E-SERVICES AND THE WTO:
THE ADEQUACY OF THE GATS CLASSIFICATION FRAMEWORK

By Emad Tinawi and Judson O. Berkey

I. Introduction

The General Agreement on Trade in Services ("GATS") establishes the global rules for the trade of services. These rules were drafted with the aim of expanding "such trade under the conditions of transparency and progressive liberalization." Yet, less than five years after their adoption by the WTO, the GATS rules of classifying services are inadequate to deal with the rapid expansion of the delivery of services electronically (what we term "E-Services"). In particular, there is considerable ambiguity as to the classification of E-Services and therefore a corresponding ambiguity as to the market access commitments made by WTO members with respect to E-Services. In fact, as we argue below, at present, it is very difficult to determine what these market access commitments are for many E-Services.

In this article, we attempt to illuminate these ambiguities and propose possible solutions for their resolution. We first outline the GATS framework into which E-Services must be placed. Then, we discuss the consensus that has been reached regarding the GATS coverage of E-Services and the seeming lack of consensus on how E-Services should be classified under GATS. The implications of the classification issue are discussed in detail. Finally, criteria for an acceptable method of handling E-Services are offered and several proposed solutions are analyzed. Our overriding concern is that ambiguities introduced into GATS resulting from the classification of E-Services may hamper the further expansion and development of E-Services.

II. The GATS Classification Framework

To determine the market access commitments made by WTO members to foreign service suppliers, one must examine each member’s GATS “Schedule of Specific Commitments.” These schedules were based on the analytic framework delineated in Article 1 of the GATS. This framework allows a WTO member to specify the level of market access commitment according to any one of four particular “modes” of delivering a service. These modes are the following:

1. Preamble to GATS.
2. Emad Tinawi is an attorney in the International Department of the law firm of Arent Fox Kintner Plotkin & Kahn, PLLC in Washington, D.C. Judson O. Berkey is a regulatory policy analyst at the Institute of International Finance in Washington, D.C. The opinions expressed in this article are solely those of the authors.

The particular commitment is made by either (a) listing all existing restrictions which apply to the provision of a service by a particular mode of delivery, (b) listing a commitment of “None” for a particular mode of delivery, or (c) listing “Unbound” for a particular mode of delivery.
Mode 1 (Cross-border): delivery “from the territory of one Member into the territory of
any other Member.” An example of cross border delivery is medical consultation
provided by a European doctor to a counterpart in India over the phone.

Mode 2 (Consumption Abroad): delivery “in the territory of one Member to the service
consumer of any other Member.” This broad category includes all services that a national
of one country obtains while in another country with the typical example being that of a
patient who travels from home to obtain medical services in another country.

Mode 3 (Commercial Presence): delivery “by a service supplier of one Member through
commercial presence in the territory of any other Member.” For example, a U.S. hospital
may provide medical services in the U.K. through a subsidiary located in London.

Mode 4 (Movement of Natural Persons): delivery “by a service supplier of one Member,
through presence of natural persons of a Member, in the territory of any other Member.”
For example, when a hospital establishes a commercial presence in London (i.e. Mode 3),
it may also be necessary for the hospital to send some of its U.S. medical professionals to
London to provide medical services to U.K. citizens.

One of the basic assumptions underlying the GATS framework is that, in general, there
must be physical proximity between the service provider and the consumer. This is the case in
Modes 2, 3, and 4. The clear exception to this assumption is in Mode 1 where the service
provider and the consumer can be thousand of miles apart. Historically, however, this mode of
delivery was not very significant as modern telecommunication networks were not available
world wide and most services could not be provided in electronic form. Prior to the rise of the
internet, therefore, cross border delivery (i.e. Mode 1) was limited to certain services, such as
consulting plans, architectural designs and insurance policies, which could be delivered over the
telephone or through the mail.\footnote{Hoekman and Sauve, p. 30.}

Given the historic need for physical proximity to deliver services, the Uruguay Round
trade negotiations concentrated on obtaining commitments that would facilitate physical access
between service providers and consumers. Mode 2 market access commitments were not
difficult to obtain because countries had no practical way of restricting their citizens from
consuming services abroad. Between Mode 3 and Mode 4, Mode 3 was the focus of the GATS
negotiators because WTO members were focused on the technology transfer that tends to
delivery. On the GATS schedules, “None” means that there are no restrictions on a particular
mode of delivery. On the other hand, “Unbound” means that a country has reserved the right to
place restrictions on a particular mode of delivery.

\footnote{Hoekman and Sauve, p. 30.}
accompany the establishment of a commercial presence. In fact, the United States considered Mode 3 as the “most critical mode of delivery” during the negotiations. 4

The rise of E-Services has diminished, and in some cases even eliminated, the need for the physical proximity between the service provider and the consumer. Thus, what was once a fundamental assumption about the delivery of services (i.e. the necessity for physical proximity) has become less relevant. For example, consider the case of a Japanese consumer who visits C. Everett Koop’s website to obtain health consulting services. Whereas before the Japanese consumer would have had either to visit a Japanese doctor working for a U.S. company in Japan (i.e. Mode 3), visit a U.S. doctor working in Japan (i.e. Mode 4), or visit a U.S. doctor located in the U.S. (i.e. Mode 2) in order to obtain such services, it is now possible to obtain these services without the movement of either the service provider or the consumer.

From a GATS classification point of view, it is necessary to decide whether such E-Services are delivered on a cross-border (i.e. Mode 1) or consumption-abroad (i.e. Mode 2) basis or some third alternative that is not within the current GATS taxonomy. 5 That is, the question becomes whether (a) the Japanese consumer is “traveling” abroad to visit a U.S.-based website (i.e. Mode 2), (b) the U.S. website is providing medical advice across borders (i.e. Mode 1), or (c) the two are meeting in some no-man’s land called cyberspace. This classification question is important as it determines what level of market access is guaranteed to the service provider. Thus, the internet has not only made the distinction between Mode 1 and Mode 2 potentially more important but it has also raised the question of whether E-Services are even in the existing GATS framework.

III. GATS Coverage of E-Services

On May 25, 1998, the WTO established a comprehensive work program to examine all trade-related issues relating to electronic commerce. 6 This work program charged the WTO’s Councils for Trade in Services, Trade in Goods, Trade-Related Aspects of Intellectual Property, and the WTO Committee on Trade and Development with producing reports examining electronic commerce issues related to their particular competence by July 31, 1999. It was anticipated that these reports would be used by the WTO General Council to develop recommendations for consideration at the WTO Ministerial meeting on November 30-December 3, 1999.

4/ Self, p.551.
5/ It is assumed that E-Services would not be classified in Mode 3 or Mode 4 as a website does not involve the physical presence of a commercial entity or a natural person.
The U.S. filed a submission on the work program on February 11, 1999 (the “U.S. Submission”).\(^7\) In this document, the U.S. stated that “there should be no question that where market access and national treatment commitments exist, they encompass the delivery of services through electronic means, in keeping with the principle of technological neutrality.” However, the U.S. suggested that because electronic commerce may “give new importance to a broad range of services,” it might be useful for WTO members to review the extent to which their GATS commitments capture electronic commerce-related services. Thus, the U.S. position appeared to be that while E-Services were encompassed within the existing GATS commitments, there may be new “electronic commerce-related services” which were not covered by the existing GATS commitments.\(^8\)

This characterization of the scope of coverage of the GATS appears to have been accepted by the WTO Council for Trade in Services. In the interim report filed by the Council on March 31, 1999 (the “Interim Report”), the Council stated that there was a common understanding that “all GATS provisions, whether relating to general obligations or specific commitments are applicable to the supply of services through electronic means.”\(^9\) Furthermore, the Council stated that “the technological neutrality of the Agreement would also mean that electronic supply of services is permitted by specific commitments unless the schedule states otherwise.” However, the Council stated that there was “a need to give consideration to the classification and scheduling of new services likely to arise in the context of electronic commerce.”

Thus, there seems to be a consensus that the GATS covers E-Services with the caveat that there may be new electronic commerce-related services that are not listed in the existing commitments schedules. Presumably, these new services could be listed as new services on the schedules which are open for commitments. However, this does not resolve the question of which mode of delivery E-Services falls into for the purpose of determining the market access guaranteed to E-Services providers.

### IV. GATS’ Classification of E-Services

\(^7\) S/C/7 (11 February 1999).

\(^8\) The European Union appeared to agree with this view. In a March 26, 1999 EU Commission document, the EU stated that “the rights and obligations under the GATS apply regardless of whether the services are provided using telecoms (electronic) means.” EU Commission DG I (26 March 1999).

While the WTO members have agreed that the GATS covers E-Services, there is less consensus on which mode covers E-Services. The Interim Report noted the difficulty in applying the “usual” definitions of Mode 1 and Mode 2 to E-Services given the fact that at times E-Services appear more like cross-border (i.e. Mode 1) transactions and at times more like consumption abroad (i.e. Mode 2) transactions. This is illustrated by the C-Everett Koop website example above, where it is not clear if either the service provider or the consumer is moving in order to effect the service transaction.

The US Submission carefully avoided classifying E-Services either in Mode 1 or Mode 2. Instead, it asked for a consideration of the implications of classifying E-Services in Mode 2 given the fact that WTO members have made many more “None” commitments in Mode 2 than they have in Mode 1. The WTO Secretariat, on the other hand, may already be considering classifying E-Services in Mode 1. In a May 17, 1999 interview, a counselor with the WTO’s Council for Trade in Services stated that the cross-border (i.e. Mode 1) commitments made by the WTO members covered the electronic delivery of services (i.e. E-Services).10/

This classification issue has significant trade law and policy implications which will be explored below.

V. Implications of GATS Classification of E-Services

Current levels of market access commitments indicate that in many service categories, most countries have agreed to place no restrictions on Mode 2 (i.e. made a commitment of “None” in Mode 2) and have reserved the right to place restrictions on Mode 1 (i.e. listed “Unbound” in Mode 1). For example, according to one study of the level of GATS commitments, WTO members have made the following levels of commitments for the eleven GATS service seectors:11/

<table>
<thead>
<tr>
<th>Services</th>
<th>Mode 1 = “Unbound”</th>
<th>Mode 2 = “None”</th>
<th>Mode 3 = “None”</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction</td>
<td>82%</td>
<td>83%</td>
<td>80%</td>
</tr>
<tr>
<td>Environmental</td>
<td>80%</td>
<td>96%</td>
<td>96%</td>
</tr>
<tr>
<td>Health</td>
<td>80%</td>
<td>89%</td>
<td>76%</td>
</tr>
<tr>
<td>Tourism</td>
<td>45%</td>
<td>88%</td>
<td>78%</td>
</tr>
<tr>
<td>Transport</td>
<td>49%</td>
<td>94%</td>
<td>74%</td>
</tr>
<tr>
<td>Recreation</td>
<td>31%</td>
<td>94%</td>
<td>86%</td>
</tr>
<tr>
<td>Financial</td>
<td>30%</td>
<td>57%</td>
<td>39%</td>
</tr>
<tr>
<td>Distribution</td>
<td>28%</td>
<td>93%</td>
<td>87%</td>
</tr>
</tbody>
</table>

10/ Pruizin, pp. 839-840. (19 May 1999) (emphasis added). Curiously, the EU Commission March 26, 1999 document does not address this classification issue.

11/ Altinger and Enders, p. 320.
Given these levels of commitments, a Mode 2 classification of E-Services will mean that many WTO members will essentially find themselves bound not to place any market access restrictions on E-Services. Thus, as more and more services are delivered electronically, countries will find that their market access commitments have expanded beyond that which they originally agreed. While some may find this expansion of market access a welcome development and in line with the successive liberalization negotiations contemplated under GATS Article XIX, this liberal treatment of E-Services classification may be troublesome for two reasons.

First, this would alter by fiat the GATS commitments that countries made during the Uruguay Round and in subsequent accession negotiations. These commitments were, at least in theory, the result of mutually advantageous negotiations under which countries made market access commitments in return for certain concessions and benefits from other countries. To classify E-Services in Mode 2 is tantamount to changing the deals reached among countries without further trade negotiations.

This seems contrary to GATS itself which calls for successive negotiations “with a view to promoting the interest of all participants on a mutually advantageous basis and to securing an overall balance of rights and obligations.” If countries are to make new market access commitments as a result of classifying E-Services in Mode 2, then such concessions should be matched by a similar concession by those countries which do not have to provide the additional market access due to their existing GATS commitments or which seem to disproportionately benefit from this liberal treatment of E-Services.

The second reason why the classification of E-Services in Mode 2 is troublesome is that countries made a commitment of “None” under Mode 2 because they believed they had no ability to control the provision of services delivered and consumed abroad. Given the fact that it is possible to regulate transactions over the internet to some degree, it is not obvious that all the

---

12/ It must be recognized that even when a country makes a commitment of “None”, it retains the ability to impose market access restrictions on health, safety, and welfare grounds under GATS Article XIV.

13/ For example, developing countries were willing to make certain Mode 3 commitments that included technology transfer requirements precisely because of the perceived trade off between market access and technology transfer.

14/ GATS Article XIX(1) (emphasis added).

15/ The European Union Directive on the Protection of Personal Data which came into effect
countries that have made a commitment of “None” under Mode 2 would have made this commitment with respect to E-Services. Thus, Mode 2 classification of E-Services may again constitute a renegotiation of the GATS commitments.

If, on the other hand, E-Services are classified in Mode 1, then the potential benefits of increased electronic trade in services may be diminished because these services will be placed in a mode in which countries have made significantly less commitments of “None” than they have in Mode 2. The lack of “None” commitments in Mode 1 means that WTO members will have the ability to impose regulatory roadblocks to E-Services. Therefore, E-Services providers may find themselves denied market access and consumers may find themselves denied the ability to obtain such E-Services. This problem may become particularly acute if one considers the facts that E-Services may very well replace “the currently held preference for establishing commercial presence in a foreign market” and that WTO members have made many more commitments of “None” under Mode 3 than they have under Mode 1.

Therefore, just as scheduling commitments on a mode of supply basis effectively meant that the commitments on commercial presence (i.e. Mode 3) amounted to disguised trade-related investment measures for services, it may be the case that classifying restrictions on E-Services in Mode 1 amounts to a disguised safeguard regime for E-Services. That is, because WTO members will be free to impose regulations that inhibit E-Services due to the nature of the

---

on October 25, 1998 (95/46/EC) is an example of a domestic regulation that affects E-Services. The directive requires EU member states to enact legislation to ensure that there are no transfers of personal data to jurisdictions outside the EU which do not provide “adequate” protection for personal data. Thus, EU service suppliers may not be able to provide services in certain foreign markets and EU nationals may not be able to consume services provided by foreign service suppliers as it may not be possible to provide certain data necessary to complete a service transaction.

16/ The U.S. Submission, p.4.

17/ Hoekman and Sauve, p 35.

18/ Because the Uruguay Round services negotiators could not agree on the form of a safeguard provision similar to that of GATT Article XIX for the GATS, they drafted GATS Article X which provided for further negotiations over a safeguard regime with any results being implemented within three years of the signing of the GATS. No agreement was reached within the contemplated timeframe and the deadline was extended until June 31, 1999. On June 24, 1999, the WTO Council on Services announced a second extension of the deadline until December 15, 2000. GATS Article XXI, however, does provide members with the ability to permanently withdraw or alter specific commitments. However, this requires three years advance notice and the negotiation of compensation on an MFN basis with all affected WTO members.
existing Mode 1 commitments, they may use this ability when they want to limit the increased market access which electronic commerce gives to foreign service providers. Again, it is not clear that this is an outcome which was contemplated in the original GATS negotiations.

In order to highlight the implications of Mode 1 versus Mode 2 classification, it may be useful to consider specific cases. For example, consider the business services sub-sectors ‘data processing services’ (CPC No. 843) and ‘database services’ (CPC No. 844). Whereas it may have been possible, but not very practical, for a person to contract with a foreign service supplier to maintain and manage a database of customer information previously, the rise of electronic commerce makes it much easier to store, process, and retrieve data which is located remotely. Thus, it may very well be the case that a domestic company in any particular country will use a foreign database processing or management firm.

When a country has a Mode 1 listing of “Unbound” and a Mode 2 commitment of “None” under its data processing/database services commitments (as Botswana, Colombia, Costa Rica, Ecuador, Pakistan, and Thailand have), then that country is faced with very different situations if E-Services are classified in Mode 1 or Mode 2. Under Mode 2, the country has no ability to regulate or control the provision of these services by foreign suppliers except on health, safety, and welfare grounds. While this may be sufficient to cover regulations such as the EU privacy law, it is not obvious that all such restrictions that a country may want to legitimately impose on E-Services will be capable of being justified on these grounds.

Mode 1 classification, on the other hand, allows these countries the ability to place any restrictions on E-Services that they please. What this means is that countries are free to restrict a form of trade in services that was not prevalent when the commitments were first scheduled. Such regulations may take the form of either increased quantitative restrictions (e.g. through licensing systems, restrictions on data flows, prohibitions on the advertising, and foreign exchange restrictions) or regulatory standards established by governments or professional bodies. Thus, the benefits that E-Services can provide may be restricted for any number of reasons. While this may not necessarily occur, it should at least be acknowledged as a possibility.

As a second example, consider Singapore and Pakistan which have listed ‘medical and dental services’ (CPC No. 9312) on their GATS schedules as Mode 1 “Unbound due to technical infeasibility” and Mode 2 “None.” Now that it is possible to provide these services as E-

19/ Given the difficulty in tracking E-Services, there may be enforcement problems with any proposed restrictions. Even if such restrictions are enforceable, it is also unclear how transparent they would be. Thus, the likelihood of countries imposing restrictions on E-Services is beyond the scope of this paper. See, Feketekuty (1998), pp. 32-34, for some discussion of this.

20/ Under the GATS, a country makes a commitment of “Unbound due to technical infeasibility” when it determines that it is not possible to provide the service via a particular mode of delivery. According to the WTO schedules such commitments are supposed to revert to “Unbound” if the provision of these services becomes feasible. This may become an important
Services, both Singapore and Pakistan will be forced either to abandon their ability to regulate the E-Services (certainly something they did not envision when making their GATS commitments) or will be permitted to place whatever restrictions they like on the E-Services (certainly something which neither foreign service suppliers nor domestic consumers will like and something which may reduce the benefits of electronic commerce).

In order to dispel the perception that the above situation only applies to developing countries, there are examples of this situation in the OECD countries’ commitments schedules as well. For example, the United States has listed the ‘construction and related engineering services’ sub-sector as Mode 1 “Unbound due to technical infeasibility” and Mode 2 “None.” However, it may now be possible to provide construction services such as stress analysis or material design as E-Services. Similarly, Japan has listed the ‘entertainment services’ and ‘sporting services’ sub-sectors this way as well. However, it is now possible to view concerts, theater performances, and other live shows via the internet and to engage in virtual sports games with others around the world. Thus, the classification problem may extend across many GATS schedules.

VI. Possible Solutions to the Classification Problem

The difficulties that arise in attempting to classify E-Services either in Mode 1 or Mode 2 outlined above illuminate possible criteria for evaluating any proposed solution to the E-Services classification problem. Any GATS classification for E-Services should do the following:

1. Allow for the expansion of E-Services.
2. Be unambiguous and transparent.
3. Not change the bargains struck within the existing GATS commitments.
4. Not require substantial re-writing of the GATS.

These criteria can be used to evaluate some of the proposals that have been proposed for resolving the E-Services classification problem. These proposals will be highlighted below.

1. Combine Mode 1 and Mode 2.

Combining Mode 1 and Mode 2 would solve the classification problem in that E-Services would be covered in the new combined category. However, this solution leads to a possibly more difficult question. In particular, when combining both modes how would one reconcile the current differences that exist between the Mode 1 and Mode 2 commitments? This solution also blurs the distinction between consumption abroad and domestically. While governments find it
difficult to monitor and control the consumption of services by their citizens abroad, they may have legitimate reasons to restrict the consumption of certain services domestically.

2. **Make the commitments in Mode 1 and Mode 2 identical**

   This solution does not solve the classification problem. While acknowledging that E-Services at times appear to be consumption abroad and at times cross border transactions, it attempts to avoid this dilemma in a practical manner by making the commitments in Mode 1 and Mode 2 identical. However, this leads to the same problem as the first proposal. Namely, are Mode 2 commitments to be decreased and become identical to Mode 1 or are Mode 1 commitments to be increased and made identical to Mode 2? One must also recognize that any changes in Mode 1 and Mode 2 commitments alters the nature of the bargains struck in the existing GATS schedules.

3. **Create a new Mode 5 for E-Services**

   This solutions calls for a new Mode 5 to specifically deal with services delivered by electronic means. Thus, this solution avoids the Mode 1/Mode 2 classification dilemma, does not disturb existing Mode 1 and Mode 2 commitments, and allows trade negotiators to strike separate bargains specifically for E-Services. Despite the attractiveness of this solution, it has a fundamental flaw in that it is not clear when an E-Service should be classified in Mode 1, Mode 2 or Mode 5? For example if a medical doctor delivers advice over the telephone, should this service be classified in Mode 1 or Mode 5? Does it make a difference if the doctor is reviewing the patient’s records which are being transmitted live via the internet while speaking on the telephone? Thus, this solution is actually likely to compound the existing classification problem as the new Mode 5 appears to cover can be legitimately classified in either Mode 1 or Mode 2.

4. **Redefine Mode 2 to require physical presence and increase Mode 1 commitments.**

   This alternative, tentatively proposed by Drake and Nicolaidis, appears to hold the most promise for resolving the classification issue. By redefining Mode 2 to specify physical presence, all E-Services are clearly classified in Mode 1. The redefinition of Mode 2, however, would have to be coupled with an immediate increase in market access commitments in Mode 1 in order to allow for the expansion of E-Services. Given the number of “Unbound” listings in Mode 1, this solution will require the WTO members to negotiate a substantial number of additional Mode 1 commitments.

**VII. Conclusion**

Resolving the ambiguities that result from the classification of E-Services within the current GATS framework is more than just an intellectual puzzle. As shown above, all of the currently proposed solutions would have significant effects on the nature of the existing commitments. While we currently believe that the fourth solution offers the most promise, it
must be noted that this solution requires the political will for a re-negotiation of the GATS schedules during the Seattle Round of trade negotiations.

Our hope is that the WTO members address the ambiguities introduced into the GATS framework by E-Services in an open dialogue. If such a dialogue does not occur or if it is obscured by narrow economic and political interests, then these ambiguities may be exploited by either proponents or opponents of trade liberalization to alter the nature of the GATS in a way that is neither transparent nor mutually beneficial. Such developments would not only undermine GATS but would also threaten the coherence of the multilateral trading system. The manner in which the WTO deals with the development of E-Services may be telling as to the future development of the WTO itself.
SOURCES


USTR. *Services in America’s Trade Agenda.* Speech delivered by Ambassador Charlene Barshefsky to the Coalition of Service Industries. (24 September 1998).

USTR. “WTO Work Programme on Electronic Commerce.” *Submission by the United States, for the General Council, the Council for Trade in Services, the Council for Trade in Goods and the Committee on Trade and Development.* (11 February 1999).


WTO. *Study from WTO Secretariat Highlights Potential Trade Gains from Electronic Commerce.* (13 March 1998).


