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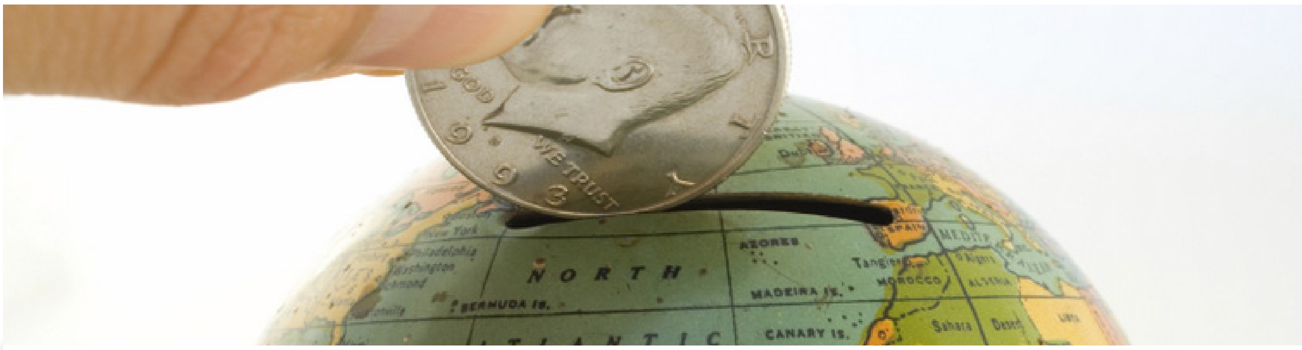

Learning by Not Doing: Subsidy Disciplines in Services Trade

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April 2015

E15 Task Force on
Rethinking International Subsidies Disciplines

Think Piece

ACKNOWLEDGMENTS

Published by

International Centre for Trade and Sustainable Development (ICTSD)
7 Chemin de Balexert, 1219 Geneva, Switzerland
Tel: +41 22 917 8492 – E-mail: ictsd@ictsd.ch – Website: www.ictsd.org
Publisher and Chief Executive: Ricardo Meléndez-Ortiz

World Economic Forum
91-93 route de la Capite, 1223 Cologny/Geneva, Switzerland
Tel: +41 22 869 1212 – E-mail: contact@weforum.org – Website: www.weforum.org
Co-Publisher and Managing Director: Richard Samans

Acknowledgments

This paper has been produced under the E15Initiative (E15). Implemented jointly by the International Centre for Trade and Sustainable Development (ICTSD) and the World Economic Forum, the E15 convenes world-class experts and institutions to generate strategic analysis and recommendations for government, business and civil society geared towards strengthening the global trade system.

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Citation: Sauvé, Pierre and Marta Soprana. *Learning by Not Doing: Subsidy Disciplines in Services Trade.* E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum, 2015. www.e15initiative.org/

ISSN 2313-3805

ABSTRACT

This paper explores the hitherto futile quest for developing disciplines on the trade- and investment-distorting effects of services subsidies. It sheds light on the multiplicity of factors that have weighed on the conduct of negotiations on subsidy disciplines in a services trade context at both the global and preferential levels and advances a few thoughts on what the future may hold for the adoption of such disciplines. The analysis suggests that it is rather unlikely that WTO Members will any time soon reach a consensus on the matter of subsidy disciplines for services beyond those that currently (and timidly) obtain in the GATS and in many preferential trade agreements. The main reason behind such a conclusion stems from a marked rise in the value of preserving policy space in a trading environment characterized by considerably greater global market contestability than two decades ago.

CONTENTS

LIST OF BOXES

LIST OF ABBREVIATIONS

ASCM	Agreement on Subsidies and Countervailing Measures
CSI	Coalition of Service Industries
EU	European Union
FDI	foreign direct investment
FTA	free trade agreement
GATT	General Agreement on Tariffs and Trade
GATS	General Agreement on Trade in Services
GVC	global value chain
IISD	International Institute for Sustainable Development
IP	intellectual property
KORUS	Korea-US free trade agreement
MFN	most-favoured nation
NT	national treatment
OECD	Organisation for Economic Co-operation and Development
PTAs	preferential trade agreements
SMEs	small and medium-sized enterprises
SOEs	state-owned enterprises
SPS	Sanitary and Phytosanitary
R&D	research and development
TBT	Technical Barriers to Trade
TFEU	Treaty on the Functioning of the European Union
TISA	Trade in Services Agreement
TPP	Trans-Pacific Partnership
TPR	Trade Policy Reviews
TTIP	Transatlantic Trade and Investment Partnership
US	United States
WPDR	Working Party on Domestic Regulation
WPGR	Working Party on GATS Rules
WTO	World Trade Organization

INTRODUCTION

Twenty years have passed since the conclusion of the Uruguay Round and the creation of the World Trade Organization (WTO). One of the Round's landmark achievements was without doubt the creation of the General Agreement on Trade in Services (GATS), setting in motion a process of progressive market opening in a sector of sustained trade and investment vibrancy and one that dominates output and employment in the economies of the vast majority of WTO Members. Yet even landmark achievements can feature a few loose ends. As it happens, the creation of the GATS, a process that started literally from a blank multilateral page, featured quite a few loose ends, not least in disciplines targeting the potentially trade- and investment-distorting effects of subsidy practices.

The issue of subsidy disciplines, for which GATS Article XV has served as a place holder, alongside discussions on emergency safeguards (Article X), government procurement (Article XIII), and the development of a necessity test for non-discriminatory domestic regulatory measures (Article VI:4) took a backseat in the negotiations and was left to be addressed in the years following the conclusion of the Uruguay Round. Although Art. XV does not feature any specific deadline to conclude negotiations on the development of multilateral disciplines on services subsidies, there is scant progress to report on this issue since the end of the Uruguay Round. In fact, none of the Uruguay Round's "leftover agenda" described above has yet to generate a multilateral consensus, such that 14 years into the Doha Development Agenda, trade negotiators are still prosecuting the Uruguay Round in the area of services trade. Such rule-making stasis offers a first, insightful, signal regarding both the inherent technical complexity of the GATS's unfinished rule-making agenda and the starkness of differences in collective preferences towards these issues among the WTO's increasingly diverse membership.

This paper explores the quest for developing disciplines on services subsidies. It sheds light on the multiplicity of factors that have weighed on the conduct of negotiations on subsidy disciplines in a services trade context (at both the global and preferential levels) and advances a few thoughts on what the future may hold for the adoption of such disciplines.

The analysis suggests that it is rather unlikely that WTO Members will any time soon reach a consensus on the matter of subsidy disciplines for services beyond those that currently (and timidly) obtain in the GATS and in many preferential trade agreements (PTAs). The main reason behind such a conclusion stems from a marked rise in the value of preserving policy space in a trading environment characterized by considerably greater global market contestability than two decades ago.

The paper first explores state practices in services subsidies, including preferred sectors of application and the various forms subsidies take across the service sector's heterogeneous landscape. It then recalls how the existing GATS framework already (if somewhat obliquely) addresses the issue of services subsidies, chiefly through the most-favoured nation (MFN) and national treatment (NT) provisions. The paper goes on to explore the current state of negotiations under the mandate of GATS Art. XV, offering a deeper analysis of the factors that have conspired to torpedo the fulfilment of the agreed negotiating mandate. It further examines whether the rising influence of state-owned enterprises (SOEs) in services markets may alter the ongoing conversation on subsidy disciplines in the sector before advancing a number of forward-looking thoughts by way of conclusion.

A BRIEF REVIEW OF STATE PRACTICES

Limited empirical or even qualitative information on subsidy practices in services is available in the economic literature or in WTO-related documents. From a sectoral point of view, and based on the admittedly imperfect insights that GATS schedules[1] or the lists of non-conforming measures appended to PTAs proceeding on a negative list basis provide, subsidies seem to be most prevalent in audio-visual (mainly by developed countries), transport (all modes), tourism (mainly by developing countries), and financial services.[2] An overview of GATS schedules reveals that almost half of those containing MFN exemptions have listed measures granting the benefit of support programmes or adopted for the implementation of benefits in conformity with support programmes to audio-visual works and suppliers of such works.[3]

GATS schedules of commitments further reveal that national treatment limitations conditioned on the size of targeted beneficiaries mostly concern subsidies under Mode

1 This is notably so under the GATS as Members can opt to keep entire sectors out of their schedule of commitments in areas where the political demand for preserving policy space is typically strongest. In such instances, the GATS yields no analytical insights whatsoever on the nature of restrictive or discriminatory practices maintained, including on sector-specific subsidy practices.

2 Poretti (2009: 253).

3 In a few GATS schedules (for example, Czech Republic, Iceland, and Slovenia), it is clearly indicated that such support programs must meet specific origin criteria.

3 (commercial presence).[4] A few WTO Members, notably Mexico and Ukraine, have inscribed limitations in their schedules that restrict the granting of subsidies to small- and medium-sized domestic enterprises.[5]

A closer look at GATS schedules of commitments further shows that subsidy-related limitations are mostly inscribed in the horizontal section of schedules, thus applying across all committed sectors, rather than being sector-specific. Out of almost 120 WTO Member schedules featuring horizontal commitments, more than one-third include limitations on subsidies, either by retaining full freedom to introduce or maintain subsidies inconsistent with market access or NT commitments, or by limiting their use to a specific nationality or group of companies (that is, small firms).

Most of the GATS schedules mentioned from which the above information is drawn make a specific reference to the term “subsidy/ies,” although a few WTO Members use a more general wording, such as “some kind of incentives/assistance” (for example, Kuwait and Qatar). It should be noted that, for the purposes of developing disciplines on services subsidies, other GATS schedules, whose entries in the horizontal section refer to tax exemptions or other fiscal incentives, could be relevant as these measures might also imply the granting of a financial advantage.[6]

Work by researchers at the International Institute for Sustainable Development (IISD) has helped to identify and define several types of subsidy practices affecting cross-border activity. These range from financial contributions to in-kind support. The IISD identifies nine different types of subsidies.

(i) Grants and other direct payments, which involve mainly time-limited payments or payments enabling a company or an individual to cover general costs or the costs of undertaking a specific economic activity.

(ii) Market price support, which can be defined as transfers of money to producers that are provided through the market as a result of policies that raise prices artificially.

(iii) Tax concessions, which consist of all subsidies provided by reducing companies’ tax burdens, such as tax exemptions, tax burdens, tax credits, and tax deferrals.

(iv) In-kind subsidies, which refer to a range of benefits that are provided in a form other than money.

(v) Cross-subsidies, which consist of market transfers brought by discriminatory pricing practices within the scope of activity of the same enterprise or agency.

(vi) Credit subsidies, which refer to loans made by a government to a company at a lower rate of interest than a commercial bank would offer, or when the government requires less collateral to back its loan, defers repayment terms or allows for a longer period to pay off the loan, as well as government guarantees, which occur when a government guarantees loans taken by companies or individuals through commercial banks.

(vii) Hybrid subsidies, which refer primarily to instruments that exploit the tax system to lower the costs of private investment.

(viii) Derivative subsidies, which include sympathetic support, compensatory or countervailing support, and subsidy clusters.

(ix) Subsidies through government procurement, which refer to benefits conferred by governments when purchasing goods and/or services.[7]

The WTO’s Trade Policy Reviews (TPR) also provide useful indications on the most prevalent forms of governmental support schemes. A quick overview of the 220 TPR reports completed to date shows that most governments prefer tax incentives (that is, income foregone) to direct grants (that is, expenditures).

Subsidy programs serve various policy aims. Export-enhancing subsidies aim, as their name implies, at increasing the value of a country’s services exports. However, by recurring to this type of subsidy, a distortion in the market may occur insofar as like services and service suppliers from third countries can be displaced. Import-displacing subsidies, on the other hand, aim at reducing the level of imported services. Such practices can result in a distortion of the market that will favour subsidised domestic suppliers over their ineligible foreign competitors.

A further type of subsidy commonly encountered in services trade—so-called investment-diverting subsidies—serve the purpose of attracting (and retaining) investments to the subsidizing country. Following Dunning’s (1994, 2002) pioneering work, foreign direct investment (FDI) can be distinguished into four distinct categories according to the investing firm’s chief motivations—(i) natural resource-seeking; (ii) market-seeking; (iii) efficiency-seeking; and (iv) strategic asset-seeking (or innovation-seeking) FDI (which can be seen as a subset of efficiency-seeking investment in

4 Adlung and Soprana (2013: 45).

5 Mexico reserves the right to grant research and development (R&D) subsidies and incentives exclusively to small service enterprises owned by Mexican nationals, whereas Ukraine’s schedule stipulates that the eligibility for subsidies and other forms of state support, including access to the financial and other material resources of the state, may be limited to small business enterprises.

6 WTO Document S/WPGR/W/13/Add.1, p. 1.

7 Steenblik (2007: 18–26).

industries with innovation-rich characteristics).[8] Although the bulk of FDI (both stocks and flows) in services was long primarily market-seeking in character, given the need for greater product tailoring in many service markets, the new geography of global value chain (GVC)-driven trade and FDI emerging from the fragmentation of production of both goods and services has seen host countries direct increasing attention to measures designed to attract and retain efficiency-seeking FDI in service markets. Here, competitiveness considerations involve a host of factors such as the quality of transport and communication infrastructure and of regulatory institutions, the ease of doing business, the ready availability of skills, the adequacy of intellectual property (IP) protection, and so on.[9]

Host country governments resort to various policy instruments with a view to attracting and retaining FDI, from tax incentives to direct subsidies, notably of an infrastructural character or targeted at worker training. Once more, distortions in the allocation of investment may occur as capital can be diverted from countries that could potentially obtain such investments in the absence of government support measures. Beggar-thy-neighbour conduct, including locational competition between the sub-national entities of individual WTO Members, is arguably more pronounced in the realm of investment than in trade. This has resulted in a clear, and recurring, revealed preference for regulatory inaction across the full spectrum of international investment instruments concluded in recent decades, including those embedded in PTAs (Box 1).[10]

Early discussions held within the GATS Working Party on GATS Rules (WPGR) under the Art. XV post-Uruguay Round negotiating mandate provided insights on the types of subsidies WTO Members considered as most affecting trade in services. Based on the objectives of government support programs, WTO Members identified four different types of services subsidies,

(i) production;
(ii) investment;
(iii) export; and
(iv) consumption subsidies.[14]

Production subsidies, which, as their name suggests, aim at stimulating the production of services, were seen as most likely to impact competitive conditions under Mode 1 (cross-border supply) even if granted under Modes 3 (commercial presence) and 4 (temporary movement of service suppliers), because cross-border suppliers would be competing against subsidized like domestic suppliers.[15] In the case of investment subsidies, whose chief purpose is to attract FDI in the subsidy-granting country, government intervention was deemed to impact only one mode of supply, that is, commercial presence (Mode 3), though one could easily see a link to the scope for increased imports of various categories of Mode 4 key personnel that a subsidized investment could generate.[16] As for export subsidies made contingent on export performance, such measures could affect like foreign suppliers operating under Mode 3 if these were not eligible for the subsidy.[17] Finally, consumption subsidies might be found in violation of the NT obligation of GATS (Article XVII), for committed sectors, when they are granted contingent on purchases from national sources.[18]

8 OECD (2005: 9).

9 CUTS (2002: 24).

10 CUTS (2002: 25).

11 James (2009: 1).

12 Sauvé (2008: 29).

13 Sauvé (2002 : 330).

14 WTO document S/WPGR/W/9, paras 31–34.

15 WTO document S/WPGR/W/9, para 31.

16 WTO document S/WPGR/W/9, para 32.

17 WTO document S/WPGR/W/9, para 33.

18 WTO document S/WPGR/W/9, para 34.

BOX 1:

Box 1: Investment Incentives

Investment incentives are “measurable economic advantages that governments provide to specific enterprises (or groups of enterprises) with the goal of steering investment into favored sectors or regions or of influencing the character of such investments.”[11] Thus, investment incentives, which can be of a fiscal or non-fiscal nature, can be considered as investment-related subsidies aimed at attracting (and retaining) foreign investments.[12] In services trade parlance, such practices target the commercial presence form of delivering services to host country markets. Like other forms of subsidies, investment incentives, which are often closely related to the imposition of performance requirements, can exert trade- and investment-distorting effects.[13] However, unlike most forms of support programs typically under review in discussions of subsidy disciplines, investment incentives specifically tend to involve positive discrimination towards like foreign service suppliers, affording foreign investors better than national treatment in many circumstances.

Subsidies can also be distinguished according to how they are granted. In an early submission to the WPGR, the government of Chile argued that subsidies could take either of two forms—(i) direct or indirect financial contributions by a government or public body, along definitional lines found in the General Agreement on Tariffs and Trade's (GATT) Agreement on Subsidies and Countervailing Measures (ASCM); or (ii) incentives to commercial presence, that is incentives used to attract FDI.[19] Chile also pointed out that monopoly rights and restrictive trade practices could also provide beneficiaries with artificial advantages tantamount to those deriving from subsidies.[20] Such observations appear particularly relevant in a services context, where domestic regulation, both discriminatory and non-discriminatory, plays such a dominant role in determining effective access to markets.

It is once more highly revealing that WTO Members have generally eschewed definitional boundaries that might confer subsidy-like properties to domestic regulatory measures—for example, prudential measures in financial markets. Such aversion to an expanded definition of the term "subsidy" in a services context must be understood against the background of the considerably greater influence that "vertical" (that is, sector-specific) communities of powerful regulatory agencies have traditionally exercised over the development, interpretation, or expansion of the GATS (an observation that obtains equally in a PTA setting; Box 2).

19 WTO document S/WPGR/W/10, p. 1.

20 WTO document S/WPGR/W/10, p. 1.

21 Govani (2015).

22 Official Journal of the European Union, C 270, 25 Oct 2008, p. 4.

23 Official Journal of the European Union, C 270, 25 Oct 2008, p. 9.

24 Van der Wee (2011); Official Journal of the European Union, C 270, 25 Oct 2008, p. 10.

25 OECD (2010: 2).

26 OECD (2010: 2).

BOX 2:

Financial Market Bailouts and Competition Policy: EU and US Approaches

The global financial crisis impacted the banking systems of the United States (US) and most European Union (EU) Members very strongly, forcing governments to bail out several financial institutions in the banking, securities, and insurance business, including a number of large institutions deemed of systemic importance to global financial markets, in an attempt to avoid a financial meltdown through contagion effects in highly interconnected financial markets and to restore financial stability. The EU, faced with the need to widen the scope of its state aid policy, presented a communication in 2008 on the application of state aid rules to measures taken in relation to financial institutions in the context of the financial crisis (the Banking Communication). This document established a framework for state aid approval by the Commission and a series of ad hoc competition policy measures in the banking system.[21] The Banking Communication was founded on Art. 107 of the Treaty on the Functioning of the European Union (TFEU), which recognizes that state aid can be used to remedy a serious disturbance in the economy of a Member State.

The global financial crisis was deemed to fall within the scope of Art. 107 TFEU, thereby qualifying the context as justifying the implementation of ad hoc measures deemed necessary to restore financial stability. In response to possible competition concerns, the Banking Communication pointed out the proportionate and temporary nature of state interventions and the need for states to unwind their actions as soon as market circumstances permitted for a competitive and efficient European banking sector to emerge from the crisis.[22] The Communication further clarified that safeguards were necessary against possible abuses and distortions of competition resulting from recapitalization schemes.[23] Thus, according to the EU, the financial crisis of 2008 showed that it would be unwise to introduce a total prohibition of state aid in the financial sector.[24]

Contrary to the EU, the US does not have a body of law that specifically regulates financial aid provided by governments to firms, as the remit of competition law focuses exclusively on the prosecution of private anti-competitive conduct.[25] However, in exceptional circumstances, such as the financial crisis of 2008, the US government did intervene in the market by providing significant financial assistance (that is, bailouts) to a few beleaguered financial institutions, a measure deemed necessary and in the interest of the general public to guarantee the stability and integrity of the country's (and the world's) financial system given the systemic importance of the private operators involved.[26] Such interventions, however, were subject to time and scope limitations to reduce the possible negative effects on competition arising from granting financial assistance to a certain group of US firms. Similar to its EU counterparts, the US government's approach to the financial crisis seems to indicate a shared Transatlantic reluctance to embrace a blanket prohibition of state support in financial services as certain market failures provide a justifiable rationale for government intervention.

An overview of TPR reports provides more useful insights on the different forms of governmental assistance in services markets, which WTO reports have conceptualized using the following analytical distinctions.

(i) Direct transfers of funds, including grants, loans and equity infusions;
(ii) potential direct transfers of funds or liabilities, for example, loan guarantees;
(iii) government revenue foregone;
(iv) supply of goods and services other than general infrastructure; purchase of goods;
(v) payments to funding mechanisms; and
(vi) income and price support.[27]

Transfer pricing (or tax optimization) mechanisms allow for goods and services given (or received) by different companies within the same group to be priced so as to obtain fiscal benefits from the different fiscal regimes of the countries where the companies have their domicile.[28] In other words, they allow companies to allocate profits and taxes across different parts of a company by taking advantage of the different fiscal regimes across the different countries where various parts of the company are domiciled.[29] Although not illegal per se,[30] as countries are entitled to offer companies tax breaks and specific tax arrangements to encourage economic activity,[31] transfer pricing practices have come under increasing (and increasingly critical) policy scrutiny as they are seen to distort competition by allowing certain firms to compete unfairly by exploiting loopholes ensuing from the absence of a unified fiscal policy across EU Members.[32] Thus, the EU Commission has started a number of investigations under its state aid rules to ensure that these mechanisms do not grant unfair advantages to certain firms operating in the EU nor act as market-distorting subsidies (Box 3).

27 WTO Document S/WPGR/W/25, p. 2.

28 La Repubblica (2015).

29 Irish Times (2014).

30 La Repubblica (2015).

31 Irish Times (2014).

32 Guardian (2014).

33 Van der Wee (2011: 11).

34 Van der Wee (2011: 2, 4).

BOX 3:

European Union State Aid Doctrine

Under EU law, subsidies may fall into two categories—(i) market-correcting subsidies, which aim at redressing or adjusting market failures such as information asymmetries, income inequality, and the like; and (ii) market-distorting subsidies, which affect competition by providing an unfair advantage to the recipients of the subsidy. From a services trade perspective, discussions to date on how to distinguish the above two categories have not been conclusive, as little information on state practices is generally available at the EU level. However, the regulatory framework implemented by the EU in its internal market can provide useful insights.

Because markets can be distorted not only by the anti-competitive conduct of companies, but also distortive state interventions, including state subsidies, state aid control is a key instrument in the EU's competition toolbox.[33] In pursuing its internal market aims, the EU has adopted a state aid control system that gives the European Commission power to vet the granting of government subsidies to companies.[34] Pursuant to such rules, which aim at preventing the distortion of competition that would ensue if a national government were to grant advantages or incentives to particular companies, the European Commission has recently exercised its right to explore certain advantageous fiscal practices to determine if they could be deemed prohibited subsidies under the EU's state aid doctrine.[35] Indeed, Article 107 of the TFEU prohibits state aid when government support to a specific EU undertaking gains an advantage in relation to its competitors in the EU internal market, distorting competition.[36] In other words, subsidies that distort competition are prohibited unless they target specific EU objectives (for example, environmental aid, regional development, research and development [R&D] promotion) and distortions of competition and trade remain at an acceptable level.[37]

According to EU state aid rules, any support that is conferred on a selective basis and leads to an advantage can qualify as state aid.[38] This definition bears some degree of resemblance to the definition of subsidies found in the WTO's ASCM as it refers to all forms of financial transfers from state bodies to public or private companies that give these companies an advantage over their competitors.[39] However, contrary to the ASCM, which, as a component of the GATT, applies solely to trade in goods, the EU state aid definition also applies to services. Much public debate has been heard on ongoing investigations carried out by the EU Commission on tax rulings applied to goods companies such as Starbucks, Fiat, and Apple and to services multinationals such as Amazon, Google, and Apple (for its music download business) in an attempt to verify whether they qualify as illegal state aids or not.

NOT EXACTLY STARTING FROM SCRATCH: EXISTING GATS DISCIPLINES APPLICABLE TO SUBSIDIES

Contrary to commonly held perceptions, subsidy measures affecting trade in services are not excluded from the realm of application of the GATS. Several GATS provisions guarantee a certain level of discipline to subsidies in services trade.[40] GATS Art. II (MFN treatment) applies to services subsidies insofar as they are measures by Members affecting trade in services, pursuant to Art. I (Scope and Definition). Moreover, in sectors, sub-sectors, and/or modes of supply in which a Member has scheduled a GATS commitment, Art. XVII (NT) disciplines also apply to subsidy practices. Subsidies must be granted on a national treatment basis unless limitations have been specifically inscribed in a Member's schedule of commitments.

As regulatory transparency can play a crucial role in understanding how pervasive government intervention can be in services trade, GATS Art. III (Transparency) can also be considered among the existing GATS disciplines addressing services subsidies. While at times couched in soft, hortatory terms, GATS Art. VIII on Monopolies and Exclusive Suppliers and GATS Art. IX on Business Practises bear some relevance in a subsidy context insofar as they draw attention to the role of government ownership and regulation in generating effects similar to trade-distorting subsidies.[41] GATS Art. VIII is also relevant given its stated objective of preventing cross-subsidization from occurring across activities or sectors.[42] Finally, subsidies in trade in services may also be disciplined under Art. XXIII:3 dealing with non-violation complaints, so far as subsidies not in explicit violation of GATS provisions might still be shown to nullify or impair benefits flowing from—or expected of—a Member's specific commitments.[43]

If disciplines on subsidies already exist within the realm of the GATS, the question is what policy rationale lay behind the decision of GATS negotiators to seek agreement on elaborate additional disciplines under the Art. XV negotiating mandate? Such a rationale can be traced to the need felt by negotiators to distinguish between subsidies that provide an unfair trade advantage and those that are granted in pursuit of legitimate public policy objectives, such as those aimed at correcting market failures, securing compliance with important regulatory objectives, and so on.[44]

NEGOTIATING SUBSIDY DISCIPLINES: LESSONS LEARNED

As noted, a handful of technically complex and politically contentious issues were left on the GATS negotiating table when the curtain fell on the Uruguay Round, with the promise these issues would be taken up once the WTO was up and running. The GATS leftover menu was a rich one, covering as it did (and still does) non-discriminatory domestic regulation (necessity), emergency safeguards, government procurement, and subsidies.

Art. XV of the GATS calls on WTO Members to negotiate with a view to developing necessary multilateral disciplines to avoid the trade-distortive effects that Members recognize subsidies may have on trade in services. In contrast to the mandate foreseen under GATS Art. X on emergency safeguard measures, for which a specific time-frame was initially foreseen (if never actually met), the negotiating mandate on subsidies under Art. XV GATS was from the outset open ended in character. This distinction suggests an early assumption on the part of GATS negotiators of the difficulty that rallying a multilateral consensus on the issue of services subsidies represented.

Twenty years after the WTO's launch, negotiations within the WPGR on the Art. XV mandate have little to show. For starters, Members have been unable to agree on the very substantive perimeter of their discussions, with no

35 Out-Law.com (2014).

36 Bird&Bird (2014).

37 Van der Wee (2011: 5).

38 Bird&Bird (2014).

39 Van der Wee (2011: 2).

40 Poretti (2008: 467).

41 Hoekman, Mattoo and English (2002: 331).

42 WTO document S/WPGR/W/9, para 40.

43 Poretti (2008: 471).

44 WTO document S/WPGR/W/10, p. 1.

universally accepted definition of the term "subsidy" in a services trade context emerging from the Working Party's deliberations. While use of the definition found in Art. 1 of the ASCM appears to carry the favour of most WTO Members, negotiations on services subsidies have been marred to this day by the absence of a commonly agreed definition of what a service subsidy is and the typology of measures to which the called-for disciplines would apply.

Further evidence of the collective revealed preference for regulatory inaction can be adduced by the desultory results of WPGR calls for the exchange of information on Members' subsidy practices in services, an essential first step in mapping the nature, modal and sectoral incidence of government support measures to which subsidy disciplines would apply. It would also distinguish the trade- and investment-distortive effects to which prospective disciplines could respond.

At the end of 2013, only five WTO Members had responded to the questionnaire designed by the WTO Secretariat for the information exchange foreseen under the Art. XV negotiating mandate—Norway, New Zealand, Hong Kong China, Poland, and Switzerland. Such a demonstrated lack of willingness to collate and share publicly available information anchored in state budgets attests to WTO Members' second thoughts after the Uruguay Round on the desirability of fulfilling the GATS Art. XV mandate.[45]

Beyond Art. XV, the GATS Art. VI:4 negotiating mandate, which calls for the adoption of a necessity test allowing to gauge the potentially unduly burdensome impact or disguised restriction to trade that non-discriminatory regulatory measures relating to qualification requirements and procedures, licensing requirements, and technical standards might represent, is also relevant to the discussion on subsidies. The regulatory intensity of services is well known. Indeed, as for Sanitary and Phytosanitary (SPS) and Technical Barriers to Trade (TBT) measures, domestic regulation forms the very currency of negotiations in services, with many behind-the-border measures at play in negotiations that do not fall within the scope of Art. XVI (Market Access) and XVII (National Treatment).[46] Such measures are at times closely linked to subsidies so far as cross-subsidization and tax/subsidy/incentive schemes rank among the various forms of domestic support measures enacted by governments to favour certain (typically local) suppliers (except in the case of investment incentives whose beneficiaries are foreign suppliers).[47] Also, just as for subsidies, domestic regulation is an essential means of pursuing a number of legitimate policy objectives whose implementation, in certain circumstances, might also generate trade- or investment-distortive or restrictive effects.

Agreeing on the elements of a necessity test, without which WTO Members will not be able to fulfil the mandate foreseen under GATS Art. VI:4, would allow a line to be drawn between legitimate regulatory intervention, even that carrying potentially trade-restrictive effects (what Alan Sykes once called "efficient protection"), and outright protectionism.[48] As with subsidy disciplines for services trade (including investment), whose existence is seen in many public policy circles as an undue constraint on policymaking, the absence of an agreed necessity test for services showcases a similar reluctance of (often powerful) national regulatory authorities to see their vertical turf challenged by what they often portray as poorly conceived, lowest common denominator, and horizontal (that is, sector-blind) trade policy constructs. Fears that a horizontal necessity test could curtail the policy flexibility national regulators currently enjoy and constrain their domestic regulatory prerogatives lie behind the Art. VI:4 stalemate.[49]

Ironically, the reluctance is most strongly felt in the US (and in several Organisation for Economic Co-operation and Development [OECD] countries), whose world leading service providers rank among the most likely victims of disproportionate or unduly burdensome regulatory conduct in foreign markets, but whose multiplicity of (often independent) domestic regulators also rank among the most turf protective of public officials.

FACTORS INFLUENCING NEGOTIATIONS UNDER ARTICLE XV

The lack of progress in negotiations on subsidy disciplines for services trade can be ascribed to several factors. These range from the intrinsic nature of services to a host of political economy considerations.

Differences in the nature, definitional boundaries (for example, the need in services for factor movement), and regulatory intensity between services and goods trade have played a significant role in imparting greater technical complexity to subsidy discussions in services relative to those prevailing at the time that the ASCM took shape. Contrary

45 Poretti (2009: 253).

46 WTO Document (2011), p. 1.

47 WTO Document (2011), p. 2.

48 Delimatsis (2008: 371).

49 Delimatsis (2008: 390).

to goods, which are essentially tangible (hence more easily traceable and measurable), storable, and traded (for trade law purposes) through one mode of supply, cross-border commerce, services are intangible (hence far more difficult to measure), non-storable, typically involve factor movement, and can be traded in three other modes beyond cross-border trade (that is, consumption abroad; commercial presence; and movement of service suppliers).

The above differences assume special relevance in the context of countervailing duty determinations since, as pointed out by Poretti (2008), the multi-modal nature of services singularly heightens the complexity of constructing a proper metric of injury and establishing a causal link between injury and subsidies at a sufficiently disaggregated "like" service or service-provider level beyond reasonable doubt (for emergency safeguard measures). The above difficulties further complicate attempts at determining the origin of traded services.[50]

As noted, defining subsidies in a services context is more troublesome than in a goods setting due to the significantly greater role (indeed all-encompassing in the absence of tariffs or other price-based instruments of border protection) played by domestic regulation in trade in services. Extending the definition of services subsidies into the regulatory domain, something WTO Members have shown little political appetite for, would raise complex boundary challenges of identification and measurement of subsidies emanating from domestic regulatory measures (for example, reserve requirements in banking; land ownership restrictions in tourism or construction and engineering services; or consumer protection restrictions in land transport).[51]

Three additional features of services trade can be seen as potential inhibiting factors to the successful negotiation of disciplines on services subsidies—(i) factor mobility; (ii) the preponderance of small and medium-sized service companies; and (iii) the significant role of SOEs in services.
The factor movement that is a distinguishing feature of services trade acts as a potentially significant hurdle to the development of disciplines on subsidies in service industries. As shown earlier, governments tend to favour the preservation of as much policy space as possible in their quest to attract and retain foreign investment (particularly in federal states), and to enhance the supply and employment prospects of local talent that is important to the growth prospects of firms in knowledge industries.

In a world where globalization and new technologies have contributed to the fragmentation of value chains, a process that was once the exclusive province of manufacturing but which today engulfs much of the service economy, there has been a worldwide intensification of locational competition over efficiency-seeking FDI that is so central to value chain dynamics. With ever more firms, including small and medium-sized enterprises (SMEs; not least because the minimum efficient scale of operation is significantly smaller in services than it is in manufacturing), from ever more countries integrating and benefiting from GVCs, governments (in both OECD and developing countries) today display increased reluctance to tie their hands and be bound by disciplines on services subsidies for fear that it could result in reducing their ability to provide the cocktail of incentives needed to enter and move up value chains.

While one can easily applaud the democratizing gains that come in the wake of a more globally contestable world economy, such gains paradoxically raise the market premium on policy space and its preservation (Box 4).

50 Poretti (2008: 480–83).

51 WTO document S/WPGR/W/9, para. 8.

BOX 4:

Ascendant Developing Country Exports and Demand for Policy Space

Globalization and the digital revolution that have characterised the 20 years since the conclusion of the Uruguay Round have vastly increased the participation of small business enterprises, including firms from least developed countries in world services trade, a process that may well have also contributed to a reduced political demand for subsidy disciplines in the sector. The dramatic reduction in distance—the end of gravity—that the digital revolution is progressively making possible has vastly increased opportunities for firms that typically operate on a smaller scale to enter the growing market for remotely supplied services. It has allowed a growing number of developing countries, big and small (India, the Philippines, Colombia, Kenya, Rwanda, Vietnam, and Mauritius, to name a few), to specialize in the supply of a multiplicity of business and professional services. In unleashing their services trade potential, governments have had increasing recourse to a host of policy instruments such as tax incentives, direct subsidies, and domestic regulation to attract and retain investments; upgrading their connectivity infrastructures (logistics, communications, and establishment of free zones); upgrading their human capital through enhanced vocational and tertiary training; and fostering services exports through improved promotional support. Developing countries have in recent years significantly expanded support to domestic firms in their quest to move up regional and GVCs. As developing disciplines on services subsidies may imply that governments have to abandon or curtail their use of such a policy toolbox, many WTO Members (not only in the developing world) seem to refrain from engaging more actively in developing such disciplines.

The rise of larger emerging markets where the state has come to play a significant leadership role in the economic landscape can also be considered an additional inhibiting factor in the lack of progress of negotiations under the GATS Art. XV mandate. In a rising number of emerging economies, as has long been the case in a number of developed economies, the state continues to be a predominant player, both passively through the growth of sovereign wealth funds and more actively as an owner-operator in key sectors such as telecommunications, banking, insurance, or air transport services. Such predominance, which an absence of codified multilateral rules has clearly facilitated, also finds its political economy anchored in a preference for policy space that rules on subsidies would be likely to constrain. This can be seen from the strong push by the US and others to codify and establish a juridical precedent for such rules in a number of mega-regional and plurilateral initiatives from which major emerging countries—the implicit target of those disciplines—are notably absent.

NEW KID ON THE RULE-MAKING BLOCK? STATE-OWNED ENTERPRISES

From a trade policy perspective, the guarantees and support, both implicit and explicit, conferred to SOEs can be likened to subsidization as such measures can distort competition by way of directed forms of regulatory or market access favoritism through preferential purchasing, commercial benevolence, and direct financial support by the home state.[52]

SOEs are heavily represented in services markets—from aviation to energy, banking, and telecommunications.[53] Understanding if and how disciplines on SOEs are desirable and/or feasible in a services trade context is thus of some importance to any discussion of subsidy disciplines in the sector.

As mentioned, the GATS features a provision disciplining possible abusive or competition-impairing practices by SOEs, Art. VIII on Monopolies and Exclusive Service Suppliers. Pursuant to Art. VIII:1 and 2, any monopoly service supplier is required to observe the MFN principle when supplying a monopoly service in a relevant market, and when competing in the supply of a service outside its monopoly rights in a sector subject to specific commitments, it shall not abuse its monopoly privileges, for instance, through cross-subsidization practices. Assessing the effectiveness of Art. VIII in curtailing the anti-competitive practices of SOEs is quite challenging as no dispute centered on this provision has ever been prosecuted before the WTO's judicial organs.

The desirability and feasibility of new rules on SOEs are currently under discussion in different negotiating fora, including plurilateral and mega-regional negotiations addressing trade in services. For example, the EU has recently put forward a draft text on state-owned enterprises in the context of Transatlantic Trade and Investment Partnership (TTIP) negotiations aimed at addressing the harmful effects of SOEs stemming from undue advantages.[54] According to the proposal, the TTIP Chapter on State Enterprises, Enterprises Granted Special or Exclusive Rights or Privileges would apply only to sectors where the parties undertook specific negotiated commitments, and provisions drawn from GATS Art. VIII: 1, 2 and 5 would be incorporated by reference into the body of the TTIP. Mirroring the widely held view that government ownership per se is not problematic, the EU proposal specifies that the TTIP would not prevent the parties from establishing or maintaining SOEs. It would, however, feature an obligation requiring the parties to refrain from requiring or encouraging SOEs to act inconsistently with the TTIP. Provisions on Non-discrimination (Art. 4) and Commercial Considerations (Art. 5) are also included in the EU proposal,[55] which aims to ensure that SOEs with monopoly powers or special rights do not discriminate against private companies.[56]

The OECD has also in recent years engaged in a policy discussion on the impact of SOEs on economy-wide performance. Its work on the relationship between SOEs and corporate governance led to the development of the principle of "competitive neutrality," which is deemed to obtain when "no entity operating in an economic market is subject to undue competitive advantages or disadvantages."[57] As no mechanism is currently in place within the OECD to ensure compliance with the above principle, enterprises that receive governmental support continue to enjoy net advantages over their private business competitors.[58]

52 Stephenson and Hufbauer (forthcoming: 7).

53 Stephenson and Hufbauer (forthcoming: 5).

54 European Union (2014: 1).

55 According to the text of Art. 5, the parties shall ensure that, with the exception of the fulfillment of public service obligations or public mandate, state enterprises and enterprises granted special or exclusive rights or privileges act in accordance with commercial considerations in the relevant territory in their purchases or supply of services, including when these goods or services are supplied to or by an investment of an investor of the other Party.

56 DG Trade (2105).

57 OECD (2012: 9).

58 Coalition of Services Industries and US Chamber of Commerce (2011: 7).

According to the Coalition of Services Industries (CSI) in the US, the government should propose the inclusion of provisions on SOEs and competitive neutrality in the Trans-Pacific Partnership (TPP) negotiations.[59] In particular, the CSI suggests that the TPP feature rules requiring the parties to have comprehensive competition laws that prohibit anti-competitive conduct; provisions that encourage the progressive reduction of public ownership stakes in SOEs; and non-conforming measures identified on the basis of a negative list approach.[60]

Disciplines on SOEs have also been addressed in the context of PTAs. For example, Art. 16.3 of the Korea-US free trade agreement (FTA) (KORUS) establishes that while nothing in the agreement prevents the parties from establishing or maintaining a state enterprise, they shall ensure that SOEs comply with the obligations of the agreement when exercising any regulatory, administrative, or other governmental authority that a party has delegated to it. The KORUS further calls on SOEs to accord non-discriminatory treatment in the sale of goods and/or services to covered investments. The EU-Korea FTA went further by requiring, under Art. 11.1 of Chapter 11 (Competition), that the parties maintain comprehensive competition laws that effectively address the abuse of dominance by one or more enterprises and provide effective control of concentrations between enterprises. The agreement further clarifies that competition law serves the purpose of preventing the benefits of trade liberalization from being nullified or impaired by anti-competitive business conduct or anti-competitive transactions.

A WAY FORWARD?

Can a silver lining be found in the hitherto futile quest for subsidy disciplines in services trade? Considering the lack of progress that has marred two decades of negotiations in this area, the recent debates in the US and the EU over the need for the flexible implementation of competition law in the context of acute market failure; the ascendency of SOEs in a growing subset of emerging trading powers; the reluctance of vertical sectoral regulatory institutions to embrace horizontal trade disciplines; and the rising political and economic value assigned to the preservation of policy space, all would appear to conspire against forward movement in disciplining subsidies in services trade.

This paper's candid reading of where we have been and why leaves little doubt that prospects for the adoption of future multilateral disciplines on services subsidies are generally grim. Realistically, it would seem most unlikely that governments will make much progress in the near future given the singular lack of political will the collective WTO membership has displayed towards fulfilling the GATS Art. XV mandate negotiated more than 20 years ago.

This paper has emphasized how the very concept of a subsidy raises a host of complex issues in services trade that are generally not found in a goods trade context, not least because subsidy-like effects in services can derive from the application of regulatory measures that might not necessarily fall under the term "subsidy" as defined under the WTO's ASCM. Certain domestic regulatory measures may indeed distort cross-border trade and investment in a manner akin to subsidies but others may be justified as they correct market failures or, more generally, are used to ensure the adequate delivery of services with public good characteristics.

Disciplines on subsidies that aim at redressing trade distortions and unfair advantages should thus logically extend to domestic regulations that induce subsidy-like effects. Once again, while prospects for seeing such an expanded definitional remit of the term "subsidy" appear equally bleak, any step in such a direction would likely require the adoption of principles of necessity or proportionality, allowing WTO judges to distinguish trade- and investment-distorting regulations from those that are "no more burdensome than necessary to ensure the quality of a service." Given, however, the limited traction that discussions on necessity have generated under the GATS Art. VI:4 mandate to date, there can be little doubt over the current buoyancy of the "market" for policy space at the interface of trade and regulatory policy.

Also, the desultory results generated by the WTO's information exchange exercise on Member states' subsidy practices in services, while theoretically hampered by the lack of an agreed definitional perimeter to report on,[61] once again reflects a clear collective aversion to rule-making advances and the concomitant loss of policy space. In a world characterized by shortening product cycles and intensifying locational competition, the ability to deploy various types of governmental assistance measures to an ecosystem populated in most countries, and particularly in developing ones, by SMEs, is increasingly seen as a necessary element of the policy arsenal required to help firms better navigate the waters of regional and global value chains. Fewer countries seem prepared today to renounce this opportunity, even if it means distorting trade, investment and/or competition through the granting of some unfair advantages.

59 Coalition of Services Industries and US Chamber of Commerce (2011: 9).

60 Coalition of Services Industries and US Chamber of Commerce (2011: 11–12).

61 In light of "servicification" and the growing fragmentation of value chains, it cannot be excluded that certain kinds of governmental support provided to services suppliers become embedded in goods and thus possibly subject to ASCM disciplines.

This paper's measured "pessimism" (one might also say its realism) towards the successful adoption of multilateral disciplines on services subsidies arises also from the acknowledgment that with the emergence of developing countries, including those where SOEs play a major role in key service sectors, negotiations are subject to an alignment of political economy forces that are no longer those that prevailed two decades ago. The ASCM, like the Uruguay Round of which it formed a part, was quite clearly the by-product of a peculiar, "end of history" moment. It is doubtful that such disciplines could easily be replicated today given the vastly more questioning attitudes that pervade public policy debates on trade and investment liberalization relative to those characterizing the heyday of the Washington Consensus.

Although a number of recent or ongoing preferential and plurilateral negotiations (for example, TPP, TTIP, Trade in Services Agreement [TISA]) are addressing the issue of new disciplines on SOEs, and may indeed generate important legal precedents able to influence the future course of WTO discussions at the trade, investment, and competition interface, one can only bemoan that such discussions do not engage the countries, chief among them China and other major emerging trade and FDI powers, at which these disciplines are primarily aimed. The continued refusal of a number of OECD countries, led by the US, to prevent China from taking part in the ongoing TISA discussions where SOE disciplines are at play in a setting seeking to maximize the agreement's critical mass, is hardly encouraging of prospects for the subsequent multilateralization of WTO-X disciplines first mooted in preferential settings.

Can anything be done to overcome the hurdles described above? Can a different approach help governments break the current logjam? Can a way be found to rekindle an analytical journey that takes better stock of today's reality while also acknowledging that a traffic light approach borrowing on the precedents set in the WTO's Agreement on Agriculture and the ASCM might actually help Members devise efficient forms of government support and avoid those that are either wasteful, most likely to distort trade and investment patterns, or weakly justified on economic grounds (as may be the case of many tax incentives targeting market-seeking FDI)? Once more, the answers to the above questions are far from simple or straightforward.

Although a new approach might be desirable, this need not imply the abandoning the approach taken so far but an expansion of what has already been done. For example, the process of information exchanges between governments, while admittedly yielding a mediocre analytical harvest to date, remains essential to any informed understanding of whether, how, and to what extent governments direct various forms of state support to their services industries. In seeking to reinvigorate this, the scope of questionnaires designed almost two decades ago would need to be extended to explore a broader subset of support measures,[62] including domestic regulations, support to SOEs, and monetary and exchange rate policies, all of which could be construed to induce subsidy-like effects to services and service providers. Efforts might also be directed to revisiting the exclusion of air transport services from the scope of the GATS, both with a view to reassessing the space that may exist for plurilateral forms of progressive market opening in a sector that bears no resemblance to that in operation when GATS 1.0 was devised, and with a view to tackling the manifold market-distorting practices that characterize global competition in air transport services, chief among which relate to SOEs.

Changes along the lines described above would require WTO Members to address the issue of subsidies in services trade no longer from the sole perspective of the form state support takes, but also from the vantage point of the effects such support induce on market competition (an approach akin to an "effects" doctrine in competition law).

Finally, and despite this paper's earlier musings against the premature expression of irrational exuberance, it may still be useful to strengthen the links between the GATS Art. VI:4 and Art. XV negotiating mandates. Discussions on the concept of a necessity test would prove undeniably useful to the adoption of prospective disciplines on services subsidies capable of distinguishing legitimate forms of public support from more nefarious or economically equivocal ones. This would entail some organizational changes in how the WPGR and the Working Party on Domestic Regulation (WPDR), the respective WTO Working Parties entrusted with the two mandates, go about their work. But surely such a challenge pales in comparison to the odds that would need to be overcome to secure a happy ending to this story.

62 See WTO Document S/WPGR/W/16.

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