

Author: Johanna Jacobsson  
Assistant Professor  
IE University (Madrid, Spain)  
Email: johanna.jacobsson@ie.edu

Services liberalization by federations and federal-type structures: what approach to sub-central measures?

### **Abstract**

The paper addresses an issue that has so far been left to little attention in literature dealing with international trade in services. It asks how services liberalization is conducted by countries that have a federal structure and where services are not regulated only on the level of the central government but also by various sub-national entities. Some of the most powerful nations, such as the United States and Canada, have divided competencies over services regulation. So does the European Union which due to its common trade policy can in its external trade relations be contrasted with federal states. The paper analyzes the different ways in which federations and other federal-type structures engage in international services liberalization by using the EU, US and Canada as examples. In order to shed more light on their treaty practice and to see to what extent sub-central levels of government appear in their services schedules, the paper reviews the GATS commitments as well as the services commitments that the EU, US and Canada have made in some of their recent PTAs. The paper shows that there are crucial differences in the way that these federal entities engage in international services liberalization. The paper also draws more far-reaching conclusions on the approach to take towards liberalization commitments by sub-central levels of government and assesses the effect that they have, or rather the effect that the lack of such commitments has, on the liberalization levels reached in modern trade agreements.

Key words: international economic law; international trade; trade in services; federalism; WTO; GATS; free trade agreements; preferential trade agreements

JEL classification: K33, K40

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## 1. Introduction

The present paper explores the issue of federalism in the international liberalization of services. It asks how to address a regional subdivision of a WTO Member and the consequences that it possibly has on that Members' services commitments. The issue has so far been largely neglected by research. It is, however, noteworthy considering that several WTO Members have constitutional structures that give powers to states, regions or other local entities in the regulation of the economic activities. In the area of services such local measures are particularly abundant and many rules concerning the quality of a specific service or the professional qualifications of service suppliers depend on sub-central regulation. Such lower level regulation is likely to have important commercial implications in cases where it includes directly discriminatory elements or otherwise aims to protect domestic services and service suppliers.

It is therefore not surprising that trade negotiators are increasingly starting to press for the inclusion of regulatory measures imposed on services not only on the level of the central government but also on regional levels. The issue has entered into spotlight especially in the context of the EU-Canada Comprehensive Economic and Trade Agreement (CETA). In that agreement, Canada has for the first time in its PTA history included a list of provincial and territorial non-conforming measures in the field of services and investments. In addition to providing binding lists of both existing and future measures, the Canadian provinces and territories have committed to providing to the EU the benefits of autonomous liberalization in a number of important services sectors. In some other PTAs, countries list their sub-central reservations, while in others they simply refer to existing restrictions of sub-central governments without actually listing them. Some PTAs, on the other hand, do not address the issue at all.

The issue is particularly important in the case of federal, or quasi-federal, states, such as Canada, Australia, Switzerland, Mexico, India, Russia and the United States. The services commitments of federal states that are part of the EU are also relevant as many services sectors remain liberalized on the level of the individual EU Member States instead of a common EU position. The paper reviews the services commitments of the EU, US and Canada in the GATS and shows to what extent the sub-central levels of government appear across their commitments there.<sup>1</sup> It also reviews the same countries' commitments in their recent services PTAs concluded with South-Korea. In addition, the paper reviews the CETA (EU-Canada) as well as the North-American Free Trade Agreement (NAFTA) that interestingly involves three federations (Canada, US and Mexico).

The paper shows that there are crucial differences in the way that the EU, US and Canada engage in international services liberalization. Interestingly, the GATS schedules of US and Canada include a higher number of limitations that have been subscribed with regard to sub-central levels of government than what is revealed by their services PTAs. This may have to do with the fact that all WTO Members had to engage in similar practice under the GATS, whereas in PTAs the partner countries can agree among themselves how to schedule any sub-national limitations to the liberalization commitments. GATS deliberately mentions measures taken by sub-central entities.<sup>2</sup> The exclusion of a Member's regional or local limitations from its schedule would thus go against the GATS. In their PTAs, US and Canada have had the practice to exempt any regional and local

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<sup>1</sup> The paper is restricted to these three WTO members only as the purpose is to demonstrate the issue in light of a few useful examples. The author is working on a book on services preferentialism which will address the issue of federalism in services more extensively and in light of more examples. The present paper is work in progress and the author welcomes any comments and suggestions.

<sup>2</sup> Art. I of the GATS specifies "measures by Members" meaning measures taken by central, regional or local governments and authorities alike.

limitations to market access and national treatment commitments. This would have been harder to do under the GATS where the number of participating states was much higher and where especially unitary states (non-federations) were unlikely to accept the exclusion of regional governments in federal states.

Interestingly, GATS Art. I:3 lit. a, sentence 2 includes the following provision:

*"In fulfilling its obligations and commitments under the Agreement, each Member shall take such reasonable measures as may be available to it to ensure their observance by regional and local governments and authorities and non-governmental bodies within its territory"*

There would appear to be at least two possible ways to interpret the provision. The first interpretation is strict and the other more lenient. The strict interpretation is adopted by Zacharias, according to whom Art. I:3 reflects general international practice and makes it clear that the GATS applies to all regulatory measures taken by any entity of a WTO member. She draws the parallel to the concept of state responsibility under customary international law and argues that similarly under the GATS states have the obligation to ensure the compliance of sub-central and non-governmental entities.<sup>3</sup> However, another possible interpretation is more lenient. According to that interpretation one could argue that the GATS actually only demands a certain effort from the Members to ensure the observance of the obligations and commitments taken by them by their regional and local governments and authorities. The extent of the effort would be limited to "reasonable measures as may be available" to the Member. It could then be argued that if no such reasonable measures were available, the breach of any obligations and commitments by local authorities would go unpunished.

This interpretation is, however, unsustainable. It would mean that Members with constitutionally divided powers over services regulation would have lesser obligations than Members with more centralized regulatory powers. Typically, this would mean that federations could commit to a significantly lesser degree than unitary states as federal states could simply argue that they cannot force any regional or local governments to comply, at least if those regions or communities had autonomy over the issues at stake. It is unlikely that unitary states would have agreed to such a carve-out. Moreover, as pointed out by Zacharias and Krajewski, it would go against the tradit

Finally, it is worth noting that the same provision applies also to non-governmental bodies within the Member's territory. According to GATS Art. I:3(a)(ii) "measures by Members" means also measures taken by non-governmental bodies in the exercise of powers delegated by central, regional or local governments or authorities. If the lenient interpretation was adopted, it would mean that a breach of GATS commitments or obligations could go unpunished also when undertaken by a non-governmental body, as long as the Member concerned had taken "reasonable measures" to avoid that. That would be a very strange interpretation considering that measures taken by non-governmental bodies must in accordance with Art. I:3(a)(ii) be delegated to them. Central governments can always take back any delegated powers, and should do so if their delegation leads to illegalities. A failure in this regard must lead to state responsibility. Such responsibility can hardly be subject to any "reasonable measures" as may be available to the central government. Therefore, the requirement for the Member to take "such reasonable measures as may be available to it" with regard to any powers delegated to non-governmental bodies is likely to mean that the central government has an active obligation to try to stop any breach undertaken by such entities. But it should not be interpreted as

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<sup>3</sup> Zacharias 2008, at 57, "Article I GATS" in Wolfrum, R., Stoll, P.-T. & Feinäugle, C. (2008) *WTO - Trade in services*. Leiden; Boston: Martinus Nijhoff Publishers. See similarly at 64 in Krajewski, M. (2003) *National Regulation and Trade Liberalization in Services: The Legal Impact of the General Agreement on Trade in Services (GATS) on National Regulatory Autonomy* Kluwer Law International.

releasing the central government from its responsibility as to the breach. The same must apply to any regional or local governments and authorities. WTO Members must do their best in making sure that all levels of government uphold the obligations and commitments under WTO law, and specifically under the GATS. This is of important practical relevance as powers in the area of services regulation are typically divided across central and local authorities. Other Members thus have an interest in asking for active observance from all national authorities, and the central government is obliged to actively participate in this regard. Any failures should, however, be attributed to the state. In the case of a dispute, the active attempt of the central government to solve the issue could, however, be possibly considered a mitigating factor.

Interestingly, the reviewed services PTAs do not include a similar obligation for the participating states to do their best to ensure the observance of the obligations by regional and local entities. This is noteworthy especially as the scheduling practice in some of the reviewed PTAs differs from the same countries' scheduling practice under the GATS. In the Canadian and American services PTAs (notwithstanding CETA), regional and local measures restricting trade in services are not explained in detail in the countries' schedules. All agreements make clear that measures taken by regional and local governments are covered; the services chapters of the reviewed PTAs all include a similar wording as GATS Art. I regarding the definition of covered measures. However, the lack of the requirement to take "reasonable measures" with regard to sub-national authorities may indicate that the parties did not want to underline the role of local governments – and the obligation of the central government to make sure that they comply with the agreements. This understanding is reinforced by the fact that both the US and Canada have in their services PTAs excluded all existing non-conforming measures (the so-called Annex I limitations) of all sub-federal entities (again, CETA notwithstanding). It would thus seem that these two powerful federal states have managed to negotiate agreements that allow them to forego any existing limitations to trade in services appearing on the regional and local levels of government.

This is noteworthy considering that PTAs should eliminate substantially all discrimination, as required by GATS Art. V. Moreover, the services chapters of the reviewed PTAs include similar wording as GATS Art. I regarding the definition of covered measures. They include those taken by regional and local governments and authorities alike. One would thus expect that sub-central measures would be similarly included in services PTAs and that they would go even deeper than the same countries' GATS commitments. However, this is not necessarily the reality. Out of the agreements by the US and Canada, only CETA by Canada engages in significant liberalization on the sub-central level. In its PTA with Korea, US has, for the first time, included an illustrative list of sub-central measures but has not made them legally binding.<sup>4</sup> The issue of federal countries' compliance with GATS Art. V is examined in the last part of the paper. The key question in this regard is how to analyze the attainment of the Art. V criteria in the case of a WTO Member that has internally divided powers in the area of services regulation. Should the requirement to eliminate substantially all discrimination across substantially all service sectors be fulfilled on the level of the central government or across all levels of government?

Federations and federal-type structures will generally be referred to as "federal entities" across the paper. This includes the EU, which is here considered to represent a "federal-type structure".<sup>5</sup> Measures taken on different national (domestic) levels of these WTO Members' will be referred to as "sub-central measures". An alternative way to name them would be "sub-national measures" but

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<sup>4</sup> The paper reviews only a couple PTAs but the author has reviewed also earlier PTAs of US and Canada and found that they very limited references to sub-central entities.

<sup>5</sup> See usage in Schütze 2009, *From Dual to Cooperative Federalism: The Changing Structure of European Law*, Oxford, Oxford University Press, 287-343.

because of the complexity in the Members' internal constitutional structures, and especially in the case of the EU, the term sub-central measures has been adopted. This is because the EU Member States, in their position towards the Union, are contrasted with sub-national entities in a single country's domestic legal order (i.e. Canadian provinces and territories and the US states). In the case of the EU, the individual services commitments of such Member States that themselves are federal states (Germany, Austria) are also relevant. The term "sub-central measures" is therefore considered to cover divergence both on domestic level (between different constituent parts of an individual EU Member State) and on the Union level (between different EU Member States). In the case of US and Canada, it covers all their internal sub-national levels of government.

The measures covered by the term "sub-central measures" are understood to cover all measures taken by other than central authorities, mainly by any regional or local governments and authorities. This is in line with the definition given in GATS Art. I:3(a)(i) to "measures by Members". Similarly, also measures taken by non-governmental bodies are considered covered as long as they are taken in the exercise of powers delegated by central, regional or local governments or authorities (GATS Art. I:3(a)(ii)).

## **2. Internal regulation of services in the EU, US and Canada**

One of the most often mentioned goals of modern trade agreements is to go deeper in services liberalization. In the area of services, liberalization necessarily means tackling regulation. That regulation is often not limited to central levels of government but reaches regional levels which may be states, territories, provinces, areas or even more local levels such as municipalities. As the supply of services, and especially professional services, is often dependent on such lower-level regulation, liberalization commitments made only by central authorities may fall short of creating the big gains that relate to truly open markets in services. However, quite surprisingly, there is so far very little literature on sub-central measures in services liberalization. Research has so far largely neglected the question of how to address an internal subdivision of a WTO Member and the consequences it possibly has on that Members' services commitments. This is striking considering the significant economic impact that such measures can have on trade. The role of regions and even cities is likely to only grow in the future and more focus should thus be directed beyond the central government.

Several WTO Members have constitutional structures that give powers to states, regions or other local entities in the regulation of services. However, services is not the only area where the issue becomes topical. Another key area is public procurement that is the object of a growing amount of literature.<sup>6</sup> There is also more generally an interesting emerging literature on multi-layered governance and the impact of federalism on international economic relations<sup>7</sup> as well as on the liability of sub-federal entities in international economic law<sup>8</sup>, but little has so far been written regarding regulation and liberalization of services trade by federal entities. This is the case even with regard to the EU. Much has been, and is written, on the EU's competencies in its external trade relations but there is a lack of literature exploring the internal divergence in services regulation between the different EU Member States and the impact that it has on EU's external services

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<sup>6</sup> See Corvaglia 2018, TTIP Negotiations and Public Procurement: Internal Federalist Tensions and External Risks, *Journal of World Investment and Trade* 19 (2018) 392–414 and Woolcock, S. & Grier, J. H. (2015) Public Procurement in the Transatlantic Trade and Investment Partnership Negotiations. *CEPS Special Report*(No. 100).

<sup>7</sup> See Woolcock, Stephen and Bayne, Nicholas, (eds.) *The New Economic Diplomacy: Decision-Making and Negotiation in International Economic Relations*. Global finance (3rd). Ashgate, Aldershot, UK.

<sup>8</sup> Timothy Meyer, *Local Liability in International Economic Law*, 95 N.C. L. REV. 261 (2017).

commitments. Such divergence is still very much a reality, even though the EU has a Common Commercial Policy (CCP) where the EU's exclusive competence has already for a long time covered services as well. When one looks at the EU's services schedules in the GATS and also in all EU's PTAs, one soon notices that EU Member States keep subscribing individual country-specific limitations, quite similarly to what happens in the case of US states in the country's GATS commitments. EU's PTAs show a tendency of going towards a more uniform EU position but country-specific limitations still remain. This is a necessity (especially in deep PTAs that aim at truly liberalizing services) considering that the EU's internal services market remains incomplete and there are big differences in services regulations between different EU Member States.<sup>9</sup>

Regional powers are applied across various economic activities. For example, both in the EU and the US, technical regulations on products and processes to protect health, safety, consumers and the environment are set on federal, state, regional and even on local agency level. In the US, state regulation often coexists with federal regulation and thus imposes a double layer of regulatory requirements with a significant economic impact on business. In the EU, national (and several layers of sub-national) regulations are abundant, especially in the non-harmonized sectors.<sup>10</sup> Considering the various policy preferences and regulatory goals that are at play across service sectors, there can be significant differences in the ways that they are regulated on different levels of government.

A large variety, and especially divergence, in the internal regulations of a country, or a trading block in the case of the EU, can clearly be a hindrance to trade in services. Therefore, one of the explicit aims of the EU's new generation trade agreements has become to include in the services schedules regulatory measures imposed on services not only on the level of the central government but also on regional levels of the other party.<sup>11</sup> However, as the paper shows, there are differences in how this is done across different federal countries and entities.

The paper analyses selected services commitments of US, Canada and the EU. US is a prominent example of a federal state with widely divided powers across different regulatory areas. The fifty American states are separate sovereigns, with their own state constitutions, state governments, and state courts. There are also significant differences between their legal systems. In terms of important service-related regulation, the states are responsible for health, education and welfare. They also have some authority over areas of justice, energy, environment and immigration.<sup>12</sup>

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<sup>9</sup> One of the few key papers in this regard is Langhammer, R. J. (2005) The EU Offer of Service Trade Liberalization in the DOHA Round: Evidence of a Not-Yet-Perfect Customs Union. *Journal of Common Market Studies*, 43(2), 311-325. On the internal EU divergence and aspiration for a common EU position, see Jacobsson, J. (2013) Liberalisation of Service Mobility in the EU's International Trade Agreements: As External as it Gets. *European Journal of Migration and Law*, 15(3), 245-261, Langhammer, R. J. (2005) The EU Offer of Service Trade Liberalization in the DOHA Round: Evidence of a Not-Yet-Perfect Customs Union. *Journal of Common Market Studies*, 43(2), 311-325.

<sup>10</sup> Beviglia-Zampetti, A. (2000) Mutual Recognition in the Transatlantic Context: Some Reflections on Future Negotiations, in Cottier, T., Mavroidis, P. C. & Blatter, P. (eds), *Regulatory Barriers and the Principle of Non-discrimination in World Trade Law*. Ann Arbor: University of Michigan Press, 303-328. 315.

<sup>11</sup> See, for example, the Commission's negotiation mandates for both the CETA and TTIP agreements. In the CETA negotiation directives it is stated that "The Agreement shall include substantial, explicit and binding commitments in all those areas under negotiation which fall, wholly or in part, under the jurisdiction of Canadian Provinces and Territories". Moreover, "the Agreement shall enter into force only upon the completion of the necessary procedures to bind the Canadian Provinces and Territories in all those areas under negotiation which fall wholly or in part under their jurisdiction." See Annex 1 of the partially declassified 2008 negotiation directives, available at <http://data.consilium.europa.eu/doc/document/ST-9036-2009-EXT-2/en/pdf> (accessed 5 June 2018).

<sup>12</sup> For a useful overview of key federations and their division of powers, as well as participation to international trade negotiations, see Walker James, Negotiation of Trade Agreements in Federal Countries, SPICe Briefing, the Scottish Parliament, 17 November 2007, available at <https://sp-bpr-en-prod-cdnep.azureedge.net/published/2017/11/17/Negotiation-of-Trade-Agreements-in-Federal-Countries/SB17-79.pdf>.

Canada, under the Constitution Act of 1867, was established as a federation and has formally distributed powers between the Parliament of Canada and the provincial legislatures. In the ten provinces of Canada, the provincial governments and parliaments are responsible for several policy areas including education, health care and agriculture.<sup>13</sup>

The European Union is made of 28 different sovereign states, each of which has its own constitutional structure, ranging from federations to unitary states. The EU itself has an internally differentiated constitutional structure. It strives for consistency in its external relations on two fronts: horizontally between its different institutions, structures, and policies, as well as vertically between the Union and the Member States. The vertical division of competencies varies across different policy areas and the Union has different techniques to manage them, such as the technique of “mixed agreements” as well as the principle of sincere cooperation.<sup>14</sup> The EU has an exclusive competence in the area of external trade relations, the Common Commercial Policy. The scope of the CCP has grown over decades. By the Treaty of Nice (2003) the ambit of the CCP was expanded to cover all GATS modes of services.<sup>15</sup> However, many services sectors remain liberalized on the level of the Member States instead of a common EU position and there are also differences in the ways that specific services are regulated on different levels of the Member States’ own internal governance.

The challenges that the EU as a multi-state actor faces in concluding services trade agreements are often similar to countries that have a federal structure. Trade liberalization by the EU reflects the combination of supranational and national jurisdiction over trade negotiation areas. Within the field of services, as in goods, the competence to conclude agreements with third parties is within the powers of the Union. However, due to the lack of internal harmonization of services regulations within the EU, the EU Member States keep scheduling their own nationally based restrictions to the common EU services schedule. In this sense, there are clear similarities to countries with decentralized regulation of service activities.

### 3. Review of the selected GATS and PTA commitments

This part of the paper gives an overview of the way that sub-central measures are described in the services commitments of the EU, US and Canada under the GATS as well as in some of their recent PTAs. The chosen sample is the PTAs that they have all concluded with South Korea. The agreements are all recent and easily comparable as they have all been concluded with the same country. In

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<sup>13</sup> See Government of Canada. (1867, March 29). Constitution Acts, 1867 to 1982. Available at: <http://laws.justice.gc.ca/eng/Const/page-4.html#h-17>.

<sup>14</sup> Barnard and Peers 2017, *European Union law*, 2nd ed. Oxford, Oxford University Press, 746.

<sup>15</sup> Originally, in Opinion 1/94, the Court of Justice of the European Union had concluded that only cross-border trade (Mode 1) fell within the Union’s Common Commercial Policy (CCP) since it was ‘not unlike trade in goods’ and involved no movement of persons. See Opinion 1/94, *Opinion of the Court of 15 November 1994 - Competence of the Community to conclude international agreements concerning services and the protection of intellectual property* [1994] ECR I-05267. The Amsterdam Treaty and the Treaty of Nice extended the Union’s competences in the field of external trade. However, prior to the Lisbon Treaty, the EU’s exclusive competence did not apply in a number of services sectors. Since the entry into force of the Lisbon Treaty on 1 December 2009, Art. 3 and Art. 207 of the Treaty on the Functioning of the European Union (TFEU) provide that trade in services, as well as commercial aspects of intellectual property and foreign direct investment, belong to the area of the CCP and thus to the category of the EU’s exclusive competence. In Opinion 1/08 the Court confirmed that the Community was, as a result of the Nice Treaty, competent to conclude international agreements relating to trade in services supplied also under modes 2, 3 and 4. Opinion 1/08, *Opinion of the Court (Grand Chamber) of 30 November 2009 — Opinion pursuant to Article 300(6) EC* [2009] ECR I-11129, paragraph 119. Opinion 1/08 concerned the modification and withdrawal of the EU’s specific commitments under the GATS following the EU’s enlargement.

addition, the services commitments of the CETA (EU-Canada) and NAFTA (US-Canada-Mexico) are reviewed. The Annex includes a table in which the results are presented in table-format.

### 3.1. Sub-central measures of EU, US and Canada in the GATS

According to Art. XX:1 GATS, each Member shall set out in a schedule the specific commitments it undertakes under Part III of the agreement. Art. XX:2 mentions ‘measures’ and states that such measures which are inconsistent with both Articles XVI (market access) and XVII (national treatment) shall be inscribed in the column relating to Art. XVI. Under Art. I:3(a), "measures by Members" means measures taken by:

- (i) *central, regional or local governments and authorities; and*
- (ii) *non-governmental bodies in the exercise of powers delegated by central, regional or local governments or authorities.*

Only Art. XVI on MA refers to a ‘regional subdivision’ as such. As has been noted by Krajewski, the ordinary meaning of the term would suggest that it is a unit which is smaller than the entire territory of a country but which is also larger than any particular local entity. According to Krajewski, regional subdivisions could be the states or provinces in a federal system or other larger administrative units in a centralized state. Since the term ‘subdivision’ implies that the entire territory of a country can be divided into regional subdivisions, a measure applying only to a particular, limited area or distinct units of the country (such as national parks or river basis) should not be covered.<sup>16</sup>

Based on a combined consideration of both Art. I and Art. XVI, it is quite straightforward to state that all sub-central measures are covered by the GATS and need to be inscribed in the WTO Members’ schedules of specific commitments when in breach of either Art. XVI or Art. XVII. The exclusion of a Member’s regional or local limitations from its schedule would thus go against the GATS.

In the light of the GATS commitments of US and Canada, it would seem that their understanding is similar. Both countries have included sub-central measures extensively. In its GATS schedule, the US has specified measures across federal, state and local levels. For legal services alone, the US schedule is 20 pages long because of differences in state-level regulation.

Canada’s GATS schedule also includes numerous mentions of the Canadian provinces and territories. They are named individually or referred to together as “Federal and sub-central governments”.

The EU’s GATS schedules includes commitments both for the entire EU as well as individual Member States. The Member States are WTO Members also on their own, which puts them in a different position compared to sub-central entities within other WTO Members. In the EU, there is also another sub-central level. This second level consists of the discriminatory regulations that are potentially in force on the sub-central (sub-national) level of individual Member States. There are,

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<sup>16</sup> Krajewski, M. (2003) *National Regulation and Trade Liberalization in Services: The Legal Impact of the General Agreement on Trade in Services (GATS) on National Regulatory Autonomy* Kluwer Law International. At 85.

however, only a few examples of limitations described on sub-national levels of the Member States in the reviewed schedules of the EU's GATS and PTA commitments.<sup>17</sup>

WTO Members' GATS commitments remain generally shallow. As there are many limitations and sectors that remain 'unbound', differences in the levels of openness within a federal country may easily remain unnoticed when looking at the country's GATS schedule alone. If the country's general (central level) liberalization is low, that may hide internal differences between more and less liberal sub-central entities. Some WTO Members may also have chosen to liberalize according to the lowest common denominator in cases where there are differences in the openness levels between different regions or other levels of government. A look into different federal countries' GATS commitments shows that in some of their schedules sub-central entities appear widely across their horizontal and sector-specific schedules (among such WTO Members are EU, US, Canada, Australia) and in some federal countries' schedules such entities make only occasional appearances (examples include Switzerland and Mexico with some mentions of regional/local measures) or zero appearances (an example is Russia with no mention of regional/local measures). The difference must be based on the way that services are regulated in the WTO Member in question (services regulated either centrally or across different levels of government) or, alternatively, it must be based on the degree of liberalization taken by the country in general (poor central level of liberalization can "hide" differences between different lower levels of government). It is hard to know what exactly is at stake in each case without knowing exactly what the competencies of the various national authorities are.

One way to shed more light on the issue is to look into federal countries' PTAs. As services commitments in such agreements are supposed to go deeper than the same countries' GATS commitments, the agreements can reveal internal divisions that are hidden in the same countries' original GATS schedules. We now turn into the services PTAs that were reviewed for this paper.

### 3.2. Sub-central measures in the reviewed services PTAs

The GATS commitments date to early 1990s and are generally considered greatly outdated (as is increasingly the GATS itself). The main avenue for services liberalization today are PTAs. However, even in them the level of liberalization still appears low. Very few countries have so far engaged in extensive opening of their services markets. As has been noted above, even the EU's internal market is far from complete in this regard.

In this part of the paper we explain to what extent the reviewed PTAs include sector-specific services commitments made by sub-central entities. It is revealed that sub-central measures restricting supply of services by foreigners are not explained in detail in several of them. The results are briefly explained here, whereas an overview of the results is included in the Annex.

Before going to the results on the sector-specific commitments, it is useful to start by looking at how "measures" are defined in the services chapters of the reviewed PTAs. As was explained above, in the GATS "measures by members" cover measures taken by *central, regional or local governments and authorities* (Art. I:3(a)(i)).

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<sup>17</sup> For example, the Åland Islands of Finland. The archipelago of Åland is a region of Finland, but compared to the other regions, it enjoys a high degree of home rule.

In the EU-Korea PTA, a similar definition for “measure” is included in Art. 7.2 of the agreement. In the US-Korea PTA, a corresponding definition is included in Art. 12.1.2 of the agreement. Their wording is not completely identical to the GATS, but extremely similar and the provisions are clearly meant to cover all levels of government (central, regional and local governments).

In both PTAs, the provision regarding market access (Art. 7.5.2 in EU-Korea and Art. 12.3 in US-Korea) also include a reference to “a regional subdivision” similarly to GATS Art. XVI. They both specify that neither party may adopt or maintain either on the basis of a regional subdivision or on the basis of its entire territory, market access limitations similar to those included in GATS Art. XVI (although not completely identical).

Similar definitions, for both national treatment and market access, can be found in the Canada-Korea FTA (Art. 9.1 Scope and Coverage of Cross-Border Trade in Services). In addition, the second paragraph of Art. 9.2 on national treatment specifies that “The treatment accorded by a Party under paragraph 1 means, with respect to a sub-national government, treatment no less favourable than the most favourable treatment accorded, in like circumstances, by that sub-national government to service suppliers of the Party of which it forms a part”. Art. 9.4 on market access applies to measures imposed “either on the basis of its [Party’s] entire territory or on the basis of a sub-national government”.

In CETA, there is no general definition for what measures of each Party are covered by the service disciplines. Instead, the issue is taken up only in the substantial obligations, and not in the part concerning definitions in the beginning of the agreement. For example, Art. 9.3 on national treatment in cross-border trade in services (Chapter 9) specifies the following:

*“1. Each Party shall accord to service suppliers and services of the other Party treatment no less favourable than that it accords, in like situations, to its own service suppliers and services.*

*2. For greater certainty, the treatment accorded by a Party pursuant to paragraph 1 means, with respect to a government in Canada other than at the federal level, or, with respect to a government of or in a Member State of the European Union, treatment no less favourable than the most favourable treatment accorded, in like situations, by that government to its own service suppliers and services.”*

A reference to different levels of government is included in Art. 9.5 regarding MFN. Art. 9.6 includes the market access principle and specifies that the prohibited limitations shall not be adopted or maintained by a Party “on the basis of its entire territory or on the basis of the territory of a national, provincial, territorial, regional or local level of government”.

Art. 9.7. (“Reservations”) specifies that the national treatment, MFN and market access disciplines do not apply to any existing non-conforming measure that is maintained by a Party at the level of the EU, a national government or a provincial, territorial, or regional government, as set out in the Parties’ schedules to Annex I. The said obligations do not apply to existing non-conforming measures of local governments either. Differently to provincial, territorial, or regional measures, such local measures do not need to be listed.

According to Art. 9.7 para. 2, national treatment, MFN and market access disciplines do not apply to a measure that “a Party” adopts or maintains with respect to a sector, subsector or activity as set out in its Schedule to Annex II. The level of government is not specified. According to Art. 1.1 (“General definitions”), “Parties” means, on the one hand, the European Union or its member States or the

European Union and its Member States within their respective areas of competence as derived from the EU Treaties, and on the other hand, Canada. It is not clear what levels of sub-central government are covered by this definition. However, as Canada has included provincial and territorial non-conforming measures in its schedule to Annex II, it appears that any future non-conforming measures by sub-central entities are meant to be covered.

In addition, Art. 1.10 (Persons exercising delegated governmental authority) states that unless otherwise specified in the agreement, each Party must ensure that persons with delegated regulatory, administrative or other governmental authority must act in accordance with the Party's obligations. It further specifies that the obligation applies "at any level of government".

Central government is defined in Art. 1.2. For Canada, it means the Government of Canada, and for the EU Party, it means "the European Union or the national governments of its Member States".<sup>18</sup>

NAFTA lacks a general definition of the authorities whose measures are covered by the agreement. Instead, the extent to which state and provincial measures are covered is specified in the substantial obligations. Article 1202 on National Treatment states that:

*"1. Each Party shall accord to service providers of another Party treatment no less favorable than that it accords, in like circumstances, to its own service providers.*

*2. The treatment accorded by a Party under paragraph 1 means, with respect to a state or province, treatment no less favorable than the most favorable treatment accorded, in like circumstances, by that state or province to service providers of the Party of which it forms a part."*

Moreover, Article 1206 on "Reservations" states that the national treatment, MFN and prohibition of local presence disciplines do not apply to existing non-conforming measures listed in Annex I and maintained either at the federal level, by a state or province, or a local government. Annex I itself includes a list of existing limitations to the disciplines (non-conforming measures), mentions that the parties must in their schedules indicate the level of government maintaining the measure for which a reservation is taken. In accordance with Art. 1206:1(a), measures taken by local governments do not need to be listed. This appears to mean measures that are adopted on lower levels than state or province.

There is no market access discipline, but Article 1207 on Quantitative Restrictions specifies that

*"1. Each Party shall set out in its Schedule to Annex V any quantitative restriction that it maintains at the federal level.*

*2. Within one year of the date of entry into force of this Agreement, each Party shall set out in its Schedule to Annex V any quantitative restriction maintained by a state or province, not including a local government.*

*3. Each Party shall notify the other Parties of any quantitative restriction that it adopts, other than at the local government level, after the date of entry into force of this Agreement and shall set out the restriction in its Schedule to Annex V.*

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<sup>18</sup> This definition is interesting as it labels the EU as "central government". The author adopts the same approach in her research where she is contrasting the relations of the EU and its Member States to federal states in the area of services regulation and liberalization.

*4. The Parties shall periodically, but in any event at least every two years, endeavor to negotiate the liberalization or removal of the quantitative restrictions set out in Annex V pursuant to paragraphs 1 through 3.”*

The NAFTA Articles 1202 and 1207 thus cover sub-central measures. However, there are limitations as to how any quantitative restrictions maintained by a state or province should be set. Any quantitative restrictions maintained by states or provinces were agreed to be set out only at later dates. Simultaneously, they were agreed to become part of periodic reviews. Local government measures, on the other hand, are not covered by Article 1207 (para. 2).

The paper now proceeds to the sector-specific commitments of the reviewed agreements and explains if they include commitments made by sub-central entities.

## *KORUS*

The U.S.-Korea Free Trade Agreement (KORUS) entered into force on March 15, 2012.<sup>19</sup> Its service commitments follow a negative scheduling method. This means that instead of describing liberalizing commitments (positive scheduling), the countries have described the instances where their internal measures fall short of the requirements agreed upon in the FTA. There are two principal methods to schedule services commitments: the so-called positive and negative scheduling, often referred to as “top-down” (negative) and “bottom-up” (positive) approach. In negative listing, a country covers all services except those listed, while in positive listing a country covers only listed services. The most famous example of a top-down agreement is the NAFTA, whereas the GATS is a positively-listed agreement. The EU has traditionally concluded positively-listed agreement but has recently started to change its scheduling practices. CETA between Canada and EU is an example of negative listing by the EU.

KORUS is an example of the most recent US FTAs where the country has begun including an illustrative list of non-conforming measures (“NCMs”) in the field of services for state level restrictions. US only began including this illustrative list of NCMs for the state level recently. A list is included in the KORUS and it was also included by the US in the originally negotiated Trans-Pacific Partnership (TPP) agreement. Earlier US services PTAs exclude all NCMs of sub-central entities without listing them.

In both agreements, KORUS and TPP, US has excluded all existing NCMs of “all states of the United States, the District of Columbia, and Puerto Rico”.<sup>20</sup> The exclusion applies to National Treatment (Articles 11.3 and 12.2 KORUS) Most-Favored-Nation Treatment (Articles 11.4 and 12.3 KORUS) Local Presence (Article 12.5 KORUS), Performance Requirements (Article 11.8 KORUS) and Senior Management and Boards of Directors (Article 11.9 KORUS). The scope is the same for the TPP, only the numbers of the articles differ. This is similar to earlier US services PTAs.

What is new is the illustrative list of state-level NCMs that is provided on the following page, as Appendix I-A (in both KORUS and the originally negotiated TPP commitments of US). However, the NCMs illustrated at the state and local level are provided for transparency purposes only and are not bound by the services provisions of these PTAs.<sup>21</sup> Annex I states "For purposes of transparency,

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<sup>19</sup> The agreement is available at <https://ustr.gov/trade-agreements/free-trade-agreements/korus-fta>.

<sup>20</sup> See p. 12 of KORUS, Annex I, the schedule of the United States and Appendix I-A to the same schedule

<sup>21</sup> Ibid. In the original TPP agreement, the information can be similarly found in Annex I, the schedule of the United States and Appendix I-A to the same schedule, at page 16. US has withdrawn from the TPP but the originally negotiated

Appendix I-A sets out an illustrative, non-binding list of non-conforming measures maintained at the regional level of government.” Footnote 1 specifies that the “document is provided for transparency purposes only, and is neither exhaustive nor binding. The information contained in this document is drawn from U.S. commitments under the General Agreement on Trade in Services, the May 2005 Revised U.S. Services Offer under the Doha Development Agenda negotiations, and related documents”. This would seem to indicate that the US is only informing of potential sub-central measures (to the extent that they were committed to under the GATS and the Doha Round Offer) but has not undertaken any new sub-central liberalization in the KORUS itself. Moreover, the list of existing sub-central measures is not binding and can thus not be relied upon based on the FTA.

As regards the market access commitments that the US has made in KORUS, Annex II includes an interesting limitation. It is specified that “The United States reserves the right to adopt or maintain any measure that is not inconsistent with the United States’ obligations under Article XVI of the General Agreement on Trade in Services as set out in the U.S. Schedule of Specific Commitments under the GATS”.<sup>22</sup> Considering the blanket reservation included therein, this appears as the US has not given any new market access commitments under KORUS but limits itself to those given under the GATS. However, it is also specified that “For purposes of this entry only, the U.S. Schedule of Specific Commitments is modified as indicated in Appendix II-A”. Appendix II-A includes limited improvements to the US GATS schedule on market access. The improvements are mostly given at the federal level (at least no regional specification is mentioned), but some of them are improvements to state-level measures.<sup>23</sup> However, the list of improvements is short and limited to a few sectors only.<sup>24</sup> In general, the list of improvements is short and indicates a poor improvement to the US market access commitments as compared to its GATS commitments.

### *EU-Korea*

The EU-South Korea free trade agreement (FTA) has been provisionally applied since July 2011 and was formally ratified in December 2015. The agreement is the first of the EU’s new generation PTAs, the so called Deep and Comprehensive Free Trade Areas (DCFTAs) and it represents a stepping-stone for future liberalization. According to the EU, the agreement with Korea goes further than any of its previous agreements in lifting trade barriers in services.<sup>25</sup>

The EU’s services schedule in the agreement includes a large number Member State-specific limitations. This is due to the fact that the EU still, to a large extent, lacks harmonized legislation with regard to how services and services-related areas of law are regulated in the Member States.<sup>26</sup> For example, in the absence of a genuine EU-wide immigration policy, service suppliers from third countries face a different immigration scheme in each Member State. Even if the Member States aim

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commitments are available at <https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpp-full-text> (accessed 20 June 2018).

<sup>22</sup> P. 8 of Appendix II-A of Annex II-US.

<sup>23</sup> Appendix II-A starts by the following statement: For the following Sectors, U.S. obligations under Article XVI of the General Agreement on Trade in Services as set out in the U.S. Schedule of Specific Commitments under the GATS (GATS/SC/90, GATS/SC/90/Suppl.1, GATS/SC/90/Suppl.2, and GATS/SC/90/Suppl.3) are improved as described.

<sup>24</sup> P. 11 of Appendix II-A of Annex II-US.

<sup>25</sup> See the European Commission’s information page on the EU-South Korea Free Trade Agreement, available at <http://ec.europa.eu/trade/policy/countries-and-regions/countries/south-korea/>.

<sup>26</sup> See Langhammer who notes that given the significant amount of national sovereignties that remain in the services trade amongst EU Member States, the EU is not yet even a free trade area. Langhammer, R. J. (2005) The EU Offer of Service Trade Liberalization in the DOHA Round: Evidence of a Not-Yet-Perfect Customs Union. *Journal of Common Market Studies*, 43(2), 311-325., 311.

at formulating unified conditions relating to issues such as period of stay and prior employment, there is still a separate work and residence permit procedure in each Member State. Another example is the absence of uniform rules regulating service professions (most relevant for sector-specific commitments under the GATS). Each Member State can apply its own qualification, license and residence requirements across the sectors. The complex and Member State-specific sectoral commitments that the EU has offered under the GATS and its services PTAs, including the EU-Korea FTA as well as CETA, illustrate how the incompleteness of the EU's internal services market appears in its external trade relations.

A look at the EU's services schedules demonstrates the situation. Both in horizontal and sector-specific commitments, the description of reservations is prescribed separately by each Member State. In some cases two or more Member States have adopted the same position, in which case the relevant states are grouped together. On some occasions, the commitment or restriction is marked as being taken by the EU if all Member States share the same commitment or restriction. The following example from the EU-Korea FTA concerns auditing services:

<p>6. BUSINESS SERVICES</p> <p>A. Professional Services</p> <p>...</p> <p>b) 2. Auditing services (CPC 86211 and 86212 other than accounting services)</p>	<p>AT: Korean auditors' (who must be authorised according to the law of Korea) equity participation and shares in the operating results of any Austrian legal entity may not exceed 25 percent, if they are not members of the Austrian Professional Body.</p> <p>CY: Access is subject to an economic needs test. Main criteria: the employment situation in the sub-sector.</p> <p>CZ and SK: At least 60 percent of capital share or voting rights are reserved to nationals.</p> <p>DK: In order to enter into partnerships with Danish authorised accountants, foreign accountants have to obtain permission from the Danish Commerce and Companies Agency.</p> <p>FI: Residency requirement for at least one of the auditors of a Finnish liability company.</p> <p>LV: In a commercial company of sworn auditors more than 50 percent of the voting capital shares shall be owned by sworn auditors or commercial companies of sworn auditors of the European Union.</p> <p>LT: Not less than 75 % of shares should belong to auditors or auditing companies of the European Union.</p> <p>SE: Only auditors approved in Sweden may perform legal auditing services in certain legal entities, inter alia, in all limited companies. Only such persons may be shareholders or form partnerships in companies which practice qualified auditing (for official purposes). Residency is required for approval.</p>
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	SI: The share of foreign persons in auditing companies may not exceed 49 percent of the equity.
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As the commitment shows, ten of the EU Member States have state-specific restrictions on the supply of auditing services in or to their territory. Between them, only two Member States provide for the same restriction (CZ and SK). For the 17 Member States that have not prescribed restrictions, the sector is ‘bound’, meaning that they do not restrict the supply of auditing services by Korean nationals.

The variety of Member State-specific limitations depends on the service sector in question but the example is illustrative of EU’s scheduling practice in its services agreements.

### *Canada-Korea*

The Canada-Korea Free Trade Agreement (CKFTA) has been in force since 2015, January 1st. As was already mentioned above, Art. 9.2 of the agreement (national treatment) specifies that the treatment accorded by a Party means, with respect to a sub-national government, treatment no less favourable than the most favourable treatment accorded, in like circumstances, by that sub-national government to service suppliers of the Party of which it forms a part”. Art. 9.4 on market access applies to measures imposed “either on the basis of its [Party’s] entire territory or on the basis of a sub-national government”. It can thus be interpreted that Canada has agreed to national treatment and market access disciplines on all levels of the government.

The agreement includes a list of national reservations for existing (Annex I) and future (Annex II) measures. Sub-central entities appear only a couple times across the annexes. An example is the following measure restricting foreign ownership of land in the Western province of Alberta<sup>27</sup>:

**Sector:** All Sectors

**Sub-sector:**

**Industry Classification:**

**Type of Reservation:** National Treatment (Article 8.3)

**Measures:**

*Citizenship Act, R.S.C. 1985, c. C-29*

*Foreign Ownership of Land Regulations, SOR/79-416*

**Description: Investment**

1. The *Foreign Ownership of Land Regulations* are made pursuant to the *Citizenship Act* and the *Agricultural and Recreational Land Ownership Act*, RSA 1980, c. A-9. In Alberta, an ineligible person or foreign-owned or -controlled corporation may only hold an interest in controlled land consisting of a maximum of 2 parcels containing, in the aggregate, a maximum of 20 acres.

2. For the purposes of this reservation:

<sup>27</sup> Annex I, Schedule of Canada.

**ineligible person** means:

- (a) a natural person who is not a Canadian citizen or permanent resident;
- (b) a foreign government or foreign government agency; or
- (c) a corporation incorporated in a country other than Canada;

**controlled land** means land in Alberta but does not include:

- (a) land of the Crown in right of Alberta;
- (b) land within a city, town, new town, village or summer village; and
- (c) mines or minerals.

However, the appearance of sub-federal measures in Canada's national schedule is only occasional. Otherwise, Canada has included a similar carve-out for sub-federal measures as is included in NAFTA. Canada's schedule to Annex I of the agreement (existing non-conforming measures) includes a statement similar to NAFTA: all existing non-conforming measures of all provinces and territories are excluded. In addition, "[f]or purposes of transparency only", Canada's Appendix I-A sets out "an illustrative, non-binding list of non-conforming measures maintained at the sub-national level of government". The list is very general and does not explain what the measures consist of. Instead, it simply lists which states have existing measures affecting citizenship, residency, local presence, economic needs tests, taxation, corporate form or training requirements.

Appendix II-A to Canada's schedule of non-conforming future measures includes a list of commitments that improve Canada's obligations under Article XVI of the GATS (market access). The list includes several improvements to Canada's GATS commitments on the level of provinces, across various service sectors. However, with regard to national treatment the inclusion of NCMs on the level of provinces is limited to a couple appearances only. This may imply that the general level of liberalization has not been very high, or that such measures have not always been counted for.

Art. 9.6 ("Non-conforming measures") notes that Annex 9-A sets out specific commitments with regard to consultation regarding a non-conforming measure adopted or maintained by a sub-national government. Annex 9-A states the following:

*"If a Party considers that an Annex I non-conforming measure applied by a sub national government of the other Party creates a material impediment to a service supplier of the Party, an investor of the Party, or a covered investment, it may request consultations with regard to that measure. If a Party considers that an Annex I non conforming measure applied by a sub-national government of the other Party prevents the development of a mutual recognition agreement or arrangement or prevents a service supplier of a Party from receiving the benefits of such an agreement or arrangement, it may also request consultations with regard to that measure. The Parties shall enter into consultations with a view to exchanging information on the operation of the measure and to considering whether further steps are necessary and appropriate."*

**CETA**

Similarly to KORUS and Canada-Korea, CETA follows the negative scheduling method in its description of NCMs. This is unusual for the EU, which has earlier been using GATS-type positive

scheduling practice in its services PTAs. The GATS is based on a "hybrid" approach: it combines a positive listing of sectors with a negative listing of restrictions. According to the EU, "the clear and comprehensive listing of the reservations provides unprecedented transparency on existing measures, in particular at provincial level".<sup>28</sup> It may be that the EU has agreed to negative scheduling at least partially due to its motivation to effectively bind the Canadian provinces.<sup>29</sup> It has been reported that the EU negotiators requested as a prerequisite to the commencement of the CETA negotiations the direct involvement of representatives from Canadian provinces. The Canadian provinces were involved extensively in the negotiations from the early stages until the ratification. An especially strong role was played by Quebec that lobbied both in Europe and at home.<sup>30</sup>

In CETA, NCMs are, across different chapters, specified as being maintained either by (i) the European Union, as set out in its Schedule to Annex I; (ii) a national government, as set out by that Party in its Schedule to Annex I; (iii) a provincial, territorial or regional government, as set out by that Party in its Schedule to Annex I; or (iv) a local government. Cross-border trade in services is included in Chapter 9 of the agreement, whereas Investment (Chapter 8), partly overlapping with Mode 3, and Temporary Entry and Stay of Natural Persons for Business Purposes (Chapter 10), overlapping with Mode 4, are separate chapters.

In the EU-Canada Comprehensive Economic and Trade Agreement (CETA), Canada has for the first time in its PTA history included a list of provincial and territorial non-conforming measures in the field of services and investments.<sup>31</sup> The Canadian provinces and territories are bound to regulatory *status quo* and have committed to providing to the EU the benefits of autonomous liberalization in a number of important sectors (architectural, engineering, foreign legal consultancy, urban planning, tourism, business services).<sup>32</sup> In addition, Canada has committed any possible future restricting measures also on the sub-national levels.

With regard to both existing and future measures applicable in Canada, Canada has included two different annexes. The first applies on the national level (federal level as well as provincial and territorial levels) and the second one applies on the provincial and territorial level. Canada's list of Provincial and Territorial measures under Annex I is 271 pages long and under Annex II 88 pages long. This is quite a difference to the Canada-Korea FTA where provincial and territorial measures

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<sup>28</sup> See "CETA – Summary of the final negotiating results" by the European Commission. Available at [http://trade.ec.europa.eu/doclib/docs/2014/december/tradoc\\_152982.pdf](http://trade.ec.europa.eu/doclib/docs/2014/december/tradoc_152982.pdf).

<sup>29</sup> Walker James, Negotiation of Trade Agreements in Federal Countries, SPICe Briefing, the Scottish Parliament, 17 November 2007, available at <https://sp-bpr-en-prod-cdneq.azureedge.net/published/2017/11/17/Negotiation-of-Trade-Agreements-in-Federal-Countries/SB17-79.pdf>.

<sup>30</sup> For a detailed account of their involvement, see Kukucha, C. (2016, October 18). Provincial/Territorial Governments and the Negotiation of International Trade Agreements. Available at <http://irpp.org/wp-content/uploads/2016/10/insight-no10.pdf>.

<sup>31</sup> "Technical Summary of Final Negotiated Outcomes, Agreement-in-principle, documents summarizing the important negotiated outcomes of the Canada-European Union Comprehensive Economic and Trade Agreement as of October 18, 2013", The Government of Canada, p.13, available at <http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/ceta-aecg/ceta-technicalsummary.pdf>.

<sup>32</sup> *Ibid.* Another area of major commercial interest is government procurement. Enhanced access to the Canadian public procurement market, including in particular access to the sub-federal levels of procurement, was a major negotiating aim of the EU in CETA. The final (not ratified) agreement provides full coverage of Canadian procurement, covering federal, provincial and municipal procurement, with relatively few explicit exceptions. See "EU-Canada Comprehensive Economic and Trade Agreement (CETA)", European Parliament, Directorate-General for External Policies, Policy Department, EP/EXPO/B/INTA/FWC/2013-08/Lot7/02-03, December 2015, available at [http://www.europarl.europa.eu/RegData/etudes/IDAN/2015/535016/EXPO\\_IDA\(2015\)535016\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/IDAN/2015/535016/EXPO_IDA(2015)535016_EN.pdf). The EU is pushing for an enhanced sub-federal market access in services and in government procurement also in the TTIP negotiations. See "The Beauty of Public Procurement in TTIP" by Patrick Messerlin, ECIPE Bulletin No. 1/2016, available at <http://ecipe.org/app/uploads/2016/02/Bulletin-0116-.pdf>.

were excluded. It shows that Canada has engaged in much deeper services liberalization with the EU by committing to a clear level of restrictions applied across all provinces and territories.

#### *NAFTA*

NAFTA Articles 1202 (national treatment), 1203 (MFN) and 1205 (quantitative restrictions) do not apply to any measure that a Party adopts or maintains with respect to sectors, subsectors or activities, as set out in its Schedules to Annexes I and II. Moreover, Article 1206 (Reservations) states that Articles 1202, 1203 and 1205 do not apply to:

*“(a) any existing non-conforming measure that is maintained by*

*(i) a Party at the federal level, as set out in its Schedule to Annex I,*

*(ii) a state or province, for two years after the date of entry into force of this Agreement, and thereafter as set out by a Party in its Schedule to Annex I in accordance with paragraph 2, or*

*(iii) a local government”.*

Paragraph 2 states that each “Party may set out in its Schedule to Annex I, within two years of the date of entry into force of this Agreement, any existing non-conforming measure maintained by a state or province, not including a local government”.

As was explained already earlier, also any quantitative restrictions (Art. 1207) maintained by states or provinces were agreed to be set out only at later dates. Simultaneously, they were agreed to become part of periodic reviews. We are not aware of such reviews having taken place but are still looking into the matter.

US, Canada and Mexico have in NAFTA excluded all existing non-conforming measures (Annex I limitations) of all sub-federal entities. However, with regard to future measures (the so-called Annex II list)<sup>33</sup> the agreements have a liberalizing effect also on state and provincial levels. The reviewed PTAs of US and Canada do not include Annex II for sub-national levels of government and it would thus seem that they do not allow for the introduction of new limitations, beyond the existing ones. However, as the existing non-conforming measures are not explained in detail, it may be hard to keep track of what sub-national measures exactly have been excluded from the treaty commitments. This is reinforced by the following statement in NAFTA (in the side letters of US, Canada and Mexico to Annex I: Reservations for Existing Measures and Liberalization Commitments”):

*“The listing of a measure in Annex I is without prejudice to a future claim that Annex II may apply to the measure or some application of the measure.”*

Article 1206 on “Reservations” states that the national treatment, MFN and prohibition of local presence disciplines do not apply to existing non-conforming measures listed in Annex I and maintained either at the federal level, by a state or province, or a local government. In order to

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<sup>33</sup> The difference between Annex I and Annex II measures is that existing measures that do not comply with the disciplines of the services agreement must be listed in Annex I and cannot be made more restrictive. Annex II includes a list of measures for which the state wants to maintain the freedom to introduce them at a later stage. Either way, a measure must be listed under one of the annexes to be upheld. Typically, an Annex I measure needs to be amended, continued or renewed in order to be validly upheld. If it is discontinued, the trading partner gets to benefit from autonomous liberalization and the measure cannot be re-introduced at a later stage, unless it has been included also in Annex II.

maintain non-conforming measures at the level of states or provinces for more than two years, the parties had to set them out in their schedule within two years of the date into force of the agreement. They did that by separate side letters dated March 29, 1996, in which all state and provincial measures in all three countries have been excluded in their entirety<sup>34</sup>. The letters apparently carried a list of such measures, but the lists are not available on the website of the NAFTA Secretariat. The side letters note that the lists are provided “for transparency”, and they are thus not likely to be comprehensive and possibly not meant to be legally binding. Non-conforming measures of local governments were not covered by the listing obligation and did not need to be listed at all (Art. 1206:1(a)(iii)).

#### **4. Application of GATS Art. V to federal entities**

This final part of the paper deals with a separate but very interesting question that relates to the legality of federal entities’ services PTAs in light of Art. V GATS.

It argues that no matter how sub-central measures are listed, from a legal point of view, sub-central measures can, in excessive amounts, be against GATS Art. V. That is because any other conclusion would seriously undermine the criterion of substantiality in the case of countries that have constitutionally divided powers in their internal regulation of service activities. Before going to that specific question, the Art. V criteria for services PTAs are analyzed more generally.

##### **4.1. What does GATS Art. V require from services PTAs?**

The GATS discipline on services PTAs, referred to in Art. V as economic integration agreements (“EIAs”), is almost five decades younger than the corresponding discipline for CUs and FTAs under the GATT. However, the two disciplines share common elements. Similarly to Art. XXIV GATT, Art. V GATS includes an internal requirement (facilitation of trade between the parties to the EIA), an external requirement (prohibition to raise the level of barriers applicable to outsiders) and a notification requirement. In addition, Art. V includes features that are specific to EIAs only. This is arguably due to the different nature of preferentialism in goods and services, as well as to changes in Members’ opinions towards PTAs in general. When the GATS was negotiated, PTAs were already part of the everyday practice of the Members. This was likely to call for more flexibility in the design of the discipline. In addition, for the way that services are liberalized, services preferentialism is often considered less harmful than preferentialism in the field of goods.<sup>35</sup> This may have encouraged a looser attitude to be reflexed in Art. V.

The flexibility is especially present in the provision of Art. V:2, which allows the EIA’s contribution to the wider economic integration between its participants to be taken into account. Even more leeway is available to developing countries. Under the provision of Art. V:3, in EIAs involving developing countries, the condition regarding the elimination of discrimination is more flexible in accordance

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<sup>34</sup> The side letters of US, Canada and Mexico are available on the webpage of the NAFTA Secretariat: <https://www.nafta-sec-alena.org/Home/Texts-of-the-Agreement/North-American-Free-Trade-Agreement>. See all three letters in Annex I, under “Non-Conforming Measures” placed at the top of the page below “Schedule of Canada”.

<sup>35</sup> Finck and Molinuevo summarize three basic reasons for this. First, there is the issue of domestic stocktaking. Second, services regulations are often applied in a non-discriminatory manner. The third reason are the liberal rules of origin that are set out in Art. V GATS and also typically applied in EIAs. Fink, Carsten, and Martin Molinuevo 2008, East Asian preferential trade agreements in services: liberalization content and WTO rules, *World Trade Review* 7 (4): 641-673.

with the level of development of the countries concerned (both overall and in individual sectors and subsectors).

Unlike Art. XXIV GATT, Art. V also includes a specific rule regarding the origin of the service suppliers. Suppliers originating in Members outside the agreement will still benefit from the EIA if they have substantive business operations within the territory of one of the members to the agreement. This potentially greatly extends the field of application of EIAs.

The entire provision of our center of focus, Art. V:1 (including footnote (1)), reads as follows:

*Art. 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 (1), and*

*(b) provides for the absence or elimination of substantially all discrimination, in the sense of Art. 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 Art.s XI, XII, XIV and XIV bis.*

*(1) This condition is understood in terms of number of sectors, volume of trade affected and modes of supply. In order to meet this condition, agreements should not provide for the a priori exclusion of any mode of supply.*

To qualify as an EIA under Art. V, the agreement must therefore satisfy three main requirements.<sup>36</sup> First, an EIA must have substantial sectoral coverage (paragraph 1(a)). Secondly, it must provide for the absence or elimination of substantially all discrimination between or among the parties and in the sectors covered under the first requirement (paragraph 1(b)). Finally, in addition to these two requirements designed to facilitate trade between the parties to the agreement (often referred to as the ‘internal requirement’), an EIA must satisfy an external requirement (paragraph 4): it must not raise the overall level of barriers to trade in services with regard to any Member outside the agreement.

The AB has not yet had the occasion, or desire, to interpret Art. V. The only reference to Art. V so far has been in the Panel Report of *Canada-Autos*. The case dealt mostly with measures relating to

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<sup>36</sup> EIAs liberalizing trade in services are admitted “provided that” the conditions of the first paragraph are met. The language makes clear that the conditions are mandatory. Cottier, Thomas, and Martin Molinuevo, 2008, Article V GATS in WTO - Trade in Services, edited by Rüdiger Wolfrum, Peter-Tobias Stoll and Clemens Feinäggle, 125-164. Leiden; Boston: Martinus Nijhoff Publishers, 130.

trade in goods but the Panel concluded that a specific measure was inconsistent also under Art. V:1(b) since it accorded an advantage to US firms and excluded other firms in another party to the EIA.<sup>37</sup>

The essence of Art. V is the requirement of elimination of discrimination.<sup>38</sup> This is in contrast to the multilateral liberalization of services under the GATS. The Preamble to the GATS does not mention elimination of discrimination but merely calls, among other objectives, for progressive liberalization of services trade. The framework for such liberalization to take place over time is provided in Part IV of the GATS: under Art. XIX GATS, Members should enter into successive rounds of negotiations of specific commitments with a view to achieving a progressively higher level of liberalization. The GATS Preamble can be compared to the Preamble of the GATT 1994, which calls for the “elimination of discriminatory treatment in international commerce”. Elimination of discrimination is thus one of the GATT’s long-term objectives but a similar statement is lacking in the GATS. Art. V, on the other hand, goes as far as requiring the *elimination of existing discriminatory measures, and/or prohibition of new or more discriminatory measures*. What does this entail when the EIA is entered into by a federal entity?

#### **4.2. What does GATS Art. V require from federal entities?**

Art. V and Art. XVII do not include any reference to a ‘regional subdivision’. It is therefore unclear to what extent regional measures are covered by the said provisions. The issue is as relevant under the GATS as it is in PTAs but in the multilateral context Members have more leeway as they may choose the level of government on which they desire to liberalize and how much they desire to liberalize. However, we would argue that they still need to exclude such local measures that they do not wish to liberalize. In PTAs the situation is different. Art. V GATS requires the elimination of substantially all discrimination between the parties with no exceptions made depending on the constitutional structure of the country concerned. Considering that in many countries services activities are to a large extent regulated on sub-central levels, the application of the Art. V requirements only to the central government could potentially leave a significant amount of non-discrimination uncounted for.

Art. V does not say anything about the level of government on which the preferential liberalization of services needs to take place. It mentions only “between or among the parties”, meaning two or several contracting parties. This should be interpreted as referring to states or customs territories such as the EU that can appear as contracting parties. As we noted earlier, in the GATS, only Art. XVI regarding market access refers to a ‘regional subdivision’. As has been noted by Krajewski, the ordinary meaning of the term would suggest that it is a unit which is smaller than the entire territory of a country but which is also larger than any particular local entity. According to Krajewski, regional subdivisions could be the states or provinces in a federal system or other larger administrative units in a centralized state. Since the term ‘subdivision’ implies that the entire territory of a country can be divided into regional subdivisions, a measure applying only to a particular, limited area or distinct units of the country (such as national parks or river basis) should not be covered.<sup>39</sup>

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<sup>37</sup> *Canada - Certain Measures Affecting the Automotive Industry*, WT/DS139/R, WT/DS142/R, Report of the Panel, circulated 11 February 2000, paras. 10.265-10.272.

<sup>38</sup> Cottier, Thomas, Panagiotis Delimatsis, and Nicolas Diebold 2008, Article XIV GATS General Exceptions in WTO - Trade in Services, edited by Rüdiger Wolfrum, Peter-Tobias Stoll and Clemens Feinäugle, 287-328. Leiden; Boston: Martinus Nijhoff Publishers, 317-318.

<sup>39</sup> Krajewski, Markus 2003, National Regulation and Trade Liberalization in Services: The Legal Impact of the General Agreement on Trade in Services (GATS) on National Regulatory Autonomy: Kluwer Law International, 85.

The question we put forward is thus whether Art. V covers measures taken on sub-central levels or on the central level only. We consider the first option to be correct. The required level of non-discrimination should be provided across all levels of government considering that the GATS covers measures taken by regional and local governments and authorities in addition to the central authorities.

In the EU, the issue of regional subdivision is relevant on two levels. First, on the level of the Union and secondly, on the level of individual Member States. On the level of the Union there is still a considerable degree of diversity in the liberalization of services among different Member States. Considering that the EU is a contracting party of the WTO and has exclusive external competence to conclude trade agreements also in the field of services, the level of liberalization of services should match the requirements of Art. V throughout all of its constituent territories – on the level of the Member States as across their own constituent parts.

The same applies to regional levels of government in US and Canada. In order to be in line with their international obligations, all WTO Members with internally divided regulatory powers in services should ensure that when signing PTAs, the commitments of all sub-central entities with regulatory powers in services reach the GATS threshold of ‘substantiality’ in terms of sectoral coverage and elimination of discrimination.

## **5. Conclusion - what approach to sub-central measures?**

The paper has given a preliminary analysis of the services commitments of a few key federal entities. As can be noted, it explains work in progress. Further research is required to analyze the differences in scheduling practices of US, Canada and the EU.

In NAFTA and the FTA concluded by Canada with Korea, sub-central measures have not been excluded from the agreements, but they are not extensively listed. That naturally complicates their analysis and makes one wonder if there really is no sub-central measures that would be more restrictive than the general federal limitations, or whether they have simply not been noted carefully enough. In KORUS, on the other hand, the US has simply excluded state-level measures and provided an illustrative list only. Based on this practice it is clear to see why the listing of sub-central measures in CETA by Canada is such a big step forward.

In CETA Canada has included in its schedule separate federal, and provincial and territorial annexes, which together form the entirety of its commitments. Canada’s two annexes with federal measures take approximately 50 pages of the agreement, whereas the two annexes with provincial and territorial restrictions occupy over 200 pages. This success is related to the unprecedented participation of the Canadian sub-central entities in the CETA negotiations.

The EU follows a scheduling practice of its own. It is still far from putting forward a common EU offer but instead describes Member State-specific limitations in cases where they exist. This goes further than what can be observed in the case of US that has not yet engaged in extensive state-specific liberalization. However, each EU Member State is a WTO Member also in its own right and this can affect the conclusions to be drawn from the EU’s commitments. However, meaningful services liberalization in any federal entity, whether a state or a structure such as the EU, should encompass sub-central measures. In the case of the EU, the same question can be posed with regard the Member States’ own sub-national measures. There is some but in general very little appearance of sub-national entities, such as the German or Austrian Länder. This may mean that such sub-central limitations do

not exist, or that such sub-central limitations have not been listed to a sufficient degree. In any case, truly deeper service liberalization calls for a more extensive inclusion of sub-central entities in international services negotiations through legally binding commitments.

When assessing WTO Members' compliance with the requirements of GATS Art. V, it may be difficult, or practically impossible, to map all existing non-conforming measures by regional entities in different countries and thus understand to what extent they do away with the amount of non-discriminatory treatment granted on the central level. That is the case especially when sub-central restrictions are not listed in a specific PTA (as is the case of the PTAs concluded by the US). Sometimes the mapping may be possible. This is the situation in CETA. The inclusion of sub-central measures should thus be encouraged also in order to analyze services PTAs in light of the Art. V criteria.

Services liberalization is likely to be weak in such federal states that liberalize services only on the level of the central government. The same applies to some other areas of trade liberalization, especially to commitments taken with regard to public procurement. Investment liberalization can be similarly affected. The general scarcity of sub-central commitments in trade agreements is noteworthy considering that many of the purported gains of modern trade agreement relate to the liberalization of behind-the-border barriers, such as discrimination against foreign service suppliers. Therefore, true and deep liberalization of services should not neglect sub-national actors but demand their greater engagement with international services trade negotiations. The example of the Canadian sub-national entities' participation in the CETA negotiations is encouraging in this regard.

## ANNEX

### GATS commitments

Country/entity	Sub-central measures covered in the treaty text	Inclusion of sub-central commitments in the sector-specific commitments	Comments
United States	Yes	Yes	Sub-central measures appear widely
Canada	Yes	Yes	Sub-central measures appear widely
European Union	Yes	Yes (on the level of EU Member States)	A very limited appearance of EU MSs' internal (national) sub-central measures

### PTA commitments

Agreement	Sub-central measures covered in the treaty text	Inclusion of sub-central commitments in sector-specific commitments by US, Canada and EU	Comments
KORUS	Yes	No	Reservation for all existing sub-central non-conforming measures (a non-binding list)
Canada-Korea	Yes	No	Same as above
EU-Korea	Yes	Yes (on the level of EU Member States)	EU Member States have included their internal sub-central commitments in a very limited manner only
CETA	Yes	Yes	
NAFTA	Yes	No	Same as KORUS and Canada-Korea