

Sir Leon Brittan  
Vice-President  
European Commission  
Rue de la Loi, 200  
B – 1049 – Brussels

Brussels, 12 July 1999

**Subject : ESN Preliminary views on Subsidies in Services**

Dear Sir Leon,

Please find enclosed the ESN Preliminary Views on Subsidies in services in the GATS framework.

A new trade round including services is set to begin in 2000. The refusal of GATS negotiators simply to transpose GATT subsidy rules to the services area was based on sound reasons. The GATS architecture is very different from the GATT, in ways that affect the ability of governments to grant subsidies. Unlike the GATT, treatment accorded by governments to *producers* of services is already covered by the GATS, as are modes of supply in addition to cross border trade. Further, the GATS national treatment obligation is only negotiable, not mandatory as in the GATT.

A pragmatic approach to the issue of specific rules on subsidies in services thus seems desirable. It would be sensible to examine the following questions. First, are subsidies in services trade significant enough to cause problems? Second, are there such problem areas that cannot be dealt with under the existing rules of the GATS? Third, if so, can workable rules can be formulated to resolve these problems?

ESN tried to give an answer to these questions. However, given the lack of information on this subject, this note sets out only the preliminary views of the ESN on this very important issue. These views may be modified or complemented in the light of further analysis of these complex matters.

The list of ESN Members supporting the Preliminary Views is attached.

I shall be grateful to you if you would pass this note to your successor in due time.

Yours sincerely,

Jerker Torngren  
Chairman  
ESN Policy Committee

Cc: H.D. Beseler, Director General, DGI; M. P. Carl, Deputy Director General, DGI; R. Madelin, Director, DGI/M

The European Services Network comprises 50 major European service companies, represented by their CEOs in the European Service Leaders Group and 36 European service federations, representing 22 services sectors.

**EUROPEAN SERVICES NETWORK****PRELIMINARY VIEWS ON SUBSIDIES IN SERVICES**

Final Version – 25 June 1999

Rapporteur: Peter Morrison, Clifford Chance

This paper represents the preliminary views of the ESN on subsidies in services, which may be modified or complemented in the light of further analysis of the issues.

A subsidy arises when a government or other public body confers a financial benefit on a specific producer or group of producers. Under the WTO Agreement, trade in services does not benefit from specific subsidies rules. Article XV of the GATS merely provides the right to consult in certain situations, and a commitment to negotiate specific rules later.

A new trade round including services is set to begin in 2000. It will have to address whether specific rules on subsidies in services are desirable and, if so, of what type. This note sets out the views of the ESN on this issue.

**I. The issue of subsidy rules in services must be examined pragmatically**

Until 1995, the GATT system covered only cross-border trade in goods, and focussed mainly on treatment accorded by governments to goods imported into their markets. Financial benefits given producers, and which altered conditions of competition for products in home or export markets, were subject to special rules set out in GATT Article XVI, and in the Subsidies Agreement.

The refusal of GATS negotiators simply to transpose GATT subsidy rules to the services area was based on sound reasons. The GATS architecture is very different from the GATT, in ways that affect the ability of governments to grant subsidies. Unlike the GATT, treatment accorded by governments to *producers* of services is already covered, as are modes of supply in addition to cross border trade. Further, the GATS national treatment obligation is only negotiable, not mandatory as in the GATT.

A pragmatic approach to the issue of specific rules on subsidies in services thus seems desirable. It would be sensible to examine the following questions. First, are subsidies in services trade significant enough to cause problems? Second, are there such problem areas that cannot be dealt with under the existing rules of the GATS? Third, if so, can workable rules can be formulated to resolve these problems?

**II. Subsidies in services trade do cause problems**

In OECD countries, and likely in most others as well, the vast majority of subsidies overall are granted in non-service industries such as steel, shipbuilding and mining.<sup>1</sup> However, subsidies in trade in services are still prevalent, as appears from WTO Trade Policy Review reports which to date have examined the policies of some 31 developed and developing countries. These reports suggest that four main service sectors are commonly subsidised: audiovisual services, air transport services, maritime transport services, tourism and banking. Subsidies in the audiovisual sector

<sup>1</sup> Robert Ford and Wim Suyker, *Industrial Subsidies in the OECD Economies*, Department of Economics and Statistics Working Paper No. 74, OECD, January 1990.

appear to be used mainly in developed countries, while those in tourism are used mainly in developing countries. Transportation (air and maritime) and banking subsidies are used by developing and developed countries alike.<sup>2</sup> Subsidisation may also occur when governments provide financial support to public sector bodies or private sector firms competing among them. Many countries tolerate *cross-subsidisation* between service activities.

### III. Existing GATS rules deal with many, but not all, problems arising from services subsidies

A service subsidy is a government measure which can alter the conditions of competition in trade in services. It is thus a practice which is within the scope of the GATS.<sup>3</sup> But to what extent do existing GATS rules actually restrain such practices?

#### **A. Most-favoured-nation treatment is binding across all service sectors, but would not restrain most types of subsidies in services (Art. II)**

The grant of a subsidy accords favourable treatment to a firm or group of firms. To the extent that the subsidy is limited formally or in effect to a service or service supplier of one foreign origin and not to another, it would violate MFN treatment.<sup>4</sup>

Although it is a powerful cross-sectoral rule, MFN would not appear to be particularly useful in restraining the grant of subsidies in services. Discrimination in the grant of subsidies does not typically distinguish among foreign firms, but rather between foreign and domestic firms.

However, the MFN obligation does prevent the use of any countervailing action against foreign subsidies, as is possible for trade in goods.

#### **B National treatment is negotiable only, but covers most subsidy practices that have effect within the market of the subsidising Member (Art. XVII)**

To the extent that favourable subsidy treatment is limited, formally or in effect, to service suppliers of domestic origin, the grant of a subsidy could violate a national treatment commitment.<sup>5</sup> For example, a subsidy made available to a domestic bank must be extended, if national treatment is to be respected, as well to foreign banks operating within the Member's territory. Since the purpose of subsidies is usually to benefit domestic producers, the national treatment commitment is a powerful discipline on the grant of subsidies.

Limits exist, however, on the scope of the national treatment commitment under the GATS.

##### 1) Applicable only in scheduled sectors

The national treatment commitment is only applicable to sectors and modes of supply entered by a Member in its GATS Schedule, and then only subject to any limitations (such as the general exclusion of subsidy measures) that are written in. It therefore only covers discriminatory subsidies in sectors in which commitments have been made. It should be noted that several countries have taken across-the-board exemptions for subsidies applicable to all service sectors in their schedules.

##### 2) Applicable only in scheduled modes

<sup>2</sup> *Subsidies for Service Sectors: Information contained in WTO Trade Policy Reviews*. Background note by the WTO Secretariat. S/WPGR/W/25. 26 January 1998.

<sup>3</sup> GATS Article I.

<sup>4</sup> GATS Article II.

<sup>5</sup> GATS Article XVII.

Members are free *not* to schedule full national treatment in any one or more of the four modes of supply. In this case, a Member is apparently free to discriminate against a service benefiting from full national treatment in a particular mode, by favouring the identical service supplied through a different mode for which it had *not* also made a full national treatment commitment. Thus to be certain of national treatment (and thus protection against discriminatory subsidisation), full commitments would have to be entered in all four modes of supply.

3) Applicable only to services or service suppliers located within a Member's territory

Article XVII does not require a Member to extend national treatment to a service supplier located in the territory of another Member.<sup>6</sup> Nor, by analogy, would the MFN provision in Article II require such treatment. It follows therefore that a subsidy does not have to be made available to all service suppliers, wherever located in the world. Likewise, national treatment would not appear to cover subsidy practices which have their effect outside the market of the subsidising Member.

**C. Monopoly provisions deal with many cross-subsidisation practices (Art. VIII)**

Article VIII of the GATS prohibits monopolies from using their monopoly power to impair the MFN provision, or their scheduled commitments, such as national treatment, inside or outside their monopoly powers. It thus in principle prevents monopolist service suppliers from engaging in *cross-subsidisation* from reserved to non-reserved services.

**D. "Non-violation" provisions deal with subsidisation whose effects could not reasonably have been expected during negotiations on market access (Art. XXII)**

Following the practice of the GATT in trade in goods, the GATS provides that, even if a government measure (such as a subsidy) violates no obligations or commitments it can still be attacked under certain conditions. These essentially are that the measure must impair the value of a national treatment or market access commitment, and that the measure could not reasonably have been anticipated. Thus, even if a subsidy could not be found to be discriminatory, it might have to be removed or compensation provided if it destroyed market access that could reasonably have been expected during the negotiation of a specific commitment.

**IV. Rule-making to improve GATS coverage of services subsidies should take account of important practical difficulties**

Certain particularities of services trade will have an important effect on rule-making in subsidies.<sup>7</sup> First, the absence of comprehensive *statistics* on services trade, as well as the differences in services nomenclature<sup>8</sup>, make it hard to assess the impact of subsidies. The dramatic growth in electronic media makes this all the more difficult. Second, the *intangible* nature of services, and the customised nature of many service transactions, makes it very hard to identify specific products, calculate unit prices, and compare like products. Third, since many services are *inputs*

<sup>6</sup> MTN.GNS/W/164, 3 September 1993. The Secretariat Note, accepted by the GATS negotiating group, states clearly that "there is no obligation in the GATS which requires a Member to take measures outside its territorial jurisdiction." The Note mentions only *suppliers* of services and not services themselves, but presumably the same principle would apply.

<sup>7</sup> See on this the WTO Secretariat paper on *Subsidies and Trade in Services*, S/WPGR/W/9, 6 March 1996, at para. 9-10.

<sup>8</sup> During the Uruguay Round, the GATT Secretariat prepared a classification list for the scheduling of commitments in services based on the United Nations' Central Product Classification (see GATT doc. MTN.GNS/W/120, 10 July 1991). Nonetheless, schedules differ considerably in their definition of the sectoral coverage of their commitments. Some Members have in fact used their own nomenclature; others have used the GATS classification but have departed from it in varying degrees. In the WTO Committee on Specific Commitments work is underway to improve the technical accuracy and clarity of schedules in view of the next round liberalisation.

into the production of goods, these services are already partly covered by subsidy disciplines applying to the related goods (GATT).

## V. Summing up: preliminary views of the ESN

Based on the foregoing discussion, the ESN makes takes the following view:

1. Although most service subsidy practices can be dealt with through existing general obligations and commitments in the GATS, subsidies having effects in markets outside the subsidising Member may need new rules

The MFN obligation and, if extended to relevant sectors and modes of supply, national treatment commitments can ensure that no subsidies contain any element of discrimination *within the market of the subsidising Member*. However, subsidies which produce affects in markets outside the subsidising Member do not appear at present to be covered. Consideration should therefore be given to drawing up rules on export subsidies or, more generally, subsidies having effects in markets outside the subsidising Member. For the sake of simplicity, these new rules might be incorporated by reference in Members' additional commitments column in their schedules. Rules could be developed applicable to all services sectors, or just one or several. Recent examples in telecoms and financial services show how much can be done on a sectoral basis.

2. Due to difficulties in measurement and enforcement, an equivalent to countervailing duties in services should not be attempted

The immense difficulties in measuring, classifying and regulating the supply of services should argue against any attempt to introduce a notion of countervail. In trade in goods, the notion is very difficult to apply fairly; in services trade it would be almost impossible.

3. In renegotiating their schedules, Members should agree to make more national treatment commitments in relevant sectors across all modes of supply

Commitments for full national treatment in relevant sectors across all modes of supply will ensure that the most common types of subsidisation are disciplined.

4. In renegotiating their schedules, Members should agree to re-examine any subsidy exemptions to determine whether they are still desirable

Some Members still maintain subsidy exemptions, including horizontal ones, in their services schedules. As part of the GATS 2000 negotiations, Members should agree to re-examine these exemptions to determine whether they are still desirable.

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**LIST OF ESN MEMBERS SUPPORTING THE  
ESN PRELIMINARY VIEWS ON  
GATS 2000 AND THE SUBSIDIES IN SERVICES**

**INSURANCE**

**Allianz Aktiengesellschaft**

**Guardian Royal Exchange**

**Hibernian Insurance Company Limited**

**BARC Versicherungs Holdings AG**

**AXA Group**

*Comité Européen des Assurances - CEA*

*Bureau International des Producteurs d'Assurances & de Réassurances – BIPAR*

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*DIT Deutscher Investment-Trust*

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*European Federation of Investment Funds and Companies - FEFSI*

*European Security Transport Association – ESTA*

*European Savings Banks Group - ESBG*

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