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Interpreting GATS National Treatment Principle:

Possibilities and Problems of Transplant from GATT

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Abstract

This paper discusses similarities between the national treatment principle of GATT and GATS, and explores possibilities of transplanting jurisprudence on interpretation of this principle from goods to services. Even though there are a number of similarities between the language of both GATT Article III and GATS Article XVII, the transplant of jurisprudence to GATS in interpretation of the national treatment principle raises the problem of high possibility of violations by Members of the World Trade Organization. The paper argues that this problem results from the uncertainty in determination of likeness, on the one hand, and the broad coverage of discrimination, on the other hand. Justification based on national legitimate policy objectives is submitted to balance this broad obligation. However, as this principle is interpreted in an objective manner, irrespective of national regulatory aims, the inclusion of regulatory objectives into this principle is proved to be unacceptable. Looking at different available approaches for reducing uncertainty in likeness and limiting the broad scope of "no less favourable treatment" standard, this paper comes up with a two-stage approach for confirming a breach of this principle, whereby GATS Article XVII on National Treatment should be read in connection with Article XIV on General Exceptions, which provides a proper space for legitimate national policy objectives.
Keywords: national treatment (NT), trade in services, necessity test

1. Introduction

The birth of the General Agreement on Trade in Services (hereinafter GATS), after eight years of negotiations under the Uruguay Round, has reflected the endeavour by contracting parties of the General Agreement on Tariffs and Trade (hereinafter GATT) to extend the multilateral trading system from goods to include services. Certain GATT principles and obligations are reworded to apply to the service realm, including national treatment principle (hereinafter NT). As one of the fundamental principles governing the multilateral trading system, NT plays a crucial role in liberalization of trade in services. *Firstly*, in contrast to trade in goods, most restrictions on trade in services reside in national regulations (Feketekuty 1988: 30–34, Trebilcock and Howse 2005: 351–353). Since liberalization of

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trade in services ultimately requires the removal of those restrictions, NT may be considered as one of key instruments. *Secondly,* furthering trade in services largely depends on negotiations with regard to undertaking commitments on NT by Members of the World Trade Organization (hereinafter WTO), which follows the progressive liberalization approach. Contrary to GATT, where NT is generally applied without making any prior commitment, the inclusion of NT in specific obligations is one of distinct features of GATS, which indicates that NT does not apply automatically to all service sectors, but only applies to scheduled sectors, sub-sectors or activities that a Member specifically lists in its commitments. *Thirdly,* the scope of NT in GATS addresses not only trade but also investment since GATS encompasses the supply of services, *inter alia*, through commercial presence of foreign service suppliers, or investment.

While NT in the context of trade in goods has been substantially explored and interpreted, the jurisprudence on interpretation of this principle in GATS is less developed. As both GATT and GATS are subject to a single dispute settlement mechanism under the WTO, there is a clear rationale for transplant of GATT jurisprudence to services sector. Furthermore, the language of NT articles in GATT and GATS shares a number of similarities, including the likeness and the standard of "no less favourable treatment". NT has been discussed among scholars and practitioners on interpretation, including transplant of GATT jurisprudence to GATS (Mattoo 1997, Krajewski 2003, Zdouc 2004). However, the fundamental nature of services of intangibility and non-storability (Feketekuty 1988, Nicolaides 1989), which is different from goods, would make the interpretation of NT more complicated in the context of services.

An appropriate methodology for this analysis is to contrast the meaning of NT as it applies in GATT with possibilities of transplant to trade in services. The negotiating history-based approach is complementary to this methodology in order to confirm the interpretation. This paper reviews literature and shall explore complicated issues arising from the possibilities of transplanting GATT jurisprudence to GATS in sections 2 and 3. An appropriate approach will be proposed in section 4. Finally, concluding remarks are made for the interpretation of GATS Article XVII.

2. Similarities and possibilities of transplanting NT from GATT to GATS

NT provision in GATT requires Members to refrain from applying any law, regulation and requirement as well as internal taxes and charges, which may affect internal sale, offering for sale, purchase, transportation, distribution or use, on the discriminatory basis between imported and like domestic products. This fundamental obligation is specified in Article III on National Treatment on Internal Taxation and Regulation, paragraphs (1), (2) and (4):

"1. The contracting parties recognize that internal taxes and other internal charges, and laws, regulations

and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.

2. The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.

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

Similarly, GATS Article XVII on National Treatment requires Members to treat foreign services and service suppliers no less favourably than like domestic services and service suppliers:

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

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

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

Although Article III applies to goods and Article XVII deals with services, the text of Article XVII: 1 has more similarities to Article III: 4 rather than to Article III: 2, in that it refers only to "like" services and service suppliers, but not to "directly competitive or substitutable" services. In addition, the structure of Article XVII is completely different from Article III: 2, which consists of two separate sentences. However, as Article XVII covers all the measures affecting supply of services regardless of fiscal or non-fiscal measures, it seems to be similar to the combination of both Article III: 2 and Article III: 4. In general, GATT Article III and GATS Article XVII share three fundamental elements, whereby Members are required to, (i) with respect to all laws, regulations and requirements affecting internal sale, offering for sale, purchase, transportation, distribution or use (or all measures affecting supply of services), (ii) accord to foreign goods (or services and service suppliers) no less favourable

treatment, and (iii) than that accorded to like domestic goods (or services and service suppliers).

In the context of services, the practice of panels and the Appellate Body (hereinafter AB) indicates that the GATT jurisprudence on interpretation of Article III may be relevant for examining the meaning of GATS Article XVII.

Firstly, GATS and GATT are in the same framework of the Agreement Establishing the World Trade Organization (hereinafter WTO Agreement), in which the former constitutes Annex 1B and the latter forms Annex 1A thereof. The Ministerial Declaration of the Uruguay Round expressly indicated that GATT practices were relevant to negotiating a multilateral framework on services.[1] Moreover, the negotiating history showed a clear expression that some GATT principles and obligations are applicable to the service realm, including transparency, most-favoured-nation treatment, and NT.[2]

Secondly, the AB in *EC—Bananas* provided a general approach to GATS that GATT jurisprudence could be relevant for the interpretation of analogous provisions in GATS.[3] The AB has compared GATT Article III and GATS Article XVII when ruling that the aims and effects test is not applicable to Article XVII as there is no comparable provision similar to Article III: 1 as the grounds for this test.[4]

Thirdly, the AB also confirmed the conclusions of previous panels on GATT Article III as a strong support for its interpretation of the word "affecting" in the context of GATS Article XVII when scope of a measure in question is to be defined.[5]

Lastly, the Panel in *Korea—Beef* recalled that the main purpose of Article III: 4 is to ensure "the effective equality of opportunities" with regard to the application of laws, regulations and requirements, and this is also applicable to GATS Article XVII: 3, which explicitly states that formally identical legal provisions would provide less favourable treatment to imported products.[6]

This legal evidence apparently demonstrates possibilities for transplanting GATT jurisprudence to services sector. The next section shall examine in details this transplant to the interpretation of three fundamental elements of NT, namely scope of measures, likeness and standard of "no less favourable treatment".

3. Specific elements for interpreting NT

3.1 Broad scope of measures affecting trade in services

In GATS, a measure is defined to have extensive coverage, which encompasses law, regulation, rule, procedure, decision, administrative action, or any other form (GATS: Article XXVIII(a)). Specifically, Article XVII also prohibits Members from application of different treatment in imposition or collection of direct taxes on foreign services or service suppliers.[7] It would suggest that this broad scope of the term "measure", regardless of fiscal or non-fiscal measures, encompasses both, internal taxes or other internal charges as stipulated in GATT Article III: 2, and law, regulations and requirements as mentioned in GATT Article III: 4. Given the broad scope of this term and GATT

jurisprudence on interpretation of Article III, the coverage of measures under GATS Article XVII would include, but not be limited to, any measure bearing governmental nature,[8] substantive and procedural measures,[9] compulsory and voluntary but legally enforceable undertakings,[10] laws and regulations directly governing trade in services and those likely adversely modifying the conditions of competition,[11] and taxes per se and tax administration measures causing financial burden on foreign services and service suppliers.[12]

In *EC—Bananas*, the Panel found that in the context of GATS, the term "measures affecting trade in services" is construed as broad as any measure affecting the supply of a service, either directly regulating the supply of a service or governing other matters that affect trade in services.[13] Based on this reasoning, European Community (hereinafter EC) measures implementing operator category rules, activity function rules, export certificates, and hurricane licenses constitute measures affecting the supply of services under Article XVII: 1.[14] The AB upheld the Panel's broad interpretation and conclusion that measures within the EC banana import licensing regime fell under the scope of the GATS based on three grounds[15]: (i) the ordinary meaning of the word "affecting" would cover any measure having "an effect on", and this would imply "a broad scope of application"; (ii) the previous panels in GATT also followed this broad interpretation with regard to Article III; and (iii) while [GATS] Article XXVIII(c) provides three examples of "measures by Members affecting trade in services", it does not limit the meaning of the term "affecting".

In sum, the term "measures affecting trade in services" has been broadly interpreted by WTO case law.

3.2 Uncertainty in determining the likeness

3.2.1 Like services

GATT jurisprudence has offered three approaches to interpreting likeness under the text of Article III: (i) a narrow interpretation of likeness in Article III: 2 first sentence, (ii) a broad interpretation of likeness with reference to "directly competitive or substitutable products" in Article III: 2 second sentence, and (iii) a broad interpretation of likeness in Article III: 4. In determination of likeness, both panel and AB have adhered to three criteria, namely (i) the products' end-uses in a given market; (ii) consumers' tastes and habits, which change from country to country; and (iii) products' properties, nature and quality.[16] The fourth criterion is a uniform tariff classification of products, which can also be relevant to confirming likeness.[17] As described earlier, because the structure of Article XVII: 1 is different from GATT Article III: 2, which consists of two separate sentences, the first and second approaches to interpreting the likeness in Article III: 2 would apparently be irrelevant to determination of likness under GATS Article XVII. In addition, the word "like" in the first sentence of Article III: 2 requires that two products must share mostly the same physical characteristics.[18] However, in case of services, a consensus among scholars (Zdouc 2004: 395–

97, Mattoo 1997: 127–28) is that physical characteristics (properties, nature and quality) of products are not a relevant criterion. Arguably, the main reason is the intangibility and non-storability of services (Feketekuty 1988: 27–36, Nicolaides 1989: 126–27). Therefore, the fundamental grounds of "physical characteristics" for making a comparison of likeness in a narrow meaning do not exist in the context of services. Furthermore, there is no similar wording in Article XVII concerning both "directly competitive or substitutive services" and "so as to afford protection to domestic production" as grounds for the second approach of interpretation.

On the other hand, as described earlier, the structure and language of Article XVII: 1 are very similar to Article III: 4 as both the former and latter refer to the terms "like" and "no less favourable treatment". With reference to GATT jurisprudence on likeness under Article III: 4 in *EC—Asbestos*, it is required that, in examination of competitive relationship among services, all evidence relating to the four criteria should be assessed and weighted, and more emphasis should be made on products' end-uses and consumers' tastes and habits.[19] The first criterion of products' end-uses seems to be the most suitable one for assessing likeness in the context of services (Zdouc 2004: 395, Mattoo 1997: 128). This would clarify the extent to which services are able to carry out the same functions. In other words, two services providing different functions would be regarded as unlikeness, such as life insurance and property insurance, because the former involves risks occurring to physical body of persons, and the latter concerns risks to assets. However, there is no clarity on the threshold for the extent of similarity in functions. It is arguable that this range of similarity would cover at least one similar function to almost similar functions. While the first extreme would lead to a broad scope of likeness, the second extreme would relatively narrow down the scope of likeness. In case of the latter extreme, because services are required to share commonality in end-uses, it is submitted that this extreme would suggest an elasticity of substitution, whereby any change in price of a service would result in a change in demand for other service. Unlike GATT Article III: 2 second sentence, where the introduction of elasticity of substitution is in conjunction with the assessment of protective aim to limit the broad scope of likeness, this criterion in GATS Article XVII: 1, as discussed later, operates independently from regulatory purpose. Consequently, it leads to the broad scope of likeness.

The second criterion is consumers' tastes and habits, which indicate the extent to which consumers are willing to purchase those services. However, the weakness of this criterion is that the consumers' tastes and habits may be relevant in determination of service likeness especially in "standardized service transaction", but less appropriate to services which require a high degree of co-production and interrelation between suppliers and consumers in order to satisfy particular customers' needs and preferences (Zdouc 2004: 396).

As noted earlier, the third criterion of physical characteristics is inappropriate for comparing services. Similar to GATT tariff classification in case of goods, service classification could be used as the fourth criterion in assessment of likeness. The Secretariat's services sectorial classification list

(hereinafter WTO classification) has been encouraged to employ as grounds for undertaking commitments on services.[20] This WTO classification identifies each sector and sub-sector corresponding to United Nations Central Product Classification (hereinafter CPC).[21] But the main weakness of this criterion, as shown by GATT jurisprudence, is that the classification list could be used as indicative, but not decisive, criterion in confirming the likeness.[22] Moreover, the literature demonstrates that service classifications are not a reliable criterion for determining the likeness because: (i) CPC has been developed by the United Nations for the statistic purpose and not necessarily based on competitive relationships of services (Krajewski 2003: 101), and (ii) the practice of scheduling commitments on NT by WTO Members may make the comparison on bindings more complicated due to differences in understanding and classification systems (Zdouc 2004: 397).[23] However, the approach of both the Panel and AB in *EC—Bananas* to the likeness seems to simplify this concern by relying on the service classification criterion, rather than either products' end-uses or consumers' tastes and habits criterion. Based on the evidence that the EC largely employed CPC for making their commitments,[24] the Panel concluded that when supplied in connection with wholesale services, wholesale transactions and different subordinated services are "like" as specified in the head-note section 6 of CPC, regardless of origin of bananas.[25]

The scope of likeness would remain broad as the AB follows strictly the objective interpretation of likeness, irrespective of national regulatory aims or purposes. In *EC—Bananas*, the EC justified its banana licensing regime on the grounds of pursuing "entirely legitimate policies" and not being "discriminatory in design and effect".[26] The AB, nevertheless, ruled out the "aims and effects" test[27] since the comparable words of "should not be applied to imported or domestic products so as to afford protection to domestic production", as a basis for this test, are not found in the context of GATS.[28]

In summary, the transplant of interpretation of GATT Article III to GATS Article XVII with regard to the second element suggests a broad scope of likeness due to the uncertainty in criteria for comparison and an objective assessment thereof. As NT in GATS is an object of negotiations, this uncertainty in determining likeness would constitute a disincentive to WTO Members in undertaking commitments on services liberalization.

3.2.2 Likeness with reference to service suppliers and modes of supply

The concern over likeness in the context of services is more complicated when service suppliers and modes of supply are involved, as there is no GATT jurisprudence on both matters. The text of Article XVII suggests that like services and like service suppliers should be read concurrently and therefore, domestic measures could be considered as violation of NT when they treat like services less favourably even if the service suppliers are unlike. According to this interpretation, for the purpose of comparison, it is sufficient to determine the likeness of services, regardless of whether service suppliers are alike or unlike. In other words, the likeness of service suppliers is not taken into

account when making determination of likeness as a whole. The Panel in *EC—Bananas* seems to follow this straightforward interpretation when it concluded that to the extent that entities provide like services, they are like service suppliers,[29] and because this reasoning was not appealed, the AB did not visit this matter. However, there are some concerns with this interpretation. *Firstly*, as discussed earlier, the approach to assessment of "like services" as the grounds for determination of service supplier is uncertain. In other words, the uncertainty of the determination of "like services" would lead to a broad coverage of likeness in services, and consequently in service suppliers. *Secondly*, determination of likeness under Article XVII based only on the likeness of services, while it would facilitate liberalization, might put pressure on domestic regulation (Krajewski 2003: 104). *Thirdly*, it would invalidate the likeness of service suppliers as the text of Article XVII refers to like service "and" service suppliers.

A stricter interpretation is proposed by Trachtman (2003: 62–64) to separate the evaluation of treatment of services from the evaluation of treatment of service suppliers. There would be no violation of NT if like services are treated differently based on the justification of different treatment with respect to different service suppliers. Following this approach, in order to determine likeness as a whole for the purpose of Article XVII, the necessary step is to assess whether services are alike, and if they are, then the sufficient step is to assess whether service suppliers are alike. This stricter interpretation has a number of advantages, including support from the negotiating history. *Firstly*, this approach is consistent with *Vienna Convention* Article 31(1), which calls for the interpretation in "good faith", and the ordinary meaning being given to terms of treaty. *Secondly*, this approach would narrow the scope of likeness in Article XVII, and then respect the regulatory autonomy of Members (Krajewski 2003: 57). *Thirdly*, as noted earlier, the distinct nature of services is intangibility and non-storability, which brings about the fact that services are produced and consumed at the same time. Although under GATT context, the process or production method seems to be not subject to Article III, it is argued that in case of services, it would not be necessary, and it is sometimes impossible, to separate a service from specific service supplier (Krajewski 2003: 106). As far as the process of supplying services is concerned, this would constitute a relevant factor in determining the actual characteristics of final service as a service product (Nicolaidis and Trachtman 2000: 252–53). *Fourthly*, the negotiating history suggested that there is "inseparability" between service supplier and service itself in the concept of NT.[30]

However, this stricter interpretation, for its part, leads to another legal issue of how the likeness of service suppliers is appraised. Following the four-criterion test in determination of likeness of service suppliers, it is argued that the most appropriate criterion might be physical characteristics, though it is difficult to find the extent to which suppliers must share the same or similar characteristics or quality, such as size of company, qualification of staff (Zdouc 2004: 397–98). This would imply a non-exhaustive list of characteristics for comparison. Zdouc (2004: 401) proposed that

the likeness of service suppliers must be based on the combination of service-related and supplier-related factors. Although this, to some extent, might limit the broad scope of the likeness of service suppliers, the inherent problem is still unsolved due to the uncertainty of a set of supplier-related factors. It is submitted that, as described earlier, a relevant factor for determination of like service suppliers might be the process of supplying services. Furthermore, in *Canada—Autos*, the Panel concluded that Intermeccania (Canadian manufacturer) could not be considered as a supplier of wholesale trade services for vehicles under the meaning of CPC entry "6111 sale of motor vehicles, including automobiles and other road vehicles", because it manufactures and sells directly to consumers a small number of vehicles per year.[31] It would suggest that market place of service supplier, including trading volume and customers' network is also relevant for determination of like service suppliers.

The second issue is whether modes of supply should be taken into account when likeness is assessed.[32] Mattoo (1997: 120) argued that in order to ensure the integrity of this principle, and better protection for foreign service suppliers, NT should be read independently from modes of supply. This would mean that for determination of likeness in Article XVII, it is not required to examine the different modes through which services are supplied. In addition, as noted earlier, the Panel in *EC—Bananas* confirmed the likeness of services based on the same CPC sub-sector, and the like service suppliers on the grounds of the likeness of services. This would imply that modes of supply are not a relevant factor in determination of likeness in the context of Article XVII. However, the literature (Zdouc 2004: 402 and Krajewski 2003: 102) shares a view that the reference to modes of supply would limit the broad scope of likeness. Moreover, the guidance for scheduling of initial commitments in trade in services clearly explained that levels of commitments in Article XVII should specify sector/sub-sector and mode of supply.[33] Therefore, in a scheduled sector or sub-sector, there would be a case that Members make full commitments on a mode of supply, but no commitment on other modes of supply. This would indicate an intention of WTO Members to treat services and service suppliers differently under different modes of supply with regard to NT. If the likeness was determined throughout all modes of supply, the meaning of commitments specified by modes of supply would be undermined.

Although the comparison of the likeness by reference to modes of supply and service suppliers is proved to narrow down the broad scope of likeness, unclear criteria for comparing service suppliers would leave the problem unsolved.

3.3 Broad coverage of "no less favourable treatment" standard

The third element in NT is "no less favourable treatment" standard. When measures are found under the scope of Article XVII and the likeness between foreign and domestic services and service suppliers is confirmed, a Member country violates NT if it accords foreign services and service

suppliers less favourable treatment than what is accorded to domestic counterparts. Because the interpretation of the term "like" services and service suppliers is broad, it is submitted that the third element must be qualified in order to balance against the second element. There are three important aspects in interpretation of this standard.

Firstly, Article XVII: 2 codifies the GATT jurisprudence on "no less favourable" standard on goods, which covers both formally identical and formally different treatment.[34] Moreover, Article XVII: 3 codifies the core requirement under GATT "no less favourable" standard, which prohibits all measures that modify conditions of competition.[35] Consequently, either formally identical or different treatment modifies conditions of competition in favour of domestic services or service suppliers, or at the expenses of foreign services or service suppliers, shall not be allowed. Therefore, the language of this Article is meant to prohibit both *de jure* and *de facto* discrimination.[36] In examination of "less favourable treatment" standard, the Panel in *EC—Bananas* followed a two-step approach to examine: (i) whether a measure is formally identical or different among foreign and domestic origin under Article XVII: 2, and (ii) whether the application of those formally identical or different treatments modifies conditions of competition for foreign services or service suppliers under the meaning of Article XVII: 3. In the first step, all four types of rules applied by the EC, namely operator category rules, activity function rules, export certificates and hurricane licenses, are found not discriminatory against foreign like service and service suppliers on the basis of their origin, thus formally identical treatment is arguably accorded to services and service suppliers.[37] However, in the second step, the Panel concluded that although all four types of rules operate in a non-discriminatory basis, they, in practice, create less favourable conditions of competition for like service suppliers of foreign origin because EC bananas import licensing regime is in favour of service suppliers of EC origin.[38] The *de facto* less favourable treatment was also found in the EC's revised license allocation system because [Ecuadorian] service suppliers "do not have opportunities to obtain access to import licenses" on equal terms and conditions.[39]

Secondly, in pursuant with GATT jurisprudence, the interpretation of the term "modifying conditions of competition" in GATS is subject to an objective assessment, regardless of regulatory purposes.[40] As noted earlier, the AB in *EC-Banana* rejected the EC's justification of its banana licensing system because the grounds for the test of legitimate policy objectives do not exist in GATS Article XVII.[41] Therefore, this would imply that the attempt to introduce national regulatory objectives for justification of less favourable treatment is legally unacceptable in the context of Article XVII. In other words, it suggests that the "no less favourable treatment" standard must be subject to an objective interpretation irrespective of domestic policy aims.

Lastly, the standard of "no less favourable treatment" is further clarified by footnote 10 to Article XVII: 1, which reads:

> "Specific commitments assumed under this Article shall not be construed to require any Member to compensate for any inherent competitive disadvantages which result from the foreign character of the relevant services or service suppliers."

In *Canada—Autos*, Canada argued that disadvantages in conditions of competition for the supply of foreign services, which were affected by the Canadian value added requirements (hereinafter CVA), had inherently resulted from the foreign characteristics of those services due to the fact that the maintenance and repair work exercised in Canada could not be supplied through Mode 1 (cross-border supply) and Mode 2 (consumption abroad).[42] The Panel found that Canada's argument was true, as it required the physical presence of service suppliers. However, other services, including repair and maintenance-related services such as consulting and advisory services, which were affected by CVA, could be supplied through Modes 1 and 2.[43] The less favourable treatment accorded to foreign services could not be defended on the grounds of "inherent competitive disadvantages which result from the foreign character" as footnote 10 only exempts Members' obligation for compensating any disadvantages due to foreign nature with respect to the application of NT.[44] According to Zdouc (2004: 412–13), footnote 10 called for the distinction between less favourable conditions of competition due to origin-neutral regulations and less competitive advantages due to foreign nature of services or service suppliers. Therefore, footnote 10 is not a justification for *de facto* discrimination under the "no less favourable treatment" standard.

Unfortunately, this analysis indicates that the "no less favourable treatment" standard as countermeasures to balance the broad scope of likeness broadly covers both *de jure* and *de facto* discrimination. In the event a measure at issue is found to modify conditions of competition in favour of domestic like services and service suppliers, there is a breach of this standard regardless of national regulatory purposes. Accordingly, the broad coverage of the "no less favourable treatment" standard would amount to another disincentive to WTO Members in negotiating services liberalization.

The following example may be useful to illustrate the above-said problems.[45] Insurance agency services (CPC 8140) are allowed to supply in country B through either entity (legal person) or individual (natural person) under full commitment on NT, i.e. no restrictions on the NT column in country B's Schedule of Specific Commitments. As noted earlier, supply of services by foreign entities in country B is exercised through Mode 3 (commercial presence) while that by foreign individuals is under Mode 4 (movement of natural persons). In order to obtain a license, entity or individual, either domestic or foreign, who wishes to supply insurance agency services, must satisfy certain requirements, including training courses in country B and licensing fees, which are different between agency entities and individual agents. WTO Members, such as country A, may claim that those measures are inconsistent with Article XVII because both suppliers are supplying like services (under the same CPC 8140) and the *de jure* discrimination exists between Mode 4 and Mode 3. In contrast,

country B may argue that all foreign and domestic agency entities are subject to the same licensing system, on the one hand, and all foreign and domestic individual agents are subject to the same licensing system, on the other hand. Accordingly, there is no discrimination between domestic and foreign service suppliers under either Mode 3 or Mode 4. While insurance agency services are codified as CPC 8140 for determination of likeness, there would be no competitive relationship between services supplied by agency entities and services supplied by individual agents because of different characteristics, including prices, quality, customers' services and network, and consequently different end-uses. Moreover, the cross-mode likeness of services was not established due to different service suppliers, i.e. entities vs. individuals, and different modes of supply, i.e. Mode 3 vs. Mode 4. Therefore, this *de jure* discrimination should be permitted by GATS because no likeness is confirmed. However, from the point of view of country A, while there is no distinction between domestic and foreign service suppliers under Mode 3, or between domestic and foreign service suppliers under Mode 4 on the basis of national-origin, the requirement of additional license by country B would put foreign service suppliers, who have been licensed by their home countries, including country A, at disadvantage to satisfy this requirement, and thus could constitute a *de facto* discrimination against foreign service suppliers. In response, country B may be at a position that even though the likeness of services and service suppliers would possibly be established within either Mode 3 or Mode 4 under the meaning of Article XVII, all country B citizens, who have been trained abroad and licensed by other WTO Members, including country A, to supply insurance agency services, must also satisfy those licensing requirements. Those licensing requirements might be consistent with Article XVII because the *de facto* discrimination against foreign service suppliers could not be established. This example shows a high possibility of violating Article XVII by the uncertainty in determining likeness as well as the broad coverage of "no less favourable treatment" standard.

As mentioned earlier, one of the distinct features of GATS is the negotiable NT, whereby Article XVII: 1 specifically refers to "Schedule" and "conditions and qualifications". The text of Article XVII: 1 would suggest that WTO Members may employ their schedules to limit such uncertainty of likeness and broad coverage of "no less favourable treatment" standard by introducing conditions and qualifications. As noted by Zdouc (2004: 403), WTO Members, nevertheless, do not deal with the likeness of services and service suppliers in scheduling their commitments. Concerning "no less favourable treatment" standard, a fundamental problem is that Members are only able to inscribe reasonably foreseeable discriminatory measures, but not all discriminations (Krajewski 2003: 113). Moreover, the recourse to the Schedules would be impossible for those Members, who have undertaken full NT with regard to scheduled sectors/sub-sectors, e.g. insurance agency services as shown by the above-said example. Probably, those WTO Members would be safe to rely on the predictability and certainty of interpreting NT.

To sum up, the WTO case law and literature review reflect the fact that in parallel with a broad approach to the interpretation of "measures" subject to GATS, the combination of uncertainty in interpretation of likeness and broad coverage of "no less favourable treatment" would lead to a high possibility for Members to violate NT in the context of services. Although different proposals have been introduced with a view to reducing this high possibility of violations through improving the certainty in determination of likeness and limiting broad scope of discrimination, the problem seems to be unsatisfactorily resolved. Consequently, the uncertainty in interpretation of Article XVII would discourage Members to undertake NT commitments for further liberalization of trade in services.

4. Toward a two-stage approach: the balance between Conditions of Competition in Article XVII and Policy Objectives in Article XIV

4.1 The recognition of national legitimate policy objectives

While expanding the production of and trade in goods and services, WTO Members are entitled to pursue their objective of sustainable development (WTO Agreement: Preamble). Specifically, the establishment of a multilateral framework of principles and rules for trade in services has led to the acknowledgement of the rights of Members to introduce new regulations for the supply of services within their territories in order to meet national policy objectives (GATS: Preamble). The negotiating history has shown the concern of negotiators, especially those from developing countries, for national policy objectives, which resulted in the exclusion of NT from general obligations (Drake and Nicolaidis 1992: 90–93, Reyna 1993: 2375–2377). Furthermore, GATS specifies that the fundamental requirement for progressive liberalization of trade in services through multilateral negotiations is aimed at ensuring the overall balance between rights and obligations of Members, while paying due respect to national policy objectives (GATS: Preamble). Therefore, there is recognition for allowing national legislators the freedom to pursue their domestic policy objectives, while preserving conditions of competition.

Although NT in GATS has been interpreted, as discussed earlier, in an objective manner irrespective of national policy aims, an introduction of second test, which respects national policy objectives, is necessary to secure the balance between rights and obligations.

In GATT dispute settlement, to justify a breach of Article III, Members have sought for Article XX, which provides for general exceptions. At the first layer, a discriminatory measure must be under any heading among ten exceptions as provided in GATT Article XX. In several cases, panels and AB have interpreted those exceptional headings with regards to "necessary" to protect human, animal, or plan life or health, and to secure compliance with laws and regulations; and "relating to" conservation of exhaustible natural resources. A discriminatory measure is proved as "necessary" only if there were no alternative measures consistent or less inconsistent with GATT, which a Member could reasonably be expected to employ to pursue its national policy objectives.[46] A discriminatory measure

is proved as "relating to" only when it must be "primarily aimed at" the conservation of an exhaustible natural resource.[47] However, those national policy goals must be legitimate, or in other words, the application of measures must reflect non-protectionist aims. Therefore, to prevent any abuse of those exceptions, in the second layer, that discriminatory measure also must satisfy three standards imposed by the opening clause of Article XX (the chapeau), where its application is not in a manner constituting a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction in international trade.[48]

The first case in GATS invoking Article XIV, which deals with general exceptions, is *U.S.－Gambling*, where the United States sought to justify its discriminatory measures (the Wire Act, the Travel Act and the Illegal Gambling Business Act) in connection with Article XVI on Market Access by relying on Article XIV(a), necessary to protect public morals or maintain public order, and Article XIV(c), necessary to secure compliance. A similar two-layer test was adopted to examine (i) whether the discriminatory measures fall within any exceptional heading of Article XIV, and (ii) whether those measures satisfy three standards of the chapeau of Article XIV.[49]

4.2 Necessity test － A problematic approach

Based on GATT jurisprudence on Article XX, an approach is proposed to read Article XVII in conjunction with GATS Article XIV, whereby the term "necessary" was integrated into Article XVII, which is called the necessity test (Mattoo 1997: 131–133, Verhoosel 2002: 3). The approach suggested that NT should be understood and interpreted by referring to the necessity of domestic regulatory objectives. Members are able to follow their domestic policy objectives as long as applicable measures are not more burdensome than necessary to achieve the corresponding objectives (Mattoo and Sauve 2003: 225). This would call for two-layer test within Article XVII to examine, firstly, whether a discriminatory measure accords less favourable treatment to foreign services and service suppliers than it does for domestic like counterparts, and secondly, whether the application of such measure is necessary to achieve national policy objectives. Although this approach would imply a balance between policy objectives and conditions of competition within Article XVII, there are some concerns.

Firstly, there is no GATT precedent in applying necessity test in assessment of "no less favourable treatment" in Article III, so it is very hard to expect that GATS jurisprudence will pursue a different direction. Furthermore, because the term "necessary" does not appear in either GATT Article III or GATS Article XVII, this indicates that there is no legal support for the necessity test in the language of Article XVII. Verhoosel (2002: 90–91) suggested that footnote 10 of Article XVII would be relevant for implying a necessity test in NT. Based on the concept of "inherent" stated in footnote 10, a panel would be required to assess whether another measure aiming at the same objectives, if adopted, would result in the same adverse effects (Verhoosel 2002: 90–91). In other words, a measure "less inconsistent with GATS" must be analyzed in order to determine whether

those adverse effects had inherently originated from the foreign character of services or service suppliers. If the answer were affirmative, the application of a discriminatory measure would not constitute a violation of Article XVII. However, in the words of Krajewski (2003: 111), this analysis would be a "circular conclusion" because the necessity test would be grounds for interpretation of both NT as well as an "inherent competitive advantage". In addition, as described earlier, footnote 10 only exempts Members' obligation to compensate for any disadvantages due to foreign nature with respect to the application of NT, but not the grounds for justification of any less favourable treatment accorded to foreign services or service suppliers.

Secondly, as Article XIV not only deals with "necessary" ((a), (b), and (c)), but also "inconsistent" ((d) and (e)), it would be inappropriate if only necessity test was read in Article XVII. In addition, as noted earlier, the chapeau of Article XIV acts as a second layer to examine the necessity. Therefore, the chapeau would constitute an integral part of the necessity test as an anti-abuse provision under the context of Article XIV. In other words, the introduction of the necessity test into Article XVII would be impartial since it ignores the importance of the chapeau under Article XIV. Moreover, if the necessity test was accepted, there would be no clear distinction between Article VI: 4, which addresses non-discriminatory measures and calls for the introduction of future disciplines that are "not more burdensome than necessary" to ensure the quality of service, and Article XVII which deals with discriminatory measures (Krajewski 2003: 112).

Thirdly, if the necessity test were adopted in Article XVII, it would automatically make Article XIV redundant in relation to Article XVII. If a discriminatory measure were found necessary under Article XVII, there would be no need to examine the policy purposes in Article XIV. However, if a discriminatory measure were found unnecessary, it would be useless to re-examine policy purposes for both Articles XVII and XIV. Moreover, the reference to the necessity of domestic regulatory objectives in Article XVII would assure the survival of "aims and effects" test, which was disregarded by WTO jurisprudence. It might be said that general exceptions, nevertheless, are still applicable to violations of other provisions.[50] In response, this argument seems to be inappropriate, as the interpretation rules of *Vienna Convention* Article 31(1) require "good faith" and "ordinary meaning". It would be unreasonable if the reading of Article XVII were to encompass Article XIV. In other words, other articles of GATS, including Article XVII must be interpreted with the recognition of the ordinary meaning of Article XIV. In addition, because Article XIV(d) specifically refers to Article XVII, the general exceptions must be a separate test applicable to, at least, Article XVII.[51]

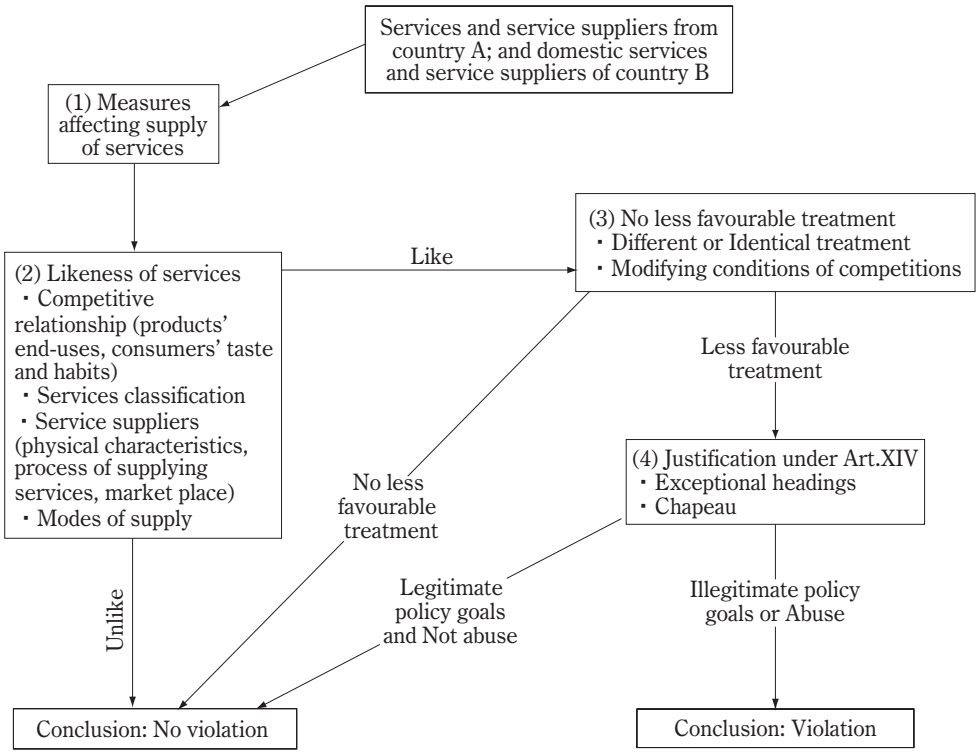
4.3 Framing a two-stage approach

To limit the high possibility of NT violation while respecting the objective assessment of Article XVII, an alternative approach is to read Article XVII first, and then Article XIV, whereby legitimate regulatory objectives and purposes of the measures shall be considered as a justification for less

favourable treatment. In this case, the interpretation of Article XVII would follow a two-stage approach to determine, *firstly* whether a measure accords less favourable treatment to foreign services and service suppliers than to domestic like counterparts, and *secondly* whether that less favourable treatment, if found, could be justified under Article XIV. While the first stage is aimed at revealing any discrimination among like services and service suppliers and is neutral to regulatory aims, the second stage will determine the proven discrimination in pursue of legitimate national policy objectives. Accordingly, the second stage will act as countermeasures against the broad coverage of discrimination as well as toward uncertainty in confirming likeness by balancing policy objectives with allegedly protective measures against foreign services and service suppliers. In other words, Article XIV will balance against the broad coverage of both "like" services and "no less favourable treatment" standard under Article XVII. However, in application of the second stage, Members are required to qualify three standards set by the chapeau as an anti-abuse provision, namely arbitrary discrimination, unjustifiable discrimination and disguised restrictions. In its turn, this anti-abuse provision would ensure the proposed balance between national policy objectives and conditions of competition.[52]

Figure 1 summarizes the analytical framework for interpretation of NT by the two-stage

Figure 1: Analytical framework for interpretation of the national treatment principle: Two-stage approach



Source: Author

approach. This approach shall consist of three elements in the event a measure in question is found under the scope of Article XVII: (i) confirming the likeness between foreign and domestic services and service suppliers; (ii) ascertaining the discriminatory measure which applies to foreign services and service suppliers irrespective of regulatory aims; and (iii) ascertaining discriminatory measure used to pursue national policy objectives in a non-protectionist manner under any exceptional heading. When a measure is found to be discriminatory against foreign services and service suppliers compared to domestic like counterparts in the context of Article XVII by an objective assessment, it would (i) not constitute a violation of Article XVII if it qualifies the requirements for any exceptional heading and the anti-abuse provision under Article XIV; or (ii) constitute a violation of Article XVII if that measure does not fall into any exceptional heading or protective intent is proved based on the examination of three standards under the chapeau. Accordingly, a WTO Member does not violate its obligations under NT as far as its measure does not constitute discrimination with protectionist aims. To continue the above-said example on insurance agency services in section 3, as claimed by country A, the consequence of determining likeness by reference only to service classifications and the broad coverage of discrimination would make licensing requirements by country B inconsistent with Article XVII. However, country B could be safe by proving that, for example, those requirements are necessary to secure compliance with its company and labour laws without protectionist aims under Article XIV.

There are three advantages in following this two-stage approach.

Firstly, it would ensure the transparency and predictability of the multilateral trading system, as well as protect WTO Members against high possibility of violation of NT. It secures the duties of Members to carry out their obligations under GATS. It also recognizes their rights to pursue legitimate policy objectives. As discussed earlier, due to uncertainty in determination of NT in GATS, this approach would provide a reliable recourse for Members to reduce the high possibility of violation. It is argued that it is very hard to examine the relationship between means and end, and this difficulty produces restrictions on a Member's choice of policy objectives because of the exhaustive list of Article XIV (Verhoosel 2002: 51–52). In response to the first part of this argument, it must be recalled that one of the principles in the WTO dispute settlement system is to achieve "a satisfactory settlement of the matter in accordance with the rights and obligations" of Members under GATS.[53] In other words, it is indispensable to examine the discriminatory measure (the means) and national legitimate policy objectives (the end) and appraise their relationship. A determination of "the end" could be made by assessment of protective application of that measure, which is "often discerned from the design, the architecture and revealing structure".[54] Moreover, GATT and WTO jurisprudence indicates that the relationship between means and end is manifested by "necessary" and "relating to", *inter alia*, under exceptional headings. The second part of this argument seems to be reasonable as Article XIV provides for only five exceptions. However, on the one hand, the multilateral framework of

principles would be less effective if there were many broad exceptions, which would harm "transparency and progressive liberalization" (GATS: Preamble). In other words, the existing five exceptions are enough. On the other hand, the existing provision of general exceptions should enjoy a broader interpretation so that they could be made truly "general" (Gaines 2001: 833).

Secondly, this approach is supported by the interpretation rules of *Vienna Convention* Article 31(1), which require "good faith" and "ordinary meaning" of the terms. Therefore, both GATS Article XVII and Article XIV could be examined without detriment to each other. In addition, the "object and purpose" of GATS are also taken into account in interpretation of NT by examining both the obligations of Members in ensuring the expansion of trade in services through the observation of multilateral framework of principles, as well as their rights to regulate the supply of services to satisfy national policy objectives.

Thirdly, this two-stage approach would be acceptable by panels and the AB as it would assure a fair dispute settlement process by balancing rights against obligations of Members:

> "The Members recognize that [the dispute settlement system of the WTO] serves to preserve the rights and obligations of Members under the covered agreements, and to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law. Recommendations and rulings of the [Dispute Settlement Body] cannot add to or diminish the rights and obligations provided in the covered agreements."[55]

Moreover, this approach is apparently consistent with the objective assessment of NT. The remaining duty is to examine two Articles together to determine whether measures in question constitute a violation of Article XVII.

5. Concluding remarks

To conclude, NT in GATS consists of three elements, namely "measures affecting the supply of services", "like", and "no less favourable treatment" standard. The first element is broadly interpreted to include both regulations governing the supply of services and other matters that indirectly affect the supply of services. The uncertainty of criteria to compare foreign and domestic services and service suppliers would lead the second element to broadening the scope of likeness. As the interpretation by both panels and AB is subject to an objective analysis regardless of regulatory aims, the third element fails to balance the broad scope of likeness due to the broad coverage of discrimination. This, in its turn, would result in the high possibility of violation of this principle by WTO Members.

To avoid this problem, it is necessary for Members to find an appropriate way to balance their broad obligations under GATS. By relying on legitimate national policy objectives as stipulated in

Article XIV, a two-stage approach is mapped for confirming the violation of Article XVII. Under this approach, although a measure may be found to be discriminatory against foreign services and service suppliers by the objective assessment, it could not constitute a violation of Article XVII as far as the measure is not discrimination with protectionist aims.

Notes

1 Ministerial Declaration on the Uruguay Round, September 1986, Part II.

2 Note on the Meeting of 15–17 September 1987, the Group of Negotiations on Services, GATT Doc. No. MTN.GNS/10 (15 October 1987), paras 11–19.

3 AB Report, *EC—Bananas*, para 231: "The Panel would have been on safer ground had it compared the MFN obligation in Article II of the GATS with the MFN and MFN-type obligations in the GATT 1994."

4 *Id*. para 241.

5 *Id*. para 220.

6 Panel Report, *Korea—Beef*, para 624.

7 GATS Article XIV(d) reads: "[Members may adopt or enforce measures] inconsistent with Article XVII, provided that the difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Members." (Footnote omitted)

8 AB Report, *Korea—Beef*, para 149.

9 Panel Report, *U.S.—Section* 337, para 5.10.

10 Panel Report, *Canada—Administration of the Foreign Investment Review Act* (L/5504–30S/140), adopted on 7 February 1984, para 5.4; and Panel Report, *EEC—Regulation on Imports o Parts and Components*, (L/6657–37S/132), adopted on 16 May 1990, para 5.21.

11 Panel Report, *Italian Discrimination against Imported Agricultural Machinery* (L/33–7S/60), adopted on 23 October 1958, para 12.

12 Panel Report, *Argentina—Measures Affecting the Export of Bovine Hides and the Import of Finished Leather*, WT/DS155/R, adopted on 16 February 2001, para 11.144.

13 Panel Report, *EC—Bananas*, para 7.285.

14 *Id*. para 7.316, 7.358, 7.377, and 7.391.

15 AB Report, *EC—Bananas*, para 220.

16 Those three criteria have been set out in the Report of the Working Party on *Border Tax Adjustments*, (L/3464), adopted on 2 December 1970, para 18.

17 Panel Report, *EEC—Measures on Animal Feed Proteins* (L/4599–25S/49), adopted on 14 March 1978, para 4.2; Panel Report, *Japan—Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, (L/6216–34S/83), adopted on 10 November 1987, para 5.6.

18 Panel Report, *Japan—Alcoholic Beverages*, para 6.22.

19 AB Report, *EC—Asbestos*, para 109 and 117.

20 Scheduling of Initial Commitments in Trade in Services, Explanatory Note, GATT Doc. No. MTN.GNS/W/164, 3 September 1993, para 16.

21 Services Sectoral Classification List, GATT Doc. No. MTN.GNS/W/120, dated 10 July 1991.

22 *See* Panel Report, *Japan—Alcoholic Beverages*, para 6.22, and AB Report, pp 23. See also AB Report, *EC—Asbestos*, para 130–131.

23 For example, WTO Secretariat (2001: 332–33) has pointed out four main differences between WTO classification and CPC with regard to insurance services: (i) accident and health insurance are included in "life insurance" instead of "non life" insurance as in CPC; (ii) reinsurance and retrocession, which are not in a specific category in CPC but included in "other insurance services", are separated as a sub-sector of insurance services; (iii) pension

fund management services are separated from life insurance services to include in asset management services under "banking and other financial services"; and (iv) "insurance brokering and agency services" and other services auxiliary to insurance are combined as a sub-sector in insurance service.

24 Panel Report, *EC－Bananas*, para 7.289.

25 *Id*. para 7.322.

26 AB Report, *EC－Bananas*, para 240.

27 The "aims and effects" test was introduced in *US－Malt Beverages*, where the Panel found that the likeness of products should be determined "not only in the light of criteria as the products' physical characteristics, but also in light of the purpose of Article III". The main reason for this approach was that, according to the Panel, the determination of likeness in the context of Article III should respect the "regulatory authority and domestic policy options of contracting parties". See Panel Report on *United States－Measures Affecting Alcoholic and Malt Beverages*, (DS23/R–39S/206) adopted on 19 June 1992, paras 5.71–72.

28 AB Report, *EC－Bananas*, para 241.

29 Panel Report, *EC－Bananas*, para 7.322.

30 Draft Glossary of Terms, GATT Doc. No. MTN.GNS/W/43 (8 July 1988), NATIONAL TREATMENT.

31 Panel Report, *Canada－Autos*, para 10.285.

32 GATS, Article I: 2 provides that supply of services is exercised through four modes of supply, namely: (i) cross-border supply, (ii) consumption abroad, (iii) commercial presences, and (iv) movement of natural persons.

33 *Supra* note 20, para 21.

34 *See* Panel Report, *U.S.－Section* 337, para 5.11.

35 *See* AB Report, *Korea－Beef*, para 144.

36 AB Report, *EC－Bananas* para 233.

37 Panel Report, *EC－Bananas*, para 7.326, 7.360, 7.379, and 7.392; and agreed by AB Report, *EC－Bananas*, para 244, 246 and 248.

38 *Id*. para 7.341, 7.368, 7.380, and 7.393.

39 Panel Report, *EC－Bananas－Recourse to Article 21.5 by Ecuador*, para 6.133.

40 *See* AB Report, *EC－Bananas*, para 216; AB Report, *EC－Asbestos*, para 100.

41 AB Report, *EC－Bananas*, para 244, 246 and 248.

42 Panel Report, *Canada－Autos*, para 10.298.

43 *Id*. para 10.300.

44 *Id*.

45 Further examples illustrated by Mattoo (1997: 128) concerning transport services, and Zdouc (2004: 402) concerning different regulations on different modes of supply.

46 Panel Report, *U.S.－Section 337*, para 5.26; AB Report, *EC－Asbestos*, para 172; AB Report, *Korea－Beef*, para 181.

47 AB Report, *U.S.－Gasoline*, pp 19–20; AB Report *U.S.－Shrimp*, para. 141–145.

48 See AB Report, *U.S.－Gasoline*, para 8–9; AB Report, *U.S.－Shrimp*, para 156.

49 *Id*. para 6.449.

50 For example, in GATT context, Regan (2002: 454－55) argued that while GATT Article XX is redundant in case of the inclusion of regulatory aims into GATT Article III, it still applies to other GATT obligations.

51 See *Supra* note 7.

52 Panel Report, *U.S.－Gambling*, para 6.581.

53 WTO, the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), Article 3(4).

54 *See* AB Report, *Japan－Alcoholic Beverages*, pp 30.

55 DSU, Article 3(2).

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