

ICTSD Programme on Trade in Services and Sustainable Development



Subsidies, Services and Sustainable Development



By Marc Benitah,

Professor of International Law, University of Quebec

In collaboration with David Vivas-Eugui, Alexander Werth and Mahesh Sugathan, ICTSD



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International Centre for Trade
and Sustainable Development

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CONTENTS

	Foreword	v
1.	Introduction	1
1.1	Disciplines on services subsidies & links to sustainable development	1
1.2	Status of the subsidies debate at the WTO	1
1.3	Objectives and structure of the paper	2
2.	Some Data on Subsidies in Services	3
3.	Is There a Need for Multilateral Disciplines on Services Subsidies?	4
3.1	Arguments in favour of multilateral disciplines	4
3.2	Arguments against multilateral disciplines	5
3.3	Finding a middle ground	6
4.	Do Effective GATS Rules Disciplining Services Subsidies Already Exist?	7
4.1	The most favoured nation (MFN) clause	7
4.2	The national treatment clause (NT)	8
4.3	The subtle interaction between market access (MA) and subsidies to services	8
4.4	'Additional commitments' under GATS	9
4.5	Consultation under GATS Article XV (2)	9
4.6	The role of non-violation complaints	9
4.7	The overall disciplining effect of the GATS	9
5.	Towards a Definition of Subsidy in Services: the Concept of 'Trade Distortion'	10
5.1	The Article XV double bind	10
5.2	The link between the concept of distortion and the comparative advantage paradigm	10
5.3	What distortion is not	11
5.4	The legal impracticability of a sophisticated definition of services subsidy	12
5.5	The necessity of integrating the simple view of distortion	13
6.	Towards a Tailor-Made Definition of a Services Subsidy	14
6.1	The atypical role of 'territory' in the production of services	14
6.2	Subsidies to consumers of services	14
6.3	Subsidies granted to natural persons (mode 4)	15
6.4	Indirect or upstream subsidies	15

7. General Considerations for Services Subsidy Disciplines	18
7.1 Three key parameters for a future model	18
7.2 Specificity in the context of services	19
7.3 Export subsidies in the context of services	20
7.4 The need for an exemption box	21
8. Adopting the Philosophy of the WTO Agreement on Agriculture	22
8.1 The exemption box	22
8.2 The 'harsh reduction or prohibition' box	27
8.3 The 'residual box': slight reductions	28
9. Adopting the Philosophy of the WTO SCM Agreement	30
9.1 Red light box	30
9.2 Green light box	30
9.3 Amber box	31
10. On the Appropriateness for a Countervailing Duty Mechanism	33
10.1 The CVD regime can become a protectionist tool	33
10.2 The risk of redundancy with the a future GATS safeguard mechanism	34
10.3 CVD: a weapon mostly used by a few developed countries	34
10.4 A CVD regime leads to rent-seeking behaviour	34
11. Comparative Analysis	35
12. Conclusions	36
Endnotes	37
References	40

FOREWORD

Ten years after services were included in the multilateral trading system, the WTO's General Agreement on Trade in Services (GATS) remains an unfinished project. It continues to arouse scepticism among its original proponents – given the arguably low level of liberalisation attained so far – as well as deep concern among others with regard to the policy orientation of its provisions. In the context of international negotiations, the GATS was the result of a knotty process of political *quid pro quos* that catapulted services into a major component of the Uruguay Round negotiations. By and large, major services providers in the US and Europe acted as *demandeurs* for services rules and for a process that would lead to global trade expansion in the sector. Their counterparts in developing countries were confused, and their development concerns – omnipresent in the process – were ultimately left appallingly vague. The absence of data, commercial insecurity and a crippling perception of an unfavourably tilted playing field prevailed in development circles throughout the negotiations. Broad public policy issues remained off the negotiating table. Difficult tensions – arising, for instance, from the fundamentally different approaches of diverse public law traditions to the role of the State in the provision of certain services – permeated the discussions. The eight years of talks to design the GATS represented a hugely rich, creative and analytical effort, characterised by complexity, technicality and a high degree of politisation.

The implementation of the Agreement has perpetuated the pattern. In the past few years – as we move into the liberalisation phase mandated as a built-in agenda in the GATS – policy-makers in developing countries, academics, and civil society analysts and advocacy organisations have expressed serious reservations about the potential implications of requiring developing countries to make greater market access concessions; the need to sequence liberalisation; the lack of adequate domestic regulatory frameworks; the imperative of universal access for essential services; and institutional reform and good governance. The unresolved discussion on whether liberalisation and further advancement of negotiations can proceed in the absence of the mandated impact assessment of implementation seems to be most troubling for practically all parties. Indeed, a comprehensive policy analysis of the implications of trade in services for sustainable development, and of the policy spaces available for implementing public policies, is still missing.

Among the most challenging and controversial issues currently on the table are negotiations aimed at establishing multilateral rules for subsidies in services. In a largely unexplored field such as the production and international exchange of services, subsidies could either distort trade and competitiveness, or enhance them. Little is found in the literature with respect to the use of incentives in the field, but it seems safe to presume that GATS Member countries are unequally endowed with the resources and ability to use policy tools to promote business activity in the services sectors. In addition, for some – whether developed or developing countries – subsidies may be a critical policy instrument to enable productive activity in otherwise unviable or incipient sectors to ensure the provision of essential services, as well as

to maintain viable public services sectors. Subsidies may also provide incentives for existing service providers to operate in a more environmentally and socially supportive manner. So far, subsidies, granted mostly by OECD countries, have raised serious concerns for many developing countries. Developing countries see these subsidies as major stumbling blocks on the way to increasing their participation in the services trade. In the ongoing GATS negotiations, WTO Members “shall aim to complete” negotiations on services subsidies under Articles XV of the GATS prior to the conclusion of the services market access negotiations. Services negotiators are therefore faced with the challenge of finding the right balance between disciplining trade-distortive subsidies, while at the same time retaining spaces for the pursuit of key public policy objectives.

As a contribution to the debate, this paper explores possible options for the establishment of new multilateral disciplines on subsidies from a sustainable development perspective. It is the first of a series of Issue Papers on systemic and sectoral topics of relevance to the current GATS negotiations produced under ICTSD's programme on Trade in Services and Sustainable Development. This programme aims at *empowering developing country policy-makers and other stakeholders at regional and international levels through information, dialogue, capacity-building and research targeted at influencing the international services trading system so that it advances the goal of sustainable development.*

We hope you will find this pleasant and informative reading and an effective contribution to the debate.



Ricardo Meléndez-Ortiz
Executive Director, ICTSD

1. INTRODUCTION

1.1 Disciplines on services subsidies & links to sustainable development

Developing countries are steadily moving up the value-added chain in services supply. If services trade follows the trend in the trade of goods, they are likely to gradually overtake developed countries in those sectors and modes of supply where they have a comparative advantage. Developed country subsidies in these areas could then become a major factor impeding the growth and diversification of developing countries' international services trade, just as their massive agricultural subsidies effectively prevent competitive developing countries from exploiting their comparative advantage.¹ Disciplining subsidies in services is thus an important precondition for levelling the playing field. Such disciplining can also have positive effects on sustainable development objectives other than economic growth,

including environmental protection through controlling the use of subsidies that act as perverse incentives.

On the other hand, subsidies are an important policy tool for assuring the provision of essential services, as well as for maintaining a viable public services sector. They can also provide incentives for existing providers to operate in a more environmentally-friendly way, just as they can be used to better integrate small- and medium-size enterprises in the services economy. Therefore, potential disciplines regulating subsidy use might have a large impact on Members' ability to provide economic incentives for promoting key policy and sustainable development objectives.

1.2 Status of the subsidies debate at the WTO

The Uruguay Round, which included negotiations on the General Agreement on Trade in Services (GATS), left Members of the World Trade Organisation (WTO) with a wide range of 'unfinished business' to be accomplished in post-Marrakech negotiations. In services, one of these uncompleted negotiating areas is disciplining the use of subsidies in services. Article XV of the GATS mandates Members – as part of the so-called GATS built-in agenda – to "enter into negotiations with a view to developing the necessary multilateral disciplines to avoid ... trade distortive effects [which] subsidies may have ... on trade in services".

Although many WTO Members have repeatedly emphasised that subsidies will have significant consequences for the effectiveness of market access concessions being made in the current GATS negotiations, the issue has thus far attracted less attention than the establishment of an emergency safeguard mechanism or disciplining government procurement in services. Members' qualms about revealing information on their services subsidisation

practices, as well as their reluctance to enter a *terra incognita* of trade rules, appear to be the key factors for the *de facto* standstill in the services subsidy debate.

The GATS negotiating Guidelines² require Members to "aim to complete" negotiations on subsidies before the conclusion of the ongoing services market access negotiations – i.e. by 1 January 2005. The WTO Working Party on GATS Rules, – where the discussions are taking place, – agreed in July 2002 on a work programme inviting Members to submit proposals on services subsidies by 31 March 2003. However, no such submissions have yet been tabled – mainly because the debate is still at a 'brainstorming' stage. In contrast, the GATS market access negotiations have already reached a more advanced stage with Members submitting bilateral requests and offers to their trading partners. Despite this procedural imbalance, Members do seem committed to concluding the subsidies negotiations on deadline.³

I.3 Objectives and structure of the paper

This paper⁴ aims to provide some initial thoughts and insights on the challenge of designing a regulatory framework for subsidies in services, which WTO negotiators could use as starting points for revitalising 'real' negotiations on this new and complex subject. Within that context, the paper also attempts to integrate some general considerations regarding the fulfilment of core sustainable development and public policy objectives through the provision of subsidies to the services sector.

In terms of structure, the paper first presents the main arguments for and against services subsidy disciplines. Second, it attempts to assess whether existing GATS rules are already sufficient for disciplining subsidies to services. Third, it outlines a new definition of a 'subsidy' adapted to the context of services. This definition implicitly includes the criterion of distortion

since GATS Article XV only targets subsidies that have 'trade-distortive effects'. The paper then sets out some general parameters and possible elements for a services subsidy regime, while taking into account the importance of subsidies in pursuing economic, social, and environmental development objectives. Special emphasis will be placed on the environmental impact of subsidies in services.

In conclusion, the paper describes two specific scenarios for developing multilateral disciplines on services subsidies: the first is inspired by the philosophy of the WTO Agreement on Agriculture (AoA), and the second follows the lines of the WTO Subsidies and Countervailing Measures Agreement (SCM). The appropriateness of a countervailing mechanism in the field of services is also examined in this context.

2. SOME DATA ON SUBSIDIES IN SERVICES

The GATS was one of the major outcomes of the Uruguay Round (1986-1994). The subject of services had not been covered by the GATT 1947 system, even though trade in services had always accounted for a fair share of many countries' foreign exchange earnings. The best estimates available suggest that global trade in services – including sales by affiliates of multinationals – stood at US\$2.2 trillion in 1997.⁵

Developing countries have a large stake in being able to compete in foreign services markets. Although members of the Organisation for Economic Cooperation and Development (OECD) dominate the trade globally, developing countries lead the list of countries that are most dependent on services as a source of foreign exchange earnings. This reflects the importance of tourism and transportation services for many of these countries. However, developing countries have also found other sources of earning foreign exchange through services such as transaction processing (e.g. China, India), back-office services (Jamaica), and information and software development services (India). Recent and emerging technological developments – such as e-commerce – also hold promises for developing countries.

While there is a lack of comprehensive information about services subsidies, there is evidence that many

WTO Members do grant subsidies in sectors such as audiovisual services, construction, distribution, educational services, environmental services, financial services, health related services, transport, research and development, and tourism.⁶ In rail transport the rate of support varies between 15 and 180 percent of the total value added.⁷ In OECD countries government support to private tertiary education amounts to 0.24 percent of total GDP. The airline industry receives state support amounting on average to more than US\$7 billion a year.⁸ Audiovisual production is supported worldwide with more than US\$2 billion of state transfers.⁹ Government support to research and development represents more than 50 percent of the total investment in R&D in OECD countries. This has important implications and upstream effects on other economic activities.

WTO Trade Policy Reviews of various countries have revealed a strong reliance on tax incentives (instead of direct grants) in the provision of such subsidies.¹⁰ This may reflect a preference in the political process for less obvious and, in terms of immediate disbursements, less 'costly' forms of support.¹¹ Therefore one can expect to see most services subsidies taking at least one of these forms: preferential credits and guarantees, equity injections, tax incentives, duty-free zones, as well as direct grants.

3. IS THERE A NEED FOR MULTILATERAL DISCIPLINES ON SERVICES SUBSIDIES?

According to GATS Article XV, “Members recognise that, in certain circumstances, subsidies may have distortive effects on trade in services. Members shall enter into negotiations with a view to developing the necessary multilateral disciplines to avoid such trade-distortive effects”.¹² The negotiations “shall also address the appropriateness of countervailing procedure”. Such negotiations shall recognise the “role of subsidies in relation to the development programs” of developing countries and take into account the needs of Members, particularly developing country Members, for flexibility in this area. For the purpose of such negotiations, Members “shall exchange information” concerning all subsidies related to trade in services that they provide to their domestic service suppliers.

Furthermore, the Guidelines for the services negotiations provide that “Members shall aim to complete negotiations under Article[s] ... XV prior to the conclusion of negotiations on specific commitments” – namely

before the end of the new round of market access negotiations on 1 January 2005.

However, despite its apparent clarity, the mandate given by Article XV has been considered by some Members as a ‘political’ decision to explore the issue without prejudging the outcome of the negotiations. Therefore, which multilateral disciplines on services subsidies are actually ‘necessary’, remains to be determined. Not surprisingly, ever since the onset of discussions on this issue at the WTO, Members have expressed greatly differing views on the desirability and feasibility of creating multilateral disciplines for services subsidies.

The following section will briefly outline the main arguments that have been put forward in favour and against the establishment of multilateral disciplines for services subsidies.

3.1 Arguments in favour of multilateral disciplines

Distortion of international trade in services

Trade negotiators have traditionally addressed the issue of subsidies in goods through the lens of distortive effects of subsidies on international trade, namely as an

impediment to free competition between countries. As will be shown later, there is no theoretical obstacle to extending this concept to the field of services subsidies.

The need to level the playing field

Many developing countries seem reluctant to open up their services markets without increased transparency and disciplines on services subsidies provided by developed countries. This is why the issue is rather high on the agenda of such developing countries as Brazil, Chile, and Hong Kong (China), which are already competitive in certain services sectors. According to these countries, developed country services subsidies could potentially restrict access to developed country markets through diminishing the value of liberalisation commitments. State support to construction services is often cited in this context.

In general, services subsidy disciplines will have important implications for developing countries due to their limited capacity to grant extensive subsidies¹³ and to their difficulty to secure sufficient financial resources to pursue other core policy objectives.¹⁴ The impact of any actual or potential subsidies granted by developing countries could be reduced or even reversed by the huge amount of subsidies provided by developed countries to their services industries.¹⁵

Multiplier effect between goods and services

Goods and services should not be considered as two separate subsets of a national economy, as there is a constant interaction and overlapping between the two via a multiplier effect. Many services (communication or transport for example) provide backbone inputs for the production of many goods. Distortions in services could therefore spill over to goods, although it might not be

easy to monitor impacts on individual goods.¹⁶ In addition, the frontier between goods and services is increasingly unclear with products that can be delivered either as a good (such as a CD) or a service (downloading the content of the CD from the Internet). Such cases, however, represent only a small portion of the overall trade in both goods and services.¹⁷

Environmentally harmful services subsidies

From an environmental perspective, one cannot remain indifferent to services subsidies. For instance, certain subsidies to the tourism, energy and transport services sectors can result in overexploitation of natural resources and intensification of the degradation of the natural heritage. Lessons can be learnt, for example, from subsidies to fishing fleets, which have led to massive overexploitation of fish stocks. One could therefore argue that disciplining subsidies to services would have a 'win-win' effect if those disciplines helped control environmentally harmful subsidies. It must be underlined, however, that the mandate given by Article

XV of GATS is based on the trade-distortive aspects of services subsidies, although nothing explicitly prevents negotiators from devising by consensus rules based on adverse environmental impacts of services subsidies. It is worth recalling in this context that WTO ministers in the second half of subparagraph 32 (i) of the Doha Ministerial Declaration, instructed the Committee on Trade and Environment "to give particular attention to: (ii) ... those situations in which the elimination or reduction of trade restrictions and distortions would benefit trade, the environment and development".

3.2 Arguments against multilateral disciplines

Pursuit of public policy objectives

Subsidies to services may be necessary (especially for developing countries) in order to reach economic, social and environmental goals. In fact, both the preamble of the GATS and the services Guidelines underline the importance of national policy objectives. Furthermore,

GATS Article XV explicitly recognises the developmental dimension of subsidies to services, as well as the necessity to "take into account the needs of Members, particularly developing country Members, for flexibility in this area".

Sequencing

Some WTO Members have indicated that it would be better to tackle the issue of services subsidies only after market access commitments have progressed much further. In other words, these Members feel that the establishment of disciplines for services subsidies should not be an excuse for slowing down the actual general liberalisation process in the service sector. Some also argue that sufficient information is lacking on services subsidies currently granted and on their actual or potential impacts on trade in services.

This kind of argument does not, however, carry much weight after the approval of the services Guidelines where Members decided to "aim to complete negotiations under Article[s] ... XV prior to the conclusion of negotiations on specific commitments". This mandate clearly demonstrates that market access cannot be addressed without trade-distortive services subsidies being dealt with in parallel. Granting greater market access commitments while maintaining subsidies merely implies the removal of one obstacle to competitive markets while retaining another.

3.3 Finding a middle ground

This paper argues that there are ways to accommodate both the concerns of those in favour of disciplines for services subsidies and those who are reluctant to develop such disciplines. The negotiations on subsidies in the goods and agricultural sectors demonstrate that the objectives of disciplining distortive subsidies, on the one hand, and preserving certain spaces for public

policies, on the other, are not incompatible *per se*. As a result, efforts could be made to define some common elements for disciplining trade-distortive subsidies to services in general, while maintaining privileged legal treatment for services subsidies that are necessary to address public policy objectives.

4. DO EFFECTIVE GATS RULES DISCIPLINING SERVICES SUBSIDIES ALREADY EXIST?

The GATS is a very complex set of rules, which already affects in many ways the legality of providing certain services subsidies. Whereas some GATS rules, such as the most favoured nation (MFN) principle, apply horizontally to all services and modes of supply, national treatment (NT) and market access obligations only apply when a Member has explicitly made a specific

commitment in a particular sector. Six GATS provisions seem most relevant with regard to disciplining services subsidies granted by WTO Members: the MFN Clause (Article II), the NT Clause (Article XVII), market access (Article XVI), additional commitments (Article XVIII), consultations on subsidies (Article XV (2)) and non-violation nullification or impairment (Article XXIII (3)).

4.1 The most favoured nation (MFN) clause

Article II of the GATS contains a general obligation applicable across-the-board to all service sectors of a Member, regardless of whether this Member has made specific commitments in these sectors. Article II (1) of the GATS states:

“With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country.”

There is a fundamental difference between the GATS and the GATT (which deals only with goods) when linking the MFN obligation to subsidies. In the GATT context, MFN only targets measures *at the border* (such as customs duties and other charges). It does not cover measures affecting the process of production of a good within a Member’s territory. As a result, a subsidy does not fall under Article I of the GATT, which contains the MFN clause in goods. In the GATS context, however, the situation is different as the MFN obligation applies to *any measure “affecting trade in services”*.¹⁸ Therefore MFN applies if a subsidy is granted in a discriminatory manner within a Member’s territory. This would be the case if a Member granted a subsidy to a firm of country B, but refused to grant the same subsidy to a firm of country C producing ‘like’ services. The MFN clause therefore has a potential and natural disciplining effect

since granting a subsidy to one foreign firm activates the fear derived from the obligation to grant it to all ‘like’ foreign firms as well. However, a Member could simply choose not to grant any subsidy to a foreign-based firm. In such a case, the whole MFN process stops and the natural disciplining effect of the MFN clause on services subsidies disappears. In addition, a Member can opt to maintain exemptions to MFN treatment under certain conditions. GATS Article II (2) states:

“A Member may maintain a measure inconsistent with [the MFN clause]... provided that such a measure is listed in, and meets the conditions of, the Annex on Article II Exemptions.”

This would occur, for example, if a country made an MFN exemption regarding the granting of a subsidy to a firm from country B while not granting it to a ‘like’ firm from countries C, D, etc. Such exemptions were possible during the Uruguay Round negotiations. Nevertheless, according to the GATS Annex on Article II Exemptions, such carve outs should not last longer than ten years (that is, not beyond 2004).

In consequence, although the MFN obligation generally has some potential disciplining effects on services subsidies, diluting measures such as the option not to grant subsidies to foreign service suppliers at all, or to schedule a MFN exemption, partially offset these potential disciplining effects.

4.2 The national treatment clause (NT)

In contrast to the general MFN obligation, the national treatment (NT) clause contained in GATS Article XVII is specific to certain sectors and conditional. Article XVII stipulates:

“In the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect to all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers.”

With regard to subsidies, the NT clause was not an issue under the GATT (which deals only with goods).¹⁹ In contrast, if a specific sector is inscribed in a Member's GATS schedule of commitments, any subsidy (which is technically a 'measure' affecting the supply of services in this sector) provided to national service suppliers has to be made available to all 'like' foreign providers operating in the territory of that Member. Thus, the NT clause exerts a potentially strong discipline on the use of services subsidies by a Member in the sectors where it made NT commitments. The idea of course is that the obligation to grant the service subsidy to foreign like

firms inhibits the desire to grant the subsidy to national service firms.

However, since Members may differ in their pace towards services liberalisation under the GATS, the obligation to implement the NT clause varies significantly according to each Member's schedule of commitments. Moreover, Article XVII allows Members to include limitations on NT in their schedules, and most of them have included limitations on national treatment that apply horizontally to all services subsidies. Others, such as Canada, the EU, Japan and the United States, have done so only with respect to specific modes and specific sectors such as research and development. The inclusion of these limitations in schedules is necessary since, without it, providing a subsidy to a service on a discriminatory basis would be illegal.

To summarise, although the NT clause potentially has a strong disciplining effect on the provision of services subsidies, its effect is reduced by the fact that only those sectors inscribed in a Member's schedule of commitments are concerned, and if so, only if the Member did not explicitly limit the application of NT by sector or horizontally.

4.3 The subtle interaction between market access commitments (MA) and subsidies to services

Market access (MA) commitments (Article XVI of GATS) are the necessary condition for the existence of previous disciplining effects (through the NT and MFN clauses). Since MA commitments only apply to those sectors included in a Member's schedule of commitments, this means for example that in other sectors, a Member has no obligation to allow a foreign firm to set up a presence within its territory. Thus, the disciplining effect of the NT and MFN clauses on services subsidies is *de facto* toothless in all sectors not included in the schedule of commitments. In those sectors, foreign firms are not even allowed market access and can certainly not ask for subsidies. Thus, a government would not be deterred from providing subsidies to its services firms in such sectors for fear of being obliged to grant the same subsidies to foreign firms through the NT and MFN clauses (see above).

Members also have the option to specify “terms, limitations and conditions on market access” (GATS Article XX (1)(a)) in the MA column of their schedules. Let us suppose that a country allows a foreign services firm to set up a presence in its territory but adds in its MA column the condition that this foreign firm must not be subsidized beyond certain limits by its national government. Although unlikely in practice, the direct effect of this type of conditional MA commitment would certainly be to discourage the government of the foreign firm to grant subsidies to its firm for fear of making difficult or impossible for it to have MA in countries which have inscribed limitative subsidies conditions in their MA column.

4.4 ‘Additional commitments’ under GATS

GATS Article XX(1)(c) allows Members to make ‘additional commitments’ in sectors where specific commitments have been made. This provision could theoretically allow the request and offer of commitments to bind, reduce, remove or otherwise discipline services subsidies in the ‘additional commitments’ column of Members’ schedules. In practice, no country has used this option. Many consider the main limitation of using

additional commitments for disciplining services subsidies to be the difference in bargaining power amongst WTO Members. In the context of the current bilateral request / offer negotiations, this difference would lead to imbalanced or even no disciplining results. Furthermore, most countries seem to favour a multilateral approach to disciplines for services subsidies in response to the mandate provided in GATS Article XV.²⁰

4.5 Consultation under GATS Article XV (2)

The GATS provision dealing with subsidies (Article XV) provides in its second paragraph that:

“[A]ny Member which considers that it is adversely affected by a subsidy of another Member may request consultations with that Member on such matters. Such requests shall be accorded sympathetic consideration.”

This Article thus provides a mechanism under which a subsidising Member is required to consider cases of

alleged trade adverse effects caused by its service subsidy. However, this provision does not specify what the consulted Member is required to do in case the country requesting the consultations is able to show that it is adversely affected. Moreover, it is obvious that Article XV (2) purposefully does not make reference to the WTO Dispute Settlement Understanding (DSU) in case no mutually acceptable solution is reached. As a result, the consultative process under GATS Article XV (2) is more or less ineffective.

4.6 The role of non-violation complaints

GATS Article XXIII (3) stipulates that if a Member considers that any benefit it could reasonably expect to accrue (from a specific commitment of another Member) is being nullified or impaired as a result, for example, of a particular subsidy, it may have recourse to the dispute settlement process. This provision too exerts a natural disciplining effect on the granting of services subsidies since a country might be forced to provide compensation for the impairment generated

through its subsidy. However, according to GATT/WTO jurisprudence, the complaining country would have to demonstrate that such a subsidy was not anticipated at the time when specific commitments were made. Since information on services subsidies is at this moment opaque for most countries, it would be surprising to see a WTO panel take seriously the argument that such a subsidy was really unexpected.

4.7 The overall disciplining effect of the GATS

Even if the GATS MFN and NT clauses have some natural disciplining effects on services subsidies, these can potentially be reversed by the large degree of flexibility Members have to determine whether and to what extent those obligations apply, as well as the general option to deny MA for specific services sectors. Moreover, by limiting MA with regard to subsidised services, a Member has some control on the extent to which its local services suppliers are exposed to competition from

foreign subsidised services on the domestic market. The option to request trading partners to make ‘additional commitments’ with regard to subsidies could even go further as a Member could try to directly influence a trading partner’s subsidy use. However, all current tools offered by the GATS for disciplining subsidies are inherently limited as their ‘bite’ is largely dependent on an individual Members’ foresight and bargaining power.

5. TOWARDS A DEFINITION OF SUBSIDY IN SERVICES: THE CONCEPT OF ‘TRADE DISTORTION’

In this section, we will prepare the ground for a definition of a services subsidy. Such a definition does not amount to the establishment of multilateral disciplines relating to services subsidies. The role of the definition

is only to circumscribe the set of support measures that could be labelled as subsidies. Only at a later stage will other provisions determine how a particular subsidy measure is to be treated.

5.1 Article XV double bind

GATS Article XV stipulates that the aim of current negotiations is to develop “multilateral disciplines to avoid ... trade-distortive effects” of subsidies to services. Moreover, Members “shall exchange information concerning all subsidies related to trade in services”.

Article XV clearly sends a double message to WTO Members: first, it indicates that only subsidies with trade-distortive effects are targeted by future negotiations; and, second, it invites all Members to exchange information about all current services subsidies. It is thus not surprising that many countries seem to reason as follows: since no definition of a subsidy is given in Article XV and since future negotiations will target only subsidies having trade-distortive effects, it is logical to

notify only those support measures that do have such effects. This ‘chicken and egg’ reasoning creates confusion and invites foot-dragging under the pretext that distortion is a vague concept.

Our aim in the following two sections is to provide a definition of a services subsidy that will naturally insert the concept of distortion in the definition itself. This definition will allow Members to start the information exchange process envisaged by Article XV without each country needing to subjectively evaluate what are the subsidies causing trade distortion, and which must be notified to other Members. To this end, the concept of distortion is clarified first.

5.2 The link between the concept of distortion and the comparative advantage paradigm

The underlying idea²¹ behind the concept of distortion of international trade in services is that it is better for each country to specialise in the production of services in which it is most efficient, compared to other countries. A subsidy is seen as a practice that distorts the natural allocation of scarce resources by the market inside a national economy, because it gives a wrong signal to the recipient firm about its real production costs. This wrong signal leads to artificial overproduction of the subsidised service compared to what the firm would have produced in a situation with undistorted production costs. At the same time, there is inside this national economy an underproduction of more socially valued services due to the lack of

productive resources, which were artificially drained by the production of the subsidised service. We thus have a welfare loss for the national economy of the subsidising country, as well as a welfare loss for the world economy insofar as subsidised services prevent the use and thus the production of similar services produced in a more efficient way in other countries.

In practice this simple vision of distortion is based on two criteria: *specificity* of the subsidy and the fact that it provides to its recipient a *benefit not available on the free market*. We will return later to these two criteria in the context of services.

5.3 What distortion is not

As there is frequently some confusion between the concept of trade distortion and certain related

concepts, it will be useful to distinguish trade distortion from these other concepts.

Distortion does not mean discrimination between domestic and foreign firms

The concept of *distortion* is sometimes confused with the issue of *discrimination* between domestic and foreign firms. Let us suppose, for example, that country A has inscribed the telecoms sector in its schedule of commitments without adding any limitations on national treatment concerning subsidies to its telecom firms. Let us further suppose that country A provides assistance to its telecom firms and that such assistance is not available for foreign telecom firms established in country A.

In such a context, one may be tempted to say that we have here a clear case of 'distortive' subsidies since the assistance is granted discriminatory. This impression is

misleading, because this discrimination falls under the national treatment (NT) clause, which stipulates that in such a case subsidies provided to domestic service suppliers must be made available to all 'like' foreign providers operating in the country in question. In other words, we have a two-stage process. First, we define certain distorting measures as subsidies, and then we impose via the NT clause that these subsidies may not be provided in a discriminatory way. Let us note, however, that the discriminatory aspect of the measures does not play a role in the first stage, namely in the definition of certain trade-distortive support measures as subsidies.

Distortion is not linked to the environmental impact of a subsidy

It is important to distinguish the distortive impact on international trade of a services subsidy from the environmental impact of such a subsidy. This is a crucial point because the explicit aim of Article XV is to discipline only trade-distortive subsidies. Of course, privileged legal treatment to subsidies having a favourable impact on the environment could be considered. Logically, however, this would need to be done at a later stage.

In the first stage, we identify a measure as a subsidy within the meaning of a general definition based implicitly on the trade distortion criterion. In the second stage, we recognise for example that such subsidies may have a favourable impact on the environment and thus deserve privileged legal treatment. Let us note, however, that the environmental impact (whether positive or negative) of the subsidy does not play a role in the first stage, namely in the general definition of a subsidy.

Distortion does not entail a sophisticated analysis of the impact of the subsidy 'across the border'

The generally accepted view of distortion is implicitly based on the idea that any interference with the allocation of resources by the market inside a national economy leads to a disturbance of international economic relations by interfering with the principle of comparative advantage.

However, there have been many theoretical attempts to go beyond this simple view of distortion. The study of these efforts is relevant for the debate about 'trade distorting' services subsidies, as these attempts are based on the idea that distortion of international trade only takes place when there is proof that governmental aid has an impact 'across the border' of the subsidising country. As underlined by Jackson:

*"(Not) just any 'distortion' should suffice for the international system to take action. In some sense, every governmental action that impinges on the economy creates a 'distortion'.... However, it is a legitimate choice for a national sovereign to accept to lower economic welfare in order to promote certain societal and governmental objectives (such as redistribution of income, or support for the handicapped). As long as the government's actions are taken in such a way that the costs are borne only by that society, it seems inappropriate for other nations in the world to complain."*²²

Certain authors argue that the following examples are instances where the distortion caused by a subsidy does not 'cross the border' of the subsidising country.²³

*Box 1: Cited cases of subsidies without cross-border effect***A neutral regional subsidy**

Let us suppose* that a web design firm in Italy has a preference for coastal cities. The government, however, would prefer this firm, for social welfare reasons, to settle in certain underdeveloped regions. To this end, the government is ready to grant a subsidy to the web design firm, but only to compensate it for the disadvantages resulting from its location in the underdeveloped region. In such a case, one can maintain that any 'distortion' will arise inside the Italian economy, since the quantity of web design services sold outside Italy will not be modified. It is only the geographical distribution of web design services that will be affected by the subsidy whose costs are born by the Italian taxpayer. In this case, according to Jackson it seems 'inappropriate' for other nations to complain.

Neutrality of a subsidy with respect to the production costs of the firm

Under this scenario, let us suppose that a web design firm receives governmental aid for constructing a new building and this aid has no direct impact on the production costs of this firm. According to the simple view of distortion expounded above, such an aid automatically leads to a misallocation of resources inside the subsidising country and subsequently to a disturbance of international economic relations.

However, according to Diamond**, the 'distorting' effect on other countries is unclear since:

"(For) a payment to have this effect, it must lead the (subsidised) firm either to increase the quantity of goods offered or to decrease the price it charges in (foreign) markets. Because the recipient firm will produce until marginal revenue equals marginal cost***, a payment will have such a detrimental impact if it either decreases the marginal cost (curve) of the (firm) or increases its marginal revenue (curve). Unless this occurs, the government payment may increase the profits of (the subsidised) firm, but no need for a countervailing duty exists."

* Jackson (J.H), "The World Trading System", Cambridge, Mass, MIT Press, 1989, page 260.

** Diamond (R), "Economic Foundations of Countervailing Duty Law", in VIRGINIA JOURNAL OF INTERNATIONAL LAW, Volume 29, 1989, pp. 784-85.

*** Beyond this point, the cost of an additional unit (marginal cost) is less than the price of an additional unit (marginal revenue) and thus it is not profitable to produce this additional unit.

5.4 The legal impracticability of a sophisticated definition of services subsidy

Even if the 'across the border' version of distortion can be used implicitly through privileged legal treatment of certain kinds of regional aid for example, one must be aware that it is legally difficult to use this version (or other sophisticated versions) for a general definition of what constitutes a services subsidy. The reason is very simple: this would lead to a situation where every complaint would become a legal battle with the subsidising country trying to prove that its aid does not have an impact 'across the border' or, in other words, that its aid does not modify the behaviour of the assisted firm.

In such a context, WTO panellists and Appellate Body members would have to become economic experts in order to decide case by case if there is a distortion 'across the border'. There is no doubt that neither they

nor WTO Members desire to tread on this dangerous ground. Panellists and the Appellate Body would be very quickly accused of becoming legislators without the expertise required for this kind of judgment. It seems unlikely that the WTO legal system would succeed in a matter where even the US legal system does not attempt to succeed. For example, the current US Final Rule relating to countervailing duties specifies clearly that it is out of question for the Department of Commerce to use the sophisticated version of distortion:

*"If there is a financial contribution and a firm pays less for an input that it otherwise would pay in the absence of a financial contribution... that is the end of the enquiry... The Department need not consider how a firm's behaviour is altered when it receives a financial contribution that lowers its inputs costs or increases its revenues."*²⁴

5.5 The necessity of integrating the simple view of distortion

It is clear that the sophisticated ‘across the border’ vision of distortion is not legally feasible and this diagnostic is valid for numerous other sophisticated versions of distortion. It is thus necessary (in order to fulfil the mandate of Article XV of GATS) to integrate implicitly the simple vision of distortion in the very definition of a services subsidy. To this end, let us return to the simple

view of distortion derived from the comparative advantage paradigm. As pointed out, this view is based on the fact that a distortive subsidy is characterised by the fact that governmental resources are artificially channelled towards certain firms, giving them a wrong signal relating to their production costs.

Specificity in the context of services

When governmental resources are selectively channelled towards certain firms, it is the job of the specificity criterion to deal with this ‘selectivity’ aspect. In fact, this aspect is exactly the policy rationale behind the specificity criterion since the ‘selectivity’ of governmental aid is perceived as a cause of distortion *par excellence* (see section V.2 above for a discussion of the conceptual link between ‘distortion’ and competitive

advantage). This type of ‘distortion’ does not occur when the support is generally available to all services sectors in the economy as in such cases the supported service provider is on par with other sectors for obtaining scarce productive resources (which is the case for example of subsidized public highways). However, we will see below that in the context of services there is a need to clarify the meaning of ‘specificity’.

The benefit criterion adapted to the services context

For a firm to receive a wrong signal about its production costs, there must be a divergence between what a free market would have provided and what is artificially provided in practice by the governmental aid. This aspect is now clearly established by WTO case law in the context of the SCM Agreement. The *Canada-Aircraft* panel confirmed that a governmental financial contribution:

“Confers a ‘benefit’... [when it] places the recipient in a more advantageous position that would have been the case but for the financial contribution. In our view, the

*only logical basis for determining the position the recipient would have been in, absent the financial contribution, is the market. Accordingly, a financial contribution will only confer a ‘benefit’... if it is provided on terms that are more advantageous than those that would have been available to the recipient on the market.”*²⁵

However, as we shall see below, this definition of ‘benefit’ needs to be adapted to the context of services where the ‘market’ differs somewhat from the one applying to trade in goods.

6. TOWARDS A TAILOR-MADE DEFINITION OF A SERVICES SUBSIDY

The ‘folly’ of reproducing the goods legal regime in the field of services²⁶ is particularly clear when it comes to defining what constitutes a ‘services subsidy’. The main

reason for this seems to be the atypical role of ‘territory’ in the context of services.

6.1 The atypical role of ‘territory’ in the production of services

In the field of goods, the familiar scenario is as follows: a good is subsidised by country A and then completely produced on its domestic territory. Those units of the subsidised good not consumed by country A’s residents are eventually consumed by residents of countries B, C, etc. on their respective territories.

This scenario seems not to hold true in the field of services. Services can be delivered through four modes: cross-border supply not requiring the physical movement of supplier or consumer, such as the provision of a website design *via* the internet (mode 1); movement of the consumer to the country of the supplier, e.g. as a tourist (mode 2); services provided in the territory of a Member by foreign entities that have established a commercial presence, such as branches of international banks (mode 3); and, finally, provision of services requiring the temporary movement of natural persons, such as Indian computer programmers entering the US to service a US firm (mode 4). (See Box 4)

In the case of mode 2, let us suppose that country A provides a subsidy to a hotel located on its territory. The residents of country A will consume a part of the subsidised services provided by the hotel. However, and contrary to the classical scenario for goods, the rest will be consumed *on the territory of A* by foreigners coming from other countries.

As for the mode 3 scenario, let us suppose that country A provides a subsidy to a firm which then establishes a

subsidiary company in country B. Insofar as the subsidiary keeps a close link with its mother firm, one could say that the product line process takes place simultaneously on the territories of A and B.

Finally, let us take an example relating to mode 4: India grants a subsidy to an Indian computer programmer who then travels to the US to provide services to US firms. Contrary to the classical scenario for goods, the product is not entirely produced on the territory of India; at least one part of the production process of the service has to take place in a territory different from the territory of the country providing the subsidy.

The atypical role of ‘territory’ in services invites the following observations:

- The benefit conferred by a subsidy to a service firm is not necessarily confined (as it is for goods) to something unavailable on the free market of the territory of the government providing the subsidy. For example, India can pay a part of the hotel expenses of its team of computer programmers staying in the US.
- The notion of an export service subsidy is not so obvious. In fact, many services, such as hotels, are not even aware that they are exporters (this issue will be addressed in more detail at a later stage).

6.2 Subsidies to consumers of services

In the field of goods, a subsidy to a consumer is not technically a subsidy. Although Article 1 of the SCM Agreement does not specify the identity of the recipient of a subsidy, Article 2 of the SCM speaks of subsidies provided “... to an enterprise or industry or group of enterprises or industries within the jurisdiction of the granting authority”. It is thus clear that in the ‘goods

scenario’, subsidies to consumers are not covered by WTO rules and it would be difficult to impose such sophistication in the new and emerging GATS context. Moreover, from a policy point of view, one can argue that “paying a subsidy (such as Econobus subsidy to take the bus and not use the car for local transportation) to consumers and not to manufactures ... does not distort

competition nor does it protect the domestic market if all manufacturers have the same chance of presenting their efficient products on this market."²⁷

Since the SCM definition of a subsidy does not cover subsidies to consumers, subsidies to consumers of

services should – by the same token – not be considered as subsidies in the context of GATS. It would therefore be useful to explicitly provide in the definition of a services subsidy that such a subsidy is a governmental financial contribution provided to a *service supplier* (see section below on subsidies to individuals).

Box 2: Other GATS and WTO provisions with effects similar to subsidies

Many GATS provisions – such as Article VIII on monopolies, Article IX on business practices, and Article XI on payments and transfers – seem to have some conceptual links to the issue of services subsidies.

However, the definition of a subsidy, whether in the case of goods or services, is a specific and technical term. Therefore, once a definition is adopted, other measures will not be considered subsidies. If the definition of a subsidy integrates the *criterion of financial governmental contribution*, many practices that might seem unfair, and could generate effects similar to those of a subsidy, would not fall within the subsidy category.

This situation may be undesirable from a policy perspective. However, it is the only way to create legal predictability. The case of state trading enterprises (STEs) in the context of the Agreement on Agriculture serves as an example: Certain practices of STEs appear to embody a subsidy element from an economic perspective. However, as illustrated by the *Canada-Dairy*^{*} case, it is impossible to challenge these practices as subsidies without showing that they fall under the technical definition of a subsidy under the SCM and the Agriculture Agreements.^{**} Therefore, issues contained in Articles VIII, IX and XI of the GATS cannot be considered subsidies under the GATS if the financial governmental criterion is adopted, which is likely to be the case.

* Canada-Measures affecting the Importation of Milk and the Exportation of Dairy Products, WTO document WT/DS103/RWT/DS113/R, 17 May 1999.

** It should be noted that WTO Members such as the EC are demanding negotiations on special rules disciplining the subsidies element of agricultural state trading enterprises.

6.3 Subsidies granted to natural persons (mode 4)

A subsidy granted to a natural person (mode 4) – in her/his capacity of a service supplier – represents a special case. For example, if India provides a subsidy to an Indian computer programmer who then travels to the US to provide her/his services, the individual programmer is not a consumer, but a provider of a service. Such measures would not automatically be excluded from a subsidy definition similar to that of the SCM (see

above). As most developing countries have a comparative advantage in mode 4, it might be in the interest of developing countries to exclude from the definition of a services subsidy, any subsidy related to mode 4. As such, subsidies granted to natural persons could either be addressed at the definitional level, or as part of a provision dealing with special and differential treatment for developing countries.

6.4 Indirect or upstream subsidies

A subsidy to a service firm could be indirect (or upstream), in the sense that this firm could benefit from a subsidised input (whether a service or a good) without itself receiving any subsidy.

For example, a hotel that uses telecommunications (telephone, fax, Internet services) provided by a subsidised telecom firm could be regarded as receiving an indirect subsidy. However, a hypothetical difficulty

arises in the context of subsidised service inputs originating from governmental providers. For example, let us suppose that a company selling website design uses computer programmers trained at a public university. Could one say, in such a case, that the website design company benefits from an indirect subsidy? The answer appears to be negative – particularly if the service is supplied through the exercise of governmental authority, which is excluded from the application of GATS by Article I(3)(b). It should not be possible for a measure, which does not technically fall under the scope of the GATS to be transformed into an indirect subsidy at a second stage. This would be the case of services identified by WTO Members as arising from the exercise of governmental authority: justice administration, tax services, customs services, air control services,

military services and some register services and public services concessions in certain countries. Further, a gentlemen's agreement seems to exist for considering public health and public education as services provided under governmental authority even if they do not explicitly fall under the terms of article I(3)(b) since these services could in practice be provided in competition with private firms.

RECOMMENDATION

However, it would make sense to specify that subsidised services supplied in the exercise of governmental authority cannot be considered as subsidised inputs, leading to an indirect subsidy if used downstream.

Box 3: Lax environmental rules as a subsidy?

Some commentators^{*} argue that if society were to allow energy services to pollute freely, it would be equivalent to granting these services a production subsidy equal to the cleanup cost borne by society. According to this view, just as tax breaks are subsidies designed to lure major employers to locate a plant in a particular municipality, so too are lax environmental rules that allow firms to avoid cleanup costs.

Although this view is sound from an economic point of view, it raises some legal problems. First of all, it does not match with the current SCM definition of a governmental 'financial contribution,' which is one of the necessary components of the SCM definition of a subsidy. In the SCM Agreement, a governmental financial contribution is defined as a direct transfer of funds, guarantees, foregone revenue that is otherwise due, governmental provision of goods and services (other than general infrastructure) or purchase of goods and services, and payments to a funding mechanism.

On the basis of this definition, it is obvious that it would be very difficult to find a lax environmental policy a governmental 'financial contribution,' especially as this policy would take the form of an omission to enact or implement legislation. Moreover, there is a legal obstacle concerning the evaluation of the amount of a subsidy. The most serious legal obstacle is, in fact, the latitude that would be given to WTO panel and Appellate Body members to make inter-country comparisons of environmental rules in order to decide if a given set of rules is lax or not. Even if this was possible, panel and Appellate Body members would have to *quantify* the amount of the subsidy according to the 'amount' of divergence between two sets of rules. This is certainly an insurmountable legal obstacle.

^{*} Hackett (Steven.C), Environmental and Natural Resources Economics, M.E Sharpe Inc, page 51, 1998

Given the above observations, it appears that while some elements of the SCM definition of a subsidy are applicable to the field of services, some aspects of the CM definition are inappropriate, and others need to be added. As a result, the following working definition for a services subsidy could be considered:

A services subsidy is:

- **A specific financial contribution made by a government;**²⁸
- **Provided to a firm located – OR NOT LOCATED – within the territory of the contributing government; and**
- **Which provides a benefit not available on the free market IN ONE OF THE COUNTRIES involved in the production line process of the service.**

Box 4: Examples of services subsidies in the four modes of supply

Most frequently, subsidies are provided by country A and the firm receiving the subsidy is located on A's territory. A part of the service is consumed in country A and another part is consumed in countries B, C, etc.

Mode 1 includes the case of an Indian firm selling web design services via the Internet and receiving a subsidy from the Indian government.

Mode 2 includes the case of an hotel with mainly a tourist clientele, the hotel being located in territory A and receiving a subsidy from A's government.

Mode 3 includes the case of a subsidiary company originating from country B that establishes a commercial presence in country A while receiving a benefit from country A not available on the free market of country B. This mode 3 scenario is important since one-half of the total assets (US\$4 trillion) of the 100 largest multinational corporations exist outside the corporations' country of origin.

Mode 4 includes the case of an Indian computer programmer travelling to the US to sell her/his services and receives a benefit from the Indian government not available on the Indian market or the US market (for example a payment by India of part of the hotel bill in the US).

Though rare, the firm receiving the subsidy could be located outside the territory of the contributing country. For example, a firm (having B nationality) could be located on the territory of A and could receive a subsidy from country B conferring a benefit not available in one of the free markets along its production line process of a service. An example of this would be the case of a French bank receiving a subsidy from the French government in order to establish a subsidiary in Geneva.

7. GENERAL CONSIDERATIONS FOR SERVICES SUBSIDY DISCIPLINES

Finding an adequate solution for disciplining services subsidies and at the same time addressing public policy and sustainable development concerns requires exploratory work based on various potentially applicable models. Two basic models are identified in this paper: the ‘goods model’ used in the WTO Agreement on Subsidies and Countervailing Measures (SCM), and the model used under the WTO Agreement on Agriculture (AoA). Nevertheless, under either model, there are some common issues that need to be taken into

account. This chapter highlights three key parameters for a future model dealing with services subsidies, related to the degree of trade distortion of a subsidy, the importance of public policy objectives and the need to provide developing countries with special and differential treatment. The chapter then deals with specificity with regard to services subsidies, the issue of export subsidies, and highlights the need for an “exemption box” incorporating certain categories of subsidies.

7.1 Three key parameters for a future model

As pointed out earlier, trade distortion is an inherent feature of a subsidy. However, subsidies can generate both negative and positive effects, so the criterion of trade distortion alone does not determine whether a subsidy is ‘good’ or ‘bad’. Moreover, since some subsidies are necessary tools for pursuing public policies, this aspect needs to be considered. Finally, a disciplinary framework would need to take into account the specific needs and constraints of developing countries. This could be done by providing developing countries with

appropriate special and differential treatment (S&D) to achieve their goals.

These key parameters are all incorporated in current WTO rules on subsidies in goods and agriculture. Both the SCM and the AoA provide for different treatment of subsidies taking into account: (a) their degree of trade distortion; (b) certain public policy objectives; and, (c) S&D for developing countries. The following chapters will consider the two existing frameworks.

The SCM framework

Under the SCM, export subsidies as well as subsidies contingent on the use of domestic over foreign services are prohibited, whereas other subsidies are ‘actionable’ – namely, they can be challenged through the dispute settlement mechanism only on the basis of their adverse trade effects on the interests of other Members. Certain subsidies are considered ‘non-actionable’ – namely, not challengeable – if they are not ‘specific’ (see below)

and/or are granted in the pursuit of certain public policy objectives such as research, regional development and environmental protection.²⁹ Under S&D, the SCM has further made various exceptions for developing countries with respect to the use of export subsidies and subsidies contingent on the use of domestic services, the ‘actionability’ of subsidies causing adverse trade effects, etc.

The AoA Framework

In agriculture, the AoA distinguishes between agricultural export subsidies which are for most of them subjected only to reduction commitments and agricultural domestic support. Domestic support is then classified according to three ‘boxes’. The so-called ‘amber box’ (Article 6 of the AoA) includes all domestic support measures considered to distort production and trade. This includes measures to support prices, or subsidies directly related to current production quantities. ‘*De minimis*’ minimal support of the amber box type is

allowed (for developed countries, payments not exceeding five percent of the value of the specific product for which they are made, and payments which are ‘non-product specific’ if their total value is less than five percent of the whole agricultural production of a country). The reduction commitments relating to *amber box* support measures are expressed for each country in terms of a Total Aggregate Measurement of Support (Total AMS).

The so-called ‘*blue box*’ (Paragraph 5 of Article 6 of the AoA) could be called “*amber box* measures with conditions”. These conditions³⁰ are designed to reduce trade distortion because they require farmers to limit production. At present there are no limits on spending on *blue box* subsidies. Finally, the so-called ‘*green box*’ (Annex 2 of the AoA) includes support measures that must not distort trade, or that cause only minimal trade distortion. Measures in this box have to be government funded and cannot involve price support. The *green box* includes, for example, direct income support for farmers that are not related to current production levels or prices (namely they are ‘decoupled’). They also include environmental protection programmes, regional development

programmes, and general infrastructure programmes. *Green box* subsidies are therefore allowed without limits.

Additionally, under S&D, the AoA allows developing countries privileged legal treatment for their general reduction commitments (for example under the so-called *S&D Box*³¹, higher *de minimis*) as well as for the possibility of maintaining n certain export subsidies during the implementation period (AoA Articles 9.4). Moreover, developing countries have been granted longer implementation periods and lesser reduction commitments. Least-developed countries (LDCs) are exempted from any reduction commitment.

7.2 Specificity in the context of services³²

In the SCM ‘goods’ scenario, a subsidy is actionable only if it is ‘specific,’ (Article 2 of the SCM), namely when it is granted selectively in law or *de facto* to a group of enterprises usually called a sector (export subsidies are deemed specific). In other words, if a subsidy is available to all sectors of the economy, it is not specific and therefore not actionable.

There are, however, some subtleties when extending this criterion to the context of services. As pointed out by Chan³³ and Prylinski & Mongialo³⁴, the issue here is whether a so-called ‘modal specificity’ concept is needed in the context of services subsidies. The answer must be based on the policy rationale behind the specificity criterion and the way subsidies to services are provided in practice.

In the real world, it is unlikely for a subsidy to be granted to all service providers within a given mode across the national economy. In other words, it is unlikely in practice to see a subsidy granted selectively to a group of firms selling different products (tourism, communications, transport, etc.), but using the same mode X. As noted by many observers, many firms do not even know (and do not care) that their product is delivered *via* a certain mode.

Nonetheless, let us suppose for the sake of argument that there is an example of such a case in a certain national economy. Let us suppose also that all the firms receiving the subsidy argue that this case does not constitute an actionable subsidy because assistance to

all providers within a given mode should not be considered as specific.

This claim would be valid if no resources have been selectively channelled to subsidised firms using the same mode and they are thus on equal terms with their competitors. This not the actual scenario, however, since there are many other services inside the national economy (besides the firms using mode X), which could have productively used these resources. In fact, the argument claiming that a subsidy granted to all providers within a given mode should not be considered specific is *implicitly viewing this mode as comprising the entire service sector of a national economy*. The flaw in this reasoning originates from forgetting that competition for governmental funds is between all firms and all modes of a national economy and not only between firms inside a given mode.

The previous analysis is based on the policy rationale behind the specificity criterion. However, one must be aware that even in the goods context, this policy rationale is never adopted completely. For example, in the United States, a subsidy provided to the entire agricultural sector is generally not considered as specific even if, from a distortion point of view, resources used by agriculture could have been channelled to other sectors of the economy (industry, services, etc.). In other words, agriculture is seen as ‘too broad’ to be considered as a specific sector. Thus, *GATS negotiators have, in fact, a certain latitude to determine if a given mode inside a national economy is*

'too broad' and cannot be considered as specific. From the point of view of distortion, this would be questionable as underlined above, but this is already the case, in a certain way, in the context of the SCM and AoA Agreements.

The same previous reasoning therefore leads us also to the conclusion that a subsidy provided only to a certain service sector without any mode consideration (telecoms for example) also should be considered specific.

RECOMMENDATION:

In sum, one can argue that the distinction between mode specificity and sector specificity is somewhat artificial. What counts is knowing if funds have been artificially channelled toward a certain group of firms to the detriment of competitive firms that could have used these funds.

7.3 Export subsidies in the context of services

In the context of goods, export subsidies (in law or in fact³⁵) are usually considered the most distortive subsidies and are thus prohibited.³⁶ What is the origin of the bad reputation of export subsidies? To provide an answer, the distortion paradigm must be once again considered.

First, export subsidies are deemed³⁷ specific in the SCM Agreement because only the export sector captures scarce productive resources. Second, the adverse trade impacts of an export subsidy are considered to be entirely passed on to foreign markets (especially third markets), whereas in the case of an internal subsidy, the adverse effects are divided between the subsidising country and foreign markets. The bad reputation of export subsidies has recently been enhanced by the accusation that, when provided by rich countries (to cotton and cereals for example), export subsidies artificially destroy the rare sectors where developing countries have a competitive advantage.³⁸

If Members wish to prohibit export subsidies to services, this could be feasible in the case of 'in law' (*de jure*) export subsidies to services. Although such subsidies are unlikely in practice, this could be the case for example if a subsidy was expressly provided on the condition that a service firm established itself in an export-processing zone.³⁹ However, adopting this view in the context of 'in fact' (*de facto*) services subsidies could lead to strange and undesirable results. In the SCM context, an aid can be considered as an 'in fact' export subsidy when "the facts demonstrate that such ... assistance would not have been granted ... *but for* anticipated exportation or export earnings".⁴⁰

In the context of services, let us consider the case of tourism (mode 2). Every subsidy provided to this sector

could fall under the previous 'in fact' definition since it is obvious that most subsidies provided to this sector, especially in developing countries, would not have been granted *but for* anticipated 'export' of tourism services and to make hard currency earnings. This result could be undesirable since we have to keep in mind that consumers from foreign countries come voluntarily to the tourist countries to enjoy these services. Moreover, contrary to cotton and cereal export subsidies, subsidies to the tourist sector do not destroy artificially this sector in the countries of origin of consumers. It is most likely that those countries have no competitive advantage in this sector (for example, no sunny climate in Canada).

Let us also consider the example of a subsidy to an Indian firm specialising in sending computer programmers to the US in order to service US firms (mode 4). Once again, it would be difficult here to categorise this kind of assistance as an 'in fact' export subsidy. The reason for this difficulty is the atypical role of the territory in the field of services. Obviously, such a practice would distort the comparative advantages between the US and India; but since a part of the production line process of the service is provided in the host country (US), the US also benefits partly from of the additional economic activity induced by the subsidy. This would not be the case in the goods scenario where the entire exported and subsidised product is manufactured on the territory of the subsidising country. The same would apply too in the case of a subsidy by Country B to help one of its firms establish a commercial presence in Country A, as also in this case a part of the production line process of the service is provided abroad.

RECOMMENDATION

In light of these examples, a prohibition of 'in fact' export subsidies in the services area would lead to many questionable results from a policy point of view. A *de facto* prohibition of export subsidies would basically imply that various types of subsidies to foreign

exchange earning firms would be prohibited regardless of the real trade distortion impacts of these subsidies. Therefore it is advisable not to adopt the notion of 'in fact' export subsidies to services in the current WTO rules negotiations, especially if Members want to keep some public policy spaces.

7.4 The need for an exemption box

Many WTO Members take the view that, regardless which model for disciplines is chosen, there is a need to exempt from general subsidy disciplines those subsidies necessary to achieve certain public policy objectives. This demand is backed up by GATS Article XV.1, which takes into account the "needs of Members, particularly developing countries Members ... for flexibility" in the area of subsidies. In order to adequately reflect these differing needs for flexibility in providing subsidies, Members could consider the creation of an *exemption box* or *public policy box* consisting of three categories

matching the three pillars of public policy from the point of view of sustainable development, namely economic development, environmental, and social development pillars. The exceptions contained in the economic development pillar of the box would – as part of special and differential treatment (S&D) – only be available to developing countries. The other two categories would be eligible for all Members to allow flexibility to pursue environmental and social policies regardless of their individual level of development.

8. ADOPTING THE PHILOSOPHY OF THE WTO AGREEMENT ON AGRICULTURE

The method used in the WTO Agreement on Agriculture (AoA) to discipline agricultural subsidies consists of two stages. First, a general set of agricultural subsidies to discipline is identified. Next, certain subsets are subjected to various disciplines – mostly stand still and reduction commitments of various degrees. Certain subsets are also exempted from the disciplines. Disciplines in the AoA are not directly based on the need to demonstrate adverse trade effects. In other words, we do not find in the AoA that an individual measure is actionable only when it produces certain adverse trade effects (e.g. serious prejudice). Adverse trade effects play only an implicit role in the *general* identification of certain subsets of measures, which are then subject to

reduction commitments or to privileged legal treatment. For example, the so-called *blue box* subset is based on the identification of measures that are supposed to reduce trade distortion because they require farmers to limit production.

This section illustrates how this method could be extended to services subsidies. The AoA method can be used across the board (excluding of course sectors not covered by GATS such as services provided in the exercise of governmental authority), or only in committed sectors. From an anti-distortion point of view the across-the-board formula appears most adequate.

8.1 The exemption box

Once the sets of services subsidies are identified by a general technical definition indicating when a support measure constitutes a subsidy, a certain subset could be the subject of privileged legal treatment. We refer to

this subset as the *exemption box*, and it would be determined on the basis of the three main pillars of public policy: environment, economic development and social development.

Subsidies related to the environment pillar

It is not always easy to distinguish subsidies that have positive environmental impacts ('green' subsidies) from those that have negative environmental impacts ('brown' subsidies).⁴¹ This is because the theoretical distinction between 'green' and 'brown' subsidies often becomes less clear in the real world. There are some governmental programmes that appear brownish-green, or greenish-brown, depending on the observer's policy perspective.

For example, consider a governmental grant programme that enables fishers to purchase new fuel-efficient fishing vessels. These new vessels may discharge less pollution and use less petroleum, but they also make it possible to travel to distant water fisheries, thereby increasing the catch and depleting high seas stocks. Consider also a governmental programme that pays private timber companies to plant new trees after clear-cut logging on public land. This programme might contribute to reforestation, but it also allows the continuation of destructive clear-cut logging practices. As such, the

fishing vessel and reforestation programmes could be reasonably characterised as either green or brown.

According to Kibel⁴², because of the difficulty of distinguishing between 'green' and 'brown' interventions, the drafters of the SCM Agreement recognised that the problem could not be solved through an international trade rule that simply permits 'green' subsidies. The invitation and opportunity for abuse under such a general rule by resource industries would be far too great. The drafters feared that if such a broad rule was adopted, the industry would simply make certain that all subsidies contained some green elements. This would provide for the necessary environmental cover for the subsidies to be justified. The result would be what Alan Dardoff and Robert Stern have termed "acupuncture with a fork": In attempting to preserve national incentives to protect natural resources, environmentalists might inadvertently be providing industry with a new legal basis to defend environmentally destructive subsidies. To curtail such abuse, the Uruguay Round AoA and

SCM Agreement set forth an extremely narrow definition of what constitutes a permissible, or non-actionable, green subsidy.⁴³ Thus, in what follows, one must be aware that some prudence is necessary to avoid the abuse feared by the drafters of the SCM Agreement. The following subsidies could be considered as potential candidates for an inclusion in the *exemption box* on the basis of their positive environmental effects. It is useful to underline from the outset that theoretically such an exemption could be absolute or conditional on the absence of a conflict with other rules. For example, subsidies promoting environmentally sound production methods could be exempted in every case or only when they do not take for example the form of prohibited export subsidies. Negotiators would have to arbitrate case by case between the legal predictability brought by absolute exemptions and policy benefits of conditional exemptions.

Subsidies promoting environmentally sound production methods: Subsidies may be provided to service providers to promote environmentally sound production methods, especially the use of renewable energy. An example is a Danish environmental aid scheme, which seeks to support the transport of goods by rail on Danish territory. The aid is in line with the White Paper on European transport policy, which acknowledges the need to shift transport from road to rail. In the same vein, one could mention subsidies to energy and transport related services favouring less dependence on fossil fuel energy. As is now well known, fossil fuel energy leads both to various local pollution problems and global warming. For China and India, which depend heavily on coal, subsidising low cost clean technologies is urgent.

Subsidies promoting the implementation of new environmental requirements: Subsidies supporting the implementation of new environmental requirements were allowed for goods in the context of the SCM Agreement (Article 8.2.c).⁴⁴ Of course, GATS negotiators could decide to provide similar or more generous privileged legal treatment in the context of services than given in the SCM Agreement. This provision is most likely to be invoked by services that are particularly susceptible of harming the environment in order to acquire antipollution equipment (in particular transport, tourism, construction and energy related distribution services).

Subsidies promoting environmentally friendly services such as ecotourism: Members may also wish to provide assistance to promote services that are inherently 'environmentally friendly' over similar services that are not. Environmentally friendly services that have the potential to promote economic growth and employment could also be especially prioritised for subsidisation, such as eco-tourism in developing countries. Ecotourism is responsible travel to natural areas that conserves the environment and sustains the well being of local people. Subsidies to ecotourism could take the form of income tax exemptions, accelerated depreciation allowances, and duty-free imports.⁴⁵ They could also take the form of financing marketing research, feasibility studies and personnel training for ecotourism. Perhaps most important is to link income generated by ecotourism to improving welfare of local communities. One example of such a link is the fact that most of South Africa's Kruger Park's 2700 employees are from local communities.

Subsidies to services through funds under Multilateral Environmental Agreements (MEAs): The *Multilateral Fund* included in the *Montreal Protocol for the Elimination of Ozone Depleting Substances*⁴⁶ provides an example of funds to services promoting the implementation of an MEA. The Multilateral Fund provides developing countries with financial aid to move to CFC-free refrigerators, CFC-free air conditioners and other CFC-free consumer products. The Multilateral Fund also helps pay for closing down CFC production facilities and increasing production of ozone-friendly chemicals. There could be a case where for example, a GATS Member invokes provisions of the Montreal Protocol's Multilateral Fund and provides payments to some of its services for environmental purposes. In the context of such a scenario, one can imagine a trade complaint, most likely from a GATS Member, which is not a party to the Montreal Protocol, portraying such payments as potentially actionable subsidies under GATS. Of course, it is arguable whether there is a governmental 'financial contribution' in such a case (since the origin of the funds is multilateral).

RECOMMENDATION

It is however preferable to specify clearly that such subsidies are legally protected under GATS since WTO panels tend to disregard MEAs provisions and public international law when it comes to interpreting provisions of WTO Agreements.⁴⁷ More often than not, the

conclusion of the panel would be that for one reason or another (for example, the MEA does not deal with the issue of the dispute) the MEA is not relevant for interpreting WTO Agreements.

Funding for alternative energy and energy efficiency research: Substantial increases in alternative energy and energy efficiency R&D occurred in the years following the OPEC induced oil price shocks in the 1970s. However, a combination of factors, including the collapse of oil prices in the early 1980s, led to a sharp decline in alternative energy R&D, with the 1993 US budget in this field being US\$200 million. Compare this R&D spending in 1993 to the US\$500 million spent on fossil-fuel R&D and over US\$600 million spent on nuclear energy R&D. In this context, one could also mention

R&D subsidies to services for enhancing solar power research and use, R&D subsidies for enhancing alternative energy use in the context of public transportation and, finally, all R&D subsidies for enhancing energy-efficient technologies by services.

Moreover, it has to be kept in mind that subsidies provided to commercial environmental services (such as sewage and waste disposal services) could benefit low-income consumers in developing countries, since they enable them to benefit from such services at lower costs (sometimes at little cost to their own governments). This would be especially beneficial if there are no commercially viable domestic environmental services firms in the developing country.

Subsidies related to the economic development pillar

Article XV of GATS specifies that future GATS negotiations relating to services subsidies shall “recognise the role of subsidies in relation to the development programmes of developing countries and take into account particularly the needs of developing country Members for flexibility in this area”. The following types of ‘development’ subsidies could be considered for privileged legal treatment in connection with the economic development pillar.

Protecting developing countries’ nascent services in the context of the life cycle of a service: Although the ‘nascent industry’ argument is debated, developing countries should consider the fact that many services seem to follow a life cycle. Many authors have noted that the life cycle theory seems to apply well to services. Engineering serves as an example. In the US, the development of the West at the beginning of the century as well as great infrastructure and construction projects led to the flourishing of engineering firms. This movement was amplified by the two world wars. US engineering firms were world leaders during the 1950s and 1970s, but gradually European and Japanese firms took their place during the 1980s. In their turn, European and Japanese firms confronted competition from the new industrialised countries (NIC), which now confront competition from low wages developing countries. As for US firms, they reacted by subcontracting and specialising in projects involving high technology.

In the field of computer and data processing services, the life cycle product theory also seems to explain the dynamics. Data processing services emerged at the beginning of the 1970s, and the world leader at that time was IBM. In Europe and Japan, governments began to practice an *nascent industry policy*, and this approach was very successful in Japan. As the technology of data processing services became increasingly mastered, cost factors became the principal source of competitiveness. Thus, at the beginning of the 1980s European and Japanese firms began to export computer and data processing services, not only to developing countries but also to the US. However, certain developing countries (India and Korea) also began to internally develop their data processing services and, since the cost factor is now predominant, are now engaged in exporting them.⁴⁸

It is important to note that the nascent industry phase may be necessary for developing countries that are learning to master the mass production of the new service at a low cost. Since a subsidy is one of the least distorting ways to protect a nascent industry, a privileged legal position for services subsidies connected with the nascent industry argument seems worthwhile to consider. Of course, it would be necessary to define precisely what a serious nascent industry is in order to avoid abuse. Such subsidy exemptions could be made clearly time bound and subject to the achievement of objective indicators.

*Subsidies to services adding value to unprocessed primary commodities*⁴⁹: Developing countries often face challenges because of their heavy reliance on volatile primary commodity markets and declining terms of trade. Fostering technological capabilities and diversifying their economies toward more value-added products could be part of a package of solutions.

Let us suppose in such a context that a service sector can add more value to a primary commodity (mineral for example). This added value could concern the product itself, the technology used for its manufacturing or its marketing. The marketing service is important for value-added purposes since competition no longer is taking place only through tariffs. Export markets will gradually evolve to having a competitive dynamic similar to the competitive dynamic found in a country's own domestic market. In other words, branding and packaging are competitive edges both in the export markets and the domestic markets. For this reason, it is important that developing countries accelerate the development and organisation of their export infrastructures through common service facilities and adequate overseas marketing representation. Market intelligence, in particular, is one aspect of national export strategy that must be prioritised. With shifts in demand and volatilities across developed regions, export market intelligence must be targeted toward an exporting nation's ability to foresee export opportunities in emerging markets. In sum, subsidies to complementary services helping to add value to primary products in developing countries are serious candidates for privileged legal treatment in the context of an 'exemption box'.

Subsidies to mitigate the digital divide: The digital divide, or the gap between those with access and the ability to use information and communications technologies (ICT), and those without, remains enormous. For example, the total Internet bandwidth in Africa is equal to that in the Brazilian city of Sao Paolo, while developed (Organisation for Economic Cooperation and Development) countries are home to 80 percent of the world's Internet users. ICT have powerful linkage effects and positive externalities which can help services firms to overcome constraints related to production and marketing such as information about potential export markets or technical requirements and standards in the importing country. Bridging the digital divide can also provide a powerful tool to help achieve the Millennium Development Goals. For example, community radio stations in Africa provide vital information on

weather disaster warnings, health and nutrition, and HIV/AIDS prevention. In such a context, it seems legitimate for developing countries to ask for privileged legal treatment for many subsidies related to the mitigation of the digital divide, including subsidies to domestic ICT firms in order to increase access and connectivity and to develop skills for the digital economy.

Temporary subsidies to local small business services to reduce dependency on 'export services': Let us suppose that a developing country confronts a rise of its external development debt and is thus mandated to adopt export-oriented policies in the context of structural adjustment programs (SAPs), which are common across many low-income countries around the world. In the context of services, these export-oriented policies could mean, for example, an intensification of services such as tourism, in order to earn the necessary foreign currency for reimbursing the external debt.

Many authors⁵⁰ have noted that such a scenario can lead to environmentally unsustainable pressure on resources such as seashores or forests in order to maintain steady export income. In such a context, subsidies to services intended to divide up the pressure among various services could claim privileged legal treatment. Of course, we are here in a grey zone where abuse is possible. However, the issue of unsustainable dependency on some services for generating hard currency gains to repay external debt is truly a problem for developing countries.

In the context of this diversification, one can mention promotion of local small business services start-ups through small business loans and business incubators (providing leasable space plus office management and marketing assistance). Micro lending, which is a highly effective strategy that promotes entrepreneurship and empowerment, can also be mentioned. Of course, these diversification subsidies must be temporary and be repealed once the small business service is viable. If permanent, these subsidies will become an invitation to create artificially protected and inefficient small business services. However, even after the expiration of the subsidies, there are possibilities (not related to GATS disciplines) of local support for these small business services. First, there could be local support if local consumers are willing to pay a small price premium for a community's social and cultural capital, allowing local small business services to survive. Second, these small

business services could survive after the expiration of the subsidies by developing niches based on the personal contact with the consumer or providing services not available elsewhere.

Additional privileged legal treatment for subsidies to cleaner technologies by services in developing countries: One cost of implementing cleaner production technologies is that oftentimes it puts these methods

beyond the reach of low-income countries. As noted above, the pressure to export resources abroad in order to repay development loans, have reinforced problems of unsustainable production in the developing world. Due to the high cost of cleaner production technologies, incentives to help their adoption by service firms in developing countries are serious candidates for a privileged legal treatment.

Subsidies related to the social pillar

Many services have an intrinsic value to society which may justify the need for subsidies (e.g. health care in remote areas). Such subsidies could fall under a 'social pillar'. Subsidies to private entities that provide such services may be justified on several grounds. First, there is often an imbalance between the level of investment required and the expected returns, which leads to the fact that full costs of these services may not be covered. For example, providing health care services in remote and poor rural areas requires investment in hospitals and infrastructure, but this is unlikely to yield profitable returns. In such cases, a subsidy may be required to ensure that these services are viable and to provide universal healthcare to all. Secondly, many of these services have positive externalities and significantly determine human development indices, the quality of life in the country, and the long-run competitiveness of the economy as well. Thirdly, many of these services are desirable as they enable societies to preserve cultural diversity or particular traditions and practices.

Subsidies provided under a social pillar would include subsidies to critically needed services such as health and education, the development of economically and socially backward regions, social fulfilment of women, programmes for minority groups, and the preservation of cultural diversity and traditional knowledge. Each of these examples of subsidies could also be applied in a regional context to bridge regional divergences with regard to the social pillar objectives.

Subsidies relating to R&D: Subsidies on R&D are generally perceived as policy instruments which can generate very positive externalities for societies through the improvement of services such as health and education. Subsidies for purchase of research equipment and training of researchers could also be included in this category.

Health and social care: Many social groups lack adequate access to healthcare due to their low levels of income. This is especially important in the context of life-threatening epidemics affecting many countries of the developing world, notably in Africa. Subsidies in terms of access to medicines and life-saving equipment, training of doctors and health workers, transport of the poor to health centres etc could be examples of subsidies under this category in order to ensure 'universal access'. Certain services may be critical from a societal perspective, especially owing to rapid urbanisation and industrialisation, as well as the breakdown of large traditional family units. These could include care of young children, crèche and nursery services and care of the elderly. The cultural context may also be of relevance in the delivery of such services.

Education and promotion of cultural diversity: Education like health is critical for economic, social and cultural development of countries. Education ensures assimilation of critical skills needed for economic development. For these and other reasons, subsidies to educational services may be needed. Culture is different from other merchandise because it goes beyond commercial aspects. Cultural goods and services convey ideas, values and ways of life which reflect the plurality of a country and the creative diversity of its citizens. Cultural diversity is now recognised as a legitimate public policy objective. In a paper tabled in 2000 on the audiovisual sector, the US recognised "the sector's specific sensitivities" and suggested that recognition be granted for "the use of carefully circumscribed subsidies for specifically defined purposes ...".⁵¹ Such exemptions could also be extended further towards education, theatre and drama among others. Preserving cultural and other diversity could also include traditional knowledge and know-how of indigenous peoples and groups.

Subsidies to assure water supply: Water is the basis of life; a unique natural resource that makes a critical contribution to human health and the well-being of all societies. Water is also considered, by the economic literature, to be a public good. This can be seen through the fact that if water is already available to one person, it costs little to provide an additional person access to it at the same place.⁵² Global water use has increased in recent decades owing to growing populations and greater use. In order to reduce the pressure on water resources, many governmental development agencies and water supply companies are moving towards full

cost pricing. However, this has brought affordability issues to the fore. Despite their anathema to national governments and development agencies seeking financially viable water services providers, there is an increasing recognition that some kind of public support in the form of subsidies will be necessary. This policy must be applied while simultaneously extending water services to low-income households.⁵³ Such subsidies could be privileged in the future design of services disciplines, especially in countries and areas where water has increasingly become a scarce resource.⁵⁴

Box 5: Services provided in the exercise of governmental authority

In the case where a service is supplied in the context of the exercise of governmental authority, without the aim of making a profit, and without competition, there is no need for a provision granting privileged treatment to subsidies for such services. In such a case, any GATS rules on subsidies do not apply, since services supplied in the exercise of governmental authority are excluded from the scope of GATS by virtue of Article 1.3 (b) of GATS.

8.2 The ‘harsh reductions or prohibition’ box

The following subsidies to services are potential targets for an inclusion in a ‘harsh reductions or prohibition’ box:

‘In law’ export subsidies

Export subsidies (in law or in fact⁵⁵) for goods are considered distortive *par excellence* and are thus prohibited⁵⁶ in the SCM Agreement. As previously noted, adopting the notion of ‘in fact’ export subsidies in the context of services could lead to strange and sometimes

unintended results. Accordingly, the concept of export subsidies in GATS should be restricted to *de jure* or ‘in law’ export subsidies (for example services in export processing zones) and these subsidies could be included in a potential ‘harsh reductions or prohibition box’.

The issue of subsidies contingent on the use of domestic over foreign services.

Like the SCM (Article 3.1(b)), adding subsidies contingent on the use of domestic over foreign services to the ‘harsh reductions or prohibition box’ could be considered. This kind of subsidy does not seem to be covered by the national treatment (NT) clause which provides only that if a subsidy is granted to a domestic firm, then an identical subsidy to a like foreign firm based on its territory has to be provided as well. At first glance, it seems logical to follow the example of the SCM Agreement and to prohibit such subsidies. Of

course, an exemption of subsidies from the NT obligation would not supersede this prohibition since, technically, this case does not seem to fall under NT.

Some proponents, however, see these kinds of subsidies – when combined with performance-related measures (e.g. use of local services requirements) – as essential to promote competitiveness in the supply-side of developing country economies.⁵⁷ Allowing developing countries to access this type of subsidy, as part of

special and differential treatment, could therefore be considered. Moreover, by virtue of its footnote 9, GATS does not seem to exclude quantitative restrictions (quotas) on imported inputs to services, even in scheduled sectors. It is therefore possible to argue that prohibiting subsidies contingent on the use of domestic input services would encourage a switch to the use of quotas against foreign input services. Since quotas are more distortive than subsidies, this could create a preference for using an economically inferior instrument.

Brown subsidies

Brown subsidies can be defined as subsidies that contribute to rapid natural resource degradation by artificially lowering the costs of extraction or production of a resource. Even though the focus of negotiators will be on adverse trade effects as indicated by their mandate under Article XV of GATS, the following subsidies are potential candidates in case of consensus between negotiators for a harsh treatment on the basis of their adverse environmental effects.⁵⁸

- Aids to services transferring toxic waste from rich to poor countries. By separating the consumption of goods from the pollution associated with these goods in rich countries, the incentive to reduce this pollution in rich countries is itself diluted.
- Subsidies paid by country A to its service firms in order to move for example carbon intensive activities to country B which has chosen not to take

The SCM prohibition of subsidies contingent upon the use of domestic products needs to be viewed in conjunction with the general prohibition under Article XI of the GATT of quantitative restrictions. It would be therefore logical to adopt in GATS the prohibition of subsidies contingent on the use of domestic services, only in cases where the switch to quotas targeting foreign inputs is not possible.

- Control measures for carbon emissions. This point is important, since otherwise we would risk a failure of multilaterally coordinated control efforts of the greenhouse effect.
- Subsidies to services in congested and ecologically fragile regions such as overexploited seashores.
- Subsidies to services threatening endangered species.
- Subsidies conditional on the use of fossil-fuel energy as an input.
- Direct subsidies (not related to inputs) to energy-related and energy distribution services using intensively fossil fuel energy.

8.3 The 'residual box': slight reductions

This box is residual by definition since it includes all subsidies to services not related to the previous two boxes. In practice, this box would entail a commitment to reduce slightly these subsidies. This commitment could take the form of a *unique* low percentage of reduction across-the-board of this entire category.

However, some remarks seem appropriate, taking into consideration the – sometimes dissatisfactory – experiences with the implementation of the WTO Agreement on Agriculture (AoA). The technique in agriculture to reduce amber box support by progressively lowering the

bound AMS (aggregate measurement of support) did not provide for adequate predictability as countries had the possibility to effectively increase certain product-specific support as long as the overall AMS reduction target was met. Additional loopholes in the AoA also lead to the strange fact that overall levels of domestic support in major subsidising countries (including *amber* box, *de minimis*, *blue box* and *green box* support) remained largely unchanged despite. This was due to so-called 'box-shifting' where former non-exempt support had been moved to the *blue* and *green* boxes, which are not subject to any reduction requirements. This is accomplished

through the *de minimis* loophole of Article 6.4 of the AoA, allowing countries to ignore support of up to five percent of the production value of a commodity.

If these shortcomings of the ‘agriculture model’ are not to be reproduced in the GATS context, then reducing *residual box* subsidies on a disaggregated, i.e. sector-

specific basis, as well as placing ceilings on support provided under the *exemption box*, or on its sub-categories, respectively, could be considered. Additionally, the disciplines of the *exemption box* should be made strict enough so that former *residual box* support cannot simply be formally redesigned and presented as a new *exemption box* payment.

9. ADOPTING THE PHILOSOPHY OF THE WTO SCM AGREEMENT⁵⁹

The philosophy of the SCM Agreement is based on the identification of three boxes, which are given the colours of traffic lights: red (forbidden), green (permitted), amber (slow down).

The '*red light box*' deals with prohibited subsidies. Prohibited subsidies are forbidden *per se* without the necessity to demonstrate their adverse effects since they are presumed to exist without any refutation of these adverse effects being possible. An illustrative list of prohibited subsidies is annexed to the *red light box*. Sometimes, this illustrative list indirectly contains some effects (as the so-called 'material advantage' criterion under item (k) of the list) that must be demonstrated in order to identify a practice as a prohibited subsidy under the illustrative list.

The '*green light box*' (where the adjective 'green' is related to traffic lights and not to environmental objectives) deals with measures that technically are subsidies, but are exempted from any discipline on the basis of certain policy rationales.

9.1 Red light box

All subsidies to services included in our previous *harsh reductions or prohibition box* are potential candidates for inclusion in this *red light box*. Let us underline that once a services subsidy is identified as included in this box, there is no need to demonstrate the adverse effects (whether trade or environmental) of this subsidy

9.2 Green light box

All services subsidies included in our previous *exemption box* are potential candidates for an inclusion in this *green light box*. Let us note that once a services subsidy is identified as included in this box, there is no need to demonstrate that certain adverse effects (whether trade or environmental) have been avoided in order to

The '*amber box*' deals with subsidies that are subject to certain disciplines, when certain adverse effects of these subsidies are demonstrated (so-called 'serious prejudice', for example). The disciplines could consist of the removal of the adverse effects of the subsidy or the removal of the subsidy itself.

Most of the previous material relating to the scenario inspired by the philosophy of the AoA could be reorganised under these three boxes. In what follows, one should keep in mind that, in the WTO context, there is no rule prohibiting a subsidy, subjecting it to reduction commitments or making it actionable, on the basis of certain environmentally adverse effects. In other words, the notion of environmentally harmful subsidies is not yet a legal concept under the WTO, and the basis for any action against a subsidy is rooted in a trade-distortion philosophy. Nevertheless, in case of consensus between negotiators, we have included tentatively in our boxes some elements derived from the notion of environmentally harmful subsidies.

in order to ask for its removal. However, adverse effects could play an indirect role in the general definition of this box, as in the case of the "material advantage" effect in item (k) of the SCM illustrative list of prohibited subsidies.

claim an exemption from disciplines for this subsidy. However, the avoidance of adverse effects could play an indirect role in the general definition of this box, as in the case of the "decoupling" criterion in the green box of the AoA.

9.3 Amber box

All subsidies to services included in our previous *residual box* are potential candidates for an inclusion in this *amber box*. Here, however, the nature of the disciplines would be different from the scenario inspired by the AoA. Subsidies included in the previous *residual box* were subjected to a reduction commitment taking the form of a unique low percentage, and this reduction commitment was in no way related to the necessity of demonstrating some adverse effects. Here, services subsidies included in the *amber box* would be actionable only on the basis of certain demonstrated adverse effects. Once this demonstration is satisfied, a Member could ask for the removal of the subsidy itself or the removal of its adverse effects.

With regard to these (trade or environmental) adverse effects, it seems once again that the atypical role of the territory in the field of services could create some situations unfamiliar in the SCM goods context. What follows is a list of some illustrative examples.

Most frequent case: the subsidized firm is located on the territory of the subsidising country.

Country A is the subsidising country and the firm receiving the subsidy is located geographically in the territory of A. A part of the subsidised services is consumed in A's territory and another part in the territories of countries B, C, etc. In such a case, the adverse effects of the subsidy may appear for example:

- On the territories of B where 'like services' (defined in the most extensive sense in order to reinforce the discipline on subsidies) are displaced by the subsidised services coming from A (*B is the potential complainant*). For example, US web design producers can complain via their government about subsidised web design provided from India via the Internet. Another example is a case in which US computer programmers can complain via their government about subsidised Indian computer programmers coming to the US.
- On the territory of A when sales of 'like' producers from B are displaced in country A's market (*B is the potential complainant*). For example, US service firms could complain via their government about being displaced in the Indian market due to subsidies provided by the Indian government to firms located within Indian territory.

- On a third market C where subsidised services by A's firms displace services coming from B (*B is the potential complainant*). For example, Indian computer programmers could complain via their government that their sales in Europe are displaced by subsidies provided in the US to US 'like' firms.

Rare scenario: the subsidized firm is not located on the territory of the subsidising country.

Country A is still the contributing country, but this time, the firm receiving the advantage is on the foreign territory of (e.g. France subsidises a French service firm located in Geneva).

Under such a scenario, adverse effects may appear:

- On the territory of A where producers of like services are displaced by sales of the subsidiary company located in B (*A is here the complainant*). Compared to goods, this is an unusual scenario, which is, however, completely coherent from a distortion point of view. The source of this rare scenario, where a group of service producers lodge a complaint against a subsidy granted by their own government, is of course the atypical role of territory in the field of services (see above).
- On the territory of a third country C, where sales from the subsidiary company located in B displace sales by C service producers in their own market C (*C is here the potential complainants against A*).

It is important to note that in all the previous scenarios the complaint is always against the subsidising government A. However, due to the atypical role of territory in the field of services, the origin of the complaining country or service firms lobbying their government for lodging a complaint, could be surprising compared to what is familiar from the goods scenario.

With regards to the adverse effects *per se*, they could be labelled:

- Injury to the sales of domestic service firms of the complaining country *in the market of the complaining country*;
- Injury to the sales of domestic service firms of the complaining country *in a third market*;
- Impairment of commitments made by the complaining country when the subsidy is unexpected at the time the commitments are made;

- Serious prejudice (with the burden of proof on the complaining or the defending country according to different cases). Serious prejudice can be defined and presumed according to various criteria (amount of subsidies, world market share, etc.).
- Adverse environmental effects: let us recall however that the notion of environmentally harmful subsidies is not yet legally accepted in the WTO context. Adopting such a notion in the GATS context would be a bold step.

10. ON THE APPROPRIATENESS OF A COUNTERVAILING DUTY MECHANISM

Article XV of the GATS specifies that negotiations on services subsidies shall address the ‘*appropriateness of countervailing procedures*’. Let us recall that in the SCM ‘goods’ context, an ‘actionable’ subsidy can be challenged in two different forums. The first forum is the multilateral WTO forum where the complaint is lodged by a country against another country and examined by a panel. In such a case, the goal is to remove or modify in some way the challenged subsidy. The second forum is the national forum of a country importing a subsidised product. In this latter forum, the complaint is lodged by an allegedly injured national industry and aims at the imposition by the importing country of countervailing duties (CVD) once a material injury of the complaining industry is demonstrated. As for the challenged subsidy *per se*, it stays untouched since the aim of the CVD is only to offset the effect of the subsidy.

The atypical role of the territory in the field of services could, however, be the source of many problems if the CVD regime prevailing in the goods context was put to practice with regard to services. In the area of goods,

subsidised products targeted by CVDs in country A are entirely manufactured and subsidised in the territory of another country B. As we know, this is not always the case in the field of services due to the special nature of the product line process of a service and the variety of modes through which a service can be supplied. Let us suppose, for example, that a tour operator is established and subsidised in country A and then provides tourist tours in country B through a kind of commercial presence. Could tour operators of country B ask their government to impose countervailing duties on the tour operator from country A? It is important to note here that the tour operator from country A uses factors of production hired in country B (buses, guides, etc.) in order to provide the tour service in country B, whereas in the goods context the targeted product is entirely manufactured on foreign territory.

In addition to the difficulties that could arise due to the atypical role of territory in the field of services, there are at least three additional arguments against extending the countervailing duty regime to the field of services.

10.1 The CVD regime can become a protectionist tool

Conceptually, a distinction must be made between unfair trade laws (subsidies and dumping) and fair trade laws (safeguards⁶⁰). In the former case, it is crucial to demonstrate that the challenged practice is ‘unfair’ by establishing, for example, the existence of a subsidy. In such a context, one could say that the injury test is in a certain way only complementary to the crucial step where the ‘unfair’ practice is identified. On the contrary, the safeguard regime (which allows countries faced with excessive imports to impose quantitative restrictions on these imports) involves no test of fairness and is entirely based on an injury test. However, Finger and Murray⁶¹ have indicated that in CVD and dumping cases in the field of goods, subsidisation and dumping are systematically found to exist in nine out of ten investigations. One reason for this high frequency appears to be that the ‘fairness test’ is being applied in an over-flexible manner in most investigations. In other words, the most probable way to avoid countervailing or antidumping duties in practice is to rebut the results of the injury test. This criterion, however, is one of the

major features of the safeguard mechanism. Also in many cases, the simple fact of filing a CVD complaint could reduce competition in several ways even if the case ends with a finding of a negative final jury determination. This is the case because:

- The costs for the exporter of responding to the CVD petition and the uncertainty regarding the potential profitability of developing a new market may create incentives for the exporter to cut back efforts for exporting and avoid litigation. Likewise, importers, especially manufacturers, will be less certain of the price they will pay in the future and may shift to other domestic sources of supply.
- Filing a CVD petition helps to build political support for the import-competing service. This support increases the likelihood that legislators will take direct action to protect the industry, or that the Executive will pressure the exporting country to limit its exports.

10.2 The risk of redundancy with the future GATS safeguard mechanism

Article X of GATS mandates WTO Members to undertake multilateral negotiations on an emergency safeguard measure (ESM) for services. Although safeguard provisions for goods exist under the WTO's Safeguards Agreement when imports enter a market in such quantities as to cause, or threaten to cause, injury to domestic producers, no such provisions exist on the services side. Many developing countries have proposed that governments be allowed to impose temporary restrictions on the supply or consumption of services (through withdrawal of concessions on market access, national treatment, or regulatory disciplines covering the provision of services) if their domestic firms are threatened by surging services imports. But industrialised countries have been extremely unreceptive to the idea of an ESM in the services sector. The US in

particular argues that the ESM advocates have failed to make a case for these safeguards and that any such rules could scare off investment by foreign service providers since they create legal uncertainty.

Although there is presently no consensus on this issue, it is possible to argue that the simultaneous establishment of a countervailing duty and safeguard regimes under GATS would lead to redundancy. As pointed out above, the injury test would likely play a decisive role in both of these regimes while the issue of 'unfair' subsidies would play a secondary role. This would be the case if most CVD petitions in services end (as in the goods context) by a positive determination of a subsidy.

10.3 CVD: a weapon mostly used by a few developed countries

It is now a well-established fact the CVD weapon is mostly used by the US and recently by the EU. For example, between 1979 and 1988 the US made 371 investigations, while only 58 investigations were initiated in all other countries combined. Although an increasing number of developing countries are beginning to launch CVD investigations, it is clear that the

proportion of CVD cases targeting developing countries would be predominant in the context of a GATS countervailing duties regime while the usefulness of such a regime would always be minor for developing countries. Thus, one can argue that it is not in the interest of developing countries to see the emergence of such a regime.

10.4 A CVD regime leads to rent-seeking behaviour

The countervailing duties regime is a typical illustration of a regime promoting rent seeking behaviour. This means that the CVD petitioner tries to bring about an uncompensated transfer (without providing work or investment) of money to himself at the expense of consumers that have to pay a higher price due the countervailing duty. In other words, although the legal objective of the CVD mechanism is to police fairness of trade practices, it will attract not only firms and industries beset by unfair competition but also, more generally, those least favourably situated vis-à-vis their foreign competitors. Such agents, as suggested by

political economy, will attempt to make their needs fit the prerequisites of the instruments and will pressure governments in order to have the instruments changed to fit their needs. It is possible however to argue that the CVD mechanism has the advantage of offering a fast relief for allegedly injured Members and that the absence of such a mechanism would make them completely dependant on the multilateral dispute settlement mechanism which is far from perfect. Although this argument is pertinent, it is perhaps the natural role of safeguard mechanisms to offer such a fast relief.

11. COMPARATIVE ANALYSIS

Independently of whichever route WTO Members finally decide to take regarding possible services disciplines, the advantages and disadvantages of the agriculture and the goods models can be summarised as follows.

*Table 1: Advantages and disadvantages of the agriculture and goods model for disciplining services subsidies*⁶²

	Advantages	Disadvantages
AoA Model	<ul style="list-style-type: none"> - Sets out a subsidies ceiling for the future and partially responds to the need to control distortion. "Better than nothing" in case of a stalemate of current negotiations under Article XV of GATS. - No need to demonstrate adverse effects of subsidies. - No need to collect data for specific sectors if an Aggregate Measurement of Support is adopted. - Easy to start negotiations. 	<ul style="list-style-type: none"> - Adequate subsidies ceilings are somewhat arbitrary and negotiations could stumble on this aspect, thus making negotiations more difficult to start. - Might allow Members to 'reallocate' subsidies within and among expected boxes unless complementary reductions and disciplines are included in the boxes. - Difficult to discipline a specific sector under this consolidated framework. - Difficult to end negotiations – past experience with the AoA shows inefficient and unsatisfactory negotiation improvement over time.
Goods Model	<ul style="list-style-type: none"> - Could be sector-specific. - Tackles 'in law' export subsidies. - Consistent with existing WTO legal framework based on similarity and difference between goods and services. - Easy for negotiations to move further. 	<ul style="list-style-type: none"> - CVD might be difficult to apply or not be desirable. - Proof of adverse effects might be difficult to obtain. - Compensatory Remedy (i.e. tariffs) could be ineffective in various modes. - Difficult to start negotiations, although strict rules might allow for a more effective disciplining effect.

12. CONCLUSIONS

This paper highlights various reasons to establish subsidies rules at the multilateral level in light of Article XV of the GATS. These include the distortive effect of services subsidies, the need to level the playing field between trade actors, the force of the multiplier effect on the overall economy, and the existence of certain environmentally harmful subsidies. However, various WTO Members, academia and civil society actors have recognised the need to retain certain public policy spaces in future disciplines and to assure an appropriate sequencing between the creation of such disciplines and further services liberalisation.

As the paper shows, the MFN and NT clauses included in the GATS have some natural but limited disciplining effects on services subsidies. Therefore, it seems clear that only negotiations under GATS Article XV could lead to a strong multilateral framework for effective disciplines on subsidies in all service sectors of a national economy.

The central conclusion of this paper is that the main obstacle to extending the concepts of the SCM Agreement to the field of services lies in the fact that the role of the territory is atypical in the context of services. This situation has a direct impact on the way that a services subsidy is defined, in particular the 'benefit' component of this definition. This fact also necessitates rigorous consideration before adopting certain notions such as 'in fact' export subsidy in the context of services.

Another important conclusion is that the issue of distortion is overestimated in the context of present negotiations. In fact, once the 'specificity' and 'benefit' criteria are slightly modified to reflect the special nature of the services field, the identification of a distortive subsidy can entirely be founded on these two criteria. One of the main themes of this paper is that a sophisticated view of distortion is legally impracticable and will transform panel and Appellate Body members into legislators and economic analysts.

As identified in the paper, the approach of the AoA ('agriculture model') and the approach under the SCM ('goods model') to disciplining subsidies offer two very different frameworks, which have been shaped by the conditions of farming on the one hand, and those of industry and manufacture on the other. Nevertheless, both models share common key features: (1) both are aimed at reducing the trade distorting effects of gov-

ernment support measures, while differentiating in their treatment of subsidies according to their degree of trade-distortion; (2) both allow for certain measures designed to address public policy objectives; and (3), both could treat developing countries more favourably.

The paper supports a model for subsidy disciplines inspired by the WTO Agreement on Agriculture (AoA). The adoption of this model would allow WTO Members to focus on serious trade barriers in services while offering, in the short term, a response to trade distortive subsidies and creating a level playing field in the current WTO round of negotiations. In the future – once most other serious barriers to trade in services have been removed – the 'agriculture model' could be strengthened or replaced by the model inspired by the SCM Agreement. The 'agriculture model' could also allow for the creation of disciplines regulating the consolidation, reduction and phase out of services subsidies while at the same time retaining Members' ability to use subsidies for promoting national policy objectives, including developmental, environmental or social concerns.

However, in order to mitigate the systemic shortcomings of the current subsidy disciplines in the field of agriculture, reducing *residual box* subsidies on a disaggregated, i.e. sector-specific basis, as well as placing upper ceilings on support provided under the *exemption box*, or on its sub-categories, respectively, should be considered. Additionally, the disciplines of the *exemption box* should be made strict enough so as not to allow former *residual box* support simply being formally redesigned in order to present it as a new *exemption box* support.

If disciplines for subsidies are to be developed based on the 'goods model', they could be designed to tackle *de jure* export subsidies. In the case of *de facto* export subsidies, the conceptual difference between export subsidies and domestic subsidies is difficult to apply in practice.

This paper does not recommend the adoption of a countervailing duties (CVD) regime due to its impracticability in the services field, its possible negative impacts on developing countries and the incentives it might create for rent seeking behaviour. Finally, an underlying theme of the paper is that the issue of disciplining services subsidies presents an opportunity for increasing trade while enhancing sustainable development in the field of services.

ENDNOTES

¹ Chan, 2003.

² Guidelines and Procedures for the Negotiations on Trade in Services, S/L/93 (29 March 2001).

³ According to the second revision of the Draft Cancun Ministerial Text (JOB(03)/150/Rev.2) Members are “committed to intensifying [their] efforts to conclude the negotiations on rule-making under GATS Articles VI:4, X, XIII and XV in accordance with their respective mandates and deadlines, noting the deadline of 15 March 2004 for emergency safeguard measures. The Special Session of the Council for Trade in Services shall review progress in these negotiations by 31 March 2004.”

⁴ In March 2003, ICTSD initiated an informal process in Geneva through holding an *ICTSD Roundtable on Trade in Services and Sustainable Development: Towards Pro-Sustainable Development Rules for Subsidies in Trade in Services* (<http://www.ictsd.org/issarea/services/dialogues/index.htm#2003>). At this dialogue, Prof. Benitah presented his major research ideas to discuss them with the Geneva trade and sustainable development community. The key points of the discussions (see http://www.ictsd.org/dlogue/2003-03-10/Synthesis%20Report_consolidated.pdf) were taken into in the production of this paper.

⁵ Hoekman and Dobson, 2000.

⁶ Prylinski and Mongialo, 2003.

⁷ Hoekman and Braga, 1997.

⁸ ICC, 1995.

⁹ Abugattas, 2003.

¹⁰ WTO, 2003.

¹¹ However, this observation is rather impressionistic in nature and may reflect developments in sectors (such as financial services) that attracted particular policy attention at the time of the Trade Policy Reviews.

¹² A footnote at this place in the text reads: “A future work program shall determine how, and in what time-frame, negotiations on such multilateral disciplines will be conducted.”

¹³ Chan. 2003.

¹⁴ Vivas Eugui, 2001

¹⁵ Chan, 2003.

¹⁶ Chan, 2003.

¹⁷ Chan, 2003.

¹⁸ GATS Article I(1).

¹⁹ In the context of GATT, NT only applies to “internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distributing or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions” (GATS Article III).

²⁰ Chan, 2003.

²¹ Shwartz and Harper, 1972.

²² Jackson, 1989.

²³ See Box 1.

²⁴ *Countervailing Duties: Final Rule*, 63 Federal Register, 65361 (1998).

²⁵ *Canada-Measures Affecting the Export of Civilian Aircraft*, WTO document WT/DS70/R, 14 April 1999, para. 9.112.

²⁶ Mary E Foote, 2002.

²⁷ Albrecht, 1998.

²⁸ The simplest thing would be here to adopt the definition of “financial governmental contribution” included in Article 1.1 of the SCM Agreement. There is a priori no need to sophisticate this definition in the context of services. As for the meaning of the word “government”, it does not seem that Article 1:3(a) of GATS defining “measures by Members” adds something really new compared to the SCM Agreement.

²⁹ Note that according to Article 31 of the SCM Agreement, certain non-actionable subsidies are no more shielded from a possible complaint, after 31 December 1999. However, it seems that there is a kind of gentlemen’s agreement concerning their non- actionability and it is currently under negotiation whether their non-actionability should be officially renewed for the future.

³⁰ Those conditions are: (i) such payments are based on fixed area and yields; or (ii) such payments are made on 85 percent or less of the base level of production; or (iii) livestock payments are made on a fixed number of head.

³¹ Article 6.2 of the Agreement on Agriculture.

³² The author thanks Thomas Chan and Daruisz Mongialo for this insight.

³³ Chan, 2003.

³⁴ Prylinski and Mongialo, 2003.

³⁵ Briefly, ‘in law’ means that the subsidy is made, explicitly in a document, contingent upon export performance. ‘In fact’ means that the total configuration of facts shows that the subsidy would not have been granted *but for* anticipated exportation or export earnings.

³⁶ Article 3.1.(a) of the SCM Agreement.

³⁷ Article 2.3 of SCM Agreement.

³⁸ See “Africa urges end to cotton subsidies”, Address by President Blaise Compaore of Burkina Faso, On the Cotton Submission by west and central African countries to the Trade Negotiations Committee of the WTO.

³⁹ The author thanks Mr. Luis Abugattas of UNCTAD for this insight.

⁴⁰ *Canada- Measures Affecting the Export of Civilian Aircraft*, WTO document WT/DS70/R, 14 April 1999, para.9.332.

⁴¹ Kibel, 1999.

⁴² Idem

⁴³ Let us recall that under the SCM Agreement, the category of environmental subsidies that were officially non actionable before 31 December 1999 (and thereafter by a tacit gentlemen’s agreement) are “assistance to promote adaptation of existing facilities to new environmental requirements imposed by law and/or regulations.” (Article 8(2)(c)). To qualify as non actionable, these environmental subsidies can only be for a “one time non-recurring measure” and must be “directly linked and proportionate to a firm’s planned reduction of nuisances and pollution, and may not cover any manufacturing cost savings which may be achieved.” (Article 8(2)(c)(i) & (iv)). To qualify as non-actionable, these environmental subsidies also cannot cover more than 20 percent of the costs of the pollution reduction measure. As for the Uruguay Round Agreement on Agriculture, let us recall that it is based essentially on reduction of subsidies. However, Annex 2 of this Agreement provides that certain payments are exempted from these reductions and they include “payments under environmental programs.” To qualify for this exemption, these

payments must “be determined as part of a clearly defined governmental environmental or conservation program and be dependent on the fulfillment of specific conditions” (Annex 2, point 12) and must be “limited to the extra costs of income involved in complying with the government program.” Annex 2, point 1, states that the exemption for certain government funding will not apply if the payments “have the effect of providing price support to producers.”

⁴⁴ As we know, in the SCM Agreement, the category of non-actionable, green light subsidies includes “assistance to promote adaptation of existing facilities to new environmental requirements imposed by law and/or regulations.”

⁴⁵ Griffith, 1980.

⁴⁶ The text of this Protocol can be found at <http://www.unep.org/ozone/montreal.shtml>

⁴⁷ Palmeter and Mavroidis, 1998.

⁴⁸ For more details see, Nyahoho (E) and Proulx (P.P), “Le Commerce International: Théories, Politiques et Perspectives Industrielles”, Presses de L’Université du Québec, 1997, page 148.

⁴⁹ *The author thanks former WTO Ambassador of Venezuela Werner Corrales-Leal for this insight.*

⁵⁰ See the Brundtland commission, “Our Common Future: From One Earth to One World”, World Commission on Environment and Development, April 1987, Oxford University Press, page 80.

⁵¹ Communication from the United States on *Audiovisual and Related Services*, S/CSS/W/21, 18 December 2000.

⁵² Mitlin and Vivas, 2003.

⁵³ *Idem.*

⁵⁴ *Idem.*

⁵⁵ Briefly, ‘in law’ means that the subsidy is made, explicitly in a document, contingent upon export performance. ‘In fact’ means that the total configuration of facts shows that the subsidy would not have been granted *but for* anticipated exportation or export earnings.

⁵⁶ Article 3.1.(a) of the SCM Agreement.

⁵⁷ For a further elaboration on the use of certain policy instruments to promote competitiveness, and the impact of trade rules upon their usage, See Corrales, Sugathan, and Primack, 2003.

⁵⁸ It is worth recalling in this context that WTO ministers in the second half of subparagraph 32 (i) of the Doha Ministerial Declaration, instructed the Committee on Trade and Environment “to give particular attention to: (ii)...those situations in which the elimination or reduction of trade restrictions and distortions would benefit trade, the *environment* and development”.

⁵⁹ The following scenario can be used across the board (excluding sectors not covered by GATS such as services provided in governmental authority) or only in sectors of commitments (*from an anti-distortion point of view the across the board formula is the most adequate*).

⁶⁰ See WTO’s Safeguards Agreement, at http://www.wto.org/english/docs_e/legal_e/25-safeg_e.htm

⁶¹ Finger and Murray, 1990.

⁶² Source Vivas-Eugui and Werth, 2003.

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