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National Treatment in the GATS: Corner-stone or Pandora's Box?

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Abstract: This paper is concerned with three problems in the interpretation of the national treatment obligation in the General Agreement on Trade in Services (GATS). First, the precise domain of Article XVII on national treatment has not been clearly delineated, particularly in relation to Article XVI dealing with market access. Secondly, there is a difference between the text of Article XVII and the structure of the schedules of commitments, which makes it difficult to interpret the scope of the national treatment obligation even for identical services supplied through different modes. The final, and most complex, problem arises in establishing the definition of "like" services and "like" service suppliers. Uncertainty about the precise meaning of the national treatment obligation may undermine the key GATS objective of creating a secure, predictable trading environment. Moreover, the extent of liberalization implied by the commitments under GATS depends on the precise choice of interpretation.

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The counterpart in international trade law of the Biblical injunction to "love thy neighbour as thyself" is the national treatment obligation. This usually requires that the products (and sometimes also producers) of other countries be treated no less favourably than national products (and producers). The national treatment obligation in the General Agreement on Trade in Services (GATS) is wider in scope but more limited in application than that in the General Agreement on Tariffs and Trade (GATT). It is wider in scope because, while national treatment under GATT is concerned with measures affecting products *per se*, the domain of this obligation in the GATS includes not only measures affecting services products, but also measures affecting service *suppliers*. It is more limited in application because, while national treatment under the GATT applies across the board, under the GATS it applies only to scheduled sectors, and there too may be subject to limitations. These differences were intended and are well known.¹

This paper is concerned with three problems in the interpretation of the national treatment obligation in GATS. These have not been adequately recognized and could seriously affect the operation of the Agreement. First, the precise domain of Article XVII on national treatment has not been clearly delineated, particularly in relation to Article XVI dealing with market access. Secondly, there is a difference between the text of Article XVII and the structure of the schedules of commitments, which makes it difficult to interpret the scope of the national treatment obligation even for identical services which are supplied through different modes. The final, and most complex, problem arises in establishing the definition of "like" services and "like" service suppliers. Striking the appropriate balance between, on the one hand, allowing regulators the freedom to make distinctions between services products and, on the other, preserving liberal trading conditions will be even more difficult in services than it has been in goods.

Uncertainty about the precise meaning of the national treatment obligation may undermine the key GATS objective of creating a secure, predictable trading environment. Furthermore, unless all Members happen to interpret existing commitments in the same way, disputes may arise regarding the precise meaning of these commitments. It would be difficult for a dispute settlement panel to pronounce judgement on these conflicts of interpretation which relate to fundamental aspects of the agreement. To anticipate these problems and to arrive at a consensual interpretation through further negotiation would, therefore, seem preferable to relying on dispute settlement. This is the premise which motivates the current paper.

The achievement of consensus on a particular interpretation would help to reduce uncertainty, and is

¹These issues have been discussed in recent papers by Ahnliid (1996), Altinger and Enders (1996), Hoekman (1995) and Low (1995).

therefore desirable in itself. But, at the same time, the precise choice of interpretation is not a matter of indifference: commitments under GATS would imply greater liberalization under some interpretations than under others. The paper does rank interpretations in terms of economic desirability, but is primarily concerned with raising key questions rather than with providing definitive solutions.

The next section provides a brief description of the elements of the GATS most relevant to the arguments presented here. The subsequent three sections deal in turn with each of the problems mentioned above. The conclusions are presented in the final section.

I. A brief description of the GATS

The GATS applies to all measures by Members affecting trade in services, defined (in Article I) to include four modes of supply:

- Cross-border*: services supplied from the territory of one Member into the territory of another. An example is software services supplied by a supplier in one country through mail or electronic means to consumers in another country.
- Consumption abroad*: services supplied in the territory of one Member to the consumers of another. Often the actual movement of the consumer is necessary as in tourism services. However, activities such as ship repair abroad, where only the property of the consumer moves, are also covered.
- Commercial presence*: services supplied through any type of business or professional establishment of one Member in the territory of another. An example is an insurance company owned by citizens of one country establishing a branch in another country.
- Presence of natural persons*: services supplied by nationals of one Member in the territory of another. This mode includes both independent service suppliers, and employees of the services supplier of another Member. Examples are a doctor of one country supplying through his physical presence services in another country, or the foreign employees of a foreign bank.²

² The GATS does not apply either to measures affecting natural persons seeking access to the employment market of a Member, or to measures regarding citizenship, residence or employment on a permanent basis.

The GATS consists of a set of general rules that apply across the board to measures affecting trade in services, and sector-specific commitments on market access and national treatment.³ Two general rules which apply to government policies affecting trade in services are most-favoured-nation (MFN) treatment and transparency. Article II on most-favoured-nation (MFN) treatment requires each Member to "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". Departures from the MFN principle are permitted for the measures listed in, and meeting the conditions of, the Annex on Article II Exemptions.⁴ Article III on transparency requires each Member to publish all measures of general application affecting trade in services, and to inform other Members promptly of any changes in measures affecting trade in services covered by its specific commitments.

The specific commitments on market access and national treatment are the core of the GATS, and the impact of the Agreement depends to a large extent on the commitments made by Members.⁵

Article XVI stipulates that measures restrictive of market access which a WTO Member cannot maintain or adopt, unless specified in its schedule, include limitations on : (a) the number of service suppliers; (b) the total value of services transactions or assets; (c) the total number of services operations or the total quantity of service output; (d) the total number of natural persons that may be employed in a particular sector; (e) specific types of legal entity through which a service can be supplied; and (f) foreign equity participation (e.g. maximum equity participation). With the exception of (e), the measures covered by Article XVI all take the form of quantitative restrictions.

Three aspects of Article XVI are important. First, the Article XVI list does not include all measures which could restrict market access. Perhaps most significantly, fiscal measures are not covered. Thus, a Member could maintain, without being obliged to schedule, a high non-discriminatory tax on a particular service which severely limits market access. Secondly, Article XVI has been interpreted in "Scheduling of Initial Commitments in Trade in Services: Explanatory Note"⁶ (henceforth,

³In addition to market access and national treatment, several GATS provisions apply mainly or exclusively to sectors where specific commitments are undertaken. Furthermore, the GATS also includes a set of attachments: annexes that take into account sectoral specificities and certain Ministerial Decisions relating to the implementation of the GATS.

⁴The possibility for taking MFN exemptions under the GATS ended with the entry into force of the WTO Agreement, except in maritime, financial and basic telecommunications services, three sectors where negotiations have not yet been definitively concluded. Any new exemptions can only be obtained by seeking a waiver under paragraph 3 of the WTO Agreement.

⁵Both the market access and national treatment provided for in the schedules must be extended to all foreign service suppliers on a non-discriminatory basis, irrespective of whether a country has listed any MFN exemptions.

⁶MTN.GNS/W/164, 3 September 1993. The document warns that "the answers should not be considered as an authoritative legal interpretation of the GATS." It is, however, the basis on which many schedules of specific commitments

Explanatory Note) to cover both discriminatory and non-discriminatory measures, i.e. measures of the type "only five new *foreign* banks will be granted licenses" and also measures such as "only ten new [*foreign and domestic*] banks will be granted licenses".⁷ Finally, the limitations must be read as "minimum guarantees" rather than "maximum quotas", i.e. a country which has promised to allow five foreign banks entry is free to grant entry to more than five. We shall return to these issues.

Article XVII:1 states the basic national treatment obligation:

"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 of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers."⁸

Unlike Article XVI, Article XVII provides no exhaustive list of measures inconsistent with national treatment. Nevertheless, Article XVII:2 makes it clear that limitations on national treatment cover cases of both *de jure* and *de facto* discrimination:

"A Member may meet the requirement of paragraph 1 by according to services and service suppliers of any other Member, either formally identical treatment or formally different treatment to that it accords its own like services and service suppliers."

The Explanatory Note provides two examples of limitations on national treatment. If domestic suppliers of audiovisual services are given preference in the allocation of frequencies for transmission within the national territory, such a measure discriminates explicitly on the basis of origin of the service supplier and thus constitutes formal or *de jure* denial of national treatment. Alternatively, consider a measure stipulating that prior residency is required for the issuing of a license to supply a service. Although the measure does not formally distinguish service suppliers on the basis of national origin, it *de facto* offers less favourable treatment for foreign suppliers because they are less likely to be able to meet a prior residency requirement than like service suppliers of

have been drafted.

⁷The presence of the word "total" in items (b) to (d) above and its absence in item (a) may suggest that (b) to (d) are concerned only with aggregative (non-discriminatory) restrictions while (a) is concerned with all (discriminatory and non-discriminatory) types of restrictions. But the Explanatory Note, and actual scheduling practice, do not support such a distinction.

⁸It should be noted that GATS Article I states that the Agreement applies to measures affecting *trade in services*, whereas GATS Article XVII refers to all measures affecting the *supply of services*. It is not clear whether any significance should be attached to the distinction. In any case, it would seem that set of measures affecting the supply of services cannot be narrower than those affecting trade in services.

national origin.

Article XVII:3 elaborates on the required standard of treatment:

"Formally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member."⁹

Article XVIII of the GATS provides for additional commitments. It states:

Members may negotiate commitments with respect to measures affecting trade in services not subject to scheduling under Articles XVI or XVII, including those regarding qualifications, standards or licensing matters. Such commitments shall be inscribed in a Member's Schedule.

A Member making an additional commitment in a particular sector to subscribe to international standards is an example of the use to which Article XVIII has been put.

A Member's specific commitments can be seen as the outcome of a two-step decision. Each Member first decides which service sectors will be subject to the GATS market access and national treatment disciplines. It then decides what measures will be kept in place for that sector which violate market access and/or national treatment respectively. It is noteworthy (for reasons that will become apparent in Section III), that while Article XVI (market access) makes a reference to the "modes of supply", Articles XVII (national treatment) and XVIII (additional commitments) do not. Nevertheless, commitments on both market access and national treatment have been specified by modes of supply.¹⁰

Entries in the schedule in a given sector with respect to a particular mode of supply fall into one of four categories. (i) *Full commitment*: "none" or "no limitations", which implies that the Member does not seek in any way to limit market access or national treatment through measures inconsistent

⁹The phrase "if it *modifies* the conditions of competition" is somewhat misleading in that it may suggest that the obligation is to preserve the status quo. On the contrary, national treatment must be interpreted as an obligation not to disadvantage foreigners *at all* rather than as an obligation not to worsen historical disadvantages. In this respect, it would perhaps have been more appropriate to use the words "if it creates unequal conditions of competition."

¹⁰The GATS schedules of commitments are structured in the following manner. In the left hand column of the table are inscribed the service activities which are the subject of specific commitments. For each of the four modes of supply noted in column two, columns three and four state whether there are limitations on market access and national treatment respectively. The extreme right hand column provides for the additional commitments on other measures affecting trade in services.

with Articles XVI or XVII. (ii) *Commitment with limitations*: the Member describes in detail the measures maintained which are inconsistent with market access or national treatment, and implicitly commits itself to take no other inconsistent measures. (iii) *No commitment*: "unbound" indicates that the Member remains free to maintain or introduce measures inconsistent with market access or national treatment. (iv) *No commitment technically feasible*: "unbound*" indicates that in the sector in question, a particular mode of supply cannot be used, for instance cross-border supply of hair-dressing services.

II. National treatment, the handmaiden of market access?

This section discusses the relationship between Articles XVI and XVII of the GATS. The precise domain of Article XVII on national treatment has not been clearly delineated, particularly in relation to Article XVI dealing with market access.

In the case of trade in goods, there is a relatively clear distinction between border measures and internal measures.¹¹ In the GATT, apart from the general MFN obligation applying to both types of measures, border measures are subject primarily to the disciplines of Articles II and XI. Article II obliges each country to levy no more than stated tariffs - which are the negotiated tariff "concessions" or "bindings" contained in each country's "schedule". Article XI contains a general prohibition on quantitative restrictions on both exports and imports, subject to certain exceptions. Internal measures are the subject primarily of disciplines in Article III, the national treatment obligation, which applies to measures affecting products *per se* (and not to measures affecting suppliers).

It has been argued that one of the basic purposes of Article III is to ensure that WTO Members do not frustrate the effect of tariff concessions granted under Article II through internal taxes and charges.¹² But is this the *only* purpose of Article III? At the time of the negotiation of the GATT, there was controversy about the scope of its application (see Jackson, 1969, and Ahnliid, 1996). One group, in particular the developing countries, wanted the obligation confined solely to the items included in the tariff schedules. The argument for this position was that the sole purpose of this rule ought to be the protection of tariff concessions. But the United States opposed this view and stated that it would be "quite impossible" for it to accept a trade agreement without "certain basic general provisions," including the national treatment obligation (Jackson, 1969, p. 278). According to Jackson the United States view prevailed due to the importance of US trade for the success of the agreement. It was stated that the national treatment obligation had the purpose not only of protecting scheduled concessions but also of preventing the use of internal taxes and regulations as a system of protection. Hence, GATT Article III ensures that discrimination against foreign products can only take the form of border measures.

The current text of Article III leaves no scope for ambiguity. The wider interpretation was confirmed by the first Report of the Working Party on "Brazilian Internal Taxes" which notes:

¹¹Though sometimes the distinction may be blurred, as for instance when an internal charge is imposed on the imported product at the time or point of importation. The interpretative note to GATT Article III clarifies that any internal tax, law or regulation which applies to an imported product *and* to the like domestic product is to be regarded as "internal" even if it is collected or enforced at the time or point of importation.

¹²See, for instance, the panel report on "Canada - Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies," (GATT, 1993), pp. 84-85, paragraphs 5.30 - 5.31.

"The working party agreed that a contracting party was bound by the provisions of Article III whether or not the contracting party in question had undertaken tariff commitments in respect of the goods concerned."¹³

GATS: text versus context

In the case of services, unlike in the case of goods, there are few measures which are applied at the "border", and most restrictions arise from internal measures. The delineation of disciplines in GATS is broadly between quantitative measures (the subject of GATS Article XVI, with the exception of XVI:2(e)) and discriminatory measures (the subject of GATS Article XVII).¹⁴ But where do *discriminatory quantitative* measures, particularly those affecting the establishment of commercial presence, fall? One answer, consistent with the texts of the two Articles, would be that such measures fall within the scope of *both* Articles. An overlap is, in fact, anticipated by GATS Article XX:2 which states

"Measures inconsistent with both Articles XVI and XVII shall be inscribed in the column relating to Article XVI. In this case the inscription will be considered to provide a condition or qualification to Article XVII as well."

This simple "book-keeping" instruction, in fact, sowed the seeds of potentially serious confusion. The market access column in the schedules of commitments contains measures which are inconsistent with Article XVI only as well as those which are inconsistent with both Articles XVI and XVII, but there is no indication (since there is no requirement to indicate) into which of the two categories a particular measure falls.

¹³WTO (1995), p. 127.

¹⁴This distinction does not correspond in any neat way to GATT distinctions. GATS Article XVI may seem to correspond to GATT Article XI in that both deal with quantitative restrictions. But whereas the latter contains a general prohibition, the former only contains a requirement to schedule limitations - in which respect it is closer in spirit to GATT Article II on schedules of tariff concessions. The scope of GATS Article XVII could be seen as wider than that of GATT Article III, not only because the former also extends national treatment to suppliers, but also because internal measures affecting trade are relatively more important in services than in goods.

Two related problems arise from, respectively, an ambiguity in the definition of domains, and from a lack of clarity in the scheduling technique. First, since the precise extent of overlap between Articles XVI and XVII is not identified, the precise scope of the national treatment obligation remains unclear. The schedules, therefore, provide no clue as to which, if any, quantitative restrictions are inconsistent with Article XVII. Secondly, the scheduling methodology leaves ambiguous the status of commitments on measures which fall in the domain of both market access and national treatment when a Member's commitments with respect to the two are not the same.¹⁵ Why does this matter? It matters because if a country has undertaken only a commitment to provide national treatment, and not to provide full market access, we do not know if it still has the freedom in future to introduce a discriminatory quantitative restriction, such as a zero quota on entry by foreign firms. If we do not know what a commitment to provide national treatment means, we do not know what it is worth.

The definition of domains

The lack of clarity in the GATS on the domain of national treatment is all the more surprising, given the clear demarcation in other contexts, such as the existing investment-related OECD instruments.¹⁶

A distinction has usually been made between measures affecting entry of the supplier into the market (i.e. the initial act of investment or establishment of commercial presence) and those affecting post-establishment activity. Significantly, the OECD national treatment declaration specifically provides that it does not deal with the right of Member countries to regulate the entry of foreign investment or the conditions of establishment of enterprises. This exclusion avoids overlap with the OECD Code of Liberalization of Capital Movements (see OECD, 1993b) which applies to these matters. Article 2 of the Code stipulates that, subject to any reservations maintained, Members must grant any authorization required for the conclusion or execution of transactions and for transfers associated with direct investment and other forms of capital movement.¹⁷

¹⁵The "Scheduling of Initial Commitments in Trade in Services: Explanatory Note, Addendum" states that "Regardless of what is inscribed in the market access column, a 'no limitations' entry in the national treatment column (expressed as 'none') would mean that national treatment is bound for the entire mode; it is not limited to what may be bound in a market access commitment with limitations." This unfortunately does not provide an answer to our question because it deals with the relatively simple issue of *modal* coverage of the two obligations, and not the issue of *measure* coverage which concerns us here.

¹⁶OECD Member countries' commitment to National Treatment is contained in the *National Treatment section of the 1976 Declaration on International Investment and Multinational Enterprises*, and the *Third Revised Decision on National Treatment*, adopted by the OECD Council in December 1991, containing obligations on notification and examination of Member countries' exceptions to National Treatment. The section of the Declaration and the Revised Decision make up what is known as the National Treatment instrument (see OECD, 1993a). The national treatment instrument calls for treatment by a host government of a foreign owned or controlled enterprises operating in their territories no less favourable than that accorded to domestic enterprises in like situations.

¹⁷The OECD commitment to accord national treatment is not a legal obligation, even though it represents a substantive political undertaking backed by procedural arrangements that are legally binding (OECD, 1993a, p. 13); however, under the

An example can be constructed to illustrate the problems that may arise in the GATS context. Say a Member has scheduled construction services, with full national treatment commitments, but bound itself to provide market access only to 10 (domestic and foreign) construction companies for 100 building contracts. The Member allocates 10 licences to domestic and foreign building companies through a non-discriminatory auction, and does not discriminate in any way while 100 building contracts are signed. Then it (a) grants all new licences (beyond the initial 10) only to domestic companies and (b) insists that all new contracts (beyond the initial 100), be signed only with national companies and not with foreign companies, including those which have already been established. The Member's actions do not violate the market access commitment since, as noted above, it represents a "minimum" rather than a "maximum" guarantee. But is the Member behaving consistently with its national treatment obligation?

There are at least three possibilities¹⁸ with regard to the potential domain of national treatment (see Figure 1)¹⁹:

- (i) *Strong national treatment* would cover both the right to establish, as well as post-establishment treatment. If this were the case, both actions (a) and (b) would be inconsistent with national treatment. The text of Article XVII supports this interpretation, since "all measures affecting the supply of services" must cover also all quantitative restrictions, including those affecting the ability to use mode 3, i.e. to establish commercial presence.
- (ii) *Post-entry national treatment* would exclude the right to establish from the scope of the national treatment obligation. If this were the case, then the Member's action (a) would not violate the national treatment obligation but action (b) would. It is possible that scheduling practice (of at least some Members) was based on the view, also reflected by certain elements of negotiating history, that the national treatment obligation is only effective once the foreign company had actually been established in the territory of a Member.²⁰

Code of Liberalization of Capital Movements, OECD Members have accepted legally binding obligations.

¹⁸The discussion below focuses on mode 3, commercial presence, in distinguishing between the measures affecting the ability to establish and those applying post-establishment. A similar distinction can also be made in the context of mode 4, the presence of natural persons, between measures affecting entry into the market and those applying post-entry. Such a distinction is less relevant for modes 1 and 2.

¹⁹For simplicity, Figure 1 does not depict measures falling within the scope of Article XVI:2(e).

²⁰This would seem to mirror the GATT approach. The argument would be that just as the national treatment obligation for goods only applies after foreign products have "entered" the country, national treatment for services should only apply after foreign services suppliers have "entered" the country.

-(iii) *Limited national treatment* would exclude all measures falling within the scope of Article XVI, including discriminatory quantitative restrictions, from the scope of the national treatment obligation. In this case, neither action (a) nor (b) would be inconsistent with the national treatment obligation.

Which interpretation is legally sound and which makes the most practical economic sense? The customary rules of application of public international law, as incorporated in the Vienna Convention on the Law of Treaties, provide a clear indication.²¹ Article 31:1 of the Convention states:

"A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms in their context and in the light of its object and purpose."

This would seem to support the strong national treatment option because the terms "*all* measures affecting the supply of services" unambiguously include also measures affecting the ability of foreign suppliers to establish commercial presence. But there is another issue: an interpretation must give meaning and effect to all the terms of a treaty; an interpreter is not free to adopt a reading that would make certain elements of a treaty redundant. If we accept the strong national treatment interpretation, what then would be the additional disciplines created by Article XVI? This Article would then address primarily non-discriminatory market access restrictions. But it would be difficult to see independent need for Article XVI:2(f), dealing with limitations on the participation of *foreign* capital - measures which would in any case be inconsistent with national treatment.

The second interpretation, post-establishment national treatment, has the appeal of creating a neat division of disciplines between Articles XVI and XVII. The former would deal with the issue of initial entry and specified non-discriminatory quantitative restrictions, and the latter with all issues of discriminatory post-entry treatment. However, given the clarity of the text of Article XVII, under public international law it would seem to matter little that this interpretation may have been intended by negotiators. Nevertheless, the possibility that this interpretation may have been the *basis for scheduling commitments*, gives it a certain credence.²²

²¹GATT panels have previously interpreted the GATT in accordance with the Vienna Convention on the Law of Treaties, a practice which has been codified by Article III:2 of the Understanding on Dispute Settlement which states: "... The Members recognize that [the WTO dispute settlement system] serves to preserve the rights and obligations of Members under the covered agreements, and to clarify the existing provisions of those agreements in accordance with the customary rules of public international law."

²²Article 31:1 of the Vienna Convention, quoted above, acknowledges the relevance of the "context" of the terms of the treaty. Article 31:2 states: "The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes: (a) ... (b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty." The status of schedules is affirmed by GATS Article XX:3 which says: "Schedules of specific commitments shall be annexed to this Agreement and shall form an integral part thereof." Thus, even though we posed the problem as one of interpreting scheduled commitments in the

But, apart from being at odds with the all-encompassing text of Article XVII, this interpretation raises another legal question: If all discriminatory quantitative restrictions are to be interpreted as covered by both XVI and XVII, then option (i) follows. If discriminatory quantitative restrictions are covered by only XVI and not by XVII, then option (iii) follows. Option (ii) requires a selective carving, i.e. measures affecting entry or establishment of commercial presence would fall within the domain of XVI and not of XVII. The legal basis for such selective precedence is not clear,²³ but the inclusion in Article XVI of limitations on the participation of foreign capital, which can be regarded as relating to establishment, supports this interpretation.

The third interpretation implies an emasculation of the national treatment obligation which would seem to be neither intended nor acceptable.²⁴ The choice, therefore, appears to be between an all encompassing obligation, suggested by the text of Article XVII, and a more limited post-establishment view of national treatment, based on what may have been the negotiating intent and possibly subsequent scheduling practice. The first interpretation seems to have a sounder legal basis, while the second has the advantage that it represents a neater division of disciplines between Articles XVI and XVII. The definition of domains, however, cannot be accomplished without examining the implications of the scheduling technique.

The scheduling methodology

light of the text, it must be recognized that the interpretation of the text itself could be influenced by the scheduling practice. Unfortunately, an inspection of the schedules cannot reveal if there is a gap between the intention and the inscriptions.

²³There are certain textual differences (noted above) between Article XVI:2(a) and Article XVI:2(b) to (d), which have been disregarded by the Explanatory Note and actual scheduling practice. The presence of the word "total" in Article XVI:2(b) to (d) would imply that Article XVI covers only non-discriminatory measures with respect to these post-establishment restrictions, and the absence of the word "total" in XVI:2(a) could be read to mean that Article XVI deals with both discriminatory and non-discriminatory measures with respect to entry. Ironically, the examples given in the Explanatory Note of market access restrictions support the converse interpretation. All examples given under Articles XVI:2(b) to (d) concern limitations only on foreigners, while the examples given under XVI:2(a) concern limitations on both nationals and foreigners.

²⁴There is, in fact, another possibility, which mirrors certain arguments presented in the GATT context. Could it be that a Member's national treatment commitment in a particular sector is limited by the extent to which the Member has made a market access commitment? A truncation of the national treatment obligation by limitations on market access could pertain only to quantitative restrictions or be more general. Returning to the example in the text, say measure (b) was not a prohibition of new contracts (beyond the initial 100) with established foreign firms, but the imposition of a 20 per cent tax on any new contracts signed with such firms. A particularly weak interpretation of national treatment would imply that neither action (a) nor (b) would be inconsistent with the national treatment obligation, which would only serve to ensure that a Member's market access commitments were not undermined by discriminatory measures. In this case, Article XVII would play a role vis-a-vis Article XVI, analogous to the role some had argued that Article III of the GATT should play vis-a-vis Article II -i.e. only to ensure that a Member's internal measures do not frustrate the effect of tariff concessions granted under Article II. This interpretation was rejected in the GATT context, and there seems to be little reason to believe that Members intended it in the GATS.

The scheduling problem is most starkly depicted by considering the case of a Member who has made no commitments on market access, but made a commitment to provide full national treatment, i.e. inscribed "unbound" with respect to market access and inscribed "none" with respect to national treatment.²⁵ The question is: what is the Member's commitment with respect to measures inconsistent with both Articles XVI and XVII - whose existence is recognized by Article XX (quoted above)? One interpretation, which would usually apply in cases of overlapping domains, is that the Member would be obliged to respect the national treatment obligation with respect to all measures covered by Article XVII, including those also falling within the domain of Article XVI. If this were true, the precise domain of the national treatment obligation, the subject of the discussion in previous sub-section, assumes considerable significance.

However, it is possible to read a different interpretation in Article XX:2 (quoted above) which states that measures inconsistent with both Articles XVI and XVII must be inscribed in the column relating to Article XVI, and that such an inscription will be regarded as providing a qualification of Article XVII as well. It could be argued that an entry of "unbound" in the market access column must be read as a qualification to all measures inconsistent, not only with Article XVI alone, but also with both Articles XVI and XVII. According to this interpretation, in the absence of market access commitments, the "none" entry with respect to national treatment would provide a guarantee of non-discrimination only in respect of measures not falling within the scope of Article XVI. If this were true, there would perhaps be little need to define the precise domain of the national treatment obligation relative to the market access obligation, since it would be possible to make meaningful commitments in the area of the overlap only under the latter and not under the former.

A summing up

²⁵This is not just a hypothetical possibility. It occurs frequently in different guises. For instance, in some cases Members have indicated that market access is subject to an economic needs test without specifying what the criteria will be - implying a degree of discretion little different from that conferred by an indication of "unbound". Elsewhere, Members have committed to a precise amount of access - so that as soon as the quota is filled, it is as if the Member were "unbound".

To conclude this section, we bring together the two problems, pertaining to the definition of the domain and the scheduling technique. If we accept the view that it is technically possible to make commitments with respect to all quantitative restrictions, including those which are discriminatory, only under Article XVI (market access), then there is little need to define the precise domain of Article XVII (national treatment). In other words, if it is not possible to make independent commitments which preclude recourse to discriminatory quantitative measures under Article XVII, then it is as if these measures did not really fall within the scope of Article XVII. But the domain problem disappears at a cost: commitments to provide national treatment alone, in the absence of complementary commitments to provide market access, have limited value. In effect, it is as if the "limited national treatment" interpretation in (iii) above were accepted. The liberalizing content of the GATS is accordingly circumscribed. If, however, national treatment commitments could be read to preclude discriminatory quantitative restrictions, even in the absence of full market access commitments, then the GATS would have a greater liberalizing impact. But how much greater depends on the answer to the "domain question", i.e. whether the national treatment obligation also includes the right to enter and to establish commercial presence (i.e. whether we accept (i) rather than (ii) above). If it is recognized to do so, then national treatment under the GATS is a powerful obligation, and accordingly the existing commitments to provide it have significant liberalizing force.

III. The modes of supply: fragmented national treatment?

In this Section, we consider the second problem of interpretation, raised by a difference between the text of Article XVII and the manner in which commitments on national treatment are scheduled. Does the national treatment obligation extend across modes of supply (as defined in Article I), or do Members retain the freedom to discriminate between identical services supplied in their territory through different modes? There are, in fact, two issues: first, whether Members can explicitly retain the right to discriminate between modes; second, whether Members who have made a full non-discriminatory commitment, can, nevertheless, apply different standards of treatment to different modes.

There is nothing in the text of Article XVII which suggests that the mode of supply is a consideration in defining "likeness" of a service: different modes of supply could be used to provide a "like" service. The structure of the schedules, however, implies that a Member's commitments are mode-specific. This is most starkly evident in commitments on market access (Article XVI), where extreme discrimination between modes is permitted, in that Members may allow the supply of a service through one mode and not through another. Even though Article XVII, unlike Article XVI, does not refer to the modes of supply, Members' commitments to provide national treatment have been specified mode by mode. For instance, a Member may have offered to provide national treatment under modes 1 and 2 but not under modes 3 and 4. The mutually agreed technique of scheduling commitments would thus seem to suggest that Members may legitimately retain the right to discriminate between the same service supplied by different modes.

The treatment of subsidies provides a useful illustration of these issues. While Article III.8(b) of GATT 1994 exempts production subsidies from national treatment, subsidies, like all measures affecting trade in services, are automatically subject under GATS to the national treatment disciplines in scheduled sectors unless limitations have been scheduled.

If "likeness" of a service were defined independent of the mode of supply, then there would be built-in protection within the Agreement for foreign suppliers of services through all modes against national subsidization. In effect, if a Member were to subsidize its own service or service supplier, the national treatment obligation would make it necessary to provide an "equivalent" subsidy to the services of other Members supplied within its territory, irrespective of the mode of supply. Otherwise, it could be argued that the subsidy had modified the conditions of competition in favour of services or service suppliers of the Member. On the other hand, if likeness were held to depend on the mode of supply (as the structure of schedules suggests), then foreign suppliers through a particular mode may not be protected against national subsidization. In this case, there would be a gap in the current disciplines which may need to be remedied.

The second issue arises even when a Member has bound itself to provide national treatment under *all four modes*. The question is whether nominally identical commitments translate into effective equality of treatment. Consider again the example of a Member who provides a production subsidy to a national services producer. For instance, the subsidy may consist of partial payment of fuel costs for transporters serving a particular domestic route. Who else could claim a right to be subsidized, given the national treatment obligation? The Explanatory Note clarifies, to an extent, the territorial scope of the national treatment obligation. Paragraph 10 of the Explanatory Note states that:

"There is no obligation in the GATS which requires a Member to take measures outside its territorial jurisdiction. It therefore follows that the national treatment obligation in Article XVII does not require a Member to extend such treatment to a service supplier located in the territory of another Member."

This would seem to imply, for example, that a Member is not obliged to extend a subsidy provided to suppliers located in its territory to suppliers located outside its territory. It should be noted, however, that the Explanatory Note addresses specifically the treatment of *suppliers* and does not deal with issues that may arise in relation to the treatment of *services* - especially with respect to the cross-border supply of a service, when the service is supplied *within* the territory of a Member while the supplier is located outside it.

Given, the commitment to provide national treatment, non-national producers of the like service located in the territory of the Member would seem to be obvious claimants to the fuel cost subsidy. In addition, it seems clear that a subsidy provided to a supplier leads to the production of a subsidized service. Thus, any subsidy provided under modes 3 or 4, would have an impact also on competitive conditions under mode 1, because cross border suppliers would be competing against subsidized local services. Could such suppliers also claim a right to the subsidy? The answer to this question will determine whether GATS already has rules which ensure non-discriminatory conditions for suppliers through all modes.

Unconditional *consumption subsidies* respect national treatment in the widest possible sense: the consumer decision to buy is not biased towards a particular source. However, consumption subsidies contingent upon purchase from a national source would seem to violate the national treatment obligation. An interesting question arises with respect to the "consumption abroad" mode of supply. Would GATS disciplines cover conditional subsidies granted for consumption abroad - conditional, for instance, on purchase from a national supplier located abroad or conditional on purchase in a particular country? Here a tension exists between the notion of territory and wider notions of jurisdiction. There may be no obligation in the GATS which requires a Member to take measures outside its territorial jurisdiction (as paragraph 10 of the Explanatory Note states), but if a Member does take such measures, is it free to act as it chooses - or should there be an obligation to take such measures consistently with GATS principles?²⁶ In the absence of such an interpretation,

²⁶Unlike in GATT, *export subsidies* are not prohibited in GATS, but a Member who had committed to provide national treatment would also be obliged to provide such subsidies to all foreign producers with commercial presence in its territory. However, would the obligation affect a Member who provides the subsidy to its producer located outside its territory? Could

there is a danger that the national treatment (and MFN) obligations would have limited value with respect to consumption abroad.

To conclude this Section, it has to be accepted that the approach to scheduling commitments by modes of supply necessarily implies a fragmentation of the national treatment obligation in a way that is not anticipated in the text of the Agreement - for a Member may retain the right to discriminate between identical services supplied through different modes by not guaranteeing national treatment with respect to each mode.²⁷ It is necessary, nevertheless, to prevent a further erosion of the discipline by clarifying the meaning of the national treatment commitments with respect to each mode. The standard for judging whether treatment is "no less favourable" for the purpose of Article XVII is the treatment of like national services and service suppliers. As such, when a Member undertakes to provide national treatment under any mode, this is the standard that should be applied. Thus, a national treatment commitment under mode 1 would assure cross border suppliers that their services would not face unfavourable conditions of competition compared to nationally produced services. For instance, a Member would be required to provide to foreign services any subsidy it chose to provide, directly or indirectly, to national services, and could not tax them at a higher rate. It is true that the distinction between foreign service and foreign service supplier may often be blurred. But it would not seem right for a Member to escape its obligations vis-a-vis foreign services supplied in its territory just because the supplier who actually receives the subsidy is outside its territory.²⁸

we argue that the Member, having chosen to act outside its territory, should be obliged to act in a manner consistent with its obligations under the GATS?

²⁷There does remain the possibility that non-violation complaints may be raised under Article XXIII:3 when there is complementarity between modes.

²⁸In fact such a reading of the national treatment obligation may be the most effective discipline on subsidization: the set of potential claimants would be so wide that the incentive to subsidize would be significantly diminished.

IV. "Likeness" and the problem of regulatory gerrymandering

In this Section, we turn to the third, and possibly most difficult problem of interpretation, related to the issue of "likeness". Article XVII of the GATS, like Article III of the GATT, disallows measures that are explicitly discriminatory, i.e. not origin-neutral. Thus if a country had made full national treatment commitments on "passenger transportation by road", and it imposed a higher tax on foreign passenger transporters by road than on national passenger transporters by road, then it would clearly be acting inconsistently with its obligations. But the question of determining origin-neutrality, and hence consistency with Article XVII, itself hinges on determining whether or not two services are "like" each other. The wider the definition of a "like" product, the wider will be the universe of measures deemed inconsistent with Article XVII. If a passenger road transportation service is a passenger road transportation service, a tax imposed on taxi services and not on bus services would clearly violate Article XVII because some foreign (taxi) services would be discriminated against relative to "like" national (bus) services. In this example, the "likeness" criterion is immune to regulatory distinctions based on the precise type of passenger road transportation service. On the other hand, the narrower the definition of "like" product, the more likely that measures will escape the Article XVII net. If a taxi service is not "like" a bus service, the foreign taxi services would have to be compared with national taxi services, and the measure could then be found to be consistent with Article XVII.

This section begins with a discussion of GATT Article III experience on the central issue of how "like" products are to be defined. Then the relevance of these issues in the GATS context is discussed.

The GATT Experience

National treatment obligations under Article III of the GATT can be divided into two groups: those relating to taxation (Article III:2) and those relating to other regulations of various types (Article III:4). Article III.2 specifies two obligations. The first sentence states that imported products cannot be subject to internal taxes or other internal charges in excess of those applied to *like* domestic products. The second sentence, referring to Article III.1, implies that such taxes or charges cannot be applied to imported or domestic products *so as to afford protection* to domestic production.²⁹ The

²⁹Note that GATT Article III:2 sets the treatment accorded to *domestic* (or local) products as the standard for national treatment, whereas in GATS Article XVII the standard is the treatment accorded to "own" or *national* services and service suppliers. Thus, under GATT, locally produced products of foreign firms are not covered by the national treatment obligation -only conventional imports are. Under the GATS, locally produced services by foreign suppliers and such suppliers themselves are covered by the national treatment obligation where undertaken.

interpretative note to Article III:2 states that

"A tax conforming to the requirements of the first sentence of paragraph 2 would be considered to be inconsistent with the provisions of the second sentence only in cases where competition was involved between, on the one hand, the taxed product and, on the other hand, a directly competitive or substitutable product which was not similarly taxed."

This suggests that a distinction is to be made between "like" products (the subject of the first sentence) and "directly competitive or substitutable" products (the subject of the second sentence), with the former set of more closely related products a subset of the latter set of more loosely related products. The standard of discipline in the two cases is different. If it were established that a foreign and domestic products were "like", then any taxation of foreign products in excess of that on domestic products would constitute a violation of Article III. If, however, foreign products and domestic products were not "like", but only "directly competitive or substitutable", then difference in treatment would not be sufficient to constitute a violation, it would need to be proved that internal taxes were being applied so as to afford protection.

Article III:4 states that:

"The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use."

The text of GATS Article XVII resembles closely the text of GATT Article III:4, presumably in recognition of the fact that services trade is more likely to be affected by non-tax regulations than taxes. It may, therefore, be instructive to examine whether there are differences in coverage and the stipulated standard of treatment between GATT Articles III:2 and III:4. First, Article III:4 refers only to "like" products and does not explicitly include "directly competitive or substitutable" products in the way that Article III:2 does. If the term "like" were to have the same meaning in Article III:4 as it does in Article III:2, then the scope of Article III:4 would be narrower than that of Article III:2.³⁰

³⁰If this were the case, then there would be an incentive to present charge elements as regulations. For instance, in the 1994 (unadopted) Panel Report on "United States-Taxes on Automobiles" (Inside U.S. Trade, 1994), there was disagreement on whether particular measures should be addressed under Article III:2 or Article III:4.

The second noteworthy element concerns the standard of treatment stipulated in Article III:4, i.e. it must be "no less favourable than that accorded to like products of national origin." GATT case law has established that this must be interpreted as meaning "effective equality of opportunities for imported products"³¹ and as protecting "expectations of the competitive relationship between imported and domestic products"³². Many subsequent panels have reaffirmed the reasoning of the 1958 Panel Report on "Italian Discrimination against Imported Agricultural Machinery" which argued that

"... the intention of the drafters [of Article III] was to provide equal conditions of competition once goods had been cleared through customs."³³

Furthermore, the word "affecting" in Article III implied that

"...the drafters intended to cover in paragraph 4 ... any laws or regulations which might adversely modify the conditions of competition between the domestic and imported products on the internal market."³⁴

It is also recognized that this provision prohibits both de jure and de facto discrimination. Thus the 1989 Panel Report on "United States - Section 337 of the Tariff Act of 1930" states:

"...it has to be recognized that there may be cases where application of formally identical legal provisions would in practice accord less favourable treatment to imported products and a contracting party might thus have to apply different legal provisions to imported products to ensure that treatment accorded to them is in fact no less favourable."³⁵

Finally, GATT panels have consistently rejected the notion that actual trade effects need to be demonstrated in order to establish inconsistency with Article III. In this context, the 1989 Panel Report on "United States - Section 337 of the Tariff Act of 1930" states:

"The Panel therefore considered that, in order to establish whether the 'no less favourable' treatment standard of Article III:4 is met, it had to assess whether or not Section 337 *in itself* may lead to the application to imported products of treatment less favourable than that accorded to

³¹See WTO (1995), p. 166.

³² See WTO (1995), p. 167.

³³GATT (1959), p. 64, paragraph 13.

³⁴GATT (1959), p. 64, paragraph 12.

³⁵GATT (1990), p. 386, paragraph 5.11.

products of United States origin. It noted that this approach is in accordance with previous practice of the Contracting Parties in applying Article III, which has been to base their decisions on the distinctions made by the laws, regulations and requirements themselves and on their *potential* impact, rather than on the actual consequences for specific imported products."³⁶ (emphasis added)

GATT Article III and the issue of likeness

GATT panels, when addressing the question of likeness under Article III, have needed to deal with the possible conflict between allowing national regulatory freedom and maintaining the efficacy of multilateral disciplines. At the risk of oversimplification, two broad approaches can be distinguished. The first approach has been to define likeness *a priori* in terms of product characteristics, end-use, tariff classification, or a combination of these elements.³⁷ Then any unfavourable treatment (or excess taxation) of like foreign products is held to be inconsistent with GATT Article III - and only justifiable by invoking GATT Article XX which deals with general exceptions. The alternative approach has been to argue that *any* distinction between products is justifiable on regulatory grounds, provided that no protectionist intent underlies it and no protectionist effect results from it.³⁸ In effect, this gives governments the freedom to define likeness, thereby permitting a larger set of measures to be deemed origin-neutral, and *prima facie*, consistent with Article III. It will be argued here that neither approach offers a completely sound precedent.

A strict legal reading of Article III suggests that the independent discipline imposed by the first line of Article III:2 (and by Article III:4) should be maintained: a Member should not discriminate between products which are *a priori* like. But then the question arises: how is likeness to be defined? The approach taken by panels has been to establish likeness on a case-by-case basis in

³⁶GATT (1990), p. 387, paragraph 5.13. The previous practice that the Panel referred to included the 1987 Panel Report on "United States - Taxes on Petroleum and Certain Imported Substances" which stated: "An acceptance of the argument that measures which have only an insignificant effect on the volume of exports do not nullify or impair benefits accruing under Article III:2, first sentence, implies that the basic rationale of this provision - the benefit it generates for the contracting parties - is to protect expectations on export volumes. That, however, is not the case. Article III:2, first sentence, obliges contracting parties to establish certain competitive conditions for imported products in relation to domestic products. Unlike some other provision in the General Agreement, it does not refer to trade effects." (GATT, 1988, p. 158, paragraph 5.1.9).

³⁷See, for instance, the 1987 Panel Report on "Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages" (GATT, 1988).

³⁸This argument was introduced in the 1992 Panel Report on "United States - Measures Affecting Alcoholic and Malt Beverages" (GATT, 1993) and found full expression in the 1994 (unadopted) Panel Report on "United States-Taxes on Automobiles" (Inside U.S. Trade, 1994).

terms of criteria such as "the product's end uses in a given market, consumers tastes and habits, which change from country to country; the product's properties, nature and quality"³⁹, and the product's classification in tariff nomenclatures. The view that one of the main objectives of Article III:2 is to ensure that WTO Members do not frustrate the effect of tariff concessions granted under Article II though internal taxes and charges may suggest that the definition of products for the purposes of Article II concessions is relevant for the definition of like products for Article III. However, being in the same tariff line would seem to be neither necessary nor sufficient for two products to be treated as "like" products for the purpose of internal taxation. Furthermore, the elevation of certain physical characteristics of the product to decisive status, as certain panels have done, regardless of consumer perception or behaviour in the market place, does not seem persuasive.

However, the most significant problem with this approach is that it skirts a key issue: what if it can be clearly established that the purpose of legislation is *not* to afford protection?⁴⁰ No measure is completely neutral in incidence. Some measures are bound to hurt foreign products more than domestic products. Are all such measures, which have even an incidental protectionist effect, to be deemed inconsistent with Article III? And does Article XX, dealing with general exceptions, provide the only means to justify measures which have even an incidental protectionist effect? Roessler (1996) argues that:

"This approach is, however, problematical. Article XX lists only ten policy goals as justifying measures deviating from the other provisions of the General Agreement, but there are far more legitimate policy goals that can only be attained by distinguishing between different product categories. For instance, policies designed to harmonize technical standards, to avoid the accumulation of waste, or to tax the consumption of luxury goods are not among the policies covered by the exemptions in Article XX. If one were to rely in the context of Article III only on the characteristics or uses of the products and examine the purpose of the product distinctions only in the context of Article XX, one would arrive at the conclusion that distinctions between physically similar products or products serving similar end-uses could only be made for the ten purposes listed in Article XX, a result that was probably not intended by the drafters of the General Agreement and that would hardly be acceptable to the contracting parties."⁴¹

³⁹Report of the Working Party on Border Tax Adjustments, adopted on 2 December 1970, p. 102, paragraph 18 (GATT, 1972).

⁴⁰To be fair to panels that have taken this approach, they did not usually have to confront a defence of a measure on the grounds that it was in pursuit of a legitimate non-protectionist objective. The problem is rather that this approach would be ill-equipped to deal with this class of disputes.

⁴¹Roessler (1996), p. 30.

Two recent panels, only one of which has been adopted, have responded to these difficulties by interpreting Article III in an innovative way.⁴² They have interpreted the first obligation in Article III:2 in terms of the second by arguing that a regulatory distinction between product categories, i.e. a pronouncement of "unlikeness", is illegitimate only if it leads to protection being afforded. This interpretation eliminates the independent discipline of the first sentence of Article III:2, that like foreign products must not be treated discriminatorily irrespective of whether it is possible to prove that protection is being afforded. Instead, these panels affirm the right of countries to define likeness in terms of the regulatory objective being pursued, provided that the aim and effect is not to afford protection.⁴³ Thus, for instance, under this approach a regulatory objective of conserving fossil fuels could be pursued by taxing fuel-inefficient cars at a higher rate than fuel-efficient cars - even if the measure has a greater impact on foreign cars.

The 1992 Panel Report on "United States - Measures Affecting Alcoholic and Malt Beverages" expresses the reason for following this approach thus:

"The Panel recognized that the treatment of imported and domestic products as like products under Article III may have significant implications for the scope of obligations under the general Agreement and for the regulatory autonomy of contracting parties with respect to their international tax laws and regulations: once products are designated as like products, a regulatory product differentiation, e.g. for standardization or environmental purposes, becomes inconsistent with Article III even if the regulation is not "applied so as to afford protection". In the view of the Panel, therefore, it is imperative that the like product determination in the context of Article III be made in such a way that it not unnecessarily infringe upon the regulatory authority and domestic policy options of contracting parties."⁴⁴

While confronting a difficult problem, this approach raises a crucial question: what standard should be set for establishing that origin-neutral measures are protectionist? Establishing the true aim of a measure is likely to be extremely difficult. What if the regulator claimed to be pursuing a non-protectionist aim but the effect were to afford significant protection to domestic industry?

⁴²The 1992 Panel Report on "United States - Measures Affecting Alcoholic and Malt Beverages" (GATT, 1993) and the 1994 (unadopted) Panel Report on "United States-Taxes on Automobiles" (Inside U.S. Trade, 1994). While the innovative approach was first introduced in the first panel report, it found full expression only in the second panel report.

⁴³This definition of likeness is, of course, not entirely unrelated to the characteristics of the two products. Rather it is the regulator who makes the choice of the relevant characteristic of the product. Thus, in the case of cars, the regulator may determine that it is fuel efficiency which is the relevant characteristic.

⁴⁴GATT (1993), p. 294, paragraph 5.72.

Would the measure still be regarded as legitimate? In other words, to what extent can a non-protectionist aim justify a protectionist effect? As has been argued in Mattoo and Subramanian (1995), the Panel which followed this approach most closely - the unadopted Panel Report on "United States-Taxes on Automobiles"⁴⁵ - set such high standards for establishing that origin neutral measures are protectionist, that it is unlikely that they would ever be met. Furthermore, the Panel, while conceding to regulators the freedom to define likeness, failed to ensure that the freedom should be exercised consistently - arbitrary exemptions for a certain class of products were uncritically accepted. For instance:

"The Panel then considered whether the exclusion from the gas guzzler measure of other fuel-consuming vehicles, in particular light trucks, was applied so as to afford protection to domestic production. The Panel first examined whether the measure had the *aim* of affording protection to domestic production. It noted that the United States had advanced a policy goal other than the protection of domestic production to justify the distinction made with respect to light trucks: the United States did not wish to tax, on the basis of fuel economy, vehicles which for technical reasons owing to their commercial or utilitarian use had relatively lower fuel economy. The Panel recognized that a measure covering all, rather than just some, vehicles would likely achieve more fully the objective of conserving fuel. In particular, the Panel noted that light truck (including sports utility vehicle) sales in the United States were a significant part of total United States vehicle sales, and that many light trucks were used for the same purposes as normal passenger automobiles. *However, in the view of the Panel, the efficiency of the measure was not by itself relevant in assessing conformity under Article III.*"⁴⁶ (final emphasis added)

To conclude this discussion, the central problem is the following: on the one hand, it would be difficult to prevent Members from invoking objectives other than those listed in Article XX as a basis for taking policy measures which may have an incidental protectionist effect; on the other hand, allowing them to do so in the context of Article III may make it possible to circumvent the disciplines of Article XX and open the door to all manner of protection being justified as incidental to the pursuit of supposedly non-protectionist aims. The next section suggests a possible solution to this problem.

GATS and likeness

⁴⁵Inside U.S. Trade (1994).

⁴⁶Unadopted Panel Report on "United States-Taxes on Automobiles", Inside U.S. Trade (1994) p. S-4, paragraph 5-33.

GATS Article XVII refers only to "like" services and service suppliers, and not to "directly competitive or substitutable" services. In this respect, as noted above, it is different from GATT Article III:2 and similar to GATT Article III:4. If GATS Article XVII is not to be more limited in scope than GATT Article III:2, then clearly the term "like" must be interpreted widely to include also "directly competitive or substitutable" services. In any case, it will be necessary to deviate in the GATS from the more literal GATT interpretations of "likeness" to arrive at an economically meaningful interpretation which would necessarily incorporate the notion of substitutability.

Consider first how the GATT precedents for defining "likeness" *a priori* would fare in the GATS context. Physical characteristics are, perhaps fortunately, irrelevant. Corresponding to the tariff classification in the case of goods, commitments in services have generally followed a classification scheme based on the United Nations Central Product Classification, which is in the process of being revised.⁴⁷ The status of this classification, and the closeness with which it has been followed in scheduling commitments, do not compare favourably with the well-developed Harmonized System classification, which is the basis for scheduling tariff concessions for goods. However, in so far as the services classification was developed and used for negotiating commitments on both market access and national treatment, it could be argued that it represents mutually accepted product distinctions for regulatory purposes.⁴⁸ Thus being classed in separate sub-sectors in the services classification may be regarded as a sufficient condition for "unlikeness". However, given the high level of aggregation of the services classification, being classed in even the finest sub-division can only be considered as at most creating a presumption that the services are like.⁴⁹

It is the reference to "end uses" which offers the most appropriate basis for comparing services. This notion is related to the economically meaningful concepts of directly competitive or substitutable, and follows the logic of the market place. After all, what matters is whether consumers treat the services in question as substitutes. It may even be possible in certain cases to estimate the cross price elasticity of demand, with high estimates creating a presumption in favour of likeness.

But irrespective of the criteria chosen to arrive at an *a priori* notion of like services, it would be

⁴⁷This classification scheme is given in GATT Document MTN.GNS/W/120.

⁴⁸Notice that in the GATT, the Harmonized System classification is used as a basis only for negotiating tariff concessions, and therefore does not represent any acknowledgement of distinction with respect to measures covered by the national treatment obligation. Furthermore, the services classification sometimes makes a distinction between services products, not because they are qualitatively different from the point of view of the consumer, but because they fall in different regulatory classes - so to use it as a point of reference to judge regulatory distinctions could be tautologous.

⁴⁹There are only 160 non-overlapping services sectors in the services classification list (GATT Document MTN.GNS/W/120) compared to 5019 at the 6-digit level in the Harmonized System 1992 classification.

difficult to deny regulators the right to make further regulatory distinctions. Furthermore, the scope for making such distinctions is arguably greater in the case of services than in the case of goods. It may be useful to begin with an example which illustrates why these issues might be particularly difficult to tackle in the GATS context. A country X, which has made fully liberal market access and national treatment commitments on transport services, imposes the requirement that only drivers trained in its own driving schools and with licenses issued in X can drive in X. It argues that the measure is not inconsistent with national treatment because foreigners have access to its driving schools and testing centres, and its own citizens trained abroad are also not allowed to drive in the country. Even though the measure is not *de jure* discriminatory, surely it is *de facto* discriminatory since the incidence of the measure is much greater on foreign drivers than on national drivers? But X argues that a determination of *de facto* discrimination must be consequent upon a determination of likeness, and in its view the service provided by a foreign-trained driver is unlike a service provided by a domestically-trained driver. Say a country Y were to complain about the measure imposed by X. How would GATS disciplines deal with this problem?

The burden of proving likeness would fall on the complainant. Country Y would argue that the services of drivers trained in X and Y are indeed like products for the purpose of Article XVII. On the other hand, X may argue that training standards are not of the same quality in Y as in X. Since standards are unlikely to be exactly the same in any two countries, the question is how much difference justifies a pronouncement of unlikeness? A WTO panel would find it difficult to appropriate the right to make this judgement from the transport authorities of country X: if it did, and judged the services to be "like", it would be forced to recommend that X should provide unconditional access to drivers trained in Y. If, on the other hand, it accepted that the services were "unlike" then no matter how great the difference in treatment, the disciplines of Article XVII would simply not apply.

In these circumstances, the most reasonable argument that a panel could advance would be that country X should subject foreign-trained drivers to tests of competence rather than insist on their undergoing local training. In other words, compulsory local training is not necessary to meet the objective of promoting road safety since the same objective could be met by the less trade-restrictive means of a qualification examination. But here is the key question: can we read Article XVII to contain a necessity test which would enable a panel to pronounce judgement on the stringency of a measure? Of course Article XIV, dealing with general exceptions contains such a test, but to move to Article XIV would require the panel to establish first that the measure is inconsistent with Article XVII. It is only then that a country would need to invoke the general exceptions provision. Thus, it would be difficult for a panel to circumvent the need to pronounce judgement on "likeness."

The "temporary" weakness of GATS Article VI

There is, in principle, a more direct route under the GATS to address the problem of origin-neutral standards which are unduly trade-restrictive. This is through Article VI which deals with domestic regulation. Today Article VI primarily provides a mandate (in Article VI:4) to develop disciplines under the GATS to ensure "that measures relating to qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade in services." Pending the entry into force of disciplines developed pursuant to Article VI:4, the only current disciplines are contained in Article VI:5, which requires that

"...the Member should not apply licensing and qualification requirements and technical standards that nullify or impair any existing sectoral commitments in a manner which:

(i) does not comply with the criteria outlined in subparagraphs 4(a) [objectivity and transparency], 4(b) [not more burdensome than necessary to ensure the quality of the service], and 4(c) [in the case of licensing procedures, of not being in themselves a restriction on the supply of the service]; and

(ii) *could not reasonably have been expected of that Member at the time the specific commitments in those sectors were made.*" (emphasis added)

The requirements in (i) could have constituted a powerful discipline, but element (ii) renders them toothless. In the extreme, it could be read as "grandfathering" all existing restrictive requirements. Thus country X could argue that training in driving schools in X had always been a requirement to drive in X and it could, therefore, "reasonably have been expected" when the specific commitments were made. This provision seriously limits the scope for translating the commitments under GATS into effective market access.

In this respect, it is worth comparing Article VI of the GATS with the newly strengthened Agreement on Technical Barriers to Trade (TBT). The key provision is Article 2. Article 2.2 states that:

"Members shall ensure that technical regulations are not prepared, adopted or applied with a view to or with the effect of creating unnecessary obstacles to international trade. For this purpose, *technical regulations shall not be more trade restrictive than necessary to fulfil a legitimate objective*, taking into account the risks non-fulfilment would create..." (emphasis added)

Thus, not only does the TBT deter discriminatory measures, as does GATT Article III, it goes further

in imposing additional disciplines on non-discriminatory measures. It makes possible a critical assessment of non-discriminatory standards from the point of view of their impact on trade in a way that is not currently possible under GATS. There is at least one other difference between the two Agreements which may be important. The TBT creates a strong presumption in favour of harmonized international standards. Thus Article 2.5 of the TBT states:

"...Whenever a technical regulation is prepared for one of the legitimate objectives explicitly mentioned in paragraphs 2 to 4 [national security, protection of human health, environment, etc.], and is in accordance with relevant international standards, it shall be rebuttably presumed not to create an unnecessary obstacle to international trade."

The corresponding provision in GATS (Article VI:5(b)) would seem to be somewhat weaker. It states:

"In determining whether a Member is in conformity with the obligation under paragraph 5(a), account shall be taken of international standards of relevant international organizations applied by that Member."

It could be argued that Article VI will eventually contain a second line of defence against origin neutral measures which escape Article XVII. But there are two problems. First, even though the domain of Article VI is all domestic regulations, significant disciplines are to be developed under the Article VI:4 mandate only for qualification requirements and procedures, technical standards and licensing requirements. Secondly, there is an intertemporal problem. It is reasonable to assume that at some point in the future Article VI of GATS will be as strong as the TBT, and note furthermore, that its domain is wider than that of the latter. If this were to happen, then the escape of certain origin neutral measures from Article XVII would indeed be less cause for concern. However, today, with Article VI not creating a strong discipline, reading Article XVII narrowly would mean an indefinite wait for meaningful disciplines.

A possible solution

It may be useful to restate the central problem described in the GATT context in GATS terms: on the one hand, it would be difficult to prevent Members from invoking objectives other than those listed in Article XIV (dealing with general exceptions) as a basis for taking measures which may have a protectionist effect; on the other hand, allowing them to do so may make it possible to circumvent the disciplines of Article XIV and open the door to all manner of protection being justified as

incidental to the pursuit of supposedly non-protectionist aims.

There is a solution to this problem: to read in GATS Article XVII, disciplines of the type previously associated only with GATT Article XX and, presumably, GATS Article XIV, both of which deal with general exceptions. This implies, on the one hand, accepting the right of regulators to pursue a legitimate objective, but on the other hand, ensuring that the objective is not pursued in a manner which affords less favourable treatment to foreigners. In effect, the question of *whether* two products are treated differently must not be separated from *how* they are treated differently. The practical implications of such an approach are described below.

The problem in the unadopted Panel Report on "United States Taxes on Automobiles"⁵⁰ was not so much that the Panel accepted the regulator's right to make distinctions provided protection was not afforded, but that in assessing whether protection was afforded, the Panel applied a weak standard. In particular, the choice of instrument and the manner of its application were not subjected to any rigorous test. Given a domestic policy objective, which governments are free to pursue under the WTO, what instruments should they be permitted or obliged to use? In the case at hand, it was clear, and the Panel recognized this, that the environmental objective could be better served by other forms of policy intervention, such as fuel taxes, but the Panel ruled that the efficiency of the measure was not by itself relevant in assessing conformity under Article III.

But even though the WTO may not be able to prescribe the choice of the optimal instrument, surely it can question the use of an instrument which discriminates against foreigners when other suitable instruments exist which would not have a similarly discriminatory effect? This is what GATT Panels have done in the context of GATT Article XX. If even the pursuit of objectives under GATT Article XX and GATS Article XIV, which have been *agreed* by all Members to be legitimate, requires the demonstration of necessity, it would be strange if a similar obligation were not imposed regarding other, *unilaterally* chosen objectives.⁵¹

On this basis, a two stage test can be suggested:

(i) Stipulate an a priori definition of like services based on similarity of end uses, and a clear relationship of substitutability and direct competition based on market conditions.

⁵⁰Inside U.S. Trade (1994).

⁵¹An alternative solution to the problem is to exclude any consideration of objectives under Article XVII, but to widen the list of legitimate objectives included in Article XIV. But it would not be easy for Members to reach agreement on an exhaustive list of legitimate objectives which alone could be invoked as justification for any domestic policy instruments.

(ii) If a Member takes measures which distinguish between what could be regarded as *a priori* like services, then that Member must assume the burden of proving that any resultant unfavourable treatment of foreigners is *necessary*. In other words, that the Member could not have achieved the stated objective through any other reasonably available measure which did not disadvantage foreign services or foreign suppliers, or did not disadvantage them as much.

Even if we accept the need to apply such a test, there remains a crucial legal question: can we read necessity in Article XVII? With regard to the standard of treatment, again GATS Article XVII resembles GATT Article III:4 in its stipulation of "treatment no less favourable." Paragraphs 2 and 3 of Article XVII elaborate on this basic obligation drawing upon the interpretations by previous GATT panels of Article III. Thus III:2 echoes the 1989 Panel Report on "United States - Section 337 of the Tariff Act of 1930" and III:3 echoes the 1958 Panel Report on "Italian Discrimination against Imported Agricultural Machinery", both of which have been quoted in the previous section. Thus, in essence GATS Article XVII establishes a standard of treatment similar to GATT Article III:4. There is no precedent of GATT panels applying a necessity test in the context of Article III.

There is a strong case that the GATT precedent of uncritical acceptance of the choice of instruments in the context of Article III needs to be disregarded. As long as Panels relating to GATT Article III focused on protectionist effect, and did not accept non-protectionist objectives as justification, it did not matter if they accepted the choice of instruments uncritically. However, the moment that Panels permitted the invocation of non-protectionist objectives as justification for protectionist effect, the absence of any discipline on the choice of instruments and the manner of their application threatened the undermining of multilateral rules. In the GATS context, since it will be difficult to resist the invocation of objectives in the context of XVII, it is imperative to apply a more stringent test.⁵² If such a test cannot already be read in Article XVII, then it would seem desirable that its explicit inclusion be considered in future negotiations.

Thus, in ruling on the "foreign-trained driver" dispute, a Panel could argue: considerations of end use and substitutability create a presumption that nationally trained drivers and foreign trained drivers provide like services. Country X, in the light of its objective of road safety, does not consider them like products. The objective is legitimate. But if the disciplines of Article XVII are not to be circumvented, *then the judgement of unlikeness itself and the manner in which supposedly unlike services are treated* must not be such as to accord less favourable treatment to foreigners. This

⁵²The necessity test as applied by previous GATT panels itself raises certain problems and is in need of refinement. There is also the problem, which exists in any case, of whether the choice of objective or the desired level of its attainment can themselves be questioned. Both these issues are discussed in Mattoo and Mavroidis (1996).

implies that the instrument chosen, and the manner of its application, should not unnecessarily discriminate against foreigners who have been deemed "unlike" nationals. Even if Country X's distinction is accepted, the instrument chosen, compulsory local training, modifies conditions of competition excessively even in the light of the objective, which could be attained by means less unfavourable to foreigners, such as driving tests.

Much of the discussion so far has focused on the likeness of services and only incidentally touched upon the issue of who could be regarded as like suppliers. GATS offers little guidance, but the approach suggested here can be extended to deal with this issue also. The logic of the national treatment discipline would suggest beginning with the presumption that *suppliers of like services are like suppliers*. Any distinction made between suppliers presumed to be like would need to be justified. But there are indications that Members may wish to take a more flexible approach to this issue. First of all, by scheduling limitations under GATS Article XVI:2(e), a Member specifies the types of legal entity through which a supplier may supply a service. Thus a Member may allow the supply of a service through a subsidiary but not a branch. Secondly, the discussion of sub-federal taxes under the GATS seems to suggest a willingness to accept that suppliers of like services located in different tax jurisdictions can be legitimately treated differently.⁵³

V. Conclusion

The main objective of this paper was to draw attention to a series of problems in interpreting the national treatment obligation in the GATS. The lack of clarity with regard to this fundamental discipline could affect the operation of the Agreement. The paper has ventured further in actually suggesting possible solutions, without wishing in any way to preempt future clarification by the Members of the WTO. Experience relating to national treatment under the GATT has been described in some detail since it will inevitably influence the interpretation of GATS Article XVII. However, the paper has attempted to show that there is a need to deviate consciously from the GATT

⁵³It may be interesting to examine how these issues have been dealt with in the OECD context. As noted above, the OECD national treatment instrument calls for treatment by a host government of a foreign owned or controlled enterprises operating in their territories no less favourable than that accorded to domestic enterprises *in like situations*. OECD (1993a, p. 22) argues, "As regards the expression 'in like situations', the comparison between foreign-controlled enterprises established in a Member country and domestic enterprises in that Member country is valid only if it is made between firms operating in the same sector. More general considerations, such as the policy objectives of Member countries, could be taken into account to define the circumstances in which comparison between foreign-controlled and domestic-enterprises is permissible in as much as those objectives are not contrary to the principle of national treatment. In any case, the key to determining whether a discriminatory measure applied to a foreign-controlled enterprises constitutes an exception to national treatment is to ascertain whether the discrimination is motivated at least in part by the fact that the enterprises concerned are under foreign control."

precedent in certain respects.

There are three main conclusions of this paper. First, a proper understanding of the GATS schedules of commitments will be difficult unless there is a clarification of the domain of Article XVII, particularly in relation to Article XVI. Two clear choices have been identified: either national treatment could be an obligation which dealt with all types of discriminatory actions, or we could take a more limited post-establishment view of national treatment. The first interpretation seems to have a sounder legal basis, given the current text of Article XVII, while the second represents a neater division of disciplines between Articles XVI and XVII, and may have been the basis for commitments scheduled by some Members. The significance of this issue depends on how scheduling techniques are to be understood, particularly when commitments on national treatment have been made in the absence of commitments to provide full market access. The interpretation which would eliminate the need to define the precise domain of Article XVII would also significantly diminish the value of national treatment commitments. While it is desirable to reach consensus on a precise interpretation, the implications of the choice for the liberalizing impact of the GATS would also need to be considered.

Secondly, it has to be accepted that the approach to scheduling commitments by modes of supply necessarily implies a fragmentation of the national treatment obligation in a way that is not anticipated in the text of the Agreement - for a Member may retain the right to discriminate between identical services supplied through different modes by not guaranteeing national treatment with respect to each mode. It is necessary, nevertheless, to prevent a further erosion of the discipline by clarifying the meaning of the national treatment commitments with respect to each mode. The standard for judging whether treatment is "no less favourable" for the purpose of Article XVII is the treatment of national services and service suppliers. As such, when a Member undertakes to provide national treatment under any mode, this is the standard which should be applied. Thus, a national treatment commitment under mode 1 would assure cross border suppliers that the conditions of competition would not be modified in favour of nationally produced services through the asymmetric application of measures such as taxes and subsidies.

Thirdly, the paper has suggested a possible solution to the difficult problem of striking a balance between, on the one hand, allowing regulators the freedom to make distinctions between services products and, on the other, preserving liberal trading conditions. Since the intrusion of regulatory distinctions into Article XVII will be difficult to resist, it is imperative that these distinctions be subject to a stringent test. In particular, a "necessity" test has been suggested to deter recourse to instruments which are more discriminatory than is necessary to achieve a legitimate objective. If

this test cannot already be read in Article XVII, it would seem desirable that its explicit inclusion be considered in future negotiations. In any case, it is highly desirable that the negotiating mandate under GATS Article VI, to develop appropriate disciplines on technical standards, qualification and licensing requirements, be fulfilled as soon as possible.

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