Introduction

I WTO and Preferential Services Liberalization

The purpose of the book is threefold. First, it examines the rules of the World Trade Organization (WTO) on economic integration agreements (EIAs), which are preferential trade agreements (PTAs) concluded in the field of services.¹ Second, it presents the results of an empirical analysis of international trade agreements concluded by the European Union (EU) and including liberalization of trade in services.² Drawing on the interpretation of the relevant WTO rules, the book analyzes the level of liberalization reached by the EU in those agreements. Particular attention

¹ EIAs are PTAs focusing on the liberalization of services. The term EIA is employed in Art. V of the WTO’s General Agreement on Trade in Services (GATS).

² ‘Empirical’ in the present book refers to the nature of our method which is to go through the EU’s services schedules in four chosen EIAs. Even though it concerns interpretation of legal text and thus corresponds to the traditional method of conducting legal research, we refer to our analysis as empirical in order to distinguish it from the interpretation of the proper texts of the agreements. Instead of engaging in an extensive interpretation of the EU’s schedules in accordance with the customary rules of interpretation, we give numerical values to the EU’s sector-specific commitments based on placing the commitments in simple categories. Our choice of vocabulary is therefore meant to take some distance to a traditional legal analysis. However, ‘empirical’ in this book does not mean information gained by experience, observation or experiment – even though experience and repeated observations are definitely useful in order to understand the complex nature of services schedules and the way in which services commitments are formulated. The scheduled services commitments are part of the overall agreement but each party provides its own commitments. They are typically vaguer and practically oriented than the actual chapters of the agreement. That makes the interpretation of services schedules somewhat special and, arguably, especially challenging.
is paid to the federal-type structure of the EU, which is reflected in the multi-level liberalization of services in the Union. Third and finally, the conclusions on the application of the WTO rules on EIAs are extended outside the EU to all states with constitutionally divided powers in services regulation. Typically, such states are federations.

The book contributes to the growing amount of research on preferential trade agreements (PTAs). Such research has become topical with the vast increase in the numbers of PTAs globally. Whereas earlier research used to be focused on PTAs in the field of goods, there is now a significant number of trade lawyers, social scientists and economists working on preferentialism in the field of services too. At the moment almost all new PTAs, especially among developed countries, include provisions on the liberalization of services. Moreover, a subset of WTO Members (including the EU) has embarked on a so-called plurilateral initiative to liberalize services through a new international agreement – the Trade in Services Agreement (TiSA).\(^3\) Considering that tariffs on goods, especially preferential ones, are already relatively low, many countries have turned their attention to services. This is a logical development also in light of new technologies that enable services to become more globally tradable. It is also widely understood that services play a key role in infrastructure as well as global supply chains. Thus the dismantling of barriers in services trade often leads to productivity gains also in other sectors of the economy.

The first part of the book focuses on the theory of preferentialism in services, taking into account the law as well as the special characteristics of services trade as compared to trade in goods. The starting point of this analysis is Art. V of the WTO’s General Agreement on Trade in Services (GATS)\(^4\). Art. V lays down the discipline for EIAs, which are PTAs including liberalization of trade in services.\(^5\) In principle, all EIAs

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\(^3\) The negotiations, however, came to a halt in 2016. For information on the negotiations that took place until then, see e.g. the webpages of the European Commission and the United States Trade Representative: http://ec.europa.eu/trade/policy/in-focus/tisa/ and https://ustr.gov/TiSA (last accessed on 1 February 2019).


\(^5\) In the following, the acronym PTA is used when referred to preferential trade agreements in general sense. Such agreements may include liberalization of goods, services or both. Several commentators, as well as the WTO Secretariat, prefer to use the term Regional
concluded by WTO Members with each other or non-Members should abide by its provisions. In practice, however, compliance with the Art. V rules is questionable to the least. There are numerous reasons behind the lack of respect for the legal discipline, but they can, in essence, be summarized in two: the rules are vague and they have proved hard to enforce.

So far, the legal content of Art. V GATS has attracted relatively little attention. Compared to the existing literature on Art. XXIV of the General Agreement on Tariffs and Trade (GATT), research on Art. V is modest in amount. Preferentialism in the field of goods has been the object of economic and policy-oriented research already for decades. However, notwithstanding the large interest, the exact conditions that Art. XXIV GATT sets for free-trade agreements (FTAs) and customs unions (CUs) also remain unclear due to the open-endedness in the wording of the conditions. No significant clarification has been attained due to the extremely low number of PTA-related disputes brought under the GATT/WTO dispute settlement procedure. The Members lack enthusiasm in enforcing Art. XXIV through multilateral control of PTAs. In practice, the legal disciplines of both Art. XXIV GATT and Art. V GATS have given up to the highly political nature of preferential trade.

The rules of Art. V are arguably even vaguer than those of Art. XXIV GATT, which is part of a much older agreement. The essence of Art. V is that it allows a limited derogation from the cornerstone of WTO law, the most-favoured nation principle. The main requirements for GATS-consistent EIAs are that, first, they have substantial sectoral coverage and, second, they provide for the absence or elimination of trade agreements (RTAs). The term PTA is here considered more appropriate since the most essential feature of such agreements is their preferentiality in the relations of the participating countries. Moreover, many of today’s PTAs are not limited to any specific region. See Bhagwati, J. (2008) *Termites in the Trading System: How Preferential Agreements Undermine Free Trade*. Oxford; New York: Oxford University Press, XI. When referring especially to the service part of a specific PTA or specific PTAs, the book refers to EIA(s). This clarifies that the purpose is to refer solely to the service elements of the agreement(s).

6 Hereinafter referred to only as Members.


8 In case a PTA regulates trade in goods in addition to trade in services, its WTO-consistency is determined also under Art. XXIV GATT.
substantially all discrimination in the sectors covered by the agreement.\(^9\)

In addition, the so-called internal and external trade requirements should be fulfilled. According to these requirements, an EIA should, on the one hand, be designed to facilitate trade between the parties to the agreement (the internal requirement) and, on the other hand, not raise the overall level of barriers to trade in services with regard to any Member outside the agreement (the external requirement). So far, we have no clear understanding of any of these requirements due to the open-ended nature of definitions such as ‘substantial’, and because of methodological difficulties in calculating the effects of barriers to services trade. At least so far, Members have been reluctant to challenge each other’s PTAs and the GATT/WTO dispute settlement has so far not given much guidance on the relevant rules.

In the absence of effective control over PTAs, it is up to the Members party to such agreements to make sure that they are complying with their obligations towards other Members. However, due to the ambiguous nature of Art. V, it is unclear what is the degree of integration that Members should follow. Thus, Members inevitably face a challenge in structuring their EIAs in a WTO-consistent fashion. Due to non-enforcement, they also lack sufficient incentive to do so. Because of the uncertainty surrounding the WTO rules on PTAs, the WTO-consistency of PTAs already in force is naturally also covered by uncertainty.\(^10\)

Economists and lawyers have already for long worried about the systemic consequence of PTAs to the multilateral trading system. So far, the debate on whether PTAs should be seen as building blocks or stumbling blocks to multilateralism has been mostly confined to the liberalization of trade in goods.\(^11\) One of the main observations of the book is that due to inherent differences between trade in goods and

\(^9\) This is to be done through elimination of existing discriminatory measures, and/or prohibition of new or more discriminatory measures, ‘either at the entry into force of the agreement or on the basis of a reasonable time-frame, except for measures permitted under Articles XI, XII, XIV and XIV bis’. Discrimination is specified to be understood ‘in the sense of Art. XVII GATS (national treatment).


services, preferentialism in services is fundamentally different from preferentialism in goods. Another important observation is that preferentialism in services is potentially less dangerous than in the field of goods but it should still be carefully analyzed and to at least some extent controlled as to prevent increase in the forms of integration that have most harmful discriminatory effects on outsiders and, in many cases, to those inside the agreement as well.

Whereas in goods trade, the central element of a PTA is a preferential tariff reduction vis-à-vis a WTO Member’s multilateral tariff binding, in EIAs the central element is the heightened elimination of discrimination towards one’s preferential partner. The difference is reflected in the legal disciplines. Unlike Art. XXIV GATT that focuses on elimination of tariffs and thus on enhanced market access for goods of preferential origin, Art. V GATS does not include any market access (‘MA’) discipline but is focused on the elimination of discrimination between the parties to the agreement. We argue that the difference stems from the basic features of services trade. Whereas altering the conditions for MA through tariffs is easily done with regard to goods, in the field of services the application of different sets of MA conditions to different partners is often unpractical and, in some cases, close to impossible. Instead of focusing on mostly quantitative MA limitations, Art. V requires extensive elimination of discrimination. It is proposed in the book that the emphasis on non-discrimination alleviates concern over growing preferentialism in services. Unlike the elimination of tariffs that takes place in goods PTAs, the elimination of discrimination through EIAs is more likely to benefit outsiders as well and thus makes EIAs less susceptible of creating trade diversion. This effect is coupled with the generous rules of origin that are required from EIAs by Art. V. Such rules are often implemented also in practice. 12

As all PTAs, EIAs are capable of creating negative effects especially for outsiders. Art. V aims at reducing such effects but it suffers from the same problem as Art. XXIV. The problem is the general ambiguity in the rules. So far there is no general understanding of the level and type of liberalization EIAs must adopt in order to satisfy the Art.

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V requirements. Neither the WTO’s dispute settlement mechanism nor the Members themselves have been able to provide guidance on the issue. The WTO’s Committee on Regional Trade Agreements (the CRTA), the official review body of all PTAs, is now mainly an enforcer of transparency. At the same time, however, there seems to be a general agreement on the urgent need to clarify what is required from PTAs. Without such clarification, PTAs continue to be undisciplined and MFN will be reduced to ‘LFN’.

II Structure of the Book

The book consists of four parts. The first part presents and develops WTO law regarding preferentialism in services. It starts by exploring the historic background of regional and preferential trade agreements and the reasons for their significant increase especially during the last two decades. It then provides a substantive analysis and interpretation of Art. V GATS that includes the detailed rules on services PTAs. The aim of the first part is to provide a theoretical framework for a legal analysis of individual services agreements. The book focuses on the so-called internal requirement for EIAs included in the first paragraph of Art. V, as well as on the possibility to give consideration to the relationship of the agreement to a wider process

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13 The same problem applies to the interpretation of Art. XXIV of the GATT. It is, however, claimed that the GATS rules on EIAs are even more open-ended than those of Art. XXIV GATT on free trade areas and custom unions.

14 On 14 December 2006, the General Council established on a provisional basis a new transparency mechanism for all PTAs. The transparency mechanism provides for early announcement of any PTA and notification to the WTO. Members will consider the notified PTAs on the basis of a factual presentation by the WTO Secretariat. In contrast to the previous review procedure, there is, however, no longer review of the consistency (from a legal perspective) of the notified PTA with the WTO rules. See Mavroidis, P. C. (2011) Always Look on the Bright Side of Non-Delivery: WTO and Preferential Trade Agreements, Yesterday and Today. World Trade Review, 10(3), 375–87, at 377, as well as Mavroidis, P. C. (2015), The Regulation of International Trade: Volume 1: GATT, Cambridge: MIT Press, at 310–11.


16 The first paragraph of Art. V requires that EIAs provide for ‘substantial sectoral coverage’ and for the absence or elimination of substantially all discrimination, in the sense of Art. XVII of the GATS (national treatment), between or among the parties, in the substantially covered sectors.
of economic integration or trade liberalization among the countries concerned (paragraph 2 of Art. V). On the contrary, the external requirement of Art. V:4, which concerns the requirement not to raise the overall level of barriers in respect of any Member outside the agreement, is not explored to the same length. That is because the book aims at providing a framework for analyzing the internal liberalization levels of EIAs. The possible tools for assessing the fulfilment of the external requirement differ from the analysis of EIAs under the internal requirement and the provisions of Art. V:2. Such tools, which largely remain to be developed, would be challenging to integrate into a textual analysis of services agreements and commitments.

The second part of the book addresses a particularly timely question which is the approach that should be adopted to services regulation, and especially services trade barriers, applied by non-central levels of government. Some of the most powerful nations, such as the United States (USA) and Canada, have divided competencies over services regulation. Arguably some of the most significant economic advantages would be realized if sub-central entities (states, regions and municipalities) engaged in deeper liberalization of services. In this regard, the EU is in the book treated as a federal entity as due to the EU’s common trade policy its behaviour in its external trade relations can be compared to federal states.

To explain the particularities that relate to the liberalization of services by the EU, Chapter 4, the first chapter of Part II, reviews the key legal issues in the EU’s trade policy in the field of services. The development of the EU’s competences in the field of services is analyzed in light of the jurisprudence of the Court of Justice of the EU (‘the Court’). In particular, we concentrate on the consequences of the unfinished nature of the EU’s internal services market on its external liberalization of services.

The third and fourth parts of the book look into practice. The third part provides a new methodology that can be used to analyze EIAs in light of the criteria of GATS Art. V:1. The method is particularly suitable for coding services liberalization undertaken by federal entities. The fourth part provides an analysis of four EIAs concluded by the EU. As a result, the book provides an evaluation of the EU’s services commitments in light of the GATS Art. V:1 discipline on EIAs. The method consists of a textual analysis of the EU’s EIAs, particularly the sector-specific services commitments, and of coding those commitments based on the existence of discrimination.
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Only the EU side’s commitments are analyzed: the purpose is to find out the approximate level of liberalization reached by the EU, as well as to assess how the EU’s method of liberalization corresponds to the Art. V criteria. Thus, no conclusions can be drawn on the agreements in their entirety. Since the EU has concluded EIAs with very different types of countries from several regions, the agreements are useful material for an analysis under the various elements of Art. V. Yet considering that all EU Member States are highly developed countries and advanced economies, the flexibility that Art. V GATS provides for developing countries does not apply to the EU side. Whereas the overall purpose of the agreement can be taken into account in the analysis under Art. V, it is argued that the EU side’s level of liberalization should always correspond to the strict requirement of ‘substantiality’ in terms of sectoral coverage and elimination of discrimination.

In the interpretation of the results in light of the WTO rules, particularly Art. V GATS, specific attention is paid to the EU’s commitments under Mode 4. We assess how the EU understands Mode 4 and to what extent the EU’s position matches the requirements of the GATS. As with the other modes, we also try to evaluate how the liberalization level in the EU’s Mode 4 commitments corresponds to the criteria of Art. V. In contrast to the other modes, the scope of Mode 4 is particularly open to different interpretations as it is not clear what categories of natural persons should be covered by it.

III Federalism and Services Liberalization: The EU and Beyond

In the WTO the EU has been one of the most active proponents of service trade liberalization. This is logical considering that the EU is the world’s biggest exporter of commercial services. During the past

17 The GATS differentiates between four modes of supply: 1) from the territory of one Member into the territory of any other Member (cross-border trade); 2) in the territory of one Member to the service consumer of any other Member (consumption abroad); 3) by a service supplier of one Member, through commercial presence in the territory of any other Member (commercial presence, or investment) and 4) by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member (Art. 1.2(d) GATS).

18 World Trade Statistical Review 2018, p. 16, available at www.wto.org/english/res_e/ statis_e/wts2018_e/wts2018_e.pdf (last accessed on 20 February 2019). If one were to take into account the share of individual countries, the biggest exporter of commercial services would be the United States. In the EU, the single biggest exporters are United Kingdom, Germany and France.
decade the EU has become active in liberalizing services trade also through PTAs with third countries. Especially in the most recent, so-called deep and comprehensive free trade areas (DCFTAs), new market opening in services is one of the main goals of the negotiations. Detailed commitments on the liberalization of services can also be found in many other types of agreements concluded by the EU with third countries. The empirical analysis conducted for the purposes of the book covers four agreements belonging to three different groups of agreements (two Association Agreements, a Free Trade Agreement and an Economic Partnership Agreement). The choice of the agreements was based on an assumption that liberalization levels would vary based on the different goals of the agreements. The results partly do reflect differences in these three types of agreements. However, overall, and maybe surprisingly, the differences in the level of non-discrimination provided by the EU to the partner countries are revealed to be modest.

The methodological choices are adapted to take into account the special circumstances of services trade liberalization by the EU towards third countries, especially the fact that regulation of services, unlike goods, is not uniform throughout the Union. However, the key understanding is that such special circumstances are relevant not only in the study of the EU, but in the study of all WTO Members with constitutionally divided powers in the regulation of service activities. Similar circumstances are likely to rise also with regard to any other existing or future free trade area that would start

19 The first such ‘deep and comprehensive’ FTAs aimed at more market opportunities were the EU–South Korea Free Trade Agreement of 2011 and the EU–Singapore Free Trade Agreement of 2013.
20 See the reviewed agreements in Appendix 2.
21 For detailed results, see Appendix 3 and Part IV of the book.
22 ‘Regulation’ in this book is understood as a broad, general political and legal concept that includes all governmental policies and measures that are aimed at influencing, controlling and guiding all private activities with impacts on others. See Krajewski, M. (2003) National Regulation and Trade Liberalization in Services: The Legal Impact of the General Agreement on Trade in Services (GATS) on National Regulatory Autonomy. The Hague: Kluwer Law International, 4. Reference can also be made to Reagan who defines regulation as ‘a process or activity in which government requires or prescribes certain activities or behaviour on the part of individuals and institutions, mostly private, but sometimes public’. See Reagan, M. (1987) Regulation – The Politics of Policy. Boston and Toronto: Little, Brown and Company, at 15. Regulation can take place on all levels of a state, as well as on supranational and international level.
concluding services agreements independently in its own name, similarly to the EU.\textsuperscript{23} The challenges that the EU as a multi-state actor faces in concluding services trade agreements are often similar especially to such countries that have a federal structure. Trade liberalization by the EU reflects the combination of supranational and national jurisdiction over trade negotiation areas. Within the field of services, as in goods, the competence to conclude agreements with third parties is within the powers of the Union.\textsuperscript{24} However, due to the lack of internal harmonization of services regulations within the EU, the EU Member States keep scheduling their own national reservations to the common EU services schedule in EIAs. In this sense, there are similarities to countries with de-centralized regulation of services. In the case of many federal states, however, such non-central measures are not often explained in detail in the country’s services schedule. A prominent example of a federal state with regional powers in the field of services is the USA. The USA has recently begun including an illustrative list of non-conforming measures (‘NCMs’) in the field of services for state level restrictions.\textsuperscript{25} However, the NCMs

\textsuperscript{23} So far, to our knowledge, the EU is the only free trade/common market area that is clearly concluding trade agreements in its own name in addition to its Member States (and thus binding itself legally too). It is also the only organization that is a Member of the WTO in its own right, in addition to its Member States. This might, however, change, as more regions are engaging in deeper integration. The EU, for its own part, is interested in agreements with other free-trade areas or common markets. Negotiations for an Association Agreement are ongoing with Mercosur. Mercosur appears as the contracting party or negotiating party to several trade agreements but it is the individual Member States rather than Mercosur that are the formal contracting parties to those agreements. The EU has also had as a goal to one day integrate its separate deals/negotiations with certain Southeast Asian countries and conclude a region-to-region trade agreement with the Association of Southeast Asian Nations (ASEAN). See European Commission’s memo ‘Overview of FTA and Other Trade Negotiations’, updated 15 February 2018, available at http://trade.ec.europa.eu/doclib/docs/2006/december/tradoc_118238.pdf, last accessed on 20 February 2019. Whether any future agreement would bind the ASEAN as an organization naturally depends on the level of integration and legal structure that ASEAN countries are willing to adopt for the organization. According to its Charter, ASEAN has been accorded legal personality as well as an explicit international treaty-making power. In most cases, however, all Member States of the ASEAN are listed as parties to the agreement. See Cremona, M., Kleimann, D., Larik, J., Lee, R. & Vennesson, P. (2015) ASEAN’S External Agreements: Law, Practice and the Quest for Collective Action. Cambridge: Cambridge University Press, at 84–7.

\textsuperscript{24} For a review of the development of EU’s competences in trade, see Chapter 4 of Part II of the book.

\textsuperscript{25} NCMs are reservations that are put forward to existing and/or future measures applied by the government in case such measures are in violation of the agreement’s services disciplines, such as the market access and the national treatment disciplines.