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Thesis title:

NEW PERSPECTIVES ON RULES OF ORIGIN FOR SERVICES

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Abstract

While rules of origin (ROO) in merchandise trade have been rigorously discussed in a vast number of economic and legal researches, ROO in services trade remain relatively nascent and have attracted insufficient scholarly attention to date. For this reason, the dissertation aspires to bridge the gap of literature by thoroughly analyzing the concept and practice of ROO for services in international trade and by scrutinizing the strands of thought on this area of rule-making over the past decades. Firstly, the investigation of origin-related provisions in the General Agreement on Trade in Services (GATS) and the relevant case law indicates that ROO for services are important to the multilateral liberalization of services trade in certain respects, but they are endowed with different characteristics from ROO for goods. A closer analysis reveals that the GATS approach to ROO for services has inherent defects as it does not observe the economic rationale of origin determination. With that in mind, the dissertation reaches beyond the GATS to explore ROO for services in preferential trade agreements (PTAs). Though they are highly diversified, PTAs basically share the same approach as the GATS when it comes to determining the origin of services, implying that such defects in the GATS approach are also prevalent in PTAs. While preferential ROO for services are considered liberal, their adverse impacts on services trade may arise from the lack of harmony and clarity. The matters become worse in the age of servicification, when trade and production are globalized and digitalized. Rethinking services ROO through the lens of trade in value added reveals that services ROO and the economic rationale are drifting further apart, and that the current approach to ROO for services does not fit for modern trade. After considering all these aspects, the dissertation finally discusses the possibility of a new approach to ROO for services by weighing the reasons for and against it and concludes that a 'product-based' approach to ROO for services may be necessary in the long run. To that end, through revisiting the 'substantial transformation' criterion, the research suggests that an import of certain concepts from merchandise trade to services trade is promising and that 'product-based' ROO for services should be initially tested in PTAs. In the short run, clarifying the rules and enhancing the harmony thereof are probably the most practical recommendation.

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Table of content

List of abbreviations

AFAS	ASEAN Framework Agreement on Services
ARO	Agreement on Rules of Origin
ASEAN	Association of Southeast Asian Nations
BIT	Bilateral investment treaty
CAD	Computer-aided design
CETA	Comprehensive Economic and Trade Agreement
CPTPP	Comprehensive and Progressive Agreement for Trans-Pacific Partnership
CVA	Customs Valuation Agreement
DDA	Doha Development Agenda
EFTA	European Free Trade Association
e.g.	*exempli gratia* (Latin, meaning 'for example')
etc.	*et cetera* (Latin, meaning 'and the other things')
EU	European Union
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GSP	Generalized System of Preferences
GVC	Global value chain
HS	Harmonized Commodity Description and Coding System
Ibid.	*ibidem* (Latin, meaning 'in the same place')
ICT	Information and communications technologies
IDE-JETRO	Institute of Developing Economies – Japanese External Trade Organization
LDC	Least developed country
MFN	Most favoured nation
MNE	Multinational enterprise
NAFTA	North American Free Trade Agreement
OECD	Organization for Economic Co-operation and Development
PTA	Preferential trade agreement
R&D	Research and development
RKC	Revised Kyoto Convention

ROO	Rules of origin
SBO	Substantive business operation
SNBT	Swedish National Board of Trade
TiSA	Trade in Services Agreement
TiVA	Trade in value added
TPP	Trans-Pacific Partnership Agreement
UK	United Kingdom
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNESCAP	United Nations Economic and Social Commission for Asia and the Pacific
US	United States of America
VCLT	Vienna Convention on the Law of Treaties
WCO	World Customs Organization
WTO	World Trade Organization
3DP	Three-dimension printing

Introduction

I. Rationale of the research

Rules of origin (ROO) are an important area of rule-making in international trade. The legal and economic aspects of ROO have been discussed for the last few decades from different perspectives. It should be noted, however, that by default they are ROO in the field of merchandise trade. There are much less attention paid to the question relating to origin determination in the field of services trade. Indeed, the existence of ROO for services is not common knowledge even to many trade scholars and practitioners.

Anyone starting the quest into this topic may be influenced by the remark of previous authors that ROO for services differ from ROO for goods in various aspect, particularly they are of much less importance. In effect, such conclusion gives the impression that this topic is not worth digging deeper due to its negligible significance. However, there are certain reasons to keep a skeptical view and to discover whether services ROO are actually that insignificant. Firstly, in principle, when it comes to the scope of coverage of the General Agreement on Trade in Services (GATS) or any other preferential trade agreement (PTA), it is necessary to define the services and service suppliers entitled to the benefits of those agreements, which is synonymous with determining the origin of services and service suppliers. Secondly, in some disputes brought to the World Trade Organization (WTO), questions relating to the origin of services and service suppliers have indeed been raised by Panels or the Appellate Body. Moreover, for the purpose of legal studies, it will be helpful to explore this under-researched area, at least to answer the question as to why ROO for services are considered not important.

Another reason that necessitates this research stems from the intention to consider the issue from new perspectives. The provision of services has developed remarkably over the past few decades. In the world of global value chains (GVCs), services may be used as inputs for manufacturing of other goods and services, and they may also be outputs in pure services GVCs. The advances in information and communications technologies (ICT) have literally transformed trade and production, including trade services. These changes perhaps have certain implications on the discussion on ROO for services. Yet, the most comprehensive works on this topic were conducted around ten years ago; this

means they are likely to lag behind new patterns of trade in services. Besides, the ROO for services, at least ROO in the GATS, are established even longer ago in a completely different world. Thus, there is a need for a study which takes into account the changes, and assesses whether or not ROO for services are keeping pace with the evolvement of trade practice.

Notably, in the traditional view, trade in goods and in services are regarded as separate spheres: in multilateral context, trade in goods is covered by the General Agreement on Tariffs and Trade (GATT), and trade in services is covered by the GATS. In PTAs, trade in goods and services are governed in separate chapters as well. However, this line is getting thinner since trade statistics in value added terms indicates that services account for a large share in the making of goods – either as inputs or as accompanying services, which proves that they are intertwined. To date, ROO for goods and services are regarded as inherently different, hence they should be based on different principles. However, since trade in goods and services are indeed interrelated, it is proper to start thinking of the shared characteristics of the two areas of rule-making. This justifies the new perspective that this dissertation relies on – looking at ROO for services from the lens of ROO for goods.

In addition, since services trade is growing rapidly not only in the multilateral trading system but also in PTAs, it is important to reach beyond the GATS to explore the origin rules in PTAs. That analysis will elucidate how services ROO in the GATS and in PTAs are similar to or different from each other. Moreover, if ROO for services in the GATS are not important, it will be useful to examine if they are not important in PTA, either. In such discussion, any link between ROO for services in PTAs and the GATS will also be analyzed. Therefore, there is a need for a research which considers at the same time non-preferential and preferential ROO for services.

For these reasons, the dissertation is dedicated to discussing the following topic: *New Perspectives on Rules of Origin for Services*.

II. Literature review

There are not many prior works that discuss in depth ROO for services. For any reason, this is a relatively under-researched area of study. A humble number of book chapters or articles briefly mention ROO for services as part of the general discussion on ROO,

which mostly focuses on ROO for goods (e.g., Hoekman, 1993 or Kingston, 1994). The mentioning of ROO for services is also scattered in a larger number of works on trade in services in which the issue of ROO is generally not focused. More recently, there are more important works analyzing ROO for services by Zampetti & Sauvé (2006), Wang (2010), Munin (2010), Fink & Nikomboririak (2008), Khumon (2015), or Dinh (2016). It seems the topic has gained greater scholarly attention with time.

Among the works that have discussed ROO for services, there are some that contribute more to the development of the theoretical framework. Hoekman (1993) discussed the difference between ROO for goods and services, and concluded that ROO for services must be based on another approach from those for goods. Abu-Akeel (1999) analyzed the difficulty in determining origin of services, and challenged the difference between the nationality of suppliers and the origin of services themselves. Zampetti and Sauvé (2006) were the first to compare ROO for services in the GATS, PTAs and investment treaties, and to rank the stringency of the rules based on criteria applied. Wang (2010) wrote one of the most influential papers on the topic, which pointed out the defects of services ROO in the GATS and suggested that the 'substantial input test' would be the way out. However, his paper does not discuss ROO in PTAs at all. Munin (2010) spent one chapter in her comprehensive book discussing ROO for services in the GATS. This is by far one of the most elaborated legal guides to interpreting definitions relating to origin of services stipulated in Article XXVIII of the GATS. Dinh (2016), the author of this dissertation, made contribution by proposing to import some concepts from ROO for goods to the field of ROO for services.

Apart from these works, there other ones focusing more on describing the state of the art. Fink and Nikomborirak (2008) discussed in depth ROO in services in a case study of five ASEAN countries. They partly discussed the factors defining the restrictiveness of the rules and their implications on trade. A more comprehensive paper by Khumon (2015) provided a thorough analysis of ROO for services in 47 PTAs concerning Asia-Pacific countries, and found that the rules are generally liberal.

In general, most of the previous works on this topic focused on the GATS, and did not discuss thoroughly ROO in PTAs. The connection between ROO in the GATS and ROO in PTAs, as well as the link between trade in services and investment concerning ROO are not fully analyzed. Besides, these works did not take into account the phenomena

and trends recently arising in international trade that may shed light on or complicate the discussion. To the extent possible, this dissertation attempts to cover such gaps in literature.

III. Methodology and research questions

The dissertation attempts to make use of common methods in legal and social sciences studies. The overall structure of this dissertation is a reform-oriented research, which is evidenced by the conclusions found in Chapter 5; therefore, it focuses intensively on assessing the adequacy of existing rules and recommends changes to any rule deemed necessary.[1] However, in each chapter of the dissertation, different methodology will be used. To be specific, Chapters 1, 2, and a part of Chapter 3 employ the methodology of theoretical legal research that aims at fostering more comprehensive understanding of the conceptual bases, and of the combined effects of current rules covering the area of services' origin.[2] To this end, the chapters use many means of statutory interpretation, both textual and beyond the text. They also effectively use the methods of comparative analysis and analogical reasoning, mostly in the arguments discussing the differences and similarities between ROO for goods and services.

Chapters 4 and 5 are the two chapters that manifest the reform-oriented nature of this dissertation. In Chapter 4, the GATS approach to ROO for services is appraised in the context of new patterns of trade to reveal how it may or may not fit for purpose. Based on the implications drawn at the end of Chapter 4, in combination with the findings of the preceding chapters, Chapter 5 has been laid groundwork to discuss the question on the necessity of a new approach. These chapters make wide use of inductive reasoning, i.e., an attempt to make broad generalizations from specific observations. Comparative analysis and analogical reasoning are also used to reinforce the perception that similar concepts in merchandise trade may also be brought into services trade.

Notably, although this is a pure qualitative legal research, in certain parts of Chapters 3 and 4, some non-legal data are also introduced to sustain the analysis, which brings it closer to the interdisciplinary approach. Moreover, the limited availability of materials

[1] Dennis Pearce, Enid Campbell & Don Harding (1987), *Australian Law Schools: A Discipline Assessment for the Commonwealth Tertiary Education Commission* (Australian Government Publishing Service), as cited in Terry Hutchinson & Nigel Duncan (2012), 'Defining and Describing What We Do: Doctrinal Legal Research', *Deakin Law Review 17(1)* 83-119, at 102.

[2] *Ibid*.

also prompts the research to resort to a method commonly used in social sciences: in-depth interviews with experts.

The dissertation aims to answer the following research questions:

- What is the purpose of origin determination in services trade, and what are the rules to define such origin?
- How ROO for services are similar to and/or different from ROO for goods?
- What are the defect and or merits of ROO for services?
- How rules of origin are formulated in PTAs?
- Are the ROO for services keeping pace with the changes in modern trade?
- Do current ROO for services need improving, and how will they be improved?
- What are the implications of a new approach to ROO for services?

IV. Contribution of the research

Firstly, given the gap in literature, this dissertation attempts to provide one of the first comprehensive works fully discussing ROO for services, particularly from a theoretical approach. As there are few previous authors addressing the topic in depth, most of the thoughts on the topic are scattered and unelaborated. This research aims to systemize the prevailing thoughts on ROO for services, refine them and reinforce them by adding more arguments and examples. It is expected that the dissertation may provide a legal guide to this undeniably under-studied area of rule-making.

Secondly, the contribution comes from the methodology aspect. Instead of describing ROO either in the GATS or in PTAs, this research aims to portray both of them and to draw the connection between them. This is also one of the first works that touches the question of whether ROO in PTAs comply with the GATS. Moreover, the dissertation not only maps the ROO in PTAs, but also zooms in certain selected PTAs and analyzes in detail the provisions relating to origin. Besides, the study of ROO for services is not separated from ROO for goods, but put in the comparative analysis with the latter.

Thirdly, the dissertation contributes by updating new phenomena and trends into the discussion of ROO for services. It is the first work to describe servicification as well as new trends of trade and production so as to draw a link with ROO for services.

The final contribution of the dissertation comes from its recommendations. Though it does not insist that a reform is mandatory, it calls for reconsideration by encouraging scholars and practitioners to think differently about ROO for services beyond the box of the current system. The conclusions drawn from the research may not attempt to become readily applicable, but it provides the direction for further studies.

Chapter 1

The concept and aspects of rules of origin for services

The chapter attempts to provide a systematic conceptual analysis of origin rules for services, thereby constructing a theoretical framework for the dissertation. It starts with an introduction into ROO for goods in hopes that this widely familiar concept will bridge the gap of perception, enabling the author to explore the concept of ROO for services – an area of rule-making in services trade that has received insufficient scholarly attention to date. The second part of the chapter is dedicated to discussing how services ROO are defined in the GATS, what origin criteria are employed, and how they function in services trade. Finally, some comparative remarks as to how ROO for services differ from those for goods will close the chapter.

1.1. Rules of origin for goods

1.1.1. The concept of rules of origin in merchandise trade

It should be accented from the beginning that ROO is a concept coined for the field of merchandise trade. Therefore, an investigation into the concept and aspects of ROO for goods is indispensable for the study of ROO for services.

In the first place, the word *origin* literally means the fact of beginning from something, or being born from particular ancestors. More broadly, origin is the point from which something starts, or the cause of something.[3] For a person, it is generally synonymous with his nationality, which may be established by birth place, marriage, or residency. It is a person's origin or nationality that may outline his citizenship obligations and rights in a jurisdiction. Likewise, in international merchandise trade, *origin* denotes *country of origin*, or the economic nationality of goods.[4] As defined by the revised International

[3] See Cambridge English Dictionary, available at: https://dictionary.cambridge.org/dictionary/english/origin (visited 19 May 2017).

[4] See, for instance, WTO E-Campus, *Made in…? Understanding Rules of Origin,* at 5, available at: https://ecampus.wto.org/admin/files/Course_611/CourseContents/ROO-E-Print.pdf (visited 19 May 2017).

Convention on the Simplification and Harmonization of Customs Procedures (revised Kyoto Convention – RKC),[5] country of origin is 'the country in which the goods have been produced or manufactured, according to criteria laid down for the purposes of application of the Customs tariff, of quantitative restrictions or of any other measure related to trade.'[6] To put it simply, the Convention indicates that the originating status of a good is attributed to the country in whose territory it is obtained or made, which is determined by certain criteria. It also asserts that some trade measures may apply to a good contingent on its origin, which, to a certain extent, illustrates how the origin of a good may have similar legal implications as that of an individual. One may infer from this definition that the origin determination of a good may be required where different market access conditions apply to the good depending on its nationality.

Since origin means the economic nationality of goods, ROO are thus the rules used to identify or attribute such nationality. To be precise, it is defined by the RKC that ROO mean 'specific provisions' that are 'developed from principles established by national legislation or international agreements', and 'applied by a country' so as to identify the origin of goods.[7] This definition construes that ROO are sets of conditions (i.e., 'origin criteria') under which a good is deemed as originating in a country. Notably, although ROO are provided either in national laws or in international treaties, their application – *inter alia*, origin determination and verification – is always at the country level.

The WTO does not provide a specific definition for ROO, perhaps because they are not a 'trade measure' as such, but rather an instrument to implement other measures. Yet, the Agreement on Rules of Origin (ARO) makes a distinction between preferential and non-preferential ROO.[8] Article 1:1 of the ARO refers to non-preferential ROO as 'laws, regulations and administrative determinations of general application applied by any Member to determine the country of origin of goods provided such rules of origin are not related to contractual or autonomous trade regimes leading to the granting of tariff preferences going beyond the application of paragraph 1 of Article I of GATT 1994.' In the meantime, under Annex II:2 of the ARO, preferential ROO are referred to as 'laws,

[5] The Kyoto Convention was drawn up in 1973 by the Customs Cooperation Council (in 1994, the Council adopted its current name, the World Customs Organization - WCO), and entered into force in 1974. The Kyoto Convention was revised in 1999.

[6] Chapter 1, Annex K of the Revised Kyoto Convention 1999 (Annex D to the Kyoto Convention 1973).

[7] *Ibid*.

[8] Annex 1A (Multilateral Agreements on Trade in Goods) of the Marrakesh Agreement Establishing the World Trade Organization, 1995.

regulations and administrative determinations of general application applied by any Member to determine whether goods qualify for preferential treatment in contractual or autonomous trade regimes leading to the granting of tariff preferences going beyond the application of paragraph 1 of Article I of GATT 1994.'

These definitions have without doubt categorized ROO into two types: one covers the ROO applied to goods traded within the WTO under the 'most favored nation' (MFN) principle;[9] the other covers the ROO developed in reciprocal or unilateral preferential agreements among WTO Members. Despite such separation, which will be elaborated later on, they share a common trait: both non-preferential ROO and preferential ROO are sets of criteria to determine the origin of goods so as to apply corresponding trade measures to the goods in question.

1.1.2. Origin criteria

In principle, the making of any product may involve either one single country or more than one. Therefore, in principle ROO need to address two scenarios where: (i) a good is entirely obtained or made in one country, and (ii) two or more countries contribute to the making of a good. For this purpose, two major criteria are applied to determine the origin of goods in line with these two scenarios: the 'wholly obtained or produced' criterion and the 'substantial transformation' criterion.

1.1.2.1. The 'wholly obtained or produced' criterion

The 'wholly obtained or produced' criterion is one of the two basic origin criteria that need to be examined to determine the origin of goods. A good is considered as 'wholly obtained or produced' in one country if its production or manufacturing is carried out entirely in the territory of that country. [10] The country where a good is 'wholly obtained or produced' is automatically accepted by ROO as its country of origin. Reasonably, in the age of globalized production, goods are increasingly made with the contribution of various countries; therefore, goods that can comply with this criterion mainly include natural resource-based ones that are obtained in a single territory and products made

[9] Article I of the General Agreement on Tariffs and Trade 1994 (GATT 1994) requires all WTO Members to accord MFN status to one another. In principle, it means a Member that receives this treatment must be granted the same privileges and advantages as the nation most favored by the Member granting such treatment.

[10] In several trade agreements (e.g., NAFTA), the requirement is: 'in the territory of one or more of the contracting parties.' See the WCO's detailed analysis of the 'wholly obtained or produced' criterion, available at: http://www.wcoomd.org/en/topics/origin/instrument-and-tools/comparative-study-on-preferential-rules-of-origin/specific-topics/study-topics/who.aspx (visited 31 May 2017).

from them. Despite slight differences in terms of the coverage, to specify this criterion, ROO in most national laws and trade agreements follow Standard 2 in Annex K of the RKC. As per this Standard, goods 'wholly produced in a given country' will be covered in exhaustive lists.

> *2. Standard*
>
> Goods produced wholly in a given country shall be taken as originating in that country. The following only shall be taken to be produced wholly in a given country:
>
> a. mineral products extracted from its soil, from its territorial waters or its seabed;
>
> b. vegetable products harvested or gathered in that country;
>
> c. live animals born and raised in that country;
>
> d. products obtained from live animals in that country;
>
> e. products obtained from hunting or fishing conducted in that country;
>
> f. products obtained by maritime fishing and other products taken from the sea by a vessel of that country;
>
> g. products obtained aboard a factory ship of that country solely from products of the kind covered by paragraph (f) above;
>
> h. products extracted from marine soil or subsoil outside that country's territorial waters, provided that the country has sole rights to work that soil or subsoil;
>
> ij. scrap and waste from manufacturing and processing operations, and used articles, collected in that country and fit only for the recovery of raw materials;
>
> k. goods produced in that country solely from the products referred to in paragraphs (a) to (ij) above.

What is clear from this list is that, the RKC narrowly construes the criterion of 'wholly obtained or produced' to include a restricted list of goods. In general, goods that fulfill this criterion must not contain any non-originating materials, which means goods that are made of inputs sourced from more than one country may in principle fail to obtain their originating status by applying this criterion. Therefore, the RKC provides another criterion – 'substantial transformation' – to address the scenarios where two or more countries participate in the making of a certain good.[11]

1.1.2.2. The 'substantial transformation' criterion

In the 'substantial transformation' criterion, 'origin is determined by regarding as the

[11] See Standard 3, Chapter 1, Annex K of the RKC.

country of origin the country where the last substantial manufacturing or processing, deemed sufficient to give a commodity its essential character, has been carried out.'[12] In other words, once a product is made up of inputs from several countries, it obtains originating status in the country that hosts the substantial works giving it an essential character. There is a possibility that works carried out in different countries may give the product equally essential characters; in that case, the last one shall be credited.

There are several methods of application to identify the fulfillment of the 'substantial transformation' criterion, which include rules that are based (i) on the change in tariff classification, (ii) the *ad valorem* percentage, or (iii) the list of specific manufacturing or processing operations.[13] All of these interchangeable methods have certain positives and negatives, and they can be applied separately or in combination.

a. Change in tariff classification

Among those three methods of application to express the 'substantial transformation' criterion, change in tariff classification is regarded by the ARO as the primary method. In its Article 9 on the objectives and principles of harmonizing ROO, the ARO divides 'substantial transformation' into two groups, in which 'change in tariff classification' stands apart, while the other methods are categorized as 'supplementary'. This Article points out that to ensure the timely completion of the harmonization work program, it 'shall be conducted on a product sector basis, as represented by various chapters or sections of the Harmonized System (HS) nomenclature.'[14] Only where the usage of the nomenclature does not enable a proper expression of 'substantial transformation' shall the Technical Committee on ROO consider elaborating on 'the use, in a supplementary or exclusive manner, of other requirements, including *ad valorem* percentages and/or manufacturing or processing operations.'

An origin rule based on this method specifies changes in tariff classification in the HS nomenclature that are necessary to constitute 'substantial transformation', thereby to confer originating status to the products at issue. It requires the processing operations to result in a product classified under a chapter, heading or sub-heading different from

[12] Paragraph E3./F1, Chapter 1, Annex K of the RKC.

[13] Stephano Inama (2009), *Rules of Origin in International Trade* (New York: Cambridge University Press), at 5.

[14] The Harmonized Commodity Description and Coding System (generally referred to as the Harmonized System or 'HS') is a product nomenclature developed by the WCO, and governed by The International Convention on the Harmonized Commodity Description and Coding System, which was adopted in 1983 and came into force in 1988.

that of its *non-originating* inputs.[15] It means if a firm produces porcelain tableware in France using plain tableware originating in the Philippines, the final products will not be deemed as originating in France if the rule is 'Change in Tariff Heading', since both decorated and plain porcelain tableware are classified under the same heading (69.11). But if the plain porcelain tableware is made in France, and pigments to decorate them are from Japan, the final products will qualify for French origin as they fulfill a change in tariff heading – pigments being embedded in the tableware are classified in heading (32.07), distinct from that of the tableware (69.11).

On the one hand, as the HS provides a nomenclature comprising of virtually all goods' descriptions and codes, along with the general interpretation rules allowing countries to arrange traded goods on a harmonized basis, it is in effect one common language for traders and customs officers worldwide.[16] Thus, utilizing a method hinged on a change in tariff classification may foster the harmony at the international level. An origin rule relying purely on the precise taxonomy of materials and products is also characterized as transparent, predictable, and objective, which stands less risk of being manipulated by traders and customs officers. On the other hand, this method requires an extensive knowledge of the HS, particularly given the fact that it is constantly updated. Besides, since operations that are simple and/or create a minimal added value may still cause a 'jump' in tariff lines, in various cases, changes in tariff classification are insufficient to reflect the 'substantial transformation'. In such cases, it often needs subordinate rules, i.e., those based on added value or processing operations. Such a combination of rules may render the implementation of ROO more complicated. Plausibly, although the HS is a versatile nomenclature, it was initially designated to apply tariffs and collect trade statistics; therefore, it is not always appropriate for origin identification purposes.[17]

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[15] See the latest edition of the HS Nomenclature (effective from 1 January 2017) for a better understanding of its structure: http://www.wcoomd.org/en/topics/nomenclature/instrument-and-tools/hs-nomenclature-2017-edition/hs-nomenclature-2017-edition.aspx (visited 20 May 2017).

[16] There is a risk that customs authorities in the countries of exporting and importing disagree on the classification of a particular product, but this is not a common practice.

[17] See Inama, *supra* note 13, at 6. See also the WCO's website for a more detailed analysis: *The Different Methods to Determine 'Substantial Transformation' – The Tariff Change Method*, available at: http://www.wcoomd.org/en/topics/origin/instrument-and-tools/comparative-study-on-preferential-rules-of-origin/specific-topics/general-annex/cth.aspx (visited 1 June 2017).

b. Ad valorem percentage

This method takes into account the degree of manufacturing or processing carried out in a country by calculating the value it adds to the products. If the value added meets a certain threshold, denoted as a percentage, the manufacturing or processing shall be considered substantial or sufficient, thereby allowing the goods to acquire originating status in the country where such manufacturing or processing takes place. Rule based on the value added requirement may be expressed in one of the following tests:

(i) *Minimum percentage* of the value added to final products (build-up or direct test): The manufacturing or processing operations carried out in the country of origin must reach a certain extent, i.e., the percentage of value they add to the final products must be equal to or exceed a given threshold, so that the latter can obtain origin there. This test requires a consideration between the value of regionally or locally created content and that of the final goods. As a result, the stringency of ROO would increase with the threshold for regional or domestic content. For instance, a rule requiring 40% regional value content will be more stringent than one requiring 35%.

(ii) *Maximum percentage* of non-originating inputs (build-down or indirect test): The use of non-originating materials or components in the processing or manufacturing in the country of origin is restricted to a maximum rate. This test relies on a comparison between the value of non-originating inputs and that of the final goods. Therefore, the stringency of ROO would be inversely proportional to the allowance of non-originating inputs. To illustrate, a rule authorizing 60% value of final products to come from non-originating materials is more stringent than one permitting 65%.

On one side of the coin, determining origin in line with an *ad valorem* requirement is a common method to reflect the 'substantial transformation' notion, as it can quantify the increase of products' value in the country where the processing or manufacturing is carried out. This method is especially suitable for those products that are justifiably processed or manufactured, but do not change in tariff classification.[18] In addition, by adjusting the percentage threshold, it allows for flexible application toward exporting

[18] An example is the case of 'Spirits obtained by distilling grape wine or grape marc' (heading 22.08) and 'Wine of fresh grapes, including fortified wines' (heading 22.04). If the origin rule applied to products under heading 22.08 is 'Change in Chapter', then all spirits distilled from imported grape wine shall not meet the requirement since the products are classified in the same chapter as the non-originating inputs. But if the *ad valorem* rule applies to this heading, the products may well satisfy the threshold (e.g., local value content 30%).

countries to fit their development stages. On the other side of the coin, this method of application lacks predictability and consistency: it is susceptible to price and currency fluctuation, and potentially exposed to transfer pricing. The calculation may also vary contingent on the basis employed to define the value of inputs and products.[19] Though the method is relatively easy to comprehend and apply in practice, the administration of an origin rule based on value added requirement is burdensome to traders since it requires sophisticated bookkeeping and accounting systems. Moreover, this method may also lead to an adverse disclosure of sensitive commercial information.[20]

c. Specific manufacturing or processing operations

This method dictates specific production processes that may confer originating status to the goods. It requires non-originating materials to go through certain processing or manufacturing operations in a country in order for the good to be deemed originating in that country. Although the RKC has dropped this method, it is still commonly used in practice: the often cited 'from yarn forward' rule is a good example.[21] As a matter of fact, this method is acknowledged by the ARO. Article 2(a)(iii) of the agreement states that in cases where this method is used, the operations conferring origin on the goods in question need to be precisely specified.

The merit of basing an origin rule on specific processing or manufacturing operations comes from the objectiveness and unambiguity of this method. In general, it is easy to comprehend and manage. With a precise characteristic, this method can also function as a supplementary requirement to accompany other methods. Yet, unlike rules based on added value or 'tariff jump', one based on processing operations cannot be applied across the board because manufacturing varies from one product to another. Drafting ROO using this method may result in excessively lengthy and detailed texts. Moreover, the emergence of new products and technical developments requires an update of the

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[19] It explains why the Recommended Practice 5 in Chapter 1, Annex K (RKC) needs to suggest the values to be used when the substantial transformation criterion is denoted in terms of the *ad valorem* percentage rule. For instance, for the goods produced, it should be either the ex-works price or the free-on-board price.

[20] See Inama, *supra* note 13, at 7. See also the WCO's website for a more detailed analysis: *The Different Methods to Determine 'Substantial Transformation' - The Value Added Method*, available at: http://www.wcoomd.org/en/topics/origin/instrument-and-tools/comparative-study-on-preferential-rules-of-origin/specific-topics/general-annex/val.aspx (visited 1 June 2017).

[21] See Inama, *supra* note 13, at 9.

lists of processing or manufacturing operations from time to time.[22]

1.1.3. Classification

As mentioned earlier in the first section of this chapter when discussing the concept of ROO, the ARO makes a distinction between non-preferential and preferential ROO. In this section, the essential features of these two categories of ROO will be analyzed.

1.1.3.1. Non-preferential rules of origin

Preceding the adoption of the ARO, Annex D to the Kyoto Convention 1973 (currently Annex K to the RKC) was the unique international treaty covering ROO. As just about twenty countries had acceded to the Kyoto Convention, there emerged an urgent need to harmonize ROO given the advancement of negotiation under the Uruguay Round.[23] With a desire to ensure that ROO would not themselves become unnecessary barriers to trade, WTO Members adopted the ARO as part of the 'single undertaking' upon the establishment of the Organization. Articles 2(b), 2(c) and 9(d) of the ARO provide that ROO shall not be used as instruments to directly or indirectly pursue trade objectives, or to 'create restrictive, distorting, or disruptive effects on international trade'. As such ROO are established to define the origin of goods for purposes other than preferential trade regimes, they are categorized by the ARO as non-preferential ROO.

Regarding the scope of application of non-preferential ROO, Article 1:2 of ARO states that they shall be 'used in non-preferential commercial policy instruments, such as in the application of: MFN treatment under Articles I, II, III, XI and XIII of GATT 1994; anti-dumping and countervailing duties under Article VI of GATT 1994; safeguard measures under Article XIX of GATT 1994; origin marking requirements under Article IX of GATT 1994; and discriminatory quantitative restrictions or tariff quotas. They shall also include ROO used for government procurement and trade statistics.' Briefly speaking, WTO Members may utilize non-preferential ROO to determine the origin of goods traded under the WTO's MFN treatment.

The ARO provides the basis to develop non-preferential ROO in national laws, which

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[22] See also the WCO's website for a more detailed analysis: *The Different Methods to Determine 'Substantial Transformation'- Specific Manufacturing or Processing Operations*, available at: http://www.wcoomd.org/en/topics/origin/instrument-and-tools/comparative-study-on-preferential-rules-of-origin/specific-topics/general-annex/spc.aspx (visited 1 June 2017).

[23] WCO, *Handbook on Rules of Origin*, at 11, available at: http://www.wcoomd.org/en/topics/origin/overview/~/media/D6C8E98EE67B472FA02B06BD2209DC99.ashx (visited 1 June 2017).

essentially follows the RKC's recommendations on the two criteria of 'wholly obtained or produced' and 'substantial transformation.' Nevertheless, because non-preferential ROO differ among each Member, a single product traded under the GATT may obtain different countries of origin depending on the ROO applied. Such diversity of national non-preferential ROO may lead to disharmony and incur high compliance costs.

Realizing the essence of systematized non-preferential ROO, the ARO has laid down a work program to harmonize the rules within three years of its initiation. Members are to approve the harmonized ROO when the latter enter into force, which is expected to bring consistency to the origin determination of a specific good across the multilateral trading system. However, due to a number of obstacles against the work program, this intended schedule has been suspended several times without any significant progress. Negotiations are still going on but without any formal timeline or deadline.[24] Until the WTO has achieved the goal of harmonizing non-preferential ROO, each Member may continue to apply its own regulation, with adherence to relevant provisions stipulated in the ARO and the GATT.

1.1.3.2. Preferential rules of origin

As can be seen from its concept, preferential ROO are used to determine the origin of goods for the purpose of according treatment more preferential than the level of MFN commitments within the WTO. The ARO specifies that this category of ROO responds to the trade interests of autonomous and contractual preferential regimes.[25]

The largest autonomous preferential regime is the Generalized System of Preferences (GSP). In 1971, the GATT contracting parties agreed on a waiver to Article I (the MFN clause) for one decade to endorse the GSP scheme. In 1979, they adopted the Enabling Clause which constituted a permanent waiver to the MFN clause, thus allowing donor parties to grant preferential tariffs via their own GSP schemes. Notably, a GSP scheme is not reciprocal; hence, a beneficiary country receiving GSP benefits does not need to treat the donor country in return. Understandably, ROO in GSP schemes allow donor countries to determine whether certain goods are entitled to the differential treatment, not the other way round. Beyond the GSP, the WTO has also adopted the Hong Kong

[24] *Ibid*. By 2017, 48 Members (with the European Union and all its members counted as one) have notified to the WTO Secretariat that they non-preferential ROO; in some cases those ROO consist of extremely brief texts.

[25] Paragraph 2, Annex II of the ARO.

Ministerial Decision (2005) on measures in favor of least-developed countries (LDCs), which seeks to grant duty free, quota free market access to the latter. Those Members participating in this initiative should develop their national ROO pertinent to imports from the LDCs in line with guidelines provided in the Bali Ministerial Decision (2013), which are further elaborated by the Nairobi Ministerial Decision (2015) on preferential ROO for LDCs. For the purpose of this dissertation, ROO in these preferential schemes will not be analyzed in details. However, although ROO in these unilateral preferential schemes serve a different purpose, in general they operate under a similar mechanism as ROO in contractual preferential regimes that will be discussed in depth.[26]

With regards to contractual preferential regimes, the GATT covers customs union and free trade area – hereinafter referred to altogether as preferential trade agreement, or PTA.[27] As an exception to Article I:1 of the GATT, WTO Members accord preferences beyond their MFN commitments to selected partners by negotiating to establish PTAs in line with Article XXIV of the GATT:

> *Article XXIV*
>
> *Territorial Application – Frontier Traffic – Customs Unions and Free Trade Areas*
>
> 5. Accordingly, the provisions of this Agreement shall not prevent, as between the territories of contracting parties, the formation of a customs union or of a free trade area or the adoption of an interim agreement necessary for the formation of a customs union or of a free trade area; provided that:
>
> (a) with respect to a customs union, or an interim agreement leading to a formation of a customs union, the duties and other regulations of commerce imposed at the institution of a such union or interim agreement in respect of trade with contracting parties not parties to such union or agreement shall not on the whole be higher or more restrictive than the general incidence of duties and regulations of commerce applicable in the constituent territories prior to the formation of such union or the adoption of such interim agreement, as the case may be.
>
> (b) with respect to free trade area, or an interim agreement leading to the formation

[26] A more detailed introduction to GSP is provided in the United Nations Conference on Trade and Development (UNCTAD), *Handbooks on the GSP Schemes*, available at: http://unctad.org/en/Pages/DITC/GSP/Handbooks-on-the-GSP-schemes.aspx (visited 2 June 2017).

[27] It is noticeable that the WTO officially employs the term 'regional trade agreements' (RTAs) to cover those trade agreements established in compliance with GATT Article XXIV, GATS Article V and the Enabling Clause (allowing for preferential trade in goods among developing countries). However, for the sake of coherence, this dissertation intentionally employs the term 'preferential trade agreements' (PTAs), which is more widely used in the academic circles. It is different from the term 'preferential trade arrangements' (also abbreviated as PTAs within the WTO), which refers to nonreciprocal arrangements such as GSP and other schemes for LDCs.

> of a free trade area, the duties and other regulations of commerce maintained in each of the constituent territories and applicable at the formation of such free trade area or the adoption of such interim agreement to the trade of contracting parties not included in such area or not parties to such agreement shall not be higher or more restrictive than the corresponding duties and other regulations of commerce existing in the same constituent territories prior to the formation of the free trade area, or interim agreement as the case may be.
>
> 8. For the purposes of this Agreement:
>
> (a) a customs union shall be understood to mean the substitution of single customs territory for two or more customs territories, so that:
>
> (i) duties and other restrictive regulations of commerce (except, where necessary, those allowed under Articles XI, XII, XIII, XIV, XV and XX) are eliminated with respect to substantially all the trade between constituent territories of the union or at least with respect to substantially all trade in products originating in such territories; and,
>
> (ii) subject to the provisions of paragraph 9, substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union;
>
> (b) a free trade area shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated on substantially all the trade between constituent territories in products originating in such territories.

In brief, for a PTA to be established in compliance with the GATT law, it must at least fulfill two requirements: cover substantially all the trade among its parties, and do not entail that non-parties to that PTA are treated less favorably than before. Nevertheless, even if a PTA member is *de jure* not allowed to apply higher duties or more restrictive non-tariff barriers to goods originating in countries outside the PTA (compared to the status before that PTA is established), the establishment of a PTA is discriminatory by nature.[28] Considering the fact that a PTA allows its members to treat each other more preferably, it *de facto* changes the conditions of competition to the impairment of non-member countries by putting them at a less advantaged situation.

A country's constituency to a PTA enables its products to enjoy preferential treatment

[28] There are various discussions on the discriminatory nature of PTAs and its consequences. For further reading, see, for instance, Craig VanGrasstek (2013), 'Chapter 13 – Discrimination and Preferences', in *The History and Future of the World Trade Organization* (Geneva: WTO Publications) 463-502.

(most visibly, lower tariffs) upon entry to the markets of other partners. The essential point is that most PTA preferences are exclusively destined for the members. As those members stand high costs and risks negotiating PTAs, they reasonably intend to grant preferential treatment to their own goods only. The problem is how they can decide if a certain good is eligible for preferential treatment or not. This economic question has initiated the creation of ROO to define which goods fall within or without the scope of preferences of a PTA. Therefore, the primary role of ROO in a PTA is to ensure that its privileges are solely confined to goods originating in a member of that PTA. In other words, preferential ROO provide the legal instrument for a PTA to assign its favorable treatment to rightful beneficiaries.

The need to specify the subject matter of a PTA comes at the same time with the need to cope with the risk of free riding, or trade deflection. In the absence of ROO, there is no clue to verify if a product sold from a PTA member to another actually originates in the former. A third country may then easily circumvent higher (MFN) tariffs by trans-shipping its goods via a PTA member's territory, most probably the one with the lowest external tariffs. The goods may either transit through this territory, or undergo simple processing operations in here before being finally exported to another PTA member at reduced rate or free of duties. Once ROO are introduced, such deflection practice may be effectively handled.

For these reasons, it is undeniable that ROO form an indispensable part of PTAs: they guarantee the proper functioning of the latter.[29]

1.1.4. Impacts on international merchandise trade

In merchandise trade, ROO (both preferential and non-preferential) are by definition endowed with two functions – specify the criteria to determine the economic origin of products (substantive), and lay out formalities to verify the fulfillment of such criteria (procedural). While ROO are expected *not* to constitute an instrument to indirectly or directly pursue trade objectives, in reality, the determination of origin may still entail significant impacts on trade flows.

Some authors point out that non-preferential ROO are useful for correction of market

[29] Maria Donner Abreu (2016), 'Preferential Rules of Origin in Regional Trade Agreements', in Rohini Acharya (ed), *Regional Trade Agreements and the Multilateral Trading System* (Cambridge: Cambridge University Press) 58-110, at 60.

distorting measures, and can help rectify already distorted markets (for instance, as a consequence of dumping or subsidy). Yet, once actually implemented, they may cause adverse effects other than just correcting market distortions.[30] Owing to the diversity of non-preferential ROO among WTO Members, controversy would ensue where they adopt different criteria to determine origin for MFN treatment. The problem becomes even worse when the procedural aspect is taken into account. In the absence of unified formalities governing the issuance and verification of proofs of origin within the WTO, each Member may require the production and presentation of different documents to implement its substantive origin criteria. For such reasons, non-preferential ROO may have an adverse effect on trade costs, and turn into a non-tariff barrier to trade within the multilateral trading system.[31]

Likewise, preferential ROO are to cope with trade deflection, but they may at the same time cause 'trade diversion' effect. Preferential treatment based on the origin of goods encourages PTA members to reduce imports from third countries and to substitute by imports from their PTA partners. For instance, similar products X and X' (originating in Japan and Korea, priced at 90 and 95 dollars respectively) are subject to an import duty of 10% when imported to Chile. Before there is a PTA between Chile and Korea it is understandable that Chile prefers to import from Japan due to the lower price. But after the PTA is established, the tariff on X' is eliminated, so prices of X and X' (duties included) are now 99 and 95 dollars respectively: X' becomes cheaper than X on Chile market. As a result, Chile may now prefer to import more X' than X. Such a shift from Japan to Korea in this simplified example implies that preferential ROO in PTAs may divert trade from one trading partner to another. In fact, ROO may hinder trade flows in a manner that third countries, although able and competitive, cannot access a PTA's market just because they are not members of that PTA.

ROO may also affect the trade flows inside PTAs. As concluded earlier, a PTA will not function rightly without ROO. However, it does not mean that preferential ROO have no adverse impact on PTAs. An indicator to assess PTAs is the 'trade creation' effect – the substitution of domestic products with imports from preferential trade partners – closely depends on the substantive content of ROO. Simple and lax ROO enable more

[30] See WCO, *supra* note 23, at 8.

[31] Aly K. Abu-Akeel (1999a), 'The MFN as It Applies to Service Trade: New Problems for an Old Concept', *Journal of World Trade 33(4)* 103-129, at 116.

products to receive preferential treatment, thus can help create more trade among the partners. In the meantime, stringent ROO make it more difficult for goods from other PTA partners to meet the criteria and enjoy privileges, thereby create less preferential trade among them. For this reason, it is possible to think of preferential ROO as safety valves to control the intra-PTA flow of goods: they ensure the existence of preferential trade flows, but at the same time regulate their magnitude.

The stringency of the ROO may also affect the production in PTAs. To fulfill stringent origin criteria, especially when a rule based on added value applies, generally a higher content of local materials and workings embedded in a product is synonymous with a better chance of meeting origin criteria. Hence, the inclusion of stricter ROO in a PTA creates higher incentives for manufactures to use more local inputs, which means that they will replace inputs from outside the PTA with those obtained inside the zone.[32] While this prospect may indeed cause more trade diversion, the positive side is that it promotes value adding manufacturing or processing operations. As stringent ROO set higher thresholds for 'substantial transformation', PTA partners cannot simply import inputs from non-member countries, have them slightly manufactured, and be entitled to preferences. Instead, they are expected to add more value through more substantial processing, which in turns assists the manufacturing sector.

Apart from the substantive aspect, the impact of preferential ROO on trade flows may take root in their procedural function. Despite an unprecedented growth of PTAs over the past few decades, there are no globally accepted standards regulating the design of preferential ROO. Each PTA devises a different set of regulations on preferential ROO, and manages them as it deems right. Firms operating in international trade are those who bear costs and risks of navigating ROO to ensure compliance with each country's regulations, resulting in a surge in transaction costs. As Garaets argues, such costs are threefold – they first come under the form of information necessary to process origin procedures; then come as a preponderance of time to assemble apposite information;

[32] Dylan Garaets (2017), 'Accommodating Global value Chains in the Union Customs Code: Towards Rules of Origin that Better Reflect Business Realities?', *Global Journal of Trade and Customs 12(2)* 64-67, at 65.
It should be also noted that there might be no domestic alternative for the supply of specific inputs or that it is easier to renounce to the preferential treatment as opposed to reorganizing the value chain and switching to domestic suppliers in order receive a preferential treatment. Thus stricter ROO are may not always benefit local input suppliers.

and finally come from the irregularity associated with firms' origin claims. He further notices that 'even after tiptoeing through tangled sets of origin rules, definitions, and product classifications, origin applications can be denied, whether at the border or by customs authorities.'[33] Moreover, firms are held liable for any differences between the preferential and the regular tariff rates if their origin proofs are refused (and fines are collected retroactively). In various cases, the cost to comply with ROO may exceed the gain from preferential tariffs, which dispirits firms from investing resources in origin procedures to claim their rights. Together with obstacles in the substantive aspect, the procedural burden may cause an underutilization of PTA preferences.

Among other prominent empirical researches, Estevadeordal and Suominen conclude that both the restrictiveness and selectivity of ROO have adverse effects on aggregate trade flows, whereas regime-wide ROO designed to add leniency to the use of product specific ROO boost trade. Remarkably, they confirm ROO's growing important role in diverting trade in intermediates among PTA parties: restrictive and selective ROO for final products do increase trade in intermediates. By examining aggregate trade flows, they also reflect a decreasing relevance of ROO in creating disincentives for exporters to qualify for PTA preferences, which implies a 'learning by doing' practice.[34]

1.2. Rules of origin for services

1.2.1. The concept of rules of origin in services trade

Although the term 'rules of origin for services' was initially used in various documents and notes during the early negotiations of the GATS, eventually it was not adopted by the agreement.[35] This may give the feeling that there are no ROO in the field of trade in services – admittedly, this concept is not familiar to the public and even to many trade practitioners. However, one may notice that the term 'origin' in the context of services trade has been referred to in certain WTO dispute settlement reports and in a number of academic works. As an example, the Panel in *China – Publications and Audiovisual Products* argues that if 'origin is the only factor on which a measure bases a difference

[33] *Ibid*.

[34] Antoni Estevadeordal & Kati Suominen (2015), *What Are The Trade Effects of Rules of Origin on Trade* (Washington, DC: World Bank Publications), at 30.

[35] For instance, GATT Secretariat (1991a), *Rules of Origin and Services: Conceptual Issues* (MTN.GNS/W/140). The document is available online at: https://www.wto.org/gatt_docs/English/SULPDF/92130040.pdf (visited 5 April 2017).

of treatment between domestic service suppliers and foreign suppliers, the 'like service suppliers' requirement is met' on the condition that there will be, or there can be, any domestic and foreign supplier which is – under the measure – 'the same in all material respects except for origin.'[36] This view has also been reaffirmed by the Appellate Body in *Argentina – Financial Services*:

> In contrast, if a complainant succeeds in making a *prima facie* case that a measure draws a distinction between services and service suppliers based exclusively on origin, and this is not rebutted by the respondent, the services and service suppliers at issue may be presumed to be 'like', and a panel may proceed the analysis of the less favorable treatment without the need to assess the competitive relationship of the services and service suppliers at issue based on the relevant criteria as adapted to trade in services.[37]

The broad use of a term not officially adopted in the GATS raises the question of where in the GATS the notion of origin is stipulated. As a matter of fact, the notion of origin is indirectly expressed – under the GATS language – as a 'service of another Member' or a 'service supplier of another Member.' The most important GATS provisions, such as market access, MFN, and national treatment (stipulated in Articles II, XVI, and XVII) shall apply to services and service suppliers of other Members. To illustrate, the Panel in *China – Publications and Audiovisual Products* argues that in a dispute relating to national treatment claims, they must, at the outset, decide if this requirement is met.

> Our first step must be to determine whether foreign-invested enterprise prohibited under the measure at issue from establishing as wholesalers are 'service suppliers of another Member' within the meaning of Article XVII.[38]

Since there is no official term 'origin' in the GATS, it is understandable that there is no provision in the GATS where the term 'rules of origin' may be found. However, as the term 'origin' is implicitly mentioned via such expressions, it is expected that the GATS also provide rules to identify such origin. In fact, by attempting to define the meaning of 'service of another Member', Article XXVIII of the GATS indeed lays down the rules for origin determination purpose. A thorough reading of this provision reveals that, in spite of the disparity in terminology, Article XXVIII suffices to be considered the ROO

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[36] Panel Report, *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/R and Corr.1, adopted 19 January 2010, as modified by Appellate Body Report WT/DS363/AB/R, DSR 2010:II, p. 261, paragraph 7.975.

[37] Appellate Body Report, *Argentina – Measures Relating to Trade in Goods and Services*, WT/DS453/AB/R and Add.1, adopted 9 May 2016, paragraphs 6.43, 6.44.

[38] Panel Report, *China – Publications and Audiovisual Products*, paragraph 7.973.

for services in the GATS.[39]

> *Article XXVIII*
> *Definitions*
>
> For the purpose of this Agreement:
>
> (f) 'service of another Member' means a service which is supplied,
>
> (i) from or in the territory of that other Member, or in the case of maritime transport, by a vessel registered under the laws of that other Member, or by a person of that other Member supplies the service through the operation of a vessel and/or its use in whole or in part; or
>
> (ii) in the case of the supply of a service through commercial presence or through the presence of natural persons, by a service supplier of that other Member;

It is apparent that to define a 'service of another Member', or the origin of that service, GATS Article XXVIII(f) delineates two prongs under which it might fall. The *chapeau* of this Article *prima facie* implies that such prongs are divided by the way a service is supplied. To this end, it is necessary to return to Article II:1 of the GATS, which states that the Agreement covers services supplied:

- from the territory of one Member into the territory of any other Member (*Mode 1 – cross-border supply*): for example, suppliers in one Member supply market or consultancy reports, tele-medical advice, or architectural drawings from abroad telecommunications infrastructure to clients in another Member.
- in the territory of one Member to the consumer of any other Member (*Mode 2 – consumption abroad*): for example, nationals of a Member go abroad as tourists, students, or patients to consume respective services in the territory of another Member.
- by a service supplier of a Member, through commercial presence in the territory of any other Member (*Mode 3 – commercial presence*): For example, a company of one Member establishes a subsidiary in the territory of another Member where

[39] Aly K. Abu-Akeel (1999b), 'Definition of Trade in Services under the GATS: Legal Implications', *George Washington Journal of International Law and Economics 32(2)* 189-210, at 203.

Indeed, the more comprehensive term that is at times referred to by the WTO and some scholars is 'rules of origin for services and service suppliers' (for instance, document TN/S/36 dated 21 April 2011 of the Council for Trade in Services.) However, the term 'rules of origin for services' is arguably sufficient, at least in the GATS context. As one may see, Article XXVIII(f) of the GATS first provides the definition for a 'service of another Member', and then all subsequent definitions, including 'supplier of that other Member', are to clarify this concept. Thus, the origin of services is the ultimate purpose, but in specific scenarios, this purpose shall be achieved by means of determining the origin of service suppliers.

this subsidiary supplies management consultancy services to local clients.

- by a service supplier of one Member, through the presence of natural persons of a Member in the territory of any other Member (*Mode 4 – presence or movement of natural persons*): For example, a foreign national provides a service within the territory of another Member as an independent consultant, or as an employee of a consultancy firm.[40]

In brief, the GATS defines services trade in conformity with the territorial presence of suppliers and consumers at the time the transactions take place. The definitions of the modes of supply (in Article I:2 of the GATS) requires each time an element to cross the border. In Mode 1, services move from one Member to another to be consumed, while in Mode 2, consumers move from one Member to another to consume the services. In Mode 3 and Mode 4, either service suppliers set up their commercial establishments in another Member where the services are provided, or service suppliers that are natural persons move to another Member to provide a service.[41]

As read in conjunction with Article I:2, apparently Article XXVIII(f) provides services ROO in line with the GATS four modes of supply. To be specific, the first prong of this Article covers the origin of services supplied across border or those consumed abroad (Mode 1 or 2): a service is deemed as originating in the Member *from* or *in* which it is supplied to customers. The second prong covers the origin of services supplied via the presence of juridical or natural persons in another Member (Mode 3 or 4): a service is deemed as originating in the Member in which its supplier holds nationality.

These two prongs are further divided into five possible scenarios.[42] The first and least complicated scenario is where a service is supplied from or supplied in the territory of the supplying Member. It is fulfilled by a service supplied under Mode 1, for instance, a legal opinion is sent from an Italy-based law firm by email to a client abroad. It may also be fulfilled by a Mode 2 service, for instance, a Chinese tourist enjoys the tourism and hospitality service in France. Under the GATS origin rules, these two services will be considered originating in Italy and France respectively.

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[40] The examples are taken from WTO, *GATS Training Module*: *Chapter 1 - Basic Purpose and Concepts*, available at: https://www.wto.org/english/tratop_e/serv_e/cbt_course_e/c1s3p1_e.htm (visited 28 May 2017).

[41] Bart De Meester & Dominic Coppens (2013), 'Mode 3 of the GATS: A Model for Disciplining Measures Affecting Investment Flows?' in Zdenek Drabek & Petros Mavroidis (eds), *Regulation of Foreign Investment: Challenges to International Harmonization* (Singapore: World Siencetific Publishing) 99-152, at 103.

[42] Nellie Munin (2010), *Legal Guide to GATS* (The Hague: Kluwer Law International), at 91.

The second scenario addressed by Article XXVIII(f) covers the situation where a vessel registered under the laws of a Member supplies maritime transport services to people or goods of another Member. The third scenario covered by this Article is similar to the second one, yet the vessel is not necessarily registered in a Member: it will be sufficient if the person who operates it, in whole or in part, is a person of that Member. Notably, the share in such operation is not indicated, so it may be just minimal. It means that a vessel, wholly or mostly owned by a person of a non-Member, may be entitled to GATS benefits if it is partly operated by a person of a Member. As these two scenarios solely cover maritime transport service by vessels, for the sake of generalization, they are not further elaborated in the following chapters.

The two last scenarios complement the coverage of four supply modes. The fourth one addresses the supply of services through commercial presence (Mode 3). The fifth one addresses the presence of natural persons not permanently established in the country of destination (Mode 4). In both cases, the services are supplied in the territory of the country of destination through the local presence of the foreign supplier, and the focal point of the origin determination shifts to the nationality of the service supplier. As an example, the service supplied by an Italian law firm in Vietnam through its subsidiary here is considered originating in Italy.

Apart from the main ROO, supplementary ROO are stipulated in Article XXVII of the GATS. The Article is drafted as a safety valve to prevent potential evasion of rules.

Article XXVII:

Denial of Benefits

A Member may deny the benefits of this Agreement:

(a) to the supply of a service, if it establishes that the service is supplied from or in the territory of a non-Member or of Member to which the denying Member does not apply the WTO Agreement;

(b) in the case of the supply of a maritime transport service, if it establishes that the service is supplied:

(i) by a vessel registered under the laws of a non-Member or of a Member to which the denying Member does not apply the WTO Agreement, and

> (ii) by a person which operates and/or uses the vessel in whole or in part but which is of a non-Member or of Member to which the denying Member does not apply the WTO Agreement;
>
> (c) to a service supplier that is a juridical person, if it establishes that it is not a service supplier of another Member, or that it is a service supplier of a Member to which the denying Member does not apply the WTO Agreement.

Pursuant to the provisions of this Article, a Member may decline to accord benefits to a service if the service is supplied from or in a non-Member or a Member to which the denying Member does not apply the WTO Agreement. Besides, a service supplier who is a juridical person might be barred from GATS benefits if it is not a service supplier of a Member or it is service supplier of a Member to which the denying Member does not apply the WTO Agreement. (It is noticeable that this Article does not mention the denial of benefits, if any, applied to a service supplier who is a *natural person*.) These supplementary rules differ from general ROO in Article XXVIII in two aspects. Firstly, they govern situations where services or service suppliers are excluded from the GATS benefits, as opposed to the general rules providing criteria so that services and service suppliers can be granted the benefits. Secondly, rules on denial of benefits are far less frequently applied than general rules.[43]

In general, ROO for services provided by the GATS are formulated in a broad manner, establishing principles applied to services regardless of their sectors. They correspond to the mode via which a service is delivered, and may necessitate the determination of service suppliers' nationality.

1.2.2. Origin criteria

1.2.2.1. Origin criteria for services under Mode 1 and Mode 2

Under Mode 1, services are supplied from the territory of a Member to that of another Member. The origin of a service traded using this mode is the country from which it is supplied. In terms of Mode 2, services are supplied in the territory of a Member to the consumers of another Member. The origin of a service supplied under this mode is the country in which the supply and the consumption of that service take place. In general, the origin of a service supplied via Modes 1 or 2 is decided by its place of provision.

[43] Heng Wang (2010), 'WTO Origin Rules for Services and the Defects: Substantial Input Test as One Way Out?', *Journal of World Trade 44 (5)* 1083-1108, at 1090.

There is no question as to how such place of provision can be defined. There is neither a question as to whether a service is actually supplied by a supplier of the country from which or in which it is supplied. By applying the rule, that any law firm in Korea sends a legal advice to a client in Japan shall result in this service being deemed as a service of Korea, irrespective of the fact that the supplier is a Korean law firm or a branch of a Swiss law firm established in Korea. Therefore, the rule for origin determination under these modes does appear to be intuitive and straightforward, but at the same time they lack the quality of being specific. Since the GATS does not provide further instructions to determine origin in these two modes, Munin asserts that the Members may, at their own discretion, elaborate on the interpretation and application of the rules.[44]

1.2.2.2. Origin criteria for services under Mode 3 and Mode 4

A service supplied via Mode 3 or Mode 4 is considered as 'service of another Member' if the supply is conducted by a 'service supplier of that other Member.' Since a 'service supplier' is defined as 'any person that supplies a service', and 'person' means 'either a natural person or a juridical person', the origin of services supplied via these modes is determined on the basis of the criteria to define a 'natural person of another Member' and a 'juridical person of another Member. The different sets of origin criteria for each category of person are analyzed hereafter.

a. Natural person of another Member

> *Article XXVIII*
>
> *Definitions*
>
> (k) 'natural person of another Member' means a natural person who resides in the territory of that other Member or any other Member, and who under the law of that other Member:
>
> (i) is a national of that other Member; or
>
> (ii) has the right of permanent residence in that other Member, in the case of a Member which:
>
> 1. does not have nationals; or
>
> 2. accords substantially the same treatment to its permanent residents as it does to its nationals in respect of measures affecting trade in service, as notified in its acceptance of or accession to the WTO Agreement, provided that no Member is

[44] See Munin, *supra* note 42, at 90.

> obligated to accord to such permanent residents treatment more favorable than would be accorded by that other Member to such permanent residents. Such notification shall include the assurance to assume, with respect to those permanent residents, in accordance with its laws and regulations, the same responsibilities that other Member bears with respect to its nationals;

The provision includes two options, in which the first one covers a national of Member X who resides in the territory of Member X or of any other Member. To illustrate, this first option involves a natural person who, according to the law of Russia, has Russian nationality. This natural person will qualify for GATS treatment as a natural person of Russia although he may reside in Russia or in any other Member.

Notably, nationality is usually a legal notion, while residence is more often referred to as a factual one. However, in certain cases, residence may reflect a legal status defined by the contexts. For instance, when it comes to income taxation, residence is normally defined in line with the test that examines which country to be regarded as the 'center of life' of the taxpayer – the place where one has permanent home with habitual abode or vital interests, etc.[45] It is noticeable that the *chapeau* of Article XXVIII(k) refers to a natural person who 'resides', whereas subparagraph (ii) specifies the requirements for a natural person who 'has the right of permanent residence'. Such a separation enables the interpretation that the word 'resides' expresses a factual status, but the term 'right of permanent residence' denotes a legal one. The interpretation is reasonable given the fact that the natural person who 'resides' mentioned in the *chapeau* relates not only to subparagraph (ii), but also subparagraph (i) covering 'national' of a Member, which is definitely a legal notion. Nevertheless, the GATS does not clarify how the factual status implied by the word 'resides' is defined: whether by the law of the Member at issue, or by any other factual criteria. As for 'the right of permanent residence', there is not any test in the GATS, such as the one on 'center of life', to define this legal notion.

The second option includes individuals who reside in Member Y or any other Member, and have the right of permanent residence in Member Y. As compared to the first one, this option reflects a weaker link between the person and the state; thus it is subject to one of the two additional conditions. In the first condition, the status of residing in the territory of Y or any other Member, together with the right of permanent residence in

[45] *Ibid*, at 94.

Y, are sufficient to label an individual as a natural person of Y, provided that Y has no nationals. Wolfrum et al. consider it a rare possibility that may address a Member not being a 'state' in international law.[46] As mentioned earlier, WTO Members include also customs territories which are not states, for instance, Hong Kong or Macau. Therefore, arguably this condition applies to the customs territories being WTO Members but do not have their nationals.

The second condition applies to a more common scenario: a natural person residing in the territory of Member Y or any other Member, who has a permanent residence right in Y, is considered a natural person of Y when, being a permanent resident, he obtains 'substantially the same treatment' accorded to nationals of Y with respect to measures affecting services trade, provided that no other Member is obligated to treat him more favorably than Y. To illustrate, a natural person who resides in the territory of Laos or any other Member shall qualify as a natural person of Laos if this person has the right of permanent residence in Laos, and as it comes to measures affecting trade in services, this person is granted 'substantially the same treatment' as a Lao national, which must be the most favorable treatment he shall be accorded by any WTO Member.

In short, when the service supplier is a natural person, its nationality in a Member for the purposes of the GATS is determined by two elements: (i) his physical residency in that Member or any other Member; and (ii) his legal status either being a national or a permanent resident of that Member (the latter subject to additional requirements).

b. Juridical person of another Member

> *Article XXVIII*
>
> *Definitions*
>
> (l) 'juridical person' means any legal entity duly constituted or otherwise organized under applicable law, whether for profit or otherwise, and whether privately owned or governmentally owned including any corporation, trust, partnership, joint venture, sole proprietorship or association;
>
> (m) 'juridical person of another Member' means a juridical person which is either:
>
> (i) constituted or otherwise organized under the law of that other Member, and is engaged in substantive business operations in the territory of that Member or any other Member; or

[46] Rüdiger Wolfrum, Peter-Tobias Stoll & Clemens Feinäugle (eds) (2008), *WTO – Trade in Services*, Max Planck Commentaries on World Trade Law Series (Leiden/Boston: Martinus Mijnhoff Publishers), at 558.

> (ii) in the case of the supply of a service through commercial presence, owned or controlled by:
>
> 1. natural persons of that Member; or
>
> 2. juridical persons of that other Member identified under subparagraph (i);
>
> (n) a juridical person is:
>
> (i) 'owned' by persons of a Member if more than 50 per cent of the equity interest in it is beneficially owned by persons of that Member;
>
> (ii) 'controlled' by persons of a Member if such persons have the power to name a majority of its directors or otherwise to legally direct its actions;
>
> (iii) 'affiliated' with another person when it controls, or is controlled by, that other person; or when it and the other person are both controlled by the same person;

A juridical person is defined in relatively broad manner by GATS Article XXVIII(l). In terms of its purpose, profit is not a factor taken into account to determine whether an entity is a juridical person or not. In terms of its ownership, a juridical person may be either privately or governmentally owned. And in terms of its form of incorporation, a juridical person may take the form of 'any corporation, trust, partnership, joint venture, sole proprietorship, or association.' The word 'including' indicates that this list is only indicative and other forms of incorporation are also permitted.

In order to be regarded as a 'juridical person of another Member', the juridical person at issue has to fall under either of two scenarios provided in GATS Article XXVIII(m). In the first scenario, it must fulfill two cumulative criteria: (i) 'constituted or otherwise organized under the law of that other Member', and (ii) having its substantive business operations (SBO) in the territory of such Member or any other Member. The criterion of 'constituted or otherwise organized' certainly highlights the role of corporation law in the country of origin, but it is not further interpreted by the GATS. Munin suggests that 'constituted' may refer to an entity established through formal processes, namely incorporation of enterprises or registration of partnership while 'otherwise organized' may cover those entities or manners of business cooperation established by contracts, namely business cooperation contract.[47] As for the criterion on SBO, the GATS follows quite a liberal approach enabling a legal person to conduct SBO in the territory of any WTO Member. It means a company constituted under the law of Canada but operates

[47] See Munin, *supra* note 42, at 98.

substantively in Mexico is still determined as a juridical person of Canada.

The second scenario provided by Article XXVIII(m) specifically covers 'the case of the supply of a service through commercial presence.' It is inferable from such distinction that the first scenario prescribes origin criteria for juridical persons at their own right, while the second one concerns juridical persons acting as commercial presence for the purpose of supplying services in another Member, who do not obtain legal personality at their own right.[48] The rationale why the GATS puts commercial presence in another category is justifiable: the criteria based on constitution or organization is insufficient in this case. For instance, if the applicable origin criterion for a subsidiary established in Cambodia by a Japanese company is simply country of constitution, the subsidiary shall originate in Cambodia. Such country of origin fails to reflect the foreign origin of the service supplier (i.e., Japan), and nullifies the existence of 'trade in services' within the meaning of GATS Article I:2.

To reflect the 'foreign' nature of this subsidiary or any other juridical person acting as commercial presence, and to ensure their activities are covered by the Agreement, the GATS adopts the approach that such a juridical person is deemed 'juridical person of another Member' if it is 'owned or controlled' by natural persons or juridical persons (as identified in the first scenario) of that other Member. In other words, the origin of a service supplied through a juridical person being commercial presence is decided by the nationality of the natural or juridical persons who own or control that commercial presence. This interpretation has been affirmed by the Panel in *Canada – Autos*, who holds that DaimlerChrysler Canada Inc. is a service supplier of the United States (US) within the scope of Article XXVIII(m)(ii)(2) since it is 'controlled' by DaimlerChrysler Corporation, a juridical person of the US as defined by Article XXVIII(m)(i).[49]

To understand the origin rule applied in this scenario, which is argued by Zdouc to be among 'the most complex issues in the framework of GATS conceptual structure', one must revisit the concept of 'commercial presence' in GATS Article XXVIII(d).[50] In line with this provision, a commercial presence can take various forms covering 'any type

[48] Werner Zdouc (1999), 'WTO Dispute Settlement Practice Relating to the GATS', *Journal of International Economic Law 2(2)* 295-346, at 330.

[49] Panel Report, *Canada – Certain Measures Affecting the Automotive Industry*, WT/DS139/R, WT/DS142/R, adopted 19 Jun 2000, as modified by Appellate Body Report WT/DS139/AB/R, WT/DS142/AB/R, DSR 2000:VII, 3043, paragraph 10.257.

[50] See Zdouc, *supra* note 48, at 328.

of professional or business establishment', for instance, the constitution, acquisition or maintenance of a juridical person, besides the creation or maintenance of a branch or representative office 'within the territory of a Member for the purpose of supplying a service.' The scope of this definition is very broad, made clear by the use of 'including' to imply a non-exclusive list. It seems the drafters of the GATS intend to assure that it can accommodate various forms of business or professional establishment allowed by Members. Therefore, commercial presence may cover fully-fledged subsidiaries, asset or contractual joint ventures, sole proprietorships, partnerships, representative offices or branches; among them the followings are three most widespread types:

- Subsidiary: A subsidiary is a legal entity with separate juridical personality from that of its parent company. It must be incorporated under the law of the country where it is located;
- Branch (or branch office): A branch does not normally acquire separate juridical personality. Instead, it is deemed the property of the parent company and is not legally distinct from it;
- Representative office: A representative office is often set up by a company in the foreign country in which the establishment of a subsidiary or branch is legally or commercially impractical or unfeasible. It generally does not conduct any actual supply of services, but just marketing or non-transactional operations.[51]

At this point, there arises a matter that though the provisions of the GATS are drafted in respect of the treatment being accorded to services and service suppliers of another Member, the scope of 'service supplier' in Article XXXVIII(g) covers only persons (i.e., natural and juridical persons). As branches and representative offices, though listed as forms of commercial presence in Article XXVIII(d), are not deemed juridical persons; the consequence is that a branch or a representative office of a foreign service supplier is not eligible for GATS treatment as a service supplier. To resolve this issue, footnote 12 to Article XXVIII(g) further clarifies the definition of 'service supplier':

[51] WTO E-Campus, *Module 6: Modal Structure of the GATS*, at 11-12, available at: https://ecampus.wto.org/admin/files/Course_411/Module_599/ModuleDocuments/GATS_M6_E.pdf (visited 2 August 2017). It is noticeable that, while the GATS is very broad in scope, it remains very flexible in application. A Member is free, in its Schedule of Commitments, to limit its Mode 3 commitments to specific types of commercial presence. Such limitation may be made either in a given services sector, or on a horizontal basis.

> Where the service is not supplied directly by a juridical person but through other forms of commercial presence such as a branch or a representative office, the service supplier (i.e., the juridical person) shall, nonetheless, through such presence be accorded the treatment provided for service suppliers under the Agreement. Such treatment shall be extended to the presence through which a service is supplied and need not be extended to other parts of the supplier located outside the territory where the service is supplied.

By including this footnote, the GATS drafters stated that service suppliers fulfilling the criteria for GATS benefits are allowed to supply services either through representative offices or branches, and still entitled to the agreement's treatment. The representative office or branch of one foreign service supplier is part of that supplier for the purposes of the GATS, and thus is eligible for the GATS treatment. However, the foreign service supplier is granted the GATS benefits only to the extent of its commercial presence in the Member where the service is provided; and that right will not be extended to other parts of that supplier existing outside the territory of the Member where the branch or representative office is established. Furthermore, the treatment confined to a supplier that maintains commercial presence being a branch or a representative office will not be the same as that granted to a supplier present in the form of a juridical person since non-juridical forms of commercial presence are not able to assume all legal obligations. The crucial obligation is that 'they should be given the same treatment as that given to 'like' suppliers in similar situations.'[52]

In terms of country of origin, where services are supplied indirectly via other forms of commercial presence within the meaning of footnote 12, the nationality of a branch or a representative office may be conveniently defined by that of the foreign supplier due to the fact that it does not have separate legal personality.[53] But where the commercial presence is a juridical person, the link between the commercial presence and a person of another Member must be exhibited on the grounds of ownership or control. To this

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[52] Note of the Secretariat (1993), *Status of Branches as Service Suppliers* (MTN.GNS/W/176). The document is available online at: https://www.wto.org/gatt_docs/English/SULPDF/92140067.pdf (visited 2 June 2017).

Notably, this footnote only mentions the case of a service supplier who is a juridical person and has a branch or a representative office abroad. It is silent as to whether a natural person may supply a service via such 'other forms of commercial presence.' But normally, an individual cannot open a representative office or a branch without first establishing a juridical person. It is also inferable that if a service is supplied via the form of commercial presence being a juridical person (e.g., a subsidiary), it is deemed 'supplied directly by a juridical person', but if the service is supplied via 'other forms of commercial presence' (e.g., a branch), it is deemed to be supplied indirectly.

[53] See Zdouc, *supra* note 48, at 329. As the case of supplying services through commercial presence being juridical persons is provided in Article XXVIII(m)(ii), the phrase 'other forms of commercial presence' can be interpreted as forms of commercial presence other than juridical persons. This is plausible given the example provided by this footnote (a branch or a representative office, which does not have full legal personality).

end, Article XXVIII(n) of the GATS provides three alternative conditions under which the ownership or control requirement is fulfilled:

- more than 50% of the equity interest in it is beneficially owned by persons of a Member;
- persons of a Member have the power to name a majority of its directors; and
- persons of a Member have the power, otherwise, to legally direct its actions.

These three options reflect three stages of growing flexibility in attributing nationality to a juridical person acting as commercial presence. As they hinge on provable factual links of ownership or control, the first two conditions are *prima facie* explicit. But the plural form of the word 'persons' implies that the beneficial owning of equity interest, and the power to name a majority of directors may rest in the hands of more than one person, either juridical or natural, or a mixture of both. This reasoning indeed implies a complexity that will be discussed thoroughly in the following chapter.

The third option portrays the weakest link between persons of a Member and the legal person acting as a commercial presence in the territory of another Member, according to which the former have the power to 'legally direct' the actions of the latter. Such an expression is ambiguous in the absence of further explanation in the GATS. The word 'legally' may be interpreted to exclude an exercise of illegal effect on the actions of the juridical person. It may also be interpreted to enfold another meaning, e.g., a direction by legal measures instead of economic measures.[54]

WTO jurisprudence affirms that the conditions of ownership and control provided by the GATS are certainly not self-explanatory because in reality the facts of a dispute do not always dexterously fit into one of them. For instance, in *China – Publications and Audiovisual Products*, the Panel makes a great effort to argue that 'holding a dominant position' and 'holding the majority of shares' are different notions:

> In assessing this interpretative issue, we note that 'holding a dominant position' suggests that one has a 'controlling' position in an entity, whereas 'holding a majority of shares' means simply that one must hold over 50% of the shares. These notions are not the same. In an entity in which shares are owned by a number of different persons, a single

[54] See Munin, *supra* note 42, at 99-100. It should also be noted that the notion of 'affiliated' as provided in GATS Article XXVIII(n)(iii) is based on the definition of 'controlled'. It describes the close relationship amongst juridical persons where one controls the other, or both are controlled by a third juridical person. While 'affiliation' does not directly relate to the origin determination of a juridical person, such relationship may affect their functioning and competitive conditions in the market, and should thus be taken into account in certain circumstances.

> shareholder may, due to the dispersed ownership interests, have a 'dominant position' while holding far fewer than 50% of shares. Thus 'holding a dominant position' does not necessarily imply 'holding a majority of shares' in an entity.
>
> We note in this respect that the GATS, in its origin rules for service suppliers of another Member, makes a distinction between ownership and control of an entity. According to Article XXVIII(n), a juridical person is 'owned' by persons of a Member if more than 50 per cent of the equity interest in it is beneficially owned by persons of that Member, while a juridical person is 'controlled' by persons of a Member if such persons have the power to name a majority of its directors or otherwise to legally direct its actions.[55]

From this ruling, it is apparent that 'holding the majority of shares' means *ownership* within the meaning of Article XXVIII(n)(i), while 'holding a dominant position' means *control* within the meaning of Article XXVIII(n)(ii). Moreover, the latter may become a criterion to distinguish by their origin for GATS purpose a widely recognized type of foreign-invested enterprises, i.e., domestic–foreign ventures. For example, depending on who 'holds a dominant position' in a Chinese–foreign contractual joint venture, the venture may or may not have foreign nationality:

> We note that the measure at issue concerns a contractual joint venture, which is the only permissible form that a foreign-invested enterprise may take if it wishes to engage in the distribution of AVHE products in China. […] However, those contractual joint ventures in which the Chinese partner holds the dominant position do not qualify as 'service suppliers of another Member', because they are not controlled by persons of another Member. In contrast, we consider that those contractual joint ventures where foreign partner holds dominant position qualify as 'service suppliers of another Member' under Article XVII. We note in this respect that in its answer to a Panel question, China agrees that a Chinese-foreign contractual joint venture qualifies as a 'service supplier of another Member' only where it is controlled by persons of another Member.[56]

To recap, where supplied via commercial presence or the presence of natural persons, service of another Member is construed as one being provided by a service supplier of that other Member. Therefore, the origin of services delivered under these two modes is tied to that of their suppliers. Under Mode 3, the origin of services is determined by addressing the question of who own(s) or control(s) the commercial presence through which a service is supplied in the territory of another Member. Notably, the GATS has

[55] Panel Report, *China – Publications and Audiovisual Products*, paragraphs 7.1392-93.
[56] *Ibid*, paragraph 7.1419.

no further instructions on the origin determination concerning Mode 4.

1.2.3. Classification

The GATS does not provide an explicit classification of ROO for services as in the field of merchandise trade. Moreover, since ROO for services do not fall within the realm of the Kyoto Convention, the latter offers no clue to categorize them. However, given the existence of services trade inside and beyond the multilateral trading system, one may foresee that a similar division into non-preferential and preferential ROO also applies to the field of trade in services. To be precise, comparable to GATT Article XXIV, GATS Article V also allows for the formation of PTAs in the field of services trade:

> *Article V*
>
> *Economic Integration*
>
> 1. This Agreement shall not prevent any of its Members from being a party to or entering into an agreement liberalizing trade in services between or among the parties to such an agreement, provided that such an agreement:
>
> (a) has substantial sectoral coverage, and
>
> (b) provides for the absence or elimination of substantially all discrimination, in the sense of Article XVII, between or among the parties, in the sectors covered under subparagraph (a), through:
>
> (i) elimination of existing discriminatory measures, and/or
>
> (ii) prohibition of new or more discriminatory measures, either at the entry into force of that agreement or on the basis of a reasonable time frame, except for measures permitted under Articles XI, XII, XIV and XIV*bis*.
>
> 3. (a) Where developing countries are parties to an agreement of the type referred to in paragraph 1, flexibility shall be provided for regarding the conditions set out in paragraph 1, particularly with reference to subparagraph (b) thereof, in accordance with the level of development of the countries concerned, both overall and in individual sectors and subsectors.
>
> (b) Notwithstanding paragraph 6, in the case of an agreement of the type referred to in paragraph 1 involving only developing countries, more favorable treatment may be granted to juridical persons owned or controlled by natural persons of the parties to such an agreement.
>
> 6. A service supplier of any other Member that is a juridical person constituted under the laws of a party to an agreement referred to in paragraph 1 shall be entitled to the

> treatment granted under such agreement, provided that it engages in substantive business operations in the territory of the parties to such agreement.

While this Article uses a different term (economic integration agreement) to name 'an agreement liberalizing trade in services', its structure and intents follow a similar path paved by the GATT: it attempts to regulate such trade arrangements among groups of Members that seek to treat one another more favorably than their MFN commitments. This view is confirmed by the Panel in *Canada – Autos*:

> Article V provides legal coverage for measures taken pursuant to economic integration agreements that would otherwise be inconsistent with the MFN obligation in Article II. Paragraph 1 of Article V refers 'agreement liberalizing trade in services.' Such economic integration agreements typically aim to achieve higher levels of liberalization between or among the parties than that achieved among WTO Members. Article V:1 further prescribes a certain minimum level of liberalization which such agreements must attain in order to qualify for the exemption from the general MFN obligation of Article II. In this respect, the purpose of Article V is to allow for ambitious liberalization to take place at regional level, while at the same time guarding against undermining MFN obligation by engaging minor preferential arrangements. However, in our view, it is not the object and purpose of Article V to provide legal coverage for the extension of more favorable treatment only to few service suppliers of parties to an economic integration agreement on a selective basis, even in situations where the maintenance of such measures may explicitly be provided for in the Agreement itself.[57]

To accomplish the 'higher levels of liberalization between or among their parties than that achieved among WTO Members', PTA members may want to restrict the subjects receiving preferential treatment to certain services or service suppliers by their origin. It is precisely for this reason that preferential ROO come into play. One can, therefore, safely envision a classification of ROO for services similar to that in goods trade: non-preferential ROO provided by the GATS are employed for the purpose of determining MFN treatment within the WTO; meanwhile, preferential ROO provide the basis for a regional liberalization of trade in services. Regarding the content of these two types of ROO, detailed analyses shall be provided in the following chapters.

According to Wang, services ROO in both multilateral and regional trade settings are needed for regulating or awarding benefits, and also for the exercise of national, MFN,

[57] Panel Report, *Canada - Autos*, paragraph 10.271.

or preferential treatment. He asserts that in the WTO context, origin determination is absolutely necessary for market access, jurisdiction, law enforcement, trade statistics, taxation, regulatory responsibility, qualification recognition (including recognition on education, experience, licenses, and certificates), technical standards implementation, government procurement, subsidies, emergency safeguard measures implementation, balance of payment, etc.[58] In terms of preferential trade, the role of services ROO is of no less significance, they ensure that the preferential treatment is extended to eligible recipients. In PTAs, the question as to which services and/or service suppliers qualify for preferences is often addressed under the provisions on denial of benefits.[59]

However, it would be hasty to conclude that preferential ROO for services function in an identical manner as those for goods. Article V:6 of the GATS provides in mandatory language that a 'service supplier of any other WTO Member' is entitled to the benefits of a PTA under certain conditions. Pursuant to the framework of Article V:6, there are two requirements for a 'service supplier of any other Member' being a juridical person (i.e., a juridical person being owned or controlled by persons of any other Member) to benefit from the preferential treatment under a PTA. The first requirement is that the juridical person is constituted or organized under the laws of one of the PTA's parties. The second requirement is that it carries out SBO in the territory of the parties (which means the GATS does not strictly require SBO in the territory of the party where such juridical person is established).

By definition, observing Article V:6 means partners of PTAs cannot at their discretion bar third countries' service suppliers from utilizing PTA benefits through establishing commercial presence. An exception to this Article is stipulated in GATS Article V:3(b). According to this provision, in case where a PTA is comprised of developing countries only, the preferential treatment can be granted exclusively to juridical persons owned or controlled by *natural persons* of the members to that PTA. Notably, neither Article V:6 nor V:3(b) mentions the treatment accorded to natural persons of third countries upon the formation of a PTA.

It also important to notice that GATS Article V:1(b) requires a services PTA to provide

[58] See Wang, *supra* note 43, at 1084.

[59] However, one should note that the nature of preferential liberalization in services trade largely differs from that in merchandise trade. In services trade, domestic regulation, either undisguisedly discriminatory in its nature or restrictive against market access on a nondiscriminatory basis, is the preferred means of protection, as opposed to border measures.

for the elimination of substantially all discrimination among its parties, regarding the sectors covered under that agreement, 'either on it entry into force or on the basis of a reasonable time frame.' It means that the GATS, to a certain extent, not only attempts to prevent the *external* discrimination between PTA parties and non-parties, but also desires to prevent the *internal* discrimination among PTA parties.

1.2.4. Impacts on international services trade

Zampetti and Sauvé argue that although services are not subject to tariffs, the need to identify the origin thereof 'arises as soon as an international agreement providing for a differential treatment between parties and non-parties is entered into.'[60] GATS is an international agreement as such – its obligations and benefits apply exclusively to the WTO Members. In addition, there are PTAs whose more favorable treatment in terms of services trade is principally granted to their constituent parties. For this purpose, it is crucial to determine the subject matter coverage of these agreements, which in turn requires assigning specific origin to services and/or service suppliers. By virtue of such role, ROO for services do have certain impacts on services trade, although the impacts are doubtlessly more difficult to assess than in merchandise trade. In general, ROO in the GATS inherently influence the liberalization of trade in services in the multilateral trading system; whereas, ROO in services PTAs may play a significant role in defining the extent to which these agreements discriminate against third countries.[61]

Like the case in merchandise trade, the impacts of preferential ROO on international services trade depend on their stringency. Mattoo and Sauvé argue that 'liberalization tends to generate gains when all barriers to entry are removed.'[62] Taking an efficiency perspective, if one PTA limits its entry to services or service suppliers originating in a partner country, it cannot ensure that privileged suppliers are the most efficient ones. Arguably, in various service sectors, the most efficient suppliers are those of countries outside an integration area, particularly developed ones. Therefore, by adopting strict ROO for services, preferential liberalization may lead to the entry of inferior suppliers, causing PTAs to be trapped in suboptimal patterns of production and supply. Besides,

[60] Americo B. Zampetti & Pierre Sauvé (2006), 'Rules of Origin for Services: Economic and Legal Considerations', in Estevadeordal et al. (eds), *The Origin of Goods* (London: Oxford University Press) 114-145, at 145.

[61] *Ibid*, at 124.

[62] Aaditya Mattoo & Pierre Sauvé (2011), 'Services', in Jean-Pierre Chauffour & Jean-Christophe Maur (eds), *Preferential Trade Agreement Policies for Development: A Handbook* (Washington, DC: World Bank Publications) 235-275, at 238.

there are also opportunity costs given the fact that efficient suppliers can 'generate the greatest positive externalities, including dynamic learning properties associated with knowledge flows and the associated rise of total factor productivity.'[63] These costs can get accumulated and inflated in the long run as a country may get stuck with inferior suppliers for long.[64] Miroudot and other researchers at the Organization for Economic Co-operation and Development (OECD) concur with this remark and add that even if PTA parties later decide to liberalize services trade on a multilateral basis, sunk costs may still restrict the entry of more competitive firms. The reason is that, by that time, suppliers with first-mover advantages will have sufficient time and capital to limit the competition pressure with other ones.[65] Thus, restrictive ROO may lead to a high level of concentration in PTA services markets.

Khumon further reasons that lenient services ROO enable PTAs to attract investment from non-parties owing to their need of expansion. The inflow of investment resulted from non-restrictive ROO is, without doubt, important for PTA parties who depend on gains from foreign investment. Moreover, it will allow domestic service suppliers to be exposed to international competition, which in turn enhances their competitiveness.[66] Mattoo and Fink carry on that the effect of lenient ownership-related ROO on alluring foreign investment is more significant where PTAs create large markets because of the economies of scale. For instance, a transport service supplier may not find it attractive to establish in Latin America if each country's market is fragmented, but may find the establishment in this area, as a continent-wide integrated market, worthwhile.[67]

In addition, imposing restrictive origin criteria on natural person suppliers in the form of temporary entry or mutual recognition confined exclusively to the nationals of PTA parties may adversely affect the overall performance of a PTA's labor market. Barring access to persons who otherwise meet local standards and qualification requirements may also diminish the human resource in an economic integration area. Furthermore, restrictive ROO applied to Mode 4 can arbitrarily drive up wages and scarcity rents in

[63] *Ibid*.

[64] *Ibid*, at 250.

[65] Sébastien Miroudot, Jehan Sauvage & Marie Sudreau (2010), 'Multilateralizing Regionalism: How Preferential Are Service Commitments in RTAs?', *OECD Trade Policy Papers No. 106* (Paris: OECD Publishing), at 21.

[66] Prapanpong Khumon (2015), 'Rules of Origin for Services in Asia-Pacific Trade Agreements', *Asian Journal of WTO & International Health Law and Policy 10(2)* 591-618, at 600.

[67] Aaditya Mattoo & Castern Fink (2002), 'Regional Agreements and Trade in Services: Policy Issues', *World Bank Policy Research Working Paper No. 2852,* at 16.

certain professional service sectors.[68]

From the above analysis, it is quite apparent that liberal ROO for preferential services trade can allow service suppliers from third countries to make good use of the market opportunities created by a PTA, particularly via establishing presence within that PTA. Despite potential advantages as abovementioned, there is a more visible risk that local players 'may lose out from opening up markets to stronger non-party suppliers.'[69] This may induce the support for a restrictive approach to the access of non-party suppliers into preferential markets. A prominent argument stems from the drawbacks of MFN-based liberalization: it can deprive countries of incentives to enter into PTAs, and can also lessen their negotiating leverage *vis-à-vis* non-members. Such concern may arise in PTAs formed among parties with significantly different degrees of openness toward services trade. In such case, a party with a more shielded market may worry that laxer ROO may extend preferences to outsider competitors on a *de facto* MFN basis, as any service supplier established in one of its partner countries can benefit from the PTA.[70]

To illustrate, if X has largely liberalized its services market, but other parties in a PTA to which X is a party maintain higher level of protection over trade in services, the lax ROO may essentially turn preferential treatment into multilateral liberalization, since services and service suppliers of non-parties may enter market of X, and subsequently find their way to the partners' markets.[71] Such 'unintentional liberalization' potentially causes adverse effects on smaller parties given their inability to compete against large suppliers, which 'may amount to a major setback to their domestic services industries and eventually, in the worst case, their market economies.'[72]

Plausibly, this view tends to be embraced by suppliers being regionally dominant, but not globally competitive. It may also come along with a variant of the 'infant industry' argument. Pursuant to Mattoo and Sauvé, international competition is augmented via the integration process, thus to a certain extent, exposure to competition in a regional market may assist firms to prepare for global competition. Finally, by the time service suppliers have cumulated competency and economies of scale by conducting business

[68] See Zampetti & Sauvé, *supra* note 60, at 127.

[69] See Khumon, *supra* note 66, at 600.

[70] See Zampetti & Sauvé, *supra* note 60, at 124-125.

[71] Pierre Sauvé (2003), 'Services', in OECD, *Regionalism and the Multilateral Trading System* (OECD Publishing: Paris) 23-43, at 32.

[72] See Khumon, *supra* note 66, at 600.

in regional markets, they will be less disinclined to MFN liberalization.[73] With respect to suppliers from non-member countries, tough preferential ROO do not always make them to suffer. Firstly, subsequent entry by more efficient suppliers can be carried out via acquisition, enabling them to circumvent those problems related to the first mover position. Secondly, in some service sectors, firms can learn by doing – the experiences gained by previous suppliers can help subsequent comers to reduce costs and increase profitability. It implies entry preclusion by strict ROO may even promote welfare, and PTAs become building blocks toward multilateral liberalization of services trade.[74]

The question is how the stringency of services ROO is devised? While criteria based on the territory from or in which a service is supplied tend to be liberal, there are distinct levels of stringency in accordance with the criteria relating to service suppliers. A PTA allowing natural persons of one party to include permanent residents is deemed to be adopting the most liberal rule, because a non-party supplier residing in any PTA party long enough may obtain the right of permanent residency to supply services under the PTA treatment. In contrast, a PTA defining natural persons of a party as 'nationals' is adopting the most stringent rule, which effectively denies benefits to nationals of non-parties to the PTA. Otherwise, they must confront onerous procedures under national laws to become nationals of a PTA party.[75]

Regarding juridical persons, Zampetti and Sauvé argue that the place of incorporation is the criterion that probably yields the most expansive coverage, and the location of a company's seat or headquarters is deemed to be the next liberal criterion if the seat is interpreted as a company's 'statutory' seat. Yet, if the test refers to the place of central administration or direction, this requirement may restrict the conferring of nationality to many juridical persons, who then assume the nationality of their parent companies. The criterion of SBO is considered as more restrictive as it excludes any company that operates primarily as 'mailbox' for taxation or other purposes. Finally, a test of control or ownership (and particularly *full* ownership) is the most stringent criterion that can be likened to a citizenship requirement for natural persons, as in effect it may deny all foreign juridical persons from PTA benefits, even if they are highly integrated into the

[73] See Mattoo & Sauvé, *supra* note 62, at 239.
[74] See Zampetti & Sauvé, *supra* note 60, at 126.
[75] See Miroudot et al., *supra* note 65, at 18.

economy of a constituent party. The authors further note that where these criteria are combined, the assessment of stringency and impacts becomes even more complex.[76]
To this point, it seems the discussion above focuses mainly on the impacts of ROO for services in regional agreements. However, one should bear in mind that such impacts are dependent on the stringency of preferential ROO, which is in turn decided by ROO of the GATS. Upon the establishment of a PTA, non-party suppliers are normally hurt by the preferences that the PTA confines to its parties. For this reason, suppliers from third parties may be prompted to establish presence in the territory of one of the PTA parties in order to gain access to the preferential treatment granted under such PTA.[77] For this reason, GATS Article V:6 sets out the obligation to extend PTA benefits to any service supplier of another Member (not a party to the PTA), on the condition that it is a juridical person constituted under the law of any PTA party and has SBO in the PTA. As a matter of fact, to be GATS-consistent, a PTA must adopt liberal ROO for foreign service suppliers.[78]

Fink holds that Article V:6 of the GATS 'prescribes precisely' the liberal nature of ROO for services in PTAs and suggests that WTO Members adopt such approach since they tend to 'consider domestically established non-party suppliers as part of the domestic economy.'[79] Moreover, the GATS also indirectly restricts the trade distorting effects of preferential services ROO by means of Article V:3(b), in which only south-south PTAs are allowed to grant privileges exclusively to 'juridical persons owned or controlled by natural persons' of the PTA parties. As it will be analyzed in depth in Chapter 3, some PTAs negotiated among developing countries have indeed adopted a restrictive policy stance based on this Article.[80]

In brief, as Miroudot et al. contend, PTAs 'are not concluded with the express purpose of granting preferences to everyone outside the PTA parties', but adopting liberal ROO for services in PTAs can be viewed as 'a way of reintroducing some degree of the MFN

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[76] See Zampetti & Sauve, *supra* note 60, at 143-144.

[77] See Miroudot et al., *supra* note 65, at 21.

[78] See Mattoo & Sauvé, *supra* note 62, at 251.

[79] Carsten Fink (2008), 'PTAs in Services: Friends or Foes of the Multilateral Trading System?', in Martin Roy & Juan Marchetti (eds), *Opening Markets for Trade in Services: Countries and Sectors in Bilateral and WTO Negotiations* (New York: Cambridge University Press) 113-147, at 126-127.

[80] See Mattoo & Sauvé, *supra* note 62, at 250.

principle back into the PTAs in accordance with GATS Article V.'[81]

1.3. Comparative analysis: rules of origin for goods versus rules of origin for services

It is evident that first negotiations on ROO for services were based on the rationale of merchandise trade. Dating back to 1991, the Group of Negotiations on Services made a remark that in principle, similar considerations to those on ROO for goods may also arise when dealing with trade in services:

> [...] Thus, collection of statistics, enforcement of technical regulations and standards, invocation of 'escape clauses', identification of producers or products originating in countries that are not party to an agreement, determining jurisdiction and regulatory responsibility, etc. may require rules of origin. Furthermore, to the extent that sector specific exemptions are sought with respect to the MFN obligation, origin rules will be required if the parties involved are concerned with the possibility of trade diversion. Finally, a need to address the issue of rules of origin in the GATS context may be due to a perceived need to impose disciplines on the design and use of such rules by parties to an agreement. Experience with rule of origin in merchandise trade indicates that origin requirements differ substantially and may have trade inhibiting effect. Therefore, it may be deemed appropriate to attempt to agree on certain disciplines in this area.[82]

However, as it has been revealed, ROO for services turn out to differ vastly from those for goods. This is resulted from the fact that services trade differs from goods trade in various characteristics, including the intangibility of transactions and the difficulty in measuring them, the need for a physical proximity between suppliers and consumers, as well as the mobility of production factors entailed by such proximity.[83]Besides, it is noted that trade in goods is carried out under only one mode (cross-border), but trade in services may be carried out through four different modes of supply. Except for Mode 1, foreign services do not literally cross any border; and even in this respect, the supply of services across border differs from that of goods as it may be supplied electronically. These distinctive characteristics make the origin determination in services trade more sophisticated and less discernible than in merchandise trade.

The distinctive features of services trade result in a major dissimilarity in terms of *the*

[81] See Miroudot et al., *supra* note 65, at 21.

[82] See GATT Secretariat (1991a), *supra* note 35, at 3.

[83] See Zampetti & Sauvé, *supra* note 60, at 117.

criteria employed to determine the country of origin. What matters in determining the origin of goods is the place where manufacturing or processing operations are carried out, and the magnitude of such operations (which can be quantified, *inter alia*, by the amount of value added to the goods). However, such approach proves to be unfeasible in services trade. Pursuant to Zampetti and Sauvé, beyond those statistical challenges posed by attempts to assess the contribution of services to economies or international trade, the challenge arising from the fact that it is not easy to evaluate the components or inputs forming a service obstructs the attempts to determine their origin relying on added value.[84] In certain sectors as energy, multimodal transport, telecommunications, or environmental services, whose delivery is network-based, it is even more difficult to measure the value added at each point over the networks.[85] Obviously, rules relying on changes in tariff classification or specific working operations are not applicable in the context of services trade. For such reasons, the criteria used to determine the origin of goods cannot be copied and pasted into ROO for services. The latter thus consider the place from or in which a service is supplied, or otherwise the nationality of its supplier. Unlike ROO for goods which focus on the goods themselves, it seems services ROO do not take services as their focal point. This is the most significant difference, which will be discussed further in the following chapters.

The *purpose of use* comes as the second difference between ROO for services and that for goods. Despite the fact that origin determination is relevant to the 'subject matter' coverage of an agreement in both merchandise and services trade, ROO for goods are primarily employed for the application of customs tariffs while ROO for services have more to do with measures behind the border – as the delivery and even the creation of services under Modes 3, 4 indeed take place in the territory of the 'importing' country. For its purpose, ROO for goods only need to deal with the goods themselves, not their manufacturers.[86] Meanwhile, to implement, for instance, licensing procedure, it is not possible to separate services and their suppliers apart. That is why ROO incorporated in the GATS and PTAs are to determine the origin of suppliers so as to accord or deny

[84] See Zampetti & Sauvé, *supra* note 60, at 119.

[85] E. Ivan Kingston (1994), 'The Economics of Rules of Origin', in Edwin Vermulst, Jacques Bourgois & Paul Waer (eds), *Rules of Origin in International Trade: A Comparative Study* (Ann Arbor: University of Michigan Press) 7-25, at 20.

[86] Therefore, a subsidiary of a Japanese company in Indonesia can still legally manufacture goods that originate in Indonesia. However, if this subsidiary is supplying services, the services are deemed to originate in Japan.

benefits to them and the services they supply.

The origin criteria used result in the third distinction relating to the *design* of the rules as opposed to ROO for goods. The latter often make use of the HS nomenclature, with origin criteria laid down chapter by chapter. Besides general rules, for products falling under specific rules, it is even necessary to look up in the legislation to figure out what criterion applies. It points out ROO for goods have an inherent variance across sectors, which may render them being targeted as an instrument to divert trade, even for non-protectionist purposes. Whereas, ROO based on the place of supply and nationality of suppliers tend to have more cross-sectoral transparency and uniformity. Even though it is insufficient to conclude on stringency at this point, one can conclude that ROO for services are relatively simple in their structure. Zampetti and Sauvé view such relative simplicity a 'marked contrast' to ROO for goods. As compared to highly detailed origin regimes in merchandise trade, ROO for services 'afford no equivalent detail but remain quite definitional in their nature.'[87]

The peculiarity in the way services are supplied also renders the origin determination of services *less definitive*. The fact that services are intangible and supplied under four different modes gives rise to several questions: where, by whom, and at what time will the origin determination take place?[88] To address part of the questions, one may recall Abu-Akeel's observation that ROO for goods decisively determine the origin 'once and for all'; whereas, ROO for services apply to transactions that have not been performed, thus the origin determination is tentative until the performance is complete.[89] It seems Abu-Akeel wants to emphasize that the origin of goods is usually determined just once, after they have been obtained or manufactured, and the determination is definitive. It differs from the case of services, particularly in Mode 3 and Mode 4, where their origin is decided before they are actually 'created' and supplied, but this decision is tentative. Let's think about a consulting contract between a service supplier of China and a client of Japan. By the time the supplier enters the market, it is possible to determine based on the ROO of the GATS that this is a service of China. However, the determination is subject to change since, for instance, the supply may be later subcontracted to another

[87] See Zampetti & Sauvé, supra note 60, at 119.

[88] See Munin, *supra* note 42, at 89.

[89] See Abu-Akeel (1999b), *supra* note 40, at 208.

supplier. Therefore, the origin of this service cannot be confirmed without monitoring until the contract is fully implemented.

One may argue that the origin rule is 'once and for all' in Mode 3: when a supplier has been determined as being owned or controlled by a person of another Member, all the services it supplies shall be deemed originating in that other Member. But the remark of Abu-Akeel remains reasonable since the 'ownership' or 'control' relationship cannot be verified without monitoring the supply of services. In practice, one factor that may render the origin determination of services provisional is the transfer of ownership or control. It is the situation discussed by the Panel in *Canada – Autos*:

> As regards Volvo Canada Ltd., it should be noted that ownership and control of this company passed from Volvo AB of Sweden to Ford Motor Co. of the United States in January 1999, when the former agreed to sell its passenger car business to the latter. As a consequence, Volvo Canada Ltd. is a juridical person of the United States according to Article XXVIII(m) of the GATS. Moreover, as Volvo Canada Ltd. closed its Canadian plant in December 1998, it would lose its right to import motor vehicles duty free under the import duty exemption.[90]

A last difference rests in the relationship of WTO's ROO and the Members' individual ROO. The ARO requires Members to adopt 'substantial transformation' as a principle to determine the origin of goods not 'wholly obtained or produced', and instructs how methods of application are to be detailed to describe this principle.[91] These provisions reveal that the ARO has a deep concern about national ROO: they may *not* be 'applied in a consistent, uniform, impartial and reasonable way', thus create barriers to trade.[92] However, one should notice that the ARO in fact does not provide substantive rules to technically determine the origin of a certain product, but just lays down standards and recommendations for the Members to construct and manage their national ROO until the harmonization of ROO has been achieved. In terms of ROO for services, it is open to question whether Members may develop their national ROO to determine a 'service of another Member' for purposes of trading within the multilateral trading system, as

[90] Panel Report, *Canada – Autos*, paragraph 10.259. Another famous example is the case of several European banks established in Mexico through their US subsidiaries after the formation of NAFTA in 1994. When the PTA between the EU and Mexico was enforced in 2000, offering similar provisions as NAFTA for financial services, some of these banks transferred back the ownership of their Mexican subsidiaries to the parent banks in Europe. See Miroudot et al., *supra* note 65, at 21.

[91] Article 3 and 9 of the ARO.

[92] See Abu-Akeel (1999a), *supra* note 31, at 116-117.

is the case of non-preferential ROO in merchandise trade.

The answer seems to be no. First, there is no trace of a Member maintaining such non-preferential ROO for services in its domestic legislation in parallel to ones for goods.[93] Moreover, it can be argued that Article XXVIII, being stipulated in the GATS in order to provide definitions for the Agreement, constitutes part of the Members' obligations. Thus, the ROO provided in Article XXVIII of the GATS are binding all Members upon their accession to the WTO. Though it appears to be less formalistic than the ARO, the Article does provide substantive criteria (as the 50% threshold in defining ownership), unlike loose standards provided in the ARO. It means that, while the harmonization of non-preferential ROO for goods in the WTO is only an objective for the future, Article XXVIIII of the GATS has effectively provided a set of harmonized, albeit unelaborated, ROO for multilateral trade in services.

In addition, for the purposes of the ARO, Article I:1 of this agreement precludes those 'contractual or autonomous trade regimes leading to the granting of tariff preferences going beyond' the MFN treatment. Consequently, ROO for goods in PTAs do not need to abide by the rules set out in the ARO, apart from some loose provisions in Annex II – *Common Declaration with Regard to Preferential Rules of Origin*. On the contrary, Article V:6 of the GATS deliberately extends a PTA's privileges to any other Member's juridical persons that have SBO in any of the PTA partner countries. By reason of this Article, in designing their preferential ROO for services, PTAs are inherently restricted by the GATS with respect to the range that they deviate from their MFN obligations. It is illustrated by Fink's observation that GATT rules on regional integration do little to discipline goods PTAs, whereas 'in the case of GATS, one might argue that Article V:6 has meaningfully limited the extent to which WTO Member can discriminate through preferential agreements.'[94]

In short, it is possible to conclude that ROO for services differ from those for goods in various aspects. Although ROO for goods appear to be more detailed and complicated,

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[93] Though they certainly have laws on citizenship and corporate nationality. They may also have their own laws to govern each service sector, for instance, a threshold on foreign equity participation allowed in the financial sector. But it is not the case, as the question here is whether any WTO Member provides another definition for 'service of another Member' than that provided by the GATS as well as other concepts that it entails; or whether any Member adopts other criteria than *place of supply* and *nationality of service suppliers* to determine the origin of a service. To the best of the author's knowledge based on reasonably available materials, no such replication of GATS Article XXVIII (either identical or with modification) is found.

[94] See Fink, *supra* note 79, at 126-127.

origin determination in services trade is actually more challenging. The reason is that ROO for services must take into account not only services and their particular features, but also service suppliers; they must cover the four modes of supply, with commercial presence indeed involving investment; and 'they have to be flexible enough to suit the wide variety of services, existing as well as services that might develop in the future.'[95] Such considerations make it reasonable to speculate that prevalent ROO for services provided for in the GATS may not fulfil these expectations. This speculation shall be evidenced in the following chapter.

[95] See Munin, *supra* note 42, at 89.

Chapter 2

A critique on the GATS rules of origin for services

This chapter is dedicated to analyzing the merits and defects of the ROO for services in the GATS. It attempts to systemize relatively scattered reflections on this topic and elaborate on these reflections in light of new insights from recent research and WTO jurisprudence. The chapter starts with arguments justifying the GATS approach and continues by indicating the loopholes of the rules, with an emphasis on the latter. At the end of the chapter, the author discusses certain reasons underlying such loopholes. Although all modes of supply are covered in the analysis, Mode 3 shall receive more attention given its significance in international services trade.

2.1. The merits of the GATS approach

As it has been analyzed in Chapter 1, ROO for services are not developed based on the notion of 'substantial transformation' as those for goods, but instead take into account the place of supply or consumption (Mode 1 and Mode 2), and nationality of suppliers (Mode 3 and Mode 4). While the GATS does not provide further elaboration on origin rules for services supplied through Mode 1 and Mode 2, it demonstrates an uncovered emphasis on detailing the rules for Mode 3 and Mode 4. Thus, one may argue that the hallmark of the GATS origin rules for services is in fact supplier-based rules.

The GATS approach to origin of services, in fact, does have its own merits. Considering the confined number of commitments liberalizing cross-border trade in services, more than 60% of international services trade is scheduled under the establishment-related form.[96] It means in a majority of transactions, services are not sold from the exporting country to the importing country as in merchandise trade, but they are supplied in the 'importing' country through various types of business or professional presence. As the

[96] Pierre Sauvé & Anirudh Shingal (2014), 'Reflections on the Nature of Preferences in Services', in Pierre Sauvé & Anirudh Shingal (eds), *The Preferential Liberalization of Trade in Services: Comparative Regionalism* (Cheltenham, Northampton: Edward Edgar Publishing) 401-412, at 408.

establishment of presence must take place before a supply is conducted and cannot be isolated from the service itself, the relevance of supplier-related criteria in identifying the origin of services is relatively intrinsic.

The GATS supplier-based approach has been favored by some recognized scholars in the field. Kingston and Hoekman are among the first authors to discuss services ROO, even before the GATS was adopted in 1994, as part of the WTO single undertaking. In his influential contribution, Kingston puts forward that it may not be feasible to simply endorse criteria similar to those employed in merchandise trade. The reason is that in a number of transactions, foreign suppliers must be present in the consumers' country, either as an individual or a sort of entity controlled by foreign persons. Therefore, the origin of services cannot be identified in the same manner as goods, and perhaps 'one needs to seek a rule which is based on the national origin of the provider, or in which signatory country the service providing entity is controlled or owned.'[97]

Holding a similar view, Hoekman is even more concrete in asserting that conventional origin criteria for goods are irrelevant in services trade owing to the non-storability of services. He puts forward that the determination of services' origin must rely either on nationality (of suppliers) or added value. He further asserts that in the services context, *ad valorem* origin rules may cause more arbitrariness and provide more discretion to the administrators because the invisibility of the production process normally inhibits an objective evaluation of the value added in a specific location. Therefore, he believes that a 'nationality-based rule of origin such as location of incorporation is perhaps the simplest and most transparent procedure.'[98]

Beyond feasibility, Hoekman's argument in favor of the use of nationality of suppliers as an origin criterion for services implies another aspect relating to the restrictiveness of ROO.[99] He contends that origin rules in existing international agreements adopting producer-based criteria (such as nationality, ownership or control) are more lenient in contrast to those for goods because they are more transparent, uniform and simple.[100]

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[97] See Kingston, *supra* note 85, at 19.

[98] Bernard Hoekman (1993), 'Rules of Origin for Goods and Services: Conceptual Issues and Economic Considerations, *Journal of World Trade 27(4)* 82-99, at 89.

[99] *Ibid*.

[100] See Abu-Akeel (1999b), *supra* note 40, at 205. Abu-Akeel, however, provides a footnote to argue that criteria cited by Hoekman 'exist in respect of measures under agreement to enable foreign direct investments in service industries, not as the criterion for origin, a totally different matter.'

Unlike origin criteria for goods which may vary from one product to another, those for service producers are not industry-specific, yet applied across the board. According to Hoekman, in most cases, a legal or a natural person will be able to demonstrate origin relatively easily. Therefore, once ROO for services are producer-based, what ensued is that such 'liberal origin criteria for service producers will also imply liberal origin rules for service products.'[101] This view is reinforced by later authors who are convinced that ROO for services should remain 'primarily instrumental in scope rather than mutating into another instrument in the protectionist toolbox.'[102]

The arguments above may strike an impression that 'nationality of service suppliers' is the last resort when other options are not workable, and the criterion generates liberal origin rules just thanks to its simplicity. However, Hoekman asserts that this criterion does have economic rationale: sufficient local value will be added in any event when a foreign entity produces services.[103] Taking this stance, Zampetti and Sauvé suggest that foreign suppliers are likely to add significant local value due to their need for physical presence and proximity to clients.[104] It means there is an economic justification for the a Member to grant GATS treatment to services supplied via Mode 3 and Mode 4 based on their supplier's nationality because in the end, the supplier of another Member will create value domestically. These arguments can be assimilated to the rationale in ROO for goods, in which the importing country may apply preferential tariffs to a good that uses a certain amount of materials originating in this country through introducing the cumulation rule.[105] It ensures that countries granting preferences also benefit more or less from such grant. The supplier-based rule in services trade would naturally suffice to secure this purpose without the need for a cumulation rule because once a supplier establishes its presence in the consumer's country, it will inevitably use resources here to supply services, and thereby create locally added value.

Beyond the above arguments, the nature of trade in services regulation is perhaps the most important factor which determines the characteristics of origin rules in this field.

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[101] See Hoekman, *supra* note 98, at 97.

[102] See Zampetti & Sauvé, *supra* note 60, at 145.

[103] See Hoekman, *supra* note 98, at 97.

[104] See Zampetti & Sauvé, *supra* note 60, at 120.

[105] The cumulation rule allows materials of one country to be considered originating in another country if they are used as inputs for production there. For instance, if the PTA between A and B allows for bilateral cumulation, A is inclined to use materials supplied by B so that the products manufactured by A satisfy origin criteria more easily.

Generally speaking, for Mode 1 and Mode 2, what is important to the regulators is the balance of payment, i.e., where the money goes to; thus, identifying the Member from which or in which a service is supplied would be sufficient. As for Mode 3 and Mode 4, the regulators may want to address the suppliers rather than the services because it is the suppliers, not the services, which cross the border. Notably, there are no tariffs on services, and most measures governing the supply of services through these modes are behind the border, directed at firms. It entails that the nationality of service suppliers is the most relevant basis for the application or denial of GATS treatment. Overall, the approach is in harmony with how trade in services is perceived and regulated.[106]

2.2. The defects of GATS approach to rules of origin for services

2.2.1. The place of supply has no relationship to the real origin of services

As explained earlier, in Mode 1, 'service of another Member' means a service supplied *from* the territory of that other Member. Hence, a service supplied across border shall obtain the originating status in the territory from which it is 'dispatched'. As the GATS does not elaborate on this rule, arguably WTO Members have the discretion to detail it into specific requirements in national legislations, which may bring the disharmony in the application of the rule.

A clue to interpret this rule comes from the finding of the Panel in *Mexico – Telecoms*. The Panel in this case argues that by linking their networks at the border with those of Mexican suppliers for termination in Mexico's territory, the US suppliers are supplying services across border within the meaning of GATS Article I:2(a).

> Subparagraph (a) describes what is referred to as 'cross-border', or 'mode 1', supply of trade in services. The ordinary meaning of the words of this provision indicates that the service is supplied from the territory of one Member into the territory of another Member. Subparagraph (a) is silent as regards the supplier of the service. The words of this provision do not address the service supplier or specify where the service supplier must operate, or be present in some way, much less imply any degree of presence of the supplier in the territory into which the service is supplied.[107]

[106] In discussion with Ruosi Zhang (Trade in Services and Investment Division, WTO).
[107] Panel Report, *Mexico – Measures Affecting Telecommunications Services*, WT/DS204/R, adopted 1 June 2004, DSR 2004:IV, p. 1537, paragraph 7.30.

Although the argument discusses Article I:2(a) and not Article XXVIII(f)(i), it reveals that the most crucial element of Mode 1 is the movement of services itself, and factors relating to their suppliers are not relevant. Thus, in determining the origin of a service supplied under this mode, one should only take into account the place from which the service is provided to another Member's territory. Plausible as it may seem, as pointed out by Zampetti and Sauvé, the application of such rule may cause one country where 'the last (and potentially less significant) stage in a multi-country production process' is carried out, or from where the service is only retailed, to be identified as the country of origin.[108] The same problem arises when it comes to services supplied via networks, because the country from which a service is delivered to its consumers may contribute the least to the value generated throughout the network.

Moreover, a rule based on the place of supply becomes problematic in cases where the cross-border supply of services is conducted via the internet. Technically speaking, it is not impossible to identify the location of internet users thanks to modern geolocation technologies. Nevertheless, such technologies are not always accurate. Their accuracy is adversely affected by both source problems and circumventions.[109] Moreover, even if the geographic location of internet users is conveniently found, such location does not necessarily represent the place from which a service is supplied, and thus the origin of services. For instance, an Australian traveler, in the middle of his stay in China, books his next hotel in Italy via *Booking.com*. This website is managed by Booking.com B.V., a company providing online accommodation reservation service, which is registered in the Netherlands and has offices in many countries including China and Italy.[110] In this example, it is rather complicated to identify exactly where the service is supplied from. It is possibly considered to be supplied from the Netherlands and thus the service has Dutch origin. However, it depends also on the role of the regional offices in the places where the search is made and where the accommodation is located. Since information technology does blur the notion of border in Mode 1, the origin criterion based on the place from which a service is supplied turns out to be somewhat outdated once applied to internet-based services.

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[108] See Zampetti & Sauvé, *supra* note 60, at 141.

[109] Dan Jerker B. Svantesson (2007), *Private International Law and the Internet* (Hague, London, Boston: Kluwer Law International), at 40.

[110] The list of headquarters and offices of Booking.com B.V. is available at: https://www.booking.com/content/offices.en-gb.html, (visited 22 November 2017).

Under Mode 2, a consumer crosses the border to consume a service that is supplied *in* the territory of another Member, thus the origin of a service provided via this mode is decided by the place of consumption. Though Wang suggests that it is 'relatively easy' to determine the origin of services in this case, [111] such easiness is rather questionable. As the rule just considers the country where consumption takes place and neglects the need to examine whether that place has a real link to the service, the above concern of Zampetti and Sauvé is relevant in this mode as well. For example, an Italian company provides its service through a retailer, who may or may not be under its control, in the territory of Vietnam. When a national of Thailand goes to Vietnam and consumes this service, the applied origin rule shall deem Vietnam as the service's origin, but the real country of origin (Italy) is not identified. The defect of the place of consumption test is further exhibited when it deals with internet-based services, because a natural person may cross the border and consume a service in another country, which is supplied via internet from a third country.

Moreover, as there is no requirement about the supplier of the service, the origin rule for Mode 2 may lead to the contradiction with those for Mode 3 and Mode 4. When a Japanese student goes to France to study, this activity is defined to fall under Mode 2, and the educational service that he consumes shall be deemed originating in France, the country in which the service is supplied. But if this institution is a local campus of a Swiss university, from the standpoint of any French student, the service in question is provided by a Swiss supplier via Mode 3 to France, thus it is deemed to originate in Switzerland according to the origin rule for this Mode. It means this service is either a 'service of Switzerland' or a 'service of France' depending on who consumes it. The criterion rule for Mode 2 is even more complicated and ambiguous when considered together with that for Mode 4. For example, a Thai architect goes to China to attend a training course, but the instructor is a national of Japan. It is quite unreasonable that he is considered to be consuming a service of China.

It is noticeable that in merchandise trade, a good may also obtain different country of origin contingent on the applicable ROO. To illustrate, the same good manufactured in Vietnam satisfying the ROO in the European Union (EU) GSP scheme and considered originating in Vietnam may not necessarily meet the ROO in the PTA between the EU

[111] See Wang, *supra* note 43, at 1087.

and Vietnam. However, it is a possibility that arises when more than one set of ROO of more than one trade agreement may be applicable to one good, so by nature different from the problem in the GATS.

The analysis reveals that origin rules for both Mode 1 and Mode 2 are not as simple as they appear to be. GATS Article XXVIII(f) tends to oversimplify the various scenarios with potential complexity under these modes of supply. In general, a test based on the place of supply or consumption is not always efficient in determining the real country of origin, particularly when it comes to internet-based services.

2.2.2. The flaws in criteria to determine 'juridical person of another Member'

As discussed the first Chapter, the determination of services' origin under Mode 3 is closely related to the definition of a juridical person; and within the meaning of GATS, there are two different types of juridical persons that may be involved in the provision of services via Mode 3: one constituted to operate at its own right and one constituted in another Member as a commercial presence for the purpose of supplying services. Based on the criteria provided in Article XXVIII(m) and (n) of the GATS, it is not easy to determine the nationality of both types of juridical persons.

2.2.2.1. The ownership or control requirement

In the first layer, Article XXVIII(m)(ii) of the GATS means that the origin of a service delivered via Mode 3 is directly related to the nationality of the juridical person acting as a commercial presence, which is in turn determined by the ownership and control requirement stipulated in Article XXVIII(n). A serious flaw in this requirement is that it does not function properly in the cases of equal or scattered shareholding structures. The application of the ownership or control test would be futile if 50% of the shares of a juridical person are owned by a person of Member A, and the other 50% by a person of Member B (or a non-Member). As a consequence, it would be impossible to define the origin of the service supplied by this juridical person.

This is what has actually happened in *Canada – Autos*: CAMI Automotive Inc. is a 50/50 joint venture of Suzuki Motor Company and General Motors of Canada Limited. Based on the GATS' ownership requirement, one cannot conclude whether CAMI is a legal person of the US or Japan. The European Communities argues that CAMI should

be deemed a legal person of the US since it is controlled by General Motors. However, there is no evidence for the Panel to examine such control, so this view is rejected:

> Regarding CAMI Automotive Inc., it appears that it is a company jointly owned by Suzuki Motor Co. of Japan and by General Motors Corp. of the United States. The European Communities have argued that, although CAMI is jointly owned by juridical persons of Japan and of the United States, it should be regarded as a juridical person of the United States as it is controlled by General Motors Corp., a juridical person of the United States. The European Communities points out that General Motors Corp. is the largest single shareholder of Suzuki Motor Co. and that Japanese nationals constitute a minority in the board of directors of CAMI. In our view, however, no evidence has been presented which would allow the Panel to determine which juridical person 'controls' CAMI, within the meaning of Article XXVIII(n)(ii) of the GATS.[112]

Under such a circumstance, CAMI can probably be regarded as originating in neither of these two Members, or otherwise a juridical person of dual nationality. The second option perfectly reflects the view of Canada in this dispute:

> According to the rules in GATS Article XXVIII(m) and (n) for determining which company is a juridical person of which Member, [...] CAMI, a 50/50 joint venture of General Motors of Canada Limited and Suzuki Motor Company is probably, under the GATS, a juridical person of both the United States and Japan.[113]

Neither the Panel nor the Appellate Body in this case confirms the nationality of CAMI, which leaves the question unanswered. As Wang remarks, on the one hand, if CAMI is a juridical person of dual nationality, shall it be entitled to MFN or national treatment as a domestic or a foreign company in Japan and the US? If CAMI suffers from unfair treatment in one of these two Members, can it seek help from the other Member under WTO law? If CAMI is treated by a third Member in a manner which may violate WTO law, whether Japan or the US can represent it for litigation? What would happen when both or neither of these Members wants to protect it in a dispute? It is not to mention the confusions in jurisdiction, domestic regulation, taxation, law enforcement, etc. On the other hand, if the ownership or control test in GATS Article XXVIII(n) is narrowly interpreted, a juridical person of 50/50 shareholding structure may possibly be found stateless. Unlike the case of dual nationality, the notion of 'stateless juridical persons'

[112] *Ibid*, paragraph 10.258.

[113] Panel Report, *Canada - Autos*, paragraph 6.882.

and 'stateless services' can entail even more serious legal consequences since they are not eligible for the WTO treatment at all.[114]

In this dispute, it is *prima facie* rather reasonable to argue that as both Japan and the US are WTO Members, so CAMI and the services it provides are expected to be entitled to the GATS treatment regardless of their nationality. Munin argues that the definition of juridical person definition in the GATS does not prevent legal entities from holding multiple nationalities; hence they may enjoy rights arising from this status in several jurisdictions. Given the fact that it is highly difficult to determine the real nationality in many cases, such broad definition may help to overcome practical difficulties.[115] Yet, for the purpose of settling disputes, arguably, it is still necessary to accurately identify which Member a juridical person belongs to. For instance, in *Canada-Autos*, the exact nationality of the service provider is crucial in deciding whether the MFN obligation is violated or the services and service suppliers of one Member are discriminated.

Moreover, such a grant of GATS treatment while avoiding determining the nationality of CAMI would be challenged if CAMI were 50% owned by a person of a non-Member. In that case, it would be more difficult to decide if it is a service supplier of a Member and the service supplied by CAMI is entitled to the GATS benefits. It is important to recall the case *China – Publications and Audiovisual Products,* in which the holding of a dominant position (i.e., control) decides whether a venture is deemed a domestic supplier or that of another Member.[116] Notably, the domestic or foreign status of the venture determines the existence of trade in services within the scope of the GATS. In spite of the fact that the Panel in this case does not rule on the possibility of a venture with equal shareholding, it is inferred from the Panel's arguments that such possibility may cause the dilemma of no person holding a dominant position. While the scenario in *China – Publications and Audiovisual Products* (partly foreign-owned) differs from that in *Canada – Autos* (CAMI is 100% foreign-owned), an equally shared ownership may lead to a similar dilemma when applying the control or ownership test.

A similar problem may occur to a juridical person of scattered shareholding structure. For instance, how the nationality of a service provider can be determined if its shares are owned by persons of different Members, none of whom meets the GATS' definition

[114] See Wang, *supra* note 43, at 1092-1093.
[115] See Munin, *supra* note 42, at 97-98.
[116] Panel Report, *China – Publications and Audiovisual Products*, paragraph 7.1419.

on control (the ability to 'name a majority of its directors or otherwise to legally direct its actions')? Apparently, in this circumstance, the ownership and control test fails to function properly as well.

Close to scattered holding is the scenario where services are jointly supplied by many providers. Wang notices that transnational collaboration in service provision plays an important role in certain sectors. Such collaboration allows for the share of technology, resources, and customers. It also enables suppliers to reduce costs, establish strategic alliances, comply with domestic regulations, explore new markets, etc. It is therefore common to see services supplied by more than one supplier in certain sectors such as digital publishing, architectural design, web hosting, etc.[117] In such cases, co-suppliers may have different nationalities, hence when the services are provided via commercial presence, their origin can hardly be determined by applying the GATS' ownership or control test. The reason is simple: if two or more service suppliers contribute to the provision of services, it is unknown which service supplier's nationality prevails. Once again, the situation may lead to the conclusion that the service is either 'stateless' or has multiple nationality.

The equal or scattered shareholding structures are quite common in reality. Pursuant to Wang, such corporate structures, among other reasons, may help to prevent against concentration, avoid abuse of control rights, attract minor shareholders, and allocate risks. He further asserts that 'the origin determination criteria based on ownership or control might encounter more difficulties with the complicated practical issues', such as companies listed in different stock exchanges, cross-shareholding, or shareholding investment funds.[118] One typical example would be the Scandinavian Airlines Systems. As of 2018, close to 39% of its voting shares are government-owned and the remaining is publicly held and traded on financial markets. The Swedish government owns 14.8%, the Danish 14.2%, and the Norwegian 9.9%. It is even more difficult, if not impossible, to define the nationality of the holders of the remaining shares that are listed on stock exchanges and traded frequently.[119]

Another practical difficulty with the test on ownership and control is raised by the EU in *EC –Bananas III*, which is the lack of formal records of shareholders and company

[117] See Wang, *supra* note 43, at 1094.
[118] *Ibid*, at 1093.
[119] See 20 largest SAS shareholders on 31 December 2017, available at: https://www.sasgroup.net/en/shareholders/ (visited 26 May 2018).

registrations. Therefore, the Panel in this case has to make decisions based entirely on the complainants' claims. The Panel justifies such lack of information by citing Article III*bis* of the GATS, reasoning that the Agreement does not require Members to reveal the confidential information if such disclosure 'would prejudice legitimate commercial interests of particular enterprises.'[120] This provision may render the application of this test a permanent difficulty in practice. Besides, Munin cautions that Article III*bis* may be abused to claim the application of GATS treatment to companies that do not fulfill origin criteria.[121]

In short, the requirement on ownership and control is not efficient in attributing legal persons with equal/scattered shareholding structure to a country of origin, particularly when there is not sufficient evidence.

2.2.2.2. Substantive business operations

In the second layer, when the ownership or control requirement is well fulfilled, then the nationality of the juridical person acting as a commercial presence shall be that of the person(s) who own(s) or control(s) it, who must be a natural person or a juridical person of a Member. Leaving aside the discussion on natural person, it is notable that, the origin rule in GATS Article XXVIIII m(ii) shall eventually lead back to the rule for juridical persons at their own rights in GATS Article XXVIIII m(i). It means that after the ownership or control link has been established between the commercial presence and a foreign juridical person, one needs to define the origin of the latter to define the nationality of the commercial presence and the service that it supplies.

It is noted that in the context of origin services, the discussion on the nationality of a juridical person being as a commercial presence only relates to one form of Mode 3, given the broad coverage of the term commercial presence. Meanwhile, the nationality of juridical persons at their own rights in this layer is crucial for Mode 3 on the whole, even though the commercial presences which they own or control take different forms. As discussed in the next section, the nationality of this type of juridical persons is also important for the origin determination of services supplied under Mode 4. Therefore, any defect in GATS Article XXVIIII m(i) can be described as more detrimental.

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[120] Panel Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, adopted 25 September 1997, as modified by Appellate Body Report WT/DS27/AB/R, DSR 1997:II, p. 943, paragraph 7.331.

[121] See Munin, *supra* note 42, at 101.

Indeed, the rules to determine the nationality of a juridical person in this layer are not simple. Its originating status in a Member is defined based on two cumulative factors: (i) constitution or organization under the law of the Member in question, and (2) SBO in the territory of any WTO Member.[122] As noted in Chapter 1, both terms 'constituted or otherwise organized' and 'substantive business operations' are not further defined in the GATS. While 'constituted or otherwise organized' may be broadly interpreted to ensure the broadest coverage of the GATS, the requirement on SBO seems to come as the test to prevent any circumvention of the rules. Even before the GATS was adopted, Kingston had foreseen that 'incorporation' might not be a useful criterion as suppliers would be 'likely to use flag of convenience, thereby making it difficult to point to where control is exercised.'[123] Besides, in industries such as shipping, air transportation, and banking, the notional and effective control might be located in different territories.[124] It is arguable that the SBO requirement aims to exclude from coverage those companies operating primarily as nameplates for taxation or other purposes. It guarantees that a juridical person is not entitled to the GATS treatment via taking formal procedures of registration or incorporation in a Member with the sole intent of obtaining nationality.

With that crucial role, the term should have been elaborated by the GATS. The lack of clarity on the term renders the whole rule to determine the origin of a juridical person ambiguous. It may also enable WTO Members to provide in their domestic legislations different definitions to clarify the term, which may provoke conflicts and disharmony detrimental to the liberalization of services trade. Moreover, unlike other terms whose interpretation can be relied on the ordinary meaning or the context for the purpose of interpreting, SBO is expected to entail much more challenge since it is a 'relative term'. Munin has highlighted such difficulty by posing a series of questions:

> What does the word substantive mean? Since this is a relative term, according to what scale will it be measured? Will it depend on the size of economy involved or of the business involved? Will substantiveness be measured qualitatively or quantitatively? Will only current data be taken into account, or also development potential, which might play an important role in the case of start-ups, for example? Another question that may be raised is whether the SBO can be in any sector or it must be in the same sector as the

[122] See Zdouc, *supra* note 48, at 330.

[123] See Kingston, *supra* note 85, at 20.

[124] *Ibid*.

> one in which the supply of the service will be take place? These interpretative questions were not yet addressed in this context.[125]

In considering GATS rules on nationality of juridical persons, Zdouc contends that its main purpose is to 'avoid multiple attribution of service suppliers to several Members, a situation that may create confusion to the rights and obligations which are relevant to that service supplier, and situations where service supplier persuades one Member, which is its country of origin, to defend its rights against another Member, whose origin that person holds as well. It is also meant to prevent service suppliers lacking attribution to any Member that could defend it rights to trade in services before the WTO.'[126] However, the analysis above shows that the criteria provided by the GATS are not always functioning properly in practice and may even go against its initial purpose. The absence of binding definitions for terms is another matter that may complicate the application of these origin criteria.

2.2.3. Vague definition of 'natural person of another Member'

Regarding the origin of natural persons, Wang asserts that in spite of certain potential challenges in the cases of persons with dual nationality or stateless persons, there will be no serious challenge in identifying 'natural person of another Member'.[127] However, there are in fact various defects in the GATS origin criteria concerning natural persons which will now be discussed.

As analyzed in Chapter 1, the GATS sets out two scenarios in Article XXVIII(k) for the definition of 'natural person of another Member': natural persons of another Member can either be its nationals or permanent residents. Regarding the treatment accorded to them by a Member where they reside and obtain the right of permanent residence, the term 'substantially the same treatment' is used to ensure close proximity between nationals and the residents at stake, but at the same time implying that the treatment accorded to them does not need to be identical.

Similar to SBO, this term may raise interpretative difficulties because it is not defined by the GATS. According to Munin, the word 'substantially' implies that GATS drafters want to emphasize substance over formalities, the *de facto* over the *de jure* treatment.

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[125] See Munin, *supra* note 42, at 98-99.

[126] See Zdouc, *supra* note 48, at 331.

[127] See Wang, *supra* note 43, at 1091. Article 1(1) of the 1954 Statelessness Convention defines a stateless person as 'a person who is not recognized as a national by any State under operation of its law.'

It ensures that, regarding measures affecting trade in services, a resident as such shall be entitled to the same treatment like nationals of that Member, even if relevant rights of such resident may be defined differently or separately.[128] This word is also included in GATT Article XXIV and GATS Article V, both referring to PTAs. In these provisions, the word 'substantially' is used to ensure these agreements have a wide coverage scope concerning the trade between their parties. Although no definition or interpretation is developed in that context, it tends to be accepted that the word refers to a considerable scope of coverage.[129] In the very context of Article XXVIII(k), this word does not refer to a coverage scope, but to the nature of treatment; hence the interpretative approach should be somewhat different. Some interpretative questions that might arise: will the comparison involve quantitative or qualitative parameters? What extent of exceptions to the rule may be allowed by this provision?

Moreover, such 'substantially the same treatment' is considered in this Article on the condition as 'no Member is obligated to accord to such permanent residents treatment more favorable than that would be accorded by that other Member to such permanent residents.' Notably, the first condition seems to be applied domestically because it is a comparison between the treatment accorded to the permanent resident at issue and to a Member's nationals. In contrast, this second condition has a much broader scope of comparison: the responsibilities that Members assume in respect of their residents at the international level, which may include, for example, securing compliance with the GATS provisions and disciplines, as far as they affect individuals.

The phrase 'more favorable' is yet another vague and undefined expression appearing in several GATT and GATS provisions. Both agreements also include the expression of opposite meaning ('less favorable treatment') in, *inter alia*, the provisions on national treatment. In that context, 'less favorable treatment' is the treatment that undermines the equal competitive opportunities of the imported goods and services. Such equality test is concentrating on the intrinsic nature of treatment, preferring it over formalities, and the legal test is applied on a case by case basis. In Article XXVIII(k), the standard of 'more favorable treatment' is meant to provide for an allowed discrimination in the level and scope of benefits accorded to residents of a Member.[130] The provision sets out

[128] See Munin, *supra* note 42, at 94-95.
[129] The detailed discussion can be found in Munin, *supra* note 42, at 226-232.
[130] See Munin, *supra* note 42, at 95-96.

that the treatment granted to a natural person by the country of permanent residence must be the most favorable treatment this person is entitled to. The purpose seems to ensure that a natural person shall not be attributed to more than one country of origin. However, an interpretative question comes up concerning the coherence between this Article and Article II:1 of the GATS on MFTN treatment, which provides that:

> With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favorable than that it accords to like services and service suppliers of any other country.

The MFN provision seems to raise a higher standard than that found in the definition of 'natural person of another Member' in Article XXVIII(k)(ii)(2), as any person that supplies a service must be treated no less favorably. It may be interpreted as implying that a Member is not expected to accord a resident of another Member, who is entitled to permanent residence in but is not a national of that other Member, a treatment that includes improved competition opportunities compared to the opportunities accorded to him by that other Member. Munin suggests that for the MFN purpose, GATS Article II:1 should be deemed as *lex specialis*, while for other purposes the standard in Article XXVIII(k)(ii)(2) would apply.[131]Plausible as it sounds, this view is yet to be confirmed by a WTO tribunal.

Last but not least, the treatment governed by this provision is 'in respect of measures affecting trade in services', namely measures that may act as barriers to services trade. Thus, the purpose of this provision is to ensure those natural persons with permanent residence rights in a Member are not discriminated by their own country of residence (through applying to them barriers to trade in services). This is a precondition for the entitlement of those natural persons to the GATS benefits. Nevertheless, the language of this provision does not address several crucial questions: Whether the effect level is an important factor? Whether measures with trivial or indirect effect on services trade are considered? Whether the precondition is construed as a general observation of the treatment in all respects, or a case by case approach would suffice?[132]

[131] *Ibid*, at 96-97.

[132] *Ibid*, at 95.

2.2.4. Nationality of suppliers is not always origin of services

As analyzed so far, the origin criteria provided by the GATS are not always efficient in identifying the nationality of juridical persons and natural persons. Nevertheless, even if the application of rules helps identify a nationality which fulfils those origin criteria, the nationality of service suppliers is not necessarily a reliable indication of the origin of services. This is perhaps the most serious defect of the GATS approach, and while the defect relates to both service suppliers being juridical persons and natural persons, the following analysis focuses more on the relationship between corporate nationality and the origin of services.

First, the ownership or control requirement is not designated to identify the ultimate owners or controllers of one juridical person, particularly where the supply of services involves a chain of legal entities. As Munin puts it, 'one may imagine a juridical person from a Member, owned by a juridical person of a Member, beneficially owning 51% of its equity interest. The latter juridical person of a Member is also owned by a juridical person of a Member beneficially owning 51% of its equity interest, etc.'[133] In such case, how would the GATS origin rules be applied? In *EC-Bananas III* and *Canada-Autos*, the Panels rule that it will be sufficient to establish ownership or control by a juridical person of another Member, defined in line with the criteria stipulated in GATS Article XXVIII(m)(i). It means the GATS origin rules do not require a tribunal to address the question as to who ultimately owns or controls a juridical of another Member. In *EC – Bananas III*, with respect to the origin of juridical persons, the Panel states that:

> As a result, suppliers that are commercially present within the EC territory and owned or controlled by, for example, Del Monte Mexico would be entitled to benefit from GATS rights because it would not matter under Article XXVIII(m) of the GATS whether Del Monte Mexico was owned or controlled by natural or juridical persons of Jordan, i.e., a WTO non-Member as long as Del Monte Mexico was incorporated in Mexico and engaged in substantive business operations in the territory of Mexico or any other Member.[134]

This interpretation of ownership and control is affirmed in a more explicit manner by the Panel in *Canada – Autos*. In this case, DaimlerChrysler Canada Inc. is determined to be a service supplier of the US within the meaning of Article XXVIII(m)(ii)(2) of

[133] See Munin, *supra* note 42, at 100.

[134] Panel Report, *EC –Bananas III*, footnote 493 to paragraph 7.318.

the GATS, because it is controlled by DaimlerChrysler Corporation, a juridical person of the US according to Article XXVIII(m)(i) of GATS. The Panel emphasizes:

> The fact that, in turn, DaimlerChrysler Corporation may be controlled by a juridical person of another Member is not relevant under Article XXVIII of the GATS. In order to define a 'juridical person of another Member' Article XXVIII(m) of the GATS does not require the identification of the ultimate controlling juridical or natural person: it is sufficient to establish ownership or control by a juridical person of another Member, defined according to the criteria set out in subparagraph (i).[135]

What can be drawn from these rulings is that, the GATS is only able to (or intends to) identify the nationality of 'first-tier' controllers or owners. The WTO adjudicators will not try to seek the actual controller, or the actual nationality of service suppliers, even if such possibility exists in various cases. Such silence is probably due to the difficulty in seeking an ultimate owner or controller. Even in a simple example on *Booking.com* raised earlier, it is much more complicated in reality since Booking.com B.V. is owned by the Priceline Group, a company headquartered in the US.[136] That is why Wang puts forward that these criteria 'cannot and do not intend to probe into the actual origin of service suppliers in the more complicated situations such as cross-holding structure and parent, daughter, or even granddaughter companies in multinational enterprises (MNEs).'[137] Munin concurs with this view and cautions that once the chain gets longer, the effective link to the Members that the GATS drafters want to ensure by this rule is watered down although the legal entities in such a chain may be entitled to the GATS benefits, as well as to the diplomatic protection of the Members involved.

Without having to prove an ultimate ownership, foreign service suppliers can exercise control via a multi-layered shareholding and do not need to retain direct shareholding relationship. An example of indirect shareholding by foreign service suppliers is found in Thailand. Despite its highly strict equity requirements, foreign suppliers manage to control entities that are directly majority owned by Thai nationals or juridical persons. In certain sectors, though Thai laws have statutory provisions to limit foreign indirect

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[135] Panel Report, *Canada – Autos*, paragraph 10.257. On appeal, the Appellate Body concludes that the Panel had confused the application of the measure at issue (a duty exemption for car manufacturers) with its application to wholesale service suppliers, and reversed the findings of the Panel. However, the Appellate Body is silent on this interpretation of owned or controlled was made.

[136] See the Priceline Group website, http://www.pricelinegroup.com/booking-com/(visited 10 November 2017).

[137] See Wang, *supra* note 43, at 1096.

shareholding via multi-level equity holding and using of Thai nominees, such indirect shareholding practice seems to be an ordinary course of business in Thailand.[138]

The failure to detect the ultimate supplier indeed reveals a more inherent defect of the GATS approach. As indicated by Abu-Akeel, the origin of services is not necessarily the same as that of the supplier. In his view, 'legal ownership of goods and services is one matter, the economic ownership of them (i.e., where and by whom they are produced) is a totally different one.'[139] To understand this view, one has to differentiate a service provider in its legal sense from that in economic sense. As Wang later further explains, a legal supplier means the one who signs the contract or is otherwise legally obliged to provide services to the service recipient, whereas an economic supplier means the real supplier of the services. A legal supplier may be the one who is subcontracted with the economic supplier, or the one who represents the economic supplier in providing the services. Therefore, an economic supplier may not be a party to the contract between the consumer and the legal supplier; and the consumer even does not know about the economic supplier at all.[140]

From WTO case law, it is apparent that the GATS directs at the nationality of the legal supplier instead of the economic one. In other words, the term 'service supplier' in the GATS should be construed in a pure legal rather than economic sense. For this reason, Abu-Akeel contends that the GATS may deny Members the right 'to trace and identify the true economic supplier of the services through appropriate ROO.'[141]Plausibly, once accepted that the country of origin should bear a genuine economic link to a service, it is apparently misleading in many instances to regard the nationality of a legal supplier as the origin of a service.

The consequence of this defect may be the risk of 'treaty shopping' and 'rule evasion' as nationality-based origin rules that turn a blind eye on the ultimate suppliers can be easily circumvented. In practice, it is not very difficult for an investor to first establish a juridical person in order to further own or control the service supplier and to finally obtain the nationality it desires. The ownership or control requirement would have no effect on these 'designs' or arrangements.

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[138] See Khumon, *supra* note 66, at 602.

[139] See Abu-Akeel (1999b), *supra* note 40, at 200.

[140] See Wang, *supra* note 43, at 1095.

[141] See Abu-Akeel (1999b), *supra* note 40, at 204.

In short, as a service supplier defined by the GATS is normally a legal one, the criteria based on service suppliers' nationality fail to detect the real suppliers and thus the real origin of services. Even if there is no doubt over the supplier-based approach that the GATS takes towards services supplied under Modes 3 and 4, the real origin of a service can be detected using that approach only when the legal supplier is also the economic one, so that the link between a service and its legal supplier is also an economic one.

2.2.5. Unclear application of origin rules for Mode 4

A narrow reading may give the impression that the GATS only covers in Mode 4 those services supplied via the presence of independent natural persons in another Member. However, it seems *Annex on Movement of Natural Persons Supplying Services under the Agreement* does provide for other scenarios:

> 1. This Annex applies to measures affecting natural persons who are service suppliers of a Member, and natural persons of a Member who are employed by a service supplier of a Member, in respect of the supply of a service.
>
> 2. The Agreement shall not apply to measures affecting natural persons seeking access to the employment market of a Member, nor shall it apply to measures regarding citizenship, residence or employment on a permanent basis.
>
> 3. In accordance with Parts III & IV of the Agreement, Members may negotiate specific commitments applying to the movement of all categories of natural persons supplying services under the Agreement. Natural persons covered by a specific commitment shall be allowed to supply the service in accordance with the terms of that commitment.
>
> 4. The Agreement shall not prevent a Member from applying measures to regulate the entry of natural persons into, or their temporary stay in, its territory, including those measures necessary to protect the integrity of, and to ensure the orderly movement of natural persons across, its borders, provided that such measures are not applied in such a manner as to nullify or impair the benefits accruing to any Member under the terms of a specific commitment.

The Annex governs 'measures affecting natural persons who are service suppliers of a Member, and natural persons of a Member who are employed by a service supplier of a Member, in respect of the supply of a service.' Supposing Member A is the country of the service supplier while Member B is that of the consumer, from the main text of the GATS and this Annex, one joint background note by the WTO and the OECD suggests that the following types of natural persons are covered by the GATS: (i) self-employed

natural persons of Member A entering Member B to supply of a service; (ii) employees of a service supplier of Member A being sent to Member B to fulfill the contract with a client there; and (iii) employees of a service supplier of Member A who has commercial presence in Member B being sent to its affiliate in Member B.[142]

Yet, there is a debate among a number of scholars on the coverage of 'natural persons of a Member who are employed by a service supplier of a Member' in paragraph 1. It is not readily clear whether a natural person of Member A working for a service company of Member B, and not falling within scenario (iii) above, shall also be covered in Mode 4. A WTO Secretariat's background note has suggested that the provision may be read to include also foreigners employed by locally-owned service companies. The matter is the scope of Mode 4 in Article I.2(d) of the GATS seems to cover *foreign employees of foreign firms* constituted in a Member only. For this reason, another background note by the WTO Council for Trade in Services states that foreigners employed by a locally-owned service firm will be covered by Mode 4 when they work on a 'contractual basis' as independent suppliers, but are not necessarily covered when they are the employees of such firms.[143] In reality, it is rather difficult to draw a line between these two groups, and it requires even more effort to verify.

Moreover, Mode 4 governs natural persons supplying services on a non-permanent or 'temporary' basis. Though persons who are seeking access to the employment market and permanent migrants are obviously excluded, the term 'temporary' is not defined in the GATS. In their specific commitments, Members usually emphasize the temporary nature of the presence of individuals (e.g., 'entry and temporary stay'), but they do not regularly specify the duration of stay allowed for under their commitments.[144] Though Members are expected to point out the duration for such purpose in their schedules of commitments, a lack of such specific duration may be construed as there is no binding undertaken in that respect.[145]

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[142] WTO & OECD (2005), *Background Note on GATS Mode 4 and Its Information Needs*, at 6, available at: https://unstats.un.org/unsd/tradeserv/TSG3-Feb06/tsg0602-16.pdf (visited 13 October 2017).

[143] WTO Council for Trade in Services, *Background Note by the Secretariat: 'Presence of Natural Persons (Mode 4)'* (document S/C/W/75, dated 8 December 1998), paragraph 56.

[144] See, for instance, the Schedules of Specific Commitments of Vietnam (GATS/SC/142, dated 19 March 2007), at 4 or Ukraine (GATS/SC/144, dated 10 March 2008) at 3-4.

[145] WTO Council for Trade in Services, *Guidelines for the Scheduling of Specific Commitments under the General Agreement on Trade in Services* (document S/L/92, dated 23 March 2001), paragraph 34.

The analysis above shows that unlike other modes of delivery, identifying the coverage of Mode 4 is complicated itself, not yet to mention the origin determination of services supplied via this mode. Apart from Article XXVIII(f)(ii), stating that a service supplied by a provider of another Member via the presence of natural persons shall be a service of that other Member, the GATS does not provide any further clue. Since the rule does not facilitate a concrete interpretation, it remains a speculation that the determination of origin in this mode may involve two scenarios as follows.

Respecting a service delivered via the presence of an independent contractual supplier or a self-employed business visitor, it is relatively straight-forward that its origin shall be determined by the nationality of these natural persons. As analyzed in the previous section, 'natural person of another Member' is defined in GATS Article XXVIII(k) as a national of, or a person who has the right to reside permanently in that other Member, subject to additional requirements in the latter case.

However, in the case of a natural person being an employee of a juridical person going to another Member to supply services, the service supplier will be the juridical person; therefore, the nationality of that natural person seems to be irrelevant for the purpose of origin determination. The background note by the WTO & OECD suggests that the nationality of legal persons should be identified in respect of the categories (ii) and (iii) listed above that cover contractual service suppliers and business visitors employed by juridical persons, as well as intra-corporate transferees. At this point, one may ask the question whether the GATS applies if the natural person employed in these categories is a national of a non-Member. Moreover, no matter whether the origin determination for services in Mode 4 points to the nationality of juridical persons or natural persons, information on the nationality of natural persons still needs to be obtained in all cases as certain measures, for instance, visa requirements, may apply to them.[146]

2.2.6. Non-equivalent rules for juridical and natural persons

It is reasonable that the origin rules for legal persons may differ from those for natural ones, as they have inherent different characteristics. However, in certain provisions of the GATS, the fact that these two categories of persons are treated dissimilarly is quite arbitrary and unjustified.

[146] See WTO & OECD, *supra* note 142, at 10.

Firstly, a prerequisite requirement for juridical persons is to have SBO within one of the WTO Members. In contrast, in respect of natural persons, as mentioned in the first chapter, there is no similar test on their 'center of interest'. Even in the case where the natural person is not a national of a Member, the GATS focuses instead on the country of residence and the ambiguous requirement on 'substantially the same treatment', as analyzed above. Such rule could render a natural person fulfilling GATS requirements without having real economic activities in any of the Members.

This leads to another matter relating to the origin of services supplied through Mode 3. GATS Article XXVIIII(m) enshrines that a commercial presence established in a WTO Member to supply services may be owned or controlled by juridical or natural persons of another Member. Where the owner or controller is a company, it must have SBO in the Member of constitution or any other Member. But no similar requirement is found with regard to individuals. Apparently, this requirement restricts a legal person being constituted in one WTO Member as a 'shell company' without SBO in that Member or any other Member from establishing or maintaining commercial presence in another WTO Member. The absence of any equivalent rule for natural persons may imply that an individual of a WTO Member may establish or maintain its commercial presence in another Member and enjoy GATS benefits, though its place of main economic interest is in a non-Member country.

Another non-equivalent treatment between legal and natural persons that may raise a more practical concern is relating to rules on regional integration under GATS Article V. Recalling that Article V:6 allows juridical persons of any WTO Member (not being a constituent party to a PTA) to be entitled to preferences under the PTA, provided that it engages in SBO in the territory of any party to this PTA. However, GATS Article V:6 does extend such third-country rights to natural persons. For such reason, a Japanese national earning a degree from a French college and obtaining a license for practice in France, will not be eligible for the same treatment confined to EU nationals if he seeks to work in Germany,.[147] Meanwhile, a Japanese company may establish a subsidiary in France and provide services to Germany as any other EU supplier. Because there is no provision in the GATS governing preferential ROO for natural persons, PTA benefits

[147] World Trade Report (2011), *The WTO and Preferential Trade Agreements: From Co-existence to Coherence* (Geneva: WTO Publications), at 193.

are not bound to be extended to third-country natural persons. That's why Fink has argued that such an omission 'biases Article V rules against natural persons.'[148]

The dissimilarity is also found in GATS Article V:3, which allows for certain flexibility in respect of the PTAs established among developing countries.

> 3. (a) Where developing countries are parties to an agreement of the type referred to in paragraph 1, flexibility shall be provided for regarding the conditions set out in paragraph 1, particularly with reference to subparagraph (b) thereof, in accordance with the level of development of countries concerned, both overall and in individual sectors and subsectors.
>
> (b) Notwithstanding paragraph 6, in the case of an agreement of the type referred to in paragraph 1 involving only developing countries, more favorable treatment may be granted to juridical persons owned or controlled by natural persons of the parties to such an agreement.

Although GATS Article V:6 requires PTAs to extend their benefits to juridical persons of third countries, Article V:3 reserves the rights of PTAs among developing countries to offer more favorable treatment to juridical persons 'owned or controlled by natural persons of the parties' to such agreements.[149] Not to mention that the term 'developing countries' is not defined and the notion of 'more favorable treatment' is not explained, it is once again open to question why the flexibility applies exclusively to this category of juridical persons. Why PTAs among developing countries are not allowed to accord better treatment to companies owned or controlled by their juridical persons? One can argue that the essence of this provision is 'to allow for preferential treatment for small and medium sized and as a limitation to the liberal rules of origin of Article V:6.'[150] But another purpose seems to be the conferral of preferential treatment to companies that have an actual link with the PTA. It is because the link between a juridical person and a PTA can be detected with more certainty where the former is owned or controlled by natural persons of that PTA.

It is the most unreasonable that Article XXVII on denial of benefits does not provide a similar treatment to natural persons and juridical persons. Article XXVII(c) just states that a Member may decline the GATS treatment to a service supplier 'that is a juridical

[148] See Fink, *supra* note 79, at 126.
[149] See Munin, *supra* note 42, at 234.
[150] See Wolfrum, Stoll & Feinäugle, *supra* note 46, at 143.

person, if it establishes that it is not a service supplier of another Member, or that it is a service supplier of a Member to which the denying Member does not apply the WTO Agreement.' There is no justification for the Article to specifically deny GATS benefits to a juridical person and not a natural person if the latter is 'a supplier of a Member to which the denying Member does not apply the WTO Agreement.' Perhaps it is thought that the circumvention of rules tends to happen with suppliers being juridical persons, therefore, requirement is needed. But this reasoning still does not satisfy the question as to why the provision does not apply to natural persons.

2.2.7. The vague line between trade and investment

Unlike trade in goods, which only takes place via one mode (cross-border), the largest share of service transactions is conducted through establishment-related transactions. In the context of the GATS, the link with investment is shown in Mode 3 – investment must be made in another Member (the establishment or maintenance of a commercial presence) so that services can be supplied in that other Member. The Panel in C*hina – Publications and Audiovisual* reasons that:

> Our first step must be to determine whether foreign-invested enterprises prohibited under the measures at issue from establishing as wholesalers are 'service suppliers of another Member' within the meaning of Article XVII. Applying the relevant definitions set out in Article XXVIII of the GATS, we observe that a service supplier of another Member, supplying a service through commercial presence, can be any entity 'owned' or 'controlled' by persons of another Member. We note that China has indicated in the horizontal commitments of its Services Schedule that, with respect to the supply of a service through commercial presence, there are three permissible forms of foreign-invested enterprises in China: wholly foreign-owned enterprises, equity joint ventures and contractual joint ventures. In light of the relevant definitions of the GATS, and in the absence of any contrary evidence before us, we can conclude that there are, or can be, foreign-invested enterprises in China that are owned or controlled by persons of another Member, and thus qualify as 'service suppliers of another Member.'[151]

What can be drawn from this paragraph is that among various forms of foreign-owned enterprises, there may be 'service suppliers of another Member' within the meaning of the GATS. In other words, among different forms of foreign investment, there may be one that falls under the meaning of supplying services through commercial presences.

[151] Panel Report, C*hina - Publications and Audiovisual Products*, paragraph 7.973.

The Panel's conclusion hints that while a supply through Mode 3 does involve foreign investment, not all forms of foreign investment shall constitute a supply as covered by the GATS. To this end, the commercial presence established or maintained in the host Member must be owned or controlled by the investor of another Member.

Indeed, Mode 3 of the GATS has a narrow scope of application owing to the threshold on control or ownership. Article XXVIII(n) of the GATS has specified the threshold of 50% for 'ownership', and the threshold based on the ability to name directors or direct their actions for 'control'. Hence it would refuse to consider an investment as a supply of services through commercial presence if only 10% of the voting power is at stake. It is inferred that when no ownership or control is acquired via an investment, there will be no trade in services. The establishment will then concern only investment, and not trade in services. It is evidenced by the Panel's argument cited above, which takes into account the actual division of shares to decide whether a Chinese-foreign joint venture should be considered as a 'service supplier of another Member' within the meaning of the GATS.

Such a narrow scope is arguably not in line with the purpose to embrace services trade liberalization of the GATS.[152] It is noted that private parties (investors) are not entitled to the WTO's dispute settlement system. Only where an investor qualifies as a 'service supplier of another Member' within the GATS, its country of origin might intervene to protect its rights. Otherwise, a supply under Mode 3 of the GATS is not established, so the GATS cannot apply.[153] Consequently, a measure affecting this investment shall fall without the scope of the GATS – it will thus be subjected to applicable investment law only or even no law at all.

Moreover, services under Mode 3 originate in another Member if they are supplied by service suppliers of that other Member. This rule gives rise to the question whether an investor must be a service supplier for measures affecting its investment to be covered by the GATS. Since a service supplier is defined as 'any person that supplies a service', it may be interpreted as implying a supply in effect. Thus, where an investor of a WTO Member seeks to establish or maintain commercial presence in another Member so as

[152] See Munin, *supra* note 42, at 102. Munin also notes that the narrow scope of the GATS can be justified by the need to balance between the purpose of trade liberalization and the prevention of abuse through complex business structures that do not promote the GATS' purposes.

[153] See De Meester & Coppens, *supra* note 41, at 105.

to supply services, would this transaction be covered by the GATS if the investor itself is not currently supplying services? De Meester and Coppens assert that GATS Article I:2(c) uses the words 'by the supplier of one Member', which may be interpreted as the requirement that the investor itself must be a service supplier in its home country. Yet, it is also arguable that the investor will become a service supplier right at the moment of investment, so it is needless to require the juridical or natural persons investing in a service sector to be service suppliers at the time they establish commercial presence in another Member to supply services.[154]

While it remains unclear, the GATS tribunal seems to favor the latter interpretation. It is ruled, for instance, by the Panel in *China – Publications and Audio Visual Products* that the scope of 'service supplier of another Member' supplying a service under Mode 3 covers 'entities that have established a commercial presence in the host Member and /or entities that seek to establish in the host Member.'[155] But this approach is criticized by some scholars that, though a broader interpretation of the term 'service supplier of another Member' may enhance trade liberalization, the Members' initial intention was definitely not to include an 'unidentifiable number of potential service suppliers when they bound themselves to specific commitments.'[156]

2.3. Ascertaining the root of the defects

The discussion above has to a large extent revealed the complexity of ROO for services. As the Appellate Body has pointed out in *Argentina – Financial Services*, origin rules for services are intricate owing to the number of concepts to be defined and the various modes through which services are supplied.

> In addition, we note the principles for determining origin set out in Article XXVIII of the GATS. The definitions of the various terms set out in Article XXVIII(f), (g), and (k) through (n) of the GATS provide an indication of possible complexities of determining origin and whether a distinction is based exclusively on origin in the context of trade in services. An additional layer of complexity stems from the existence of different modes of supply and their implications for the determination of origin of services and service suppliers.[157]

[154] *Ibid*, at 106.

[155] Panel Report, *China — Publications and Audiovisual Products*, paragraph 7.974.

[156] See Wolfrum, Stoll & Feinäugle, *supra* note 46, at 554.

[157] Appellate Body Report, *Argentina – Financial Services*, paragraph 6.40.

Beyond its complexity, ROO provided by the GATS include various vague expressions lacking agreed interpretation, for instance 'legally direct its actions', 'substantially the same treatment', 'substantial business operations', which undermine the predictability and certainty in the interpretation and application of the rules. However, although the rules' intricacy and vagueness do exasperate the defects of the GATS origin rules, they are not the ultimate cause thereof. Arguably, the failure to detect the origin of services stems from the fact that the ROO do not follow the economic rationale underlying the notion of origin determination.

As the comparative analysis in Chapter 1 reveals, ROO for goods focus on the making of goods, which places the latter at the center of the origin determination process. The country of origin in merchandise trade is supposed to have a genuine economic link to the good: it is one of the main contributors, or even the most important contributor to the production thereof. ROO for goods endeavor to ensure that, to the extent possible, the country of origin identified by following the rules is *economically justified*. This is somewhat a principle governing the origin determination in merchandise trade.

On the contrary, the analysis so far reveals no clue that ROO for services, based mainly on the place of supply or consumption and the nationality of the service supplier, take into account the process through which a service is produced and delivered. Given the most significant share of Mode 3 and the fact that origin rules for services supplied via this mode are most elaborated, one can argue that ROO for service in the GATS are in essence ROO for service suppliers. Among those authors who criticize the approach of the GATS, Abu-Akeel concludes that 'calling a producer based rule a rule of origin will be a contradiction in terms' because it may 'amount to having no rule of origin at all to govern international trade in services.'[158]

Notably, there is an argument favoring this supplier-based approach mentioned at the beginning of this chapter: some scholars argue that foreign service suppliers certainly create locally added value upon their establishment in another Member. This may be a reason underlying the motive of Members when setting out requirements for granting GATS treatment in Mode 3. As the presence of foreign suppliers does contribute to the wealth of the host country, it is unnecessary to provide any other requirement, such as domestic employment, and the origin of the suppliers will be sufficient. However, one

[158] See Abu-Akeel (1999b), *supra* note 40, at 208.

may easily see that the role of foreign suppliers in the country of establishment has no relevance to the question as to where the services they supply originate in. In fact, this argument even hints that as a supplier of Member A creates value during its supply of services in Member B, it is reasonable to deem the services as originating in Member B. Meanwhile, according to the GATS origin rules, services supplied in Member B by a supplier of Member A is always considered a service of Member A.

To justify the defects of the GATS, it is inferred from the view of previous authors that one should not look at services ROO with the mindset of merchandise trade. Arguably, some of the items indicated in this chapter are not necessarily defects, but differences in designing ROO stemming from the nature of trade in services. It is undeniable that the GATS origin rules do not center on services, but this may be a deliberate choice. In fact, it is only in Mode 1 that services cross the border. In Modes 3 and 4, the suppliers cross the border rather than the services themselves. For this reason, as Jansen argues, 'targeting suppliers rather than the services they supply may thus be appropriate to do from a 'technical' point of view.'[159]

However, even if it is accepted that suppliers should be targeted instead of services, the previous analysis has also revealed that the GATS rules do not attempt to find out the real economic service supplier. A similar justification for this problem is that ROO for services are not designed for the same purpose as those for goods. As the first chapter has indicated, ROO in merchandise trade explicitly serve the purpose of restricting the extent to which non-parties free-ride the benefits of trade agreements. Reasonably, the GATS negotiators may have had a similar purpose in mind if they constructed services ROO based on criteria such as the level of business operations or the level of domestic employment (for juridical persons), or criteria related to individuals' center of interest (for natural persons).[160] However, the criteria adopted by the GATS 'may pursue goals that are more related to regulatory questions than to pecuniary interests.'[161] The reason is that criteria such as incorporation or residency focus more on the legal relationship, and not the economic one, between service suppliers and the relevant Members.

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[159] Marion Jansen, 'Comment: Is Services Trade Like or Unlike Manufacturing Trade?', in Marion Panizzon et al. (eds), *GATS and the Regulation of International Trade in Services* (Cambridge: Cambridge University Press) 139-142, at 139.

[160] *Ibid,* at 140.

[161] *Ibid*.

It is noted that to a certain extent, the clarification of the relationship between service suppliers and regulators may have economic sense in certain sectors, namely financial services or telecommunications, where regulation plays a crucial rule in guaranteeing the proper functioning of markets. However, this remains a conjecture; and as Jansen puts, 'it would be interesting to analyze whether these were the motives treaty drafters had in mind when deciding to use criteria based on incorporation or residency.'[162]

[162] *Ibid*.

Chapter 3

Rules of origin for services in preferential trade agreements

As a significant share of commercial services is traded under preferential regimes, it is insufficient if ROO for services are not investigated beyond the GATS. Chapter 3 will complete the picture portraying ROO for services in international trade by first discussing the proliferation of PTAs covering services, followed by a broad review of preferential services ROO. Some important PTAs are then selected for an analysis of their dissimilar provisions in this area of rules making. By examining the practice of PTAs, this chapter also serves as a connection to Chapter 5, where the wide adoption of the GATS approach in PTAs becomes one reason necessitating the reconsideration of that approach.

3.1. The landscape of preferential trade agreements covering services

3.1.1. Services PTAs are proliferating and diversifying

The commitments under the GATS differ substantially from those under the GATT as a Member's obligations on liberalizing trade in services (including national treatment and market access) only apply to the sectors that it decides to cover in the schedule of commitments, and in most cases are subjected to further limitations or conditions. As a result, many service sectors are not covered by any market access commitments and remain 'unbound', so no guarantee of access is granted to other Members. Indeed, the majority of WTO Members provide no market access commitments in the majority of sectors, which undeniably results in the stagnant progress of multilateral liberalization of services trade.[163]

[163] Martin Roy, Juan Marchetti & Aik Hoe Lim (2008), 'The Race towards Preferential Trade Agreements in Services: How Much Market Access is Really Achieved?', in Marion Panizzon et al. (eds), *GATS and the Regulation of International Trade in Services* (Cambridge: Cambridge University Press) 77-110, at 80.

In contrast, regional liberalization has experienced impressive growth in the past two decades. The 'new generation' PTAs covering services component are proliferating all over the world.[164] As of January 2018, according to the WTO's database, 151 in force PTAs notified to the WTO have services in their scope, 39 of which (roughly one third) were notified in recent years (2013 – 2017). Most of these PTAs cover both goods and services from the beginning; for instance, the one between Canada and the EU, which was notified in August 2017. Yet, some PTAs expand the scope to include services after the initial agreements only covering goods have been notified. To cite an example, the free trade agreement (on goods) between the Association of Southeast Asian Nations (ASEAN) and India had been notified in August 2010, five years before their economic integration agreement (on services) was notified in August 2015.[165]

The World Trade Report 2011 reveals that out of 85 PTAs notified to the WTO by that time, more than 30% follow the structure similar to the GATS, with a set of obligations on, for instance, national treatment and domestic regulation, covering the four modes of supply and schedules of commitments based on the positive list modality. [166] Nearly half of these 85 PTAs follow the structure which is similar to the North American Free Trade Agreement (NAFTA).[167] They apply different sets of obligations to services trade, and use the negative list modality in scheduling the commitments. A NAFTA-type PTA often features one chapter on cross-border trade in services, one investment chapter that covers all sectors (including investment in services), and some other chapters on temporary entry for business persons, telecommunications, and financial services. The remaining 20% of these 85 PTAs, particularly ones between the EU and its candidate countries, are not conveniently categorized as following the GATS or NAFTA model as they aim at deeper regional integration.[168]

The difference in the modalities for the scheduling of commitments does have certain implications. The positive list modality implies the obligations in the PTAs only cover the service sectors specified in the schedules of commitments. Meanwhile, the negative

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[164] See Fink, *supra* note 79, at 113.

[165] WTO, *Regional Trade Agreements Information System*, available at: http://rtais.wto.org/UI/PublicSearchByCrResult.aspx (visited 12 January 2018).

[166] See *World Trade Report 2011*, at 133.

[167] NAFTA is an agreement signed by Canada, Mexico, and the US, which entered into force on January 1, 1994.

[168] It is noted that most PTAs involving the US do not have separate chapters on the temporary entry of business persons. See *World Trade Report 2011*, endnote 18 and 19, at 154.

list approach means the obligations apply to all sectors, subject only to any reservation indicated explicitly. In other words, the positive list only covers what is listed, whereas the negative list covers everything apart from what is listed.[169] Hence, as noted by Roy and Marchetti, a PTA adopting the negative list modality is expected to generate more transparency and predictability than the GATS since the market access conditions are guaranteed for 'all but a few' sectors.[170]

Over time, many PTAs have however innovated in terms of scheduling modalities and approaches. Various PTAs, notably those recently signed by the US, combine elements of both the GATS and NAFTA models by using the negative list modality and featuring an obligation on market access inspired by the GATS which applies to all supply modes. In particular, Japan's PTAs with Thailand and the Philippines seek to utilize the assets of both modalities by scheduling their commitments on a GATS basis, and exchanging alongside the 'comprehensive, non-binding lists of non-conforming measures affecting services trade and investment' to promote greater regulatory transparency.[171]

Moreover, regardless of the positive list or negative list modality that they take, many PTAs introduce certain additional sector-specific provisions. Examples can be found in provisions on mutual recognition in a number of PTAs, provisions pertinent to express courier services in PTAs involving the US,[172] or those pertinent to sea transport services in the EU and the CARIFORUM states.[173]

Beyond those differences and innovations in structure or market liberalizing methods, most of the PTAs tend to share a large similarity within themselves and with the GATS. They often embrace basic disciplines governing trade in services, including scope and definitions, market access, national treatment, domestic regulation, exceptions, etc. In addition, as Roy and Marchetti remarked, 'the multifaceted nature of trade in services has resulted in the inclusion of distinct but complementary sets of disciplines to cater

[169] *Ibid,* at 133.

[170] Martin Roy & Juan Marchetti (2008), 'Services Liberalization in the WTO and in PTAs', in Martin Roy & Juan Marchetti (eds), *Opening Markets for Trade in Services: Countries and Sectors in Bilateral and WTO Negotiations* (New York: Cambridge University Press) 61-112, at 74.

[171] Pierre Sauvé (2006), 'Been There, Not (Quite) (Yet) Done That: Lessons and Challenges in Services Trade', *NCCR Working Paper No.18* (Bern: National Centre of Competence in Research), at 22.

[172] See *World Trade Report 2011,* at 134. See also Ruosi Zhang (2008), 'The Liberalization of Postal and Courier Services', in Martin Roy & Juan Marchetti (eds), *Opening Markets for Trade in Services: Countries and Sectors in Bilateral and WTO Negotiations* (New York: Cambridge University Press) 378-404, at 397.

[173] *Economic Partnership Agreement between the CARIFORUM States and the European Community and its Member States*, Article 109, available at: http://trade.ec.europa.eu/doclib/docs/2008/february/tradoc_137971.pdf (visited 20 January 2018).

for the existence of, *inter alia*, several modes of supplying services as well as complex sectoral issues.'[174] Therefore, commitments on the liberalization of trade in services are often incorporated in inclusive PTAs covering not only chapters on trade but also ones on investment, movement of natural persons, or financial services, etc. These chapters either provide specific obligations for, or clarify the application of certain disciplines to those policy areas or sectors.[175]

Beyond the proliferation of PTAs, a group of 23 WTO Members accounting for 70% of global trade in services are engaged in the discussions launched in 2013 on a potential Trade in Services Agreement (TiSA). As a sector-specific plurilateral agreement, TiSA is expected to level the playing field and set new standards for services trade that may eventually be brought into the multilateral system.[176] It attempts to open markets and enhance rules in a variety of areas namely financial services, telecommunications, sea transport, e-commerce, and the temporary stay of individuals to supply services. More than 20 negotiating rounds have been conducted up to now, covering a broad range of issues relating to market access and new (or improved) regulation for trade in services. The structure of TiSA is basically developed from the GATS, with all negotiated terms being in line with the latter, including 'scope, definitions, disciplines related to market access and national treatment, as well as exceptions.'[177]

3.1.2. Evaluate the preferential liberalization of services trade

Commitments in PTAs provide a level of preferences which is largely better than those provided by the GATS, taking the form of new bindings for sectors not yet committed in the parties' GATS schedules (GATS-X), or higher bindings for sectors already covered by their GATS schedules (GATS+). Some studies acknowledge that PTA commitments on services generally transcend GATS commitments now in force, and even transcend the offers hitherto proposed in the Doha Development Agenda (DDA).[178]

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[174] See Roy & Marchetti, *supra* note 170, at 74.

[175] *Ibid*.

[176] Rachel F. Fefer (2017), 'Trade in Services Agreement (TiSA) Negotiations: Overview and Issues for Congress', *Congressional Research Service Report*, at 6.

The 23 WTO Members include: Australia, Canada, Chile, Chinese Taipei, Colombia, Costa Rica, the EU, Hong Kong China, Iceland, Israel, Japan, Korea, Liechtenstein, Mauritius, Mexico, New Zealand, Norway, Pakistan, Panama, Peru, Switzerland, Turkey, and the United States.

[177] European Commission, *Trade in Services Agreement (TiSA) Factsheet,* available at http://trade.ec.europa.eu/doclib/docs/2016/september/tradoc_154971.doc.pdf (visited 27 January 2018).

[178] See, for instance, Roy et al., *supra* note 163; Roy & Marchetti, *supra* note 170.

To be specific, by screening the services commitments undertaken in 28 PTAs, Roy et al. examine the average share of sub-sectors being committed under the GATS, under Doha offers and under PTAs for Modes 1 and 3. The figures show that, in terms of the width of commitments, PTAs have brought significant advances to both supply modes. In terms of sectoral coverage, the contribution of PTAs is also impressive. On average, sectoral coverage reaches 73% for Mode 1 and 85% for Mode 3, doubling that achieved by the Doha offers and by existing GATS commitments respectively.[179]

Another research by Miroudot et al., investigating services schedules of commitments in 56 PTAs, also finds that on average, preferential services commitments surpass the GATS. Strikingly, 72% of 155 sub-sectors covered by these 56 PTAs have commitments on market access and national treatment, and the commitments are GATS+ in 42% of the sub-sectors. The levels of commitments are found to vary across modes of supply: fewer bindings are made under Modes 1 and 2, but they are usually in sub-sectors not covered by PTA parties' GATS schedules; whereas, the bindings under Modes 3 and 4 cover more sub-sectors but they are generally GATS+ ones. Distribution and business services are the sectors with the highest level of GATS+ commitments; while transport, recreational, cultural and sporting, and health and related services are the sectors with particularly high number of GATS-X bindings. In respect of construction and financial services, PTAs often bring forth improved commitments rather than new ones.[180]

Regarding commitments by sector, in general, there are more bindings at the sectoral level for Modes 1 and Mode 3 in PTAs as compared to the GATS. Notably, sectors that are more challenging to negotiate at the GATS level (e.g. education, audiovisual) have also allured fewer GATS+ bindings than those sectors such as telecommunications or financial services. Yet, preferential commitments for these challenging services still go remarkably beyond GATS ones in spite of the fact that in PTAs involving large trading partners, the more sensitive sectors (e.g. maritime transport for the US or audiovisual services for the EU) are often subject to little or no improvement.[181] Besides, PTAs have made progress with regard to government procurement in services, but the disciplines for this are not part of PTAs' services chapters.[182]

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[179] See Roy et al., *supra* note 163, at 81-82.

[180] See Miroudot et al., *supra* note 65, at 5.

[181] *Ibid*.

[182] See Roy & Marchetti, *supra* note 170, at 74.

As investigated by the WTO, the average level of sectoral coverage attained in PTAs is not different among developed and developing partners, but the dissimilarity with the GATS commitments is more visible for developing ones, since they often commit under fewer service sub-sectors at the multilateral level.[183] Besides, the state of development does tend to shape the features of PTA partners' GATS+ commitments. For developed economies, owing to their deeper GATS commitments, GATS+ commitments in PTAs tend to be more limited, which mainly improve the level of bindings in sectors already covered by their GATS schedules. In contrast, for developing ones, there is a spread of GATS+ bindings across all sectors, with marked advances 'in business, environmental services, distribution, education, and postal-courier services.'[184] Without any prejudice to this finding, the commitments of each WTO Member also differ across PTAs. To cite an example, Singapore's commitments vary noticeably in its PTAs with the US, Japan, and other ASEAN partners. Considerable variations are also identified in preferential services commitments of Australia, Chile and South Korea.[185]

Despite the fact that PTA commitments are less significant for Mode 4 as compared to other modes of supply, pursuant to the research of Carzaniga, except for the US (in its more recent PTAs), several Asian countries, and the European Free Trade Association (EFTA), all other Members' PTA commitments have gone beyond their GATS bindings, or even their latest DDA offers, although such advances are not sizable.[186] Moreover, it is noted that Mode 4 commitments are normally defined in a cross-sectoral manner in both the GATS and PTAs. Hence, a broader sectoral coverage of most PTAs entails the extension of commitments to a number of previously uncommitted sectors.[187]

About the framework of 'rules' governing trade in services, most agreements have not drifted far from the GATS in disciplining services subsidies or allowing for emergency safeguard measures. They also provide no extensive additional provision on domestic regulation, transparency and mutual recognition.[188] There are yet some examples that

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[183] See *World Trade Report 2011,* at 134.

[184] *Ibid*. There are certainly counter-examples to this overall trend. For instance, the ASEAN countries (except for Singapore), introduce rather limited GATS+ commitments in their PTAs.

[185] *Ibid,* at 136.

[186] Antonia Carzaniga (2008), 'A Warmer Welcome? Access for Natural Persons Under PTAs', in Martin Roy & Juan Marchetti (eds), *Opening Markets for Trade in Services: Countries and Sectors in Bilateral and WTO Negotiations* (New York: Cambridge University Press) 475-502, at 496-499.

[187] See *World Trade Report 2011,* at 136.

[188] See *World Trade Report 2011,* at 134 and Roy & Marchetti*, supra* note 170, at 74.

embody GATS+ commitments, for instance, a necessity test on domestic regulation in the PTA between Switzerland and Japan, or additional services-specific provisions on transparency in many agreements involving the US.[189]

Finally, PTAs are sometimes GATS-minus, which means they consist of commitments providing for less than what is bound under the GATS. As Adlung and Morrison argue, there are four typologies of GATS-minus commitments: tightening the existing GATS limitations, setting additional restrictions not listed in the GATS, omitting sub-sectors or sector segments, and including reciprocity elements. [190] To cite just an example, the Economic Partnership Agreement between Japan and Thailand contains some GATS-minus elements. Most apparently, in its services schedule Thailand lowers the foreign equity ceilings for telecommunication services from 40% (GATS) to 25%.[191]

3.1.3. The connection between investment chapters and trade in services chapters

As abovementioned, 'new generation' PTAs cover not only trade in goods and services, but also investment and even other non-trade issues. Since trade in services via Mode 3 involves the constitution and/or maintenance of a 'commercial presence' in another country, this mode of supply in fact relates to investment in the field of services. Thus, in PTAs where both investment and services trade are covered, how will the two areas interact, and whether there will be an overlapping? Given the dominant share of Mode 3, these questions prove to be crucial for the origin determination of services in PTAs. By nature, in PTAs where establishment-related services transactions are provided in the investment chapter instead of the trade chapter, ROO for this mode of supply may be found in the investment chapter. The notion of origin becomes even more complex where the establishment-related supply of services is included in both chapters.

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[189] The provisions mentioned can be found in the *Agreement on Free Trade and Economic Partnership between Japan and the Swiss Confederation*, Article 48, available at: http://www.mofa.go.jp/region/europe/switzerland/epa0902/agreement.pdf (visited 20 January 2018); and, for instance, in the *United States - Peru Trade Promotion Agreement*, Article 11.8, available at: https://ustr.gov/sites/default/files/uploads/agreements/fta/peru/asset_upload_file234_9537.pdf (visited 20 January 2018).

[190] Rudolf Adlung & Peter Morrison (2012), 'Poison in the Wine? Tracing GATS-minus Commitments in Regional Trade Agreements', *WTO Staff Working Paper ERSD-2012-04*, at 16.

[191] WTO Committee on Regional Trade Agreements, *Factual Presentation: Economic Partnership Agreement between Japan and Thailand (Goods and Services)* (document WT/REG235/1, dated 18 April 2011), at 37.

Pursuant to Houde et al., the investment and services chapters in PTAs inspired by the GATS and NAFTA differ in their structure and coverage, which entails different forms of interaction.[192]

***NAFTA-inspired PTAs*:** In these PTAs, there is a sharp separation between chapters on investment and those on cross-border trade in services with an aim to restrict their interaction. The former will govern investment disciplines on both manufacturing and services sectors (normally with an exception of financial services), whereas the latter is devoted to liberalizing services trade deliver via all modes but commercial presence.[193] In other words, Mode 3 supply of services is treated under the regime for investment.

NAFTA itself is the most illustrative example of PTAs with no interaction between the trade in services and the investment chapters. However, NAFTA-inspired PTAs recently concluded do allow for a limited interaction. For instance, some clauses in the chapter on cross-border services trade in the PTA between the US and Morocco (market access, domestic regulation, and transparency) apply to the investment chapter under certain conditions.[194] A clause on the 'relation to other chapters' is also included to clarify that other chapters prevail in case there is any inconsistency with the investment chapter.[195] Besides, though financial services are provided in a separate chapter, some provisions of the investment and the services trade chapters are incorporated to this sector.[196]

GATS-inspired PTAs: GATS-inspired PTAs generally cover investment and trade in services in separate chapters, but investment in services is normally governed by both disciplines. In such PTAs, the supply of services, including via commercial presence, is governed by chapters on cross-border services trade. Meanwhile, clauses on protection of investment in services, particularly expropriation, compensation for damages, and dispute resolution, are provided by investment chapters.[197] In resonance with the form

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[192] Marie-France Houde, Akshay Kolse-Patil & Sebastien Miroudot (2008), 'The Interaction Between Investment and Services Chapters in Selected Regional Trade Agreements', in OECD, *International Investment Law: Understanding Concepts and Tracking Innovations (*Paris: OECD Publishing) 241-340, at 245-247.

[193] *Ibid*, at 245.

[194] *United States – Morocco Free Trade Agreement*, Article 11.1(3), available at: https://ustr.gov/sites/default/files/uploads/agreements/fta/morocco/asset_upload_file680_3841.pdf (visited 19 January 2018).

[195] *Ibid*, Article 10.2(1), available at: https://ustr.gov/sites/default/files/uploads/agreements/fta/morocco/asset_upload_file651_3838.pdf (visited 19 January 2018).

[196] *Ibid*, Article 12.1(2), available at: https://ustr.gov/sites/default/files/uploads/agreements/fta/morocco/asset_upload_file441_3843.pdf (visited 19 January 2018).

[197] See Houde et al., *supra* note 192, at 246.

of trade and investment interaction, GATS-inspired PTAs can be divided further down as follows:

The interaction is defined in the investment chapter: This option is adopted by a large number of GATS-inspired PTAs. The chapters on services trade come first and contain market access and national treatment obligations toward commercial presence, while the chapters on investment define their coverage and provide rules to handle potential inconsistency with the services trade chapters.[198] This approach is adopted, for instance, in the PTA between New Zealand and Singapore: the commitments in the investment chapter shall not apply to any measure affecting the investments already regulated by the chapter on services trade to the extent that 'they relate to the supply of any specific service through commercial presence.'[199]

The interaction is defined in the trade in services chapter: This option is adopted in a fewer number of PTAs, in which the interaction is embodied via a 'service-investment linkage' clause in the chapter on services trade. This type of interaction may minimize the possibility of inconsistency between the two areas by indicating liberalization and protection obligations governing the investment in services.[200] To illustrate, in the PTA between India and Singapore, certain provisions on investment such as expropriation or compensation for damages 'shall apply *mutatis mutandis* to measures affecting the supply of service through commercial presence in the territory of the other party.'[201]

No interaction is defined: This approach is often found where investment is concluded as an agreement separated from the PTA containing the services in trade chapter. For instance, the clauses on transfers are found in both the PTA and the investment treaty between EFTA and Korea, with one being less permissive than the other.[202] In addition,

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[198] *Ibid*.

[199] *Agreement between New Zealand and Singapore on a Closer Economic Partnership*, Article 26, available at: https://www.mfat.govt.nz/assets/FTAs-agreements-in-force/Singapore-FTA/NZ-Singapore-CEP-full-text.pdf (visited 19 January 2018).

[200] See Houde et al., *supra* note 192, at 246-247.

[201] *Comprehensive Economic Cooperation Agreement between the Republic of India and the Republic of Singapore*, Article 7.24, available at: http://investmentpolicyhub.unctad.org/Download/TreatyFile/2707 (visited 19 January 2018).

[202] *Free Trade Agreement between the EFTA States and the Republic of Korea*, Article 3.13, available at: http://www.efta.int/media/documents/legal-texts/free-trade-relations/republic-of-korea/EFTA-%20Republic%20of%20Korea%20Free%20Trade%20Agreement.pdf (visited 19 January 2018).
Agreement on Investment between the Republic of Korea and the Republic of Iceland, the Principality of Liechtenstein and the Swiss Confederation, Article 5, available at:
http://www.efta.int/sites/default/files/documents/legal-texts/free-trade-relations/republic-of-korea/Investment%20Agreement/Investment%20Agreement.pdf (visited 19 January 2018).

this approach is also adopted in certain PTAs which cover investment, such as the one between Singapore and Japan. In this agreement, the services trade chapter lays down obligations regarding four modes of supply, while the investment chapter governs the measures affecting investment (excluding government procurement and movement of natural persons who are investors). There is no provision to handle a potential conflict between them.[203] Houde et al. remark that this approach counts entirely on 'the rules of interpretation of international law' to clear up the connection between the chapters on investment and services trade. Such a lack of clarity may cause confusion, thus recent PTAs tend to abandon this approach and favor a more precise and explicit one.[204]

It is noted that PTAs involving the EU and the EFTA countries (Iceland, Liechtenstein, Norway, and Switzerland) largely adopt the GATS approach, but unique features have separated them from other GATS-based PTAs.[205] To illustrate, in the PTA between the EU and Chile, there are chapters governing trade in services and investment that cover all modes of supply, financial services and establishment. However, the establishment chapter opts to preclude services from its coverage – it applies to 'establishment in all sectors with the exception of all services sectors, including financial services sector.'[206] The same provision is also found in the PTA between EFTA states and Chile, in which the establishment chapter narrows down its scope by ruling out investment in services sectors.[207] These PTAs are peculiar because an inclusion of four modes of supply in the chapter on services trade is similar to the GATS, but the exclusion of investment in all services sectors to eliminate interaction is closer to NAFTA.

3.2. Rules of origin for services in preferential trade agreements – approaches and practices

3.2.1. A general review of preferential ROO in services PTAs

3.2.1.1. The diversity of origin criteria

[203] *Agreement between Japan and the Republic of Singapore for a New-Age Economic Partnership*, Chapters 7 and 8 available at http://www.mofa.go.jp/region/asia-paci/singapore/jsepa-1.pdf (visited 19 January 2018).

[204] See Houde et al., *supra* note 192, at 247.

[205] *Ibid*.

[206] *Agreement Establishing an Association between the European Community and its Member States and the Republic of Chile*, Article 130, available at: http://eur-lex.europa.eu/resource.html?uri=cellar:f83a503c-fa20-4b3a-9535-f1074175eaf0.0004.02/DOC_2&format=PDF (visited 19 January 2018).

[207] *Free Trade Agreement between the EFTA States and the Republic of Chile,* Article 32, available at: http://www.efta.int/media/documents/legal-texts/free-trade-relations/chile/EFTA-Chile%20Free%20Trade%20Agreement.pdf (visited 19 January 2018).

As introduced Chapter 1, ROO for services in PTAs are crucial for the identification of services and service suppliers eligible for PTAs' benefits. In PTAs, ROO for services are often provided in 'denial of benefits' clauses as well as relevant terminology definitions. Considering the proliferation of services PTAs, preferential ROO for services are also diversified in terms of both structure and restrictiveness.

By reviewing a vast number of PTAs as well as bilateral investment agreements (BITs), Zampetti and Sauvé realize that the actual practices of PTAs with respect to the origin of services in Mode 1 and Mode 2 are quite limited. Many PTAs are silent on the issue while a prevailing number of them follow the GATS approach, identifying as origin the country from which or in which the service is supplied.[208] However, as analyzed in the following sections, most PTAs require in the clauses on denial of benefits that services be supplied from or in one party's territory by suppliers meeting certain requirements, otherwise they will be barred from preferential treatment. Therefore, one should note that although the origin of services supplied in PTAs under these modes is determined regardless of the nationality of service suppliers, the latter may eventually decide their eligibility of preferential treatment.

The ROO for services in the customs union among the Andean Community (including Bolivia, Colombia, Ecuador, and Peru) is an exception. It is one of the few agreements which explicitly employ the term 'origin of services'. Moreover, in case of cross-border supply of services, beyond the requirement that services originating in the sub-region must be 'produced and furnished directly from the territory of a Member Country', the supply must be conducted by suppliers originating in the sub-region themselves.[209]

For services supplied through Mode 3 and Mode 4, a variety of PTAs also closely follow the GATS approach. Regarding services supplied with the presence of natural persons, where the nationality of individuals is relevant for the purpose of granting preferences, most PTAs rely on the definitions of nationals and permanent residents. Yet, the issue of dual nationality is generally not touched.[210]

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[208] See Zampetti & Sauvé, *supra* note 60, at 133 and 143. The authors reviewed BITs since practice with respect to the nationality of investors, in many cases, would also cover investors active in the supply of services. However, this dissertation would not focus on BITs.

[209] Decision 439 (dated 11 June 1988), *General Framework of Principles and Rules and for Liberalizing the Trade in Services in the Andean Community,* Article 23, available at: http://www.sice.oas.org/Trade/Junac/decisiones/dec439e.asp (visited 25 January 2018).

[210] See Zampetti & Sauvé, *supra* note 60, at 134.

In as much as the nationality of legal persons are relevant for the origin determination of services, such criteria as incorporation, place of the seat, ownership or control, and SBO are those mainly used. Though the country of ownership or control is adopted as the sole test by a few PTAs, in general, these criteria are rarely used in isolation. More often it is combined with other criteria in the definitions to form positive rules, or with additional negative criteria provided in the clauses on denial of benefits.[211]

Regarding the first approach, PTAs involving EU and EFTA states normally adopt a requirement for both the incorporation test and the SBO test. For instance, the PTA between EFTA and Singapore deliberately includes in the scope of 'juridical of another party' a service supplier of a WTO Member being a non-party to the agreement as long as it is a 'juridical person constituted under the laws of a party, and engages in SBO in the territory of the parties.'[212] The Singapore–Japan Economic Partnership Agreement also features a denial of benefit clause, but this clause does not provide any additional requirement. This is because its definitions have defined a juridical person of the other partner as any entity constituted in that partner's territory, even if owned or controlled by persons of non-parties, providing that this juridical person has SBO in the territory of either party.[213]

Various bilateral and regional PTAs in the Americas have adopted the later approach, where additional requirements are provided in the clauses on denial of benefits. These include, *inter alia*, NAFTA and various agreements among Latin American countries. A similar model is also adopted by PTAs in which one party comes from the Americas, for instance, in agreements between China and Panama, between Chile and Korea, and between Singapore and the US.[214] Notably, the PTA between Australia and Singapore also follows this approach: it does not set out any other requirement in its substantive rules to identify an enterprise of another party than that it is constituted or otherwise

[211] *Ibid*, at 135. Regarding terminology, various PTAs do not use 'juridical person', but adopt the term 'enterprise'. They may also expand the term enterprise to include branches which have SBO. Some PTAs make the difference between 'enterprise' and 'locally established enterprise' (which is equal to a form of commercial presence).

[212] *Free Trade Agreement between The EFTA States and the Republic of Singapore*, Article 22 (l), available at: http://www.efta.int/media/documents/legal-texts/free-trade-relations/singapore/EFTA-Singapore%20Free%20Trade%20Agreement.pdf (visited 5 February 2018).

[213] See *Agreement between Japan and the Republic of Singapore for a New-Age Economic Partnership*, *supra* note 203, Article 58, Article 62 and Article 70.

[214] *Ibid*, at 135-136. See, for instance, the *United States – Singapore Free Trade Agreement*, Article 8.1 and 8.11, available at: https://ustr.gov/sites/default/files/uploads/agreements/fta/singapore/asset_upload_file708_4036.pdf (visited 5 February 2018).

organized under the law of such party. Nevertheless, the PTA can deny its benefits to a service supplier of the other party if it is an enterprise owned or controlled by persons of a non-party or persons of the denying party, and it has no SBO in the territory of the other party.[215]

In line with the findings of Zampetti and Sauvé, Miroudot et al. also find that ROO for services are generally not the center of PTAs' concerns. In addition, services ROO tend to concentrate more on service suppliers rather than on the services themselves.[216] This is rather common among PTAs following the NAFTA model, where 'denial of benefits' clauses are directed at suppliers only. In particular, the PTA between Chile and the US contains footnotes in the provisions on national treatment, MFN treatment and market access, indicating that 'service suppliers' shall have the same meaning as 'services and service suppliers' as in the respective GATS articles. [217] It indeed implies that the origin rules for suppliers are deemed inclusive enough to replace those for services.

A more recent research by Khumon reviews clauses relating to ROO for services of 47 PTAs in the Asia-Pacific region. The author finds that for natural persons to provide services, generally the requirements focus on the nationality test. Some PTAs directly refers that test to domestic laws.[218] For example, the agreement between the US and Korea requires 'national' to mean as defined in the Korean Nationality Act and the US Immigration and Nationality Act.[219]

Khumon acknowledges that criteria based on the incorporation of non-party juridical persons one PTA party combined with SBO are the most commonly used (by 45 out of the 47 PTAs reviewed, in which 16 of them also refer to the requirement on diplomatic relationship with the non-party country). The rule based on control and ownership by a natural or a juridical person of one of the parties is only employed by 2 out of the 47

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[215] *Singapore-Australia Free Trade Agreement (Chapter 7)*, Article 1 and Article 16, available at: http://dfat.gov.au/trade/agreements/safta/official-documents/Documents/safta-chapter-7-171201.pdf (visited 5 February 2018).

[216] See Miroudot et al., *supra* note 65, at 16.

[217] *United States – Chile Free Trade Agreement (Chapter 11 - Cross-Border Trade in Services)*, footnotes 2, 3, 4 to Article 11.2, 11.3 and 11.4, available at https://ustr.gov/sites/default/files/uploads/agreements/fta/chile/asset_upload_file233_4005.pdf (visited 6 February 2018).

[218] See Khumon, *supra* note 66, at 603.

[219] *Free Trade Agreement between the United States of America and the Republic of Korea (Definitions)*, Article 1.4, available at: https://ustr.gov/sites/default/files/uploads/agreements/fta/korus/asset_upload_file816_12698.pdf (visited 6 February 2018).

PTAs.[220] He also realizes interesting perspectives by comparing Asia-Pacific PTAs with major PTAs outside the region. In addition to conventional requirements, some north-north PTAs also deny benefits to any third country that fails to maintain international peace and security or protect human rights. This very basis for denying benefits is not found in the Asia-Pacific services ROO reviewed.[221] Khumon asserts that once this has been formulated as a ground to deny PTA benefits, it is interesting to see whether this new ground will be reproduced in upcoming PTAs. Yet, he foresees that future PTAs, at least in those involving Asia-Pacific states, will be less likely to deviate from the GATS approach.[222]

In most PTAs, there is still a lack of definitions for terms, particularly SBO, and even control or ownership. An exception is found in the PTA between China and Hong Kong, which broadly defines juridical person as any legal entity duly constituted or organized under the applicable laws of Mainland China or Hong Kong. Yet, there are provisions laying down in great detail the criteria for Hong Kong service suppliers who provide services in the form of juridical persons. These criteria determine incorporation and SBO, in which the latter is based on the nature and scope of business, minimum years of operation, profit tax, business premises, and employment of staff. Moreover, there are particular rules apply to law firms the legal services sector.[223]

In short, where the origin of services is determined based on the nationality of service providers as natural persons, the criteria are generally regulated by the national law of the PTA signatories and PTAs often cover both citizens and permanent residents. In terms of service providers being juridical persons, PTAs often utilize a combination of various criteria, most typically the place of incorporation, place of the corporate seat, SBO, and the ownership or control test.

3.2.1.2. How restrictive are preferential ROO for services?

In the first chapter, it has been indicated that the stringency of services ROO may vary depending on the criteria used and construed, particularly for Mode 3 and Mode 4. In

[220] See Khumon, *supra* note 66, at 608-609.

[221] See Khumon, *supra* note 66, at 611. An example is the *Canada - European Union Comprehensive Economic and Trade Agreement* (CETA), which will be discussed in the next section.

[222] *Ibid.*

[223] See *Mainland and Hong Kong Closer Economic Partnership Arrangement (Agreement on Trade in Services),* Annex 3, Article 3.2(3) and Article 3.3, available at: https://www.tid.gov.hk/english/cepa/legaltext/files/consolidated_a5.pdf (visited 5 February 2018).

principle, considering the width of the set of services and services suppliers entitled to an agreement's treatment, where the origin of natural persons is relevant, permanent residency is less stringent than citizenship. Meanwhile, in respect of legal persons, the ascending order of restrictiveness among the criteria is place of incorporation, location of company's statutory seat or headquarters, SBO, and finally, control or ownership.

In reality, as Zampetti and Sauve assert, the diversity of practices does complicate the ranking of preferential services ROO by their level of stringency since there is no clear trend in the combination and accumulation of origin criteria.[224] Miroudot et al. further argue that it is difficult to provide a ranking to illustrate the stringency of preferential service ROO since 'the practical impact of legal provisions differs according to national interpretations of legal terms and concepts.'[225] Besides, the ranking is not only complex because the criteria are combined, but also because they are more often accompanied by benefit denial clauses. It is not to mention the fact that various important terms are left undefined, which renders these tests more contentious.[226]

However, some agreements are apparently more liberal, illustrated by the extension of benefits to entities that have less connection with the partners of the PTAs. Meanwhile, others show a preference to grant preferential treatment only to services provided by persons effectively linked to the signatories.[227] To illustrate, Khumon realizes that most PTAs involving Asia–Pacific countries have liberal services origin provisions in respect of natural persons. For instance, the PTA between EFTA states and Singapore and the ASEAN Framework Agreement on Services (AFAS) only require natural persons to be at least permanent residents.[228] Whereas, more restrictive criteria are found in various PTAs that involves Japan.[229] To cite an example, the ROO for services in the agreement between Japan and Vietnam grant preferences only to PTA nationals by defining that a 'natural person of the other party' is a person residing in that other party or elsewhere, who must be a national of that other party under its law.[230] There are instances of PTAs where Japan adopts strict definitions which limit natural persons only to its nationals,

[224] See Zampetti & Sauve, *supra* note 60, at 142.
[225] See Miroudot et al., *supra* note 65, at 17.
[226] See Zampetti & Sauvé, *supra* note 60, at 143-144.
[227] *Ibid*, at 140.
[228] See Khumon, *supra* note 66, at 604.
[229] *Ibid*, at 604-505.
[230] *Japan-Viet Nam Economic Partnership Agreement*, Article 58(k), available at: http://www.mofa.go.jp/region/asia-paci/vietnam/epa0812/agreement.pdf (visited 7 February 2018).

while its partners set out more lenient requirements. For example, in the PTA between Japan and Switzerland, Japan requires a natural person of Japan to be a national, but Switzerland accepts both Swiss nationals and permanent residents in Switzerland.[231]

By reviewing different models of PTAs, Miroudot et al. realize that in general the least restrictive rules on natural persons, i.e., only require at least permanent residency, are found in PTAs following the NAFTA model. Agreements involving the EU, in contrast, only confine the PTA privileges to their nationals. This approach becomes a barrier for third party individuals to gain benefit from the PTAs. In between, there are PTAs that allow permanent residency where 'it entails the same treatment as nationals in respect of measures affecting trade in services.'[232]

Regarding juridical persons, PTAs in the Asia-Pacific region embody great variance in stringency. A number of PTAs provide liberal ROO for juridical persons, which extend benefits to all juridical persons incorporated in one of the parties and conduct SBO in the territory of a PTA party.[233] In contrast, the PTA between Japan and the Philippines stipulates a slightly more restrictive provision denying benefits to a service supplier of the other party if the service is supplied by a juridical person owned or controlled by a person(s) of a non-party that does not have diplomatic relationships with the denying party.[234] The most stringent provision may be found in the PTA between Thailand and Australia where 'a party may deny its benefits to a service supplier of the other party if the service supplier is owned or controlled by persons of a non-party.'[235] One may note that Thailand allows full foreign ownership in the construction and distribution sectors, but limits the preferences to firms owned or controlled by Australian persons. Instead, third party investors are to observe the 49% foreign equity ceiling in these sectors and cannot control any Thai company.[236]

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[231] See *Agreement on Free Trade And Economic Partnership between Japan and the Swiss Confederation*, *supra* note 174, Article 44(k).

[232] See Miroudot et al., *supra* note 65, at 18.

[233] See Khumon, *supra* note 66, at 605. See, for instance, the *Malaysia-Australia Free Trade Agreement*, Article 8.2 and 8.15, available at http://fta.miti.gov.my/miti-fta/resources/Malaysia-Australia/MAFTA.pdf (visited 7 February 2018).

[234] *Japan–Philippines Economic Partnership Agreement*, Article 85, available at: http://www.mofa.go.jp/region/asia-paci/philippine/epa0609/main.pdf (visited 7 February 2018).

[235] *Thailand–Australia Free Trade Agreement*, Article 804, available at: http://dfat.gov.au/trade/agreements/tafta/fta-text-and-implementation/Documents/aus-thai_FTA_text.pdf (visited 7 February 2018).

[236] Carsten Fink & Marion Jansen (2007), 'Services Provisions in Regional Trade Agreements: Stumbling or Building Blocks for Multilateral Liberalization?', paper presented at the *Conference on Multilateralizing Regionalism*, (Geneva, 10-12 September 2007), at 11.

It is notable that sometimes the same country carries a different level of stringency in services ROO of different PTAs to which it is a party. As Khumon remarks, the Japan–Singapore PTA is expected to anchor a 'new-age PTA' supporting deep and substantial liberalization to strengthen the competitiveness of both countries. Such expectation is reflected in the liberal origin rules extending preferences towards non-party countries' service suppliers, as long as they carry out SBO in the territory of one of the parties.[237] Meanwhile, restrictive services ROO are found in PTAs between Japan and developing countries (e.g., Indonesia, Thailand, and Vietnam). Khumon argues that this is due to the low level of bindings by Japan's partners: developing countries have less incentive to extend PTA benefits to non-members to avoid any threat to the economy, i.e., 'more external competition from rigorous liberalization'.[238]

In their research, Miroudot et al. have found that in respect of juridical persons, there are also a variance in the structure of services ROO among the different types of PTAs. The EU model normally provides a definition for juridical persons which covers place of incorporation and SBO tests. PTAs following the NAFTA broadly defines a juridical person based solely on the place of incorporation test, but allows for the possibility to deny benefits when there is a lack of SBO. Whereas, hybrid agreements introduce both a restrictive definition and a clause on denial of benefits.[239] The authors assert that the most lenient group of ROO are those considering place of incorporation as sufficient to determine a juridical person as that of one party. Although this does not eliminate the possibility of a service being denied from PTA treatment if it is delivered by a non-party supplier, there is no requirement on SBO in these ROO.[240]

Regarding those ROO introducing a SBO test, the level of stringency is decided by the conditions on the territory where the SBO are conducted. Certain PTAs are regarded as more liberal because they permit juridical persons owned or controlled by non-parties to be constituted under the law of one party and have SBO in the territory of any party. To illustrate, the subsidiary of a Dutch services firm established in Singapore can take advantage of the treatment under the Japan–Singapore PTA by carrying out its SBO in Japan. This is not allowed by the ROO in the PTA between the US and Bahrain, where

[237] See *Agreement between Japan and the Republic of Singapore for a New-Age Economic Partnership*, supra note 203, Article 62.

[238] See Khumon, *supra* note 66, at 610.

[239] See Miroudot et al., *supra* note 65, at 17.

[240] *Ibid*, at 20.

a party may deny the PTA benefits to a service supplier of the other party if the service is supplied by an enterprise having no SBO in the territory of the other party, which is 'owned or controlled by persons of a non-party, or of the denying party'.[241] It is obvious that PTAs adopting this approach require the commercial presence to have SBO in the territory of the PTA party where it is established or maintained.

When ROO additionally require that the juridical person must be owned or controlled by person(s) of the PTA parties, it in effect means foreign-owned or foreign-controlled companies are barred from the PTA treatment. As discussed earlier, the PTA between Thailand and Australia may exemplify this type of restriction; however, this instance is not commonly found. Some PTAs (e.g., Chile–Korea, Japan–Malaysia, Japan–Mexico, Japan–Philippines, and Singapore–US) deny their benefits to service suppliers owned or controlled by a non-party with whom the denying party do not maintain diplomatic relationships, or on whom certain trade sanction measures are imposed.[242] Unlike the clause in Thailand–Australia, this latter form of clause deny benefits to a considerably smaller number of non-party suppliers.

Another question relates to the condition under which the branch of a foreign supplier established in one PTA party will benefit from the preferences. Fink and Jansen realize that there is some variations in terms of the treatment confined to branches of foreign enterprises. Several PTAs refuse to extend their preferences to branches of non-party service suppliers. For financial services, the authors argue that 'such a restriction may have prudential motivations, as branches are typically regulated by the country of the parent firm.'[243] However, since a number of PTAs define service suppliers of one party as nationals of that party or enterprises constituted under the laws of that party (which may include those constituted as commercial presence of foreign service suppliers), it seems that while subsidiaries of foreign suppliers in a PTA party can meet the criteria, branches and representative offices thereof do not.[244]

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[241] *Ibid*, at 20. See the *United States-Bahrain Free Trade Agreement (Chapter 10: Cross-Border Trade in Services)*, Article 10.1(2), available at: https://ustr.gov/sites/default/files/uploads/agreements/fta/bahrain/asset_upload_file418_6280.pdf (visited 8 February 2018).

[242] See Khumon, *supra* note 66, at 601. See, for instance, the *Malaysia-Japan Economic Partnership Agreement*, Article 109, available at: http://fta.miti.gov.my/miti-fta/resources/auto%20download%20images/55894af110378.pdf (visited 8 February 2018).

[243] See Fink & Jansen, *supra* note 236, at 11.

[244] Notably, in Fink & Nikomborirak, see below note 250, at 127, the authors remark: 'most PTAs extend benefits to both incorporated and non-incorporated non-party supplier (branches and representative offices) if they have SBO.' But this conclusion seems to emerge from the authors' negligence in treating branches as juridical persons.

In terms of the current trend in the accumulation of different origin criteria, Zampetti and Sauvé assert that the criteria tend to be combined where PTA parties want to limit the preferences to those entities that have effective economic links with them, so as to prevent free-riding by service suppliers of non-parties. In contrast, when free-riding is not a serious concern and the signatories want to broaden their PTA's coverage and to minimize the adverse diversion of trade and investment, PTAs may oft for more liberal rules, i.e., those based on the place of incorporation or the SBO tests.[245] Miroudot et al. also acknowledge that for juridical persons, most PTAs employ the SBO test to decide whether a third party's company will be eligible for preferences. In principle, the level of stringency may vary pursuant to the meaning conveyed by the term SBO. However, countries often follow a liberal approach in practice, and do not introduce the test with the sole purpose to prevent non-parties from PTA benefits where they are regarded as juridical persons in one PTA party. The authors also note that the most crucial source of restrictiveness comes from the rules requiring companies to be controlled or owned or by person(s) of one PTA party, but this criterion is rarely used.[246] As a matter of fact, lenient ROO for services and service suppliers have an significant role in reducing the distortions caused by PTAs. As some authors argue, the concern in the field of trade in goods about 'a spaghetti bowl of multiple and differing' ROO does not tend to 'arise to the same extent' in the field of trade in services. [247]

In general, the authors seem to concur that a vast majority of PTAs adopt liberal ROO for juridical persons. With a few exceptions, most services PTAs tend to provide liberal ROO through a lenient benefit denial clauses which only bar the PTA preferences from juridical persons failing the SBO test. As the WTO remarks, the typical requirement in PTAs' ROO for services is 'establish a legal presence and a certain level of commercial activity in one of the PTA members.'[248]

It should, however, be noted that while most of the studied PTAs have liberal ROO for juridical persons, ROO for natural persons remain restrictive in many PTAs. As Sauvé and Shingal contend, origin rules for Mode 4 rank among the most restrictive of all.[249] Moreover, though liberal ROO extend PTA preferences to non-party service suppliers,

[245] See Zampetti & Sauvé, *supra* note 60, at 144.
[246] See Miroudot et al., *supra* note 65, at 22.
[247] See Roy et al., *supra* note 163, at 185-186.
[248] See *World Trade Report 2011*, at 169.
[249] See Sauvé & Shingal, *supra* note 96, at 408.

they cannot be deemed as a substitute for MFN treatment or the multilateralization of services trade. ROO still discriminate between PTA and non-PTA suppliers as the latter may be denied benefits if they fail to meet the SBO test, whereas the former are eligible for preferences irrespective of their footage of business activities in the PTA parties.[250] Although liberal ROO allow non-party suppliers to gain from lower trade costs within PTAs, they still incur the costs of incorporation, authorization, application for practice license, etc. In other words, as lenient as they are, services ROO still impose additional costs on a parent company when it seeks to supply via its foreign affiliate; therefore, it is arguable that 'there is still a preference granted to domestic companies.'[251]

3.2.2. Preferential ROO for services in selected PTAs

3.2.2.1. North American Free Trade Agreement (NAFTA)

The NAFTA came into force on January 1994, forming a trilateral trade agreement in in North America, which sought to liberalize trade among the US, Canada and Mexico. As one of the most ambitious PTAs, it has abolished most tariff and non-tariff barriers to trade and investment among the partners. NAFTA aims to enhance the competition conditions to embrace market access and investment opportunities within the bloc.[252]

In NAFTA, investment and both cross-border trade in services are governed by *Part V: Investment, Services and Related Matters*, where investment comes first in Chapter 11 and services trade comes later in Chapter 12. The disciplines for financial services are provided separately in Chapter 14. As mentioned above, in the NAFTA model, services provided via commercial presence will be covered in the investment chapter. It is noted that NAFTA includes also Mode 4 in the scope of cross-border trade in services, which is quite different from various other agreements where the temporary entry of natural persons for supplying services is provided in a separate chapter.[253]

What is peculiar about NAFTA is that there is no such term as 'service of a party.' It is noted that in the GATS, treatment is conferred on the condition that service is service

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[250] Carsten Fink & Deunden Nikomborirak (2008), 'Rules of Origin in Services: A Case Study of Five ASEAN Countries', in Marion Panizzon et al. (eds), *GATS and the Regulation of International Trade in Services* (Cambridge: Cambridge University Press) 111-136, at 126.

[251] See Miroudot et al., *supra* note 65, at 21.

[252] GlobalEdge, https://globaledge.msu.edu/trade-blocs/nafta/memo (visited 8 February 2018).

[253] Full text of the Agreement is available online at: https://www.nafta-sec-alena.org/Home/Texts-of-the-Agreement/North-American-Free-Trade-Agreement?mvid=1&secid=7684fdb8-1784-4b39-b068-1b9a13952814 (visited 2 February 2018).

of a Member. From the structure of Article XXVIII, it is apparent that for the purpose of defining 'service of another Member' that entails the need to define other terms, i.e., 'service supplier', 'person', 'natural person of another Member', or 'juridical person of another Member'. Meanwhile, NAFTA opts to use a different approach which is based entirely on service provider. Article 1201 of NAFTA states that the Chapter shall apply to the measures adopted or maintained by one party 'relating to cross-border trade in services by service providers of another party.' Hence although the definition of cross-border trade in services resembles the provision of the GATS, it needs to be interpreted narrowly.[254] For instance, services supplied across border from the US to Canada may fall within the scope of the GATS if the supply is conducted by a NAFTA provider. It is even more obvious in item (b) of this definition, which covers the supply of service 'in the territory of a Party by a person of that Party to a person of another Party', which is the form of supply equivalent to Mode 2 of the GATS. However, NAFTA indicates that the supply of a service via this form must be carried out by a person of the party where 'consumption abroad' takes place. It is worth recalling the previous discussion that the GATS is silent as to who actually provides services in Mode 2, and it provides no other requirement than the place of consumption. In the NAFTA's definition, the phrase 'in the territory of a Party by a person of that Party to a person of another Party' seems to imply that it does not include the possibility of Canadian persons providing services to Mexican persons in the territory of the US, which is quite realistic in practice. This may give rise to the question: when a Canadian patient goes to Mexico to be treated by a US doctor, will this supply be covered by the definition at hand?

This peculiarity partly explains why NAFTA does not provide any definition on service of a party. Instead, all origin-related provisions are directed towards 'service provider', which is construed as 'a person of a Party that seeks to provide or provides a service.' It is notable that this definition differs from that of the GATS because it unambiguously includes two categories of persons: those with the intention to provide, and those who actually provide services. This definition is more specific and may avoid an uncertainty

[254] See Article 1213 of NAFTA, which provides that:

For purposes of this Chapter, cross-border provision of a service or cross-border trade in services means the provision of a service:

(a) from the territory of a Party into the territory of another Party,

(b) in the territory of a Party by a person of that Party to a person of another Party, or

(c) by a national of a Party in the territory of another Party, but does not include the provision of a service in the territory of a Party by an investment, as defined in Article 1139 (Investment Definitions), in that territory.

as found in the GATS definition.[255] Besides, NAFTA does not follow the language of the GATS (i.e., dividing 'person' into 'juridical person' and 'natural person'), but it instead construes this term as including a 'national' or an 'enterprise'.

The definition of 'national' is found in Article 201 (Definitions of General Application), and means 'a natural person who is a citizen or permanent resident of a Party and any other natural person referred to in Annex 201.1.' The Annex in turn refers to domestic laws in providing country-specific definitions for this term:

> *Annex 201.1: Country-Specific Definitions*
>
> For purposes of this Agreement, unless otherwise specified, national also includes:
>
> (a) with respect to Mexico, a national or a citizen according to Articles 30 and 34, respectively, of the Mexican Constitution; and
>
> (b) with respect to the United States, 'national of the United States' as defined in the existing provisions of the *Immigration and Nationality Act*.

Meanwhile, 'enterprise of a Party' is defined in Article 1213 to include one 'constituted or organized under the law of a Party, and a branch located in the territory of a Party and carrying out business activities there.' This definition includes two categories: for an enterprise per se, place of constitution is the only requirement that it has to observe to qualify for the nationality in a NAFTA country. However, for a branch, to be covered in the scope of the agreement, it needs to be located in a party and to conduct business activities in the territory of that party. Since there is no additional condition, NAFTA's definition of enterprise is indeed very lenient. A Chilean firm may set up its subsidiary in Canada and this subsidiary will be immediately considered an enterprise of Canada regardless of its SBO or ownership. The more stringent rule only applies to the case in which this Chilean firm sets up a branch in Canada; then for this branch to be deemed an 'enterprise of Canada', it needs to have business activities in Canada.[256] Even in this case, NAFTA does not indicate the level of engagement as it contains no word such as 'substantial' or 'main' preceding 'business activities.' Therefore, it is arguable that any level of business engagement would satisfy this requirement. However, to balance this relatively broad definition, further requirements are provided in the 'denial of benefits' clause, which narrows down the set of providers eligible for NAFTA preferences:

[255] See *supra* section 2.2.7.

[256] Notably, this definition specifically mentions branch, not representative office. Thus, a representative office of a Swiss bank in Canada may be denied NAFTA benefits by the US, but not a branch of the same bank.

Article 1211: Denial of Benefits

1. A Party may deny the benefits of this Chapter to a service provider of another Party where the Party establishes that:

(a) the service is being provided by an enterprise owned or controlled by nationals of a non-Party, and

(i) the denying Party does not maintain diplomatic relations with the non-Party, or

(ii) the denying Party adopts or maintains measures with respect to the non-Party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of this Chapter were accorded to the enterprise; or

(b) the cross-border provision of a transportation service covered by this Chapter is provided using equipment not registered by any Party.

2. Subject to prior notification and consultation in accordance with Articles 1803 (Notification and Provision of Information) and 2006 (Consultations), a Party may deny the benefits of this Chapter to a service provider of another Party where the Party establishes that the service is being provided by an enterprise that is owned or controlled by persons of a non-Party and that has no substantial business activities in the territory of any Party.

In Article 1211(1), there are three scenarios where a NAFTA Member can deny benefits to a service supplier of another party. The first two scenarios relate to services supplied by an enterprise owned or controlled by nationals of a non-party if that non-party has no diplomatic relations with the denying party, or if it relates to certain measures that the denying party adopts or maintains towards the non-party. The third scenario only focuses on the supply of transportation services. A more common provision on denial of benefits is provide in Article 1211(2), according to which NAFTA preferences can be denied where the service is 'supplied by an enterprise owned or controlled by persons' (which is broader than 'nationals' in the preceding paragraph) of a non-party, and this enterprise conducts no SBO in the territory of any NAFTA country. In other words, an enterprise owned or controlled by persons of third parties, not falling within the cases covered by Article 1211(1), may be entitled to NAFTA benefits if it has SBO in the area. For instance, if the subsidiary of a European services firm is established under the US laws and has SBO in the territory of any NAFTA partner, it will be treated as any other US firm once it seeks to invest in Mexico.[257] However, NAFTA deliberately sets a higher

[257] See Miroudot et al., *supra* note 65, at 21.

requirement for a branch of the same firm to be entitled to NAFTA preferences: if it is established under the US laws, it must have SBO in the US.

In respect of the supply of services relating to investment, it is governed by Chapter 11, which lays down the regulation of investment covering all sectors. It is notable that the coverage of the term 'investor' is broader than 'service provider' in the services chapter. The definition of an 'investor of a Party' includes 'a Party or state enterprise thereof, or a national or an enterprise of such Party that seeks to make, is making or has made an investment.' This chapter also includes a provision on denial of benefits:

> *Article 1113: Denial of Benefits*
>
> 1. A Party may deny the benefits of this Chapter to an investor of another Party that is an enterprise of such Party and to investments of such investor if investors of a non-Party own or control the enterprise and the denying Party:
>
> (a) does not maintain diplomatic relations with the non-Party; or
>
> (b) adopts or maintains measures with respect to the non-Party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of this Chapter were accorded to the enterprise or to its investments.
>
> 2. Subject to prior notification and consultation in accordance with Articles 1803 (Notification and Provision of Information) and 2006 (Consultations), a Party may deny the benefits of this Chapter to an investor of another Party that is an enterprise of such Party and to investments of such investors if investors of a non-Party own or control the enterprise and the enterprise has no substantial business activities in the territory of the Party under whose law it is constituted or organized

While the clauses on denial of benefits are generally similar between the two chapters, it is possible to spot some minor differences. Article 1113(1) covers the investors being enterprises owned or controlled by 'investors of a non-Party': it is not restricted to the cases where the enterprises are controlled or owned by nationals of a non-party found in Article 1211(1), but by non-NAFTA investors in general. Therefore, the chance of an enterprise being denied of NAFTA benefits by this provision is higher than in the trade chapter. Moreover, though Article 1113(2) shares a similar approach to Article 1211(2), it does set out a more stringent requirement. For any investor being an enterprise of a NAFTA party, which is owned or controlled by non-party investors, the SBO has to be conducted in the territory of the party where the enterprise is established (meanwhile, the rule in the services trade chapter allows it to operate substantively in any party).

What may be a legal implication entailed by Article 1113(2)? Under both chapters, EU investors are permitted to constitute enterprises in the US under the US laws in order to provide services to Mexico since NAFTA's ROO will treat this EU-owned enterprise as enterprise of the US. If this EU-owned enterprise only commits cross-border supply of services, it must have SBO in any NAFTA member (according to the requirement of the chapter on cross-border trade in services). However, if such EU-owned enterprise wishes to provide services by way of establishment in Mexico, it must have SBO in the US. It seems Article 1113(2) aims to address a potential circumvention when such EU-owned enterprise does not have any SBO in the US, but just take advantage of its legal position to establish a commercial presence in Mexico.

It is noteworthy that in both chapters, and even in Article 201 (Definitions of General Application), there are no definitions to determine control, ownership, and SBO.

3.2.2.2. ASEAN Framework Agreement on Services (AFAS)

Recognizing the importance of services trade, ASEAN Member States launched a joint effort towards enhancing liberalization of services within the region through the AFAS, signed on 15 December 1995. Subsequently, a protocol amending the AFAS was signed in 2003, which aims to substantially eliminate restrictions to services trade among the ASEAN partners to enhance the capacities and competitiveness of the service suppliers. The agreement provides broad guidelines to guarantee fair market access and national treatment for ASEAN service suppliers, yearning for the achievement of commitments beyond each member's GATS commitments. The bloc's next agenda is to negotiate the ASEAN Trade in Services Agreement, which is expected to be the legal instrument for further integration of services trade in the region.[258]

Most significantly, Article XIV of the AFAS sets out that 'the terms and definitions and other provisions of the GATS shall be referred to and applied to matters arising under this Framework Agreement for which no specific provision has been made under it.' It in fact entails that the AFAS shall refer to the definitions provided under GATS Article XXVIII, particularly the term 'service of another Member.' It means the discussion on ROO in the GATS will apply to the AFAS context. For this reason, one may reasonably expect that the 'denial of benefits' clause in the AFAS will also closely follow the GATS

[258] The introduction to the agreement is available in http://asean.org/asean-economic-community/sectoral-bodies-under-the-purview-of-aem/services/; full text of the Agreement can be found at: http://investasean.asean.org/files/upload/Doc%2008%20-%20AFAS.pdf (visited 2 February 2018).

approach. However, as cited below, Article VI of the AFAS does depart rather far from Article XXVII of the GATS. Instead of stipulating benefit denial rules for both services and service suppliers in line with four modes of supply, the provision at hand chooses to address service suppliers only.[259]

> *Article VI: Denial of Benefits*
>
> The benefits of this Framework Agreement shall be denied to a service supplier who is a natural person of a non-Member State or a juridical person owned or controlled by persons of a non-Member State constituted under the laws of a Member State, but not engaged in substantive business operations in the territory of Member State(s).

This is one of the shortest clauses on denial of benefits found in all the PTAs examined. By excluding non-qualifying suppliers from AFAS benefits and being silent on services, it is closer to the NAFTA approach as analyzed above. Because the benefits are denied to natural persons of non-partners, it means only natural persons of the ASEAN states are entitled to AFAS benefits. Moreover, because the GATS' definitions will apply, it is inferable that natural persons eligible for AFAS preferences include not only nationals but also permanent residents of ASEAN members – the latter subject to requirements specified in Article XXVIII(k)(ii) of the GATS.

For juridical persons, the clause is quite explicit where, for example, Thailand refuses an EU-owned firm established in Vietnam from setting up its subsidiary in Thailand if this company fails the SBO test. However, in the case of cross-border supply (Mode 1), how would the eligibility for preferential treatment be defined by this Article? It is not self-explanatory whether the supply of a service from the territory of Vietnam to Laos is sufficient for preferential treatment, or the supply must be performed by an eligible service supplier. It seems the purpose of this clause is to ensure a non-ASEAN service supplier who has established commercial presence in an ASEAN Member State needs to pass the SBO test to gain market access to another AFAS party irrespective of mode of supply. For this reason, there is a high probability that a cross-border supply as such is not entitled to AFAS treatment if the supplier fails to fulfill the criteria in this clause on denial of benefits.

This clause entails yet another question that may be relevant not only to the AFAS but to any PTA failing to provide clear definitions: since this clause only mentions 'juridical

[259] An example of a PTA that replicates both GATS definitions and its denial of benefits clause is the *Malaysia-Australia Free Trade Agreement*.

persons owned or controlled by persons of a non-Member State', what is the treatment to other forms of commercial presence of non-ASEAN service suppliers (i.e., branch or representative office)? Notably, when the definition of commercial presence explicitly includes these non-juridical forms, or when a PTA refers to the GATS definitions as in the case of the AFAS, it only means that one PTA partner may gain market access into another PTA partner through opening a representative office or a branch. However, it is unclear as regards the status of, for example, a branch of a non-ASEAN company in Vietnam, particularly when this branch seeks to supply services to another AFAS party. One may recall that in NAFTA, an 'enterprise of a party' is explicitly defined to include a branch established under the laws of a party and has SBO therein, so the uncertainty does not arise. Based on Article V:6 of the GATS, it may be argued that the GATS only requires a PTA to extend its benefits to a juridical person owned or controlled by non-partners' persons; thus a branch or representative office established or maintained by a non-partner's company will not be included. However, this point may raise different understanding and should therefore be clearly drafted. To avoid uncertainty, examples of higher clarity as in NAFTA or the PTA between Malaysia and Pakistan quoted below should be taken as good practice:

> In order to prevent the possibility of companies of a third State unduly benefiting from this Agreement, companies of a third State registered in the territory of the country of another Party, their offices, liaison offices, 'shell companies' and 'mail box companies' and companies specifically established for providing certain services to their parent companies are not service suppliers of another Party under this Agreement.[260]

Besides the above discussion, it is important to draw attention that the term SBO, whose definition is not provided by the GATS, is not further defined by this PTA.

3.2.2.3. Comprehensive Economic and Trade Agreement (CETA) between Canada and the EU

This PTA between Canada and the EU was concluded in October 2016, embodying the shared commitments of its parties to promote free and fair trade. As a progressive and modern trade agreement, the CETA is expected to enhance economic activities between the parties, and at the same time guarantee shared values and the role of governments

[260] *Agreement between the Government of the Islamic Republic of Pakistan and the Government of Malaysia for a Closer Economic Partnership*, Article 69(g), available at: http://www.commerce.gov.pk/PMFTA/PAk-Malaysia-FTA(TXT).pdf (visited 10 February 2018).

in the economy. The CETA was approved by the Canadian Parliament in May 2017, by the European Parliament in February 2017, and it has been provisionally applied from September 2017.[261]

Article 9.1 of the CETA defines cross-border trade in services as the supply of a service 'from the territory of a Party into the territory of the other Party'; or 'in the territory of a Party to the service consumer of the other Party.' However, it is further clarified that cross-border services trade 'does not include the supply of a service in the territory of a Party by a person of the other Party.' It means the supply of services via commercial presence or the presence of natural presence shall be provided in separate chapters on investment and temporary entry of natural persons.

It is provided in Article 9.2 that the trade in services chapter shall apply to 'a measure adopted or maintained by a Party affecting cross-border trade in services by a service supplier of the other Party.' It means, like in NAFTA, a cross-border supply of services falls within the scope of CETA only if it is carried out by a supplier of a CETA member. This entails the need to look at the definition of 'service supplier' so as to interpret the agreement's ROO for services. Pursuant to Article 1.1 of CETA (Definitions of General Application), 'service supplier means a person that supplies or seeks to supply a service' and 'person means a natural person or an enterprise.' In addition, CETA also provides a more specific definition for 'person of a Party' that covers 'a national or an enterprise of a Party'. It *prima facie* seems that natural persons of a CETA member are meant to include only nationals. However, the term 'national' is construed broadly as 'a natural person who is a citizen as defined in Article 1.2, or is a permanent resident of a Party.'[262] It is noted that in the GATS and in various PTAs, 'national' is considered as a category separated from 'permanent resident', but in CETA the definition of 'national' contains the latter. All in all, a natural person of a CETA party may be a citizen or a permanent resident thereof. Particularly, the term 'citizen' has 'party-specific definitions' provided in Article 1.2 of the CETA:

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[261] For more information, see the *Joint Interpretative Instrument* between Canada and the EU, available at: http://ec.europa.eu/trade/policy/in-focus/ceta/ (visited 31 January 2018).

The CETA's provisional entry into force covers provisions over which the EU has exclusive competence, thus it excludes provisions on investment protection and investor-state dispute resolution mechanism. Being a mixed agreement, the CETA shall not fully enter into force until the completion of all national ratification procedures. Full text of the agreement is available at: http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf (visited 1 February 2018).

[262] There is a specific definition for 'natural person', but it is used the context of *Chapter 8 – Investment*.

> For the purposes of this Agreement, unless otherwise specified: citizen means: (a) for Canada, a natural person who is a citizen of Canada under Canadian legislation; (b) for the European Union, a natural person holding the nationality of a Member State;

Apparently, Canada and the EU follow different interpretations of 'citizen'. For Canada, 'citizen' is a citizen per se, while for the EU, 'citizen' refers to 'a natural person holding nationality of' an EU Member State. Technically, citizenship is understood as a juristic or legal concept showing that an individual is registered as a citizen by the government of the respective country, while nationality is an ethnic or racial concept that provides the status or relationship allowing a nation the right to protect a person from another nation.[263] It is unclear if the CETA members intend to make such technical distinction between 'citizenship' and 'nationality' because in practice, the two terms are often used interchangeably.

The term 'enterprise' is defined by Article 1.1 of the CETA as 'an entity constituted or organized under applicable law, whether or not for profit, and whether privately or governmentally owned or controlled, including a corporation, trust, partnership, sole proprietorship, joint venture or other association.' Noticeably, there is a more specific definition for 'enterprise of a Party' provided in Article 8.1 of the investment chapter, which is only for the purposes of that chapter; hence, in other chapters, the definition of enterprise provided by Article 1.1 will apply. Pursuant to this Article, an enterprise of a CETA party is defined by place of constitution and may take a number of forms as indicated (the method of listing forms of enterprise is close to that in the definition of 'juridical person' in the GATS). Such lenient definition is found also in NAFTA, which is then balanced by the clause on denial of benefits. However, CETA favors a different approach in respect of this clause:

> *Article 9.8*
>
> *Denial of benefits*
>
> A Party may deny the benefits of this Chapter to a service supplier of the other Party that is an enterprise of that Party and to services of that service supplier if:
>
> (a) a service supplier of a third country owns or controls the enterprise; and
>
> (b) the denying Party adopts or maintains a measure with respect to the third country that:

[263] International Justice Resource Center, http://www.ijrcenter.org/thematic-research-guides/nationality-citizenship/ (visited 10 February 2018).

> (i) relates to maintenance of international peace and security; and
>
> (ii) prohibits transactions with the enterprise or would be violated or circumvented if the benefits of this Chapter were accorded to the enterprise.

This provision excludes from its scope of benefits 'an enterprise of the other Party' and 'services of that service supplier' where the enterprise is owned or controlled by a service supplier of a third country, subject to one of the two additional requirements. Notably, the CETA does not apply the common threshold on SBO as found in various other PTAs. Instead, the denial may be due to measures adopted or maintained by the denying party with respect to the third party which relates to international peace and security, or which forbids transactions with the enterprise at issue. Reasonably, by not requiring SBO, the CETA is indeed quite liberal in its approach: almost all enterprises established in a CETA party, regardless of their ownership or control, shall be eligible to gain market access to another party. Unfortunately, an elaboration on the criteria of ownership or control is not provided by the CETA.

Since the CETA follows the approach of NAFTA, which limits the connection between chapters on investment and cross-border trade in services, in this agreement there are no such services provided through commercial presence. Except for financial services, all establishment-related supply of services is treated as investment (under Chapter 8 of the CETA). For this reason, it will be important to explore relevant concepts in this investment chapter.

Article 8.1 of the CETA provides fairly detailed definitions for investment and investor. Investor is defined by this provision as 'a Party, a natural person or an enterprise of a Party, other than a branch or a representative office, that seeks to make, is making or has made an investment in the territory of the other Party.' Obviously, the agreement deliberately excludes branches and representative offices from the scope of the term 'investor'. More specifically, 'an enterprise of a Party' is defined as follows:

> For the purposes of this definition, an enterprise of a Party is:
>
> (a) an enterprise that is constituted or organized under the laws of that Party and has substantial business activities in the territory of that Party; or
>
> (b) an enterprise that is constituted or organized under the laws of that Party and is directly or indirectly owned or controlled by a natural person of that Party or by an enterprise mentioned under paragraph (a);

Compared to the definition of 'enterprise' for general application, an enterprise in the investment chapter must comply with both criteria on the place of constitution and on SBO. The SBO is restricted to be carried out in the territory of constitution. Moreover, 'enterprise of a Party' may also include one enterprise established under the laws of a party, owned or controlled by an individual of that party or by an enterprise of the first type. There is no SBO requirement for the second type of enterprises. Particularly, the case of an enterprise established in a party, but owned or controlled by an investor(s) of the other party is covered in the category of 'locally established enterprise', which is a juridical person 'constituted or organized under the laws of the respondent and that an investor of the other Party owns or controls directly or indirectly.' However, there is no definition for such terms as ownership, control, and SBO.

Regarding investors who are natural persons, Article 8.1 of the CETA also provides the same definition as found in the chapter on trade in services, plus specific provision for Latvia. Pursuant to this Article, a 'natural person of Latvia' is defined to cover not only individuals having the nationality of Latvia, but also those 'permanently residing in the Republic of Latvia who is not a citizen of the Republic of Latvia or any other state but who is entitled, under laws and regulations of the Republic of Latvia, to receive a non-citizen's passport.' Particularly, this Article lays down a provision on the possibility of dual nationality, which is rarely found among PTAs:

> A natural person who is a citizen of Canada and has the nationality of one of the Member States of the European Union is deemed to be exclusively a natural person of the Party of his or her dominant and effective nationality. A natural person who has the nationality of one of the Member States of the European Union or is a citizen of Canada, and is also a permanent resident of the other Party, is deemed to be exclusively a natural person of the Party of his or her nationality or citizenship, as applicable.

Apart from these distinctions, the clause on denial of benefits found in Article 8.16 of the investment chapter is almost the same to that in the chapter on cross-border trade in services. However, due to explicit and implicit differences in the scopes of the term 'enterprise' in the two chapters, the restrictive effect of this clause in the investment chapter tends to be more significant than that in the trade chapter.

Services transactions equivalent to GATS' Mode 4 is regulated by the CETA's Chapter 10 on 'Temporary Entry and Stay of Natural Persons for Business Purposes.' Its article

10.1 defines '*natural persons for business purposes*' to be 'key personnel, contractual service suppliers, independent professionals, or short-term business visitors who are citizens of a Party.' Among these groups of natural persons for business purposes, the definitions for the terms 'contractual service suppliers' and 'independent professionals' are the most noticeable ones:

> *contractual service suppliers* means natural persons employed by an enterprise of one Party that have no establishment in the territory of the other Party and that have concluded a *bona fide* contract (other than through an agency as defined by CPC 872) to supply a service to a consumer of the other Party that requires the presence on a temporary basis of its employees in the territory of the other Party in order to fulfil the contract to supply a service;
>
> *independent professionals* means natural persons engaged in the supply of a service and established as self-employed in the territory of a Party who have no establishment in the territory of the other Party and who have concluded a *bona fide* contract (other than through an agency as defined by CPC 872) to supply a service to a consumer of the other Party that requires the presence of the natural person on a temporary basis in the territory of the other Party in order to fulfil the contract to supply a service.

It is noted from the general definition of 'natural persons for business purposes' that the CETA requires them to be citizens. Since there is no chapter-specific definition for this term, it is arguable that the definition of 'citizen' in Article 1.2 applies, which does not cover permanent residents. This lack of coherence in the use of the terms 'natural person', 'national', and 'citizen' across the agreement is arguably a defect of the CETA. It is also crucial to emphasize that the definition of 'enterprise' in this chapter refers to the definition in Article 8.1 of the investment chapter, not the general one that applies to the chapter on cross-border trade in services.

3.2.2.4. Free Trade Agreement between the EU and Korea

The EU–Korea free trade agreement is the EU's first PTA with an Asian country, which is also the first one of the new generation of PTAs, characterized by a far-reaching and comprehensive coverage. The agreement is unprecedented compared to any previous PTAs in removing barriers to trade; hence it is expected to enhance not only trade and economic growth in both signatories, but also to exert indirect impacts on other Asian nations and beyond by showing the EU's interest in doing business with new partners and its commitments to fair trade. The PTA had been provisionally applied since July

2011 and was amended in 2014 to include Croatia after its accession to the EU in 2013. The PTA has been formally ratified and entered into force since December 2015.[264]

In this PTA, both investment and trade in services are governed by Chapter 7 on 'Trade in Services, Establishment and Electronic Commerce.' Similar to NAFTA and CETA, in Section B of this Chapter, the scope of cross-border trade in services is not to cover the supply of services via commercial presence, which is covered by Section C (investment). However, it is noted that audiovisual services are excluded from both sections. Finally, Section D of this Chapter regulates measures affecting 'the entry and temporary stay of key personnel, graduate trainees, business service sellers, contractual service suppliers and independent professionals'.

What is peculiar about this agreement is that it does not provide a clause on 'denial of benefits'. Therefore, origin-related definitions are found in Section A of Chapter 7 and several other provisions across the chapter. With certain modifications, the definitions of this PTA are largely close to those of the GATS. In Article 7.4.3, cross-border supply of services is defined as 'the supply of a service (i) from the territory of a Party into the territory of the other Party; and (ii) in the territory of a Party to the service consumer of the other Party.' Article 7.5.1 obligates each party to 'accord to services and service suppliers of the other party treatment no less favorable than provided for under the terms, limitations and conditions agreed and specified in the specific commitments.' Besides, footnote 6 of this Article further requires each party not to adopt or maintain any measure that forces service suppliers of the other party to have establishment or to be residents in a party's territory as a condition for the cross-border supply of services. Yet, it is not clear from these provisions if all services supplied from or in the territory of one PTA party will be entitled to preferential treatment. In other words, do services need to be supplied across border by certain service suppliers to receive PTA benefits? Since there is no clause on denial of benefits and/or a definition on 'service of another party' as found in the GATS, the question is left unanswered.

Unlike other PTAs, Article 7.1(l) of this free trade agreement defines a service supplier as 'any person that supplies or seeks to supply a service, including as an investor', and a person is further defined by Article 7.1(c) to include both natural persons or juridical

[264] See more at European Commission, http://trade.ec.europa.eu/doclib/docs/2011/october/tradoc_148303.pdf (visited 1 February 2018). Full text of the agreement is available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2011:127:FULL&from=EN (visited 1 February 2018).

persons. The agreement considers natural person as 'a national of Korea or one of the Member States of the European Union according to its respective legislation'. Thus, it is inferable that the PTA shall not extend its treatment to permanent residents. As for juridical persons of a Party, the definition in Article 7.2(f) is quite similar to the GATS by dividing them into two categories:

> (i) a juridical person set up in accordance with the laws of one of the Member States of the European Union or of Korea respectively, and having its registered office, central administration or principal place of business in the territory to which the Treaty on European Union and the Treaty on the Functioning of the European Union apply, or of Korea respectively. Should the juridical person have only its registered office or central administration in the territory to which the Treaty on European Union and the Treaty on the Functioning of the European Union apply or of Korea, it shall not be considered as a juridical person of the European Union or of Korea respectively, unless it engages in substantive business operations in the territory which the Treaty on European Union and Treaty on the Functioning of the European Union apply or of Korea respectively; or
> (ii) in the case of establishment in accordance with Article 7.9(a), a juridical person owned or controlled by natural persons of the EU Party or of Korea respectively, or by a juridical person of the European Union or of Korea identified under subparagraph (i) respectively.

For the first category of juridical persons, it provides some criteria contingent on legal establishment, registered office, central administration, or principal place of business. However, the criteria on registered office and central administration are not sufficient by themselves, hence need to be accompanied by the SBO test. The second category of juridical persons is intended to cover 'establishment within the territory of a party for the purpose of performing an economic activity' by means of constituting, acquiring or maintaining a juridical person; or maintaining or creating of a branch or representative office. It is quite similar to the way GATS defines juridical for the purpose of supplying services via commercial presence.

As for the determination of ownership or control, the EU–Korea free trade agreement replicates the criteria stipulated in GATS Article XXVIII(n). After defining investor as 'any person that seeks to perform or performs an economic activity through setting up an establishment', Article 7.9(b) also includes a footnote (which resembles footnote 12 to Article XXVIII(g) of the GATS) dealing with the situation when 'economic activity is

not performed directly by a juridical person but through other forms of establishment such as a branch or a representative office.' The agreement further defines 'subsidiary of a juridical person of a Party' as one juridical person that is 'effectively controlled by another juridical person of that Party.' However, the word 'effectively' is not clarified.

Although the term SBO is not defined, the footnote 6 to Article 7.2(f)(i) suggests that it can be equivalent to the 'effective and continuous link' found in the Treaty establishing the European Community:

> In line with its notification of the Treaty establishing the European Community to the WTO (WT/REG39/1), the EU Party understands the concept 'effective and continuous link' with the economy of a Member State of the European Union enshrined in Article 48 of the Treaty as equivalent to the concept 'substantive business operations' provided for in paragraph 6 of Article V of the GATS. Accordingly, for a juridical person set up in accordance with the laws of Korea and having only its registered office or central administration in the territory of Korea, the EU Party shall only extend the benefits of this Agreement if that juridical person possesses an effective and continuous link with the economy of Korea.[265]

3.2.2.5. Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)

After the US withdrew from the Trans-Pacific Partnership (TPP) agreement, the trade ministers of the remaining 11 parties agreed in November 2017 to implement the TPP without the US, and also to rename it the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). The CPTPP basically incorporates the original agreement, although a few provisions from chapters on trade facilitation, investment, trade in services, government procurement, intellectual property rights, environment, and transparency are suspended. Liberalization obligations in crucial areas as textiles, technical barriers to trade, sanitary and phytosanitary measures, competition, dispute settlement, state-owned enterprises and labor are uninjured. It is noticeable that tariff concessions reached under the TPP remain intact, which will eventually remove duties on 95% of merchandise trade. The benefit gained from the liberalization of goods and services trade within the CPTPP in the medium term is expected to be at least 0.3% of the parties' aggregate gross domestic product (37.3 billion US dollars).[266]

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[265] See also *Communication from the European Communities and their Member States to the WTO Committee on Regional Trade Agreements* (document WT/REG39/1, dated 24 April 1998), at 7.

[266] http://wtocenter.vn/news/core-things-know-about-trans-pacific-trade-pact-cptpp (visited 28 January 2018).

Following the NAFTA model, the CPTPP's chapter on cross-border services trade does not include 'the supply of a service in the territory of a Party by a covered investment', while the supply 'by a national of a Party in the territory of another Party' is covered.[267] Although cross-border trade in services is provided for in Chapter 10 of the agreement, several origin related definitions are found in Chapter 1 (Initial Provisions and General Definitions). Article 10.1 of the CPTPP provides that 'service supplier of a party means a person of a Party that seeks to supply or supplies a service', and 'person of a Party' is specified in Article 1.3 as 'a national or an enterprise of a Party'. Noticeably, 'national' in the CPTPP is also construed broadly, which covers one 'natural person who has the nationality of a Party' subject to party-specific definitions, or 'a permanent resident of a Party'. Subsequently, in specific Annex 1-A, a 'natural person who has the nationality of a Party' is defined to include a natural person who holds nationality or one who is a citizen of a CPTPP signatory according to its applicable law.[268]

The definition of enterprise found in Article 1.3 of the CPTPP is as broad as the GATS' definition for juridical persons. According to this Article, 'enterprise means any entity constituted or organized under applicable law, whether or not for profit, and whether privately or governmentally owned or controlled', which covers 'any corporation, trust, partnership, sole proprietorship, joint venture, association or similar organization.' In the context of the trade in services chapter, the CPTTPP takes the similar approach to NAFTA by construing 'enterprise of a Party' as 'an enterprise constituted or organized under the laws of a Party, or a branch located in the territory of a Party and carrying out business activities there.' It means, for the purpose of this chapter, the main origin criterion for enterprises is the place of constitution, with an additional requirement on business activities pertinent to branches. However, certain limitations are found in the clause on denial of benefits.

> *Article 10.10: Denial of Benefits*
>
> 1. A Party may deny the benefits of this Chapter to a service supplier of another Party if the service supplier is an enterprise owned or controlled by persons of a non-Party, and the denying Party adopts or maintains measures with respect to the non-Party or a

[267] Full text of the Agreement is available at https://www.mfat.govt.nz/en/trade/free-trade-agreements/free-trade-agreements-concluded-but-not-in-force/cptpp/comprehensive-and-progressive-agreement-for-trans-pacific-partnership-text/ (visited 28 January 2018).

[268] Particularly, for Brunei Darussalam, a 'natural person who has the nationality of a Party' means 'a subject of His Majesty the Sultan and Yang Di-Pertuan in accordance with the laws of Brunei Darussalam.'

> person of the non-Party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of this Chapter were accorded to the enterprise.
>
> 2. A Party may deny the benefits of this Chapter to a service supplier of another Party if the service supplier is an enterprise owned or controlled by persons of a non-Party or by persons of the denying Party that has no substantial business activities in the territory of any Party other than the denying Party.

It is noted that this clause does not address services; instead, it is only directed toward service suppliers, particularly enterprises. The first paragraph of this Article enshrines quite a common rule, according to which the CPTPP's treatment may be denied from a service supplier being 'an enterprise owned or controlled by persons of a non-Party' if it falls under certain prohibitive measures. The second paragraph provides a common basis for the denial of benefits, but there is a distinction as compared to various PTAs: the denial can be exercised even where that service supplier is owned or controlled by 'persons of the denying Party'. For example, a service company in Vietnam owned by a person of Australia may still be denied of benefits if it has no SBO in any other CPTPP party than Australia. Here CPTPP provides a clearer threshold than other PTAs in that it accepts SBO to be carried out in any party, except the denying Party itself.

In Chapter 9 on investment, investor of a party is defined broadly and unambiguously as 'a Party, a national or an enterprise of a Party that attempts to make, is making, or has made an investment in the territory of another Party.' Notably, on the definition of 'enterprise', footnote 1 to Article 9.1 states that: 'For greater certainty, the inclusion of a 'branch' in the definitions of 'enterprise' and 'enterprise of a Party' is without prejudice to a Party's ability to treat a branch under its laws as an entity that has no independent legal existence and is not separately organized.' Basically, this provision suggests that branches are included in the scope of enterprise under a conditional expansion, but it does not necessarily imply the parties have to consider branches as independent legal entities under their laws.

As regards the 'denial of benefits' clause, but for a difference in the order of provisions as well as any implicit or explicit difference between the treatment to a service supplier and that to an investor and its investment, this clause largely uses the same criteria as those in the services trade chapter.

> *Article 9.15: Denial of Benefits*
>
> 1. A Party may deny the benefits of this Chapter to an investor of another

> Party that is an enterprise of that other Party and to investments of that investor if the enterprise:
>
> (a) is owned or controlled by a person of a non-Party or of the denying Party; and
>
> (b) has no substantial business activities in the territory of any Party other than the denying Party.
>
> 2. A Party may deny the benefits of this Chapter to an investor of another Party that is an enterprise of that other Party and to investments of that investor if persons of a non-Party own or control the enterprise and the denying Party adopts or maintains measures with respect to the non-Party or a person of the non-Party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of this Chapter were accorded to the enterprise or to its investments.

Although CPTPP is a new agreement, unfortunately it provides no definitions for such terms as SBO, ownership or control. In general, it closely follows the NAFTA approach in establishing ROO for services, but tends to employ stricter requirements.

3.3. Assessing the GATS consistency of preferential rules of origin for services

As introduced in the first chapter, since PTAs are considered an exception to the MFN principle, a condition has been imposed by GATS Article V:6 to restrict the distorting effects of PTAs on service suppliers of non-parties. This Article requires the extension of PTA's benefits to a non-party service supplier who constitutes a legitimate juridical person under the laws of one PTA party, and conducts SBO in any PTA party. Thus, it means that once established in a PTA's party, a foreign-owned firm may be permitted to provide services to other parties under the treatment granted in the PTA, subject to the fulfillment of the SBO test. An exception to this rule is provided by Article V:3(b) of the GATS, pursuant to which PTAs involving only developing countries may accord 'more favorable treatment to juridical persons owned or controlled by natural persons of the parties' to such an PTA.

Indeed, various PTAs unambiguously express their consistency with GATS Article V:6. In this respect, the definitions of juridical persons or enterprises play a crucial role in determining a PTA's GATS consistency. The most liberal ROO in PTAs define juridical persons or enterprises of one party as those constituted under the laws of a PTA party with no further requirement on ownership or control and business activities. It means

that all juridical persons constituted in a PTA party are regarded as originating service suppliers. However, as examined in the previous section, this liberal approach is often balanced by clauses on denial of benefits, mainly because PTAs want to prevent abuse by foreign companies that do not have genuine economic link to the PTAs.

The most common ROO in PTAs feature 'denial of benefits' clauses that narrow down the set of juridical persons or enterprises entitled to preferences by setting out certain additional tests. In some cases, such additional tests are provided in the definitions of juridical persons or enterprises, instead of the benefit denial clauses. To a large extent, these tests decide the consistency of the ROO in PTAs with GATS Article V:6.

As analyzed in the previous sections, the most commonly used test is SBO. To cite just an example where the method of drafting is rather different from other PTAs, the PTA between Japan and Singapore stipulates in Article 58 that 'juridical person of another Party' means one which is either 'constituted or otherwise organized under the law of one Party, and, if owned or controlled by natural persons of non-Parties or juridical persons constituted or otherwise organized under the law of non-Parties, is engaged in SBO in the territory of either Party.' This definition in fact already includes the type of juridical persons to which GATS Article V:6 intends to extend preferences. Moreover, the PTA provides another clause regarding service suppliers of non-parties as follows:

> *Article 62: Service Suppliers of Any Non-Party*
>
> Each Party shall also accord treatment granted under this Chapter to a service supplier other than those of the Parties, that is a juridical person constituted under the laws of either Party, and who supplies a service through commercial presence, provided that it engages in substantive business operations in the territory of either Party.

Though there seems to be an overlapping between the two articles, arguably this is an example of the most explicit way to express compliance with the GATS. The clause on denial of benefits confirms such compliance by providing that the benefits of this PTA are denied to a service supplier being a juridical person not falling within either Article 58 or Article 62. Apparently, the standard of the GATS Article V:6 has been met.

However, there are several issues that need to be addressed regarding the test of SBO. On the one hand, since the term SBO is not defined in the GATS, it is open to question whether or not the application of this term in PTAs observes the purposes of the GATS. The interpretation of this term is at the discretion of PTAs' members, hence there is no

benchmark to determine whether the interpretation and application of the SBO test is GATS-consistent, particularly in case of disputes.

On the other hand, some PTAs start to introduce criteria for the SBO test. The attempt is not directly inconsistent with Article V:6 of the GATS; however, if these criteria turn into more restrictive thresholds, they may end up departing from what the expectation of the GATS. Indeed, Emch has examined the criteria to clarify the term SBO employed by the two economic partnership agreements between Mainland China and Macao and Hong Kong.[269] The author analyzes whether the 'ordinary meaning' of the term SBO in its context and in the light of the intents and purposes of the GATS can be interpreted flexibly enough to permit the introduction of the criteria found in the two agreements. The analysis of the criteria have led to different findings: some do not cause problems, while others' compliance with GATS Article V:6 is more doubtful. It is thus concluded that although these agreements represent 'the first genuine attempt to add flesh to the vague concept', which is certainly a positive attempt, in cases where any of the criteria are considered too restrictive, their compatibility with the GATS may be challenged by the WTO dispute settlement body.[270]

Another question relates to the territory where the SBO of foreign-owned or controlled juridical persons take place. In some PTAs examined above, it is required that the SBO are engaged in the party of establishment, or in any PTA party other than the denying one. Arguably, the requirements tend to be more restrictive than the standard found in Article V:6 of the GATS, which allows SBO to be in the territory of any PTA party. It is noted that where the denial applies to a juridical person of a party owned or controlled by the denying party that does not have SBO in any other party than the denying one, such is also a restrictive requirement, but it does not violate GATS Article V:6 because it does not relate to non-party owned enterprises.

Where the PTAs apply other requirements on top of or different from SBO, it is worth questioning whether they are more restrictive than the GATS' standards. For example, in some PTAs, the benefits can be denied to firms owned or controlled by persons of a third party for foreign policy reasons. Indeed, those PTAs do not exclude cross-border

[269] *Mainland and Macau Closer Economic and Partnership Arrangement*, http://fta.mofcom.gov.cn/article/hongkong/macao/macaoxieyi/200901/424_1.html (visited 19 February 2018). The text of the two agreements are virtually identical, see *supra* note 223.

[270] Adrian Emch (2006), 'Services Regionalism in the WTO: China's Trade Agreements with Hong Kong and Macao in the Light of Article V(6) GATS', *Legal Issues of Economic Integration 33(4)* 351-378, at 378.

trade with all foreign-owned or controlled companies in the other party, but only those that are owned by persons of a country where trade is not permitted due to diplomatic or security reasons, so it is difficult to conclude whether such requirements are in line with GATS Article V:6. Besides, this type of restriction may be justified by the security exception in GATS Article XIV*bis*, which states that nothing in the agreement shall be taken to 'prevent any Member from taking any action which it considers necessary for the protection of its essential security interests.' Apart from this type of restriction, the more typical ground to deny benefits is due to measures prohibiting transactions with an enterprise or measures violated or circumvented if the treatment of the agreement is accorded to that enterprise. Such requirements are more ambiguous, and may offer PTA parties more discretion in their interpretation and imposition of the rules.

Beyond the discussion on SBO, there are certain minor differences identified, but it is not possible to conclude whether they are consistent with the GATS. For example, the origin rules for services under Modes 1 and 2 in the GATS are based solely on the place of supply. There is no other requirements, e.g., on the persons who actually supply the services. However, in almost all PTAs reviewed, it is unambiguously provided that the services must be supplied across border by eligible providers, or that the benefits may be denied if the service suppliers are owned or controlled by persons of a non-party or of the denying party. It seems plausible to argue that PTAs are not restricted by Article V:6 of the GATS in this respect, hence there is lesser probability that such approach is against the GATS' standards.

There are certain instances that may be challenged against the provisions of the GATS governing preferential agreements involving only developing countries. For instance, the PTA between Thailand and Australia denies the benefits of the service chapter to 'a service supplier of the other party where that service supplier is owned or controlled by persons of a non-party.' Another example is found in the India–Singapore PTA, but only concerning services supplied through commercial presence.[271]

> *Article 7.23: Denial of Benefits*
>
> 1. Subject to prior notification and consultation, a Party may deny the benefits of this Chapter:
> [...]

[271] See *Comprehensive Economic Cooperation Agreement between the Republic of India and the Republic of Singapore*, *supra* note, Article 7.23.

> (c) to the supply of a service through commercial presence, if the Party establishes at any time that persons of a non-Party own or control, or have acquired ownership or control over through subsequent transactions, the service supplier.

As Australia and Singapore are likely be classified as developed countries in the WTO, it is not immediately clear how the ROO of these PTAs comply with the requirement of GATS Article V:3(b). Moreover, even if the developing country status of such countries is not challenged, it is notable that Article V:3(b) makes way for a relaxation of Article V:6 only in the case of a juridical person owned by individuals of PTA parties. Thus, it seems that any PTA providing a similar provision to the above may be found to violate GATS Article V:3(b) upon investigation.

Another question of compliance may come from the structure of PTAs. In NAFTA-type PTAs that cover trade via commercial presence in the investment chapter, whether or not requirements more restrictive than that allowed by Article V:6 will be inconsistent with the GATS' standards? Though the relation between the GATS and the investment chapter in PTAs is sometimes a grey area, different agreement architecture should not come as the possibility for Members to deviate from their GATS obligations. One may argue that the GATS deals with service suppliers and the investment chapters in PTAs deal with investors, but what the GATS requires for service suppliers is to be construed as what PTAs requires for investors to the extent it relates to the supply of services. In this sense, apparently, Article V:6 of the GATS also applies to benefit denial clauses in the investment chapters of PTAs.

All in all, there are probably more inconsistencies between PTAs and the GATS. From a legal point of view, it is a difficult matter as both types of agreements are in force and the question as to which one prevails involves complex legal analysis. Each agreement may indicate what happens in case of inconsistencies, but they may also be silent about this issue and one has to rely on the general principles of treaty interpretation in public international law. Notably, inconsistent provisions generally have no consequence for countries unless when they are challenged by companies or governments. In that case, a WTO panel or an international court may decide which provision prevails. Moreover, the compliance of PTAs with the GATS can be discussed at the WTO in the Council for

Trade in Services or by the Committee on Regional Trade Agreements, but it is merely a discussion, not some kind of enforcement of Article V.[272]

A more concrete conclusion for the discussion on GATS consistency is that apart from a few agreements explicitly excluding juridical persons owned or controlled by persons of third parties without a justification, ROO for services and service providers in PTAs are generally found to be liberal. Among several authors, Khumon contends that most PTAs adopt liberal ROO to juridical persons to comply with the broader liberalization aim under GATS Article V.[273] It is quite convincing considering the fact that in the area where the GATS is silent, i.e., the treatment of non-party natural persons, preferential ROO remain quite restrictive.

To recap, the discussion in this chapter has revealed that unlike ROO for goods which are crucial in defining the origin of a product and its eligibility for benefits guaranteed by a PTA, ROO for services mainly seek to clarify the conditions under which a supply is excluded from the preferences of a PTA. Notably, services ROO in PTAs focus more on service suppliers as compared to the GATS, and the options for criteria in PTAs are also more diversified. In general, origin rules for juridical persons are based on one of or a combination of the following criteria: the country in which an entity is constituted, the center of the juridical person's business activities, and the ownership or control of the juridical person. By nature, a more liberal approach will extend PTA benefits to all enterprises constituted and engaged in SBO in one of the parties. Meanwhile, the more stringent approach may restrict PTA benefits to juridical persons ultimately owned or controlled by persons of a PTA party.[274] While ROO for juridical persons are generally described as liberal, they contain many subtle discrepancies in terms of both structure and content. On the contrary, ROO for natural persons are relatively harmonized, but remain highly restrictive. The analysis also points out that many crucial terms remain unelaborated by PTAs, including recently negotiated ones; and that the consistency of preferential services ROO with Article V:6 of the GATS is at times questionable.

[272] This part of the discussion is written based on the discussion with Mr. Sébastien Miroudot (OECD).
[273] See Khumon, *supra* note 66, at 609.
[274] See Fink, *supra* note 79, at 120.

Chapter 4

Rules of origin for services in the age of servicification

This chapter shall bridge a link between new trends of trade and production and the discussion on ROO for services. It describes the new context of the global economy in which global value chains (GVC) become a dominant feature, and manufacturing is increasingly dependent on services. Such dependence, known as the phenomenon of 'servicification', sheds light on the multifaceted role of services in GVC, particularly when considered from a 'trade in value added' perspective. In addition, the trends of internationalization and digitalization, largely enabled by technology changes, also reinforce the servicification phenomenon by transforming the methods that services are produced and supplied. As the new context has redefined services and the supply of services, the chapter goes on to indicate some of its direct or indirect implications on ROO for services.

4.1. The servicification of global value chains

4.1.1. The concepts of global value chain and servicification

These days, countries no longer participate in international trade merely by exporting final products, but also by specializing in many stages of the manufacturing process. A recent joint report by the WTO and the Institute of Developing Economies – Japanese External Trade Organization (IDE-JETRO) remarks that such various stages to create final products can be connected via the notion of a 'value chain', which delineates 'the sequence of activities that firms undertake to create value, from the conception of a product to its manufacturing and commercialization.'[275] Participating in stages in such value chains enables one country to utilize its comparative advantages. In addition, by focusing on specific tasks and integrating to highly systematic business models, those

[275] WTO & IDE-JETRO (2011), *Trade Patterns and Global Value Chains in East Asia: From Trade in Goods to Trade in Tasks* (Geneva: WTO Publications), at 115. The report is available online at: https://www.wto.org/english/res_e/booksp_e/stat_tradepat_globvalchains_e.pdf (visited 20 February 2018).

chains of related activities may help create more added value, even exceeding 'the sum of the value of the constituent parts and processes.'[276]

Pursuant to the Swedish National Board of Trade (SNBT), in the stylized model, value chains often start with upstream services activities namely research and development (R&D) or design, run on through manufacturing or assembly before ending with more downstream activities, e.g., marketing, brand management or post-sales services. It is suggested that the activities in the two ends of the chains are often the most value and intellect-intensive ones. Meanwhile, standardized activities are normally found in the middle of the chains, where they tend to generate less added value.[277] As globalization allows for the restructuring of firms' operations in an international scale by slicing up and optimizing their value chains through outsourcing or offshoring certain activities to various companies across different geographical locations, a broader term has been coined – 'global value chain' (GVC).[278] Nowadays, 'international production, trade and investments are increasingly organized within GVCs where the different stages of the production process are located across different countries.'[279] This phenomenon is also defined by other terms, such as 'global production sharing, trade in tasks, off-shoring, fragmented production, or vertical specialization'.[280]

While production of goods and provision of services used to be considered as separate spheres, the rise of GVCs reveals the fact that they are indeed interconnected: there is an increased use of services as inputs for production in manufacturing industries, and a trend of firms producing and providing more services beside tangible products.[281] It

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[276] *Ibid*, at 10-12.

[277] SNBT (2013a), *Global Value Chains and Services – An Introduction* (Stockholm: National Board of Trade), at 8. The report is available online at: https://www.kommers.se/Documents/dokumentarkiv/publikationer/2013/rapporter/report-global-value-chains-and-services-an-introduction.pdf (visited 25 February 2018).

[278] See WTO & IDE-JETRO, *supra* note 275, at 10, 115. The report describes offshoring as an enterprise's decision to contract the supply of specific goods or services to foreign suppliers, who can be independent or affiliated firms. Meanwhile, outsourcing describes an enterprise's decision to acquire specific inputs from an outside (unaffiliated) firm, instead of internally producing them. Therefore, offshore-outsourcing is a special form of outsourcing, where the contractual parties are not present in the same country.

[279] Organization for Economic Co-operation and Development (OECD), *Global Value Chains*, available at: http://www.oecd.org/sti/ind/global-value-chains.htm (visited 23 February 2018).

[280] SNBT (2012), *Everybody is in Services – The Impact of Servicification in Manufacturing on Trade and Trade Policy* (Stockholm: National Board of Trade), at 11, available online at: https://www.kommers.se/Documents/dokumentarkiv/publikationer/2012/skriftserien/report-everybody-is-in-services.pdf (visited 28 March 2018).

[281] Sébastien Miroudot (2017), 'The Servicification of Global Value Chains: Evidence and Policy Implications', *UNCTAD Multi-year Expert Meeting on Trade, Services And Development* (Geneva, 18-20 July 2017), at 2.

is the source of the phenomenon recently defined as 'servicification of manufacturing'. Indeed, 'servicification' is not a new phenomenon because the growing important role of services in the economy has been discussed for a long time. However, it is not until recently that the role of services within manufactured industries has been extensively documented along with the evolvement of GVCs. It is argued that the phenomenon of servicification is by nature related to GVCs as the latter operate via the deployment of services. Yet, servicification goes beyond GVCs since services also help to redefine the method through which manufacturing firms generate value.[282] In terms of trade policy, the concept of servicification 'highlights the increasing complementarity between the manufacturing of goods and the provision of services.'[283]

The literature on servicification dates back to the work of Levitt in early 1970s, which contend that: 'There are no such things as service industries. There are only industries whose service components are greater or less than that of other industries. Everybody is in services.'[284] By late 1980s, Vandermerwe and Rada coined the term 'servitization' to depict the trend of manufacturing firms selling more and more services.[285] Recently, various authors use the term 'servicification' so as to describe 'a broader shift towards services not only in sales of firms but also in the way they produce.'[286]

In this chapter, the servicification of manufacturing means 'the manufacturing sector is increasingly relying on services, whether as inputs, as activities within firms or as output sold bundled with goods.'[287] To be specific, 'servicification' shall encompass: (i) the increased use of services as inputs, which results in a higher share of added value originating from services industries; (ii) the shift within manufacturing firms towards services activities; (iii) the convergence of goods and services sold together in bundles by manufacturing firms that are increasingly providing services.[288]

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[282] Sébastien Miroudot & Charles Cadestin (2017), 'Services in Global Value Chains: From Inputs to Value Creating Activities', *OECD Trade Policy Papers No. 197* (Paris: OECD Publishing), at 8.

[283] SNBT (2015), *Servicification on the Internal Market – A Regulatory Perspective* (Stockholm: National Board of Trade), at 6. The report is available online at: https://www.kommers.se/Documents/In_English/Report-Servicification%20on%20the%20Internal%20Market%20%E2%80%93%20a%20regulatory%20perspective.pdf (visited 22 February 2018).

[284] Theodore Levitt (1972), 'Production-line Approach to Service', *Harvard Business Review 50(5)* 20-31, at 1. The paper is available online at: https://hbr.org/1972/09/production-line-approach-to-service (visited 7 March 2018).

[285] Sandra Vandermerwe & Juan Rada (1988), 'Servitization of Business: Adding Value by Adding Services', *European Management Journal 6(4)* 314-324.

[286] See Miroudot & Cadestin, *supra* note 282, at 8.

[287] *Ibid.*

[288] *Ibid.*

The SNBT confirms that servicification occurs at all stages of typical GVCs. In the first stage (preproduction and inputs), servicification occurs mainly due to the relative rise in the value of services as compared to goods inputs. This is because many knowledge and value-intensive business services (e.g., finance, insurance or communications) are highly important for sophisticated industries. In the second stage (manufacturing and assembly), servicification is caused by the fact that this stage has become increasingly digitalized, which means it is partly or fully supported or controlled by digital services. In the third stage (output and after-sales), servicification comes from various services being sold by manufacturing firms to customers, either embodied into the products or alongside the products as indispensable services.[289] This remark will be testified in the following analysis on the role of services in GVC and the evidence of servicification.

4.1.2. The role of services in global value chains

The role of services in the world economy has long been underrated, and it is not until recently that new literature on GVCs has urged a reconsideration of such role.[290] Since the GVC framework looks into 'the sequences of value added within an industry, from conception to production and end use,' it recognizes that 'services and manufacturing activities are intertwined.'[291] For such reason, services are not only important to GVCs in the same manner as goods do (i.e., they are meant for both end consumption and as inputs for the making of other products or services), but they also assume a distinctive role in GVCs:

Services serve as links in GVCs: As GVCs represent a higher level in the international division of labor. In order to manage geographically fragmented production processes, firms rely on such services as transport, communication, logistics, finance… Thus, the first role designated for services in GVCs is to connect manufacturing activities across countries. Miroudot and Cadestin consider services as the 'glue' in GVCs and contend that without these links, GVCs would cease to exist.[292]

Services serve as outsourced inputs in GVCs: Heuser and Mattoo assert that 'services are not only support functions which enable GVCs, but they are also crucial inputs in

[289] See SNBT (2015), *supra* note 283, at 7-8.

[290] See, among other papers, Antoine Gervais & Bradford Jensen (2013), 'The Tradability of Services: Geographic Concentration and Trade Costs', *National Bureau of Economic Research Working Paper Series No. 1975*. The paper is available online at: http://www.nber.org/papers/w19759.pdf (visited 13 March 2018).

[291] See Miroudot, *supra* note 281, at 1.

[292] See Miroudot & Cadestin, *supra* note 282, at 9.

key stages of production.'[293] To illustrate, a value chain may begin with R&D or design activities, and end with marketing or distribution activities. All these activities are not just the 'glue' in the GVCs, but 'per se important production stages.'[294] Moreover, once these activities are outsourced, they are obviously services inputs. Noticeably, some of these services inputs are horizontal, i.e., they are necessary for all types of firm in any GVCs (e.g., accounting and legal services), while others are vertical, which means they are industry specific (e.g., portfolio research in the banking and finance sector).[295]

Services serve as in-house inputs in GVC: This aspect arises from a notion relating to functions inside firms. It is ordinary that firms generate their own support activities in house, for instance, infrastructure management activities. Although these activities are often regarded as part of the firms' functions, they are indeed services provided by the firms themselves instead of being outsourced. The implication is that 'services are produced not only by services firms, but also by manufacturing firms.'[296] Moreover, as Miroudot and Cadestin argue, it is necessary to examine services supplied in house for 'a full assessment of the impact of services on trade and value creation.'[297]

Services sold bundled with goods by manufacturing firms: This feature in the role of services arises from the fact that manufacturing firms at times do not sell goods alone, but sell them together with services. For example, a machine can be exported bundled with installation or maintenance services. This type of services is in general necessary for customers to make use of the good, either at the time it is exported, or later during its operation. Firms are inclined to sell such bundles since it enables them to generate more value from the core goods and create long term relationship with customers. As for customers, bundled services are important as domestic alternatives are not always available, and the bundles are often offered as a cost-cutting solution. In certain cases, accompanying services can even become requisite for the sale of goods, without which the goods cannot be sold.[298] As manufacturing firms are responsible for a remarkable

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[293] Cecilia Heuser & Aaditya Mattoo (2017), 'Services Trade and Global Value Chains', in David Dollar, Jose Reis & Zhi Wang (eds), *Measuring and Analyzing the Impact of GVC on Economic Development* (Washington, DC: World Bank Publications) 141-159, at 143.

[294] See Miroudot & Cadestin, *supra* note 282, at 9.

[295] Gary Gereffi & Karina Fernandez-Stark (2010), 'The Offshore Services Value Chain: Developing Countries and the Crisis', *World Bank Policy Research Working Paper Series No. 5262*, at 5.

[296] See Heuser & Mattoo, *supra* note 293, at 143.

[297] See Miroudot & Cadestin, *supra* note 282, at 10.

[298] *Ibid*.

share of services sales and exports, Miroudot argues that it is rather artificial for trade statistics to distinguish between firms producing goods or producing services.[299]

Noticeably, according to Cusumano et al., not all product-related services provided by manufacturing firms are complementary. In fact, they can also be a 'substitute' for the sale of the good, for instance, rental services provided in lieu of cars. Moreover, albeit all bundled services to a certain extent share the purpose of comforting customers upon the purchase of a product, they can be further divided into two types. The first type aims to smooth the sale or use of a good without significantly altering its functionality, while the second type may expand its functionality. A basic training service offered by the manufacturer exemplifies a 'smoothing' service; and major customization creating customer-specific features to a product portrays an 'adapting' service.[300]

Whether services serve as inputs for production, as in-house activities within firms, or as complementary services to exported goods, the commonality is that they enable the manufacturing firms to generate value.[301] As discussed above, there would be no GVCs without services connecting the globally split steps of production. It is also noted that GVCs create more value than the aggregated value at each of these step. Apparently, it is 'linking services' that pave the way for the creation of value in GVCs. In cases where services are used as inputs, the added value comes either from the services themselves, or from the costs saved when they are outsourced. To be specific, some services inputs as legal or banking services may help manufacturing firms create value via improving their operations and productivity. Meanwhile, other services inputs, namely transport or logistics services may reduce costs for firms as they are less costly when outsourced thanks to the scale economies of external providers. As for services produced in-house, similar benefit is gained when manufacturing firms invest more resources in domestic services activities. If it is less costly to produce certain in-house expertise or when it is necessary to maintain the competitive advantage by self-producing these services, the higher allocation of resources to services activities within firms is also able to increase value. For example, more in-house R&D helps to enhance the innovative capacity, and can transform into better products than those of competitors.[302] Last but not least, the

[299] See Miroudot, *supra* note 281, at 2.

[300] Michael Cusumano, Steven Kahl & Fernando Suarez (2014), 'Services, Industry Evolution and the Competitive Strategies of Product Firms', *Strategic Management Journal 36(4)* 559-575, at 562-563.

[301] See Miroudot & Cadestin, *supra* note 282, at 11.

[302] *Ibid*, at 11-12.

provision of complementary services not only improves the organization of firms (and brings a new source of income), but also creates more value for consumers by offering them cost-saving tailored solutions. As Miroudot and Cadestin argue, the interactions between producers and customers allows for 'higher levels of customization and these tailored solutions also enhance productivity and contribute to growth.'[303]

4.1.3. Measuring servicification from a 'trade in value added' perspective

4.1.3.1. Trade in value added

Conventional trade statistics systems were formulated to measure economic activities based on the gross value of trade among partners. As a consequence, they often fail to indicate how foreign upstream producers are connected to end consumers.[304] The rise of GVC has further compelled the development of statistical methods to portray such connection. In general, trade statistics must assess value added at each stage of a GVC to reflect the contribution of all primary production factors.

To begin with, the concept of 'trade in value added' (TiVA) is defined as 'an alternative to the traditional measure of international exchanges in goods and services, adapted to the evolution of global supply chains, which enables the domestic content included in gross export flows to be estimated.'[305] In other words, TiVA examines the specificity of trade taking place among different actors of a GVC. Unlike conventional statistics that assesses cross-border trade on a gross basis, entailing the risk of multi-counting trade flows, TiVA records such flows 'on a net basis' at each stage of the vertical chain. Thus, it allows 'the specificity of the new business model behind global manufacturing to be incorporated, complementing usual trade statistics where trade in goods and services is progressively being substituted by trade in tasks.'[306]

To illustrate the difference between TiVA and traditional trade statistics, let's consider a simplified example on a production chain concerning three parties, which begins in Vietnam and France with the manufacturing of machinery parts for export to Japan. A Japanese firm then combines the imported parts with domestic ones, assembles them

[303] *Ibid*, at 12.

[304] David Dollar (2017), *Order from Chaos: Global Value Chains Shed New Light on Trade* (Washington, DC: Brookings Institution), available at: https://www.brookings.edu/blog/order-from-chaos/2017/07/10/global-value-chains-shed-new-light-on-trade/ (visited on 21 February 2018).

[305] See WTO & IDE-JETRO, *supra* note 275, at 195.

[306] *Ibid*, at 95.

into a machine, and sells the machine to the French market. Remarkably, the machine finally imported into France is made from parts originating in various countries, even France itself. Trading activities taking place among the three actors of this production chain raises several questions regarding the attribution of the value of the machine to Japan, the ultimate exporter in the GVC.

In traditional statistics, Japan's export to France shall be recorded with a value of 100, including that of the components sourced from Vietnam and France. This leads to the problem of multiple-counting since the value of intermediates is recorded twice: once when the parts are sold from Vietnam and France to Japan, then when the machine is exported from Japan to France; so in the end, the value of Japan's export to France is overstated. In contrast, measuring vertical trade flows in this chain using value added terms may help avoid this problem. For instance, if the value of the parts bought from Vietnam and France amounts to 55, the domestic value added of Japan in its export to France will be recorded as 45, excluding the value of inputs not sourced in Japan. The example indicates that value added is a component of gross exports, so the estimate of TiVA is always equal to or lower than that under traditional statistics.

The measuring of various sources of value added in each globally traded product shall require a huge effort, thus statisticians employ an indirect method of estimation. They rely on international input-output tables that combine national accounts and bilateral data on goods and services trade, enabling the evaluation of value added incorporated in exports and the breakdown of such value into domestic and foreign content. In brief, the domestic value added content of exports shows the aggregation of the added value contained in each domestic sector contributing to GVCs, while the foreign value added content of exports indicates trade among countries involved in GVCs.[307]

The database on TiVA constructed by the OECD and the WTO is among the initiatives that promote this new approach on trade statistics. The joint initiative addresses TiVA by assessing 'the value added by each country in the production of goods and services that are consumed worldwide.'[308] Based on this database, the WTO has built the *TiVA and GVCs: Country Statistical Profiles* to show the 'contribution of foreign trade to an

[307] *Ibid*, at 96.

[308] OECD, *Trade in Value Added*, available at: http://www.oecd.org/sti/ind/measuringtradeinvalue-addedanoecd-wtojointinitiative.htm (visited 25 February 2018).

economy, the interconnection of national economies within GVCs, and the impacts of the services industry on trade.'[309]

It is further clarified by OECD-WTO that the domestic value added content of exports consists of (i) 'domestic value added sent to consumer economy' being incorporated in end or intermediate products or services that are absorbed by the destination country; (ii) 'domestic value added sent to third economies' embodied in intermediate products or services sold to one economy before being re-exported (as part of other products or services) to another economy; (iii) 'domestic value added re-imported in the economy', acquired from intermediate goods or services previously exported, which are later sent back to the original economy as part of the imported intermediates to produce exports. In the meantime, foreign value added content of exports, which demonstrates the level of 'vertical specialization', is defined as 'the value added of inputs imported in order to produce intermediate or final goods or services to be exported'.[310] Hence, one may see that in the simplified example above, the 'vertical specialization' level of Japan is 55.

Among various purposes, the assessment of TiVA indicators, particularly the domestic value added content of exports, enables a more accurate portrayal of the share of each sector in the production of exports, thereby allows an economy to identify the sources of comparative advantages and competitiveness. TiVA statistics also helps to estimate of the contribution of foreign content in one economy's exports, which brings another perspective to analyze the actual impact of international trade on economic growth. It also offers a useful tool to evaluate the effectiveness of trade policy measures affecting GVCs of firms in the era of globalization.[311]

To this point, one may question how TiVA is relevant in the analysis on servicification. This new approach to trade statistics enables a more accurate estimation of the actual share of services to the value added incorporated in exports of an economy. Therefore, it brings intuition to the role of services in the exports of manufactured goods, as well as in total exports.[312] TiVA statistics is expected to point out that services account for a larger share in the value of merchandise and total exports (as compared to the figures

[309] WTO (2013), '*Trade in Value Added and Global Value Chains' Profiles Explanatory Notes*, at 1. The document is available online at: https://www.wto.org/english/res_e/statis_e/miwi_e/Explanatory_Notes_e.pdf (visited 25 February 2018).

[310] *Ibid*.

[311] See WTO & IDE-JETRO, *supra* note 275, at 95.

[312] *Ibid*.

provided traditional statistics). If the move from the gross-based to value added-based statistics remarkably raises the share of services in the economy, it is inferable that the TiVA approach amply testifies the phenomenon of servicification.[313]

4.1.3.2. The increased use of services inputs

To examine the servicification phenomenon, the most direct way is to look at the use of services as inputs in production. Many researchers have found that the contribution of services to TiVA is not only large (remarkably larger than their share in gross trade), but also growing. For instance, Heuser and Mattoo have estimated the share of services in world exports over the period 1980-2009 and realized that the share in gross terms remains around 20% after thirty years, whereas, in value added basis, it has increased 'from below 30% to more than 40%'.[314] This is in line with the finding of Miroudot and Cadestin that, in 2011, '49% of the value added in world gross exports originates in the service sector.'[315]

Miroudot and Cadestin elaborate on distinguishing between services exported directly by services firms and those embedded in intermediates for production (with the latter comprising both domestic and foreign services inputs). Based on the share of domestic direct value added in exports, the authors find out that while some countries are more specialized in exporting commodities and manufacturing goods, others are considered services exporters. However, in all economies, the domestic indirect and foreign share of value added in gross exports reveal the importance of all the services inputs (both domestic and foreign) used by exporting firms.[316] There are certain countries in which manufacturing of exports relies on a higher contribution of services value added, most remarkably Denmark, Finland, France, Iceland, Luxembourg, etc. Whereas, the share of services value added in China and the US has not materially changed between 1995 and 2011 (even a slight decrease for China).[317]

Case studies on the inputs of specific manufacturing firms indicate a broad number of services being used. A study by the SNBT shows Sandvik Tooling, a Swedish company manufacturing tools, relies on more than 40 different types of services to operate its

[313] See Miroudot & Cadestin, *supra* note 282, at 13.

[314] See Heuser & Mattoo, *supra* note 293, at 145.

[315] See Miroudot & Cadestin, *supra* note 282, at 13.

[316] *Ibid*, at 13-15.

[317] *Ibid*, at 16-17.

supply chains, which is almost half of the sectors covered in the GATS classification.[318] In another case study, the SNBT has analyzed Aromatic, a relatively small company in the agro-food sector supplying ingredients to bakeries. Although the food sector is one of the least servicified industries, Aromatic still relies on 50 different types of services to carry out its activities.[319]

Notably, services participate in GVC 'not only as outsourced inputs or final products, but also as inputs provided in house, which traditional value added measures do not capture.'[320] As mentioned in the next section, where the value of in house services can be quantified, the value of services embodied in manufacturing and its contribution to GVC could be even higher.

4.1.3.3. Services activities within manufacturing firms

The level of servicification can be measured by taking into account the share of value added originating from services sectors. However, conventional value added research often neglects in-house services supplied within manufacturing firms which constitute part of this servicification.[321]

By nature, it is challenging to directly measure the value of these services activities. In one of its attempts, the OECD adopts the methodology of analyzing labor force related to services activities in manufacturing industries. Miroudot and Cadestin state that in all economies, employment in manufacturing industries accounts for a relatively small share of total employment, and between 25% and 60% of manufacturing employment is indeed working in service functions.[322] The differences across countries are justified firstly by the sectoral composition. Core manufacturing activities account for a higher share of employment in those manufacturing sectors with low technology content such as textiles and apparels. Whereas, technology-intensive industries, namely electronics or ICT, require more supporting services, resulting in a higher share of employment in

[318] SNBT (2010), *At Your Service – The Importance of Services for Manufacturing Companies and Possible Trade Policy Implications* (Stockholm: National Board of Trade), at 4. The report is available online at: https://www.kommers.se/Documents/dokumentarkiv/publikationer/2010/skriftserien/report-2010-2-at-your-service.pdf (visited 7 March 2018).

[319] SNBT (2013b), *Just Add Services: A Case Study on Servicification and the Agri-Food Sector* (Stockholm: National Board of Trade), at 9-12. The report is available online at: https://www.kommers.se/Documents/In_English/Publications/PDF/Just-Add-Services.pdf (visited 16 March 2018).

[320] See Heuser & Mattoo, *supra* note 293, at 148.

[321] See Miroudot & Cadestin, *supra* note 282, at 18.

[322] *Ibid.*

R&D activities.[323] Beyond these differences across industries, patterns across countries are also influenced by their role in GVCs. For instance, headquarters economies often feature a higher share of employment in headquarters services, which are in-house by definition. It explains why certain countries as Luxembourg, Switzerland, or Germany have higher share of manufacturing employment in services activities.[324]

Employment data highlight the higher number of jobs in services activities but do not necessarily prove the share of value added relating to such activities. The information on wages is necessary to estimate the value added by in-house services and the general contribution of both in-house and outsourced services to the manufacturing sector. In the finding of Miroudot and Cadestin, once expressed in value added instead of as the number of jobs, the contribution of in-house services is even higher. Presumably, jobs related to service support functions are generally more high-skilled, and account for a larger share of labor compensation. On average, in-house services account for around 15% of gross exports of manufacturing products. It is also found that in all countries, there are more services outsourced (both domestic and offshore) than insourced. This is reasonable considering the various types of services that a manufacturing firm needs to sustain its activities. To carry out all these activities in house is not practical, thus a majority of them must be outsourced, especially if they require expertise or skills that will be too costly for internal provision, or on infrastructure or networks that can only be operated outside the firm.[325]

For the manufacturing sector alone, Miroudot and Cadestin find that on average, 15% of the value added in gross exports of manufactured products originates from in-house provision of services.[326] Thus, once the in-house provision of services is considered, the value of manufacturing exports relating to services rises from 37% to 53% in countries covered in their research. It means over 50% of the value added in the manufacturing sector comes from services activities, much higher than the ratio of one third recorded by traditional statistics. In fact, after adding exports of services firms, the overall share of services value added in gross exports is close to two-thirds.[327] The figure is even more

[323] *Ibid*.

[324] *Ibid*, at 19.

[325] *Ibid*, at 21.

[326] *Ibid*.

[327] *Ibid*, at 40.

noticeable given the fact that world exports of commercial services reached 4.8 trillion US dollars in 2016, up from 2.9 trillion in 2006.[328]

4.1.3.4. Services sold bundled with goods

Services within manufacturing firms are not only used as inputs for, or to support the manufacturing process, but also to be bundled with the goods sold to customers. This aspect in the roles of services in GVCs is even more difficult to be measured. In theory, trade statistics is built upon a strict separation between goods and services, hence any such bundle must be recorded as two separate transactions in the balance of payments. In reality, it is not very clear when there is only a single contract or transaction. While industry-level data may record the sales or exports of services by manufacturing firms, they normally do not distinguish as separate figures the value of services sold bundled with goods.[329]

Miroudot and Cadestin attempt to provide evidence on manufacturing activities which are linked with the provision of services by calculating the share of firms involved just in manufacturing activities, just in services activities, or in both. The authors find that in almost all countries, the largest number of firms are found in the service sector and providing only services. This group comprises of many small firms providing retailing, food and accommodation, and other small-scale services. Firms in the manufacturing sector are generally larger and fewer. A crucial finding is that firms selling both goods and services come second as the largest group in various countries.[330] It means that the companies engaged in both types of activities are by no means merely exceptions, they account for a large share in total sales and exports.[331]

The fact that a variety of services activities related to distribution are at times bundled with goods reflects the way GVCs are organized. Unlike what statistical classifications suggest, it is common for the same firm to be involved in both manufacturing and the distribution activities. For instance, many manufacturing firms also provide transport services, in particular when the transportation of the goods needs special technologies or skills from the same sector (e.g., pipeline transport in the petroleum industry). This

[328] WTO (2017), 'Chapter II | Trends in World Trade: Looking Back Over the Past Ten Years', in *World Trade Statistical Review* (Geneva: WTO Publications), at 11. The chapter is available online at: https://www.wto.org/english/res_e/statis_e/wts2017_e/WTO_Chapter_02_e.pdf (visited 10 March 2018).

[329] See Miroudot & Cadestin, *supra* note 282, at 22.

[330] *Ibid*, at 24.

[331] *Ibid*, at 26.

reason also applies to storage and warehousing, as well as services related to recycling and material recovery.[332]

Though distribution-related services are essential to the operations of GVCs, there are other services bundled with goods which embody the 'indispensable' services required to sell goods. For instance, construction services are indispensible in the wood product industry as normally the sale of wood may not happen if it is not part of a construction contract. In the machinery industry, maintenance, repair, or installation are regarded as indispensable services because without them, firms are not able to sell the machines they manufacture.[333]

Although they are not bundled with goods, the group of services being 'substitutes' for goods also reflects the trend of servicification. Some firms have switched to a business model in which they rent the product instead of selling it. Some firms have decided to focus on providing services instead of manufacturing goods since the former becomes more profitable than the latter over time.[334] IBM is one famous example: the company, from a hardware producer, has moved up in its GVC and redefined itself as a business solutions provider which supplies 'an industry-leading portfolio of consulting, delivery and implementation services, enterprise software, systems and financing.'[335]

4.1.4. Servicification and 'Mode 5 services' – services traded under the rules for goods

The concept of servicification gives rise to the argument that the GATS' supply modes fail to capture the sizable and growing share of services incorporated in physical goods circulated across the world. In fact, as reflected by Cernat and Kutlina-Dimitrova, this category of services 'accounts for 34% of manufacturing and primary sectors exports' in the EU.[336] Considering such phenomenon, the authors suggest a hypothetical mode of services supply, which is called 'Mode 5'.

What is the coverage of 'Mode 5' and how is it relevant to servicification? By definition, 'servicification' refers to the phenomenon of manufacturing firms using more services

[332] *Ibid.*

[333] *Ibid.*

[334] *Ibid*, at 10-11.

[335] Zahir Ahamed, Takehiro Inohara & Akira Kamoshida (2013), 'The Servitization of Manufacturing: An Empirical Case Study of IBM Corporation', *International Journal of Business Administration 4(2)* 18-26, at 21.

[336] Lucian Cernat & Zornitsa Kutlina-Dimitrova (2014), 'Thinking in a Box: A 'Mode 5' Approach to Service Trade', *Journal of World Trade 48(6)* 1109-1126, at 1114.

at all stages along their GVCs. Hence servicification covers services inputs, production and post-sales services, which is indeed the whole life cycle of a product. Whereas, the coverage of 'Mode 5' reflects production services being embodied in the manufacturing process of a physical product. Therefore, 'Mode 5' services 'are domestic intermediate services inputs incorporated in one country's merchandise exports.'[337] For example, to produce cars, a company may need consulting, design, engineering, as well as logistics services to buy inputs and organize the production chain. These 'Mode 5' or embodied services differ from the embedded services, which are services related to the sales of a good or another service, namely post-sales support, technical assistance, training, and maintenance. The reason is that these services are supplied under the four traditional modes, and, therefore, excludable from the coverage of 'Mode 5'. To be precise, 'Mode 5' represents a subdivision of 'servicification', covering domestically produced services that constitute a component of an exported good's value.

An essential feature of 'Mode 5' is its simultaneous relation 'to goods and services, as it focuses on the interrelation between merchandise and services trade.'[338] Besides, many 'Mode 5' services (e.g., architecture, design, engineering, and R&D) are value-intensive and closely linked to technology. To cite just one example, 90% of the EU's exports are intensive in intellectual property.[339] For such reason, they are essential to embrace the competitive advantages of manufacturing firms, especially in the context of GVCs.

Cernat and Kutlina-Dimitrova calculate the size of 'Mode 5' services by assessing their share in gross merchandise exports. They find that it ranges from 20% (China) to 34% (the EU). In absolute value, the EU's 'Mode 5' services exports for 2009 are estimated to exceed 300 billion euros. Notably, there is a clear growing trend in 'Mode 5' exports: as compared to 1995, the share of 'Mode 5' in the EU's 2009 gross exports has risen by 23%, and that in the US has risen by 37% over this period.[340] The importance of 'Mode 5', however, varies across industries: the EU's industry with the largest share of 'Mode 5' in gross exports is transport equipment (40%), and then textiles (37%); whereas, the 'Mode 5' share is only 24% and 16% respectively in agriculture and mining.[341]

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[337] *Ibid*, at 1116.

[338] *Ibid*, at 1115.

[339] *Ibid*, at 1116.

[340] *Ibid*, at 1117.

[341] *Ibid*, at 1118.

The essential and growing contribution of 'Mode 5' services embodied in merchandise exports necessitates an evolvement of trade policy to reflect this trend. The traditional view is that different regulations apply to merchandise trade and services trade. In the multilateral context, trade in goods is regulated by the GATT while trade in services is governed by the GATS. But the concept of 'Mode 5' reveals that a considerable number of services are currently traded indirectly under the regime for goods. For example, in case where a software is exported across border separately, the transaction will appear as trade in services; but if it is installed in an ICT equipment, its value will be counted as part of the good and there is no more services transaction.[342]

The most obvious consequence is that services indirectly exported in the 'box' of goods as such are usually subject to customs duties. But tariffs are not the only concern; it is undoubted that other sets of rules on merchandise trade, particularly ROO, may have influence over the supply of these 'Mode 5' services. In general, the 'Mode 5' approach reveals that a portion of domestic services exports is treated as part of goods, so these services may have to comply with merchandise trade rules. Hence, barriers to trade in goods may impede the supply of a 'package' of offerings by 'servicified' manufacturing firms.[343] It further highlights the need to develop trade rules that are more compatible with the way goods and services are blended in the era of servicification.

4.2. The internationalization and digitalization of trade and production

Internationalization and digitalization can be seen as separate trends of modern trade and production. However, as shall be discussed in this section, to a large extent, these trends are intertwined with servicification. On one hand, they are part of this broader trend; on the other hand, they can be categorized among the drivers thereof.

4.2.1. Internationalization of the supply of services inputs

The emergence of GVCs has brought the possibility of 'international specialization not only in final goods and their parts, but also in services and service tasks.'[344] Apart from the role as enablers in GVCs, services are disaggregated into separate tasks and traded in a way to similar tangible inputs. In GVCs, not just the assembly of goods but various

[342] *Ibid*, at 1119.
[343] World Trade Report (2013), *Factors Shaping the Future of World Trade* (Geneva: WTO Publications), at 293.
[344] See Heuser & Mattoo, *supra* note 293, at 142.

other service-related tasks have also been outsourced or offshored. As Roach remarks, 'offshore outsourcing of services is occurring all over the value chain, from low value added transaction processing or call centers to activities with high intellectual capital content as software programming, design, engineering, accounting, actuarial expertise, legal and medical advice, and a broad array of business consulting functions.'[345] There are different causes driving the trend: in some cases, offshoring is a mean to cut costs; in other cases, it is to gain from expertise not available domestically. By and large, the offshoring of services to lower-cost foreign suppliers is expected to boost productivity since each economy can focus on its comparative advantage. The higher specialization also brings new opportunities for emerging suppliers.[346]

Indeed, the phenomenon of internationalization is already reflected in the analysis on servicification. The OECD find that the share of services in world trade in value added terms has increased between 1995 and 2009, then decreased due to the financial crisis. Hence, the total services value added in gross manufacturing exports at the aggregate level does not provide clear evidence of servicification in terms of inputs. However, all manufacturing industries have higher shares of foreign services value added over this period while the domestic services value added decreases, except in certain industries such as food, wood products, papers, print and publishing and utilities. The increased use of foreign services shows that the offshoring of services tasks has occurred in most industries. Arguably, in terms of inputs, it would be more accurate to discuss the trend of internationalization rather than servicification.[347]

To illustrate, in China, a country with relatively low direct services exports, the indirect inputs does account for almost one third of the value of services exports, half of which comes from foreign services inputs. This implies that countries specializing in services may include even higher foreign services content in their services exports.[348] Miroudot and Cadestin realize that with the exception of China and the Philippines, who choose to raise domestic services inputs, the trend of internationalization of services inputs is found in all other countries.[349]

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345 Stephen Roach (2004), 'How Global Labor Arbitrage Will Reshape the World Economy', *Global Agenda* (the Magazine of the *World Economic Forum Annual Meeting*), available at http://ecocritique.free.fr/roachglo.pdf (visited 1 March 2018).

346 See SNBT (2013a), *supra* note 277, at 8.

347 See Miroudot & Cadestin, *supra* note 282, at 16.

348 See Miroudot & Cadestin, *supra* note 282, at 13-15.

349 *Ibid*, at 17.

The data from WTO-OECD reveal that over the period from 1995 to 2011, over 65% of the rise of services value added in exports is brought by a growth in services embodied in other exports. Although the growth is found in both domestic and foreign embodied services, the latter has grown more rapidly. This fact indicates that an increased share of embodied services is sourced overseas, which is an evidence of internationalization. The authors emphasize that since statistics in merchandise trade is recorded on cross-border basis, the value added of foreign services supplied under Mode 3 is reflected in the domestic category. Hence, the above statistics probably still understates the share of foreign services value added in exports (and the trend of internationalization).[350]

Another evidence of the internationalization trend is experienced in the development of services GVCs. Until now the analysis has focused on services used by (or produced within) the manufacturing industries. To complete the analysis, it will be important to consider how services industries are organized.[351] There is hitherto limited research on 'pure' services GVCs, but it is evident that such GVCs 'are created in a variety of service sectors, namely banking, tourism, audiovisual, and possibly also education and health services, as well as business processing services.'[352]

While the various stages in services value chains may resemble conventional ones, the value added in each stage is likely to differ. In a number of sectors, firms have widened the range of services they provide and created new types of connection with customers. In the view of Stabell and Fjelstad, the term 'value chain' should be used to describe an industry in which 'products move sequentially from upstream to downstream, adding value at each stage'.[353] Thus, it is argued that certain industries (e.g., construction and food services) do conform with such linear model; however, for most industries, this is not necessarily true. For this reason, the authors instead suggest two other modalities of value creation. A modality is 'value network', which generates value through linking customers. To illustrate, value is created in the insurance industry by having a number of customers share the risks to cover the damage of just a few. There are also network-based services where the networks are physical, and the value is created thanks to the linking and sharing of infrastructure, e.g., telecommunications and transport services.

[350] See Heuser & Mattoo, *supra* note 293, at 146.

[351] See Miroudot & Cadestin, *supra* note 282, at 28.

[352] See SNBT (2013a), *supra* note 277, at 9.

[353] Charles Stabell & Øystein Fjeldstad (1998), 'Configuring Value for Competitive Advantage: On Chains, Shops, and Networks', *Strategic Management Journal 19(5)* 413-437, at 416-420.

The other modality that may portray value creation in a number of services industries is 'value shop', in which value is acquired via settling the customers' problems. Unlike value chains which rely on standard processes, tailored solutions are indispensable for value shops. Plausibly, consultancy or R&D services are proper examples for this value creation modality.[354]

Baldwin and Venables concur with this view and make a vivid comparison assimilating services GVCs with 'spiders' (as opposed to 'snakes' which describe conventional value chains).[355] In its essence, the concepts of 'value networks' and 'value shops' may widen the set of business models that policy-makers have in mind when they deal with GVCs to avoid the simple thought of 'the pure manufacturing value chains with a sequential production.'[356]

While services GVCs are generally shorter than those of goods, there is fragmentation and internationalization of production in these GVCs as well.[357] In many cases, services companies want to source their inputs internationally. For instance, Heuser & Mattoo find that some financial services suppliers do offshore analytical tasks and particularly the management of back-office data. Likewise, architects are found to offshore certain design works, and doctors to offshore the interpretation of X-ray images.[358]

Business services sector is a striking example to illustrate the segmentation of services production. The OECD has characterized the roles of countries in GVCs regarding two segments of this sector, computer and related activities, and other business services.[359] Though the main market for business services is in developed economies, the industry has been globalized – certain business services are offshored to developing economies, where qualified labor is available at lower costs.[360] A higher tradability of these services allows multinational enterprises to establish global integration competence centers in one country and serve their foreign affiliates via new communication tools.[361]

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354 *Ibid*, at 420 and 427.

355 Richard Baldwin & Anthony Venables (2013), 'Spiders and Snakes: Offshoring and Agglomeration in the Global Economy', in *Journal of International Economics 90(2)* 245-254.

356 See Miroudot & Cadestin, *supra* note 282, at 28-29.

357 Koen De Backer & Sébastien Miroudot (2014), 'Mapping Global Value Chains', *ECB Working Paper Series No. 1667*, at 14.

358 See Heuser & Mattoo, *supra* note 293, at 142.

359 See De Backer & Miroudot, *supra* note 357, at 18-30.

360 *Ibid*, at 28.

361 See Miroudot & Cadestin, *supra* note 282, at 12.

4.2.2. The digitalization of production and trade

In reality, there is no official definition to describe the digitalization of production and trade. Such terms as e-commerce, digital trade or digital economy are frequently used in a flexible way. A narrow definition views digital trade as that in digitalized products, but a broader one may consider it as the use of ICT in conducting business.[362] Although there is a disharmony in terminology, it is quite commonly agreed that servicification of manufacturing is inherently related to digital technologies. The development of ICT allows enterprises to automate production, increase productivity, and change the way they create value. Digital trade allows firms, particularly smaller ones, to enter distant markets and cut business costs through enhancing GVCs' efficiency. [363]

The most visible change is the transformation of merchandise trade patterns that ICT advancement has brought about through the emergence of 'digitalizable goods', which include many software and media products. The United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) estimated that cross-border trade in digitalizable products accounts for 0.3% of world's trade in goods in 2014.[364] However, digital downloads of these products may be classified as part of services trade, such as under the 'personal and recreational services' category. Indeed, software has not been recorded as trade goods in by many countries in recent years. Meanwhile, statistics on services trade has shown that the value of personal and recreational services exported globally over the period of 2006–2015 significantly increases from 25 to 40 billion US dollars.[365] It is inferable that trade in digitalizable products has shifted from the sphere of goods to that of services, resulting in a higher share of services in world trade.

Digitalization does not just affect trade in digitized goods or personal and recreational services; in fact, the provision of many services is also influenced. Apparently, in these days, conducting both digital and conventional business relies heavily on inputs from such sectors as information or telecommunications. To be specific, in the tourism and hospitality industry, more and more tickets, hotels and tours are now booked and paid

[362] While the term 'digital trade' is widely used by the OECD, the US International Trade Commission, the EU, or McKinsey Global Institute, the term 'electronic commerce' or 'e-commerce' is used by the WTO and UNCTAD. In this dissertation, they are used interchangeably. See UNESCAP, below note 364, at 107.

[363] See Miroudot & Cadestin, *supra* note 282, at 12.

[364] UNESCAP (2016), Chapter 7 – 'International Trade in a Digital Age', in *Asia-Pacific Trade and Investment Report: Recent Trends and Developments*, at 109. The report is available online at: http://www.unescap.org/sites/default/files/aptir-2016-ch7.pdf (visited 5 March 2018).

[365] *Ibid*, at 110.

online. E-banking and the provision of insurance services via the internet has become prominent in the finance and insurance sector. Certain professional services, e.g., legal and medical services are growingly relying on internet-based communications.[366] More remarkably, the digitalization in trade has also turned some non-tradable services into tradable. Zampetti and Sauvé conclude that technological changes have enhanced the tradability of services, reducing the need for physical presence and simultaneity in the supply and consumption of services arising from their non-storability.[367]

To illustrate, medical and educational services used to be generally deemed as difficult to be delivered across border owing to the need for direct contact, but today they have become tradable in the form of tele-health and online courses. Given their large scope, it is calculated that cross-border trade in internet-enabled services sectors accounts for about 88% of total world trade in commercial services.[368] The UNESCAP estimate that in the Asia-Pacific area, the digital content in exports in 11 services industries has increased more than 100% during the period of 1995–2011, particularly the growth of that content in educational services is nearly 200%.[369]

Digitalization has an interconnection with the trend of internationalization of services inputs. It is often viewed that services are less vertically specialized due to the need of direct contact between suppliers and clients. As a matter of fact, a substantial share of the services market is dominated by small domestic firms that supply services directly to local clients using restricted foreign inputs.[370] However, the scenario has changed in recent years – services production and provision have become much more fragmented. The offshoring of intermediate services to specialized suppliers becomes more feasible for trade in services due to the development of digital trade. Nowadays, a Chinese firm may have a law firm in Italy to draft their contracts, or an Indian firm may be hired to maintain a French company's website. Such practice will not be feasible in the absence of digitalization. The application of ICT in trade has allowed services production to be 'separated from consumption and scaled up, creating final services with higher value added.'[371]

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366 *Ibid*.

367 See Zampetti & Sauvé, *supra* note 60, at 120.

368 See UNESCAP, *supra* note 364, at 110.

369 *Ibid*.

370 See De Backer & Miroudot, *supra* note 357, at 7.

371 See SNBT (2013a), *supra* note 277, at 8.

Digitalization also embraces the development of value networks and value shops. Due to ICT advances, these days there are new services provided via the internet or mobile applications. For example, Uber can be seen as a firm providing transport service, but the value in its business model comes from a platform that helps to connect users and drivers, and to organize the ride and payment in a convenient way for customers.[372] A more significant example showing the role of digitalization to value networks is where the former permits customers to become active participants in the ecosystem to create value. For example, the LEGO Group use a web portal to design new models of toy sets on the basis of ideas submitted by its fans. Thanks to such networks, the LEGO Group 'became the world's largest toy company in 2015'.[373] As for value shops, internet helps solve the problem of location, which is more important for this model of value creation. The reason is that online accessibility makes it more feasible to approach the location-specific knowledge and skills.[374]

4.2.3. The case of 3D printing

The digitalization of trade has blurred the separation between merchandise trade and services trade. Three-dimensional printing (3DP) provides a striking example for such transformation in trade and production. 3DP refers to the manufacturing technique in which 3D objects are 'printed' by multiple layers of 'ink' based on a specific computer-aided design (CAD). To put it simply, 3DP involves a process where the image created by CAD software is sent to a 3D printer that build the product by placing thin layers of material one by one. 3DP technology may be used to directly build products, or it can be applied as indirect steps in combination with conventional manufacturing. Notably, the most important difference between 3DP and traditional manufacturing techniques is the creation and the transfer of CAD files, possibly across border, without which the production will not take place.[375]

3DP transforms production processes through the inclusion of various services-related tasks. As a matter of fact, 3DP manufacturers use software solutions which enable the

[372] Benjamin Edelman & Damien Geradin (2016), 'Efficiencies and Regulatory Shortcuts: How Should We Regulate Companies Like Airbnb and Uber', *Stanford Technology Law Review* 19(2) 293-328, at 297.

[373] Eamonn Kelly (2015), 'Business Ecosystems Come of An Age', *Business Trends Series* (Deloitte University Press), at 7-8.

[374] See Miroudot & Cadestin, *supra* note 282, at 28.

[375] SNBT (2016), *Trade Regulation in a 3D Printed World* (Stockholm: National Board of Trade), at 9. The report is available online at: http://unctad.org/meetings/en/Contribution/dtl_eweek2016_Kommerskollegium_en.pdf (visited 27 February 2018).

precise measuring and customizing of the objects for individual customers, and finally print the tailored products.[376] Besides, a further shift towards services occurs when the 3D printer is used by a service supplier treating the client. For example, in the field of dental services, normally the physician will send a cast of his client's jaw to one dental engineer to make the implant. By using 3DP techniques, the physician can also design the implant and print it at his clinic. In this manner, 'the dentist – a service provider – has taken over the task of manufacturing.'[377]

By enabling the digital economy to 'move from the world of data to the physical world,' arguably, 3DP further blurs the boundary between manufacturing and services.[378] It is notable that the question as to whether an offering is a good or a service may not be an issue for a business. However, for statistics and trade policy purposes, that distinction is important as it may challenge basic perceptions of trade. Hence this technology has 'the potential to transform manufacturing processes, reconfigure global supply chains and give rise to business models that are hard to imagine today.'[379]

It is expected that 'the breakthrough of 3DP and consumer products being 3D printed will come in 2025.'[380] It is also approximated that 67% of producers are applying 3DP. Although a high number of them are still in the pilot stage, 'the technology has moved beyond its initial focus on design and prototyping applications of 3DP toward creating more and more finished products, either as final products or as input into other goods (parts).'[381]

The development of 3DP further proves that the digitalization of trade and production forms part of a broader evolution in the way firms create value and also allows more services to be traded cross-border, particularly as inputs in GVCs. Such practices have made service transactions become more visible in book-keeping and statistics, thereby confirming the servicification phenomenon.[382]

The case of 3DP also initiates the question of whether the WTO regulatory framework fits for the development of this new method of production or there is a need to change

[376] See SNBT (2015), *supra* note 283, at 15-16.
[377] *Ibid*, at 16.
[378] *Ibid*, at 6.
[379] Marc Sachon (2016), 'Additive Manufacturing Reconfigures Industrial Operations – 3D Printing: The Digitalization of Manufacturing', *IESE Alumni Magazine No. 141*, available at: http://www.iese.edu/Aplicaciones/upload/ENAlumniMagazine1413DPrinting.pdf (visited 19 March 2018).
[380] See SNBT (2016), *supra* note 375, at 9.
[381] *Ibid*, at 14.
[382] See SNBT (2015), *supra* note 283, at 6.

the rule book. It is notable that a number of WTO rules shall not apply when there are no goods crossing the border. As a matter of fact, the tasks of producing final goods in 3DP will come closer to consumers. Where manufacturing is in the same country with consumption, WTO rules for goods trade are not applicable as they are applicable only when goods cross border. In fact, regulations and commitments for trade in goods will remain significant only for the imports of printers, spare parts, and 'ink'.[383]

3DP removes a number of intermediary goods and replaces them with services inputs, which may involve different activities namely designing CAD files, transmitting digital information, setting up and managing e-markets for those files, etc. Therefore, part of the manufacturing process, as well as the trade associate with this process, will longer falls within the WTO's regulatory framework for merchandise trade, but that for trade in services. The involvement of more services elements in the value chain, which tends to reinforce the role of the GATS, marks a clear shift within trade rules. Yet, the extent to which 'GATS will be relevant depends upon future clarifications on the distinction between goods and services.'[384]

Apart from shifting the focus into services regulation, the application of 3DP may also change the focus in new services negotiations. Reasonably, commitments in sectors as designing, retailing services, and other services related to production will become more important as 3DP turns mainstream. Commitments in establishment-related mode of supply will also be important to embrace the rights of designing firms and contracting manufacturers to establish commercial presence in overseas markets. In addition, the digitization of manufacturing in 3DP, which relies on the transfer of data across border, is also expected to increase the focus on commitments under Mode 1.[385]

4.3. Some implications on ROO for services

4.3.1. Direct influences on services ROO

The emergence of GVCs has brought changes to the way firms carry out their business and the patterns in which trade is conducted. The present discussion indicates that in the world of GVCs, trade and production are increasingly servicified, internationalized and digitalized. Noticeably, such changes have 'not been reflected in trade rules, trade

[383] See SNBT (2016), *supra* note 375, at 23.

[384] *Ibid*, at 32.

[385] *Ibid*, at 26.

negotiations or trade governance structures.'[386] It is therefore necessary in the context of this dissertation to explore the implications of these new trends on services ROO.

First and foremost, the trend of servicification implies that services play an even more crucial role in the world economy. The state of the art these days is absolutely different from that in the early 1990s, when several authors used to think that ROO for services had 'no significant economic effects', perhaps because of the assumedly humble share of services in world trade by that time.[387] Hence, once services have gained significance, the economic needs underlying their origin determination will also increase.

One of the most important implications for the origin determination of services comes from the role of services in GVCs. Arguably, the GATS' four modes of supply and ROO are devised with the intents and purposes to cover mostly the services supplied to end consumers; meanwhile, it is apparent from the above analysis that services are widely used as inputs for the manufacturing of goods or the production of other services. As a result, there is a reasonable doubt that current ROO for services are incompatible with this category of services and the way they are supplied.

Moreover, pursuant to Zampetti and Sauvé, the highly technological sophistication of services production, the globalized production networks causing the segmentation of services GVCs, and the widespread offshoring of services activities may all 'complicate the task of assigning an origin or nationality to services and service providers.'[388]

The first complication caused to services ROO resembles the concern that has already been raised in merchandise trade. By nature, ROO in this field tend to better reflect the economic link between the country of origin and the product as compared to ROO for services. However, the rise of GVCs shows that the conventional approach to ROO for goods fails to keep pace with the internationalization of production. Since production becomes segmented, it seems more proper to think of a product as being 'made in the world'.[389] Yet the current approach 'does not reflect the geographical fragmentation of the production chain': it still credits the whole value of a product to the single country

[386] Jane Drake-Brockman & Sherry Stephenson (2012), 'Implications for 21st Century Trade and Development of the Emergence of Services Value Chains', *ICTSD Working Paper* (Geneva: International Centre for Trade and Sustainable Development), at 31.

[387] See Kingston, *supra* note 85, at 20.

[388] See Zampetti & Sauvé, *supra* note 60, at 120.

[389] The term 'made in the world' has become an initiative in the WTO: https://www.wto.org/english/res_e/statis_e/miwi_e/miwi_e.htm (visited 23 March 2018).

considered as the country of origin.[390] The consequence is that the origin of goods may eventually deviate from its economic nature.

The concern holds true in respect of origin of services. As analyzed in Chapter 2, ROO for services by themselves are prone to failure in detecting the economic link between the country of origin and the services. Therefore, the trend of internationalization may challenge services ROO even more than those for goods because they are not designed to substantiate the fact that services production and supply may involve a number (or network) of service providers. Arguably, GATS Article XXVIII tends to conceptualize a service as being supplied by one single provider, from or in one single country. In fact, the segmentation of services production and the rise of services value chains point out that services may also be made up of inputs from many countries, and the production and/or supply of services can be offshored to foreign suppliers. Failing to capture this practice further weakens the competency of ROO for services. It also implies that they may become obstacles to the evolvement of services trade.

The fragmentation in production brings even more complicacy to ROO for services as compared to goods. Internet and information technology makes the division of tasks become more feasible, so many companies outsource, for instance, the customer care services, to other companies in other countries. To illustrate, one may think about the instance in which a Chinese firm is contracted to supply call center service for a Swiss company. This provider, in turn, outsources the supply of the service to one Thai firm. The example portrays how challenging it is to identify the real origin of services in the era of internationalization: it is Thailand who actually produces a service which will be nominally supplied to Switzerland by China. One should recall the discussion on legal supplier and economic supplier in Chapter 2, and the finding that the GATS approach only targets at legal suppliers. For such reason, in this era of production collaboration, where the supply of services is offshored by the economic supplier to the legal supplier, the recipient may not at all know the identity of the economic supplier.[391]

As the WTO puts, 'technology in the form of internet access has brought an additional layer of complexity to the measurement of international trade.'[392] It is undoubted that

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[390] See WTO & IDE-JETRO, *supra* note 275, at 94.
[391] See Wang, *supra* note 43, at 1095.
[392] See *World Trade Statistical Review 2017*, 'Chapter IV | Merchandise Trade and Trade in Commercial Services', at 45. The chapter is available online at: https://www.wto.org/english/res_e/statis_e/wts2017_e/WTO_Chapter_04_e.pdf (visited 10 April 2018).

one aspect of measurement relates to origin of services. In the second chapter, several arguments have been posed against the origin criteria of the GATS on the ground that they become ineffective when services are supplied via the internet. Now this concern is multiplied when internet-based services are no longer exceptions as they used to be in the 1990s, but become increasingly dominant. It means that the defects of the rules are not peculiar to some services but may affect a much wider range of services.

In the time of digitalization, the determination of services' origin is cumbersome itself when dealing with pure services, and becomes even further challenging when it comes to digitalized products that are on the thin line between goods and services. It is quite brain-twisting to determine whether these products shall be governed by the rules for trade in goods or services and how they shall be classified in statistics? The SNBT has pointed out the risks that 'the rules on goods and services differ from, or even conflict with, each other, hence leading to a confusing regulatory framework.'[393] In this area of ROO, there is a possibility of a digitalized product being conferred different countries of origin depending on the status as a good or a service, which is a source of confusion and incoherence. As the SBNT further asserts, 'in the end it is up to the WTO's dispute settlement mechanism to decide this through case law.'[394] Notably, if the trade of such digitalized products is considered trade in services, the supply thereof via the internet may well fit to Mode 1 of the GATS, but then the question regarding their origin arises. Because such terms as border or territory are utterly vague in cyber trade, any attempt to identify the origin of these services based on the territory from or in which they are supplied may be prohibitively difficult. Otherwise, where the regulators prefer to treat digitalized products as hybrids of goods and services, they may need to devise specific rules for them, including origin rules.

In the specific case of 3DP, it is expected that this revolutionary production technique would also bring some challenges to services ROO. The most significant change when 3DP replaces conventional manufacturing is the more intensive use of services inputs. By nature, those services closely rely on the movement of data among different actors. It is noted that the transfer of data (for instance CAD files, a main component of 3DP) may take place across border. Although the WTO does not provide specific and explicit rules on cross-border transfer of data, commitments with Mode 1 are expected to gain

[393] See SNBT (2015), *supra* note 283, at 9.
[394] See SNBT (2016), *supra* note 375, at 25.

importance since data flows may be well governed by this mode of supply. Thus, once 3DP gains mainstreamness, it may be the case that the provision of services via Mode 1 will become more crucial, and the need to identify the origin of services supplied via this Mode will increase. Another aspect of the increased use of services-related inputs in 3DP may be the diminishing of trade in intermediary goods, which may result in an evaporation of tariff revenues. The SNBT foresees that, until there are more concrete rules, some countries may want to impose tariffs on data flows if it is practicable.[395] As a consequence, the issue regarding the origin of data and other services inputs in 3DP may become highly relevant and controversial.

Beyond the rather theoretical question regarding origin criteria, there is another more practical question regarding the restrictiveness of current services ROO. The fact that value creation in services GVCs may take many forms other than chains entails certain implications on the role of ROO and the evolvement of services GVCs. With respect to value networks, the most detrimental trade barriers are, in many cases, sector specific regulation and the failure to enforce competition rules. For instance, the 'rules related to data localization or commercial presence requirements can also prevent companies from creating a network of users across borders.'[396] In respect of value shops, the main barriers come from the movement of natural persons, so it implies that stringent rules under Mode 3 and Mode 4 will be most detrimental to these value creation models. In the meantime, it seems ROO for Mode 1 will be important for the internationalization of services inputs within both services and manufacturing firms as they directly affect the offshoring of services.

4.3.2. Indirect influences through ROO for goods[397]

As it has been analyzed earlier in this chapter, the servicification phenomenon reveals that in GVCs, services-related steps are equally important as, or even more important than pure manufacturing-related ones. Moreover, from a value added approach, these services-related steps contribute remarkably to the overall value of goods. Given their role in the manufacturing of goods, those costs related to services should be taken into

[395] *Ibid*, at 30.

[396] See Miroudot, *supra* note 281, at 4.

[397] The main arguments in this section (discussing the services component in goods) is developed from part of the author's own paper:
Khuong-Duy Dinh (2017), "Mode 5' Services and Some Implications for Rules of Origin', *Global Trade and Customs Journal 12(7/8)* 299-304, at 303-304.

account. As Geraets et al. assert, this phenomenon means that beyond manufacturing operations, 'modern ROO must factor the value (and the location) of the design, R&D, marketing, transport, and perhaps even the sales (retail) of the final product.'[398] To put it differently, the authors advocate a reform to ROO in merchandise which includes in the origin determination 'the value added during these stages of the production.'[399] By taking a similar yet more cautious view, this chapter suggests that at least the services component in goods, or 'Mode 5' services, needs to be included in defining the country of origin of goods.

Firstly, it must be emphasized that current ROO for goods have not paid due attention to the contribution of services embodied in goods. Where the origin criteria are based either on the HS or specific processing and manufacturing operations, services inputs are generally not part of the consideration as the 'tariff jump' and the processing rules focus exclusively on tangible inputs. Where the *ad valorem* percentage method is used, such services are rarely included, depending on the substantive content of the rules.

One may take the RVC threshold in the PTA between the US and Korea as an example. In this PTA's ROO, when the build-up method is used, RVC is calculated by 'the value of originating materials, other than indirect materials, acquired or self-produced and used by the producer in the production of the product.'[400] Indeed, this formula merely takes into account tangible inputs, and there is no instruction regarding services used for production. Whereas, in the build-down method, RVC is calculated indirectly based on 'the value of non-originating materials, other than indirect materials, acquired and used by the producer in the production of the good.'[401] Notably, this formula shows the relation between the value of the exported goods and that of non-originating materials (tangible inputs), and it is silent about intangible inputs (or 'Mode 5' services).

A peculiarity in the ROO of this PTA is that the RVC threshold in the build-up method is lower than that in the build-down method (35% vs. 45%). A possible reason to justify this difference is that the numerator in the build-up formula includes only the value of

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[398] Dylan Geraets, Colleen Carroll & Arnould R. Willems (2015), 'Reconciling Rules of Origin and Global Value Chains: The Case for Reform', *Journal of International Economic Law 18(2)* 287-305, at 300.

[399] *Ibid*.

[400] See Article 6.2(1), 'Chapter 6 – Rules of Origin and Origin Procedures' of the *Free Trade Agreement between the United States of America and the Republic of Korea*. The text of the chapter is available online at: https://ustr.gov/sites/default/files/KORUS%20-CHAPTER%20SIX-%20RULES%20OF%20ORIGIN%20AND%20ORIGIN%20PROCEDURES.pdf (visited 20 March 2018).

[401] *Ibid*.

originating materials, while that in the build-down method includes all the value after deducting non-originating materials. It is noticeable that to calculate added value, the build-down formula only subtracts the value of non-originating tangible inputs, so all service inputs (regardless of their origin) are probably deemed part of the added value. Therefore, arguably, the 10% is meant to quantify the difference between 'the value of originating materials' and that resulted from 'the value of products minus the value of non-originating materials' as the latter may include services-related components.

However, the ROO in the ASEAN Trade in Goods Agreement adopts a rather different approach: both direct (build-up) and indirect (build-down) methods to calculate RVC set the same threshold of 40%. Remarkably, in the direct method, the numerator in the formula is more clearly defined.[402] Apart from originating material cost, it also includes other costs that are detailed in of Article 29.2(c), (d) of the agreement:

> (c) Direct labor cost shall include wages, remuneration and other employee benefits associated with the manufacturing process;
>
> (d) The calculation of direct overhead cost shall include, but is not limited to, real property items associated with the production process (insurance, factory rent and leasing, depreciation on buildings, repair and maintenance, taxes, interests on mortgage); leasing of and interest payments for plant and equipment; factory security; insurance (plant, equipment and materials used in the manufacture of the goods); utilities (energy, electricity, water and other utilities directly attributable to the production of the goods); research, development, design and engineering; dies, molds, tooling and the depreciation, maintenance and repair of plant and equipment; royalties or licenses (in connection with patented machines or processes used in the manufacture of the goods or the right to manufacture the goods); inspection and testing of materials and the goods; storage and handling in the factory; disposal of recyclable wastes; and cost elements in computing the value of raw materials, i.e. port and clearance charges and import duties paid for dutiable component.

It is arguable that this formula has included a range of 'Mode 5' services embedded in the production of goods. Perhaps it is the reason why the ROO do not set out different thresholds for the two methods: the numerator in the build-up formula is more or less equivalent to the numerator in the build-down formula (i.e., the value of goods minus that of non-originating materials).

[402] See Article 29.1(a), 'Chapter 3 – Rules of Origin' of the *ASEAN Trade In Goods Agreement*. Full text of the agreement is available at: http://fta.miti.gov.my/miti-fta/resources/2.ASEAN_Trade_in_Goods_Agreement_.pdf (visited 20 March 2018).

But how does a reform, if necessary, to ROO for goods eventually relate to the issue of services origin? The answer is quite straightforward: if it is agreed that services inputs are important for the calculation of origin of goods, then it entails the need to identify the origin of these embedded services. Otherwise, ROO for goods may fail to precisely identify the origin of the goods even if they have taken 'Mode 5' services into account. In principle, an attempt to bring ROO for goods closer to the economic rationale would require an examination of the origin of both tangible and intangible inputs.

To illustrate, assume that a machine is manufactured in Korea using parts originating in China. The machine is designed by a company of Germany before it is assembled by a subsidiary of that company in Korea. If the applicable origin rule in the PTA between the US and Korea sets a 45% RVC threshold using the build-down method, this means the value of the machine deducting that of the Chinese parts must account for at least 45% value of the product. If design work accounts for 30% of the value of the machine, it is worth questioning the origin of thereof since a large part of its value added comes from a service apparently not originating in Korea. As analyzed above, the build-down RVC formula in this PTA is silent about services inputs. Therefore, though it may seem unsatisfactory, that fact is not likely to alter the origin of the product: it is still deemed as originating in Korea. The example highlights the defect of ROO for goods: they only take into account *where* rather than *how* the substantial transformation takes place.

The discussion is particularly meaningful in the case of 3DP. Though the SNBT argues that origin determination in 3DP may still go along with the principle 'last substantial transformation', it is also noted that '3DP changes when and how these principles can be used.'[403] Notably, the production process of 3DP is not as complicated as traditional manufacturing, therefore, it is less costly. Reasonably, the focal point in terms of value added tends to shift to inputs, principally the CAD and the ink. The striking feature of 3DP is that the substantial transformation would take place in the consumers' country; while the largest share in value is created by the country providing imported inputs.[404] The shift challenges the conventional perception of substantial transformation, which implies that ROO for goods will fail to identify the economic nature of products if they only consider *where*, and not *how*, the substantial transformation takes place.

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[403] See SNBT (2016), *supra* note 375, at 27.

[404] *Ibid*.

Another important implication relates to the case of goods and services being sold as a package. More often a transaction of such package is deemed as a sale of goods, but there will also be a service transaction where the sellers charge the services separately. In the previous section, it has been revealed that services embodied in exported goods may be subject to a combination of relatively complicated trade measures as they are at the border of rules covering direct service exports and those covering manufactured goods. An example raised earlier is that these 'Mode 5' services may have to pay duties while the same services supplied under Mode 1 would not. In terms of ROO, a twisting issue arises: since many services are being regulated by the rules for trade in goods, it means many services accompanying physical products 'are not considered in terms of origin but simply take the origin of the goods.'[405] It is therefore worth questioning that in case such services are charged separately, how their origin should be determined. It is also crucial to note that, every time services bundled in goods are not separated and they take the origin of goods as that of themselves, the traditional origin specific trade barriers (e.g., tariffs) are also relevant to services.

Notably, the phenomenon of servicification – and particularly the concept of 'Mode 5' – raises the awareness that many manufactured products should no longer be defined as 'goods' in its traditional meaning but as 'complex bundles or hybrids of goods and services interactions.'[406] To address such interrelation between services and goods, the suggestion is to consider at the same time the origin of goods and their services inputs. As the SNBT argues, the main policy implication of servicification is simply to think in terms of 'goods and services', rather than 'goods or services'.[407] The new generation of ROO may need to focus on the contribution of each country in the production of goods and services over GVCs. Otherwise, ROO will skew trade statistics as 'the relative share of raw materials, R&D, intellectual property, and marketing are not factored into the total value of the product.'[408] Therefore, while the construction of rules requires more elaboration, it is clear that ROO for goods should be reformed to incorporate 'Mode 5' services components, and at the same time we need to find proper solutions to handle the task of determining the origin of these services.

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[405] See SNBT (2015), *supra* note 283, at 9.

[406] See Cernat & Kutlina-Dimitrova, *supra* note 336, at 1114.

[407] See SNBT (2012), *supra* note 280, at 18.

[408] See Geraets et al., *supra* note 398, at 294.

To recap, this chapter describes the new context of international trade, where services become increasingly important. Not only accounting for a higher share in world trade as direct exports, services also become crucial inputs for the production of goods and other services. In addition, the production and supply of services are more fragmented, and 'pure' services GVCs are thus formed. Recent technology development has further transformed the way services are supplied and involved in highly innovated trade and production processes. This new context on the one hand highlights the significance of the origin determination of services, but on the other hand it also pinpoints the defects of current services ROO. The approach of GATS, despite the advantage of its simplicity, may turn out 'unsuited to the evolving reality of technologically sophisticated services that are increasingly traded electronically and made up of input sourced from various locations.'[409] Beyond the implications for services trade, the growing important role of services in the manufacturing sector does imply that a future reform of ROO for goods cannot be carried out without taking ROO for services into consideration.

[409] See Zampetti & Sauvé, *supra* note 60, at 143.

Chapter 5

The way forward: the prospect of a 'product-based' approach

Since the GATS approach to ROO for services is characterized as containing various defects, particularly in the new context of international trade, this chapter completes the discussions throughout previous chapters by addressing the question concerning the availability and necessity of alternatives to the prevalent approach. The chapter starts by considering the reasons for and against the adoption of a new approach to ROO for services. Inspired by the concept of 'substantial transformation', it will then discuss the prospect of a 'product-based' approach, which focuses on services rather than service suppliers. Though an elaboration on the technical design of origin rules is beyond the ambition of this chapter, it attempts to provide some insights into how they should be formulated and applied, as well as what legal implications they may entail. Given that a 'product-based' approach is still far from becoming mainstream, the chapter is closed with some realistic short-term recommendations to improve the current ROO for services.

5.1. The necessity of a new approach to rules of origin for services

5.1.1. Why is a new approach necessary?

As it has been analyzed in Chapter 2, the GATS approach to ROO for services contain various defects caused by the underlying reason that it does not observe the economic rationale of origin determination, thus it is not efficient in identifying the actual origin of services. Not to mention the fact that the GATS rules are usually unclear, which lack definitions and elaboration on technical terms, this approach results in the absence of ROO for services per se, as the origin criteria are mainly targeting at service suppliers, and not services themselves. Though for Modes 1 and 2, the rules are directed towards

services, the analysis has pointed out that such criteria based on the place of supply or consumption are arbitrary in various cases, which do not truly focus on the economic origin of services. The distinctive feature of the GATS ROO is the supplier-based rules, and as indicated, 'a rule of origin for services that connects origin to the nationality of the service supplier (or so-called service producer) is not conceptually compatible with the rationale mandating a rule of origin.'[410] Therefore, the idea to determine a 'service's origin based solely on the nationality of its provider seems to somewhat undermine the initial intention of the ROO.'[411]

To make the matters worse, the absence of genuine ROO for services is more obvious in PTAs. The analysis in Chapter 3 reveals that in various PTAs, the contracting parties do not even provide origin rules for services, but instead establish rules exclusively for suppliers. To a certain extent, the preferential ROO are no more than the requirements on the rights to provide services, while the concept of 'origin of services' does convey a broader meaning. It is worth recalling the remark of Abu-Akeel that such skew toward service suppliers may mean that there are in fact no ROO to govern international trade in services.[412]

Secondly, as Zampetti and Sauvé argue, 'the GATS does not depart substantially from the practice under bilateral and regional agreements.'[413] This remark has been proved by the findings of Chapter 3 that the GATS approach is widely reproduced in PTAs. It is apparent that PTAs may adopt different models in drafting their services ROO, but most of them follow an approach which is either similar to or influenced by the GATS. The word 'follow' does not necessarily mean that ROO for services in PTAs are in line with Article V:6 of the GATS, but that the GATS approach is reflected in the way PTAs define which elements grant preferences to eligible services and service suppliers. It is thus plausible to contend that, as the approach of the GATS contains inherent defects, such defects may be replicated in PTAs as well. Noticeably, the need to identify which services and service providers are eligible for preferential treatment is more crucial in PTAs than in the GATS. For this reason, the defects of services ROO may become even more detrimental in the province of preferential trade in services. It also suggests that

[410] *Ibid*.

[411] Karen Lapid (2006), 'Outsourcing and Offshoring under the General Agreement on Trade in Services', *Journal of World Trade 40(2)* 341-364, at 362.

[412] See Abu-Akeel (1999b), *supra* note 40, at 208.

[413] See Zampetti & Sauvé, *supra* note 60, at 140.

a better approach to services ROO may be beneficial to services trade both within and beyond the WTO.

Such defects become more evident considering new trends of trade and production as analyzed in Chapter 4. This chapter indicates that the ROO provided by the GATS are basically designed for services that are supplied by one provider to one final consumer, and not services serving as inputs for production in GVCs or as outputs obtained from internationally sourced inputs. As Munin's argues, the definition of the GATS does not cover situations in which services are supplied via multiple 'stations'.[414] Hence looking at services trade in the rise of GVCs from a TiVA approach, one may find that services ROO depart further from the economic nature of the concept of 'origin'. Moreover, the development of technology has materially changed the way services are produced and supplied, posing more challenges on the origin determination of services via applying the conventional approach. In this respect, the GATS approach fails to keep pace with the evolvement of trade and production in the age of servicification.

Furthermore, trade in services is not simply conducted by itself and for itself. Services can be inputs in the production of goods, and vice versa. Therefore, a new approach to ROO for services would be relevant for trade in goods as well. As it has been discussed in Chapter 4, services inputs and activities are making greater share in the production of goods, shown by the share of services in the value of manufactured goods. Plausibly, it will come to a point when the inclusion of services inputs in the calculation becomes crucial to determine the origin of goods. However, once it has been agreed that services sold packaged with goods, and those embodied in goods ('Mode 5' services) should be factored into the origin determination of goods, the need to identify the origin thereof arises at the same time. This leads to a vicious circle: it is not possible to determine the origin of goods precisely if ROO applicable to services are endowed with defects. Thus, a reform of ROO for goods would not only involve the consideration of services inputs, but also calls for efforts to improve ROO for services.

Finally, a new approach to ROO for services may have certain relevance to the field of investment. This issue has not been fully discussed in the previous chapters, although it has been accented that investment and services trade are inherently interconnected: the supply of services through commercial presence indeed involves the establishment

[414] See Munin, *supra* note 42, at 102.

in the consumer's market. The GATS covers investment to the extent that it is a mode of service supply (Mode 3); whereas, in a large number of PTAs, the supply of services through commercial presence is regulated by the investment chapter, not the trade in services one. Unlike policy measures in merchandise trade, which are mainly directed at goods, services trade and investment measures are mainly directed at suppliers and investors. For this reason, there is an analogy between the roles of ROO in these fields. Similar to ROO in trade agreements, ROO are also necessary for investment treaties 'to ensure that a foreign investor holds a relevant link with one of the signatory countries party to the agreement, which accords them, and not others, the preferences enshrined in the instrument.'[415]

By nature, just as ROO for services supplied via Mode 3, ROO in investment also need to set out nationality requirements for natural persons and juridical persons.[416] As for natural persons, most investment treaties grant protection to persons being 'nationals' of one contracting party; particularly, some treaties extend their benefits to ones being permanent residents in one contracting party. Meanwhile, criteria for juridical persons are in general provided by two provisions which put together a positive and a negative factor to determine the nationality of the investors: (i) one defining an investor falling within the coverage of an investment treaty by attributing it to a contracting party. To that end, the place of constitution is the most common criterion; and (ii) one excluding from an investment treaty's scope any foreign investor not having a real economic link with the party where it is located, though it may meet the first test on constitution. For this purpose, most investment treaties will rely on the ownership and control criterion in combination with the SBO test.[417]

The likeness between ROO in services trade and investment implies that the defects of the former may also be found in the latter. The concern becomes more plausible given the fact that the nationality of investors is an increasingly complicated issue. Pursuant to the UNCTAD World Investment Report 2016, firms, particularly affiliates of MNEs, are normally controlled by multilayered networks of ownership involving a number of companies. Over 40% of the foreign affiliates have been controlled via complex chains

[415] Martín Molinuevo (2008), 'Can Foreign Investors in Services Benefit From WTO Dispute Settlement? Legal Standing and Remedies in WTO and International Arbitration', in Marion Panizzon et al. (eds), *GATS and the Regulation of International Trade in Services* (Cambridge: Cambridge University Press) 296-323, at 302.

[416] *Ibid*.

[417] *Ibid*, at 303.

of cross-country links concerning around three jurisdictions. In that event, 'corporate nationality, and with it the nationality of investors in and owners of foreign affiliates, is becoming increasingly blurred.'[418] This type of affiliates is more common among the biggest MNEs – 60% of whose foreign affiliates have multilayered ownership relations to the parent entities. Such blurring of investor's nationality has caused the application of origin criteria based on foreign ownership or control in investment treaties become more challenging, which is detrimental in a world where ownership-related measures remain pervasive: '80% of countries restrict majority foreign ownership in at least one industry'.[419] It is recorded that about 30% of investor-state claims are filed by claimant entities which are ultimately owned by a parent entity in a non-partner country. Such indirect ownership structures and shell companies may significantly expand the reach of investment treaties, causing uncertainty and the *de facto* multilateralizing effect. As a consequence, some recent investment treaties attempt to cope with the obstacles via introducing more restriction in their definitions, benefit denial clauses, and SBO tests. However, it is not the common practice in the vast majority of existing treaties.[420]

Apparently, a reconsideration of ROO in investment is necessary to avoid difficulty in determining the scope of coverage of investment treaties for the sake of both investors and states. Given their similarity, it is inferred that a new approach to ROO in services trade may shed light on the concerns over ROO for investment.

5.1.2. Why is a new approach not necessary?

From the viewpoint of practitioners, there is no need to reconsider the rules if they do not adversely affect international trade in services. Even if we neglect the fact that any change within the WTO in terms of a covered agreement is next to impossible, at least for now, the improvement of the rules may not be necessary if it has no positive effect. This is a valid point to consider because most detrimental barriers to trade in services are not caused by ROO for services. Unlike trade in goods, ROO in both the GATS and in PTAs are described as liberal, thus there is little possibility that they hinder market access. As the rules have been in place for over two decades and there is no significant evidence on their impairment to trade, improving them seems not to be in the concern of policymakers and traders though they are found to have certain defects.

[418] World Investment Report (2016), *Investor Nationality: Policy Challenges* (Geneva: UN Publications), at xii.
[419] *Ibid,* at xiii.
[420] *Ibid*.

Many authors, despite criticizing ROO for services, point out that if ROO for services follow the path of ROO for goods, they would become overcomplicated. As Abu-Akeel has argued, 'it seems that any member of the GATS is in a position, if it so chooses, to introduce significant complications in the face of the Agreement and its objectives of liberalizing and further expanding the international trade in services' by introducing ROO for services that may be 'extremely difficult to administer and will, in effect, put new obstacles in the face of international service suppliers.'[421] Therefore, some authors argue that services ROO should remain definitional to avoid such risk. It is foreseeable that in order to substantiate the purpose of identifying the economic origin of services and suppliers, ROO for services will need to be constructed in a more detailed manner. For instance, if the determination of services' origin is based on value added, it would require evaluating the contribution of all inputs at all stages of production. Even if the application of such rules is technically feasible, such task is cumbersome as it requires huge efforts, which is against the purpose of facilitating international services trade. It is not to the mention the procedural aspect of those origin rules, which may altogether turn services ROO into a protectionist instrument.

Moreover, it is also arguable that the roles of ROO for goods and services are different; therefore, there is no need to observe the similar economic rationale. For the purpose of regulating services, getting to know the place from or in which a service is provided, or the origin of its service supplier is sufficient. There is no immediate point in digging deeper to the multiple layers of ownership and control, or uncovering the composition of a service to define the contribution of each stakeholder.

5.1.3. A balance analysis

First of all, whether or not services ROO should be based on the economic rationale is a crucial question. Undeniably, economic law by definition must reflect the economic principles and activities. Indeed, the language of the GATS makes it clear by providing for 'service of another Member' or 'service supplier of another Member'. The word 'of' implies a high level of belonging, i.e., a strong connection between the service and the country of origin. The origin determination of services is expected to look for the most reasonable nationality for the services, which is the country related to the services the most. Such purpose is beyond doubt because it would not be meaningful if the service

[421] See Abu-Akeel (1999a), *supra* note 31, at 118.

does not have a real economic link with the country of origin. In that case, the country of origin found is possibly arbitrary, and does not live up to the intention of Members in negotiating the GATS.

At this point, it is highly important to restate that the sequence of definitions provided in Article XXVIII of the GATS shows an intention to take services as the starting point for origin consideration. It is also evidenced by many negotiating documents, in which GATS negotiators actually attempted to build ROO to determine the origin of services. Even in defining 'like service suppliers', services are one of main factors to considered, as asserted by the Panel in *EC – Bananas III*, 'to the extent that entities provide these like services, they are like service suppliers'.[422] That the GATS ends up centering more on criteria for suppliers and not services only implies the challenge in the formulation of the rules – it does not mean the origin determination of services is not necessary, or can be replaced completely by determining the nationality of the suppliers. In fact, the concern over a lack of economic link in the supplier-based rules was raised during the early negotiations of the GATS:

> Establishing the nationality of the entities by employing an ownership, substantial interest or control test is often a very difficult matter. Even if it can be done it may be as inappropriate as a decision to determine nationality or origin on the basis of the location of incorporation. For example, a firm incorporated in country X (a signatory to the GATS) but controlled in country Y (a non-signatory) may sell products that embody mostly inputs sourced from country Z (a signatory).[423]

Once it is agreed that the origin determination of services should follow the economic rationale and current ROO for services fail to observe that rationale, it means that the rules should be reconsidered. In principle, there should be other rules which allow for the detection of actual service suppliers; or to be more precise in a world of GVCs, the suppliers bearing the closest economic links to services.

Regarding the relevance of ROO for services in the practical area, it is noted that their effect on market access has at times been pinpointed. For instance, the 50% threshold can become a bar to market access. Moreover, the influence of ROO on market access is clearer in terms of preferential agreement since GATS Article V sets the benchmark to which third countries' companies may gain preferential access into a PTA. The case

[422] Panel Report, *EC –Bananas III*, paragraph 7.322.
[423] See GATT Secretariat (1991a), *supra* note 35.

of the United Kingdom (UK) leaving the EU (Brexit) is a proper example showing that the discussion on services ROO is relevant for market access in reality, and is not only a theoretical issue. Beyond the relationship between the UK and the EU, that between the bloc and third countries will be affected by Brexit. Imagine a foreign country used to establish its commercial presence in the UK to provide services to the EU market. It is not yet clear at this time what will be the situation after Brexit, but it seems that the preferential treatment shall be denied when the UK is no longer an EU Member. Most obviously at risk will be the component of the UK banking sector made up of non-EU-headquartered banks, which have established subsidiaries in the UK to obtain the EU banking passport. These firms, whose assets accounts for about 14% of the UK banking sector in 2015, would no longer find the reason for establishing in the UK. The parent entities may want to relocate them to other EU states, e.g., Ireland or Luxembourg.[424]

Another relevance of origin of services in relation to market access may stem from the field of trade in goods. To illustrate, there have been discussions on the increase of the regional content under NAFTA. While it has not touched the issue of origin of services inputs, it is not very far from that as services account for a large share in manufactured goods.[425] Where a good is manufactured in Mexico by a foreign-owned company using offshored services, this is a fair reason for the US policymakers to consider examining the source of services inputs to decide whether the good is eligible for NAFTA benefits. The origin of services is also important to the application of trade remedies. If a trade war breaks out between the US and China, and a good is manufactured in Mexico with services inputs originating in China, it is not too speculative to think that the origin of services may affect the import of that good. This concern is more realistic considering the return of protectionism and anti-globalization, when countries may want to shield domestic industries and restrict the quantity of imports entitled to preferences.

It is true that the attempt to satisfy the economic rationale in services does render the rules more difficult to build and administer. However, experiences in the area of trade in goods also reveals that lengthy and detailed origin rules are not always synonymous with complicacy. Indeed, the restrictiveness of the rules does not depend solely on the

[424] John Armour (2017), 'Brexit and Financial Services', *Oxford Review of Economic Policy* 33(S1) 54-69, at 65.

[425] For a more detailed analysis, see Caroline Freund (2017), 'A US Content Requirement in NAFTA Could Hurt Manufacturing', *Peterson Institute for International Economics Trade and Investment Policy Watch*, available at: https://piie.com/blogs/trade-investment-policy-watch/us-content-requirement-nafta-could-hurt-manufacturing (visited 1 April 2018).

complicacy, but indeed the thresholds used in the rules themselves are also one of the factors. A simple and straight-forward rule requiring a 50% RVC is by definition much more restrictive than a lengthy and detailed one requiring only 30%. Therefore, while the concern over the complicacy of ROO services is undeniably valid, one must bear in that not all attempts to clarify rules may bring adverse effects.

In contrast, short and simple rules does not necessarily mean clarity and applicability. Rules that are too brief sometimes cause unpredictability and misinterpretation. There are several examples in the field of ROO for goods, particularly non-preferential ROO, where some countries only provide brief definitions that are not clear enough in terms of coverage, origin criteria and procedures. In fact, for firms operating in international trade, predictability is a crucial element, and rules that are not predictable in terms of outcome can be as detrimental as stringent one.[426] The lesson from the field of trade in may be a counter-argument to the claim that services ROO should remain definitional. All the analysis in Chapter 2 has revealed that some of the rules, particularly for Mode 1 and Mode 2, are not elaborated; and certain key terms in origin rules for Mode 3 and Mode 4 are not defined. Such vagueness may well become a source of conflicts and be manipulated by countries in their application of the rules.

From a more theoretical perspective, it is undoubtedly necessary to develop rules that reflect more accurately the practice of international services trade. If we refuse to step out of the box and the comfort zone of existing rules for fear that new rules or theories may be highly complex, eventually it will be harmful to international trade. Noticeably, services ROO serve the collecting of trade data and provide a basis for the formulating of trade policies, so they should be as precise as possible. In fact, this argument can be supported by citing the example of the TiVA concept. It is true that this new approach to a certain extent complicates trade statistics and challenges various existing concepts in international trade, but it is important to be researched and developed as it offers a different lens to view trade for the sake of policy making. For example, 'calculating the US–China trade deficit using value added data reduces the deficit by 25 percent,' such difference indeed means a lot to their bilateral trade relations.[427]

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[426] This part of the argument is written based on the discussion with Mr. Darlan Marti (WTO).

[427] Kemal Derviş, Joshua Meltzer & Karim Foda (2013), V*alue-Added Trade and Its Implications for International Trade Policy* (Washington, DC: Brookings Institution), available at: https://www.brookings.edu/opinions/value-added-trade-and-its-implications-for-international-trade-policy/ (visited on 21 April 2018).

In this chapter, it is asserted that the issue of ROO for services should be viewed from both short term and long term perspectives. First, the WTO and PTAs need to improve ROO by providing definitions or guidelines for vague terms, and working towards the harmonization of rules. Then, in the long run, trade scholars and practitioners should start framing a new approach to ROO for services.

5.2. Towards a 'product-based' approach[428]

5.2.1. Revisit the 'substantial transformation' criterion

5.2.1.1. Looking for similarity, not dissimilarity

At this point, one may ask the question what policymakers and trade scholars should do if they want to call for a reform. It is quite clear that the rules set by Article XXVIII of the GATS do not offer much room for improvement if they are expected to become more economically justified. The criteria currently found in the GATS and PTAs are basically not focusing on services, so transforming them into something innovative is 'mission impossible'. In other words, a long term reform would not come out of simply just patching up the current GATS-based origin rules. Instead, it is necessary to think out of the box to see whether there is any alternative solution to the problem.

It is noted that while discussing ROO for services, previous authors often focus on the difference between goods and services. For instance, Kingston notes that most service sectors differ from goods as one 'cannot evaluate the different components that make up a service'.[429] In addition, Zampetti and Sauvé analyze the characteristics of services (e.g., intangibility, indivisibility, and non-storability), and conclude that those 'salient characteristics of how services are produced and traded internationally help to explain key differences in rule design.'[430] To a large extent, it is widely agreed that differences between services and goods do make it unfeasible to import concepts from the field of goods into that of services. Such differences also shape the hallmark of services ROO: focusing on service suppliers rather than services themselves, and being neither sector nor service specific (applied across the board).

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[428] The discussion in this section is mainly developed from part of the author's paper:

Khuong-Duy Dinh (2016), 'The Standstill of Rules of Origin for Services: Towards a 'Substantial Transformation' Approach', *Journal of International Economic Law 19(4)* 845-862, at 854-862.

[429] See Kingston, *supra* note 85, at 20.

[430] See Zampetti & Sauvé, *supra* note 60, at 144.

Though the line between services and goods is by no means disappearing, the analysis in Chapter 4 suggests that it is becoming thinner. Services and goods are increasingly sold together as packages. Moreover, there are more and more digitalized products as hybrid forms between goods and services. Hence instead of looking for more different characteristics to support a peculiar approach to ROO for services, it is arguable that one should look at the matter from the opposite side. That is, common characteristics between goods and services may permit an importation of ROO for goods into the field of services trade to facilitate a 'product-based' approach.

Abu-Akeel is among the first authors to revisit the concerns raised during early GATS negotiations in terms of ROO for services. In the analysis on the dissimilarity between economic and legal suppliers, he provides an intuitive example to prove the irrational nature of the GATS rules. The example also suggests that the principle of determining origin in merchandise trade should be considered in services trade.

> [...] A shipment of Colombian coffee is bought and packaged by a Chicago commodity trader and subsequently sold to a French consumer. This shipment is considered by France, for purposes of determining origin, as a good originating in Colombia rather than in the US. If this conclusion is undoubtedly correct, then it is difficult to see why management services provided to Egypt by a US firm through an assembly of Brazilian engineers, computer programmers, and financial analysts is treated by Egypt as originating in the US rather than in Brazil. In this case, the US firm is the producer or legal supplier of the services. The US is the country of the producer firm, and it is the country that may espouse any claims by such firm under the law of the GATS. The US, however, is not the economic origin of the services.[431]

Munin also contends that to overcome the narrow scope of application of the GATS as compared to scenarios that may happen in reality, the GATS may consider adopting a similar approach to that in merchandise trade, although she fully acknowledges there will be certain challenges. For instance, the intangibility of services renders it arduous to receive and evaluate data on the relative contribution of each 'station' in the supply chain to the final service.[432]

The concern of Munin holds true even until now, not to mention at the time the GATS was drafted. However, it is expected that the development of trade statistics may lend a helping hand in handling the obstacle. About one decade ago, the notion of assessing

[431] See Abu-Akeel (1999b), *supra* note 40, at 206.
[432] See Munin, *supra* note 42, at 102.

the domestic value added in exports was not common at all, but these days it becomes increasingly trendy thanks to the availability of data. Though there is not yet a similar TiVA database for pure services GVCs, it is expected that the development of statistics will soon bridge the gap. Besides, because data needed for origin purposes are mainly at firm level, the possibility of collecting information on the share of various parties in the value created through the production and supply of a service is even higher.

5.2.1.2. 'Substantial transformation' in services trade

Since ROO for goods focus on processing activities, many scholars conclude that their criteria are not suitable for services. Hoekman argues that 'most trade services will be 'substantial transformations' of whatever inputs are used, simply because the service will not have existed before it is sold. That is, the non-storability of services frequently makes these traditional approaches irrelevant. The same applies to physical content requirements (number of domestic widgets, weight, etc.), as services tend to be both intangible and indivisible.'[433] Zampetti and Sauvé note, besides statistical challenges posed by the efforts to measure the contribution of services to domestic economy and international trade, the fact that services are intangible and often embodied in other goods or services is an additional challenge against the effort to rely on value added to identify their origin. Moreover, where services are supplied via networks, there will be insufficient information about the production structure and the inputs involved in the final service offerings. All in all, the authors conclude that 'criteria such as substantial transformation and changes in tariff headings that are the hallmarks of rules of origin for trade in goods are clearly not workable in a services context.'[434]

Taking a more liberal view, Kingston does recognize the possibility of applying 'origin concepts analogous to those developed for trade in goods', yet 'with some difficulty' 'in a narrow range of cases where the service itself can be defined to move internationally', for instance, a database accessible to users in other countries via the internet. He also asserts that 'the rule of substantial transformation, however, could be applied in very restricted instances, and rules based on added value concepts, which might be easier to determine, might also be occasionally relevant'.[435]

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[433] See Hoekman, *supra* note 98, at 89.

[434] See Zampetti & Sauvé, *supra* note 60, at 119.

[435] See Kingston, *supra* note 85, at 19.

What is noticeable in these seemingly contradictory views is that they both interpret the term 'substantial transformation' not as precisely as it should be. As introduced in Chapter 1, the rules to identify the origin of goods may employ one of the two criteria: the criterion of goods 'wholly obtained' in a given country, applied where only one country enters into consideration in attributing origin; the criterion of 'substantial transformation', applied where two or more countries take part in the production of the goods. The latter criterion can be detailed by a number of methods of application that can be used separately or in combination with each other: (i) a rule requiring a change of tariff classification; (ii) a rule based on specific manufacturing or processing operations; and (iii) a rule based on the *ad valorem* percentage of added value. A line is to be drawn between 'substantial transformation' as a notion, and the methods via which this notion is expressed. Thus, either putting them together as 'criteria such as the substantial transformation test and change in tariff heading' (Hoekman, Zampetti and Sauvé), or separating them apart as 'the rule of substantial transformation… and rules based on added value concepts' (Kingston) may not accurately reflect the nature of this term.

In practice, the 'substantial transformation' criterion is specified in PTAs or national laws in various ways. Each PTA may choose one of the three methods of application as the principal rule and use the others as alternatives. The thresholds also vary across PTAs, resulting in some ROO being more stringent than others. This practice indicates how the concept of 'substantial transformation' is detailed into rules and suggests that there would be different models to specify this criterion.[436]

In general, the 'transformation' requirement applies to non-originating inputs, which requires them to undergo in a country of origin 'last substantial process or operation', which is 'economically justified' and 'resulting in the manufacture of a new product or representing an important stage of manufacture.'[437]It is inferred that when more than one country involves in the production process, the country of origin should be the one whose contribution is of significant importance to the making of the product. A proper set of ROO should be able to detect and confer the country of originating status to the country with such characteristic. In other words, ROO *should* ensure that compliance with them will reflect the 'substantial transformation' notion.

[436] See Inama, *supra* note 13, at 4.
[437] The Council of European Communities, Regulation 802/68, OJ L.148/1(1968).

The word 'should' suggests that there may be instances where the application of ROO leads to an unsatisfactory result, i.e. the country of origin only makes a minor portion of contribution to the final goods. An example of such phenomenon is that of iPhones 4 and iPads – they are designed by Apple (headquartered in the US), yet assembled in China with components imported from various other countries. Kraemer, Linden and Dedrick realize that manufacturing operations in China only add 1.8% and 1.6% to the value of these iPhones 4 and iPads respectively.[438] The remainder is found to originate in Japan and advanced economies, in which the fertilization and generation of critical services inputs as well as marketing or R&D are based. Despite the minor contribution of China, the goods are deemed as 'made in China' under applicable ROO.[439] Although the example is not a common practice, it reveals that ROO for goods do have their own defects – ROO sometimes identify a country as the country of origin of a good though this is not the country where the good in fact undergoes substantial transformation. It is noted, however, that the defects are with the rules formulated to specify the criterion of 'substantial transformation', but not the criterion itself.

Revisiting the concept of 'substantial transformation' may shed light on the discussion on ROO for services. Despite its merits, the reasoning that services do not exist before they are sold and consumed, so they inherently involve 'substantial transformation' of all inputs used, is not completely satisfactory. If put that way, anything will undergo a 'substantial transformation' from what they are before. A live animal being slaughtered is by all means 'transformed substantially' to a dead one (or meat). Yet, in all ROO for goods, slaughtering is listed as minimal operation, which does not confer origin to the goods. Another example is the assembling of a motorbike: is it reasonable to deem the assembling of non-originating parts into a motorbike as 'substantial'? Using the same argument, a motorbike does not exist before it is assembled, so the assembling process doubtlessly turns a 'non-motorbike' into a motorbike, i.e., 'substantial transformation'. But in most practical cases, assembling does not qualify to confer originating status to goods, particularly when the value added rule applies. Hence, it is quite hasty to think of 'substantial transformation' as a simple 'before versus after' change. This reasoning

[438] Kenneth Kraemer, Greg Linden & Jason Decrick (2011), 'Capturing Value in Global Networks: Apple's iPad and iPhone', *PCIC Working Papers on Value of Innovation*, at 11. The paper is available online at at: http://pcic.merage.uci.edu/papers/2011/Value_iPad_iPhone.pdf (visited 13 April 2018).

[439] WTO, 'Trade in Value Added: What Is the Country of Origin in An Interconnected World?', *Background Paper of the International Trade Statistics Section,* available at: https://www.wto.org/english/res_e/statis_e/miwi_e/background_paper_e.htm (visited 30 April 2018).

should be borne in mind if one wants to apply the 'substantial transformation' concept to the field of services.

The question is whether or not there is similar 'substantial transformation' in services. Similar to goods, services cannot be created from nowhere, out of nothing; it requires resources and involves production processes. And the creation of a particular service from certain inputs may involve one country or many countries; in the first scenario, the 'wholly obtained' criterion applies, while in the second case, arguably it is possible to apply the 'substantial transformation' criterion.[440] The implanting of the 'substantial transformation' criterion from the sphere of goods into that of services should not and cannot be a simple 'copy–paste', but requires a process of adaptation. In such process, what need to be retained are the intents and purposes of this criterion but the rules to specify 'substantial transformation' are expected to differ from those for merchandise. No matter what rules apply, the country deemed as the origin of a service should make a contribution of significant importance to the formation of that service.

It is clear from the critique in Chapter 2 that in various cases, the ROO for services in the GATS identifies a country of origin which does not make a significant contribution to the service as such, or even does not have any real economic link with the service at hand. This is partly because ROO for services employ criteria that are not based on the services themselves, particularly providers' nationality. Therefore, in order to observe the 'substantial transformation' criterion, it is crucial to build rules different from the current ones that focus more on services, and not on suppliers. It is also arguable that such product-based approach can be established via an elaboration on the 'substantial transformation' criterion.

5.2.1.3. Formulate 'product-based' rules in line with the 'substantial transformation criterion'

Similar to the field of goods trade, there may be different methods to formulate origin rules based on the 'substantial transformation' criterion. Abu-Akeel is among the first authors to argue that ROO for services have to 'look beyond the nationality of the legal supplier (producer) to the sources of actual inputs into the traded services.'[441] Likewise,

[440] An example of a 'wholly obtained' service is a lawyer in Singapore who sends his advice to a client in Laos via email. It seems wholly obtained services are often supplied under Modes 1 and 2, but not always. For instance, a student from China goes to Germany to study in a master programme jointly organized by a German and an Italian university. In this case, the education service that he consumes is not 'wholly obtained' in Germany.
[441] See Abu-Akeel (1999b), *supra* note 40, at 206.

Lapid also thinks 'in order to assert ROO for services that would conform to economic rationale, the origin of the service and all of its inputs must be identified.'[442]

Being an author who strongly believes that the origin of services themselves is of 'much more importance than the nationality of their suppliers', Wang suggests a method that directly focuses on the processes via which services are supplied.[443] Given the fact that services cannot be supplied without intangible inputs, he puts forward the application of a 'substantial input test', where the amount of all inputs are evaluated based on the value they contribute to a service. The Member whose substantial inputs are added to a service will be determined as the country of origin thereof. In particular, the test not only cares about where the value is added, but also how substantial the added value is. It is noted that by employing such test, the shareholding structure of juridical persons no longer matters; neither does the divorce between legal and economic suppliers. He believes the test is consistent with the purpose of the GATS (i.e., limit benefits to WTO members), and the purpose of origin requirements (i.e., determine where the services come from).[444]

The advancement of trade statistics such as the TiVA database and the harmonization of accounting and auditing standards may crucially lend a helping hand to accomplish Wang's proposal and turn the 'substantial input test' into workable rules. However, to think of Wang's 'substantial input test' as a simple biggest monetary contribution rule may be misleading. In some cases, the most important input of a service is not highest monetarily valuated. For instance, the most important input of the education services in a school comes from its teaching activities even though a cost breakdown may show that the costs on teaching activities do not account for the largest share in the school's expenditures. It means the substantiality of any input should be considered on a case-by-case basis, and not always simply a monetary valuation.[445]

Taking a similar view, Munin proposes two options to formulate product-based origin services ROO. The first one involves weighing the relative contribution of each station

[442] See Lapid, *supra* note 411, at 362.

[443] See Wang, *supra* note 43, at 1102.

[444] See Wang, *supra* note 43, at 1103-1107.

[445] At this point, Rule 3(b) of the *General Rules for Interpretation of the Harmonized System* may have certain implications on substantiality of inputs: 'Mixtures, composite goods consisting of different materials or made up of different components, and goods put up in sets for retail sale, which cannot be classified by reference to 3 (a), shall be classified as if they consisted of the material or component which gives them their essential character, insofar as this criterion is applicable.'

in the supply of a service. This method generally follows the similar mechanism as the 'substantial input test' suggested by Wang. Besides, the nationality of a service may be attributed to the country with a majority of stations via which it is produced. Although the latter option seems to be more technically feasible, there is a risk that the majority of stations may account for a relatively minor portion in the entire service's value, but the biggest share is credited to a station located elsewhere.[446]

5.2.2. The possibility of sector-specific rules

In merchandise trade, rules designed to detail 'substantial transformation' may differ across sectors and even products. Particularly, in PTAs, besides general rules applied across the board, there are often product-specific rules provided for each chapter, and may even for each heading in the same chapter. This can be explained by the fact that in attempts to express the 'substantial transformation' criterion, one single origin rule cannot fit to all goods.

In the meantime, a striking feature of services ROO is that they are neither sector- nor product-specific. Yet, similar to trade in goods, it is arguable that financial services are different from environmental services, so it is unreasonable to presume that an origin rule that works in one sector will also work in another. That is to say, to establish one-size-fits-all origin rules for services irrespective of their sectors is arguably groundless. That is another point which adds up to why current supplier-based ROO cannot work properly: as they are supplier-based rules, they do not take into account the feature of each service and the way each service is supplied. Thus, a product-based approach for services ROO tends to entail that they should be sector-specific.

Another reason favoring the prospect of sector-specific based approach indeed comes from the counter-argument that ROO for services serve the regulatory purposes more than pecuniary interests. Jansen contends that if regulatory considerations play a role, and such role is sufficiently taken into account, one may expect ROO services to 'differ significantly across service sectors and to reflect the differences in the importance and the nature of regulation across sectors.'[447] Moreover, commitments regarding national treatment and market access are made sector-specific, so there is no reason why origin rules for services cannot follow the same path.

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[446] See Munin, *supra* note 42, at 102.

[447] See Jansen, *supra* note 159, at 140.

Notably, the document MTN.GNS/W/120 provides the list of services sectors and sub-sectors governed by the GATS.[448] This sectorial classification was built in 1991 in order to assist services negotiations in the Uruguay Round via guaranteeing a comparability and consistency of commitments. Its 160 sub-sectors are indeed the aggregate of more detailed categories provided by the UN Central Product Classification.[449] This figure is nothing comparable to higher than 5000 headings and sub-headings of goods listed in the HS Nomenclature.[450] It means there is no technical reason against the formulation of sector-specific ROO in the field of services trade.

All in all, it is suggested that rules to express the 'substantial transformation' criterion in services be designed as sector specific ones. This would be a burdensome work, but it is not impossible, particularly because schedules of commitments in PTAs generally do not cover all service sectors. It should be possible for origin rules to be provided as a column corresponding to each service sector. It is essential to note at this point that though sector-specific services ROO may still vary among modes of supply (as they do now), practice from the field of trade in goods, where there is only one mode of supply, suggest that they will no longer be the key element in origin consideration.

5.2.3. The prospect of a 'bottom-up' reform

Although Wang's aforementioned 'substantial input test' is a new approach compared to previous thoughts on the topic, it is indeed inspired by a proposal at the early stage of the GATS negotiations. This test takes root in the concern in the MTN.GNS/W/140 document – which has never been adopted in the interpretation of the GATS. To make way for the test to be adopted by the WTO, Wang argues that since the general rule of interpretation provided by Article 31 of the Vienna Convention on the Law of Treaties (VCLT) leaves the meaning of 'ownership' and 'control' requirements in Article XXVIII of the GATS ambiguous, its Article 32 on supplementary means of interpretation must be applied.[451] From a legal perspective, it is a highly persuasive argument to justify the test since the W/140 document may fall within the 'preparatory work of the treaty and the circumstances of its conclusion' so it suffices to be deemed 'supplementary means

[448] GATT Secretariat (1991b), *Services Sectorial Classification List* (MTN.GNS/W/120). The document is available online at: https://www.wto.org/english/tratop_e/serv_e/serv_sectors_e.htm (visited 19 April 2018).

[449] UN, https://unstats.un.org/unsd/cr/registry/cpc-21.asp (visited 19 April 2018).

[450] See WCO, *supra* note 14.

[451] The Vienna Convention on the Law of Treaties is a UN's treaty governing the international law on treaties between states. The Convention was adopted in 1969 and entered into force in 1980.

of interpretation' pursuant to Article 32 of the VCLT. Yet, from a practical perspective, it appears to be an over-optimistic argument because of the fact that WTO panels and the Appellate Body have not traditionally 'relied extensively on supplementary means of interpretation'.[452] Besides, it is noted that this 'substantial input test' is not the only way to construct product-based ROO for services: there may be various ways to denote 'substantial transformation' (there may be even different criteria than the 'substantial transformation' which is also product-based). It means another test to bring to life the 'product-based' approach may not have any relationship to the W/140 document, thus it may not be justified by applying Wang's argument.

The dissertation would want to go beyond Wang's recommendations by asserting that in general, a product-based approach should be implemented in PTAs rather than the WTO. Although the WTO does provide the framework for trade in services, the limited multilateral commitments in services have turned it into a less effective forum to deal with matters arising in this field. As shown in Chapter 3, it is beyond doubt that trade in services are growingly regionalized, bringing fair opportunity for a new approach to be tested within PTAs. Logically, as PTAs deal more with services trade than the WTO, the relevance of service origin rules will be more prominent in the former.

There are other reasons justifying this suggestion. Due to the WTO's consensus-based decision making process, modifications of existing covered agreements are by far very challenging. Since its establishment in 1995, trade negotiations at the WTO have been rather stagnant; thus, it is of no possibility that the new approach may be adopted via negotiations, especially when the Members do not consider it necessary. Another way of making changes in the WTO relies on the tribunal's interpretation of the law, which is what Wang has suggested. However, the development of the GATS jurisprudence is indeed rather slow, which casts doubt on the chance that such a crucial change may be approved through WTO tribunal's decision.[453] Moreover, in recent years, the blockage against the appointment of new Appellate Body judges has been unsolved. The US has blamed the WTO court for the so-called 'judicial activism', i.e., it has indulged in rule-making beyond what the Members have negotiated and signed up for at the WTO. It is,

[452] See Wang, *supra* note 43, at 1101.

[453] Until May 2018, there have only been 28 cases citing any article of the GATS in their request for consultations. The list of cases is available at the WTO Dispute Settlement Gateway, https://www.wto.org/english/tratop_e/dispu_e/dispu_agreements_index_e.htm (visited 3 May 2018).

for these reasons, unlikely that any new approach will be welcomed in the WTO in the future if it goes through the judicial branch.[454]

Meanwhile, agreement can be reached by negotiations more easily in PTAs. Moreover, there would be no difficulty in complying with the GATS if PTAs adopt such 'product-based' approach to services ROO as long as Article V:6 of the GATS is not violated. So it is plausible that PTAs offer more room for innovation in this area of rule-making. If a new approach to services ROO, or at least supplementary means of interpretation to GATS Article XXVIII, is adopted by the WTO before being spread to PTAs, this would be a 'top-down' reform. But if the changes take place in PTAs before finally adopted at the WTO, the reform would be described as 'bottom-up'.

Apart from being more feasible, such a 'bottom-up' reform is also more effective. Even if the 'product-based' approach to services ROO was adopted by the WTO, it would be much more difficult to be implemented in the multilateral context. Whereas, it would be easier to define 'substantial transformation' via, for instance, the 'substantial input test' in PTAs where the creation and provision of services involve a smaller number of parties. In other words, PTAs are ideal test sites for the new approach since they allow the rules to be formulated, implemented, and controlled more effectively.

Cautiously speaking, given the difficulties it may encounter in the multilateral context, a 'top-down' reform is prone to failures in its first steps, which is bound to discourage PTAs from adopting a 'product-based' approach. In contrast, having it tested, adjusted, and accomplished in PTAs is an effective way to persuade the WTO Members that the new approach would be fruitful in the multilateral trading system.

5.2.4. Some legal implications of the new approach

5.2.4.1. Country of origin identified different from applying the current approach

A product-based approach is bound to affect the results obtained from the application of origin rules, which may have consequences on trade statistics and policies based on origin. This can be exemplified by a company providing consulting services which has its headquarters in France and controls branches in Latin American countries. All the

454 For a more detailed analysis, see Tetyana Payosova, Gary Hufbauer & Jeffrey Schott (2018), 'The Dispute Settlement Crisis in the World Trade Organization: Causes and Cures', available at: https://piie.com/system/files/documents/pb18-5.pdf (visited 3 May 2018).

analysis work for this market is carried out in the US. What is the origin of the service delivered by its branch in Mexico to local customers? The answer depends on the role of the branch: if it is simply a connecting point to receive orders and deliver reports, it performs a 'minimal operation' which does not confer originating status to the service. In this case, the 'substantial transformation' criterion is likely to identify the US as the country of origin. But a more active role of the branch (e.g. interpreting reports to give advice) may make Mexico the country of origin (even if its contribution to the services in terms of monetary value may be lower than that of the US). Anyhow, the 'substantial transformation' criterion is expected to find either the US or Mexico as the country of origin, but not France (the country detected by applying the GATS approach, which in fact indeed has little link with the service).

Such product-based approach based on the 'substantial transformation' criterion may raise concern in some cases that are usually deemed uncontroversial. For example, an education institution constituted under the law of the UK opens one branch campus in India. According to GATS rules, the education service supplied via the branch campus will originate in the UK. On the one hand, it is argued that the British elements in this service are more essential, so the service should be deemed to originate in the UK. On the other hand, it is rebuttable that once established in India, this branch campus has to respect local regulations and infrastructure, as well as recruit local staff. It explains why studying at the branch campus, even with professors from the UK, is by no means similar to studying in the main campus. In this sense, there has been some 'substantial transformation' taking place in India, and the origin of the service should be India. In fact, both arguments have their own merits, the answer depends on the rules to specify the 'substantial transformation' criterion, as well as the actual role of relevant parties.

5.2.4.2. Does the GATS allow for a new approach?

Among other authors, Abu-Akeel believes that 'the GATS contains nothing to preclude members from formulating their ROO for international service trade so as to enforce the same economic rationale underlying the ROO for international trade in goods.'[455] It is also argued by Lapid that as ROO for services are left unstandardized, 'each country may formulate its own rules'.[456] It is inferable from these arguments that the 'product-

[455] See Abu-Akeel (1999a), *supra* note 31, at 117.

[456] See Lapid, *supra* note 411, at 362.

based' approach may be adopted by WTO Members with no apparent violation of their GATS obligations. The remark tends to be precise with respect to PTAs as preferential ROO for services can take whatever approach provided that they are in harmony with GATS V:6. There is no obstacle for a PTA to implement this 'product-based' approach, and at the same time to ensure that foreign suppliers established and have SBO within the PTA are granted the same preferential treatment. In other words, if the approach is applied the same to PTA suppliers and eligible foreign owned and controlled suppliers, it is likely to satisfy the requirement of the GATS.

But in the context of multilateral trade, there are some doubts about these views. As it has been discussed via Chapter 1, ROO in the GATS are different from those for goods provided in the ARO. The ARO indeed does not provide substantive origin criteria, so WTO Members may select the applicable methods and set out their own thresholds in non-preferential ROO. This in effect means each Member can define goods originating in another Member by its own criteria. In contrast, the GATS has provided substantive criteria to determine the origin of services although such criteria may be inefficient or lacking in details.

As mentioned in the discussion in the part suggesting a 'bottom-up' reform, while the 'substantial input test' may be applied as a supplementary source of interpretation, as allowed for by Article 32 of the VCLT. However, 'substantial input test' is only a mean to denote substantial transformation in the 'product-based' approach, so there may be other means for such purpose. Besides, there is no certainty that the WTO judges may agree to this reasoning. Therefore, it is still important to ask the question whether the GATS allows its Members to formulate 'product-based' ROO for services.

Legally speaking, the definitions are substantive provisions of the GATS, thereby they form part of the Members' obligations under the agreement. By specifying their GATS commitments in schedules of specific commitments, Members bind themselves to the treatment confined to services and service suppliers of other Members in line with the GATS' definitions. Indeed, it is not evidenced in practice how a Member has provided different sets of ROO (i.e., different definitions) for 'service of another Member'.

It is true that Members have the right to provide more clarifications, add more details to the rules. This is the practice under, for instance, the Customs Valuation Agreement (CVA). The CVA provides the principles and methods to determine the customs value

of goods, based on which Members construct their domestic laws. It is expected that if the domestic law uses a method based on arbitrary minimum price (that is against the principles of the CVA), it will make such law inconsistent with the agreement. A more relevant example to consider may be taken from ROO for goods: if a Member bases its non-preferential ROO for goods on producer's nationality requirements instead of the current approach, its law tends to be inconsistent with the ARO.

Following this logics in reasoning, as regards ROO for services, the new approach will not simply add clarity to the GATS definitions, but substantially change the nature of services ROO. As shown above, a shift to 'product-based' ROO may completely change the results acquired from the application of current origin rules. Hence there is a high possibility that if a Member wants to follow the 'product-based' approach, the rules or definitions that it constructs will be incompliant with the GATS.

But it should be stressed that, pragmatically speaking, a WTO Member may at its own discretion formulate non-preferential ROO for services, as the question of consistency is only addressed by a tribunal's decision when the rules are challenged.

5.2.4.3. Does the new approach preclude existing criteria?

The above discussion on a 'product-based' approach does not necessarily preclude the use of existing criteria on place of supply or consumption, and nationality of suppliers. In determining the origin of a service, the identity of the suppliers may still need to be considered to avoid the scenario where a company of a developed economy establishes its commercial presence in a developing one to utilize preferential treatment destined for the latter, while not obliged to use local manpower.[457] The requirement is critically important in the case of a company setting up its commercial presence in the territory of a PTA partner. Without an identification of nationality, the firm 'would benefit from preferences intended for members, even if it does not use the labor market of members to the agreement.'[458]

Moreover, if the 'product-based' approach is adopted in PTAs while the GATS remains unchanged, criteria such as ownership or control, SBO are still important to determine to what extent a PTA may extend its treatment to third countries' services and service suppliers. Supplier nationality should be considered one of the elements to determine

[457] See Lapid, *supra* note 411, at 363.
[458] *Ibid*.

the preferential treatment. Perhaps one juridical person constituted in the territory of a partner should be able to set up commercial presence in another party as the primary condition; but the services supplied via this commercial presence need to be put under review to guarantee consistency with the 'substantial transformation' criterion. To put it differently, market access may be based on one company's nationality, but the denial of benefits should be on its own services.

Beyond sector-specific rules, it is expected that services' origin needs to be decided on a case-by-case basis. It is the practice currently found in the field of goods: depending on its compliance with applicable origin rules, a producer or exporter will obtain proof of origin for this present shipment, but fail to obtain the document next time. Even in a self-certification regime where traders are permitted to certify the origin of goods by themselves, there are still risk management mechanisms to prevent manipulation and fraudulent acts. In merchandise trade, foreign investors are allowed to set up factories to manufacture goods in a country, but the origin of goods is decided by, among other things, the actual composition of inputs. This principle can be employed in the area of services as well: there should be a distinction between the rights of establishment and the treatment conferred upon the services supplied. It may eventually entail an *ex post* review of the production and supply process.

However, the purpose of this research is not to argue for the immediate application of the 'product-based' approach. Practically, it states that the new approach may provide another perspective for consideration. Therefore, a new approach does not necessarily lead to the abolition of current rules but can work as supplementary ones. It is similar to the prevalent approach to ROO for goods which is still based on traditional statistics and assigns the whole value of the good to only one country labelled as the 'country of origin'. In this context, the initiatives such as TiVA are introduced not as rivalry but as complementary instruments to analyze and formulate trade policies.

5.3. What can be done in the short-term?

Despite being one of the first authors to discuss the possibility of 'product-based' ROO for services, Wang also foresees that 'any such rule, although fully consistent with the underlying economic rationale of the concept of origin, will be extremely difficult to formulate and to administer, particularly in this era of industrialization and global

sourcing of services.'[459] Lapid concurs that ROO for services as such may be extremely difficult to formulate as, unlike ROO for goods, 'the origin and components of a service are difficult to define and document.'[460] Although in the long term, the development of trade statistics can facilitate the implementation of the new approach, it seems that in the short term, what should be done is to improve the current ROO for services so that it can best facilitate services trade.

It is also important to learn from other aspects of economic law. For instance, current ROO used in the area of goods has proved incompatible with GVCs and trade in value added. The discussion above has further blurred the notion of 'country of origin' since imported goods are decreasingly linked to the geographical origin declared in customs documents. However, these rules cannot be replaced at once, and the existence of new approaches such as TiVA will not be adopted soon. Thus, they co-exist and supplement each other until new rules are put into practice.

Notably, this is also what has been recommended in the field of investment law, where the rethinking of ownership-based investment policies may include both safeguarding the competency of ownership rules and looking for alternatives. Firstly, it is suggested that policymakers need to test the 'appropriateness' of ownership rules in comparison with other mechanisms in the investment-related policy areas, e.g., tax or competition. Secondly, they can try to 'strengthen the assessment of ownership chains and ultimate ownership and improve disclosure requirements.'[461] It means that beside the long run need to reconsider the ownership-based rules, in the short term, they can improve the implementation of these rules. This view is also relevant to the field of services trade.

In the short term, it is put forward that the WTO Council on Trade in Services should clarify those terms that have not been defined by GATS Article XXVIII. One may note that the Council have circulated some previous documents of to interpret, for instance, the treatment to branches and representative offices. It is thus expected that the terms related to the ownership and control, residence, SBO… which are found to be vague in Chapter 2 can be put on the table for consultation. In fact, in the context of the WTO's Negotiating Group on Rules, Chile has recommended SBO as a topic for analyzing and

[459] See Abu-Akeel (1999a), *supra* note 31, at 117.

[460] See Lapid, *supra* note 411, at 363.

[461] *World Investment Report 2016*, at xiii.

clarifying, although it is not further discussed.[462] Noticeably, the WTO has three pillars and currently two of them are under difficulties – negotiations and dispute settlement. Hence in the future, it is expected that the regular bodies of the WTO will play a more significant role in the multilateral trading system. For this reason, it would be suitable for the WTO Secretariat to take more active steps in facilitating the draft of documents dealing with these terms.

In defining such terms, certain lessons may be drawn from investment law. It is noted that apart from basic information on the investors' identity and nationality (through a disclosure of business relationships, structure of the groups, links with foreign states), many countries are now looking for further information, e.g., 'the investing company's financial statements, origin of funds, methods of financing, list of people on the board of directors, agreements to act in concert, business plans, future intentions, and even sometimes the reasons for the investment.'[463] Moreover, the experiences in some PTAs, namely that between Hong Kong and Mainland China, may also provide some clues to the work of defining and clarifying terms.

In this respect, it is also useful to look further from trade and investment law in order to see some hints from other fields of law. For instance, the EU's insolvency law holds that a parent company and its subsidiary are treated independently to a large extent in proceedings. The European Court of Justice rules in the *Eurofood* case that:

> Where a debtor is a subsidiary company whose registered office and that of its parent company are situated in two different Member States the presumption laid down in the second sentence of Article 3(1) of Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, whereby the center of main interests of that subsidiary is situated in the Member State where its registered office is situated, can be rebutted only if factors which are both objective and ascertainable by third parties enable it to be established that an actual situation exists which is different from that which location at that registered office is deemed to reflect. That could be so in particular in the case of a company not carrying out any business in the territory of the Member State in which its registered office is situated. By

[462] See Negotiating Group on Rules (2004), Chile – Submission on Regional Trade Agreements (document TN/RL/W/152).
[463] *World Investment Report 2016*, at 100.

> contrast, where a company carries on its business in the territory of the Member State where its registered office is situated, the mere fact that its economic choices are or can be controlled by a parent company in another Member State is not enough to rebut the presumption laid down by that Regulation.[464]

Another effort which is not directly related to ROO is the multilateral liberalization of services trade. Lapid contends that the extreme difficulty in applying ROO for services renders a further multilateral liberalization 'the only practical recourse in solving this dilemma' as it 'would eliminate the need to trace the origin of a service.'[465] Such a view has its certain merits, but given the deadlock of multilateral negotiations, multilateral liberalization is not an easier mission than identifying origin. The hope is however laid on PTAs, in particular the ambitious ones on services as TiSA. Besides, it is also noted from the analysis in Chapter 3 that liberal preferential ROO may in effect cause the *de facto* multilateralization of preferences; therefore, calling for more lenient origin rules and denial of benefits clauses in PTAs would be necessary as well.

Finally, it is also necessary to guarantee the compliance of PTAs with Article V:6 of the GATS. Notably, the discussion at the end of Chapter 3 still leaves it open in some cases where the 'denial of benefits' clauses in PTAs may depart from the GATS requirement. Although what illustrated under the discussion on preferential services ROO provides a ground to conclude that ROO in PTAs are often liberal and compliant with the GATS, it does not mean they do not pose any obstacle to facilitating trade. Fink has indicated that 'different levels of openness in services for different trading partners may reduce the transparency of the trading regime', particularly considering the regulatory nature of barriers to services trade.[466] Harmonization of preferential ROO for services should therefore be encouraged for the sake of firms seeking to gain preferential treatment.

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[464] Case C-341/04 (Eurofood IFSC Ltd), *Judgment of the Court (Grand Chamber)* dated 2 May 2006, paragraph 69.1. The judgement is available online at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62004CJ0341 (visited 15 April 2018).

[465] See Lapid, *supra* note 411, at 363.

[466] See Fink, *supra* note 79, at 121.

Conclusion

As reflected via relevant case law, the notion of origin is important for the functioning of the GATS because the determination of a service and/or service supplier of another Member is the basis to establish the existence of trade in services within the coverage of this agreement. The notion of origin and origin determination is also crucial for the implementation of various obligations in the GATS. However, this area of rule-making seems to gain some scholarly attention during the negotiations of the GATS, and then it lost attractiveness until quite recently. That ROO for services become under-studied may be caused by the following reasons: (i) they do not assume visibly significant role as ROO for goods; and (ii) they are of high complexity, so scholars refrain from digging deeper into this topic.

To the extent allowed by reasonably available resources, the dissertation has made an attempt to carry out a comprehensive research on ROO for services. The findings have confirmed that there are provisions in the GATS which function as rules to identify the origin of services and service suppliers. However, the ROO found in the GATS are not provided as detailed and technical methods and criteria, but remain rather definitional. In general, ROO for services do not focus on services. For Modes 1 and 2, the origin of services is determined based on the place of supply. Meanwhile, for Modes 3 and 4, the origin of a service is contingent on the nationality of its suppliers. Regarding suppliers being individuals, the GATS applies the nationality or residence tests. As for suppliers being juridical persons, it refers to such criteria as incorporation, ownership or control, and SBO within a relevant territory. Besides these positive origin rules, the GATS also provides negative rules in the clause on denial of benefits.

Such approach, despite being regarded as liberal, at the same time contains a number of defects. It is either inefficient to determine the origin of services, or does not sustain the identification of the genuine origin of services and service suppliers. As compared to origin determination in the field of goods trade, the latter has a stronger economic rationale as it is based on the ‘substantial transformation’ criterion. It is expected that services ROO also seek to attribute the services to a country with the closest economic relationship to the services. However, as it has been shown, the designation of services ROO differs significantly and that rationale has not been part of the consideration. As

a result, the origin of services is not identified by economically justified factors which relate to their production and supply, e.g., the level of transformation within a relevant territory. In other words, ROO for services do not serve the purpose to determine the economic origin of services.

Similar to ROO for goods, ROO for services have a more significant role in PTAs than in the GATS. However, it is also noted that the GATS sets out a requirement for PTAs to observe in formulating their ROO, thus it defines the characteristic of being liberal of services PTAs. For a PTA to comply with Article V of the GATS, its benefits must be extended to any juridical persons of another third country constituted and has SBO in one of the PTA member. As a result, suppliers of non-parties are allowed to indirectly benefit from the preferences granted in PTAs. While such liberal preferential ROO are not a replacement for multilateral liberalization, they do help minimize the distortive effects incurred by PTAs.[467]

Though the ROO for services in the GATS and PTAs appear to be functioning properly, there are several reasons that necessitate the reconsideration of the GATS approach. Firstly, since most PTAs follow the approach of the GATS, the imperfection of the rules would replicate in the regional context. In fact, the supplier-oriented approach is even more evident in PTAs, where most of the ROO address nationality of suppliers and do even not touch on the services at all. Moreover, what found in the fourth chapter does imply that services trade in the twenty-first century is more complicated than it was at the time the GATS was negotiated. Such complexity is the result of the rise of GVCs in the global economy, which is characterized by the unbundling of stages of production across borders. Firms are not only distributing manufacturing stages to cut costs and gain comparative advantages; they are also outsourcing services-related works, which makes global production networks more sophisticated.[468] When looking at services as offerings, as input in GVCs or as output of GVCs, it highlights the fact that the current so-called services ROO are not reflecting these aspects at all. Moreover, the increased share of services in manufacturing does suggest that ROO for goods need to take into account services and origin thereof. The future development of rules to regulate unfair trade in the field of services also implies that the origin determination of services may become more important. All in all, the new context of international trade renders the

[467] See Miroudot et al., *supra* note 65, at 27.
[468] See *World Trade Report 2011*, at 111.

current approach to ROO for services outdated, and advocates a reconsideration and reconceptualization of the approach to ROO for services.

Indeed, it is arguable that the ROO are intentionally designed to service the regulation purpose, and the need to define the genuine origin of services has never existed in the formulation of the rules. This indeed gives rise to another more theoretical argument: there are not yet genuine ROO for services in the sense of economics, which are rules to define the origin of a service in resonance with the process in which it is produced and supplied. The notion of establishing such rules used to be mentioned during early negotiations of the GATS but has never been actually brought to life. For this reason, a new approach to services ROO is needed, although it may not aim to serve the current regulatory purposes.

The 'product-based' approach to services ROO may be deemed as a long term solution. It has been argued that the previous interpretation of substantial transformation was not accurate, thus the spirit of this concept may well be applied to the field of services. What is important is to determine those rules which denote the concept of substantial transformation. One of the suggestions is the test on substantial input. Although this approach is not readily practicable, the development in statistics namely TiVA may be a building block in the construction of new origin rules for services trade. While there is some way to argue that the 'product-based' approach does not violate the GATS, the change should be implemented first in PTAs where it is more legally feasible, and also because the role of ROO in preferential trade is more significant.

In the short run, looking from a more realistic viewpoint, it is important to handle the problems arising from the current rules. Though it is not deemed important but there are indeed disputes relating to the definition of service supplier within the WTO, so it gives rise to a concern that other terms may raise similar difficulty. Indeed, the GATS and services trade in general are new as compared to trade in goods, so any issue that is not controversial now may become controversial in the future. Therefore, clarifying the rules would be an important target in the short run. In any case, it is important to find a balance between the purpose of liberalization and regulation in order to pursue the ultimate objective – promoting trade in services.

Up to this point, one may conclude that under the present system of trade in services, the GATS approach to ROO for services may well fit for the purpose although they are

not origin rules per se in an economic sense. A new approach to ROO for services may, therefore, be helpful in reflecting the flows of services in terms of value added in the era of servicification. The formulation of such 'product-based' rules perhaps does not have a direct influence on the current system of services trade regulation, but it serves the purpose of better understanding, and promote a future system of trade in services. It may seem unnecessary if one thinks of the current system as static or unchangeable. However, similar to TiVA, which has not found its way to become mainstream in trade statistics, a 'product-based' approach is important because it enables the reflection of the flow of trade in services from another more economic-justified perspective, which may be important for both trade scholars and practitioners.

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