in more detail in the sections below). It is hoped that this provisional definition could be the starting point to facilitate the exchange of information and for the development of further disciplines for subsidies in services. In addition, the definition is not intended to determine whether subsidies falling under the definition are trade-distorting or not, or whether they should be disciplined.

The proposal articulates that the basic definition of a subsidy could be “a measure by which a Member provides a specific financial contribution or affords any form of income or price support, and a benefit or an advantage is thereby conferred, i.e., on terms more favourable than those available to the potential recipient or beneficiary in the market.”⁶⁵ It is also proposed that a financial contribution be considered a subsidy if it falls within the meaning of one of the measures in the following non-exclusive list: direct transfer of funds; potential direct transfer of funds or liabilities; government revenue that is otherwise due is foregone; government provides goods or services other than general infrastructure and public services (services available to the public in general); and government purchases of services. Finally, it is envisaged that a subsidy measure should fall within the scope of Article I:3 (a) of the GATS and, therefore, that any financial contribution granted by central, regional or local governments and authorities, as well as non-governmental bodies in the exercise of delegated powers, would be covered. This proposed provisional definition has generated significant debate and even more questions.

⁶³ Intervention of a member of the US delegation in the discussions of the WPGR. See S/WPGR/M/56, paragraph, 28, 7.

⁶⁴ WPGR, “Communication from Hong Kong, China and Mexico: Non-Actionable Subsidies in Trade in Services,” JOB (07)/27, March 2007, 15.

⁶⁵ *Ibid.*, 16.

Financial Contribution

In *US-Export Restraints*, the Panel observed that in the negotiating history of Article 1.1, “the requirement of a financial contribution from the outset was intended by its proponents precisely to ensure that not all government measures that conferred benefits could be deemed to be subsidies.”⁶⁶ The Panel also stated that “by introducing the notion of financial contribution, the drafters foreclosed the possibility of the treatment of any government action that resulted in a benefit as a subsidy.”⁶⁷ It appears that the same concern would apply to services particularly since regulatory measures may give rise to subsidy-like effects.

In the proposed definition, the circumstances in which a financial contribution is considered to be a subsidy are the same as those found in paragraphs (i) and (ii) in Article 1: 1.1 (a) (1) of the ASCM. However, paragraph (iii) has been expanded to include the notion of public services while paragraph (iv) has been excluded altogether. In terms of the reference to public services, there have been questions as to how this element of the proposed definition squares with the scope of the GATS Article I: 3, especially paragraphs (b) and (c) which carve services provided in the exercise of governmental authority out of the scope of the GATS.⁶⁸ The proponents of the proposed definition sought to include the notion of ‘public services’ in the ASCM term ‘general infrastructure’ to cover services provided by the government to the public in general. They clarified that the intention was not to prejudice the scope of Article I:3 of the GATS. However, it is not clear how this notion of public services differs from services provided in the exercise of governmental authority. Given that there is much uncertainty as to the scope of Article I:3 (a) itself, this inclusion could prove to be problematic to say the least.⁶⁹

The US delegation has raised the interesting question as to the implications of the requirement in the proposed definition that a subsidy measure should be within the scope of Article I: 3(a).⁷⁰ Specifically, would this mean that financial contributions granted by central, regional or local

⁶⁶ Panel Report, *United States - Measures Treating Exports Restraints as Subsidies*, WT/DS194/R, paragraph 8.65, 89.

⁶⁷ *Ibid.*, paragraph 8.38, 82.

⁶⁸ WPGR, “Synthesis of Views Expressed on the Definition of Subsidy: Informal Note by the Secretariat,” JOB(05)/4/Add.1, March 31, 2006, 2.

⁶⁹ Adlung and Krajewski provide interesting analyses of the debate. See Rudolf Adlung, “Public services and the GATS,” *Journal of International Economic Law* 9, no. 2 (2006): 455- 485; and Markus Krajewski, “Public Services and Trade Liberalization: Mapping the Legal Framework,” *Journal of International Economic Law* 6, no. 2 (2003): 341- 367.

⁷⁰ WPGR, “Report of the Meeting of 21 June 2006: Note by the Secretariat,” S/WPGR/M/56, paragraph 28, 7.

governments as well as non-governmental bodies in the exercise of delegated powers would be covered? While it is clear that measures taken by central, regional or local government authorities should be covered, there is an element of uncertainty about how this applies to non-governmental authorities exercising delegated powers. If the service provided by the non-governmental authority in the exercise of delegated authority is in fact a service which is supplied in the exercise of government authority will it still be considered a measure within the scope of the GATS?

On the basis of the ruling of the Panel in *US-Export Restraints*, it may be concluded that the purpose of paragraph (iv) was to prevent governments from circumventing their obligations in paragraphs (i) to (iii) by providing support through a private body.⁷¹ However, the proposed definition omits this “anti-circumvention provision”. It can only be speculated that the intention was that GATS Article I:3 (a) would prevent Members from circumventing their obligations in this way.

Price or Income Support

Dariusz and Mongialo suggest that the notion of price or income support is not entirely appropriate for a definition of subsidies in services since ‘income or price support’ as a possible form of subsidy may play an even more important role in the service sector than in the goods sector.”⁷² They further question whether the future definition of a subsidy should contain a list of forms of ‘income or price support’ which would be considered as a subsidy.

Some delegations have raised the question of whether regulatory measures could be considered a form of price support.⁷³ While the notion of price or income support may need to take into account the concerns articulated by Dariuz and Mongialo, the definition should exclude the subsidy-like effects of regulatory measures.

⁷¹ Panel Report, *United States - Exports Restraints*, paragraph 8.53, 84.

⁷² Robert Prylinski and Dariusz Mongialo, “Definition of Subsidy in the GATS,” ICTSD Roundtable on Trade in Services and Sustainable Development: “Towards Pro-Sustainable Development Rules for Subsidies in Trade in Services,” Geneva, March 10, 2003, 2.

⁷³ Intervention of the US delegation in the discussions of the WPGR. See “Report of the Meeting of 7 February 2005: Note by the Secretariat,” S/WPGR/M/51, March 18, 2005.

Benefit

The proposed definition includes the definition of the term ‘benefit or advantage thereby conferred’ as drawn from ASCM jurisprudence.⁷⁴ The Appellate Body in *Canada-Aircraft* concurred with the Panel that

“the word ‘benefit’, as used in Article 1.1(b), implies some kind of comparison. This must be so, for there can be no ‘benefit’ to the recipient unless the ‘financial contribution’ makes the recipient ‘better off’ than it would otherwise have been, absent that contribution. In our view, the marketplace provides an appropriate basis for comparison in determining whether a ‘benefit’ has been ‘conferred’, because the trade-distorting potential of a ‘financial contribution’ can be identified by determining whether the recipient has received a ‘financial contribution’ on terms more favourable than those available to the recipient in the market.”⁷⁵

The concept of benefit is important since it narrows the scope of possible subsidies by excluding government support that does not confer a benefit to the recipient.⁷⁶ However, some delegations have questioned the appropriateness of this concept for application to some services sectors as traditional market benchmarks might not exist for these services.⁷⁷ Examples include education, environmental and health services. Nonetheless, whether a traditional market benchmark can be found or not, it is expected that there will be still statistical challenges which would make the measurement of a benefit difficult.

Territory

One problem in the development of a definition of a subsidy in services relates to the atypical role of the notion of territory in services.⁷⁸ According to the ASCM, there is a subsidy when there is “a financial contribution by a government or any public body *within the territory of a Member...*” (Emphasis added). Subsidies in the ASCM context are territorially bound, that is to say, that the concept of ‘territory’ provides a link between the financial contribution and the

⁷⁴ Report of the Appellate Body, *Canada - Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, August 2, 1999, paragraph 149, 37.

⁷⁵ *Ibid.*, paragraph 157, 40.

⁷⁶ WPGR, “Synthesis of Views Expressed on the Definition of Subsidy: Informal Note by the Secretariat,” JOB(05)/4/Add.1, paragraph 13, 3.

⁷⁷ WPGR, “Report of the Meeting of 21 June 2006: Note by the Secretariat,” S/WPGR/M/56, paragraph 28, 7.

⁷⁸ Benitah, *Subsidies, Services and Sustainable Development*, 14.

subsidising Member. Therefore, a subsidy provided by a government to a firm outside of its territory would not be subject to the discipline of the ASCM. In the proposed definition of a subsidy, the notion of territory as found in the ASCM definition has been discarded. The wholesale adoption of the ASCM definition of a subsidy would place some subsidies such as export subsidies for Mode 3 suppliers outside of the scope of subsidies disciplines. Some experts are, however, of the view that “it is certainly necessary- given the modal structure of the GATS- to introduce the notion of territory.”⁷⁹ This notion of territory would need to be flexible enough to capture the relationship between the financial contribution and the subsidising Member.

Consideration should also be given to the relationship between the concepts of territory and benefit. Benitah observes that the benefit conferred by the subsidising government is not necessarily confined to that particular government’s territory as services are traded through four distinct modes.⁸⁰ In addition, the benefit conferred by a subsidy is not necessarily confined to something unavailable on the free market of the territory of the government providing the subsidy.” In this regard, Benitah has elaborated a number of useful scenarios. In Mode 3, country A may grant a subsidy to a domestic company which has a subsidiary in country B. If the service is co-produced between the company and its subsidiary, a part of the benefit is conferred in country B. For Mode 4, if country A grants its service supplier a subsidy, at least one part of the service must be produced in the territory of the importing country and the benefit is conferred there. Although in these cases a benefit is conferred, the question is to whom.

Specificity

As noted earlier, the ASCM makes the link between the subsidy measure and trade distortion through the notion of specificity. One of the key issues is whether the notion of specificity is relevant to trade in services. Given the central role that the concept plays in the ASCM, a case could be made for the adaptation of a modified form of specificity in the realm of services. The notion of specificity can be considered from a sector specific perspective or a modal perspective or perhaps a combination thereof.⁸¹ The determination of the desirability of a notion of modal

⁷⁹ Rudolf Adlung, communication by e-mail, July 30, 2007.

⁸⁰ Benitah, *Subsidies, Services and Sustainable Development*, 14.

⁸¹ Chan suggests that the fact that NT obligation is entered by mode might also call for distinction of subsidies by mode. See Thomas Chan, “Speaking Points,” ICTSD Roundtable on Trade in Services and Sustainable Development: “Towards Pro-Sustainable Development Rules for Subsidies in Trade in Services,” Geneva, March 10, 2003, 2.

specificity must be “based on the policy rationale behind the specificity and the ways subsidies are provided in practice.”⁸² In practical terms, there is the difficulty of defining specificity taking into account the nature of the service sector.⁸³ An intriguing question is whether horizontal subsidies granted in a sector which is the subject of market access limitations would be deemed to be specific. In the final analysis, the distinction between modal specificity and sector specificity has been held to be somewhat artificial and the important issue is whether funds have been artificially channelled towards a certain group of firms.⁸⁴

There has been some discussion on whether the definition should include the notion of trade distortion. It seems reasonable that a broad-definition of subsidies in services be developed and that some form of the notion of specificity be used to differentiate the trade distortive subsidies from those which have little or no trade effects. Given the difficulty in progressing on the definition of a subsidy, Hong Kong, China and Mexico suggested that it would be useful to identify non-distortive subsidies as was done in the ASCM, which should not be made subject to subsidies disciplines.⁸⁵ While the desire of the *demandeurs* to make headway is understandable, such an approach would seem to have limited value as Members would not be in the best position to determine which subsidies in the potential universe of support measures should be accorded privileged legal treatment.

Categorisation

Treatment of Prohibited Subsidies

Export subsidies are deemed to be the most injurious to international trade since they impact on third country markets, distort the domestic markets of the subsidising country as well as the importing country. However, the accuracy of this conclusion in relation to the international trade in services is indeterminate. This has important implications for the ways in which export subsidies for services should be disciplined. Sauvé is of the view that the ASCM approach of banning export subsidies could work theoretically for Mode 1 since the situation is comparable to

⁸² Benitah, *Subsidies, Services and Sustainable Development*, 19.

⁸³ Prylinski and Mongialo, “Definition of Subsidy in the GATS,” 4.

⁸⁴ Benitah, *Subsidies, Services and Sustainable Development*, 20.

⁸⁵ WPGR, “Communication from Hong Kong, China and Mexico: Non-Actionable Subsidies in Trade in Services,” JOB (07)/27, March 2007, 1.

that in goods.⁸⁶ However, in relation to Modes 2, 3 and 4, the issue is far more complex. According to Sauvé, export-enhancing subsidies are unlikely or unrealistic.

In examining the limited information gleaned from TPR reports, one can detect a few examples of export subsidies. For example, Rwanda permits investors operating in export processing zones to be exempt from duties or taxes on machinery, equipment, and other inputs in to production; all other taxes levied on enterprises; and withholding taxes and taxes on dividends. Enterprises in these zones are required to export at least 80% of their production; or to be engaged in the export of services.⁸⁷ Under its Export Industry Encouragement Act, Jamaica offers service providers serving clients in non-CARICOM countries full income tax relief or gains, full relief from import duties, excise duties and general consumption tax on raw materials and capital goods for a maximum of 10 years.⁸⁸

Given that there is no certainty as to the extent of the distortion caused by an export subsidy for services, it might be premature to adopt the ASCM approach of prohibiting export subsidies. In this regard the approach of the AoA might be more appropriate. Export subsidies could be notified with a view to disciplining those that are more distortive of trade. The obligation to notify would create increased transparency.

While the ASCM prohibition applies to both *de jure* and *de facto* export subsidies, some caution must be sounded against disciplining *de facto* export subsidies for services.⁸⁹ In the ASCM context, the basis of proving that a *de facto* export subsidy exists “when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings.”⁹⁰ By contrast, for some services, the granting of a subsidy is tied to anticipated export earnings, for example almost all subsidies for the delivery of tourism services through Mode 2 may be considered *de facto* subsidies.

⁸⁶ Sauvé, *Developing Countries and the GATS 2000 Round*, 100.

⁸⁷ World Trade Organisation, “Subsidies for Services Sectors- Information contained in Trade Policy Reviews: Background Note by the Secretariat,” S/WPGR/W/25/Add.5, March 27, 2007, 7.

⁸⁸ *Ibid.*, 22.

⁸⁹ Benitah, *Towards Disciplines on Subsidies*, 20.

⁹⁰ WTO, *The Legal Texts: Results of the Uruguay Round of Multilateral Trade Negotiations*, 233.

Treatment of Actionable Subsidies

Sykes has argued that WTO rules for the identification of problematic domestic subsidy programs are flawed from an economic standpoint. Firstly, even when an industry is a net recipient of support, those benefits may be socially justifiable. WTO law is not capable of addressing the question of whether the subsidy addresses some legitimate problem. Even when the rationale for a support measure is socially justifiable, “it will likely arise narrowly and case-by-case, so that the policy response will often appear ‘specific.’”⁹¹

Secondly, WTO law to a considerable degree ignores the question of whether subsidies have an effect on the output of the beneficiary, and thus the attendant question of whether foreign competitors can be harmed by it (and to what extent). There is no requirement that the ‘benefit’ from the subsidy has any effect on production. These issues may be even more acute for services sectors many of which are prone to market failures and so require more active government involvement.

The AoA makes Amber Box subsidies subject to reduction commitments while the ASCM makes them actionable only on the basis of certain demonstrated adverse effects. Benitah recommends that there should be an Amber Box for subsidies for services and that such subsidies should be actionable only on the basis of certain demonstrated effects.⁹² Once such demonstrated effects are proven, the Member could ask for the removal of a subsidy itself or the removal of the adverse effects.

Adverse Effects

The adverse effects test in the ASCM aims at determining the anti-competitive effects which affect international trade.⁹³ In order to establish the existence of adverse effects, two elements need to be present: first, an effect on international trade and second, a distortion of competition. In the ASCM, three types of adverse effects are specified: injury to domestic industry, nullification and impairment of benefits and serious prejudice.

⁹¹ Sykes, “The Economics of WTO Rules on Subsidies and Countervailing Measures,” 21- 22.

⁹² Benitah, *Towards Disciplines on Subsidies*, 31.

⁹³ Begivlia Zampetti, Americo. “The Uruguay Round Agreement on Subsidies: A Forward Looking Assessment,” *Journal of World Trade* 29, no. 6 (1995):

Injury to Domestic Industry

Zampetti argues that injury to the domestic industry cannot be equated to distortion of competition since it is inherent in the process of competition that some firms prosper while others do not. In the ASCM, the concept of injury is defined as material injury to a domestic industry, threat of material injury to a domestic industry or material retardation of the establishment of such an industry. A determination of injury must be based on positive evidence and involve an objective assessment of both the volume of subsidised imports for like products and the consequent impact of these imports on the domestic producers of such products. Firstly, given the statistical challenges in the area of services, it may not be feasible to transpose the injury test as is from the ASCM to subsidies disciplines for services. Secondly, given that services trade takes place through four modes, it would need to be decided whether the domestic industry is the entire sector or a specific mode within a sector. This also gives rise to questions of likeness which are very difficult to resolve in the services context. The ASCM stipulates that like products are those that are essentially identical. Given the possibility of supply of services through four modes there may be a significant difference in how the concept of likeness is applied.⁹⁴ Nevertheless, some notion of injury to a domestic industry and the conditions under which such injury is determined are critical to assessing the effect of a subsidy in services and creating adequate rules to discipline these effects. These elements are key to establishing that the subsidy has created distortions in competition.

Nullification and Impairment

As is the case of goods, governments can offset an efficiency-enhancing reduction of distortive trade barriers by providing subsidies which restore the distortion of trade and circumvent the obligation. The concept of nullification and impairment already exists within the GATS and plays a role in potentially disciplining the use of subsidies. (This is discussed further in **Chapter 3**).

⁹⁴However, Pauwelyn argues that what is significant is whether the regulation affords less favourable treatment of imports and foreign services and service suppliers on the basis of country of origin and that questions of likeness are peripheral. For a full discussion see Joost Pauwelyn, "The Unbearable Lightness of Likeness," Duke Law School, n.d. [database online]; available from http://www.law.duke.edu/fac/pauwelyn/pdf/unbearable_lightness.pdf; accessed July 30, 2007.

Serious Prejudice

Serious prejudice in the ASCM is deemed to exist when the subsidy affects the cost and revenue structure of the targeted firm or industry relative to competitors and thus influences its supply behaviour.⁹⁵ Such transformation of the firm's or industry's behaviour is only relevant to the extent that it has an effect on international trade. The ASCM sets out four cases in which serious prejudice may arise. Serious prejudice may arise where the effect of the subsidy is to displace or impede the imports of a like product of a Member into the market of the subsidising Member; or where the effect of the subsidy is to displace or impede the exports of a like product of another Member from a third country market. Serious prejudice may also arise where the effect of the subsidy is significant price undercutting by the subsidised product as compared with a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market. The final instance in which serious prejudice may arise is where the effect of the subsidy is an increase in the world market share of the subsidising Member as compared with the average share it had during a previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted. It is important to have a test of serious prejudice in determining the effect of a subsidy for services since the test is able to take into account the effects of the support measure on different markets- that of the subsidising country, the importing country, third countries and the rest of the world.

Exemption Box

Sykes contends that the exceptions created in the ASCM, with the exception of the R&D category, are questionable and that "the premise that subsidies can be dedicated to particular purposes and shown to be used in that fashion is shaky."⁹⁶ With reference to the R&D category, such support may generate positive externalities and it may be undersupplied by a private market. However, the WTO rules do not call into question whether the particular research plausibly required subsidisation.

On the other hand, the other categories are seen to be highly problematic. In terms of assistance to disadvantaged regions, Sykes is not convinced that there is an economic basis to suppose that subsidies for industrial development in such regions will address any market failure. Subsidies to cover environmental compliance costs are also held to be questionable on economic grounds.

⁹⁵ Zampetti, "The Uruguay Round Agreement on Subsidies: A Forward Looking Assessment," 23.

⁹⁶ Sykes, "The Economics of WTO Rules on Subsidies and Countervailing Measures," 24.

Conventional economic wisdom would require the polluting party to internalise the cost of the negative externality through the application of taxes, hence the ASCM gives preference to a less efficient economic tool- provision of a subsidy.

Despite Sykes' scepticism, all of the models examined contain some form of exemption box. The AoA exempts Green Box subsidies and the ASCM exempts non-specific subsidies from discipline. Given that the ASCM no longer exempts the Article 8 subsidies from discipline, this Agreement is currently the most stringent regime. These exceptions reflect areas of great sensitivity within the national economies of Members. With regard to services, it is expected that these sensitivities may be even more acute and only a significant level of exceptions will provide Members with a measure of comfort that they have been able to preserve their policy space. Benitah makes a number of arguments in favour of privileged legal treatment for three categories of subsidies for services: those related to environmental protection, those related to a social pillar and those related to an economic development pillar. Environmental protection subsidies would be for subsidies aimed at promoting environmentally sound production methods, the implementation of new environmental requirements, promoting environmentally friendly services and subsidies to services through funds under multilateral environmental agreements. Subsidies related to the economic development pillar would provide protection for developing countries' nascent services, subsidies to services adding value to unprocessed primary commodities, subsidies to mitigate the digital divide, temporary subsidies to local small business services to reduce the dependency on 'export services' such as tourism and subsidies for the use of cleaner technologies by service providers in developing countries. Subsidies related to the social pillar would include subsidies to R&D; health and social care; education and promotion of cultural diversity and to assure water supply. While the three categories of exemptions are understandable, they appear rather broad and may result in a carving out of a great many of the services sectors from the scope of future subsidies disciplines. On the other hand, this may very well be the price for subsidies rules for services.

Chapter Three

Subsidies Disciplines in International Agreements

3.1 Existing Subsidies Disciplines within the GATS

As noted earlier, the reluctance of the Members to progress the negotiations on the development of subsidies disciplines may be explained by the fact that Members are still able to protect their interests. This level of comfort may be explained by the fact that the GATS already contains provisions which serve to some extent to discipline the use of subsidies. The first part of this Chapter explores the nature and strength of these disciplines. The second section examines the existing disciplines on subsidies in a number of RTAs.

GATS II

Article II of the GATS stipulates that each Member shall accord to services and service suppliers of any other Member treatment no less favourable than it accords to like services and service suppliers of any other country. Consequently, the MFN provision makes it obligatory for a Member granting a subsidy to one foreign service supplier to extend similar treatment to like service suppliers from other Members. The MFN clause may be particularly important if there is no national producer and therefore the national treatment provision is not operative.⁹⁷ The fact that the subsidising Member must accord MFN treatment in providing subsidies may serve to deter governments from offering subsidies to foreign suppliers. Nevertheless, if there is no foreign service supplier located in the territory of the Member or if the Member does not grant subsidies to any foreign service suppliers or if the Member has inscribed a derogation in its MFN Exemption List which restricts the provision of subsidies to specific foreign suppliers, then GATS Article II has no effect in disciplining services subsidies for this Member.⁹⁸

In assessing the efficacy of the discipline of Article II in relation to markets in which the effect of the subsidy may be felt, the MFN obligation may operate to ensure that there is no discrimination in the market of the subsidising Member. The MFN instrument is also capable of checking distortion in the supply of a service via Mode 3. However, the effects of the subsidy in the market of the importing Member, third country export markets and the world market remain

⁹⁷ Working Party on GATS Rules, "Subsidies in Services: Note by the Secretariat," S/WPGR/W/9, March 6, 1996, paragraph 24.

⁹⁸ Ahuja, *Towards Developing Subsidies Disciplines Under the GATS*, 8.

unchecked. This would be the case for both export-enhancing and import-displacing subsidies. (See **Table 3.1**) In addition, the MFN obligation is unable to discipline any distortions which may affect trade in Modes 1 and 2 since Members are not required to extend any GATS obligations to suppliers located outside of their territory.

GATS III

The transparency obligation could potentially discipline the use of trade distortive subsidies since Members are required to notify all measures that affect the operation of the GATS. In addition, the requirement to notify the provision of subsidies could generate debate within the Member which could create significant internal political economy pressures to abandon programmes which favour narrow interests.⁹⁹ Paragraph 5 allows other Members to cross-notify the Council for Trade in Services of measures applied by other Members. The cross-notification provision is potentially the strongest transparency discipline since it allows affected Member to notify of the existence and effect of the subsidy. Mandatory *ex-ante* notification would constitute the strongest type of transparency discipline for subsidies.¹⁰⁰

GATS VIII

Paragraph 1 requires Members to ensure that monopolies and exclusive service providers do not use their power to negate the MFN commitment of Article II or to undermine any specific commitments in schedules. Paragraph 2 states that where a monopoly competes in a sector outside of the domain of its monopoly power and the particular sector is the subject to a specific commitment, the Member must ensure that the monopolist does not use its position in a manner inconsistent with the scheduled commitment. Paragraph 5 applies the same requirement for exclusive service providers. The provisions aim at preventing the cross-subsidisation across sectors or activities.¹⁰¹ In addition, the provision applies to both private and public entities hence ensuring the behaviour of both types of dominant firms are disciplined.

⁹⁹ Pietro Poretti, e-mail communication, September 4, 2007.

¹⁰⁰ Ibid.

¹⁰¹ Working Party on GATS Rules, "Subsidies in Services: Note by the Secretariat," S/WPGR/W/9, March 6, 1996, paragraph 40.

Table 3.1

Potential Disciplining Effects of Selected GATS Provisions on Subsidies

GATS PROVISION	SUBSIDY TYPE	EFFECT BY MARKET	EFFECT BY MODE
Article II- Most Favoured Nation Obligation (MFN)			
	Export	<u>Domestic:</u> Discrimination among foreign suppliers in domestic market disciplined.	I. Competition arises from outside of the national territory and obligations of the GATS do not extend beyond the national territory. ¹⁰²
		<u>Foreign Importing Country:</u> Distortive effect unchecked by MFN.	II. Competition arises from outside of the national territory and obligations of the GATS do not extend beyond the national territory.
		<u>Third Country Exporter:</u> Distortive effect unchecked by MFN.	III. MFN only can discipline distortion when foreign service providers exist in domestic market
		<u>RoW:</u> Distortive effect unchecked by MFN.	IV. While service of foreign supplier is provided in domestic market of subsidising country, it is unlikely that the foreign service provider will be entitled to the same treatment as the domestic supplier.
	Import	<u>Domestic:</u> Discrimination among foreign suppliers in the domestic market disciplined.	I. Competition arises from outside of the national territory and obligations of the GATS do not extend beyond the national territory.
		<u>Foreign Importing Country:</u> Effects left unchecked.	II. No effect as the foreign service provider competes from another jurisdiction.
		<u>Third Country Exporter:</u> Effects left unchecked.	III. Effective only when foreign service suppliers exist in domestic market.
		<u>RoW:</u> Effects left unchecked.	IV. It would be illogical to grant an import-displacing subsidy to foreign exporter.
Article VIII- Monopolies and Exclusive Service Suppliers			
	Export	<u>Domestic:</u> Provision addresses distortion in the domestic market. This type of	I. The monopoly or exclusive service providers' action is aimed at increasing external

¹⁰² Members States are not required to extend treatment outside of their territory. See World Trade Organisation. Council for Trade in Services, "Guidelines and Procedures for the Negotiations on Trade in Services," S/L/93, March 29, 2001.

GATS PROVISION	SUBSIDY TYPE	EFFECT BY MARKET	EFFECT BY MODE
		subsidy will increase market share in foreign market. This provision cannot discipline the latter distortions.	market share. Foreign cross-border service providers are unlikely to be affected by such action.
		<u>Foreign Importing:</u> No disciplining effect as the distortion occurs in a foreign market.	II. The conditions of competition may be distorted, but since distortion takes place outside of domestic territory, the discipline of Article VIII is ineffective.
		<u>Third Country Exporter:</u> No disciplining effect as the distortion occurs in a foreign market.	III. The conditions of competition may be distorted, but since distortion takes place outside of domestic territory, the discipline of Article VIII is ineffective
		<u>RoW:</u> No disciplining effect as the distortion occurs in a foreign market.	IV. Not applicable.
	Import	<u>Domestic:</u> If the Member has made a commitment in the sector, then this instrument can discipline cross-subsidisation.	I. Effective discipline where commitment exists.
		<u>Foreign Importing:</u> No disciplining effect as the distortion occurs in a foreign market.	II. Effective discipline is exerted where there is a commitment since the provision limits the capacity of monopoly or exclusive service provider to restrict consumption abroad.
		<u>Third Country Exporter:</u> No disciplining effect as the distortion occurs in a foreign market.	III. Effective discipline where commitment exists.
		<u>RoW:</u> No disciplining effect as the distortion occurs in a foreign market.	IV. Effective discipline where commitment exists.
Article XVII- National Treatment Obligation (NT)			
	Export	<u>Domestic:</u> If there is a commitment, NT obligation exerts disciplining effect in the domestic market by limiting discrimination between domestic services and service suppliers and foreign services and service suppliers.	I. Competition arises from outside of the national territory and obligations of the GATS do not extend beyond the national territory.
		<u>Foreign Importing:</u> Instrument cannot address effects in foreign market.	II. Competition arises from outside of the national territory and obligations of the GATS

GATS PROVISION	SUBSIDY TYPE	EFFECT BY MARKET	EFFECT BY MODE
			to not extend beyond the national territory.
		<u>Third Country Exporter:</u> Instrument cannot address effects in foreign market.	III. If there are commitments, then the NT obligation can discipline discrimination.
		<u>RoW:</u> Instrument cannot address effects in foreign markets.	IV. It is improbable that a subsidising country would offer an export subsidy to a foreign Mode IV service provider.
	Import	<u>Domestic:</u> If there is a commitment, NT obligation exerts disciplining effect in the domestic market by limiting discrimination between domestic services and service suppliers and foreign services and service suppliers.	I. Competition arises from outside of the national territory and obligations of the GATS do not extend beyond the national territory.
		<u>Foreign Importing:</u> Instrument cannot address effects in foreign market.	II. Competition arises from outside of the national territory and obligations of the GATS do not extend beyond the national territory.
		<u>Third Country Exporter:</u> Instrument cannot address effects in foreign market.	III. If there are commitments, then the NT obligation can discipline discrimination.
		<u>RoW:</u> Instrument cannot address effects in foreign market.	IV. It is illogical that a subsidising country would offer an import displacing subsidy to a foreign Mode IV service provider.

Explanatory Notes:

Subsidy type:

Export- Export-enhancing subsidy

Import- Import-displacing subsidy

*Effect by Market:*¹⁰³

Underlying question- does the discipline address effects in the different markets?

¹⁰³ The identification of markets which could be affected by a subsidy is drawn from Article 6:3 of the ASCM as it was felt that this provided a useful analytical basis upon which the foregoing analysis is based. It is not, however, the intention to conclude whether the provisions related to serious prejudice can be applied to the subsidies in services.

- Domestic- The effect of the subsidy is to displace or impede the imports of a like service of another Member into the market of the subsidising Member.
- Foreign Importing- The effect of the subsidy is a significant price undercutting by the subsidised service as compared with the price of a like service of another Member in the same market or significant price suppression, price depression or lost sales in the same market.
- Third Country Exporter- The effect of the subsidy is to displace or impede the exports of a like service of another Member from a third country market.
- Rest of the world (RoW)- the effect of the subsidy is an increase in the world market share of the subsidising Member in a particular subsidised service as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted.

Modes of Supply in Trade in Services:

Underlying question- is the discipline effective for the particular mode of supply?

- I- Cross-border supply of a service from the territory of one Member into the territory of another Member.
- II- Consumption of the service in the territory of another Member.
- III- Commercial presence in the territory of a Member.
- IV- Supply of a service in the territory of one Member through the movement of a natural person from the territory of another Member.

Article VIII is only effective in relation to import-displacing subsidies since it disciplines the behaviour of the monopoly or exclusive service provider *within* the subsidising Member's territory. On the other hand, it is ineffective in disciplining export-enhancing subsidies and it leaves any effects beyond the domestic territory unchecked. In modal terms, the discipline of GATS VIII on import-displacing subsidies is effective for all four modes of supply as potential distortions that could affect the provision of a service are dealt with. However, the scope of this instrument is limited to sectors in which the Member has made commitments.

GATS XV:2

GATS XV:2 provides that Members which consider themselves to be adversely affected by a subsidy of another Member may request consultations with that Member on such matters and

such requests are to be accorded sympathetic consideration. Since this clause does not indicate what course of action is to be taken by subsidising state, this consultation process has a rather limited effect.

GATS XVII

In the sectors in which Members have scheduled specific commitments, and subject to any qualifications and conditions attached to those commitments, Members are required to 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 it accords to its own like services and service suppliers. The national treatment clause may have a disciplining effect on the use of subsidies since it obliges Members to provide treatment no less favourable than they accord to their own like services and service suppliers. In addition, the obligation also dampens the desire to grant subsidies to national service providers.¹⁰⁴ As national treatment is a conditional obligation, the potentially powerful disciplining effect of this obligation is limited by the extent of the commitments inscribed in each Member's schedule of commitments.

The national treatment obligation can discipline discrimination in the granting of both import and export subsidies. However, it cannot discipline distortionary effects beyond the domestic market of the subsidising government. In addition, the national treatment provision can effectively be used to ensure that the conditions of competition are not modified in Mode 3.

Ahuja articulates a number of situations in which the national treatment clause is unable to deal with all kinds of subsidy-induced trade distortions in the domestic territory of the subsidising Member or in the third country. First, he points to the case where the foreign service supplier is located outside of the country and the Member has committed to provide a subsidy to all national service providers regardless of the of supply.¹⁰⁵ Although there is distortion in the pattern of trade, a Member is not required to take measures outside of its territorial jurisdiction. Therefore a subsidy provided under Mode 3 or 4 would have an impact on competitive conditions under Mode 1, because cross-border suppliers would be competing against subsidised local services.¹⁰⁶

¹⁰⁴ Ahuja, *Towards Developing Subsidies Disciplines Under GATS*, 8.

¹⁰⁵ *Ibid.*, 13-14.

¹⁰⁶ Aaditya Mattoo, "National Treatment in the GATS: Corner-Stone or Pandora's Box?" *Journal of World Trade* 31, no. 1 (1997): 120.

Secondly, if consumption subsidies are provided and linked to domestic suppliers, these tend to distort trade. Thirdly, subsidising the special skills of nationals can distort trade inside and outside of the territory. When the subsidised service providers temporarily move abroad, there is some distortion. Even if there is no temporary movement, subsidised specialised skills may distort trade when the outsourcing of services to the subsidising Member takes place via Mode 1.

GATS XXIII:3

Measures that are not inconsistent with the GATS, but nullify or impair the benefits of an existing concession may give rise to a non-violation complaint under Art XXIII:3. In assessing the value of the non-violation complaint in the GATS, Poretti looks to the GATT and WTO jurisprudence developed on GATT Article XXIII: I (b).¹⁰⁷ Under GATT Article XXIII: I (b), the complaining party has to cumulatively prove the existence of three things. Firstly, the application of a measure by a WTO Member; secondly, the existence of a benefit accruing under a relevant agreement and; thirdly, the nullification and impairment of such a benefit as a result of the application of the measure in question.

According to Poretti, the key to analysing the efficacy of the non-violation complaint instrument in disciplining services subsidies is the existence of a benefit which one Member expects to accrue on the basis of another Member's specific commitments. The very existence of a specific commitment translates to a requirement that the country must provide a minimum level of market access to its domestic market. Therefore, the non-violation complaint instrument is useless against trade distortive effects caused by export-enhancing subsidies, where the distortion occurs in third markets. A similar situation would exist in the case of investment-diverting subsidies. Poretti concludes that the efficacy of the non-violation complaints instrument is arguably concentrated on import-displacing subsidies, where the bulk of trade distortion occurs in the market of the subsidising Member itself.

¹⁰⁷ Poretti, "Waiting for Godot: Subsidies Disciplines in Services Trade," 7-8.

It should also be noted that some services to subsidies can be disciplined through other WTO instruments. The ASCM provides remedial action against subsidisation of services embodied in goods.¹⁰⁸

Overall, the disciplinary effects of the existing GATS rules appear to be limited. Firstly, most of the provisions only address the trade distortive effects resulting from import-displacing subsidies. Consequently, their value depends on the prevalence of domestic support over other types. Secondly, most of the provisions are weakened by the inherent flexibility of the GATS.

3.2 Existing Subsidies Disciplines in Regional Trade Agreements

3.2.1 European Community (EC)

The EC regime on subsidies (referred to by the EC treaty as state aid) applies to both goods and services. The definition of state aid is similar to the definition of subsidies in the ASCM. For a measure to be considered state aid it must satisfy four conditions, namely, it must lead to a transfer of resources from the state, it must constitute an economic advantage that the undertaking would not have received in the normal course of business, it is selective and thus affects the balance between certain firms and their competitors and it must have a potential effect on competition and trade between member states.¹⁰⁹ A key difference, however, is that the focus of EC regime is on distortions of competition within the internal market.

The state aid system is based on the need to allow Member States' the freedom to design their economic policy while ensuring a level playing field for all undertakings in the internal market regardless of the country of establishment.¹¹⁰ The basic notion is that state aid distorts competition in the internal market and may lead to a reduction in the overall competitiveness of European industry by providing unjustified advantages to some firms thereby preventing or delaying market forces from adapting to forthcoming challenges and rewarding the most competitive firms.

¹⁰⁸ Sauvé, "Completing the GATS Framework: Addressing Uruguay Round Leftovers," 323-323.

¹⁰⁹ Working Party on GATS Rules, "The Community Regime for State Aid in the Services Area," Informal Note: Communication from the European Communities, JOB no. 4302, July 6, 2000.

¹¹⁰ Commission of the European Communities, "State Aid Scoreboard," COM (2007) 347, Brussels, June 28, 2007 [database online]; available from http://ec.europa.eu/comm/competition/state_aid/studies_reports/2007_spring_en.pdf; accessed August 22, 2007.

In the EC model, all state aid is considered as incompatible with the objectives of the Common Market. However, this principle of incompatibility does not amount to a full-scale prohibition on state aid.¹¹¹ Member States are required to notify the Commission of their intention to make use of any such exception. Aid granted without the prior notification and approval of the Commission may be considered illegal.

The EC Treaty provides for a number of exemptions to the state aid rules. State aid for social objectives, granted to individual consumers, provided that it is granted without discrimination related to the origin of the products concerned is considered compatible. Similarly, aid for remedying damage occasioned by natural disasters or exceptional occurrences is deemed compatible. There are also exceptions for regional development. Regional aid may be granted to improve standards of living or remove underemployment in regions where these indicators deviate considerably in comparison to the EU average or to facilitate the development of certain economic areas which are disadvantaged as compared with the national average.

There are also horizontal rules for the granting of particular categories of aid which are aimed at tackling problems which may arise in any industry or region. These types of aid are specifically for research and development, environmental protection, rescuing and restructuring of firms in difficulty, employment and training. In addition, the EC has industry specific or sectoral rules for state aid to specific industries. These rules apply to sensitive sectors, agriculture and fisheries and aquaculture, and parts of the transport sector.

To demonstrate that state aid has an effect on competition and trade in Member States, it is sufficient to show that the beneficiary is involved in an economic activity and that he operates in a market in which there is trade between Member States.¹¹² Trade is also affected if it is demonstrated that the aid makes trade more difficult or impossible. Small amounts of aid or *de minimis* aid are however exempted. *De minimis* aid is defined as aid of less than Euro 100, 000 per enterprise over 3 years (other than in certain sectors).

Where Member States assign exclusive rights or service of general economic interest to an undertaking, the compensation of the net cost of such public missions may be allowed, however,

¹¹¹ Ahuja, *Towards Developing Subsidies Disciplines Under the GATS*, 18.

¹¹² Working Party on GATS Rules, "The Community Regime for State Aid in the Services Area," paragraph 13, 3.

there should be no overcompensation, in particular in order to avoid cross subsidisation from the reserved area to the competitive business.¹¹³

If schemes are deemed to be illegally implemented, the Member State concerned may be required to recover the sums paid out and the recipient of the unlawful aid to pay it back. No mechanism exists for countervailing state aids, rather, the Commission has the authority to instruct the Member State concerned to abolish or alter a state aid. Failure of a state to comply with the Commission's decisions may result in the matter being referred refer the matter to the Court of Justice directly.¹¹⁴

In the period 2000 to 2006, the Commission took 608 decisions on unlawful aid.¹¹⁵ In addition, there are around 200 pending unlawful aid cases which are still under Commission scrutiny. With reference to the industry and services sectors, in relative terms, decisions involving unlawful restructuring aid made up 62% of the total number of decisions on restructuring aid. Similarly, unlawful rescue aid accounted for almost half (48%) of all rescue aid.

3.2.2 European Economic Area (EEA) Agreement

Article 61 of the EEA Agreement states that unless otherwise provided, “any aid granted by EC Member States, EFTA States or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between contracting parties, be incompatible with the functioning of this Agreement.”¹¹⁶

In the event that either party to the Agreement considers that the other is applying incompatible measures, the provisions of Article 64 will apply. Article 64 (1) provides for an exchange of views within two weeks if one of the surveillance authorities considers the implementation of state aid by another surveillance authority is not in conformity with the maintenance of equal conditions of competition within the territory covered by the Agreement. It further states that if a

¹¹³ Ibid., paragraph 26- 27, 7.

¹¹⁴ WPGR, “Provisions on Subsidies Related to Trade in Services in Regional Trade Agreements: Note by the Secretariat,” S/WPGR/W/12, 2.

¹¹⁵ Commission of the European Communities, “State Aid Scoreboard.”

¹¹⁶ *Agreement on the European Economic Area* [database online]; available from <http://secretariat.efta.int/Web/EuropeanEconomicArea/EEA%20Agreement/EEA%20Agreement.pdf>; accessed July 18, 2007.

commonly agreed solution has not been found by the end of this two week period, the competent authority of the affected party may immediately adopt appropriate interim measures in order to remedy the resulting distortion of competition. Consultations are then to be held in the EEA Joint Committee with a view to finding a commonly acceptable solution. If within three months the EEA Joint Committee has not been able to find such a solution, and if the practice in question causes or threatens to cause distortion of competition affecting trade between the parties, the interim measures may be replaced by definitive measures, strictly necessary to offset the effect of such distortion. Priority is to given to such measures that will least disturb the functioning of the EEA.

3.2.3 European Free Trade Association (EFTA) Agreements

EFTA-Chile

The EFTA-Chile Agreement does not provide an independent framework for disciplining subsidies rather Article 81 (2) provides that “the rights and obligations of the Parties in respect of subsidies related to services shall be governed by the GATS.”¹¹⁷ The Agreement offers no remedy for trade distortive subsidies and paragraph 3 of Article 81 merely provides that “each Party may request information on individual cases of state aid believed to affect trade between the Parties. The requested Party will make its best efforts to provide such information.”

EFTA-Singapore

Article 29 of Chapter III of the EFTA-Singapore Agreement provides that “a Party which considers that it is adversely affected by a subsidy of another Party may request consultations with that Party on such matters. Such requests shall be accorded sympathetic consideration.”¹¹⁸

Beyond this direct reference to subsidies, there are two other articles which may exert a measure of discipline on the use of subsidies. The first is the MFN provision in Article 23 (1) which provides that the parties shall accord immediately and unconditionally to any measure covered by the Chapter, treatment no less favourable than that accorded to the services and service suppliers

¹¹⁷ *Free Trade Agreement between the EFTA States and the Republic of Chile* [database online]; available from http://secretariat.efta.int/Web/ExternalRelations/PartnerCountries/Chile/CL/CL_Agreement.pdf; accessed July 18, 2007.

¹¹⁸ *Agreement between the EFTA States and Singapore* [database online]; available from http://secretariat.efta.int/Web/ExternalRelations/PartnerCountries/Singapore/SG/SG_FTA.pdf; accessed August 23, 2007.

of non-parties. According to Annex VI to the FTA, the parties may derogate from this obligation if they have listed the measure in their GATS Annex II Exemption List or the treatment is granted under agreements concluded by one of the Parties with a non-Party which have been notified under Article V bis of the GATS.

The second is the national treatment provision found in Article 25, which essentially mirrors GATS Article XVII. Both Articles 23 and 25 can be applied to subsidies as they fall within the meaning of the word measure which is defined in Article 22 as “any measure by a Party, whether in the form of a law, regulation, rule, procedure, decision, administrative action or any other form.”

3.2.4 Australia-New Zealand Closer Economic Relations Trade Agreement

(ANZCERTA)

ANZCERTA has developed a special regime for trade in services. The Protocol on Trade and Services is unique among international agreements regulating trade in services by virtue of the fact that it explicitly seeks to discipline export subsidies. Specifically, Article 11 of the Protocol stipulates that “members should not introduce new or expand existing export subsidies, or incentives, having a direct distorting effect on trade in services between them.”¹¹⁹

ANZCERTA also contains other instruments which provide a measure of discipline in the use of subsidies. Article 12 (2) establishes that “Member States shall endeavour to prevent monopoly service providers under their direct control from using revenues deriving from their monopoly activities for the purpose of subsidising services they may provide in competition with persons of the Member States.” This provision is similar to Article VIII:2 in the GATS which seeks to prevent monopolies from cross-subsidising services in sectors in which Members have made specific commitments.

The transparency provisions in Articles 16 (1) and (2) are also relevant in this context since they contain a requirement for ANZCERTA Member States to provide written notice to the other of any proposed or actual measure that it considers might materially affect the operation of the Protocol and such notice must include the reasons for the measure. The written notice is to be

¹¹⁹ Protocol on Trade in Services to the Australia New Zealand Closer Economic Relations Trade Agreement [database online]; available from http://www.dfat.gov.au/geo/new_zealand/anz_cer/215.pdf; accessed July 21, 2007.

given as far in advance as possible of implementation of the measure. If prior notice is not possible, the Member State implementing the measure shall provide written notice to the other Member State as soon as possible after implementation.

Article 2 stipulates that the Protocol applies to any measure, in existence or proposed, of a Member State that relates to or affects the provision of a service by or on behalf of a person of the other Member State within or into the territory of the first Member State. Article 3 further elaborates that the term “measure includes any law, regulation, or administrative practice.” Therefore, a subsidy would be subject to the transparency requirements.

In terms of remedies available, Article 19 of the Protocol provides that “Member States shall, at the written request of either, promptly enter into consultations with a view to seeking an early, equitable and mutually satisfactory solution, if the Member State which requested the consultations considers that an obligation under the Protocol has not been, is not being, or may not be fulfilled; or the achievement of any objective of this Protocol is being or may be frustrated.” No specific remedy akin to a countervailing measure is contemplated within the framework of the Protocol.¹²⁰

3.2.5 Caribbean Community (CARICOM)

Chapter Five of the Revised Treaty of Chaguaramas sets out the legal framework for the provision of subsidies for goods in Articles 96 to 115. Article 1 entitled “Use of Terms” establishes that the term “subsidies” includes the subsidies set out in Schedule V and shall apply *only* in relation to goods. There is no specific legal regime in relation to subsidies in services, but a few of provisions introduce some basic obligations and commitments that might provide guidance regarding the actions to be taken in the case of trade-distortive subsidies within CARICOM.¹²¹

Article 79:2 stipulates that each Member State shall refrain from trade policies and practices, the object or effect of which is to distort competition, frustrate free movement of goods and services, or otherwise nullify or impair benefits to which other Member States are entitled under this Treaty. This article would cover subsidies by Member states. Art 69:1 states that the Member

¹²⁰ WPGR, “Provisions on Subsidies Related to Trade in Services in Regional Trade Agreements,” 1.

¹²¹ Abugattas, *Towards Disciplines on Subsidies* , 4.

States shall harmonise national incentives to investments in the industrial, agricultural and services sectors and Article 69:3 (c) provides that regimes for the granting of incentive may provide for non-discrimination in the granting of incentives among Community nationals.

Article 187 provides for recourse to dispute settlement concerning the interpretation and application of the treaty including: “allegations that an actual or proposed measure of another Member State is, or would be, inconsistent with the objectives of the Community; allegations of injury, serious prejudice suffered or likely to be suffered, nullification or impairment of benefits expected from the establishment and operation of the CSME ...or allegations that the purpose or object of the Treaty is being frustrated or prejudiced.”¹²²

3.2.6 Mercado Común del Sur (MERCOSUR)

MERCOSUR does not go beyond recognising that subsidies may in some circumstances have a distortive effect on trade in services. In Article XVI (1) of the Montevideo Protocol, the Member States indicate that common guidelines on subsidies in general will be agreed upon.¹²³ Clearly, the intention is that the same disciplines that are applied to trade in goods will apply to trade in services. However, it seems that the common guidelines have not yet been agreed upon. Article XI (2) of the Protocol provides that the mechanism of Article XV:2 will apply.

3.2.7 Andean Community

Article 18 of the Andean Community General Framework contains a general obligation to apply subsidies to services in a competitively neutral way and requires the adoption of further rules on the subject.¹²⁴ In 1999, the Andean Commission enacted special rules to prevent and correct distortive effects of subsidies. These apply to subsidies in general and do not distinguish between goods and services subsidies. The rules contain detailed provisions on the definition of a subsidy in general, or actionable and of specific subsidies, and on the calculation of a benefit element of a subsidy. The rules also specify the determination of a damage cause by a subsidy and possible remedies, including preliminary measures.

¹²² *Revised Treaty of Chaguaramas Establishing the Caribbean Community Including the CARICOM Single Market and Economy* [database online]; available from <http://www.caricomlaw.org/docs/revisedtreaty.pdf>; accessed July 21, 2007.

¹²³ Marcus Krajewski, “Services Liberalization in Regional Trade Agreements: Lessons for GATS ‘Unfinished Business’?” *Regional Trade Agreements and the WTO Legal System*. Ed. Lorand Bartels and Federico Ortino. (Oxford: Oxford University Press, 2006), 195.

¹²⁴ *Ibid.*, 195.

3.2.8 The Ill-fated Free Trade Area of the Americas (FTAA)

While the promise of the FTAA has remained unfulfilled, it is nevertheless useful to consider the approach the members of the RTA would have taken to disciplining subsidies. The draft text revealed that there was no more than a commitment to develop subsidies disciplines for services. It would appear that the negotiators held very divergent views on the issue. MERCOSUR had proposed that subsidies disciplines should consider export subsidies, the prohibition of injury or import displacing subsidies, the definition of non-actionable subsidies and enforcement through the dispute settlement mechanism of the FTAA.¹²⁵ It is worthy of note that this proposal is more developed than the envisaged disciplines in the Montevideo Protocol.

Article 18 of the draft agreement reveals that the factors to be considered in developing subsidies disciplines included aspects of MFN and national treatment, specificity by type of delivery, territorial application, transparency, the concept of “necessity”, the importance of the “least trade restrictive” concept, neutralising measures, exceptions, terms for eliminating subsidies, and flexibility for certain Parties.¹²⁶ The negotiators contemplated the elaboration of general disciplines as well as potential development of specific disciplines by sector. The disciplines on subsidies in services were to reflect: the prohibition on export subsidies, for example an illustrative list of measures; the prohibition on causing harm to, or shifts in third markets, with compliance subject to a case by case resolution by the FTAA’s Dispute Settlement System, and; subsidies that are permitted or non-actionable.

3.3 Typology of Approaches to Disciplining Subsidies

Generally, in assessing the international agreements four main approaches to dealing with subsidies for services can be discerned. Firstly, there is the GATS approach which provides limited disciplines. Secondly, there is the approach adopted by the EC to apply the same disciplines to goods and services. It seems that MERCOSUR may follow this approach when developing disciplines. Thirdly, there is the ANZCERTA approach which tackles export subsidies. Fourth and finally, the NAFTA approach which explicitly excludes subsidies from the scope of the agreement. The NAFTA approach has been followed by an overwhelming number of RTAs these include, Canada-Chile, Mexico-Colombia-Brazil and Mexico-Central America.

¹²⁵ *Free Trade Area of the Americas Draft Agreement*, FTAA.TNC/w/133/Rev.3, November 21, 2003 [database online]; available from http://www.ftaa-alca.org/FTAADraft03/ChapterXVI_e.asp; accessed July 18, 2007.

¹²⁶ Ibid.

Conclusion

In sum, while a number of GATS provisions have the potential to discipline the provision of measures of support, the effect of these disciplines has been to a significant extent limited by the inbuilt flexibility of the GATS. In addition, existing GATS disciplines are for the most part ineffective in remedying the effects of trade distortive subsidies in third country markets.

Generally, the relatively weak capacity of the WTO system to discipline subsidies in services has not been complemented by the development of regional rules. With the exception of the EC regime no other comprehensive regional framework for dealing with unfair subsidisation exists. Indeed, very little progress has been made at the regional level in developing subsidies disciplines. The approach to dealing with subsidies has been general and only ANZCERTA targets export subsidies. None of the agreements contemplates countervailing action against unfairly subsidised services, rather “a dispute settlement-related approach seems to be preferred, combined with substantive disciplines on the use of subsidies.”¹²⁷ There is very much a wait and see approach to developments at the multilateral level.

The lack of development of regional disciplines may be an advantage for the multilateral system since it could possibly minimise the potential for conflict between the regional rules and any future international rules. In addition, while regional agreements would be able to discipline the effects of unfair subsidisation among regional partners, they would be powerless to deal with the effects on subsidies applied by states outside of the RTA on the parties to the RTA.

Nevertheless, there may be some room for the development of regional disciplines where it is clear that the effect of the subsidies is to distort trade within the RTA. For example, disciplines on some types of investment-diverting subsidies where the effects of the subsidies are limited to the RTA. However, a realistic determination of which approach is better or what is the appropriate balance of regional and multilateral rules for subsidy use cannot be made unless a comprehensive identification of existing subsidies and their effects at the regional and international level is undertaken.

¹²⁷ WPGR, “Provision on Subsidies Related to Trade in Services in Regional Trade Agreements,” 3.

CHAPTER FOUR

Is there a Way Forward?

4.1 Alternative Multilateral Approaches

Sector-Specific Disciplines

As early as 1993, UNCTAD raised the prospect of using a sector-specific approach to deal with subsidies in services given the heterogeneous nature of service sectors and the differences in the way in which trade in services takes place.¹²⁸ It is assumed that it would be extremely difficult to adopt a common approach to identify the trade impact of subsidies.

UNCTAD had proposed that the sectoral focus should be on areas where subsidies have a major impact on trade in sectors of export interest to developing countries, such as in construction and engineering services.¹²⁹ The proposal includes an examination of issues related to the different modes of delivery, especially as they relate to possible benefits received by corporations to allow them to compete more effectively in trade in services.

The sectoral approach potentially offers a number of benefits. Firstly, it may allow progress in addressing trade distortive subsidies in precisely those specific sectors in which subsidies have a major impact on areas which are of export interest to developing countries. Such an approach would curb the use of subsidies to undermine negotiated market access. Secondly, sectoral rules would allow the fashioning of disciplines which can more comfortably accommodate the peculiar nature of some services industries and the way in which trade in such services is effected. Thirdly, the elaboration of sectoral subsidies disciplines offers the opportunity to avoid or remedy the effects of trade distortive subsidies in third country markets which are almost undisciplined by the current rules.

However, there are some difficulties with the proposed sector-specific subsidies disciplines. These include the fact that conceptual details would need to be ironed out for each sector. For example, a definition which provides objective and predictable criteria for determining what a

¹²⁸ UNCTAD, *The Impact of Subsidies on Trade in Services*, (Geneva: UNCTAD, 1993), UNCTAD/SDD/SER/3, 13.

¹²⁹ Chakravarthi Raghavan, "Services Subsidies Need Sector-Specific Approaches," [database online]; available from <http://www.sunsonline.org/trade/areas/services/07140094.htm>; accessed August 23, 2006.

subsidy is would still need to be formulated and the application of the notion of specificity would have to be considered. This approach could present trade ministries and officials with responsibility for the specific sectors with difficulties in creating and administering sectoral disciplines. In addition, the officials from services sectors will find it difficult to develop policies to encourage the growth of these sectors with the imposition of limiting conditions on how one of their most readily available policy tools is utilised. Another possible problem could be the unevenness of disciplines between sectors whereby some subsidy practices may be subject to more stringent disciplines in some sectors than others due to the operation of political economy factors in negotiations.

Beyond these issues questions remain as to how the current horizontal disciplines would interact with sectoral disciplines. Would there be tighter disciplines for the sectors which would have sectoral disciplines? And if so, what would be the policy rationale for more stringent disciplines for services? There is also the question of whether the disciplines for the targeted sectors would be conditional or unconditional. Given that the GATS is an inherently flexible agreement, then a case could be made for the sector-specific disciplines to be similarly flexible. Added to this is the imperative to take the needs of developing countries into account in the development of disciplines. Thus, to what extent should developing countries be subject to the disciplines?

Partial Disciplines Approach

Ahuja has suggested that the creation of partial disciplines may be able to address the most trade distortive subsidies. The development of limited disciplines appears to be a more elaborate version of the sector-specific approach which was discussed earlier. The aim would not be to discipline all trade distortive subsidies, only the most distortionary ones.¹³⁰ In the absence of a comprehensive framework to deal with trade distortive disciplines, the development of partial subsidies disciplines is seen as a modest beginning.

In concrete terms, the partial disciplines approach would address “certain forms of subsidies to certain sectors and under certain modes only, depending on who the beneficiaries are, and what are the effects on trade.”¹³¹ Ahuja identifies a list of areas which may be ripe for the application of this approach. Firstly, all firm specific subsidies in basic infrastructure sectors especially in

¹³⁰ Ahuja, *Towards Developing Subsidies Disciplines Under the GATS*, 35- 37.

¹³¹ *Ibid.*, 36.

financial and telecommunications sectors could be targeted initially. Secondly, some disciplines could be imposed on subsidy practices in sectors in which higher commitments have been made such as tourism. Thirdly, subsidy measures would be specifically targeted at firms engaged in earning foreign exchange through services export. Fourthly, consumption support that is tied to a service supplier could be disciplined. Fifthly, certain kinds of subsidies that take the form of export guarantees and export credit/loans extended to any service sector would most certainly be trade distortionary and should be restricted; likewise benefits accorded to outbound foreign direct investment could be disciplined.

Ahuja notes that although the transport sector receives a significant level of support from government, its trade distortionary potential remains to be established and so Members may wish to be cautious in attempting to create disciplines for these subsidies. In addition, social sectors such as health and education that have attracted minimal commitments and in which there is a strong public policy rationale can be ignored initially.

In assessing the proposal for limited disciplines, this approach offers many of the same advantages as the sector-specific framework. Namely, the application of limited disciplines tackles the most trade-distortive subsidies and provides a legal instrument to deal with the effects of such subsidies on third country markets. Similarly, there is a concern with respect to whether the disciplines would be applied in sectors in which commitments have been made.

In terms of the targeting of firm specific subsidies in basic infrastructure, there should be some flexibility for developing countries since such services are usually producer services on which production of other goods and services depends. In addition, given that the provision of basic infrastructure is in most cases subject to market failure and government intervention is intended to achieve social goals this may create difficulties for some developing countries. Likewise, the targeting of subsidies toward firms which earn foreign exchange through the export of services would impact negatively on developing countries. The targeting of discriminatory consumption subsidies would introduce a new element into the GATS as it would attempt to determine the conditions which can be attached to subsidies granted to consumers.

Plurilateral Approach

Given that attempts to elaborate a comprehensive multilateral framework for the use of subsidies have been unsuccessful, Adlung has raised the idea of using a plurilateral approach to disciplining service subsidies since “the range of potential ‘perpetrators’ is limited to some 30 or 40 developed and economically advanced developing countries”.¹³² The key question is whether it would “be possible to motivate a critical mass of governments that have a joint- fiscal and economic policy- interest in protecting themselves from subsidy-related temptations?”

The creation of plurilateral disciplines also offers a first step towards disciplining subsidies in services. Nevertheless, the likelihood that a sufficiently strong set of incentives exists which would drive Members to create such a framework seems to be low. Moreover, the plurilateral disciplines proposal seems familiar to the unsuccessful approach under the GATT for the disciplining of subsidies in goods.

Competition Policy Approach

The EC approach revolves around the notion of distortion of competition within the internal market. Several arguments can be made against the application of an EC-type regime for dealing with the distortive effects of subsidies on trade in services. Firstly, an EC-modelled regime would severely curtail the flexibility Member States that currently enjoy and would therefore be politically unacceptable.

Secondly, there is no corresponding entity within the WTO framework to the European Commission, which could meaningfully determine whether the subsidy qualifies to be one of the exceptions. Of course, it is not necessary to have such an entity, and Members could establish criteria to determine the conditions under which particular subsidies could be considered exempt. However, the basic point is that such a framework would create more stringent multilateral disciplines for subsidies in services than those that apply to goods and agriculture and there is no reason to justify the application of tighter disciplines. In addition, it would create more stringent rules for subsidies than any other area of rules for trade in services such as domestic regulation, emergency safeguards or government procurement. Moreover, if one adopts Adlung’s line of reasoning that the absence of subsidies disciplines could be partial compensation for the lack of

¹³² Adlung, “Negotiations on Safeguards and Subsidies in Services: A Never-Ending Story?” 263.

an emergency safeguard, then the application of the EC model to the creation of multilateral subsidies rules would affect the willingness of countries to engage in further liberalisation as it would severely limit recourse to these measures to protect key industries when the need arises.

4.2 The Cost of Failure

As the analysis in **Chapter 3** revealed, neither the existing disciplines in the GATS nor the provisions in RTAs are able to remedy the trade distortive effects that subsidies may have in the markets of third countries. The lack of disciplines leaves Members with few avenues to address the problems caused by such subsidies and; consequently, even fewer remedies. In addition, the lack of an agreed framework to address the use of distortive subsidies opens the door to judicial activism since WTO Panels and the Appellate Body could use existing rules in such a way as to determine issues on which Members have not yet fully agreed.

Developing countries in particular remain at a disadvantage in the services liberalisation process as they face the uncertain situation of whether other Members will undermine market access concessions by distortive subsidisation practices. This goes to the heart of the notion of legitimacy of expectations in the multilateral system where concessions granted in exchange for meaningful market access are devalued. This may to some extent account for the chilling effect on services liberalisation. The plight of developing countries is further exacerbated by their limited capacity to subsidise or the inefficient allocation of resources as they attempt to subsidise to maintain or acquire market share.

Given that subsidies may be applied to protect markets in the absence of an emergency safeguard mechanism, the unchecked use of subsidies leaves a loophole in the multilateral system which may be subject to abuse. On the positive side, the lack of strong rules on the use of subsidies may provide some comfort to Members who have not made commitments in specific sectors to protect their interests through subsidisation practices.

4.3 The Development Dimension

Article XV makes it clear that the needs of developing countries should be taken into account in the development of disciplines on subsidies. Subsidies to services are critical to developing countries for a number of reasons. Given that some service industries represent critical inputs into the production of other goods and services, subsidies for services play an important role in

developing supply-side capacity in developing countries as they can serve to increase productivity and national competitiveness. In the absence of such subsidies, the market would either not produce such services or produce them in an insufficient quantity.

In UNCTAD's view the need for subsidies for services is more crucial for developing countries as few, if any, alternative policy tools are available to policy makers due to, *inter alia*, relative institutional underdevelopment.¹³³ In the case of social services, subsidising sectors such as health, education, energy and other vital services is far more important for the fulfilment of basic human needs in developing countries.

UNCTAD also contends that service industries possess a significant amount of untapped development potential in most developing countries. As such, the provision of subsidies is a necessary condition to fostering new and nascent service industries as developing countries try to diversify away from traditional exports and widen their productive base in order to reduce their vulnerability to external economic shocks.

In this context, the recognition of Article XV of the need to provide flexibility for developing countries is of vital importance. The ways in which this can be achieved, however, require careful consideration. UNCTAD has made a call for multilateral disciplines to maintain a high degree of freedom for developing countries to implement subsidy programmes, while progressively restricting the capacity of developed countries to do so. This call reflects the negotiating position of a number of Latin American countries during the Uruguay Round. These countries had proposed that "developed countries as of the date of entry into force, not grant new subsidies or increase existing subsidies and suggested that they commit to dismantling all existing subsidies within a given time period."¹³⁴ In this historical context, the political viability of UNCTAD's proposal is rather questionable. In addition, the diversity of developing countries means that some countries within this category have far more resources to subsidise than others. This could result in continued distortions in trade in services and undermining of market access opportunities for the more resource scarce developing Members due to subsidisation practices by other developing countries.

¹³³ UNCTAD, *Subsidies to Services Sectors: A Neo-Protectionist Distortion or a Useful Development Tool?* 39.

¹³⁴ Terrence Stewart, *The GATT Uruguay Round: A Negotiating History (1986- 1992)*, Vol. II (Deventer: Kluwer Law and Taxation Publishers, 1993), 2386.

4.4 Conclusions

The foregoing study suggests a number of important findings. Firstly, while a number of useful concepts can be drawn from other existing WTO rules on subsidies, some of these concepts are more appropriate than others for creating a comprehensive framework for subsidies disciplines in services. The study elaborated a number of theoretical and practical challenges in adapting the concepts found in other WTO agreements. Careful analysis is required to determine which concepts can be easily transposed and which ones need to be tailored to meet the peculiar requirement of trade in services.

Secondly, the present GATS disciplines are far more capable of dealing with import-displacing subsidies than export-enhancing subsidies. Existing GATS disciplines are insufficient to deal with all of the effects of trade distortive subsidies, particularly in third country markets. However, in the absence of conclusive evidence that there is pervasive use of subsidisation practices which negatively affect market access in the subsidising country and other Members, it cannot be confirmed whether there is a need for a much more comprehensive framework to avoid or remedy such effects. In this regard, a crucial element in making a definitive determination is the fulfilment of the information exchange mandate. However, the reasons for the lack of progress on this front are highly complex and to some extent understandable since Members fear the future use of such information against them.

Thirdly, with the exception of the EC rules on subsidies, the provisions related to services subsidies in RTAs are even less developed than those in the multilateral framework and offer little guidance as to how more extensive multilateral rules should be framed. The study seems to confirm that the multilateral approach is the way to deal with subsidisation practices with negative trade impacts as bilateral trade agreements and RTAs are unable to deal with distortions in third country markets.

Fourthly, the lack of progress at both levels is a telling sign that there is insufficient political will to deal with the effects of trade distortive subsidies. Perhaps Sauvé is correct in his cynical observation that this potential for trade distortion seems only to be a matter of concern for economists. The reasons for the lack of progress may be found in the fact that the effects of subsidies in services are not overly deleterious, the current state of play allows Members to

maintain a policy tool to protect their interests and that the issue is politically sensitive- a case of dwellers in glass houses not throwing stones.

Approaches discussed in **Chapter 4** offer alternative routes for fulfilling the mandate of GATS Article XV. These approaches are not without their pitfalls, but do offer some useful insights as to what types of subsidies and effects should be priority targets for multilateral attention. Partial and sector-specific approaches to disciplining subsidies offer a promising start to tackling this issue. The formulation of such disciplines may provide the multilateral system with much needed feedback on the necessity of developing further the legal framework. Nevertheless, once these sector-specific or partial disciplines are created, unless there is some convincing political economy reason for continuing the process, similar to the need to harness the US' liberal use of countervailing duties in the area of goods, there is the possibility that political inertia may prevent any further elaboration of rules.

In the final analysis, rapid progress on the creation of rules governing the use of trade-distortive subsidies is not to be expected. There are simply too many other multilateral trade issues which take precedence over the subsidies rules for services question. Notwithstanding this fact, beyond the mandate of Article XV, some Members possess the strong conviction that such disciplines are necessary and this should keep the issue alive on the multilateral agenda. The timeframe in which this task is to be completed remains an open question.

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