The legal system for the international trade in services under the EU and the WTO

RAMON TORRENT

This article analyses how community law deals with the legal system for the international trade in services. It draws a distinction between the obligations for market access and national arrangements and the likelihood of the Community deciding to harmonise internal national regulations. It goes on to explain the content of the World Trade Organisation (WTO) services agreement, and a notion as confused as trade in services introduced by this agreement, which refers not only to the international exchange of services but also to foreign investments. Finally, it examines how the Bolkenstein Directive was intended (with partial success) to disrupt traditional community logic, and how the Spanish state has used its transposition into national law to establish «as if they came from Brussels» a series of regulations which have nothing to do with the directive.

An economic view of the international exchange of goods and services

From a strictly economic viewpoint, there are no particular differences between international exchanges of goods and international exchanges of services. The two are essentially the same: production takes place in one country (country A) and demand comes from another (country B). All effects linked to production (from localisation of productive units and occupation to income from sales) take place in A, but everything to do with the creation of the demand takes place in country B. It doesn't matter whether A produces and exports cereals and cars or produces and exports hotel or accounting services.

However, there is a material difference between the international exchange of goods and its equivalent in services. In the former, it is always the goods which «travels» from the country of export or origin to the country of import or destination. In international exchanges of services, on the other hand, there are two possible situations:

- As in the case of the international exchange of goods, the service itself may travel from the country of origin to the country of destination (international transport, the broadcasting of a television programme, the provision of accounting or engineering services to a company in another country, etc.).

- But in other cases, what travels is not the service, but the person who uses or consumes it. This may mean physical travel, for example in international tourism, where the service is given in A, the demand comes from B, and it is a consumer in B who travels to A to consume the service there. Or in a virtual situation, if someone in B takes out insurance in A, or the services of a bank established in A are used by phone or on the Internet. From the economic viewpoint, in the latter case, nothing is essentially different from former case, but there are some significant aspects. For example, the issue of the individual travelling. But in any case, it makes sense to differentiate between the cross-border supply or provision of a service – where it is the service that travels - and its consumption abroad – where the service does not travel, but either physically or virtually, the consumer travels to the country where the service is performed.

As we will see below, these are the Type 1 and Type 2 of services supply differentiated under the World Trade services agreement.

It is sometimes claimed that there is another difference between the international exchange of goods and that of services: the provision of a service would be associated with the direct contact between the provider and the person using or consuming the service. But even in the past this did not always happen, as proved by the case of the international reinsurance activities of insurance companies, which have always existed and have always been conducted from a distance. It is clear today and for the foreseeable future, information technologies favour this separation between the production or provision of the service and its use.

The legal system for the international exchange of services

Although from the economic standpoint international exchanges of goods and services are substantially similar, their legal systems, both internally and internationally, have up to now been completely different.

The best way to verify this is by referring to the measures that Article XVI of the WTO services agreement, GATS (General Agreement on Trade in Services), identifies as restricting the access of services to the markets. Most of this measure does not refer to the international exchange of services but, as we will see below, addresses a

completely different issue: direct foreign investments in the services sectors, in other words, the conditions under which a service provider can establish itself in a foreign country or take over control of a services company in that country. In any event, the measures make greater reference to the provider of the service than to the service provided.

The only measures that directly affect the international exchange of services (those in Section C of that article) 1 belong more to the perspective of quantitative restrictions if we compare them with measures applicable to the international trade in goods.

The most common instrument used for restricting access to the market in the international trade in goods, a tariff, does not apply in the exchange of services. This is one of the mysteries of international relations.

We next discover that the instrument most commonly used for restricting access to the market in the international trade in goods, the use of a tariff, does not apply in the international exchange of services. Of all the mysteries of international relations, this is one of the most difficult to explain. It has sometimes been argued that duties are not applicable to services because they do not cross borders. However it is clear that this argument is unfounded, since the reality of the international exchange of services contradicts it. It is also obvious that there is nothing stopping us from creating a tax, a tariff or any other tax, which can be applied for example every time an imported film is shown in a cinema, or whenever a national insurance company conducts a reinsurance operation abroad.

I think that the reason why we do not use duties (or more generally any tax) in regulating the international exchange of services is mainly the «routine» effect («not stopping to think», or in this computer age, the «cut and paste» mentality) that explains so many of the features of the our political systems (including international relations).

Because even if we adopt a very liberalising perspective, it would be easy to apply an argument to the international exchange of services that is based on something that is more or less generally agreed in relation to the international trade in goods: duties are preferable to quantitative restrictions (which still exist in services).

It is true that as regards limitations to market access in the international exchange of services, the battery of instruments available tends to be much smaller than in the trade in goods, mainly taking the form of quantitative restrictions (the most extreme example of which is prohibition). Perhaps this is also why, in practice, the real limitation to access does not so much come from direct restrictions applied at borders, but arising directly from internal regulations on the conditions for service provision (for example, diplomas for professionals, or financial regulations for financial services). Even if not discriminatory, these will inevitably favour national providers (which are generally adapted to the regulations of their own country) and impede the provision of services by foreign professionals and companies (which are also normally adapted to the regulations of their countries of origin and therefore do not comply with the regulations of the foreign country where they wish to conduct their services).

The legal system for the international exchange of services under European community law[2] before the Bolkenstein Directive

To make progress on researching services in a regional process we cannot look only at regulations on market access, but must consider

producing some uniform legal measures that internally harmonise the internal rules applicable to the provision of services. This is what European community law has done since 1957, adopting a focus similar to the approach to the international trade in goods.

First, it introduced into primary law (in the provisions of the treaty itself) the obligations of free market access and national treatment, under which the following are prohibited:

- The introduction of direct barriers at the borders for access to the market of each member state of services supplied from other member states (Art. 56 TFU – ex. Art. 49 TEC);

- Giving less favourable treatment to imported services than to equivalent, equal or similar services produced internally. This is a general obligation of Art. 18 TFU - ex Art. 12 TEC - and a specific obligation, in the fiscal field, of Art. 110 TFU - ex Art. 90 TEC.

There may be indirect barriers if the internal regulations that govern the production/provision and marketing of services differ between member states, even if they are not discriminatory.

But compliance with these obligations does not guarantee that economic flows between member states can operate as they do within the internal markets of each state, even if they are not subject to restrictions. There may be indirect barriers if the internal regulations that govern the production /provision and marketing of services differ between member states, even if they are not discriminatory. To deal with this situation, the treaty gave the Community (now the Union) the competence to harmonise national regulations and to prevent such indirect barriers from appearing. This competence is exercised by the production of secondary law (above all directives), as established in Articles 56 *et seq* of the TFU.

Barriers to exchanges between member states can be justified for different reasons, which the Court of Justice includes under the denomination *imperative demands*.

The Court of Justice dealt joint with issues on direct barriers to market access and the existence of non-discriminatory internal regulations which, due to existing divergences, may cause indirect barriers. Jurisprudence here is Cassis of Dijon, applicable to trade in goods, and the equivalent jurisprudence in the services field. In spite of this, since indirect barriers created by the convergence of internal regulations were often justified by imperative demands[3], the double focus indicated above reappeared: the obligations of market access and national treatment established by primary law, on the one side, and the possibility of producing secondary law that would harmonise internal regulations and eliminate indirect barriers in full conformance to community law, on the other.

The legal system for the international exchange of services under the World Trade Organisation

The World Trade Organisation (WTO) is an international organisation that appeared as a result of the Uruguay Round of negotiations held under the General Agreement on Tariffs and Trade (GATT). The Uruguay Round (1988-1993/94) not only changed the international system applicable to the trade in goods. It also created what amounted to an international organisation (the WTO) and two new agreements were adopted which were radically different from GATT. One on services (GATS: General Agreement on Trade in Services), and the other on intellectual property (TRIPS: Agreement on Trade-Related Aspects of Intellectual Property Rights). A new mechanism was also created to resolve differences, applicable to all agreements.

The reasons why services (and intellectual property rights) were included in a round of negotiations under an agreement (GATT) which only refers to trade in goods are not easy to explain. Although it could be argued that the international exchange of goods has many points in common with the exchange of services, it is also true that until the Uruguay Round, legal disciplines, both internal and international, in both fields followed very different channels (and as we shall see below they still do, because for GATT, the notion of trade refers only to international exchange, while for GATS it also refers to direct foreign investment). It was the industrialised countries which imposed these two new areas in which they had an interest on the negotiating agenda. The acceptance of develping countries was bought with the argument that the reintegration into the general disciplines of GATT of two sectors as important as agriculture and textiles, which over time had become separated, would be beneficial to them, and would compensate for the obligations they would have to accept in the two new areas. After the Round ended, this argument on the balance in concessions was vigorously opposed by most developing countries, who maintained that they made many more concessions than the developed countries. This explains why the new round of negotiations, launched at Doha in 2001, had to be held under the sign of development (to rebalance results that had been over favourable to the developed countries in the Uruguay Round).

The inclusion of the two new areas in negotiations is also explained by the interest that the European Commission had always had in expanding the notion of trading policy which defines the exclusive competence of the European Community in the field of international relations. The best evidence of this interest comes from the fact that, even while the WTO agreements arising from the Uruguay Round were being signed, the Commission initiated a procedure before the Court of Justice of the European Communities asking that, on the basis of the new notion of trade of the WTO agreements, the Court should recognise that all topics dealt with under these agreements should be the exclusive competence of the Community. In its Report 1/94 of 15 November 2004, the Court rejected the Commission's arguments and accepted those of the Council's Legal Service to the effect that the notion of trade in WTO law (above all under the agreements on services and intellectual property) does not coincide with the notion appearing in the trading policy in European community law and that member states could therefore retain partial competence on the issues dealt with under these two agreements.

Be that as it may, the notion of trade in services introduced by GATS has had very negative effects on the consistency and transparency of the system of international trading relationships. In fact, this notion deals not only with the international exchange of services, but also with foreign investments in the services sectors, a completely different subject from the legal, economic and political standpoint.

The notion of trade in services introduced by GATS deals not only with the international exchange of services, but also with foreign investments in the services sector.

For example, GATT governs the system applicable to Ford cars produced in the USA and exported to Spain, but not the activities of the Ford company in its factory in Spain. For GATT, Ford cars made in Spain are Spanish cars, and if marketed in Spain will fall outside its remit. GATT applies to these cars only if they are exported (but it would then treat them as Spanish cars). On the other hand, GATS is concerned (as a priority) with the system applicable within Spain to the subsidiary of a US services sector company. For GATS, although this company is a company under Spanish law, it is still an American company.

In practical terms, Article I of GATS defines four types of service provision.[4] The first (supply from abroad) and the second (consumption

abroad) apply as we have seen above to the international exchange of services. But the third type, a *commercial presence*, does not refer to the international exchange of services, but to direct foreign investment in the services sectors (even though not even a single service provided in the country of destination is exported, because all are consumed internally).[5]

Under today's globalisation process, the increase in transnational activities and distribution of the ownership of capital between financial institutions means that the notion of a company's nationality has lost its meaning and become obsolete.

This approach of GATS leads to the introduction of a revolutionary definition of a company's nationality that sets it apart from the criteria of the Barcelona Traction sentence of the International Court of Justice, under which a company is or belongs to the country where it was constituted, established or operates.[6]

The group of definitions included in Article XXVIII of GATS breaks with this principle by establishing that a company's nationality is that of the persons who own or control the company. In other words, a company constituted in A, which is owned or controlled by persons from B, is a company with the nationality of country B.

The approach of GATS also contradicts the often stated thesis that at the present stage of globalisation, the notion of a company's nationality has lost any meaning and is now obsolete. This is in the context of the increase in transnational activities and the distribution of ownership of capital among financial institutions (pension and investment funds, for example), the ownership of which is also distributed internationally. Defenders of this thesis have to admit that the only principle under which GATS has been able to organise its provisions involves defining a company's nationality according to the nationality of the persons who control or own it.

On the other hand, the concept of services used by GATS is very wide (wider than under European Community law). Not only do they «comprise any service in any sector except services supplied in the exercise of governmental authority», but the exception (services supplied in the exercise of governmental authority) is defined in a very restrictive manner: «a service supplied in the exercise of governmental authority means any service that is supplied neither on a commercial basis nor in competition with one or more service providers». In other words, the Spanish public television is a service covered by the GATS agreement because it is a «service in any sector» and cannot be considered as anything but as a «service supplied in exercise of governmental authority» because it cannot be denied that «it is supplied ... in competition with one or more service providers».

The result of these two circumstances - the inclusion of direct foreign investment within the notion of trade in services and the wider notion of service - is that GATS has a much wider scope than GATT.

Once the universal scope of GATS has been established, we can ask how it was possible that states taking part in the Uruguay Round negotiations accepted such vast obligations, which can so seriously limit the exercise of their legislative power. The answer lies in the fact that although the GATS agreement is certainly very wide-ranging, the obligations it imposes are not very weighty; it is in fact a kind of «à la carte» agreement.

GATS does not aim to create a general uniform law applicable to companies or individual service providers; in other words, it does not aim to harmonise the legislations of member states of the WTO. Nor does it aim to achieve all at once and immediately a comprehensive liberalisation of the services sector (liberalisation, not in the public or private sense, but as regards the

possible access of foreigners; this should be emphasised because there have been many misunderstandings on the subject). GATS has two objectives:

- To consecrate the principle of multilateralism in the services sector.

- To start the liberalisation of the sector.

GATS aims to consecrate the principle of multilateralism and to start the liberalisation of services.

To do so, it distinguishes two types of obligations:

- General obligations. The main general obligation is the acceptance of the principle of multilateralism. Every member state of the WTO must give equal treatment to the service providers of other member states, including subsidiaries of foreign companies established in their territory. As always when we refer to the principle of multilateralism, there is an obligation not to discriminate between foreigners; there is no obligation to treat foreigners in the same way as nationals. But to make agreement more acceptable, even this general obligation can be subject to exceptions. First, as in GATT and under certain conditions, regional integration zones are authorised. Secondly, WTO member states could established a list of exceptions to the obligation of non-discrimination between foreigners (a list closed in 1994 and not extendible).

- Specific obligations. The two main obligations here are the liberalisation of market access and the obligation to give national treatment once companies or providers of services from other states have entered a country's market.

But these two specific obligations only apply to the sectors and aspects of the legal system of the companies or individual service providers included in a list of commitments drawn up by each WTO member state.

The Bolkenstein Directive and its transposition into Spanish law

As we have seen above, the existence of divergencies in internal regulations applicable to service provision is not contrary to the principles of European community law in so far as it is minimally justified on the basis of the criteria established by the Court of Justice. Further: at least in theory, the Community could only harmonise regulations if this harmonisation was justified by the principle of subsidiarity. This legal situation created a necessarily slow, laborious political process not exempt from frustrations: continuing the gradual harmonising of the regulations that were most suitable for furthering integration within the interior market.

At the start of the 21st century, the European Commission decided to take the middle way. On the basis of the article in the treaty that permits the harmonising of national sector regulations, it decided to present a draft directive, the so-called Bolkenstein Directive, which in fact did not claim to harmonise anything but simply to prevent the application of national regulations to services supplied from other member states. This was what was known as the «country of origin principle»: it was enough for services supplied from member state A to meet the regulations of this state to enable its supply to all other states in the European Union.

What happened with the Bolkenstein Directive proposal is highly indicative of the present unsatisfactory state of European integration.

First of all, its discussion within the framework of the European institutions before becoming Directive 2006/123 of 12-XII-2006 was extraordinarily confused. It never clarified what is so easy to explain and has in fact already been explained in the previous paragraph: that, on the basis of the article of the treaty that permits national sector regulations to be harmonised, the proposal did not actually claim to harmonise

anything but simply to prevent the application of national regulations to services supplied from other member states.

Secondly, the resulting text was a veritable pot-pourri of pieces of the original proposal and exceptions and new texts with a different orientation brought in from all directions.

Thirdly, its transposition into Spanish law has been used for things that have nothing to do with its provisions. It is true that the preamble of the Spanish «Omnibus Law» (Law 25/2009, of 22 December) says in announcing the content *and objectives: «Secondly, with the aim of further encouraging the services sector and achieving greater competitiveness ..., it extends the principles of good regulation to sectors not affected by the Directive, following an ambitious approach that will permit them to contribute ... to the effective suppression of requirements or obstacles...»*. But are people negatively affected by the Law conscious of this?

RAMON TORRENT

Professor of Political Economy and Director of the Observatory of Globalisation of the UB, Coordinator of International WTO/Regional Integration Chair and the Observatory of EU-LA Relations (OBREAL).

Former member of the Legal Services of the Council of Europe, and Director for International Relations of the same body

Notes

1. c) Limitations to the total number of service operations or in the total amount of service production, expressed in designated numerical units, in the form of contingents through the demand for a test of economic needs (this section does not include the measures of a member that limit inputs earmarked for the supply of services).

2. The Treaty of Lisbon has finally merged the European Community and the European Union, resulting in the disappearance of the former. In spite of this, it is better for the objectives of this article to refer to European Community law rather than the law of the European Union, since it is the Treaty of the European Community which established the legal framework that is commented on below. Later the TFU is quoted as the Treaty on the Functioning of the European Union, a new version and title of the old constituent Treaty establishing the European Community – TEC - according to the Treaty of Lisbon.

3. Imperative demands that the Court is much more disposed to appreciate in the case of indirect barriers than in the case of their direct equivalents.

4. Type 4, "movement of individual persons", is not a "different type" of services provision but an aspect of the other three.

5. In effect, "commercial presence" is defined in Article XXVIII as "every type of commercial or professional establishment, through, among other means, *i)* the constitution, acquisition or maintenance of a juridical person and *ii)* the creation or maintenance of a branch or representative office".

6. In reality, the Barcelona Traction sentence deals with the problem from the investment standpoint: what is the "national" state of a company and which is therefore legitimised to act internationally in defending its interests. The sentence closed the long series of lawsuits arising from the financier March's operation to take control of Barcelona Traction, the Belgo-Canadian company established in Catalonia, and that had issued bonds mainly in the United Kingdom) and its transformation into FECSA. This operation is the best possible demonstration that *a)* globalisation has been around for a long time and is inherent in a capitalist economy, and *b)* the political-financial operations of the years immediately after the Second World War are nothing compared to those of the 2000s. See http://www.icj-cij.org/docket/index.php?p1=3&p2=3&k=1a&case=50&code=bt2&p3=5&PHPSESSID=f4ae22d7885ebbc33e015375270c9ce3.