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As long as the King behaves, his subjects will follow his example and the world will govern itself.
Lao-tzu, *Tao Te Ching*, 6th century BC.

Man must be disciplined, for he is by nature raw and wild.
Immanuel Kant, *Pädagogik*, 1803.

ABSTRACT

At first glance, this paper deals with a simple classification issue only: the coverage and treatment of certain manufacturing operations and the resulting products under the General Agreement on Trade in Services (GATS) rather than under its long-standing counterpart in merchandise trade, the General Agreement on Tariffs and Trade (GATT). Yet there are important structural/conceptual differences between the two Agreements, which may have far-reaching consequences, *inter alia*, for the use of GATT-based tariffs and trade remedies (anti-dumping and countervailing measures). It is submitted that the currently applied classification system could prompt companies to (re-)define the ownership conditions of otherwise identical production activities, with a view to avoiding GATT disciplines. However, the relevant criteria separating goods- from services-related operations are not only hard to specify and monitor in practice, but it is also difficult to see an underlying policy rationale. In the interest of clarity and consistency, WTO Members might thus want to close this conceptual trapdoor. Due to the rapid proliferation of international production-sharing arrangements, the stakes will likely be rising.

***Keywords*:** Trade in services (GATS), trade in goods (GATT), classification problems

***JEL classifications*:** F13, F53

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A. BACKGROUND

The entry into force of the General Agreement on Trade in Services (GATS), as a result of the Uruguay Round (1986-1993/4), added a new dimension to the multilateral trading system: its extension to a category of products which were traditionally considered to be 'intangible', 'non-storable' or even 'non-tradable'. Inevitably, given the novelty of the concepts involved, the interaction between the GATS and the General Agreement on Tariffs and Trade (GATT), its long-standing counterpart in merchandise trade, has created some uncertainties and triggered disputes.

As could have been expected, the early dispute rulings in the history of the GATS, though few in number, addressed some basic questions of scope and coverage. In this respect, *EC - Bananas* clarified, *inter alia*, that the application of the two Agreements - GATT and GATS - is not mutually exclusive. Apart from measures that fall exclusively within the scope of GATT, when they affect trade in goods as goods, and measures exclusively within the scope of GATS, when they affect the supply of services as services, there is a third category: measures that fall within the scope of both Agreements. According to the Appellate Body, "[t]hese are measures that involve a service relating to a particular good or a service supplied in conjunction with a particular good".[1]

This paper deals with another facet of the interaction/overlap between GATT and GATS that has been widely ignored to date: the potential applicability of GATS disciplines to certain operations that are traditionally considered as goods-producing activities, such as farming, mining or manufacturing. For example, manufacturing processes, if conducted on a fee or contract basis, are listed as services in the Sectoral Classification List that has been generally used by WTO Members to schedule their specific commitments in services. Whenever an economic entity performs such functions, GATS rules become applicable at certain stages. As a result, divergent sets of trade disciplines apply to otherwise identical operations and the resulting products, depending on who - the producer/supplier or somebody else - owns the inputs and outputs.

To outline the ensuing uncertainties and, possibly, the need for clarification, the following discussion focuses on the manufacture of metal products, machinery and equipment that is conducted on a fee or contract basis (mfc). Nevertheless, there are many more cases, possibly extending across the full range of agricultural, mining and manufacturing processes, where similar issues may arise. While there is no concrete evidence of such cases at present, to our knowledge, it is well conceivable that structural differences between GATT and GATS could be used by economic operators with a view to benefiting from the investment-liberalizing and -protecting effects of the GATS and/or avoiding trading partners' use of GATT-based tariffs and trade defensive instruments, in particular anti-dumping and countervailing duties.

The following observations are organized in four main sections. The starting point is a discussion of the definitional scope of 'services' and its relevance for the interpretation and application of GATS disciplines. The focus is on the Services Sectoral Classification List and, more specifically, on the definition provided for "services incidental to …" and relevant sub-sectors, including "manufacturing on a fee or contract basis". In the light of the Classification List, Section C then traces possible changes in the applicability of GATT and GATS disciplines, depending on certain ownership criteria, although the underlying production processes and resulting products might be identical. As a next step, section D seeks to explain potential consequences for the use of tariffs and trade remedies (anti-dumping and countervailing duties) in merchandise trade and the ensuing incentive for companies to set up international production arrangements in a particular way. This is complemented by a brief recapitulation of how this issue has (not) been dealt with in the WTO to date. Section E

[1] Appellate Body Report, *European Communities - Regime for the Importation, Sale and Distribution of Bananas (EC - Bananas)*, WT/LDS27/AB/R, adopted 25 September 1997, para. 221.

concludes with a brief outline of how the classification-related uncertainties in the treatment of genuinely identical manufacturing processes could be avoided, provided WTO Members manage to overcome their long-standing hesitation.

B. WHAT ARE SERVICES?

1. The GATS is silent, but …

The GATS does not contain a definition of 'services', insofar comparable to the GATT, which does not define the meaning of 'goods' either. If anything, there is an almost tautological paraphrase in Article I:3(b) of the Agreement: "'services' includes any service in any sector except services supplied in the exercise of governmental authority".[2] Nevertheless, GATS Article I:2 specifies what constitutes the *'supply of a service'* in terms of four types of transactions, called modes of supply. These consist of conventional cross-border trade, i.e., supplies from the territory of one Member into that of another Member (mode 1), supplies in a Member's territory to service consumers of other Members (mode 2, consumption abroad, with tourism as a typical example) as well as supplies through commercial presence (mode 3, generally involving inward foreign investment) or through the presence of natural persons (mode 4) in another Member's territory.

In turn, the distinction between individual modes depends on the territorial presence and/or the nationality of the suppliers or users involved.[3] Under mode 1 only territorial presence matters; the service must be provided from the territory of one Member (B) into that of another Member (A) regardless of the nationality of, or relationship between, sender and recipient (e.g., the transportation of furniture by a B-based remover from its stores in B to those in A). In the case of mode 2, the consumers'/users' nationality and actual location matter; a natural or juridical person of A obtains a service from a supplier of whatever nationality within the territory of Member B (e.g., a patient in A travels abroad to take medical treatment in a hospital established in B). Mode 3 is concerned whenever a person of another Member (B) supplies services within A's territory through business or professional establishment to users/consumers of whatever nationality (e.g., an international consultancy firm incorporated in B establishes a branch in A to provide specialized services to clients throughout the world). In a similar vein, mode 4 covers situations in which natural persons of another Member (B) provide services in A, either as independent suppliers or as employees of a foreign-owned service firm (e.g., the international consultancy firm sends staff from its headquarters to support its fledgling office in A).

A definitional backbone of what constitutes a service is provided, however, by the Services Sectoral Classification List MTN.GNS/W/120, the so-called W/120. The list was developed by the then GATT Secretariat in the early 1990s at the request of Uruguay Round participants and has generally been used since for scheduling services commitments.[4] W/120 consists of eleven large sectors, from business services to transport services, which are composed of some 160 sub-sectors, as well as a residual category of 'other services not included elsewhere'. This implies that at least those sub-sectors that are explicitly listed in W/120, mostly in combination with a classification number

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[2] Apparently, however, this particular provision is not (primarily) intended to define the definitional scope of Agreement, but to exclude one particular type of services, those provided in the exercise of governmental authority, from cover.

[3] In the following examples, Member A is always the Member covered by the commitments undertaken under the respective modes. For a discussion of the definitional scope of individual modes, see Zacharias, Diana (2008), 'Part I - Scope and Definition', in Rüdiger Wolfrum, Peter Tobias Stoll and Clemens Feinäugle (eds), *WTO - Trade in Services*, Leiden and Boston, 31-69, at 48-53.

[4] The Montreal Ministerial Declaration of December 1998 mandated the Secretariat to prepare such a text. For more information on this and related issues see Leroux, Eric H. (2008), 'From *Periodicals to Gambling*: A review of systematic issues addressed by WTO adjudicatory bodies under the GATS', in Marion Panizzon, Nicole Pohl and Pierre Sauvé (eds), *GATS and the Regulation of International Trade in Services*, Cambridge.

drawing on the United Nations provisional Central Product Classification (CPC prov.)[5], can be considered to fall under the GATS. In turn, the CPC, which was initially developed for statistical purposes, further defines the scope and content of what is covered by individual categories.

2. Implications of the Services Sectoral Classification List

The use of W/120 is strongly recommended in the Scheduling Guidelines, which were adopted by Members in March 2001, and to which it is attached. (The 2001 Guidelines, contained in WTO document S/L/92, are based on an earlier version, MTN.GNS/164, prepared in 1993 to assist participants in structuring their Uruguay Round schedules.) According to the Appellate Body's decision in *US-Gambling*, both the Scheduling Guidelines and W/120 constitute supplementary means of interpretation within the meaning of Article 32 of the *Vienna Convention*.[6] This means that they can be referred to in order to confirm the meaning of specific commitments resulting from the application of Article 31 of the Convention (General Rule of Interpretation), or when an interpretation according to this Article remains ambiguous or obscure, or when it leads to a result that is manifestly absurd or unreasonable.[7] Current services schedules could not be understood without recourse to the 1993 Guidelines since their format and structure as well as some of the key terms used ('unbound' and 'none'), are not specified in the GATS itself.[8] This is also the case when it comes to defining the precise scope of individual modes of supply.

The Services Sectoral Classification List provides not only a reference point that helps Members specify the object of a commitment, it also circumscribes a (minimum) outer perimeter of the Agreement in terms of sectoral coverage. While any Member is free to depart from W/120 in spelling out commitments in its respective GATS schedule, it cannot modify the sectoral extension of the Agreement in order, for example, to exempt individual services that are listed in W/120 from horizontal GATS obligations, such as the requirement of most-favoured-nation (MFN) treatment. Such horizontal obligations apply regardless of the existence of commitments. In other words, whenever GATS disciplines depart from (potentially) corresponding GATT provisions and the Agreement provides no further guidance, the listing of a product/service in W/120 may determine the respective scope of application in borderline cases. The only 'special case' is air transport, which is fully included in W/120 although the GATS almost completely exempts this sector from coverage.[9]

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[5] United Nations (1991), *Provisional Central Product Classification*, Statistical Papers Series M, No. 77, New York. 'CPC' 'CPC prov.'.

[6] Appellate Body Report, *United States - Measures Affecting the Supply of Cross-Border Gambling Services (US – Gambling)*, WT/DS285/AB/R, adopted 20 April 2005; para 197.

[7] Leroux and Ortino would have gone further than Appellate Body's finding in *US-Gambling*. Like the initial Panel decision, they consider the Guidelines to constitute context in the sense of Article 31 of the Convention. Leroux, Eric H. (2007), 'Eleven Years of GATS Case Law: What Have We Learned?', Journal of International Economic Law, 10(4), 749-93, at 761; and Ortino, Federico (2006), 'Treaty Interpretation and the WTO Appellate Body Report in *US-Gambling*': A Critique', Journal of International Economic Law, 9(1), 117-48, at 128-32.

[8] See also Leroux (2007), op cit., at 763f (footnote 61).

GATS Article XX:1 requires each WTO Member to submit a schedule of specific commitments. The schedules are organized according to a common format, consisting of four columns that specify, respectively, the sector concerned; any limitations on market access, as defined in Article XVI, per mode of supply; any limitations on national treatment, as defined in Article XVII, per mode of supply; as well as any additional commitments the Member may undertake on measures not falling under market access or national treatment.

[9] Pursuant to the Annex on Air Transport Services, the Agreement does not apply to 'measures affecting traffic rights, however granted' or to 'measures directly related to the exercise of traffic rights'. Explicitly covered are only three types of ancillary services: aircraft repair and maintenance, selling and marketing of air transport services, and computer reservation system services. In addition, as indicated in above n 2, Article I:3 exempts one particular type of services, regardless of the sectors concerned, from the Agreement's scope: 'services supplied in the exercise of governmental authority'. Further, as reflected in Annex 1, there are some policy- or issue-related exclusions concerning maritime transport and government procurement of services.

Given its legal status (see above), any modifications of W/120 would need to be endorsed collectively by Members.

3. Scope of 'manufacturing services'

Within business services, W/120 lists five distinct categories of services that are incidental to respectively, agriculture, hunting and forestry (CPC 881), fishing (CPC 882), mining (CPC 883 and 5115), manufacturing (CPC 884 and 885, except for 88442), and energy distribution (CPC 887). To facilitate the following discussion, the focus is on 'services incidental to the manufacture of metal products, machinery and equipment' as covered by CPC 885; in turn, this category comprises nine sub-categories, from 'manufacture of basic metals on a fee or contract basis' to 'manufacture of other transport equipment on a fee or contract basis'. Our basic line of argument would not change, however, if any of the other 'services incidental to (…)' had been chosen. For instance, it appears that sub-categories of CPC 884, such as 'manufacture of textiles, wearing apparel and leather products on a fee or contract basis' (CPC 8842), would prove as economically relevant as the current example.

The Explanatory Notes contained in part III of the United Nations Provisional Central Product Classification further specify the content of 'manufacturing on a fee or contract basis' (mfc) in the context of 'services incidental to manufacturing'. Accordingly, mfc consists of "manufacturing services rendered to others where the raw materials processed, treated or finished are not owned by the manufacturer" and also includes "assembly, installation other than construction work, fitting of articles, maintenance and repair services". Though this initial version of CPC was developed in the late 1980s, and might now appear to be outdated in parts, later versions do not contain significant changes in this particular area.[10]

Overall, 26 Members currently maintain commitments under CPC 885. As far as modes 1 to 3 are concerned, these are mostly without sector-related limitations on either market access or national treatment ('none').[11] Two more Members have offered to undertake new or significantly extended commitments in the context of the Doha Round.[12] However, in a number of cases, the sector-specific entries are qualified by horizontal limitations that apply across all services scheduled by the Member concerned. Particularly relevant in the current context are exclusions of subsidies from national treatment, implying that the authorities retain the right to exempt foreign-supplied services or foreign

[10] The most recent variant of CPC, version 2 of 31 December 2008, contains a division 88, entitled 'manufacturing services on physical inputs owned by others'. These are defined to include "services performed on physical inputs owned by units other than the units providing the service" and are characterized as "outsourced portions of a manufacturing process or a complete outsourced manufacturing process". It is further clarified that, since this division covers manufacturing services, "the output is not owned by the unit providing this service".

[11] Such commitments without limitations ('full commitments') across modes 1 to 3 have been assumed by sixteen Members: Albania, Armenia, Austria, Chinese Taipei, Croatia, Georgia, Iceland, Kyrgyz Republic, Latvia, Lithuania, Moldova, Oman, Panama, Saudi Arabia, Viet Nam and Ukraine. Four more Members - Gambia, Jordan, Malaysia and Sierra Leone - have scheduled full commitments at least for modes 1 and 2; two Members - Nicaragua and South Africa - for modes 1 and 3; and Kuwait for mode 3. For the remaining mode(s), the latter schedules contain limitations on market access and/or national treatment or deny any bindings ('unbound'). Three Members - Dominican Republic, Indonesia and Lesotho - while undertaking commitments under CPC 885, have inscribed limitations or non-bindings, to varying degrees, across all three modes. Moreover, certain schedules contain potentially restrictive limitations of a cross-sectoral (horizontal) nature. This is the case for Iceland (foreign equity ceiling of 25 per cent and other measures), Kuwait (prohibition on direct foreign ownership), Oman (foreign equity ceiling of 70 per cent), and Saudi Arabia (approval requirements for foreign investment).

The above overview excludes several schedules that severely limit the sector scope of CPC 885, for example, in confining it to consultancy activities and the like (Switzerland's schedule is a case in point). Commitments on mode 4 have been ignored in view of their limited relevance in the current context.

[12] The offers have been made publicly available either directly by the Members concerned or on the Websites of interested associations; see for example http://uscsi.org/wto-negotiations/wto-on-the-services-industry (visited 6 July 2012). The two Members referred to above are Nigeria and Switzerland.

service suppliers from financial assistance they may use in support of like domestic services or service suppliers.[13] Yet, the question in the current context is not only whether relevant commitments have been undertaken, but whether the (non-) existence of a particular category in W/120 *automatically* implies, or exempts from, certain trade disciplines. Pursuant to Article XX:3 of the GATS, Members' Schedules are 'an integral part' of the Agreement. As treaty text, they reflect the common intentions of all WTO Members. Thus, as long as one commitment under CPC 885 is scheduled by at least one Member, this might be deemed to reflect Members' collective recognition that this particular sector falls under the GATS and, consequently, is subject to horizontal obligations such as MFN treatment.[14]

C. POLICY CONSTRAINTS: A HYPOTHETICAL CASE

Imagine that SMW (Swabian Motor Works), a producer of cars considers relocating the manufacturing of certain models to a lower-cost country B. The country's attractiveness may be due in part to a generous subsidy programme for the car industry. SMW's management ponders two scenarios of how to organize relations with the producer/supplier in B, which it intends to establish as a joint-stock company. To ensure close control over the company's operations, SMW will keep a majority equity stake.

Scenario I: The company procures the materials and components on its own account, from whatever sources, and performs the manufacturing process according to the instructions received. The cars are sold to SMW which, in turn, markets them under its brand name in A and abroad. Scenario II: SMW provides all materials and components, which it continues to own. Again, these inputs may stem from a variety of sources, including from suppliers located in B. On completion of the manufacturing process, identical to that carried out under scenario I, the manufacturer is paid for the services rendered and SMW receives *its* cars for sale.

Of course, the two scenarios are highly hypothetical and, possibly, may never exist in such pure form. They simply serve to explore the applicability of potentially relevant GATT and GATS provisions and their interaction/overlap during individual stages of the procurement, production and sales process.

1. Production- and investment-related disciplines

The existence of such disciplines at multilateral level essentially depends on the applicability of the GATS provisions governing mode 3 (commercial presence). This apparently is the case under scenario II, given the definitional scope of CPC 885 and the fact that the new company, to be established in B, would be majority-owned by a juridical person of another Member, i.e. A.[15] The transactions described under scenario I would not fall under the GATS, even if the manufacturing processes and resulting products were identical, simply because the manufacturer itself owns the inputs which, in turn, precludes coverage under W/120.

Conducting a manufacturing process on a fee or contract basis, in accordance with CPC 885, offers the following advantages from the *perspective of a foreign investor* (in this case, SMW):

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[13] Relevant limitations have been scheduled, with certain variations in scope, by Armenia, Bulgaria, Croatia, Jordan, Norway, Switzerland and Ukraine (modes 1 to 3); Estonia and Georgia (modes 1 and 2); and Lithuania, Saudi Arabia and Viet Nam (mode 3).

[14] In *US – Gambling* (para 182), the Appellate Body confirmed that "Members' Schedules constitute relevant *context* for the interpretation of subsector 10.D of the United States' Schedule", which, in turn, was "the logical consequence of Article XX:3 of the GATS. Of course, this decision does not apply to those services that the Agreement expressly excludes from coverage; see above n 9. See also Appellate Body Report, *China - Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products (China - Audiovisuals)*, WT/DS363/AB/R, adopted 19 January 2010.

[15] The relevant definition is contained in Article XXVIII(m) of the GATS.

(a) Participation in the benefits associated with any relevant GATS commitments on market access and national treatment that B might have undertaken under CPC 885, in particular with regard to mode 3 and, possibly less so, mode 4[16]; and

(b) automatic extension, under the GATS' MFN clause, of the best treatment (in terms of taxation, subsidization, levels of foreign equity participation, employment of foreign nationals, etc.) that B might extend to like suppliers from other countries and/or is committed to respect under the most favourable of its bilateral investment treaties (current and future).[17]

Thus, everything else being equal, there is an incentive for the investor (SMW) to opt for an mfc-type operation. In some 20 WTO Member economies the project would benefit from full commitments on market access and national treatment under mode 3 (with the possible exclusion of subsidies), implying, *inter alia*, the absence of quantitative restrictions on the number of suppliers, their operations and assets and, in most cases, levels of equity participation.[18] In virtually all other instances, the investor could rely at least on MFN treatment, subject to a range of permissible departures.[19]

There is some evidence that treaty obligations add an element of predictability to a country's trade and investment regime which could influence locational decisions.[20] Apparently in expectation of such effects, the vast majority of WTO Members have signed bilateral investment treaties that, *inter alia*, guarantee foreign investors national treatment on a post-establishment basis (there are currently over 2'700 such treaties around the world). Similar motivations may have prompted a number of Members to undertake GATS commitments on mode 3 (commercial presence) for CPC 885 and other mfc-related services.[21] In turn, their existence might affect an investor's preference for a particular legal/institutional form of engagement, e.g., favouring manufacturing on a fee or contract basis over alternative arrangements where the manufacturer/processor owns the materials and components used as inputs.

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[16] The definitional scope of mode 4 is quite narrow and virtually all current commitments are subject to tight limitations. See for example Carzaniga, Antonia (2003), 'The GATS, Mode 4 and Pattern of Commitments', in Aaditya Mattoo and Antonia Carzaniga (eds), *Moving People to Deliver Services*, Washington D.C., 21-26, and other contributions to this volume.

[17] BITs generally provide for national treatment on a post-establishment basis. See Adlung, Rudolf and Martin Molinuevo (2008), 'Bilateralism in Services Trade: Is there Fire Behind the (BIT-)Smoke?', Journal of International Economic Law, 11(2), 365-409.

[18] See above n 11 and 13.

[19] The possibly most important cases are Economic Integration Agreements and the MFN exemptions taken by many Members at the date when the GATS entered into force (for more details see Adlung, Rudolf and Antonia Carzaniga (2009), 'MFN Exemptions under the General Agreement on Trade in Services: Grandfathers Striving for Immortality?', Journal of International Economic Law, 12(2), 357-92). However, a cursory look at the lists of MFN exemptions suggests that these are not particularly relevant in the current context.

[20] Berger, Axel, Matthias Busse, Peter Nunnenkamp and Martin Roy (2012), 'Do trade and investment agreements lead to more FDI? Accounting for key provisions inside the black box', International Economics and Economic Policy (forthcoming). However, other studies, including for the United States, could not confirm the existence of a positive link (see, for example, Peinhardt, Clint and Todd Allee, 'Failure to deliver: The Investment Effects of US Preferential Economic Agreements', The World Economy, 35(6), 757-83).

[21] Both Articles XVI:1 and XVII:1 stipulate that the scheduled conditions of market access and national treatment must be extended as a minimum to like services and service suppliers of any other Member. (Article XVI:1: "With respective to market access …., each Member shall accord services and service suppliers of *any other Member* treatment no less favourable than that provided for under the terms limitations and conditions agreed and specified in its Schedule"; Article XVII:1: "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* … treatment no less favourable that that it accords to its own like services and service suppliers" (emphasis added).) In the same vein, the Scheduling Guidelines confirm that a Member taking national treatment or market access commitments "must accord the stated *minimum* standard of treatment specified in its schedule to all other Members" (MTN.GNS/W/164, para 14, emphasis in the original).

Nevertheless, there are potential constraints under *both* scenarios that could impinge on SMW's locational decision: the vulnerability of the cars produced in B, supposedly benefitting from lavish subsidization, to trade remedies that other Members may take under relevant GATT Agreements, in particular the Agreement on Subsidies and Countervailing Measures (ASCM, Box 1).

Box 1. Trade Remedy Provisions under GATT and GATS - an Overview

GATT

Subsidies: The Agreement on Subsidies and Countervailing Measures (ASCM) addresses two separate, but closely related topics: the provision of subsidies and the use of countervailing measures to offset injury caused by subsidized imports. The Agreement contains a definition of subsidy and also introduces the concept of a 'specific' subsidy - i.e., a subsidy available only to an enterprise, industry, group of enterprises, or group of industries in the country (or state, etc.) that extends the subsidy. The disciplines set out in the Agreement only apply to specific subsidies. In this context, the ASCM focuses on two categories of subsidies: prohibited and actionable. Subsidies that require recipients to meet certain export targets or to use domestic instead of imported goods are prohibited. Actionable subsidies are not prohibited, but can be challenged either through multilateral dispute settlement or through countervailing action if they adversely affect the interests of another Member.

Dumping: Article VI of the GATT provides for the right of contracting parties to apply anti-dumping measures, i.e. measures against imports of a product at an export price below its "normal value" (usually the price in the domestic market of the exporting country) if such imports cause injury to a domestic industry. More detailed rules are provided in the so-called Anti-dumping Agreement (Agreement on the Implementation of Article VI of the General Agreement on Tariffs and Trade 1994). A Member may not impose an anti-dumping measure unless it determines, pursuant to an investigation conducted in conformity with the provisions of this Agreement, that there are dumped imports, material injury to a domestic industry (or threats thereof), and a causal link between the dumped imports and the injury.

Safeguards: Pursuant to Article XIX of the GATT, a WTO Member may take a 'safeguard' action (i.e., restrict imports temporarily) to protect a domestic industry from an increase in trade of any product which is causing, or threatening to cause, serious injury to this industry. The Agreement on Safeguards sets out requirements for an investigation, which include public notice for hearings and other appropriate means for interested parties to present evidence. It also sets out the criteria for establishing 'serious injury' and the factors which must be considered in determining the impact of imports. In principle, safeguard measures have to be applied irrespective of source. The Agreement lays down time limits for all safeguard measures.

GATS

Subsidies: The GATS offers more scope for subsidization than the GATT. The only discipline generally applicable across all services, whether scheduled or not, is the MFN requirement. In scheduled sectors, it is complemented by the national-treatment obligation which, however, may be subjected to limitations. The actual impact on trade plays no role in this context, although Article XV recognizes that "in certain circumstances, subsidies may have distortive effects on trade in services". The latter Article also provides for further negotiations "with a view to developing the necessary multilateral disciplines to avoid such trade-distortive effects" and to address "the appropriateness of countervailing procedures". However, these negotiations have made very little progress, if any, since their inception some 15 years ago, and the issue of countervailing duties has played virtually no role to date. 'Export subsidies' are not subject to any particular disciplines.

Dumping: The possibility of anti-dumping action is not even raised as a possible negotiating issue in the GATS. The drafters might have seen the difficulties, given the specificities of services (intangibility, etc.) and associated data problems, of defining any appropriate basis for such action.

Safeguards: Article X of the GATS mandates Members to negotiate "on the question of emergency safeguard measures based on the principle of non-discrimination". While the results should have entered into effect within three years, the negotiations have subsequently been extended several times without producing much convergence, if any. Given the many flexibility provisions of the Agreement, is there additional need for contingency protection? Members are free under GATS, for example, to subject their access commitments to stringent quotas, including on market shares, or the possibility of an economic needs test.

The latter Agreement allows for the introduction of countervailing duties and, depending on the circumstances, other measures to offset or challenge the subsidies offered in B. Another deterrent, though possibly less relevant in the current case, is the use of anti-dumping duties pursuant to the Agreement of the Implementation of Article VI of the GATT 1994 (AD Agreement). Such duties might be levied on imports of products found to undercut their home market price or, if not representative, appropriate alternatives (export price to a third country or a constructed 'normal value'). Overall, anti-dumping measures are by far the most 'attractive' form of trade remedies within the WTO's remit.[22]

2. Product-related disciplines

(i) The broad picture

A *production process conducted on the manufacturer's own account (moa)*, i.e. under scenario I, would qualify as a 'normal' manufacturing operation, beyond the definitional scope of GATS. Consequently, the investment- or employment-related effects mentioned above with regard to modes 3 or 4 of the GATS would not materialize. Of course, what would continue to matter for the resulting products, if traded beyond the border, is the GATT and its product-focused disciplines. In turn, this means for importing countries that tariffs are the only legitimate instruments of 'normal' trade protection and, if the relevant criteria are met, remedies against dumped imports.[23] National treatment is otherwise guaranteed (GATT Article III), implying that domestically established manufacturers must not in principle benefit from other protective measures. Subsidies, while exempt from the scope of GATT Article III, are disciplined under the Agreement on Subsidies and Countervailing Measures.

The Scheduling Guidelines seek to clarify the respective scope of GATS and GATT. They expressly confirm that there is "no requirement in the GATS to schedule a limitation to the effect that the cross-border movement of goods associated with the provision of a service may be subject to customs duties or other administrative charges. Such measures are subject to the disciplines of the GATT".[24] This means, by way of example, that the existence of import tariffs on, say, cars would not be inconsistent *per se* with a full commitment on national treatment of road freight transport, including car carrier services, under mode 1 (cross-border trade) of the GATS, despite the adverse impact on the foreign supplies/suppliers of such transport services as compared to like domestic supplies/suppliers, which tend to focus on internal rather than on cross-border transport.[25]

There is an apparent element of tension between these stipulations and Article I:1 of the GATS ("This Agreement applies to measures by Members affecting trade in services") and its interpretation by the Appellate Body in *EC-Bananas*.[26] Who would doubt that the imposition of duties on whatever goods that are "associated with the provision of a services" could affect supplies of transport services, postal and courier services, wholesale and retail trade, and possibly many more

[22] From January 1995 to end-June 2011, 2601 such measures were reported, as compared to 164 countervailing measures and 114 safeguards actions (given their origin-neutral application, in principle, the latter actions may be deemed less relevant in the current context). Over the same period, there were 90 cases where affected governments sought consultations under the AD Agreement, 91 cases under the ASCM, and 40 cases under the Safeguards Agreement. See the respective overviews on the WTO Website (http://www.wto.org/english/tratop_e/tratop_e.htm, accessed on 3 August 2012).

[23] In the case of subsidized supplies, the ASCM contains additional options for Members, apart from imposing countervailing duties, to protect the interests of affected domestic industries (see Box 1).

[24] MTN.GNS/W/164/Add. 1, para 6, and S/L/92, para 7.

[25] See below n 33.

[26] "In our view, the use of the term 'affecting' reflects the intents of the drafter to give a broad reach to the GATS. The ordinary meaning of the word 'affecting' implies a measure that has 'an effect on', which indicates a broad scope of application. This interpretation is further reinforced by the conclusions of previous panels that the term 'affecting' in the context of Article III of the GATT is wider in scope than such terms as 'regulating' or 'governing'." (Appellate Body Report, *EC - Bananas*, para 220.)

services? What Members might have wanted to avoid, however, is the invocation of GATS commitments with a view to challenging completely legitimate restrictions, under the GATT, across possibly the full range of merchandise trade. Unfortunately, however, they did not endeavour to further clarify the concept of measures restricting movements of goods that are "associated" with the provision of services as compared to measures that "affect" trade in services.[27]

Under scenario II - *manufacturing on a fee or contract basis (mfc)* - the GATT certainly matters as well. However, its interaction with GATS disciplines may warrant further attention. The two Agreements come into play, interact or overlap, at different stages of the production/marketing process.

It seems reasonable to assess the manufacturing operation, including the underlying investments, in the light of the GATS as far as the supply of W/120-listed *services* (CPC 885) is concerned. This implies that it would be completely legitimate for B to grant production subsidies as long as all foreign-owned firms producing like services within its territory benefit from MFN treatment and, in the event of relevant commitments, national treatment. Yet, what would this mean for the resulting *goods* (cars) once these are imported into A or any other country?

If the extension of production subsidies cannot be challenged under the GATS, this does not imply that competing car producers, or, rather, the respective authorities, are deprived of their rights under the ASCM. While the mfc-operations, possibly in combination with investment, production and even export subsidies, might be deemed consistent with one set of disciplines, under the GATS, the resulting products might be confronted with equally legitimate countermeasures under the GATT.[28] The status of a set of measures under one Agreement is not necessarily indicative of its status under the other Agreement.

(ii) A closer look at relevant modes[29]

- Cross-border trade (mode 1)

If a car, which has been manufactured on a fee or contract basis, is to be treated as a good on importation into another WTO Member's territory, the question arises what this Members' GATS obligations and commitments under mode 1 actually entail. The full commitments undertaken by 20-odd WTO Members on cross-border trade under CPC 885 must have meaning. However, what could it be?

A closer look into the GATS might help. Pursuant to Article XXVIII(b), the supply of a service is defined to include its "production, distribution, marketing, sale and delivery". It could thus

[27] The quote from the Scheduling Guidelines, in the preceding paragraph, is also confusing for other reasons. First, it is stated that there is no requirement in the GATS *to schedule a limitation* in the cases concerned; this leaves open the possibility, nevertheless, that the measures used are inconsistent with relevant provisions of Article XVI or, more likely, Article XVII of the GATS. Second, the following sentence stipulates, without reservation, that GATT disciplines are applicable to the use of duties and other administrative charges; this might be read to imply that the scope of the two Agreements is mutually exclusive.

[28] If subsidized imports cause injury to its domestic industry, the affected Member may impose a countervailing duty to offset the advantages gained: A case normally starts with the official submission of a written complaint by the affected industry that injurious subsidization is taking place. The competent authorities must review the accuracy and the adequacy of the evidence submitted, and verify that the complaint has been made by, or on behalf of, the domestic industry. Imposition of countervailing duties, once injurious subsidization has been found, is discretionary, and use of lesser duties is encouraged (i.e., the authorities may refrain from collecting the full amount of the subsidy). If a countervailing duty is imposed, it must be levied on a non-discriminatory basis on imports from all sources found to be subsidized and causing injury.

[29] It is important to bear in mind that the product-related disciplines discussed in the following, from the perspective of an 'importing' country under modes 1 and 2, apply regardless of the ownership status of the mfc-based producer in B. The company might well be domestically owned, for instance.

be argued that an mfc service, while produced and delivered abroad, forms part of a good, and is to be treated as such, when it enters the territory of the Member concerned. Nevertheless, other facets of what constitutes the supply of a service, such as sale and marketing, can be provided cross-border independently of the good. These would not only be covered by the MFN and other horizontal obligations under the GATS, but could also be made subject to specific commitments. Of course, such commitments would not be very commercially meaningful, but this is the case for many other mode-1 commitments as well, including in sectors such as hospital, hotel or restaurant services.

- Consumption abroad (mode 2)

  Both versions of the Scheduling Guidelines explain the scope of mode 2 as follows:

  "Consumption abroad: This mode of supply is often referred to as 'movement of the consumer'. The essential feature of this mode is that the service is delivered outside the territory of the Member making the commitment. 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", or is situated abroad, are also covered" (emphasis in the original, see MTN.GNS/W/164, para 19, and S/L/92, para 29)[30].

There can be little doubt, given its inclusion in W/120, that manufacturing on a fee or contract basis is as much a service as ship repair which, in turn, is listed as 'maintenance of repair of vessels' with a reference to CPC 8868. However, if it is sufficient for a transaction to be covered by the GATS that only the property of the consumer (in this case, SMW) moves or is situated abroad, it may well be presumed that, *from A's perspective*, the mfc-produced supplies fall under mode 2 of the Agreement. If there is an element of uncertainty, it is the question whether the SMW-owned raw materials and components must be supplied into B, whether from A or any other Member, or whether they must simply be owned by SMW, regardless of their origin. The fact that the Scheduling Guidelines expressly refer to the possibility that the property "is situated abroad" weighs in favour the latter option.

In turn, the above considerations suggest that tariffs or other trade restrictions A might impose on the cars that have been manufactured abroad on SMW's account, need to be assessed in the light of the GATS. Their importation could no longer be considered simply to constitute cross-border movements of goods (cars) that are "associated with the provision of a service", e.g. road freight transport (car carriers), and that, according to the Scheduling Guidelines, must therefore be assessed in the light of the GATT. In the present context, services are not used as a means of transport, communication or otherwise, but, comparable to ship repair, form a constitutive component of a transaction falling under mode 2 of the GATS.[31] From this perspective, the imposition of tariffs constitutes a government measure that affects trade in services as defined under the Agreement.[32]

The policy implications could be significant:

First, pursuant to GATS Article XVII:3, the existence of mode-2 commitments on national treatment in the sectors concerned (here: CPC 885), if not qualified by relevant limitations,

[30] As noted before, MTN.GNS/W/164 is the initial version of Guidelines, circulated in September 1993, while S/L/92 is a revision adopted by the Council for Trade in Services in March 2001.

[31] As argued by Zacharias (see above n 3), mode 1 also applies to situations "when the service can be *embodied in a transportable medium*, such as written documentation or a computer disk, or when it can be sent abroad through *telecommunications channels*" (p. 49), while mode 2 extends to cases "in which the consumer's property, on which the service that is going to be delivered is to have effect, crosses the border or is situated abroad" (p. 50, emphasis in the original). However, there is an element of inconsistency insofar as the author also associates herself with the statement that "services are *commercial activities which are not embodied directly in tradable, tangible products*" (p. 43).

[32] Pursuant to its Article I:1, the GATS "applies to measures by Members affecting trade in services".

would require the importing Member not to take measures that modify the conditions of competition in favour of own like services or service suppliers. Yet the imposition of import tariffs on mfc supplies almost inevitably results in such a modification of competitive conditions provided the services/suppliers concerned can be considered to be alike.[33] If so, however, the Member would thus not be allowed under the GATS to impose on such supplies the car duties it might have inscribed in its tariff schedule under the GATT. By the same token, if mfc cars and otherwise identical non-mfc cars are to be considered like products in the sense of GATT Article I:1 (General Most-Favoured-Nation Treatment), this Member would need to suspend the tariffs on any such cars in order not to violate its *MFN obligation under the GATT*.[34] As a last resort, of course, there would still be the option of renegotiating a commitment under GATS Article XXI, with a view, for example, to withdrawing any bindings on national treatment under mode 2, against compensation of affected Members.

Second, the imposition of countervailing or anti-dumping duties on mfc supplies falling under mode 2 of the GATS (i.e., any merchandise imports that had been produced abroad on an mfc basis), while permissible under the GATT, might be in violation of that Member's *MFN obligation under the GATS*. GATS Article II:1 requires Members "with regard to any measure covered by the Agreement", thus including supplies falling under mode 2, to extend "immediately and unconditionally" to services/suppliers of all others Members the best treatment they may grant to like services/suppliers of any country. A distinction based on subsidy- or pricing-practices employed or tolerated in the originating country would certainly be inconsistent with this standard. Thus all Members, regardless of their mode-2 commitments, would no longer be able to employ GATT-consistent trade remedies vis-à-vis mfc supplies commissioned abroad. There is neither a possibility under the GATS to introduce countervailing or anti-dumping measures (Box 1), nor to seek new MFN exemptions beyond those already contained in a Member's respective list, if any.[35] Of course, the relevance of the MFN obligations depends on the existence of like services/service suppliers in at least one third country.[36]

In the context of this particular case, it is important to bear in mind that the hypothesized consequences arise only in the relationship between A and B, given that the 'consumer' of the services supplied in the territory of B is a juridical person constituted under the laws of Member A.[37] Sales of the B-produced SMWs into the territory of other Members would not constitute mode-2 trade from the perspective of these Members as long as the importers/commissioners concerned do not own the raw materials and other inputs used. However, uncertainties remain. For example, what would be the situation if a subsidiary of SMW, established in C and owning the inputs, had commissioned the B-based subsidiary to produce the cars for marketing in C?

(iii) Scope for protective action (?)

The above considerations do not necessarily imply that an importing Member is deprived of any scope for trade-defensive measures against foreign mfc-produced supplies that fall under mode 2

[33] However, given the broad modal scope of the GATS, compared to the GATT, the assessment of likeness under the Agreement is fraught with particular difficulties. See, for example, the discussion in Mireille Cossy (2008), 'Some thoughts on the concept of 'likeness' in the GATS', in Panizzon, Pohl and Sauvé (eds), above n 4, 327-57.

[34] For a discussion of the relevant provision see, for example, Guzman, Andrew T., and Joost H. B. Pauwelyn (2009), *International Trade Law*, Aspen Publishers, 291-295.

[35] See above n 19.

[36] Note the qualification in above n 33.

[37] Article I:2(b) defines trade under mode 2 to consist of the supply of a service "in the territory of one Member to the service consumer of any other Member". Further, pursuant to GATS Article XXVII(i) and (j), a "'service consumer' means any natural or juridical person that receives or uses a service". In order to qualify as a juridical person of A, SMW must "be constituted or otherwise organized" under the law of A and be engaged "in substantive business operations" in A's territory or the territory of any other Member (Article XVIII(m)).

of the GATS. One conceivable option is the extension of subsidies that would strengthen the competitive position of domestic industries and, thus, tilt the playfield against foreign supplies ('import-displacing subsidies').

According to the Scheduling Guidelines, Members are not required under the GATS to take measures beyond their territorial jurisdiction. This means that the subsidy-related disciplines, MFN treatment and, depending on commitments, national treatment, which must be respected vis-à-vis domestically established foreign-owned *suppliers*, need not be extended to like service *suppliers* competing from abroad.

> "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" (MTN.GNS/W/164, para 10 and S/L/92, para 15).

Producer-related subsidies, investment grants and the like are thus deemed permissible *under the GATS*, regardless of their trade effects.[38] Moreover, a large share of the Members that undertook commitments under CPC 885 retained the right to use discriminatory, i.e., national-treatment inconsistent, subsidies. It might be argued that these Members are not only entitled to subsidize competing domestic *suppliers* of mfc services, but also the resulting *products* (cars) in order to persuade potential aspirants (SMW) not to move abroad.

However, there are important constraints. Other Members whose producers, whether mfc- or moa-based, are adversely affected by the (compensatory) subsidies that might be granted by A could resort to counter-measures under the ASCM if the relevant criteria are met. As indicated before, such measures could consist of countervailing duties as far as the products (cars) enter their own markets or, in the event of trade-displacing or -impeding effects elsewhere, the Members could request consultations and, if inconclusive, refer the case to dispute settlement. Moreover, the government already subsidizing its mfc exports (B) might increase the initial levels of support and engage in sort of a 'subsidy race'.[39]

D. … AND WHERE IS THE PROBLEM?

1. Implications for GATT-based tariff protection and trade remedies

The preceding discussion suggests that, if the overlap/interaction between GATS and GATT causes 'problems', these arise mostly in the context of what is defined as trade under mode 2 (consumption abroad) of the GATS.

First, it appears that in the absence of relevant limitations on national treatment under mode 2, the Members with commitments under CPC 885 - and/or other services provided on a fee or contract basis - might have foregone the right to impose their GATT-scheduled import duties on the goods concerned, including those produced on the manufacturers' own account, once their companies conduct mfc operations abroad.[40] Indeed, none of the more than 20 Members with commitments under

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[38] See also Adlung, Rudolf (2007), 'Negotiations on Safeguards and Subsidies in Services: A Never-Ending Story?', Journal of International Economic Law, 10(2), 235-65.

[39] As indicated before (Box 1), the use of 'export subsidies', in this case under mode 2, is not disciplined under the GATS as long as the MFN obligation and relevant commitments on national treatment, if any, are respected. In other words, there must be no discrimination against or between foreign-owned providers that are established within the respective Member's territory and would like to benefit from the subsidies as well.

[40] Certain conceptual uncertainties remain. In particular, would the mode 2-related obligations apply to the imported product as is, or be limited to the value generated by the mfc supplier abroad, net of the costs of the components used? And what would be the situation if some of the inputs had also been produced on an mfc basis?

CPC 885, some of which host car producers, currently maintain potentially relevant limitations or deny bindings (entry: 'unbound'). In the context of our hypothetical case, this could imply that, ultimately, they may need to fully liberalize *all* car imports under the relevant tariff category. Of course, whether this is considered to be a 'problem' depends on the perspective taken. In any event, as long as the commitments apply, and are complied with, the outcome would be trade-liberalizing.

Second, since mfc-produced goods (cars), once entering the commissioner's (SMW's) home market, should be assessed in the light of the GATS, according to our reading, the authorities concerned would need to accept these supplies even if the conditions for trade-defensive measures under the GATT are met. The GATS does not allow for such measures, with the exception of MFN-based safeguard actions. (Such actions would be permissible in the absence of market-access commitments in the sector concerned or, if commitments exist, these had been subjected to quantitative ceilings or, depending on the criteria used, an economic needs test.) As indicated before, a Member's inability to take anti-dumping or countervailing action does not depend on the existence of specific commitments; it simply results from the quasi-automatic extension of the MFN obligation to services and their suppliers under the GATS. Also, it is irrelevant in this case whether SMW holds an equity stake in, or provides the inputs used by, the B-based manufacturer. What matters is SMW's prior ownership of the materials, parts and components and, thus, its status as a mode-2 consumer of mfc services under CPC 885.

Of course, as indicated before, the government concerned might use *producer- or product-related subsidies* in order to neutralize their domestic consumers' preference for cheaper mfc-produced foreign cars. (The vast majority of Members, i.e., those without commitments under CPC 885 plus those whose commitments are subject to relevant limitations, would be free to extend the latter form of subsidies as well.) However, both options do not appear to be particularly attractive. First, contrary to the use of anti-dumping or countervailing duties, there would be a fiscal cost for the country concerned and, second, the (MFN-based) extension of compensatory support, regardless of the origin of the mfc imports, would impinge on a possibly far wider range of Members than those that initially indulged in subsidization. And the subsidies might be challenged or countervailed under the ASCM.

These considerations are not meant to imply that there is a conflict between potentially relevant treaty provisions. (According to Jenks, "conflict of law-making treaties arises only where simultaneous compliance with the obligations of different instruments is impossible".)[41] Apparently, A could simultaneously meet its obligations under GATS and GATT/ASCM - in not intervening at all. The authorities might simply dispense with their right to employ regular tariffs and/or resort to potentially relevant trade remedy provisions. However, the consequences could be far-reaching. Schedules of tariff concessions under the GATT specify the maximum tariff rates Members are allowed to impose on imports. They reflect the concessions exchanged in previous negotiations and, thus, represent a deliberately conceived balance of rights and obligations. Dispensing with the exercise of these rights under newly defined conditions (mfc operations under the GATS) might thus prove politically difficult to accept.

There are possibly very few processed goods which could not be produced alternatively through mfc-based or conventional moa operations. If the former type of arrangements proliferated, there might be very limited scope, according to our reading, for the invocation of trade remedy provisions to protect affected domestic competitors. As discussed before, Members would retain the right to operate tariffs on mfc-based imports (and their moa-based equivalents) if they refrained from commitments on "services incidental to … " or, otherwise, if they exempted relevant commitments from national treatment under mode 2. However, the implications for AD and countervailing measures are unavoidable. Given their incompatibility with the MFN requirement under GATS Article II, which applies unconditionally across all services, such measures would no longer be

[41] Jenks, Wilfred (1953), 'The Conflict of Law-Making Treaties', British Yearbook of International Law, 401-53, at 451.

available. Of course, not everybody would consider the resulting constraints to be undesirable, whether economists or philosophers (Lao-Tzu: "… *and the world will govern itself*"), but quite a number of WTO Members might not be amused.

Inevitably, there could be an imbalance in treatment between products manufactured on a fee or contract basis in a highly subsidizing country (B), constituting mode 2 supplies from the commissioner's home-market perspective (A), and the same products, with similar levels of subsidization, produced in this country on a moa basis. The former supplies would be less prone to countermeasures on importation into A than the latter. In the absence of other (dis-)incentives, SMW would thus be well advised to opt for the mfc scenario. It would not only prove attractive in view of its investment-protecting effects, owing to B's mode 3-related obligations (section C.1), but could also help prevent trade-defensive interventions on the part of A.[42]

Nevertheless, doubts linger. Is there any economic or other rationale for discriminating between *identical products* resulting from *identical processes* and offered under *identical conditions*? Had Members anticipated the potential consequences, as submitted above, would they have endorsed W/120 and the Scheduling Guidelines in their current form - and/or, otherwise, would they have undertaken commitments on "services incidental to …"?[43] The extension of the Agreement's scope to 'manufacturing services is also surprising insofar as the resulting products were already covered, undoubtedly, by GATT disciplines prior to the GATS' entry into force. All cars imported into A, whether mfc- or moa-produced, would have drawn the country's regular tariffs and could have been subjected to GATT-based trade remedies. Our reasoning thus implies at least that the creation of the GATS - or, rather, the adoption of W/120 - reduced the relevance of certain GATT disciplines for a specified range of products that are now also subject to the GATS. At the same time, it has provided a playfield for innovative production arrangements that, in reality, might be surrounded by a far higher dose of uncertainty than our example (SMW) suggests.

2. (Non-) Treatment in the WTO to date

The scenarios outlined above are (still) hypothetical insofar as there is no evidence to date of any related trade frictions. Nevertheless, the situation may change. With the proliferation of international supply chains, there may be an increasing government interest in attracting productions or production stages that are deemed to be of strategic economic or developmental importance. And it is somewhat intriguing to see that the legal status of the policies that might be used has drawn so little attention to date.[44]

In late 2000, a Chairman's Note circulated in the competent WTO body, Committee on Specific Commitments, asked delegations to comment on the following issues: "(a) various services, that are supplied to manufacturers, are subject to the GATS and are classified or classifiable under W/120; (b)

[42] As already indicated in above n 29, the two decisions - first, to own an mfc-providing company abroad and, second, to use its services - are not strictly connected, although they may normally coincide. SMW might well invest in a subsidiary conducting mfc operations in B, and benefiting from the country's mode 3-related obligations and commitments, without necessarily consuming the services itself. By the same token, the coverage of the mfc supplies commissioned abroad by SMW or any third-country importer under the GATS, mode 2, does not depend on the latter owning the company involved.

[43] In the absence of specific commitments on the sector/mode concerned, there would have been an opportunity for Members, at the Agreement's entry into force, to seek exemptions from MFN treatment for specified types of measures. These could include, of course, trade remedy measures on mfc-based supplies. However, understandably, it appears that no Member anticipated the need for such exemptions and acted accordingly. See also above n 19.

[44] It may be worth recalling that the range of sectors potentially concerned reaches far beyond CPC 885 ('services incidental to the manufacture of metal products, machinery and equipment') to include services such as 'manufacture of food, beverages and tobacco' (CPC 8841), 'manufacture textiles wearing apparel and leather products' (CPC 8842) and 'manufacture of furniture; manufacture of other articles n.e.c.; recycling' whenever these services are supplied 'on a fee or contract basis'.

pure manufacturing should, however, not be classified as services, even if it is carried out on a fee or contract basis; (c) services incidental to manufacturing, such as drilling, should be treated on a case-by-case basis". [45] In the following discussion, most participants agreed that, in principle, manufacturing activities should not be classified as services, although some said that the classification in the CPC of 'manufacturing on a fee or contract basis' as a service should be given more attention. Doubts were also raised whether it was within the mandate of the Committee to reach formal conclusions on such issues. In May 2001, the chairperson then summarized that "it seemed that generally Members did not consider the issue to be a matter of priority" and that the discussion be "concluded at that stage without drawing any conclusion".[46]

A related issue was taken up by WTO Members in 2012, in the Committee on Specific Committee, based on a Secretariat Background Note on energy services.47 The Note refers to past discussions in the Committee of whether production 'on a fee or contract basis' should be regarded as a service under the GATS and considers this question to be important for the energy sector as well. For instance, section 884 of the CPC covers "manufacture of coke, refined petroleum products and nuclear fuel, on a fee or contract basis". According to the Secretariat Note, if production on a fee or contract basis were considered to be a service, this would mean, inter alia, that oil refining is subject to the GATS when performed on such a basis. However, the Committee's informal exchange on this issue apparently remained limited, again, in scope and depth.

One aspect has been completely ignored in past discussions among Members: the profound definitional uncertainties blurring the distinction between mfc- and moa-based operations. The hypothetical scenario described above, relatively clean and neat, will possibly never be replicated in practice. Rather, the competent authorities would be confronted with a plethora of thorny questions. For example, what is the level of (non-) ownership above which manufacturers will be deemed to provide their services on a fee or contract basis; does it suffice if two-thirds, four-fifths or (…) of the inputs are owned by others? Is it possible for any subsidiary within a multi-national production network to commission subsidiaries in other countries with mfc operations and thereby qualify as a service consumer under mode 2? And what about situations in which a manufacturer, keen to avoid GATT disciplines, simply lends the necessary funds to the commissioner (SMW) which would then buy and own the inputs?

WTO Members' hesitation to deal with the mfc issue may have wider ramifications beyond their obligations and commitments under the GATS. Also concerned are many services-related RTAs, which are also based essentially on W/120 and employ the same modal definition as the GATS. (Some 100 RTAs have been notified to the WTO to date under relevant provisions.) Pursuant to Article V:1 of the GATS, the parties to such agreements are required, *inter alia*, to provide for 'substantial sectoral coverage' and, in the sectors covered, for 'the absence or elimination of substantially all discrimination, in the sense of Article XVII' (national treatment). This implies that the questions discussed before may be even more pressing in an RTA context whenever the signatories assumed new or deeper commitments, beyond their GATS schedules, on mfc-based supplies. Indeed, there are 28 WTO Members without GATS commitments on either CPC 884 or 885 that scheduled such services in one or more of their RTAs (situation as of November 2011).[48]

[45] S/CSC/M/18/Rev.1 of 24 April 2001.

[46] S/CSCM/20 of 7 June 2001.

[47] S/C/M/62 of 4 April 2012 and S/C/W/311 of 12 January 2010.

[48] This count is based on an update of the dataset initially developed in Marchetti, Juan and Martin Roy (2008), 'Services Liberalization in the WTO and in PTAs', in Juan Marchetti and Martin Roy (eds), *Opening Markets for Trade in Services; Countries and Sectors in Bilateral and in WTO Negotiations*, Cambridge.

E. BACK TO THE DRAWING BOARD?

It is quite unlikely that Members were aware of the subtleties discussed above when they endorsed the Scheduling Guidelines and W/120 in the early 1990s. The challenge of creating a new agreement - with its particular modal structure, extension to the treatment of producers/suppliers, possibilities of non-tariff trade protection, etc. - left little time and resources to explore conceptual and definitional ramifications in detail. In turn, after the start of the Doha Round, some ten years later, there was little appetite for such work either. New and/or improved commitments are difficult to negotiate against the backdrop of parallel negotiations on scheduling and classification issues, which might not only change the 'balance' of existing commitments, but also the framework within which the new regimes would be implemented. This could explain, to a degree, why Members preferred to consider the mfc issue not to be "a matter of priority" in the early days of the Doha Round.

There are quite a number of critical observers of the WTO system who might concur with this assessment, though possibly for different reasons. From their vantage point, there should be other priorities for WTO Members than agonizing over classification issues on the borderline between goods and services trade. Rather, the current segmentation of trade disciplines ought to be removed. The objective would be to facilitate the operation of global value chains through common rules that embrace all cross-border supplies of products, whatever their nature, as well as movements of users (whether physically or electronically) and of producers/production factors (capital and workers).[49] Indeed, some strides in this direction have been made in a number of recent RTAs, in the form, for example, of cross-cutting chapters covering investment and labour movements across both goods and service sectors.

Nevertheless, no trade agreement, however open, is reasonably conceivable without proper sector classification. There will always be sectors that are considered to warrant special treatment for whatever (cultural, social, etc.) policy reasons and, thus, must be defined/classified accordingly. Second, the 'borderline problem' is unlikely to vanish either. The vast majority of current RTAs allow the parties, as far as goods are concerned, to take countervailing, anti-dumping or safeguard actions.[50] The agreements normally refer to existing GATT provisions, possibly combined with additional consultation or information-exchange clauses, and a bilateral safeguard mechanism during a phase-in period. Mfc-based supplies are on the other side of the definitional border...

Therefore, the question remains what could realistically be done, over the short and medium-term, to address the inconsistencies or, at least, uncertainties discussed in this paper.

The possibly most workable option, if any, would be a modification of the Sectoral Classification List W/120.[51] In the current context, this would mean removing the "services incidental

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[49] See, for example, the discussion in World Economic Forum (2012), *The Shifting Geography of Global Value Chains: Implications for Developing Countries and Trade Policy*, Geneva.

[50] This is confirmed by the 22 factual presentations of RTAs covering both goods and services that the WTO Secretariat submitted under the Transparency Mechanism for Regional Trade Agreements between January 2010 and end-July 2012. Overall, a study examining 74 agreements, including goods-only PTAs, found that only few agreements explicitly prohibited the use of antidumping duties (9 agreements) or countervailing duties (5) in trade among the parties. See Prusa, Thomas J. (2011), '*Trade Remedy Provisions*', in Chauffour, Jean-Pierre and Jean-Christoph Maur, *Preferential Trade Agreement Policies for Development*, Washington D.C., 179-96, at 185.

[51] Hypothetically, Members could also develop subsidy disciplines under the GATS that would at least narrow the existing conceptual gap vis-à-vis the GATT. However, there are important technical problems, related for example to the cross-modal effects that might be associated with subsidies (see, e.g., section C.2(iii)), and political sensitivities that have prevented Members so far, in the Working Party on GATS Rules, to make any tangible progress in this regard. Relevant discussions commenced just after the conclusion of the Uruguay Round in 1995… See also Adlung (2007) in above n 3838. Other options such as adopting an Annex to the GATS could also be considered, but achieving such a treaty amendment might prove even more procedurally challenging.

to manufacturing", as covered by CPC 884 and 885, from the List. "Maintenance and repair services of equipment", including machinery, electrical products, optical instruments and the like, would not be affected as they are covered elsewhere under W/120 and CPC[52]; and the same applies to repair services of transport equipment, i.e., of vessels, aircraft, rail transport and road transport equipment, and an additional range of products.[53] This implies, *inter alia*, that the main text of the Scheduling Guidelines, including para 29 (section C.2(iii)), could remain unchanged.

What would be required is a decision by Members, in the Council for Trade in Services, modifying W/120 and confirming that mfc-based supplies are not considered to constitute services within the scope of the GATS. In turn, such a decision would need to apply retroactively from the date of the Agreement's entry into force.[54] The guiding principle: A service (good) is a service (good) at any time...

What would a cost/benefit assessment look like?

On the one hand, in view of the generally liberal current commitments by a number of Members (over 20 on CPC 885 only), it might be argued that significant liberalization gains are at risk. As explained above, a full commitment on mode 2 (consumption abroad) could ultimately mean that the competent authorities have foregone the right to operate any customs tariffs on the supplies concerned, whether mfc- or moa-based. In turn, this reading implies that the existence of such commitments constitutes a significant concession - although very few of the Members involved, on either side, might have realized this to date. At the same time, the proposed classification change would also affect potentially meaningful access commitments under mode 3 (commercial presence) and, possibly less so, given definitional limits in coverage and restrictive scheduling patterns, mode 4 (presence of natural persons). To a certain extent, however, the investment-related effects might be compensated by the current framework of 2700-odd investment treaties and, increasingly, the investment chapters of RTAs that tend to apply on a cross-sectoral basis.

On the other hand, given the impossibility of reconciling anti-dumping or countervailing measures with the MFN requirement of the GATS, as presumed above, all Members would regain the right to impose such measures on mfc-based supplies, regardless of the existence of relevant commitments. What appears to be a step backwards, in terms of liberal access conditions, might look differently from a *trade negotiator's perspective*. Everybody would have restored their ability to take defensive action, in conformity with relevant GATT Agreements, across the full range of merchandise trade. And this may matter increasingly over time, whether one likes it or not, given the rapid proliferation of new forms of international production arrangements and the ensuing temptation for governments to facilitate their companies' participation through financial incentives.

Finally, there should be an overriding 'public-good' rationale for collective action to close the conceptual trapdoor. Otherwise, what purpose would be served by trade disciplines that discriminate, contingent solely on ownership rights, between identical products that resulted from identical operations? Whether one subscribes to our interpretation of relevant WTO provisions or not, the above discussion indicates the existence of profound definitional uncertainties with potentially significant economic implications. It is possibly only a matter of time for a WTO dispute panel to be

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[52] The relevant categories are CPC 8861 to 8866.

[53] Maintenance and repair services of aircraft and vessels fall under CPC 8868, and maintenance and repair services of road transport equipment under CPC 6112 and 8867. A range of repair services would be affected, however. The CPC refers in particular to "repair services incidental to metal products, machinery and equipment". Yet, the trade values involved might be limited.

[54] In theory, it might be conceivable to exempt existing commitments under CPC 884, 885 etc. from this decision, thus continuously depriving the Members concerned of the possibility to collect tariffs on the products involved. However, such a distinction would be unworkable in view of those GATS obligations, including the MFN requirement, that apply unconditionally across all service sectors, regardless of the existence of commitments.

involved. Rather than relying on case-related adjudication, however, it would certainly be preferable for Members to develop a broadly applicable solution, in a non-confrontational setting, that helps clarify the borderline between GATT and GATS in the case of 'manufacturing services'. Such clarification would also benefit many RTAs, some 30 at present, where similar questions arise.

Of course, the option remains for Members, in the tradition of Lao-tzu, to take inspiration from well-behaving heavyweights and otherwise allow world trade to govern itself. Yet this does not appear to be the prevailing sentiment. Experience also suggests that in the absence of common disciplines, everybody feels free to impose their rule. And Kant may be right: man is by nature raw and wild.

Annex 1. Relevance of the GATS for the supply of individual services

	Sectors without specific commitments	**Sectors subject to specific commitments**
A. <u>All services</u> (except B. and C.)	***<u>Unconditional obligations</u>:*** **Most-favoured-nation treatment (Art. II)[a]** Transparency (Art. III: 1 & 4) Availability of legal remedies (Art. VI:2) Monopoly control (Art. III:1)[b] Consultations in the event of - certain restrictive business practices (Art.IX:1) - subsidies with adverse effects (Art. XV:2)	***<u>Unconditional obligations</u> (see 2nd column)*** <u>*Conditional obligations*</u>*:* Additional transparency obligations (Art. III: 3 & 4)[c] Domestic regulation (Art. VI:1, VI:3, VI:5, VI:6)[d] Additional obligations concerning monopolies (Art. VIII:1, 2 & 4)[e] Unrestricted capital transfers and payments (Art. XI, FN 8 of Art. XVI) Non-discriminatory access/use of public telecom networks and services (Annex on Telecommunications) ***<u>Specific commitments as specified in schedules</u>:*** **Market access (pursuant to Art. XVI)[f]** **National treatment (pursuant to Art. XVII)[f]** Additional Commitments (optional) (Art. XVIII)
B. <u>Special cases</u> (i) Maritime transport (Decision on Neg. on Maritime Transport Services) ---------- (ii) Government procurement (Art. XIII:1)	See above, except for most-favoured-nation treatment	(i) Like all other scheduled services (see above)[g] ---------- (ii) Non-application of market access and national treatment commitments (Art. XVI & XVII) and related conditional obligations
C. <u>Excluded sectors/measures</u>	(i) Services provided in the exercise of governmental authority (Art. I:3) (ii) Air transport (measures affecting traffic rights and directly related services, barring three exceptions)	

[a] Permissible departures: (a) MFN exemptions listed pursuant to Article II:2; (b) participation in Economic Integration or in Labour Market Integration Agreements (Art. V and V*bis*); and (c) recognition of foreign licences, certificates, etc. (Art. VII).

[b] Purpose: Ensure compliance with MFN principle.

[c] More comprehensive transparency obligations, including notification requirements, than in sectors not subject to specific commitments.

[d] Purpose: Prevent excessive regulatory activities and/or particularly burdensome requirements from undermining the commercial value of specific commitments.

[e] Purpose: Prevent market distortions (e.g. through anti-competitive cross-subsidization) in areas where specific commitments have been undertaken (see also footnote 66).

[f] Market access and national treatment may be made subject to limitations.

[g] Negotiations in this sector were suspended in 1996. Commitments that have been undertaken, nevertheless, may be withdrawn without compensation at the conclusion of the current round.

Source: Adlung, Rudolf (2006), 'Public Services and the GATS', Journal of International Economic Law, 9(2), 455-85, at 459.