

SYSTEMIC ISSUES ARISING FROM ARTICLE V OF THE GATS

Communication from Hong Kong, China

The following communication has been received from the Permanent Delegation of Hong Kong, China with the request that it should be distributed to all Members.

I. INTRODUCTION

1. This paper deals with the Economic Integration Agreements on Services (EIAS). Hong Kong, China believes there is a lack of clarity with respect to many of the key terms of the relevant GATS provisions.

2. This paper attempts to identify the issues that arise from the interpretation and application of GATS Article V and related provisions of the GATS. The list of issues raised is non-exhaustive, and is without prejudice to the positions of any WTO Members on the subject. The purpose of the paper is to stimulate discussion in this important area of the GATS. Hong Kong, China believes the issue is of sufficient importance to warrant examination not only in the CRTA but also in other relevant bodies of the WTO including the CTS.¹

II. INDIVIDUAL PROVISIONS IN ARTICLE V

3. The language in the chapeau of GATS Article V:1 - "This Agreement shall not prevent any of its Members from being a party to or entering into an agreement liberalizing trade in services" - raises a question regarding the scope of the exemption granted to EIAS. More specifically, does it create a cover for the departure of an EIAS from not only the MFN obligation, but also other obligations of the GATS, and if so, which obligations? The critical issue here is the meaning of the words "shall not prevent". In other words, which obligations of the GATS, other than the MFN obligation, would "prevent" Members from "being a party to or entering into an agreement" that meets the test of Article V?

4. Article V:1(a) establishes a requirement of "substantial sectoral coverage", and footnote 1 spells out the factors that are to be considered in assessing whether this condition has been met. Specifically, footnote 1 calls for an examination of the number of sectors, volume of trade affected and modes of supply covered by the liberalization provisions of the agreement. But it is unclear what it means. There has already been discussion in the CRTA as to whether a whole service sector can be excluded and if the EIAS would still pass the test. Should due account be taken of the volume of trade affected? In other words, should the language in footnote 1 be viewed as providing a basis for assigning weights to the sectors covered by the liberalization provisions, or as establishing three separate factors to be considered in making an overall judgement? Are the factors exhaustive?

¹ Hong Kong, China has made a similar submission to the CRTA (WT/REG/W/34).

Would it be helpful to provide further guidance on what constitutes “substantial coverage”, e.g. a proportion of the total number of sectors or volume of trade?

5. Footnote 1 of Article V:1(a) also states that the “agreements should not provide for the *a priori* exclusion of any mode of supply”. Does this mean that any EIAS has to cover investment and labour mobility in the sense of Modes 3 and 4 as it relates to trade in services? Is this requirement for labour mobility circumscribed by the provisions of paragraph 2 of the *Annex on Movement of Natural Persons Supplying Services under the Agreement*? Paragraph 2 of the *Annex* provides that the GATS “shall not apply to measures affecting natural persons seeking access to the employment market of a Member, nor shall it apply to measures regarding citizenship, residence or employment on a permanent basis.” Could a reasonable interpretation of this language be that an economic integration agreement on services must provide labour mobility for natural persons employed by firms supplying services, or for natural persons with established contracts to supply services?

6. Article V:1(b) states that a GATS-consistent EIAS should provide “for the absence or elimination of substantially all discrimination, in the sense of GATS Article XVII” (on national treatment), with certain enumerated exceptions. This raises questions both with respect to the meaning of the term “substantially all” and the scope of the exceptions. How should “substantially” be interpreted? Would it be desirable to give this term greater precision? The term “substantially all” is the same term that is used by GATT Article XXIV. Does the discussion of the meaning of this term as applied in GATT Article XXIV:8 provide any insights with respect to its meaning in GATS Article V?

7. Article V:1(b) excepts measures permitted under Articles XI (IMF Provisions on Payments and Transfers), XII (Balance of Payments), XIV (General exceptions related to health, safety, taxation and public order), and XIV bis (National Security). This list does not cover for instance, Article VII (Recognition), Article X (Emergency Safeguard Measures), Article XIII (Government Procurement), Article XV (Subsidies), the *Annex on Air Transport Services* and the *Annex on Financial Services*. This raises several questions:

- Does this mean that Members of an EIAS cannot discriminate against each other in the application of domestic measures related to the licensing of professionals, the granting of domestic subsidies, government procurement, air traffic rights, and prudential supervision?
- Does it mean that they are not allowed to apply Emergency Safeguard Measures in their trade with each other? How does this square with the requirement of Article X:1 that “There shall be multilateral negotiations on the question of emergency safeguard measures based on the principle of **non-discrimination**”? On the basis of a literal reading, the requirements of Article V:1(b) and Article X:1 would seem to be in conflict, unless one were to adopt an expansive interpretation of the language in the chapeau of Article V:1.
- Do all existing EIAS meet the test of Article V:1(b) that all forms of discrimination with respect to the regulation of professional services, air transportation services and financial services are eliminated? Do they all provide for the elimination of all forms of discrimination in government procurement of services or in the provision of subsidies to services suppliers?
- How should the requirements of Article V:1(b) be interpreted with respect to the further negotiations contemplated under Articles VII, X, XIII, XV, and the various annexes to the GATS?

8. Article V:1(b) requires that the EIAS eliminate discriminatory measures “either at the entry into force of that agreement or on the basis of a reasonable time-frame.” What is a “reasonable time-frame”? Does Article XXIV:5(c) of the GATT, as interpreted by the Understanding on the Interpretation of Article XXIV of the GATT 1994, provide a useful reference point?

9. Article V:2 provides that an evaluation of the conditions under the provisions of Article V:1 may consider the relationship of the EIAS “to a wider process of economic integration”. This raises at least two questions. First, what does a “wider process of economic integration” mean? Second, how should the existence and content of such a “wider process of economic integration” affect the evaluation of whether the conditions under paragraph 1(b) are met?

- A wider process of economic integration could be interpreted in at least two different ways. First it could mean a process involving not only the elimination of barriers to trade in services, but also the elimination of barriers to trade in goods. Second, it could mean a process that went beyond the elimination of discrimination to the harmonization of government regulatory measures among Members of an EIAS. These two interpretations are not mutually exclusive.
- Nothing in Article V:2 itself points to the intent of the provision. One possible meaning of Article V:2 is that the existence of a wider process of economic integration could lower the threshold of what would be considered acceptable in terms of the remaining areas of discrimination among members. Thus, for example, a wider process of harmonization of regulatory measures in professional services could be expected to lead to the elimination of all forms of discrimination in the regulation of professional services. Another possible interpretation of Article V:2 is that the time-frame for a parallel liberalization of trade in goods should affect what should be considered a “reasonable time frame” for the elimination of all forms of discrimination affecting trade in services.

10. Article V:3(a) gives developing countries “flexibility” in meeting the conditions of Article V:1, particularly with respect to its subparagraph (b). A number of questions arise with respect to this provision.

- What is the implication of the reference to Article V:1 to the flexibility that might be provided in applying Article V:1(a), which requires that an EIAS provide substantial sectoral coverage? Does it imply that only limited flexibility should be provided in applying the condition in subparagraph (a)? If so, how might that flexibility be set out?
- Does the reference to flexibility in the application of the conditions of Article:1(b) apply to the elimination of “substantially all discrimination” as well as to the “reasonable time frame” for accomplishing this goal? Would it be useful to elaborate on the extent of “flexibility” available to developing countries? Would it be desirable to spell out a rationale for the flexibility granted to developing countries, e.g. shield them from international competition in underdeveloped sectors or subsectors, give them time to develop the competitiveness of particular sectors or subsectors, or give them time to develop a functioning regulatory system in particular sectors or subsectors? Would it be possible, on the basis of a particular rationale, to set out that flexibility in an appropriate fashion?
- Does the notion of “in accordance with the level of development of the countries concerned” in Article V:3(b) limit the “flexibility” to only the services regime of the

developing country Members in the case of an EIAS comprising both developed and developing countries Members?

11. Article V: 4 states that EIAS “shall not in respect of any Member outside the agreement raise the overall level of barriers to trade in services within the respective sectors or subsectors compared to the level applicable prior to such an agreement.” A number of questions arise in interpreting and applying this provision.

- What system is to be used in testing whether or not the overall level of barriers to trade in services vis-à-vis outsiders has been raised in individual sectors or subsectors? Does this test have to be met with respect to both the sectors and the subsectors?
- How can the level of barriers be evaluated on an objective basis in practice? In most cases, differences in regulatory mechanisms and the well known absence of detailed data on services would make it practically impossible to calculate an overall level for the barriers in effect before the implementation of the EIAS. In theory one could convert all barriers into tariff equivalents, and all of these tariff equivalents could be converted into an average tariff for the members of the EIAS. The calculation of such a tariff equivalent, however, would run into insurmountable data and methodological problems in practice.
- A related question is under what circumstances an EIAS will entail changes to the level of barriers to trade in services with Members outside the EIAS. Are they related to some forms of harmonization/alignment among members to the EIAS as to their respective treatments of third parties, in a way similar to that envisaged in the external trade regime of customs unions for goods? Does it relate also to the concept of “wider process of economic integration” in Article V:2? Would Article V:5 imply that to withdraw or modify the Annex to Article II Exemption was not permissible and that the Article XXI route was required for any withdrawal or modification of commitments?
- Since it may be impossible to calculate the overall level of barriers in effect before the adoption of the EIAS, Members might want to consider an alternative test. One alternative approach would be to require that an EIAS not reduce the level of trade in any sector or subsector, or that it not reduce the growth of trade in any sector or subsector below a historical trend. This alternative approach might also be handicapped by a shortage of detailed data, but it would run into fewer methodological problems.

12. Article V:3(b) allows an EIAS involving only developing countries to grant “more favourable treatment” to service suppliers owned by “juridical persons owned or controlled by natural persons of the parties to such an agreement.” Does the requirement of Article V: 4 put an effective limit on the more favourable treatment that can be granted to companies owned by citizens of such an EIAS, by requiring that the overall level of barriers in each sector and subsector be no higher than before? Would it be possible further to clarify the degree of favourable treatment that might be accorded by establishing some limits on the degree of more favourable treatment, or by establishing conditions for the granting of more favourable treatment? For example could more favourable treatment be reserved to enterprises that are not globally competitive?

13. Article V:6 grants a service supplier of another Member certain rights under the EIAS “provided that it engages in substantive business operations”. How is the “substantive business operations”, a concept also found in GATS Article XXVIII:(m)(i), to be interpreted? Is this term

meant to distinguish a service supplier producing services from one selling services? Or is it meant to distinguish between a service supplier actively producing and/or selling services from one which is merely properly legally established but without as yet any production and sales activities? Or is it intended to distinguish between service suppliers who may be “carrying on” a service (without being formally established) from those who are properly legally established?

14. Article V:7 requires prompt notification of the establishment or modification of EIAS. How does the requirement for prompt notification relate to the requirement of Article V:5 for at least 90 days advance notice of the withdrawal or modification of a Member’s schedule in connection with the conclusion, enlargement or modification of an EIAS? Does Article V:5 in effect define “prompt” as used in the context of Article V:7 as requiring notification of the conclusion, enlargement or modification of an EIAS 90 days before it takes effect?

III. GENERAL DISCUSSION OF ARTICLE V

15. A general question that might be explored is whether there are any inter-linkages between GATS Article V and GATT Article XXIV. One such link could arise, for example, from a possible interpretation of the provisions of Article V:2 of the GATS, which links an examination of the conditions established in Article V:1(b) to the existence and content of “a wider process of economic integration or trade liberalization among the countries concerned.” If the term “a wider process of economic integration” is interpreted to mean a process involving the liberalization of goods as well as services, such a link might be seen to exist.

IV. CONCLUSIONS

16. This paper clearly shows that there is a large number of important and basic questions that need to be addressed regarding EIAS. Some suggestions on ways forward are floated in the paper.
