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# **THE REGULATION OF SUBSIDIES WITHIN THE GENERAL AGREEMENT ON TRADE IN SERVICES OF THE WTO**

**PROBLEMS AND PROSPECTS**

**Pietro Poretti**



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# Global Trade Law Series

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VOLUME 22

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## List of Abbreviations

ANZCERTA	Australia New Zealand Closer Economic Agreement
ADA	Anti Dumping Agreement
AoA	Agreement on Agriculture
ASCM	Agreement on Subsidies and Countervailing Measures
ASEAN	Association of Southeast Asian Nations
CARICOM	Caribbean Community
CCD	Convention on the Protection of the Diversity of Cultural Expressions
CFI	European Court of First Instance
CUSFTA	Canada-United States Free Trade Agreement
DDA	Doha Development Agenda
DOC	United States Department of Commerce
DSU	Understanding on the Rules and Procedures Governing the Settlement of Disputes
EC	European Communities
ECAs	Export Credit Agencies
ECJ	European Court of Justice
ECT	Treaty Establishing the European Community
EEC	European Economic Community
EFTA	European Free Trade Association
EU	European Union
ESM	Emergency Safeguard Measures
FDI	Foreign Direct Investment
FSC	United States Foreign Sales Corporation Regime
FTA(s)	Free Trade Agreement(s)
GATS	General Agreement on Trade in Services
GATT	General Agreement on Trade and Tariffs

GDP	Gross Domestic Product
GPA	Government Procurement Agreement
LDCs	Least Developed Countries
MAI	Multilateral Agreement on Investment
MERCOSUR	Mercado Comun del Sur (Southern Common Market)
MFN	Most Favoured Nation
NAFTA	North American Free Trade Agreement
OECD	Organization of Economic Cooperation and Development
PTA(s)	Preferential Trade Agreement(s)
RTA(s)	Regional Trade Agreement(s)
SG	Agreement on Safeguards
SME(s)	Small and Medium Enterprise(s)
TPR	Trade Policy Review
TRIMs	Agreement on Trade-Related Investment Measures
TRIPS	Agreement on Trade-Related Aspects of Intellectual Property Rights
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNESCO	United Nations Educational, Scientific and Cultural Organization
USCIT	United States Court of International Trade
USITC	United States International Trade Commission
USTR	United States Trade Representative
VCLT	Vienna Convention on the Law of Treaties
WCO	World Customs Organization
WPDR	Working Party on Domestic Regulation
WPGR	Working Party on GATS Rules
WTO	World Trade Organization

## Preface

Subsidies amount to one of the most complex issues in terms of non-tariff barriers to trade. On the one hand, they inevitably distort conditions of competition. On the other hand, they amount to a key instrument in implementing governmental policy goals and in bringing about distributional effects by means of public funding. In the field of General Agreement on Tariffs and Trade (GATT), basic provisions entailed in Articles VI and XVI were subsequently elaborated in special agreements, culminating in the Uruguay Round in the Agreement on Subsidies and Countervailing Measures (SCM), and the Anti-dumping Agreement. These agreements have been accompanied ever since by case law and the evolving jurisprudence of panels and the Appellate Body. The same cannot be stated for services. The General Agreement on Trade in Services (GATS) Agreements is still in its early and infant stage. It does not contain even basic specific provisions on subsidies. Article XV mandates Members to undertake negotiations with a view to develop such disciplines over time. Ever since 1995, these negotiations have stalled and made little or no progress. This is partly due to the fact that conceptual approaches have not been developed so far, and simply transcription of rules on goods is not possible due to the simple fact that services by and large are invisible and are not subject to border measures and thus the possibility of countervailing duties. Moreover, there is a lack of data on services relating to subsidies. We still do not know to what extent subsidies are actually been used in most of the sectors, with the exception perhaps of audiovisuals where much work has been done caused by intense debate in the World Trade Organization (WTO) and in United Nations Educational, Scientific and Cultural Organization (UNESCO).

The present thesis undertakes to take stock of these problems and of implied disciplines on subsidies in the GATS Agreement. The author undertakes to examine the basic notions and concepts, the pertinent provisions of the Agreement and to explore potential avenues as to how the balance between lawful and unlawful,



beneficial and harmful subsidization of services could be addressed in future negotiations based upon Article XV GATS. It goes without saying that this is complex and difficult task which the author addressed while he was a research fellow at the World Trade Institute and subsequently a visiting fellow at Georgetown University in Washington DC. The lively discussions with Pietro Poretti on the subject, and many other related issues, during his time at the World Trade Institute at the University of Bern are a fond memory. As a fellow, he made an important contribution to the Institute, and so does his thesis in preparing for future disciplines in subsidies in services in WTO law which may eventually be closer to unfair competition rules than classical trade remedies.

Prof. Thomas Cottier  
Berne, September 2009

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# Introduction

The words printed here are concepts. You must go through the experiences.

*St. Augustine (354-430AD)  
Numidian-born Bishop  
of Hippo theologian &  
philosopher*

This book explores the issue of multilateral regulation of services subsidies starting from the negotiating mandate of GATS Article XV.<sup>1</sup> By taking stock of the discussions conducted under the aegis of the Working Party on GATS Rules since 1995, and drawing from the experience of existing subsidies regimes at the WTO and EU levels, the main aim of this book is to facilitate discussion on services subsidies and on their possible regulation. Because of the current lack of comprehensive information on subsidization in the services context the analysis undertaken is largely conceptual. Concrete examples have been used to substantiate proposals and conclusions whenever possible.

This book is divided into three parts. Part I sets out the foundations. Part II is dedicated to legal analysis. Part III comprises two sectoral studies: on investment-diverting subsidies, and on subsidies to the audiovisual services sector. The contents are, in more details, as follows.

## 1. FOUNDATIONS

Part I sets out the foundations. Chapter 1 provides a concise assessment of trade in services and illustrates the core-distinguishing features of services, trade in

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1. The case law, as well as scholarly writing, up to 1 Jul. 2009 is considered.

services, and the structure of the GATS. These elements play an important role in the way services subsidies are shaped, and need to be taken into consideration when elaborating possible disciplines.

Chapter 2 discusses the four GATS 'Uruguay Round leftovers', namely domestic regulation, emergency safeguard measures, subsidies and government procurement, and the progress done (or not done) so far under the respective negotiating mandates. Particular attention is devoted to negotiations on subsidies, their mandate and status, and to an assessment of the estimated costs of their failure.

Chapter 3 analyses subsidies and subsidies-induced trade distortion – with the help of conventional trade theory – and substantiates the case for multilateral regulation of services subsidies. It concludes that the current double standard under which industrial and agricultural goods subsidies are subject to disciplines, while the use of services subsidies is almost entirely left at the discretion of the individual WTO Members, is not justifiable.

Chapter 4 discusses situations where governments rely on subsidies to achieve public policy objectives and the need to isolate these forms of support from trade distortive subsidies for the purpose of negotiations. It illustrates the treatment reserved to non trade-related subsidies under existing multilateral subsidies regimes as well as under EU State Aid rules.

Finally, Chapter 5 gathers information from a variety of sources in an attempt to describe subsidization in the services context. Although the assessment is not comprehensive, it highlights the current paucity of data and the Members' failure to adhere to the information exchange request of GATS Article XV. Further, it emphasizes the fact that comprehensive data on services subsidies is critical for the progression of the negotiations.

## 2. LEGAL ANALYSIS

Part II contains the legal analysis. Chapter 6 proposes a three-tier classification of services subsidies based on their trade distortive effects, namely export-enhancing, import-displacing and investment-diverting subsidies.

Chapter 7 sets forth a definition of subsidy in the services context, building upon the definition contained in the WTO Agreement on Subsidies and Countervailing Measures (ASCM). It analyses the multiple elements of the ASCM definition and the extent to which these can serve the purpose of disciplines on services subsidies. WTO case law and the EU Courts' jurisprudence on State Aid have been used to demonstrate that the definition contained in the ASCM can be used as a model for services subsidies.

Chapter 8 examines a number of existing GATS provisions that exert a measure of discipline on services subsidies, as well as the remedies currently available under the Agreement. A preliminary discussion of the concept of likeness in the services context is followed by an analysis of the following provisions: the MFN and national treatment obligations, Article VIII on monopolies and exclusive

service suppliers, the non-violation complaints instrument and the consultations provision of Article XV(2), as well as Article VI(5) on domestic regulation. The transparency obligation completes the chapter.

Chapter 9 explores the desirability and appropriateness of countervailing measures in the services context. The analysis illustrates the economic perplexities that surround such a remedy, and emphasizes the copious technical hurdles that arise when attempting to impose countervailing measures to subsidized services imports.

Chapter 10 provides a compilation of disciplines on services subsidies contained in Preferential Trade Agreements, and analyses the extent to which they may provide inputs and guidance for the ongoing multilateral negotiations under GATS Article XV.

Finally, Chapter 11 discusses the impact services subsidies may have on a country's economic development. It concludes that any future discipline should acknowledge the asymmetry of development among WTO Members through special and differential treatment for developing countries.

### 3. SECTORAL STUDIES

Two sectoral studies address the specific issues of investment-diverting subsidies and subsidies to the audiovisual services sector. Chapter 12 examines the issue of government incentives to attract foreign direct investment, the potentially diverting effects of such measures on investment flows, and their place in the negotiating mandate of GATS Article XV.

Chapter 13 discusses the sensitive issue of subsidies to the audiovisual services sector, and the tension between trade and culture. It highlights the particularities of audiovisual services and the possibility of adopting sector-specific subsidies disciplines to complement horizontal rules.

Conclusions summarizing the key findings of each chapter as well as an epilogue complete the book.

# Table of Contents

<b>List of Abbreviations</b>	<b>xiii</b>
<b>Preface</b>	<b>xv</b>
<b>Acknowledgements</b>	<b>xvii</b>
<b>Introduction</b>	<b>xix</b>
1. Foundations	xix
2. Legal Analysis	xx
3. Sectoral Studies	xxi
<b>Part I</b>	
<b>Foundations</b>	<b>1</b>
<b>Chapter 1</b>	
<b>International Trade in Services and the Multilateral Trading System</b>	<b>3</b>
1.1. International Trade in Services: Some Figures	3
1.2. Barriers to International Trade in Services	5
1.3. The Multilateral Regulatory Framework for Trade in Services	7
1.4. Goods and Services: Some Fundamental Differences	9
<b>Chapter 2</b>	
<b>Completing the GATS Framework and the Case for Services Subsidies Disciplines</b>	<b>13</b>
2.1. GATS Article VI(4) (Domestic Regulation)	15
2.2. The Working Party on GATS Rules	17
2.2.1. GATS Article X (ESM)	18

2.2.2.	GATS Article XIII (Government Procurement)	20
2.2.3.	GATS Article XV (Subsidies)	22
2.2.3.1.	<i>Demandeurs</i> and the Costs of Failure of the Negotiations under GATS Article XV	22

### Chapter 3

#### Trade Distortion and Supranational Regulation of Services Subsidies 27

3.1.	The Effects of Subsidies in the Light of Classic Free Trade Theory	27
3.2.	Subsidies and International Trade	29
3.3.	The Concept of Trade Distortion in the Existing Subsidies Regimes	30
3.4.	Trade Distortion and GATS Article XV	32

### Chapter 4

#### Positive Externalities and Public Policy Objectives 37

4.1.	Subsidies and Positive Externalities	38
4.2.	Positive Externalities in Existing Subsidies Regimes	39
4.3.	Positive Externalities and GATS Article XV	42
4.4.	The Scope of the GATS: 'What Is In and What Is Out'	43
4.4.1.	The GATS' Encompassing Coverage	43
4.4.1.1.	GATS Article I(3)(b) and (c)	44
4.5.	The ASCM Concepts of 'Specificity' and 'General Infrastructure'	47
4.6.	Preserving Policy Space in Future Disciplines	48

### Chapter 5

#### Analysis of the Currently (Un)Available Data on Services Subsidies 51

5.1.	The Opacity of Governmental Support and GATS Article XV	51
5.1.1.	Collecting Information on Services and Services Subsidies	52
5.1.2.	Difficulties in Collecting Data on Services	53
5.1.3.	The Information-Exchange Mandate of GATS Article XV	55
5.1.3.1.	The (Non-)Fulfilment of the Information-Exchange Request of GATS Article XV	57
5.1.3.2.	Increasing Participation in the Information-Exchange Request	59
5.2.	Available Information on Services Subsidies	61
5.2.1.	The WTO Secretariat's Questionnaire	61
5.2.2.	TPR Reports and Other WTO Publications	62
5.2.3.	The Members' Schedules of Specific Commitments and Lists of MFN Exemptions	65
5.2.4.	Studies on Services Subsidies Conducted in Other International Fora	67
5.3.	Is There a Need for Subsidies Disciplines in the Services Context?	68

**Part II****Legal Analysis****71****Chapter 6****Classifying Trade-Distorting Services Subsidies****73**

6.1.	Distortion in Foreign Markets: Export-Enhancing Subsidies	74
6.1.1.	Export-Enhancing Subsidies and Modes of Supply	76
6.1.2.	Export-Enhancing Subsidies and the Mandate of GATS Article XV	79
6.2.	Distortion in the Market of the Subsidizing Country: Import-Displacing Subsidies	80
6.2.1.	Import-Displacing Subsidies and Modes of Supply	84
6.2.2.	Import-Displacing Subsidies and Market Access Rights and Obligations	85
6.2.3.	Consumers' Subsidies as Import-Displacing Subsidies	86
6.3.	Distortion of Investments Flows: Investment-Diverting Subsidies	87

**Chapter 7****Defining Services Subsidies****89**

7.1.	Definitional Issues and the Scope of Future Disciplines	90
7.2.	General Perceptions on Subsidies	91
7.3.	A Possible Model: The ASCM Definition of a Subsidy	91
7.3.1.	Financial Contribution by a Government or Any Public Body (ASCM Article 1(1)(a)(1))	93
7.3.1.1.	Direct Transfer of Funds and Government Revenue Otherwise Due Foregone or Not Collected (ASCM Article 1(1)(a)(1)(i) and (ii))	94
7.3.1.2.	Government Provision of Goods or Services Other Than General Infrastructure (ASCM Article 1(1)(a)(1)(iii) <i>ab initio</i> )	95
7.3.1.3.	Government Purchase of Goods (ASCM Article 1(1)(a)(1)(iii) <i>in fine</i> )	97
7.3.1.4.	The Fourth Form of Financial Contribution of the Definition of a Subsidy (ASCM Article 1(1)(a)(1)(iv))	98
7.3.1.4.1.	Payments to Funds (ASCM Article 1(1)(a)(1)(iv) <i>ab initio</i> )	99
7.3.1.4.2.	Entrustment and Direction of Private Bodies (ASCM Article 1(1)(a)(1)(iv) <i>in fine</i> )	99
7.3.1.4.3.	Entrustment and Direction in EU State Aid Regime	101



7.3.1.4.4.	Transposing ASCM Article 1(1)(a)(1)(iv) <i>in fine</i> into the GATS Framework	103
7.3.2.	Income or Price Support	105
7.3.3.	The Concept of Benefit of ASCM Article 1(1)(b)	106
7.3.3.1.	Benchmarks for the Calculation of Benefit to the Recipient (ASCM Article 14)	106
7.3.3.2.	The Concept of Benefit in the ASCM Case Law	107
7.3.3.3.	Subsidies, Benefits and Privatized Companies	108
7.3.3.4.	The Atypical Role of the Territory in the 'Production' of Services	110
7.4.	Complementary Definitional Issues	111
7.4.1.	Subsidies, Public Purchase of Services and GATS Article XIII	112
7.4.1.1.	The Economic Significance of Public Procurement of Services	112
7.4.1.2.	The ECJ and CFI Case Law and the EU Commission's Practice on State Aid and Public Procurement	113
7.4.1.2.1.	Openness and Transparency of Awarding Procedures and Presumption of State Aid	114
7.4.1.3.	Government Procurement of Services in the WTO Framework	115
7.4.2.	Domestic Regulatory Measures and 'Implicit Subsidies'	118
7.5.	The Concept of Specificity	119
7.5.1.	The Rationale Behind the Concept of Specificity	121
7.5.2.	The ASCM Specificity Provision	121
7.5.3.	Specificity and Modes of Supply	124
<b>Chapter 8</b>		
<b>Existing GATS Subsidies Disciplines and Remedies</b>		<b>127</b>
8.1.	Subsidies in the Current GATS Framework	127
8.2.	'Like Services' and 'Like Service Suppliers'	128
8.2.1.	Applying the GATT and WTO 'Like Products' Test in the Services Context	129
8.2.1.1.	Properties, Nature and Quality of Services	130
8.2.1.2.	Services Classification	130
8.2.1.3.	Services End-Use and Consumers' Habits	132
8.2.2.	'Likeness' of Services and Service Suppliers	133
8.2.3.	'Likeness' Across Modes and Means of Supply	135
8.3.	Existing Services Subsidies Disciplines	136
8.3.1.	Most-Favoured Nation (GATS Article II)	136
8.3.2.	National Treatment (GATS Article XVII)	139