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The Use of Free Zones for the Promotion of the Offshore Industry in MERCOSUR Countries: A Reasonable Choice?

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Abstract

This paper discusses the suitability of using free zones as a mechanism for the promotion of the offshore industry in MERCOSUR countries, both from a legal and a broader policy perspective. From a legal perspective, the paper examines the consistency of the incentives offered by free zones with WTO disciplines and discusses the implications that stem from this for offshore suppliers that operate within free zones. The paper also discusses the merits of using free zones in light of the attributes sought by multinational corporations when choosing an offshore destination and suggests that, instead of offering goods-biased fiscal incentives, governments should focus on improving IT and communications infrastructure, training the local workforce, encouraging research and development, upgrading the legal framework, and securing a business-friendly environment.

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I. Introduction

The information technology (IT) revolution opened a window of opportunities for companies to contract out segments of their business process to outsiders in search of efficiencies and economies of scale, unleashing what is usually referred to as "outsourcing," i.e., "the act of transferring some of a company's recurring internal activities and decisions rights to outside providers, as set in a contract."[1] The same practice is known as "offshore outsourcing" or simply "offshoring" when the outside provider is located outside the territory where the outsourcing company is located. Depending on the business model chosen, offshoring can be "captive" when the outside supplier is an affiliated firm and "non-captive" when the offshore work is allocated to an independent third-party supplier.

What began with the offshoring of information technology services[2] now includes a wide array of IT-enabled services, including business process offshoring[3] and higher-value services associated with knowledge-process offshoring.[4] The global market for the offshoring of IT and IT-enabled services was estimated at around $90 billion in 2008 (up from $30 billion to $35 billion five years earlier), of which IT services accounted for 60 percent.[5] It is expected that the offshoring market will continue to expand geographically, through different sectors as well as across business functions.[6] Originally concentrated in a reduced number of countries[7], the geographical diversification of the offshoring market is growing steadily.[8] The Latin America and Caribbean region appears to be an increasingly important offshoring destination.[9] The bulk of business processes offshored to this region used to be in relatively low-skilled contact centres, but now the offshoring of higher value-added services is growing steadily.[10]

Offshoring can bring a number of benefits for the offshore country, including the creation of attractive employment opportunities, industrial diversification, export revenues, knowledge transfer, and economic upgrading.[11] Not surprisingly, a stiff contest is underway among developing countries to attract the largest possible volume of offshore businesses into their territory. To succeed in this highly competitive environment, governments must, on the one hand, understand what type of local attributes multinational corporations are looking for when choosing an offshore destination, and, on the other hand, implement policies that are suitable for boosting those sought-after attributes in such a way that maximizes the returns for the host country.

The offshore industry is relatively new in MERCOSUR countries[12], and so are the poli-

cies designed for supporting its development. In this vein, it is not uncommon to use trade policy instruments such as free zones, originally designed for encouraging trade in goods, such as free zones as a mechanism for supporting the offshore industry. In its most basic form, a free zone simply consists of a special customs regime applicable to part of the territory of a country where any goods introduced are generally regarded, insofar as import duties and taxes are concerned, as being outside the customs territory.[13] But the type of incentives offered by a free zone may go well beyond a special customs regime, depending on the specific purpose the zone regime aims to achieve. During the second half of the twentieth century, some countries began to use free zones to promote export-oriented manufacturing activities, which offered not just customs duty exemptions, but also exemptions on indirect taxes levied on inputs used for the manufacturing of exported products, direct tax incentives for free zone users, a more liberal regulatory environment, and a modern infrastructure.[14]

Nowadays, free zones have become an extremely popular trade policy instrument.[15] They are used for a variety of purposes, including the development of disadvantaged regions, generating income and employment, attracting investment—especially foreign direct investment, and promoting technology transfer.[16] Competitive pressures have been pushing toward the standardisation of the incentives offered by free zones across the world.[17] Typical incentives offered by a free zone include exemption, remission, or deferral of indirect taxes and import charges levied on goods and services that are consumed in the production of exported products, and exemption or remission of indirect taxes levied on the production and distribution of exported products. While these types of incentives are of interest only to export-oriented manufacturing companies, free zones also typically offer other types of incentives that can be of interest to any type of firm, such as exemption or remission of corporate taxes, exemption from most local and indirect taxes, no restrictions or taxes on capital and profit repatriation, exemption from foreign-exchange controls, provision of public utilities at below-market rates, and provision of good-quality physical infrastructure. As a result, in recent years, free zones have been attracting offshore service suppliers, including data processing, call centres, management services, internet gaming, education services, distribution services, technology services, production and distribution of films, sound recording, heath and veterinary services, banking and insurance, professional services, and retailing and merchandising. [18]

For example, the Costa Rican free zones offer a wide range of tax incentives that are rel-

evant for companies supplying services intended for export, including, *inter alia*, exemption from payment of tax on capital and net assets and payment of the land tax; exemption from sales and consumption tax on purchases of goods and services; exemption from all taxes on profits; and exemption from any municipal or business tax.[19] India has created several free zones, which provide for different forms of income tax reductions, including a complete tax holiday to companies that are set up in the free zones for the first 10 years of operation.[20] Free zones in Rwanda offer service exports a one-stop centre for administrative formalities and approvals for businesses.[21] This service is provided by the Rwanda Investment and Export Promotion Agency.

The expected benefits of foreign investments in the offshore industry for the host country are well known. Governments of developing countries are ready to offer fiscal incentives to attract offshore businesses on the assumption that the growth of the offshore sector will bring a long list of positive spillovers for the local economy, including, *inter alia*, job creation, revenue generation, transfer of technology, and improvement of the national business culture.[22] What is less known is to what extent the incentives offered actually manage to attract the right investments and deliver the expected benefits for the host country in a way that justifies the opportunity cost of waiving fiscal obligations.

The specialised literature indicates some degree of discrepancy with regard to the costs and benefits of free zones.[23] From a developmental perspective, one of the risks of free zones is that they may end up becoming a segregated geographical enclave with poor or no linkages with the rest of the economy. In the manufacturing sector, the ILO has found backward linkages of free zones with the local economy to be minimal, with only 3 to 9 percent of inputs being purchased on the domestic market due to the inability of local producers to meet world market standards for price, quality, and delivery terms.[24] In the service sector, it has been suggested that the potential for linkages with the local economy differs by industry.[25] For instance, in the area of R&D, foreign affiliates may engage in cooperative projects with local companies, universities, or technology institutions, whereas, in the software development sector, foreign affiliates derive most of their income from exports to their parent companies, generating few knowledge spillovers for the domestic economy.[26] Using free zones as a means to attract foreign companies in the latter sector can only reinforce the enclave nature of their operations. One way to promote closer interaction, learning, and competition between local and foreign suppliers is by gradually transforming traditional

export processing zones into technology and science parks, where both of them can interact in the same area.

The purpose of this paper is to discuss the suitability of using free zones as a mechanism for the promotion of the offshore industry in MERCOSUR countries, both from a strictly legal and a broader policy perspective. From a legal perspective, a country's discretion to grant fiscal or financial incentives is constrained by disciplines stemming from the multilateral and regional trade agreements that the country is part of. The legality of the incentives can always be challenged before international tribunals and, if found inconsistent with applicable trade disciplines, the defendant country may be forced to remove them. Despite the importance of this issue, little research has been devoted to examining the consistency of the incentives offered by free zones with WTO disciplines and the implications that stem from this for offshore suppliers that operate within free zones. The merits of using fiscal incentives for the promotion of the offshore industry are also open for discussion. There are concerns about the value for money of waiving fiscal obligations for a specific group of firms and the market distortions that this practice may create. Hence, it is necessary to identify the type of attributes sought by multinational corporations when choosing an offshore destination and to discuss what role governments should play in order to boost those sought-after attributes. The remainder of this paper is organised as follows: Section II examines the free zone regimes in MERCOSUR countries. Section III assesses the consistency of free zone incentives with WTO disciplines. Section IV discusses the suitability of free zones for the promotion of the offshore industry. Section V explores other mechanisms for the promotion of the offshore industry, and Section VI concludes the discussion.

II. Free zone regimes in MERCOSUR countries[27]

A. Argentina free zone law

1. General provisions

Argentinean free zone legislation can be traced back to the beginning of the twentieth century, but it was not until 1994 that a comprehensive legal framework for free zones was adopted. Law 24331 of 17 June 1994 stipulates the objective of free zones, the mechanisms for their administration and control, and the fiscal and customs regime applicable to the activities carried out within

their boundaries.[28] The statute authorises the National Government to create a free zone in each Argentine province and to establish up to four additional free zones in geographic regions whose critical economic situation and/or border status with other countries justifies exceptional conditions.[29] The creation of the free zone requires an agreement between the national government and the provincial government, whereby the latter adheres *in totum* to the provisions of this statute.[30]

A free zone is defined as an area where the entrance and exit of merchandise is not subject to the usual customs controls, is exempted from payment of taxes other than fees for services rendered that could be established, and is not subject to prohibitions of an economic character.[31] The area must be fenced off in a manner that ensures its isolation from the national customs territory.[32]

According to the statute, the objective of free zones is to stimulate trade and industrial export activity, helping to extend the increase in efficiency and reduction in costs associated with the activities undertaken within such zones to investment and employment.[33] The statute further stipulates that free zones must function in accordance with national trade policy, they must contribute to the growth and competitiveness of the economy, and they must be fully incorporated into the regional integration process.[34] Moreover, it is expressly stated that free zones should become a development centre in those areas where they are established by employing human resources and using other resources available in those areas.[35] The types of business that can be undertaken in free zones include commercial activities, industrial activities, and the supply of services, including warehousing services.36

The free zone operator is the person selected through a bidding process responsible for running the free zone in accordance with a concession agreement.[37] The operator can be either an entirely private person or a public-private partnership. The free zone operator is responsible, among other things, for providing the basic infrastructure and services necessary for the normal operation of the free zone in accordance with the concession agreement.[38] Concessions for operating free zones are granted for a period of 30 years extendable for 10 additional years. As of September 2009, the Executive Power had authorised the creation of 22 free zones.[39]

The direct free zone user is the natural or legal person, national or foreigner, that is entitled to run his or her business within the free zone in accordance with an agreement with the free zone operator, for an agreed-upon price and during an agreed-upon period of time.[40] The indirect free zone user is the natural or legal person, national or foreigner, that is entitled to run his or her busi-

ness within the free zone in accordance with an agreement with the direct free zone user.[41] In order to take advantage of the fiscal incentives offered by the free zone regime, some service suppliers have applied to become free zone users and are now operating within some of the free zones created under this legislation, in particular Cordoba Free Zone, which is trying to promote itself as a hub for exports of highly qualified professional services.[42]

2. Incentives

The entrance of merchandise into the free zone from the national customs territory or third countries is exempted from all import charges, existing or to be created, except for fees paid for services rendered.[43] The transfer of merchandise from the free zone to third countries is exempted from all import charges, existing or to be created, except for fees paid for services rendered.[44] The entrance of merchandise into the free zone from the national customs territory shall be considered a suspended export.[45] The transfer of merchandise from the free zone to the national customs territory is regarded as an import.[46]

Merchandise exported from the national customs territory to a free zone and subsequently exported to third countries, either in the same state or having undergone transformation, processing, combination, mixture, or any other enhancement within the free zone, is covered by the general export duties regime. Nonetheless, the value added to the goods through processing or transformation in the free zone is exempted from such duties.[47]

The transfer of merchandise from the free zone to third countries is not eligible for any incentive other than the incentives established in accordance with international agreements subscribed by Argentina and the remission of taxes effectively paid, provided that exporters domiciled in the national customs territory are entitled to such remissions.[48]

The provision of basic utilities (telecommunications, gas, electricity, water mains, sewerage, and drainage) within the free zone is exempted from national taxes.[49] Free zone users are not entitled to the benefits and fiscal incentives included in industrial promotion schemes, regional or sectoral schemes, existing or to be created in the national territory.[50] The statute stipulates that the agreement between the national and provincial governments for the creation of a free zone must include a commitment by the provincial government not to grant free zone users exemptions from provincial taxes, except for fees paid for services rendered.[51] However, the Government of La Pampa Province

provides additional fiscal incentives, including, *inter alia*, the exemption of free zone users from payment of all provincial or municipal taxes, existing or to be created.[52]

The national customs authority must set up an office in each free zone to be able to deal with all of the administrative procedures and documentation that free zone users need to comply with for clearing customs.[53] In addition, the statute exempts imports and exports from or into free zones from the economic restrictions or prior deposits that may be applicable for international trade transactions.[54] On the other hand, free zones are subject to the same labour law that is applicable in the national customs territory,[55] and the financial transactions within the free zone are subject to the same financial and exchange rate regulations applicable in the national customs territory.[56]

3. Conditions for incentives

Free zone users can carry out industrial activities, but with the sole purpose of exporting the manufactured goods to third countries.[57] When the merchandise is subject to a production process that involves manufacturing, mixing, or any other activity aimed at transforming and adding value to the merchandise, the statute determines that the merchandise must be exclusively destined for third countries.[58] In other words, the import of merchandise manufactured in the free zone into the national customs territory is prohibited.[59] The only exception to this rule consists of the manufacture of capital goods made with foreign inputs.[60] They can be imported into the national customs territory, provided that they are not produced in the national customs territory or in the existing special customs areas and subject to payment of import charges and restrictions applicable to imports from third countries.[61]

Merchandise that remains in the same condition as it was when it was introduced into the free zone, or that has been subject to ordinary manipulations designed to improve its appearance or commercial value, can be transferred from the free zone into the national customs territory.[62] The transfer of merchandise from the free zone to the national customs territory is regarded as an import, subject to payment of import charges and restrictions applicable to imports from third countries.[63] The statute says nothing about the provision of services from the free zone into the national customs territory.

B. Brazil Export Processing Zone Law

1. General provisions

Export Processing Zones (hereinafter EPZs) are industrial districts subject to a special regulatory regime that provides fiscal, foreign exchange, and administrative incentives to firms operating within them, subject to the condition that at least 80 percent of the firms' gross income is exported. The aim of EPZs is to boost exports, reduce regional imbalances, and strengthen the balance of payments, fostering technological transfers and improving the nation's economic and social development.[64]

EPZs have a protracted history. Legislation authorising their creation was first adopted in 1988.[65] However, the effective establishment of EPZs faced stiff resistance from the industrial sector, particularly from the FIESP (Sao Paulo Industrial Association) in the south, and from supporters of the Manaus Free Trade Zone in the north, which feared that fiscal incentives offered to companies operating within EPZs could leave them at a competitive disadvantage with EPZs' production.[66] As a result, the fiscal incentives offered by the EPZs' legislation have been subject to various amendments.[67] The current regime is laid down by Law No. 11508/2007, of 20 July 2007, as amended by Law No. 11732/2008, of 20 July 2008.[68]

Proposals for the creation of EPZs are submitted by states or municipalities, jointly or separately, to the National Council of Export Processing Zones (Conselho Nacional das Zonas de Processamento de Exportação, hereinafter CZPE). The proposal is first assessed by the CZPE and then forwarded to the Executive Power.[69] The final decision on the authorisation of EPZs is made by a presidential decree, which must strictly limit the physical area of the EPZ.[70] Among other requirements, the proposal for the creation of the EPZ must include evidence of availability of land, financial resources and minimum energy, and communication and transport infrastructures necessary for meeting the EPZ's demand.[71]

Between 1988 and 1994, the Executive Power authorized the creation of 17 EPZs[72], but only four completed infrastructure works, and none of them is yet in operation.[73] Since the adoption of the current regulatory framework in 2007, the CZPE has given its official support for two proposals for the establishment of EPZs in Suape and in Assu.[74] There are about a dozen applications awaiting authorisation. ABRAZPE expects that, by the end of September 2010, 4 or 5 EPZs

will start the setting-up process and, by the end of the 2010 semester, another 10 or 12 will follow suit.[75]

EPZs are monitored by the CZPE. The CZPE has authority, *inter alia*, to assess proposals for the creation of EPZs, authorise the establishment of companies in EPZs, approve industrial projects, and set out general policies on EPZs.[76]

EPZs are operated by a legal entity specifically created for this purpose. EPZ operators must supply services to the EPZ users (i.e., companies installed in the EPZ area) and must support and assist customs authorities. The EPZ area must be demarcated and closed to ensure fiscal control of the operations carried out there. The EPZ operator must comply with instructions from relevant government agencies regarding area enclosing, surveillance, and security devices.[77] The operator must also provide the facilities and equipment required for control, surveillance, and local customs management.[78]

To become an EPZ user, a company must be duly authorised by the CZPE.[79] There is no restriction in terms of nationality of the company. It can be a domestic or foreign company. According to the current legislation, EPZs are meant to host only companies dedicated to the manufacturing and export of goods.[80] However, ABRAZPE, the EPZs' industry association, is planning to lobby the Brazilian Congress to amend the current regime in order to allow the inclusion of service companies in EPZs as well, in particular IT companies.[81]

2. Incentives

Payment of taxes levied on domestic purchases of goods and services by EPZ users is suspended for the following taxes and contributions:[82] Tax on Industrialised Products (Federal Excise Tax); Contribution to Social Security Financing (COFINS); and Contribution to the Social Integration Programme (PIS/PASEP).

Payment of taxes levied on imports of goods and services by EPZ users is suspended for the following taxes and contributions:[83] Import Duties; Tax on Industrialised Products (Federal Excise Tax); Contribution to Social Security Financing (COFINS - Imports); Contribution to the Social Integration Programme (PIS/PASEP-Importacao); and Import Freight Surcharge for the Renewal of the Merchant Navy on goods imported by sea (AFRMM).

The suspension of tax payment covers domestic purchases or imports of machinery, equipment, and instruments necessary for industrial installation or intended to integrate the production process of the company and raw materials; intermediate products; and packing materials necessary for the company's activities.[84] Machinery, equipment, and instruments, whether new or used goods, must be incorporated into the company's fixed assets and not resold.[85] The raw materials, intermediate products, and packaging materials, whether imported or purchased in the domestic market, must be fully used in the production process of the end product.[86]

The suspension of payment of import duties and the Import Freight Surcharge for the Renewal of the Merchant Navy is subject to the general export requirement[87] for a five-year period from the occurrence of the taxable event.[88] With respect to the importation of raw materials, intermediate products, and packing materials, the exemption of import duties and AFRMM is terminated in case of re-exportation or destruction of goods at the expense of interested parties, or export of goods in the same state into which they were imported.[89]

Some free zone regimes stipulate that free zone users are not entitled to any fiscal incentives other than those offered by the free zone regime itself. The Brazilian EPZ regime, by contrast, allows for the accrual of EPZ incentives and other fiscal incentives offered by a specific list of statutes according to the conditions stipulated therein:[90] For example, EPZ users allowed to operate in EPZs located in the SUDAM (Superintendência do Desenvolvimento da Amazônia) or SUDENE (Superintendência do Desenvolvimento do Nordeste) areas are entitled to the fiscal incentives stipulated by the SUDAM/SUDENE programmes aimed at promoting the development of the Amazon and North East Regions.[91] Such programmes include a fiscal incentive consisting of a 75-percent reduction of income tax for a 10-year period.[92] Therefore, EPZ users operating in EPZs located in the SUDAM/SUDENE areas will be entitled to an exemption on income tax, albeit for a limited period of time.[93]

EPZ users are also entitled to a reduction to zero of income tax on remittances abroad aimed at the promotion of Brazilian products in foreign markets.[94] The benefit covers foreign remittances intended exclusively for payment of expenses related to market research for Brazilian export products; expenses arising from the participation of firms in fairs, exhibitions, and similar events linked to the promotion of Brazilian products, including leases and rentals of booths and exhibition areas; and the cost of advertising undertaken pursuant to those events.[95]

The EPZ statute also offers some regulatory advantages. Imports and exports by companies authorised to operate in an EPZ are exempted from licenses or authorisations from federal agencies, with the exception of sanitary, national security, and environmental controls.[96] Foreign currency earned by companies operating in EPZs as a result of their exports is not subject to the legal and regulatory provisions related to foreign exchange that are applicable to other national companies. Law 11371/2006 allows exporting companies to hold a limited percentage of their foreign currency in overseas financial firms (the percentage is fixed by the National Monetary Council). That limit is not applicable to companies operating in EPZs[97], who are allowed to keep abroad 100 percent of their foreign currency earned in exports. Thus, they are under no obligation to convert their foreign currency into Brazilian Reais, which allows them to avoid foreign exchange risks.

3. Conditions for incentives

To benefit from the incentives, companies located in EPZs must export at least 80 percent of the turnover related to the sales of goods and services.[98] This allows a maximum of 20 percent of the company's turnover to result from sales of goods and services to the domestic market. The domestic sale of products manufactured in EPZs, and the goods and services used as inputs into the production of those products, are subject to all taxes imposed on domestic acquisitions or importations.[99]

The CZPE may raise the percentage of the company's turnover that must result from exports, or it may even prohibit altogether the sale of products manufactured in EPZs to the domestic market if it verifies that sales to the domestic market have a negative impact on the domestic industry.[100] The CZPE may also impose minimum total investment requirements on companies applying for authorisation to operate in an EPZ, when so set forth by regulation.[101]

Companies located in EPZs are allowed to carry out only those activities related to the manufacturing of goods expressly authorised by the CZPE,[102] and they may not establish a branch or have interests in another legal entity located outside the EPZ regime.[103] The statute also prohibits the establishment of companies in EPZs whose projects consist of the mere transfer into the EPZs of industrial plants already installed outside the EPZs.[104]

Incentives are time-limited. When authorizing the establishment of a company in an EPZ, the CZPE must limit the incentive regime for that company for a maximum of 20 years, renewable for an additional 20-year period.[105] In exceptional circumstances, the CZPE can extend the incentive regime period to allow extra time for the amortization of large-scale types of investments.[106]

C. Manaus Free Zone[107]

The Manaus Free Trade Zone (ZFM) is defined as an area of free trade of imports and exports and special tax incentives, established with the purpose of creating in the Amazon region an industrial, commercial, and agricultural centre with economic conditions that allow its development, bearing in mind local factors and the great distance between the centre and the main consumers of its products.[108] The definition clearly shows that the Manaus Free Zone is a regional development policy instrument rather than a trade policy instrument. Its main purpose is not to support the export of manufacturing activities, but to attract the location of firms in a particular region of the country characterised by lagging behind other regions in terms of development. The Manaus Free Zone is administered by the Superintendence for the Manaus Free Zone (SUFRAMA), an autonomous agency created in 1967 and linked to the MDIC. SUFRAMA also manages Brazil's seven other free trade zones.[109]

In order to attract firms to the Manaus area, the Manaus Free Zone offers a range of fiscal incentives. At the federal level, there is a reduction of the Import Duty by up to 88 percent of the IPI exemption; a reduction of 75 percent of the income tax; and additional non-refundable, exempt contributions to PIS/PASEP and COFINS in the internal operations of the ZFM.[110] Moreover, there is, at the state level, a partial or complete refund of ICMS (Tax on Circulation of Goods and Services) and, at the municipal level, exemption from IPTU taxes (Tax on Real Property and Urban Land).[111]

The main requirement for the concession of the fiscal incentives is the observance of the basic productive process (BPP) criteria, under which firms need to undertake agreed-upon local manufacturing steps for specific products, and provide a detailed description of the various stages of assembly, preparation, and transformation of inputs used for manufactures.[112]

The main difference between the Manaus Free Zone and the Export Processing Zones is related to the conditions for the access of the free zone's products to the domestic market. Companies located in the Manaus Free Zone have unrestricted (they can sell all of their production in the Brazilian market) and preferential (taking advantage of the fiscal incentives) access to the Brazilian domestic market. Companies located in EPZs have restricted (sales limited to 20 percent of their gross income) and non-preferential (subject to full payment of all applicable taxes) access to the Brazilian domestic market.

Unsurprisingly, most production in the ZFM is industrial and destined for the domestic market: in 2007, 95.9 percent of its production was sold in the Brazilian market, up from 88.4 percent in 2003, noted at the time of the previous review. Production for the domestic market increased substantially during the period under review, almost doubling between 2004 and 2007 to US$24.7 billion; production for export remained stagnant. The main activities in the ZFM are: electronics, information technology and telecommunication goods (including mobile phones), two-wheel vehicles, chemicals, thermoplastics, lighters, pens, disposable shavers, mechanical machinery, metallurgical products, and watches. In 2008, firms located in the ZFM, which number more than 500, reported revenues of R$30 billion (Brazilian Real) and 100,000 jobs.[113]

D. Paraguay Free Zone Law

1. General provisions

The free zone regime was introduced in 1995 by Law No. 523/95.[114] Free zones are defined as areas located outside the national customs territory, authorised by the Executive Power and subject to the fiscal, customs, and administrative control laid down by Law 523/95.[115] They must be established in a privately owned area that must be duly fenced off to ensure their isolation from the national customs territory.[116]

The free zone operator is the legal person authorised by the Executive Power to run a free zone in accordance with a concession agreement. It must provide the infrastructure necessary to allow free zone users to run their undertakings. Concessions are granted for a maximum of 30 years, with a possibility of renewing the term for the same period once.[117] Free zones must be run by private operators only.[118] The Executive Power may authorise the free zone operator to set up a single undertaking exclusively for the purpose of manufacturing goods for exports. In this case, the

free zone operator also becomes subject to the obligations applicable to free zone users.

The free zone user is the natural or legal person entitled to carry out activities within a free zone in accordance with the provisions stipulated by the statute, the regulations, and the contract between the free zone user and the free zone operator. The free zone user can carry out the following activities: (a) commercial activities such as warehousing, where goods enter and leave the free zone without undergoing any type of transformation or modification; (b) industrial activities, i.e., assembly activities and manufacturing goods for export by way of processing raw materials and/or semi-processed products, whether of domestic origin or imported; and (c) services, i.e., repair and maintenance of equipment and machinery. Other services not specified in the statute that are intended for international markets may be authorized by the Executive, at the request of the National Council of Free Zones, in which case they, too, enjoy the fiscal incentives included in the statute.[119]

In 2002, free zone concessions were granted to Consorcio Trans Trade S.A. y Asociados and to Zona Franca Global del Paraguay S.A.C.S, for 30 years in each case.[120] Both zones became operational in 2003. The free zone assigned to Consorcio Trans Trade S.A. y Asociados had 57 users at the end of 2004; the import taxes levied during the period from 2 January to 30 November 2004 on imports into the Paraguayan customs territory from the free zone amounted to G/48 billion (US$8.1 million). Commercial, industrial, and service-related activities are authorised in the free zone. The zone assigned to Zona Franca Global del Paraguay S.A.C.S. had 37 users at the end of 2004; the import taxes levied between 2 January and 30 November 2004 amounted to G/68 billion (US$11.6 million)[121.] Commercial and service-related activities are authorized in that free zone. The authorities indicated that, at the beginning of 2005, the users of the free zones did not export goods, but were only involved in service activities.[122]

The statute establishes a National Council of Free Zones responsible, *inter alia*, for controlling and supervising the operation of the free zones. The Council is composed of representatives of the Ministries of Finance, Industry and Trade, Public Works, and Communications; one representative of the free zone operators, and one representative of the free zone users.[123]

2. Incentives

Free zone users are exempted from any national, regional, or municipal taxes except for the single free zone tax.[124] The exemption includes any direct taxes levied on the income generated by free

zone users; taxes levied on the commercial, industrial, and service activities carried out by free zone users; and taxes levied on the payment of royalties, commissions, fees, interest, and any other payment for services, technical assistance, transfers of technology, loans, hiring of equipment, and any other service supplied by third countries to free zone users.[125] The establishment of free zone user companies and the remission of profits made by such companies to third countries are also exempted from any kind of tax.[126]

The introduction of goods into free zones, either from third countries or from the national customs territory, is exempted from all national, regional, or municipal taxes, except fees for services actually rendered.[127] The exemption includes the introduction of capital goods, even those subject to a leasing contract.[128] Capital goods introduced into the free zones in accordance with the tax exemptions granted by the statute cannot be sold, leased, or transferred under any title to persons resident in the national customs territory, without payment by the purchaser of import charges. The sale, lease, or transfer of any title of capital goods to other free zone users for their use within the free zone is exempted from all taxes.[129] The export or re-export of products and services from a free zone to third countries, to the national customs territory, or to other free zones is exempted from all national, regional, or municipal taxes.[130] Free zone operators are exempted from VAT on the services that they provide to free zone users.[131]

3. Conditions for incentives

Free zone users that carry out commercial, industrial, or service activities and are engaged exclusively in exports must pay a single free zone tax at a rate of 0.5 percent (half percent) over the total value of gross revenues from exports.[132]

Free zone users that carry out commercial, industrial, or service activities and are engaged in both exports and sales to the national customs territory must pay a single free zone tax at a rate of 0.5 percent over the total value of gross revenues from exports, provided that sales to the national customs territory do not exceed 10 percent of the enterprise's gross sales revenue. [133] If sales to the national customs territory exceed 10 percent of its gross sales income, the free zone user must pay, in addition to the single free zone tax, the income tax applicable to commercial, industrial or service activities that corresponds to the gross sales income generated by sales to the national customs territory.[134]

All imports into the national customs territory from free zone users that carry out commercial, industrial, or service activities in the national customs territory are subject to all import charges, including tariffs, except for those products manufactured in the free zone that comply with the requirements of the rules of origin in force and hence are regarded as domestic products.[135] The statute allows the Executive Power to create tariff preferences for those products that are considered strategic for the country's development.[136]

Sales of any type of goods or services from the national customs territory to a free zone are regarded as exports, subject to payment of all taxes and duties that may correspond and subject to customs and administrative procedures applicable to exports.[137]

E. Paraguayan Maquila Law

1. General Provisions

The maquila consists of an in-bond processing regime that was introduced in Paraguay in 1997 with a view to support its industrial development, create jobs, and boost exports.[138] The system became operational in March 2001, when the National Council of Maquila Export Industries (CNIME) approved the first eight maquila programmes. In 2001, a Chamber of Maquiladoras was set up to promote the development of maquiladoras and provide impetus to bonded assembly activities in the country.[139]

Maquila activities are based on a maquila export contract between a maquiladora and a foreign company. Under the agreement, the foreign company supplies the maquiladora with raw materials, inputs, machinery, equipment, tools, technology, guidance, and technical assistance for the latter to perform for the account and order of the foreign company certain value-added activities such as transformation, elaboration, repair, assembly, or industrial processing.[140] The end product is then exported by the maquiladora for the account and order of the foreign company to the originating country and/or to any other country in the world.

The Maquila Law imposes no restrictions on the type of activities that can be carried out by the maquiladora for the foreign company. The maquila programme can consist of carrying out either manufacturing or service activities[141]. Most commonly, the maquiladora imports, on a duty-free basis, raw materials and equipment from the foreign company for assembly or manufacturing

and then re-exports the assembled product. More recently, however, some maquila programmes have been approved purely for the provision of services such as call centre services.[142]

In order to become a maquiladora, the interested company must submit a maquila programme and a maquila export contract to the CNIME for approval. The CNIME is composed of representatives of the Ministry of Industry and Trade, the Ministry of Finance, the Central Bank, the Technical Secretariat of Planning for Economic and Social Development, and the Ministry of External Relations. The maquila programme must describe the characteristics of the industrial process or service, schedules of imports, production, exports, employment generation, percentage of value added, percentage of loss and wastage, period of time of the programme, and any other data that may be established by the regulations.[143] The maquila programme must be approved by a joint resolution of the Ministry of Industry and Trade and the Ministry of Finance.

Any natural or legal person established in Paraguay, whether national or foreign, can apply to establish a maquiladora and be entitled to the benefits conferred by the Maquila Law.[144] A maquiladora can be either a company specifically established for carrying out a maquila export programme or an already-established business directed at the domestic market, with idle capacity of its installations and for which a maquila programme is approved.[145] The Law also allows maquiladoras to subcontract some industrial processes to local companies and, if the subcontractor so requests and the maquila programme is approved, the status of ”submaquiladora” (maquila subcontractor) is conferred together with entitlement to specific treatment under the Law.[146]

2. Incentives

The maquiladora pays a single maquila tax of 1 percent on the value added in Paraguayan territory (goods purchased, services contracted, and wages paid in the country) or on the value of the invoice issued by the maquiladora to the account and order of the contracting foreign company, whichever is higher.[147] The submaquila contract (contract for the subcontracting of maquila services) is subject to a single tax of 1 percent by way of income tax. This tax applies to the amount of the invoice for submaquila services.[148]

The maquiladora is exempted from all other national, departmental, or municipal taxes.[149] This includes a total exemption of import charges and export charges levied on imports and exports

of goods specified in the maquila programme and subject to import and export conditions stipulated by the statute. The statute stipulates that maquiladoras with an approved maquila programme and a maquila contract registered with the authorities may temporarily import, on a duty-free basis, goods that include raw materials and inputs necessary for production and exports, machinery, tools, equipment, trailer boxes, and containers.[150]

Raw materials and inputs necessary for production must be used within six months after entering the country. There is a possibility that the period can be extended for a maximum of six additional months. The other goods mentioned above may remain in the country as long as the maquila programme for which they were authorized remains in effect, with the exception of the trailer boxes and containers, whose maximum stay in the country shall be six months. The maquiladora must carry out its initial temporary imports within one year, starting from the date of the resolution approving the maquila programme.[151]

The maquiladora is entitled to recover the VAT levied on the domestic purchase of goods and services through negotiable credit certificates.[152] The maquiladora is required to provide a guarantee for the value of any applicable charges. The guarantee may take the form of a mortgaged or pledged real asset or of insurance policies issued by national companies.[153]

Maquiladoras specializing in the provision of call centre services are entitled to promotional rates on telecommunication services. This incentive was created in December 2006 by an inter-institutional agreement between the Ministry of Industry and Trade, the Paraguayan Telecommunications Company (COPACO) and the Paraguayan Telecom regulator (CONATEL) for a three-year period, which is renewable.[154] The agreement was designed to support the establishment of call centres operating under the maquila regime by charging promotional rates on telecommunication services. To be entitled to this benefit, the applicant must have in place an approved maquila programme. The promotional rate is limited to international traffic use without access to domestic public networks.

3. Conditions for incentives

The maquiladoras' final products or services must be exported. However, the legislation allows the maquiladora to sell on the national market merchandise derived from the transformation, elaboration, and finishing of the raw materials and inputs, as well as the capital goods temporarily

imported for the fulfillment of the maquila programme, subject to CNIME authorization .[155] The regulations stipulate restrictive criteria for authorizing domestic sales in order to complement the domestic demand for the product when the product is not produced in the country or when the condition for a balanced foreign exchange budget is met.[156] Sales to the domestic market are subject to the payment of the duties and taxes required for placing the product on the domestic market and to income tax on the share sold in the domestic market, according to a "profitability coefficient" established by the tax authority. Sales to the domestic market may not exceed 10 percent of the volume exported during the last year and must maintain the same quality checks and standards that apply to its exported products.[157] Capital goods imported under the maquila regime may, as an exception, be nationalized by means of a definitive import dispatch after payment of all of the corresponding taxes.[158]

F. Uruguay Free Zone Law

1. General provisions

The free zone regime was adopted in 1987.[159] Free zones are public or private areas of the national territory, duly fenced off and efficiently isolated, which are designated by the government upon the advice of the Free Zones Honorary Advisory Committee, with the purpose of carrying out therein, under the tax exemptions and further benefits set forth by the Law, any kind of industrial, commercial, or service activities such as: (a) commercialisation of goods, storage, deposit, preparation, selection, sort, break down, assembly, handling, and mixture of any foreign or domestic goods or raw materials; (b) establishment and operation of manufacturing industries; (c) supply of any kind of service, either within the free zone or from the free zone to third countries; (d) other activities that the Executive Power might deem convenient for the development of the domestic economy or for the economic and social integration of the countries.[160] The objective of free zones is to encourage investment, expand exports, increase the use of domestic labour, and foster international economic integration.[161]

Free zones must be operated either by the state or by duly authorised private persons known as free zone operators. In practice, there are three types of free zones: those belonging to and managed by the state, those owned by the state but managed privately, and private free zones.[162] Aguada Park and the World Trade Centre Free Zone are expressly designed for service suppliers.

The free zone operator must supply the necessary and adequate infrastructure for the establishment and operation of a free zone in exchange for a price agreed upon with each free zone user.[163] Private persons willing to operate a free zone must submit an application for authorisation to the Executive Power, enclosing plans for an investment project whose economic feasibility must be duly evidenced together with the benefits that such project would bring to the country. The applicant must also pay the government a lump sum or make periodic payments for the authorisation, depending on what is agreed upon in each case.[164] The free zone operator must administrate the free zone in compliance with the terms of the corresponding authorisation. In case of any breach of the terms of the authorisation, the free zone operator can be subject to fines, or their authorisation can be withdrawn, depending on the nature of the infringement.[165] In case of revocation of the authorisation or any other serious situation that is liable to cause the said revocation, the Executive Power may, through the Free Zone Office, take any measure deemed necessary for the supply and maintenance of the infrastructure required for the due operation of the free zone.[166]

A free zone user is the natural or legal person, national or foreigner that has acquired the right to carry out activities of a commercial, industrial or service nature within a free zone. The free zone user may not perform any activity of a commercial, industrial, or service nature outside the free zone.[167] A direct free zone user is the natural or legal person that has acquired the right to carry out activities within the free zone through the signature of an agreement with the free zone operator.[168] An indirect free zone user is the natural or legal person that has acquired the right to carry out activities within the free zone through the signature of an agreement with the direct free zone user, using or taking advantage of the free zone user's facilities.[169] Operating within the free zone is not restricted to free zone users. Any domestic or foreign company can perform commercial activities within these areas, but they are not entitled to the free zone incentives.

2. Incentives

Free zone users are exempted from any national taxes, either existing or to be created in the future, including those whose exemption is specifically required by law.[170] Exempted taxes include, among others: Gains Tax or Tax on Income from Economic Activity (IRAE, formerly IRIC)[171], Net Worth Tax (Impuesto al Patrimonio)[172], Tax on the Incorporation of Corporations and Capital Gains Tax (for free zone user corporations)[173] and Tax on Bank Assets for for free zone users who

provide financial intermediary services.[174] Social welfare charges are not exempted. However, foreign nationals working in a free zone may opt in writing not to benefit from the Uruguayan social security benefits, and therefore to be exempted from the payment of the corresponding contributions.[175] Salaries and any other income generated from activities performed in the free zone are subject to the Personal Income Tax (IRPF).

Any goods, services, merchandise, and raw materials that enter the free zones, whatever their origin, are exempted from all import duties or charges applicable at the time of import, including those requiring by law a specific exemption, whatever the nature thereof.[176] The exemption is phrased in very broad terms, without restricting in any way the type of goods that may be imported into the free zone. In the absence of any specific limitation, one should assume that it includes, *inter alia*, inputs, machinery (new or used), productive assets, or merchandise destined for sale.[177] The exemption is not subject to any condition such as, for example, the need for the goods to be consumed in the production of the exported product. Finally, goods entering the free zone do not need to be re-exported within a certain period of time. They enjoy a right to unlimited stay. Similarly, any goods, services, merchandise, and raw materials imported into the free zones, as well as any products manufactured therein, may exit the free zones at any time, free from any present or future taxes or any other duties, encumbrances, and charges, including those requiring by law a specific exemption, whatever their nature.[178]

The circulation of goods and the supply of services within the free zones and the entry of goods from abroad into free zones are exempted from VAT and Specific Internal Excise Tax.[179] Public bodies that supply services to free zone users or provide them with inputs are allowed to charge promotional rates for their goods or services.[180] Also, the National Telecommunications Administration must not establish differential rates for telecommunication services based on the distance between Montevideo and the location of the free zone, although other differentiated rates may be applicable, such as those based on volume or traffic.[181] The Uruguayan Port Authorities must collect fees for the services actually rendered with respect to the goods coming from or going to the free zones, but the rate charged must not exceed the direct cost of the service involved. To this effect, the entry or exit of any goods and their transportation to/from the free zones shall be considered international transit, but entry or exit duties must be charged only once.[182]

In addition to fiscal and financial incentives, the free zone regime confers a number of regulatory advantages. First, industrial and commercial state-owned monopoly suppliers must operate under a free competition regime within the free zone area.[183] Second, no local content requirements, created or to be created, shall apply to activities carried out within the free zones.[184] Third, there shall be no restrictions on the entry into and exit from the free zones of securities, national or foreign currency, and precious metals[185] Fourth, corporate free zone users are entitled to a special regime for a quick approval of new legal entities and rapid changes to their articles of association.[186] Fifth, free zone users shall be able to introduce goods needed for their consumption, construction, and repair of industrial equipment, buildings, and installations into the free trade zones, with the only requirement being having the invoice stamped by the General Trade Authority – Free Zone Department.[187] In the specific case of services, the list of activities that have been considered the export of services by the legislation must be taken into account, which includes services that are deemed necessary to be rendered within the free trade zone.[188]

Finally, in order to provide additional security for free zone users and make the regime more stable, all tax exemptions, benefits, and rights stipulated by the free zone legislation are expressly guaranteed by the state. The statute stipulates that the state is obliged to compensate free zone users for any harm or losses caused by a modification in the free zones' regulatory framework.[189] Furthermore, the statute stipulates that, should the free zone operator lose his or her operator status, the Executive Power, through the Free Zone Office, may take any measure deemed necessary for the supply and maintenance of the infrastructure required for the due operation of the free zone.[190] An additional guarantee for free zone users provides that the land where the free trade zones are located is legally committed to that specific purpose during the term granted by the free zone operator, and it cannot be used for any other type of activity.[191]

3. Conditions for incentives

From a customs point of view, the activities performed in a free zone are carried out outside the national customs territory. As a result, the introduction of goods from the free zone into the national customs territory is regarded as an import, subject to payment of all customs duties and taxes that may correspond.[192] The introduction of goods from the free zone into the national customs territory is subject to payment of both VAT[193] and Special Internal Excise Tax.[194] Likewise, the introduction

of goods from the national customs territory into the free zone is regarded as an export, subject to payment of all customs duties and taxes that may correspond.[195]

In principle, free zone users may not perform any industrial or commercial activities outside the free zone or supply services from the free zone to the national customs territory.[196] However, there are some exceptions to this rule. The statute authorises free zone users to supply certain telephone and IT services from the free zone to the national customs territory, including international call centres (excluding those that have the national customs territory as their sole or principal destination), e-mail services, e-learning, and issuance of electronic signature certificates.[197] Furthermore, the statute confers on the Executive Power the discretion to authorise the supply of new services from the free zone to the national customs territory.[198] Since 2006, the Executive Power has exercised this power on three occasions. So far, the services that can be supplied from the free zone to the national customs territory, in addition to those specified by the statute, include software development, IT consultancy, and IT training services; management services, administration, accounting, and the like, provided by related entities engaged in providing logistics shipping services and logistics port services; and film processing services, including digitalization and color correction.[199]

When free zone users supply services in the national customs territory, the provision of a service is subject to state monopolies, state exclusive regimes, and public concessions that apply therein.[200] With respect to the tax treatment of services supplied from the free zone to the national customs territory, the statute provides that such services will be taxed in the same way as those services provided from abroad with regard to the supplier and to its deductibility by the consumer.[201] In addition, Decree 84/2006 stipulates that the tax exemptions provided by the statute will not be extended to the provision of services by free zone users to the national territory.[202] For such an activity, free zone users shall be subject to the tax regime in force at the time of the supply of the service.

As a condition for keeping a free zone user's status and for enjoying all tax exemptions, franchises, benefits, and rights offered by the statute, at least 75 percent of the workforce employed by a free zone user must consist of Uruguayan citizens. Under extraordinary conditions, the said percentage may be reduced upon authorisation by the government, on account of special features of the activities to be performed and "reasons of public interest."[203]

III. Consistency of free zone incentives with WTO disciplines[204]

For WTO members, the discretion to grant fiscal or financial incentives such as those offered by free zones is not unfettered. Although the WTO agreements do not expressly refer to free zones, they include provisions both on trade in goods and on trade in services that discipline the offering of fiscal or financial incentives, particularly those that discriminate against foreign products or services, or create trade distortions. Notwithstanding the fact that free zones have become an extremely popular trade policy instrument[205], little research has been devoted to examining the consistency of free zone incentives with WTO disciplines.[206] Published studies so far are mainly focused on examining the implications of the Agreement on Subsidies and Countervailing Measures (ASCM) for free zones, overlooking the implications of the disciplines included in the General Agreement on Trade in Services (GATS), despite the growing number of service suppliers operating from free zones.

A. Agreement on Subsidies and Countervailing Measures

The Agreement on Subsidies and Countervailing Measures (hereinafter ASCM) contains disciplines targeting subsidies that may have distortive effects on trade in goods. Its disciplines do not apply to incentives granted to service suppliers. However, there are important reasons for considering the ASCM in a study concerned with the offshore industry. First, free zones host both goods manufacturers and service suppliers. An inconsistency between a free zone incentive and the ASCM should require an amendment of the free zone regime, which could affect the offshore service suppliers that operate within the free zone. Second, the ASCM also disciplines the provision of subsidised services to producers of goods.[207] And, finally, the ASCM has been taken as a reference model for the negotiations on subsidies disciplines for trade in services.[208] Therefore, identifying what is unlawful under the ASCM can help to anticipate what type of incentives could become unlawful once disciplines on subsidies for services are agreed upon.

1. Definition of subsidy

According to the ASCM, for a measure to constitute a subsidy, it must: represent a *financial contribution or income support by a government*, which confers a *benefit*, to a *specific* recipient. The ASCM distinguishes between direct and indirect financial contributions. A government or any pub-

lic body provides a direct financial contribution when it makes a direct transfer of funds by way, for example, of grants, loans, or equity infusion, or a potential direct transfer of funds by way, for example, of loan guarantees; when it forgoes government revenue that is otherwise due; or when it provides goods or services other than general infrastructure, or purchases goods. A government can also make indirect financial contributions by channelling payments through a private body.

To qualify as a subsidy, the financial contribution must confer a *benefit* to a specific recipient, i.e., an advantage that it could not obtain in the marketplace.[209] There is a proposal currently being discussed by the working group on WTO rules to include a footnote in the text of the agreement clarifying the meaning of "benefit." The proposal stipulates that a benefit is conferred when the terms of the financial contribution are more favourable than those otherwise commercially available to the recipient in the market.[210]

Also, to qualify as a subsidy, the financial contribution must be conferred on a *specific* recipient.[211] A subsidy is specific when the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises (*de jure* specificity).[212] By contrast, if the subsidy is granted subject to objective criteria or conditions, i.e., generally applicable neutral criteria, which do not favour certain enterprises over the others such as the number of employees or size of the enterprise, it must be considered non-specific, and thus not subject to the ASCM disciplines.[213] There may be circumstances where, despite an appearance of non-specificity, there may be reasons to believe that the subsidy may, in fact, be specific. In such circumstances, other factors may be considered such as the number of enterprises entitled to the subsidy, the amount of the subsidy, and the way the granting authority exercises its discretion to grant the subsidy.[214] The agreement includes three cases where the specificity requirement is taken for granted: subsidies limited to certain enterprises located within a designated geographical region within the jurisdiction of the granting authority;[215] local content subsidies;[216] and export subsidies.[217]

2. Classification of subsidies

The ASCM distinguishes between prohibited forms of subsidies (i.e., subsidies contingent upon export performance or local content requirements) and actionable subsidies (defined by default, i.e., any scheme that is a subsidy and is not a prohibited subsidy). Subsidies contingent, in law or

in fact, upon export performance are prohibited.[218] Annex I of the ASCM includes an illustrative list of export subsidies. Any subsidy coming under the purview of the illustrative list is *ipso facto* prohibited, without any additional need to demonstrate that it is contingent upon export performance.[219] Subsidies not included in the illustrative list can only be branded as export subsidies upon demonstration of their contingency character, in law or in fact, upon export performance.

De facto export contingency operates when a WTO Member links benefits to exports without explicitly stating in the law that this has indeed been the case. The agreement stipulates that the *de facto* export contingency standard is met "… when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings."[220] However, the ASCM also stipulates that the mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of Article 3(1)(a).

The ASCM exempts the following WTO Members from the prohibition on export subsidies:

a) Members designated as least developed countries by the United Nations

b) Members listed by Annex VII(b) until their GNP per capita reaches US$1,000 in constant 1990 dollars for three consecutive years.[221]

Developing countries other than Annex VII(b) countries (including those that have graduated from Annex VII(b)) were required by Article 27.4 to phase out their export subsidies within an eight-year period ending on 31 December 2002. However, a mechanism for an extension beyond that date is provided by the same provision, based upon a timely application to an agreement by the Committee on Subsidies and Countervailing Measures (hereinafter, Committee). If the Committee does not affirmatively determine that an extension is justified, the export subsidy at issue must be phased out within two years from the end of the last authorized period.[222]

In 2001, a special procedure was implemented to address the concerns of certain small developing country Members.[223] The purpose of the 2001 special procedure was to grant extensions over a period of five years to certain WTO Members for certain programmes that met agreed-upon qualifications.[224] Members that met all of the qualifications were eligible for a five-year extension of the transition period (i.e., until 31 December 2007), plus the additional two-year phase-out pe-

riod provided for in Article 27.4 (i.e., until 31 December 2009). Following a request for a further extension, in July 2007 the WTO General Council approved an extension of these procedures through 31 December 2013, with the final two-year phase-out period ending not later than 31 December 2015.[225] Under the July 2007 decision, the members receiving the extensions agreed not to seek any further extensions past the end of 2015 and to eliminate their export subsidies no later than that date.[226]

It is interesting to note that a significant number of the notified programmes under Article 27.4 relate to free zones.[227] According to Article 25.7, Members recognize that notification of a measure does not prejudge on the nature of the measure and, therefore, does not constitute an admission that these programmes are, in fact, export subsidies prohibited by the ASCM. But the fact that a significant number of Members who relied on Article 27.4 requested extra time for phasing out their free zone regimes at least suggests a degree of concern about the consistency of their free zones regimes with WTO law.

Members that requested an extension of the transitional period under Article 27.4 must phase out export subsidies for products that have reached "export competitiveness" over a period of two years.[228] Export competitiveness exists if exports of the product have reached a share of at least 3.25 percent in world trade for that product for two consecutive calendar years.[229]

None of the MERCOSUR countries have relied on Article 27.4 to request extra time to phase out their free zone legislation. While Uruguay did rely on Article 27.4, the purpose of its application was for an extension of the transitional period to phase out its export incentive scheme for the automotive industry, known as the Automotive Industry Export Promotion Regime.[230] Argentina and Paraguay could have resorted to Article 27.4 or the 2001 procedure to request a transitional period for their free zone regimes, but they chose not to do it. Brazil's legislation on export processing zones dates from 2007, whereas the 2001 procedures are limited to measures that came into existence no later than 1 September 2001. Brazil could have relied on Article 27.4, but choose not to do so.

Any incentive that meets the three requirements necessary to constitute a "subsidy" within the meaning of the ASCM and is not a prohibited subsidy is an actionable subsidy. Actionable subsidies may be maintained, provided they do not cause adverse effects to the interests of other Members, i.e., injury to the domestic industry of another Member, nullification or impairment of benefits accru-

ing directly or indirectly to other Members under GATT 1994, or serious prejudice to the interests of another Member (including threats of serious prejudice).[231] Any WTO Member that considers itself adversely affected by an actionable subsidy may request consultations with the Member that maintains it and could eventually refer the matter to the Dispute Settlement Body.[232] Developing countries are not exempted from actionable subsidy rules, except for some "*de minimis* cases."

Finally, Article 8 of the ASCM includes a category of "non-actionable subsidies", i.e., subsidies that are not specific within the meaning of Article 2 and certain subsidies that are specific but are used for specific purposes indicated by the ASCM, namely, assistance for research activities, assistance to disadvantaged regions, and assistance to promote adaptation of existing facilities to new environmental requirements. The provision on non-actionable subsidies was meant to be applied for a period of five years, subject to review to consider extending its applicability.[233] The discussions in the Committee led nowhere and, as a result, the provisions relating to the definition of and response to non-actionable subsidies have by now been *de facto* deleted from the ASCM.

Developing countries have proposed maintaining the category of non-actionable subsidies for measures implemented by them, with a view to achieving legitimate development goals, such as regional growth, technology research and development funding, production diversification and development, and implementation of environmentally sound methods of production.[234] The proposal is currently being discussed under the umbrella of the Doha Round of negotiations.[235] The Ministerial Conference urged Members to exercise due restraint with respect to challenging such measures during the course of the negotiations. [236]

3. Implications for MERCOSUR countries

The consistency of MERCOSUR countries' free zone incentives with the disciplines stipulated by the ASCM depends on whether the incentives in question constitute a "subsidy" within the meaning of the agreement and, if so, whether they are contingent, in law or in fact, upon export performance.

3.1. Free zone incentives that constitute a "subsidy" within the meaning of the ASCM

Fiscal incentives offered by MERCOSUR free zones meet the three requirements necessary to constitute a "subsidy" within the meaning of the ASCM. First, they constitute a "financial contri-

bution by a government" by way of expressly surrendering to collect government revenue that is otherwise due.[237] By definition, only governments can forgo fiscal incentives and, even when the free zone is operated by a private entity, the fiscal incentives granted to free zone users remain a governmental measure. Second, the fiscal incentives confer a "benefit" on free zone users within the meaning of the ASCM, by way of exempting them from paying taxes otherwise due and therefore placing them at an advantage when compared to like enterprises operating in the national customs territory.[238] Finally, the fiscal incentives are "specific" because they are limited to certain enterprises located within a designated geographical region within the jurisdiction of the granting authority.[239] The specificity is also implied by the requirements and conditions for the establishment and operation of free zones.[240]

However, the ASCM excludes from the definition of "subsidy" the core fiscal incentives typically provided by free zones, namely:

(a) exemptions or remissions of indirect taxes levied on the production and distribution of exported products, provided they are not in excess of the indirect taxes levied on the production and distribution of like products when sold for domestic consumption[241]

(b) exemptions, remissions, or deferrals of prior-stage cumulative indirect taxes levied on goods and services that are "consumed"[242] in the production of exported products, provided they are not in excess of prior-stage cumulative indirect taxes levied on goods and services used in the production of like products when sold for domestic consumption[243]

(c) remissions or drawbacks of import charges levied on inputs that are "consumed"[244] in the production of the exported product, provided they are not in excess of those actually levied on inputs that are actually consumed in the production of the exported product.[245]

The exclusions from the definition of subsidy must be interpreted narrowly. Any fiscal incentive that is not expressly excluded falls within the definition of "subsidy." In fact, there are several incentives offered by MERCOSUR countries' free zone laws that are not covered by these exclusions and hence fall within the ASCM definition of "subsidy," namely:

- The Brazilian EPZ statute provides for the suspension of payment of indirect taxes and import charges levied on the domestic purchases and imports of machinery, equipment,

and instruments, whether new or used, that are necessary for industrial installation or intended to integrate the production process of the company.[246] The statute further provides that machinery, equipment, and instruments, whether new or used, must be incorporated into the company's fixed assets and must not be resold.[247] But it is still plausible to argue that this requirement is not sufficiently restrictive to satisfy the "consumption" requirement provided by the ASCM to exclude the incentive from the meaning of "subsidy." Capital goods cannot be "consumed" in the production of the exported product in such a way that satisfies the requirements of Annex II and footnote 61 of the ASCM, and, therefore, tax incentives on domestic purchases and imports of machinery, equipment, and instruments constitute a "subsidy" within the meaning of the ASCM. [248]

- The Brazilian EPZ statute also provides for the suspension of payments of contributions to social security financing levied on domestic purchases or imports of goods or services (COFINS/COFINS – Imports).[249] According to the ASCM, the full or partial exemption, remission, or deferral, specifically related to exports of social welfare charges paid or payable by industrial or commercial enterprises, constitutes an export subsidy.[250]

- Finally, the Brazilian EPZ statute allows for the accumulation of incentives offered by the EPZ regime with other incentives. [251] The SUDAM (Superintendência do Desenvolvimento da Amazônia) and SUDENE (Superintendência do Desenvolvimento do Nordeste) programmes offer a 75-percent reduction of income tax for a 10-year period[252] Hence, EPZ users operating from EPZs located in the SUDAM/SUDENE areas are entitled to direct tax incentives. According to the ASCM, the full or partial exemption, remission, or deferral, specifically related to exports of direct tax incentives paid or payable by industrial or commercial enterprises, constitutes an export subsidy.[253]

- The Paraguayan Law on Free Zones exempts free zone users and the activities carried out by them from any national, regional, or municipal taxes, except the single free zone tax.[254] The exemption is quite broad, including, *inter alia*, direct taxes levied on the income generated by free zone users; taxes levied on the commercial, industrial, and service activities carried out by free zone users; and taxes levied on the payment of royalties, commissions, fees, interest, and any other payment for services, technical assistance, transfer of technology, loans, hiring of equipment, and any other service provided

to free zone users by overseas suppliers.[255] Considering its scope, there is no doubt that this exemption constitutes a "subsidy" within the meaning of the ASCM.

- The Paraguayan Law on Free Zones also exempts the introduction of goods into free zones, either from third countries or from the national customs territory, from all national, regional, or municipal taxes, except fees for services actually rendered.[256] The exemption expressly includes the introduction of capital goods.[257] As mentioned, capital goods cannot be "consumed" in the production of the exported product in such a way that satisfies the requirements of Annex II and footnote 61 of the ASCM, and, therefore, tax incentives on imports of capital goods constitute a "subsidy" within the meaning of the ASCM.[258]

- The Paraguayan Maquila Law levies on maquiladoras a single maquila tax of 1 percent on the value added in Paraguayan territory (goods purchased, services contracted, and wages paid in the country) or on the value of the invoice issued by the maquiladora to the account and order of the contracting foreign company, whichever is higher.[259] The maquiladora is exempted from all other national, departmental, or municipal taxes, including direct taxes. As mentioned, exemptions of direct taxes constitute a "subsidy" within the meaning of the ASCM, which does not fall within the ASCM's exclusion.

- The Uruguayan Law on Free Zones exempts free zone users from any national taxes, either existing or to be created in the future[260], including, among others, direct taxes such as Gains Tax or Tax on Income from Economic Activity (IRAE, formerly IRIC)[261], and Capital Gains Tax (for free zone user corporations).[262] Again, exemptions of direct taxes constitute a "subsidy" within the meaning of the ASCM, which does not fall within the ASCM's exclusion.

- The Uruguayan Law on Free Zones also exempts imports of goods entering the free zones from payment of import duties and other charges to imports of goods entering the free zones. The statute stipulates that "any goods, services, merchandise and raw materials that enter into the free zones, whatever their origin, shall be exempted from all import duties or charges applicable at the time of import, including those requiring by law a specific exemption, whatever the nature thereof."[263] The exemption is phrased in very broad terms, without restricting in any way the type of goods that may be introduced into

the free zone on a duty-free basis. In the absence of any specific limitation, one should assume that it includes, *inter alia*, inputs, machinery (new or used), productive assets, or merchandise destined for sale.[264] Furthermore, the exemption is not subject to any condition such as, for example, the need for the goods to be consumed in the production of the exported product. By contrast, the ASCM allows for the non-excessive remission of duties levied on imported inputs *that are consumed in the production of the exported product* (emphasis added).[265] As mentioned above, duty-free treatment of inputs that are not consumed in the production of the exported product, such as capital goods and production equipment, fall within the ASCM's definition of "subsidy. "

3.2. Contingency of free zone incentives upon export performance

The contingency of the incentives offered by the Brazilian EPZ statute upon export performance is clear. The statute expressly requests EPZ users to export at least 80 percent of the turnover related to the sales of goods and services.[266] In its turn, the ASCM prohibits Members from granting or maintaining subsidies that are contingent, in law or in fact, upon export performance.[267] Hence, those incentives offered by the EPZ that fall within the meaning of subsidy are inconsistent with the ASCM's prohibition on export incentives.

The Paraguayan free zone statute stipulates that free zone users must pay a single free zone tax at a rate of 0.5 percent over the total value of gross revenues from exports, provided they are engaged exclusively in exports[268] or are engaged in both exports and sales to the national customs territory, but the sales to the national customs territory do not exceed 10 percent of the enterprise's gross sales revenue. [269] If sales to the national customs territory exceed 10 percent of its gross sales income, the free zone user must pay, in addition to the single free zone tax, the income tax applicable to commercial, industrial or service activities that corresponds to the gross sales income generated by sales to the national customs territory.[270]

The Paraguayan statute does not prohibit free zone users from selling their goods to domestic consumers, but the fiscal incentives are not extended to revenues from domestic sales, creating a strong incentive in favour of exports. In other words, the fiscal incentive reaches its maximum value when the free zone user consigns all of its sales or at least 90 percent of them to third countries, which clearly constitutes a *de jure* export performance requirement. The fiscal incentives

offered by the Paraguayan Maquila Law are also contingent upon export performance. In this case, the statute expressly stipulates that sales by maquiladoras to the domestic market in a given year may not exceed 10 percent of the volume exported the year before.[271] As a result, those incentives offered by the Paraguayan free zone regime and maquila regime, which fall within the meaning of subsidy, are inconsistent with the ASCM's prohibition on export incentives.

The Uruguayan free zone statute does not include a specific provision conditioning the fiscal incentives to a specific export performance requirement. However, the statute stipulates that the introduction of goods from the free zone into the national customs territory is regarded as an "import" [272], and therefore subject to payment of all customs duties and taxes that may correspond. It could be argued that conditioning access to the domestic market to payment of all duties and taxes that may correspond constitutes a *de facto* incentive for free zone users to export their production (on a tax-free basis) rather than sell it in the domestic market (on a taxed basis).[273] By accepting this argument, it follows that those incentives offered by the Uruguayan free zone regime, which fall within the meaning of subsidy, are inconsistent with the ASCM's prohibition on granting or maintaining subsidies that are contingent in fact on export performance.[274] Even if the argument suggesting the existence of a *de facto* export performance requirement is not accepted, the fiscal incentives that fall within the definition of subsidy remain "actionable" within the meaning of the ASCM[275], i.e., they can be maintained, provided they do not cause adverse effects to the interests of other WTO Members. [276]

3.3 Free zone incentives that do not constitute a "subsidy" within the meaning of the ASCM

In addition to fiscal incentives, most free zones also offer incentives of an infrastructural nature such as access to improved telecommunication networks, broadband, power supply, roads, and ports. According to the ASCM, the provision by a government of general infrastructure does not constitute a subsidy, but the provision of goods or services other than general infrastructure does.[277] It is further specified that the provision of services by a government shall not be considered conferring a benefit unless the provision is made for less than adequate remuneration.[278] Moreover, the ASCM prohibits governments from providing goods or services for use in the production of exported products on terms or conditions more favourable than those provided for the production of like products for domestic consumption.[279]

The Uruguayan free zone law allows public bodies that supply goods or services to free zone users to charge them promotional rates.[280] Should public bodies decide to supply goods or provide services at promotional rates (e.g., the provision by the state-owned telecommunication company of telecommunication services to firms operating within the free zone area at a rate significantly lower than that charged to consumers outside the free zone), the rates could be challenged as a prohibited subsidy, since the ASCM expressly prohibits the provision by governments or their agencies of services for use in the production of exported goods on terms or conditions more favourable than those provided for use in the production of goods for domestic consumption.[281]

The Brazilian EPZ law and the Uruguayan free zone law offer regulatory incentives such as trade facilitation measures, more liberal foreign exchange regimes (except for currency retention schemes, which involve a bonus on exports), and exemption from national monopolies and so forth, which do not constitute "subsidies" within the meaning of the ASCM and, thus, are not caught by the ASCM's disciplines.

3.4 Achieving compliance with the ASCM

To bring inconsistent fiscal incentives into conformity with the ASCM, it is necessary to reform the statute that created them. One possibility could be to eliminate the export performance requirement by allowing free zone products full access to the domestic market. By removing the export performance requirement, the fiscal incentive is no longer prohibited by the ASCM but remains an "actionable subsidy," i.e., any other Member that considers itself adversely affected by it may trigger an investigation to determine the existence, degree, and effect of any alleged subsidy.[282] Maintaining actionable subsidies can introduce an element of uncertainty that may affect foreign investors' locational preferences. An actionable subsidy can be converted into a non-specific subsidy by extending the incentive to all firms subject to objective criteria or conditions irrespective of location and not just to firms allowed to operate within a designated geographical enclave. Non-specific subsidies fall outside the scope of the ASCM. A more radical option could be to remove the fiscal incentive altogether. If Members decided to go for this option, they should be particularly careful with the rights of existing free zone users, which are already benefiting from such incentives.[283]

Before embarking on any law reform process aimed at aligning their free zone regimes with their WTO commitments, MERCOSUR countries should first assess the risk of being challenged for breaching them. To begin with, the issue of the consistency of free zones with WTO law has never been in the spotlight. The ASCM confers upon any Member the right to make, at any time, a written request for information on the nature and extent of any subsidy granted or maintained by another Member, or the reasons for which a specific measure has been considered not to be subject to the requirement of notification,[284] but, so far, no Member has exercised this right specifically regarding fiscal incentives offered by free zone regimes. In addition, free zone incentives have not been the subject of any GATT/WTO claims. Of course, the absence of claims does not, in itself, guarantee the legality of these incentives, but it, at least, indicates some level of tolerance by WTO Members with respect to measures that have been in place for many years.

The ASCM contains provisions on special and differential treatment for developing country Members that must be borne in mind. As mentioned, Argentina, Brazil, Paraguay, and Uruguay did not resort to the mechanism provided by the ASCM to extend the phase-out period for their export subsidies. Yet, the ASCM does contain other provisions that make it more difficult for other WTO Members to challenge measures that are allegedly inconsistent with the ASCM, when such measures are maintained by developing country Members.[285] In addition, the Ministerial Conference Decision on Implementation-Related Issues and Concerns urges Members to exercise due restraint with respect to challenging measures implemented by developing countries with a view to achieving legitimate development goals, such as regional growth, technology research and development funding, production diversification, and development and implementation of environmentally sound methods of production.[286] Having said that, the low risk of challenges at the WTO level is not, in itself, a reasonable argument for maintaining free zones.

It is worth noting that, while Argentina has notified the Committee concerning its Law on Free Zones pursuant to Articles XVI GATT 1994 and 25 ASCM[287], Brazil[288], Paraguay[289], and Uruguay[290] have not notified the Committee concerning their free zone regimes.

B. General Agreement on Trade in Services

1. Mandate to negotiate disciplines on subsidies

The GATS does not include disciplines on subsidies, but mandates WTO Members to negotiate them.[291] Negotiations on subsidies have been carried out by the Working Party on GATS Rules (hereinafter WPGR), which was established on 30 March 1995 by the Council for Trade in Services, but faced significant obstacles from the very beginning. During more than 15 years of work, the WPGR has not made any significant progress in advancing an agreement on disciplines for trade distortive subsidies. One of the main reasons for this lack of progress is the negotiators' failure to clearly identify the problem that needs to be addressed. The ASCM recognises that, in certain circumstances, subsidies may have distortive effects on trade in services, but no one knows exactly what those circumstances are. The impact of subsidies on trade in services is heavily under-researched, and there is limited information about the type and scale of support measures provided by Members to their service suppliers.[292] No Member has so far put on the negotiating table concrete evidence about the distortive effects of any specific governmental support measures adopted by another Member, let alone complaints about the trade-distortive effects of specific export incentives given to the offshore industry.[293]

The chairman of the WPGR has recently stressed that, unless inputs were received from delegations on the nature of the problem to be addressed and the means for doing so, little progress could be expected.[294] He urged delegations wishing to intensify work in this area to submit their inputs specifying how the trade-distortive effects of subsidies might be addressed.[295] In connection with this, the U.S. representative complained about the difficulty of designing disciplines in circumstances where the nature and extent of the problem that those disciplines are meant to address is far from clear. He also reminded delegations that WTO Members are meant to address significant trade problems and not hypothetical ones.[296]

Trade in offshore services represents a tiny fraction of global trade in services.[297] There is no evidence regarding the trade-distortive effects that might be caused by incentives to the offshore industry, and, so far, no Member has complained about them. The magnitude of these incentives is negligible compared, for example, to the rescue packages for the financial sector provided by American and European financial authorities. In other words, there are no apparent reasons for assuming that these types of incentives will become the main target of potential disciplines on

subsidies for services. And whatever the final outcome of the negotiations is, it will always include provisions on special and differential treatment for developing country Members, which will give them plenty of time to phase out their export incentives, should they be found to be incompatible with the agreed-upon disciplines.

In conclusion, the multilateral negotiations on disciplines for subsidies on services pose no immediate risk for the incentives given by Members to their service suppliers. At least for the short to medium term, it is not reasonable to expect a negotiating outcome that could force Members to dismantle incentives for service suppliers such as those offered by MERCOSUR countries' free zone laws.

2. National treatment

There is a common misconception about the GATS that associates the absence of disciplines on subsidies for trade in services with an unfettered discretion to grant fiscal or financial incentives for the supply or consumption of services. However, the GATS is concerned with any measure that affects trade in services, and includes a number of disciplines that limit Members' discretion to grant fiscal or financial incentives , most notably, the national treatment and the most favoured nation standards.[298]

The national treatment discipline compels Members to accord services and service suppliers of any other Member treatment that is no less favourable than that accorded to its own "like" services and service suppliers with respect to all measures affecting the supply of services[299]. The provision clearly states that treatment shall be considered less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member.[300] Therefore, the discipline encompasses not only measures that formally accord treatment that is more favourable to domestic services and service suppliers than that accorded to foreign suppliers (i.e., *de jure* discrimination), but also measures that, despite formally according identical treatment to both domestic and foreign services and service suppliers, in practice discriminate against the latter because they face greater difficulties in complying with them (i.e., *de facto* discrimination).[301]

In principle, the obligation not to discriminate that stems from the national treatment discipline refers to all measures affecting the supply of services, including, *inter alia*, fiscal incentives,

financial contributions, transfers of funds, or any other form of financial assistance. Unlike GATT 1994,[302,] the GATS does not include a specific carve-out for the payment of subsidies exclusively to domestic producers. But, on the other hand, the GATS calls on Members to enter into negotiations with a view to developing multilateral disciplines on subsidies.[303] Distinguished scholars have argued that the mere fact that there is a provision calling for negotiations on multilateral disciplines on subsidies leave them completely unregulated under GATS until the negotiations come to a fruitful end.[304]

By contrast, there are good reasons for supporting the idea that the payment of subsidies is not completely excluded from the scope of application of Article XVII. First, the 2001 Scheduling Guidelines expressly state that Article XVII applies to subsidies in the same way that it applies to all other measures.[305] The Appellate Body has recognised that, although not part of the treaty itself, the Scheduling Guidelines do shape the interpretation of treaty provisions as a supplementary means of interpretation.[306] In addition, Members' practice in scheduling specific commitments suggests that there is an understanding, at least among some Members, that subsidies are covered by Article XVII.[307] For instance, Switzerland's schedule of specific commitments includes a "horizontal limitation" (i.e., a limitation applicable to all sectors included in its schedule) expressly excluding subsidies, tax incentives, and tax credits from its national treatment commitments on modes 1 (cross-border supply) and 2 (consumption abroad). A similar horizontal limitation is included in Korea's schedule of specific commitments for mode 3 (commercial presence). The schedule expressly reserves Korea's right to limit eligibility for subsidies, including tax benefits, to companies that are established in Korea according to the pertinent laws. It also excludes research and development subsidies from its national treatment commitments. Armenia provides an example of one of the broadest carve-outs for subsidies. The schedule of specific commitments specifies that Armenia's national treatment commitments are unbound for all service sectors and modes of supply with respect to subsidies. Only legal entities constituted under Armenian legislation are eligible for subsidization, irrespective of their capital ownership.[308]

More importantly, the words used to define the scope of application of Article XVII have been interpreted broadly by WTO adjudicatory bodies. In its relevant part, Article XVII provides: " … each Member shall accord to services and service suppliers of any other Member, in respect of all measures *affecting* the supply of services…"[309] (emphasis added). Likewise, Article I provides

that the agreement applies to measures implemented by Members *affecting* trade in services.[310] Both panels and the Appellate Body have indicated that the word "affecting" suggests that no measures are excluded *a priori* from the scope of the GATS. For instance, in *EC-Bananas,* the panel indicated the following: "The scope of the GATS encompasses any measure of a Member to the extent it affects the supply of a service regardless of whether such measure directly governs the supply of a service or whether it regulates other matters but nevertheless affects trade in services."[311] The Appellate Body, confirming the panel's interpretation, added: "In our view, the use of the term 'affecting ' reflects the intent of the drafters to give a broad reach to the GATS. The ordinary meaning of the word "affecting" implies a measure that has "an effect on," which indicates a broad scope of application. This interpretation is further reinforced by the conclusions of previous panels that the term "affecting" in the context of Article III of the GATT is wider in scope than terms such as "regulating" or "governing."[312] In light of these rulings, it is reasonable to suggest that, in the event of a dispute, adjudicatory bodies would be inclined to find that measures such as the direct transfer of funds or fiscal incentives for service suppliers are measures that affect trade in services and thus fall within the scope of Article XVII.

The implications stemming from the application of the national treatment standard on granting fiscal or financial incentives are significant. Like any other measures affecting trade in services, Article XVII forces Members to grant them in a non-discriminatory way. In other words, the national treatment (NT) standard outlaws financial or fiscal incentives given to domestic service suppliers that result in less favourable conditions for the supply of a service by like foreign suppliers.

There are, however, important caveats that limit the scope of application of the national treatment discipline. First, it applies only to services inscribed in a Member's schedule.[313] A country retains full discretion to discriminate against foreign services and service suppliers by refraining from inscribing a given service sector in its schedule of specific commitments. Second, Members may qualify their specific commitments by inscribing measures in the schedule that are incompatible with the NT obligation, which they nevertheless wish to maintain.[314] Third, both the GATT Document Scheduling of Initial Commitments in Trade in Services: Explanatory Note[315] and the Guidelines for the Scheduling of Specific Commitments under the GATS[316] limit the territorial applicability of the NT obligation, although the text of the agreement does not expressly address this issue.

The NT obligation has a direct implication for free zone regimes. Free zones that host service suppliers must be open for both domestic and foreign service suppliers. In service sectors where specific NT commitments have been undertaken, limiting access to free zones only to domestic suppliers breaches the national treatment obligation with respect to like foreign service suppliers with a commercial presence in the territory of the Member where the free zone is located.

3. Most favoured-nation treatment

The most favoured-nation treatment (hereinafter MFN), a principle known as "favour one, favour all," forbids WTO Members to discriminate between trading partners. Article II of GATT 1994 stipulates that, with respect to "any measure covered by the Agreement," Members must extend immediately and unconditionally to services or service suppliers of all other Members "treatment no less favourable than that accorded to like services and service suppliers of any other country.".Since the payment of incentives to service suppliers constitutes a ''measure'' within the meaning of the GATS, these incentives are covered by the MFN discipline. In other words, a Member cannot grant a fiscal or financial incentive to a foreign service supplier from country A, but refrain from extending the same treatment to like service suppliers from any other WTO Member.[317]

The scope of application of the MFN standard is defined broadly. Unlike the national treatment standard, it applies to all sectors and modes of supply, regardless of Members' specific commitments.[318] However, the MFN provision gives Members the opportunity to maintain measures that are inconsistent with the MFN treatment, provided that such measures are listed in and meet the conditions of the Annex on Article II Exemptions.[319]

The MFN obligation has direct implications for free zone regimes. First, free zones that host service suppliers must be open for any foreign service supplier with a commercial presence in the territory of the Member where the free zone is located, regardless of the supplier's origin. Second, customs duty exemptions fall within the meaning of "measures" affecting trade in services.[320] Hence, customs duty exemptions granted by free zone regimes on the import of goods necessary for the supply of services must be extended to goods originating in any WTO Member. Extending the duty-free exemption to goods from Member A or B, but not extending the same treatment to goods originating from Member C or D, can breach the GATS MFN obligation.

4. Implications for MERCOSUR countries

Fiscal incentives included in the Uruguayan Law on Free Zones are available for natural or legal persons, national or foreigner, and, therefore, on their face, they are not discriminatory. However, the statute authorises free zone users to supply certain types of services from the free zone to the national customs territory.[321] The statute further stipulates that the Executive Power may authorise the supply of new services from the free zone to the national customs territory.[322] Since 2006, the Executive Power has exercised this power on three occasions. At present, there are a number of services that can be supplied from the free zone to the national customs territory, including, *inter alia*, software development services, IT consultancy services, and IT training services. In turn, Uruguay's GATS schedule includes a full commitment to national treatment on computer and related services for modes 1, 2, and 3. As long as the free zone users supply the services to the national customs territory under the same conditions that are applicable to the supply of services by like foreign service suppliers with a commercial presence in the Uruguayan territory but operating outside the free zone, there is no risk of inconsistencies with Uruguay's national treatment obligations.[323] However, if free zone users were allowed to take advantage of any of the incentives offered by the free zone regime, while competing with like foreign service suppliers not entitled to such incentives, there could be a risk of discriminatory treatment in breach of the NT standard. [324]

Similar concerns can be raised with respect to the incentives offered by the Paraguayan free zone regime. This statute also allows free zone users to direct part of their sales to customers located in the national customs territory, provided certain conditions are met. Allowing a narrow group of service suppliers to access the domestic market under a tax regime more beneficial than that which is applicable to like foreign service suppliers established in the Paraguayan territory, but outside the free zone, could be regarded as discriminatory behaviour that is inconsistent with national treatment obligations on service sectors where specific commitments have been undertaken. But, so far, given the fact that Paraguayan-specific GATS commitments are almost non-existent, these concerns remain at a purely speculative level.

Brazilian Export Processing Zones are open only to companies dedicated to the manufacturing and export of goods, although the situation could change in the future.[325] Again, even if this occurs, the chances for inconsistencies are minimal since Brazil's GATS commitments are quite modest.

Argentina's free zone incentives are offered to natural or legal persons, national or foreigner.[326] There is no *de jure* discrimination against foreign service providers, and there is no apparent reason to infer a *de facto* discriminatory situation. However, the Argentinean law stipulates that free zones should become a development centre in the areas where they are established by employing human resources and using other resources available in those areas in accordance with the provisions of the statute and subordinated legislation.[327] Imposing a specific requirement on free zone users to use, for example, local service suppliers available in the area where the free zone is located is clearly discriminatory against like foreign service suppliers that are not located in that area and, depending on the specific commitments undertaken, could be inconsistent with the NT obligation. So far, however, there is no evidence that subordinated legislation has imposed specific local content requirements in such a way.

In summary, save for the minor concerns expressed above, MERCOSUR countries' free zone incentives are not inconsistent with GATS disciplines. The main reason for this is that MERCOSUR countries' GATS commitments, which determine the scope of application of existing disciplines, are limited to only a very narrow number of service sectors and modes of supply. The situation could change in the future if, as a result of multilateral negotiations, MERCOSUR countries opt for extending their GATS commitments to new sectors and modes of supply. GATS disciplines on subsidies, which are currently being negotiated, could eventually outlaw some of the current incentives offered by free zone regimes, but no meaningful results are expected from these negotiations in the short to medium term. By contrast, some free zone incentives are inconsistent with the ASCM. Since this agreement is only applicable to trade in goods, it should not affect the consistency of these incentives when the beneficiary is a service supplier. However, if challenged, an inconsistency between a free zone incentive and the ASCM could require an amendment of the free zone regime, affecting the offshore service suppliers that operate within the free zone.

IV. Suitability of free zones for the promotion of the offshore industry

MERCOSUR countries' free zone regimes offer attractive benefits to any kind of foreign investor, including multinational corporations seeking suitable offshore locations. To start with, they offer generous fiscal incentives. By way of example, in Paraguay, free zone users are exempted from any national, regional, or municipal taxes, except the single free zone tax, whereas, in Uruguay, free zone users are exempted from any national taxes, either existing or to be created in the future, except contributions to the social security system. In addition, free zones offer attractive regulatory incentives such as trade facilitation measures, a more liberal regime for foreign currency earnings, and, in the Uruguayan case, an exemption from national monopolies. Finally, free zone users get access to top notch infrastructure and services. It has also been suggested that the location of a considerable number of blue chip companies in a specially designated geographical space facilitates business networking and encourages positive synergies. However, a closer look at the particular needs of multinational corporations seeking an overseas destination for offshoring purposes, the cost of free zone incentives, and the expected benefits from them for the host country raise serious concerns about the efficacy of this policy instrument for the promotion of the offshore industry.

Offshoring is not purely a savings exercise. A multinational corporation would normally decide to outsource part of its business process to an offshore location as a means to boost its competitiveness by saving costs and achieving efficiency gains without undermining the quality of its products or services. Hence, a range of factors influences a corporation's decision whether to offshore and, more importantly, where to offshore part of its business process.[328] At the top of the list is the quality of the IT and communications infrastructure. Cross-border digital provision of services requires low-cost, high-performance, and reliable broadband services and acceptable levels of internet security. Access to a sufficiently deep pool of appropriately trained graduates is also crucial. This is not just about cheap labour; it is about the capacity of the job market to meet a quantitative and qualitative surge in demand for jobs that require, at a minimum, an appropriate level of IT skills, but also a range of soft skills such as communication, problem-solving, and critical thinking skills and, most probably, a good command of the English language. Since offshore services are delivered online, the quality of the legislation that supports and protects electronic business and communications also matters, in particular protection of intellectual property rights and data, privacy protection

of information sent across the wire, and a tough approach to combating illegal online activity. Last, but not least, as is the case with any foreign investor, multinational corporations looking for a suitable offshore destination will certainly take into account the capacity of the host country to offer a stable, open, and transparent business environment, including low overhead costs, an efficient bureaucracy, transparent and consistent regulations and a strong political commitment to open trade, receptiveness to foreign investment, and private property protection.[329]

In light of the above, the need for direct incentives to encourage the development of the offshore industry should not be taken for granted. On the contrary, from a market-based perspective, the transfer of public funds to a specific group of market players should be thoroughly justified, and, in principle, there is nothing to suggest that the offshore industry must be supported with public funds to flourish. Other things being equal, fiscal and regulatory incentives can tip a foreign investor's preference for one particular location over another, but the variety of factors at stake influencing a multinational corporation's choice for a particular offshore location questions the rationale of a trade policy instrument designed to attract offshore business solely or primarily based on fiscal and regulatory incentives. In addition, free zones are a goods-biased trade policy instrument predominantly used for promoting export-oriented manufacturing activities rather than offshore services. Not surprisingly, typical incentives offered by free zones, such as exemptions from import duties levied on inputs consumed in the production of the exported product and simplified customs procedures for imports and exports, are only relevant for manufacturers of goods.[330]

The efficacy of other fiscal incentives in attracting offshore businesses is also unclear, particularly the generous direct tax exemptions offered by some free zones. Despite the fact that these types of fiscal incentives are commonly used to attract foreign direct investment, their relative advantages and disadvantages have never been clearly established.[331] It has been suggested that fiscal incentives are secondary to more fundamental determinants of investment decisions, such as market characteristics, relative production costs, resource availability, skill levels, political and economic stability, and the quality of the regulatory framework.[332] It is only among countries with similar characteristics in these areas that fiscal incentives can play a more significant role. But even in these types of situations, an inappropriate use of incentives may create undesirable market distortions, for example, favouring large corporate investors with higher bargaining power to the detriment of small investors, or foreign companies over domestic companies.[333]

Also, from a host country's perspective, it is expected that the opportunity cost of waiving fiscal obligations to foreign investors should be outweighed by a long list of positive spillovers for the local economy, including, *inter alia*, job creation, revenue generation, transfer of technology, and improvement of the national business culture.[334] But the specialised literature indicates some degree of discrepancy regarding the costs and benefits of free zones.[335] One of the concerns that has been raised regarding free zones refers to their linkages with the rest of the economy. In the manufacturing sector, the ILO has found backward linkages of free zones with the local economy to be minimal, with only 3 to 9 percent of inputs being purchased on the domestic market due to the inability of local producers to meet world market standards for price, quality, and delivery terms.[336] In the service sector, it has been suggested that the potential for linkages with the local economy differs by industry.[337] For instance, in the area of R&D, foreign affiliates may engage in cooperative projects with local companies, universities, or technology institutions, whereas, in the software development sector, foreign affiliates derive most of their income from exports to their parent companies, generating few knowledge spillovers for the domestic economy.[338] Using free zones as a means to attract foreign companies in the latter sector can only reinforce the enclave nature of their operations. The chances for maximizing the returns on fiscal incentives are also compromised by the fact that some investments in the offshore sector are of a "footloose" character, i.e., a type of investment characterised by a relatively weak lasting interest to remain in any particular country and one that does not attract high transaction costs should the investor decide to change location.[339] From the host country's perspective, fiscal exemptions linked to spending on training, research, and development or quality certification appear to be more likely to deliver better value for money than flat exemptions on income taxes.

In summary, the key factors taken into account by multinational corporations when choosing an offshore destination are the quality of the IT and communications infrastructure, the availability of a sufficiently large and appropriately trained workforce, and a friendly business environment. The limited influence of fiscal incentives on multinational corporations' decision-making process, the fact that free zones are a goods-biased trade policy instrument that overlooks the particular needs of trade in services, and the absence of conclusive evidence suggesting that free zones' benefits outweigh their costs raise questions about the merits of this policy instrument for the promotion of the offshore industry, particularly when it is not accompanied by a broader strategy aimed at strengthening other factors that influence destination preferences.

V. Other mechanisms for the promotion of the offshore industry

The fundamental reasons for outsourcing business processes overseas and the factors affecting the comparative advantages of offshore destinations call for a carefully designed and comprehensive support strategy for the offshore industry that goes beyond the mere waiving of fiscal obligations. Such a strategy should include a range of actions in different areas, with governments playing an active role in providing an adequate physical and legal infrastructure, boosting the quality of the country's human capital, creating a supporting environment for research and development, and securing the conditions for a business-friendly environment. This does not suggest that incentives involving the direct allocation of public resources to specific beneficiaries by way of fiscal exemptions or financial grants should not be used. However, it calls for using them with caution, weighting the type and number of incentives to be offered against their expected returns, and, more importantly, complementing such incentives with other types of actions aimed at ensuring that the fundamental determinants for an attractive offshore destination are in place. The following paragraphs examine different areas where governments can intervene in order to establish an enabling environment for the offshore industry to flourish, and provide examples both from MERCOSUR countries and beyond.

A. Improving IT and communications infrastructure

The prospects for development of the offshore industry are inextricably linked to the quality of the IT and communications infrastructure, which is exemplified, *inter alia*, by extensive personal computer ownership, broadband penetration, access to wireless devices and all types of communication networks, as well as fast and safe internet service providers. A strong IT and communications infrastructure is likely to foster the country's credibility with regard to attracting outsourced branches of foreign companies, and, as long as this infrastructure is reliable, it will also encourage foreign companies to directly purchase the services provided by national companies. But upgrading a country's IT and communications infrastructure is expensive and requires large-scale investments. Given its strategic importance not only for the offshore industry, but also for the competitiveness of all sectors of the economy, there is a strong case for government intervention in this matter, either through public investment or by harnessing private investment within clearly set public policy goals.

Examples of government initiatives aimed at improving the IT and communications infrastructure include the four-year plan of Taiwan's government to deploy a national WiMAX network, an initiative which, in addition to improving connectivity, is meant to spur the local development of related software and design services.[340] The Indian Department of Information Technology (DIT) runs the Information Technology Investment Regions (ITIRs) scheme under which each state in India can set up an integrated township for facilitating growth of IT-BPO with world class infrastructure.[341] The Sri Lankan Information and Communication Technology Agency (ICTA) is building connectivity infrastructure such as the installation of information and communication backbones (Rural Telecom Network) to provide competitive and affordable telecommunications services, including a network of service delivery centres (Nenasalas) to empower the population in the rural areas of the country with affordable access to information and communication technologies. [342]

B. Training the workforce

Given its breathtaking pace of growth, one of the major challenges for the offshore industry in remaining competitive is the capacity of the local job market to meet the demand for increasing numbers of appropriately trained IT-BPO professionals. At a minimum, appropriate training includes basic IT skills, foreign language skills, and soft skills such as communication, problem-solving, and critical thinking skills. But, bearing in mind that the types of skills required can change quickly, it is also important to have in place flexible educational and vocational training systems that can easily adapt their curricula to current market trends. A key element for success in this respect is to improve the coordination between institutions of higher education and the private sector. The difficulty for many countries is that universities cannot always respond quickly to the changing demands for employers. Otherwise, good working relationships between business and universities can make the difference.

Governments have a direct role to play in securing an appropriately trained workforce for the offshore industry by ensuring universal access to high-quality education, including, where possible, the teaching of foreign language skills, but also by creating enabling conditions for the private sector to participate in training services and by encouraging the industry to train its own employees. In India, the central and state governments, together with the private sector, have es-

tablished a network of universities specialised in technology: the Indian Institutes of Technology (IIT) and the Indian Institutes of Information Technology (IIIT). A dedicated agency known as the All India Council of Technical Education (AICTE) is responsible for fostering collaboration between educational institutions and industry associations with a view to reviewing curricula to ensure their quality and relevance for the industry. Pushed by the National Association of Software and Services Companies (NASSCOM), in 2008, the Indian government agreed in a Detailed Project Report[343] to create 20 more IIITs. These institutes are meant to be organised on a Private-Public Partnership (PPP). Each IIIT will be fully autonomous, with important funding from private institutions, which will also send their experienced employees as visiting faculty members.[344] The government also provides support for "finishing schools," i.e., training institutions run by private firms aimed at enhancing soft skills among fresh graduates.[345]

Some governments use fiscal incentives to encourage the industry to train its own employees. Brazil, for example, offers IT and communications companies tax deductions of 200 percent of the amount spent on training their employees.[346] Argentina[347] and Chile[348] also offer companies tax credits for expenses incurred in training their employees. In Chile, training may be provided internally or by external services authorised by the National Service for Training and Employment run by the Ministry of Labour. In Jamaica, employers are eligible for a reimbursable training grant, which is administered by the state agency responsible for vocational training. Companies may access training grants up to a maximum of 20,000 Jamaican dollars per employee.[349] The government of Croatia also offers incentives for vocational training or retraining of employees (up to 50 percent of related costs are tax deductible).[350] In these cases, the concern of creating market distortions is minimised by the fact that, in the majority of cases, the incentives offered are of a horizontal character, i.e., available to any company across all economic sectors. Concerns about the value for money of the incentives are also minimised by the fact that the money saved by beneficiaries in forgone taxes must be spent on training, increasing the chances for positive spillovers.

C. Encouraging research and development

When it comes to offshoring, higher value-added processes, such as financial analysis, data mining, engineering and architectural design, distance learning or telemedicine, and a supportive environment for research and development, become key determinants for the competitiveness of

the sector, helping IT firms—particularly smaller ones—to develop or gain access to innovative solutions.[351]

Governments can play a significant role in creating a supportive environment for research and development, primarily through public investment in higher education, but also by way of encouraging strong ties between the university system and the industry. Universities play a key role in producing the knowledge that the industry needs to survive in a highly competitive environment, which underscores the strategic importance of aligning universities' research output with industry needs. For example, in Egypt, the Information Technology Industry Development Agency (ITIDA) established the Information Technology Academia Collaboration (ITAC) initiative, which runs programmes aimed at linking academic research with industry and market needs. Also, the Product Development Projects (PDPs) and the Advanced Research Projects (ARPs) provide research funding for partnerships between research institutions and ICT industrial partners.[352] In India, the DIT supports various research and development programmes in the IT sector, aimed at developing new technologies and making existing technologies more affordable to the people. A number of academic institutions have been financially supported by the DIT to carry out R&D projects in the field of e-Learning.[353] The recent creation by Xerox of an innovation hub offers a good example of the way in which ties between industry and universities can be developed. Located in the city of Chennai, it will enable Xerox to expand and build on the strong partnerships with India's top technical and business schools. Professor Timothy Gonsalves, director of IIIT Mandi, notes that students and professors of IIIT Madras and IITM's Rural Technology Business Incubator have benefited tremendously by working closely with Xerox researchers on business challenges specific to India. This kind of partnership is likely to be extended all across India.[354]

In MERCOSUR countries, there is a lot that can be done in order to improve the relationship between industry and universities, and there are already promising initiatives that should be further developed such as the agreement between the free zone in the province of Cordoba, Argentina (ZOFRACOR SA) and Universidad Nacional de Cordoba for the provision of highly specialised professional services in areas such as electronics, engineering, hydraulics, and transport.[355]

Fiscal incentives can also be used to encourage research and development. In Brazil, for example, the Law on Capacity Building and Competitiveness Enhancement in Information Technology offers a range of fiscal incentives to encourage IT companies to invest in research and development, create new products, and improve the sector's competitiveness, with initiatives such as

a reduction in the Tax on Industrialised Products (IPI) levied on domestic purchases and imports of equipment for research and development and software materials.[356]. The beneficiaries are IT companies that manufacture IT goods or provide IT services through tax credits provided by the federal government or research institutes, centers, and laboratories, and through financial support from IT companies that choose to outsource the execution of research projects. To qualify for the incentives, IT companies must invest at least 5 percent of the turnover from product sales (after the deduction of other indirect taxes) and the value of the acquisition of the products benefited by the programme in research and development.[357] In the same vein, Chile provides R&D incentives to taxpayers who have R&D contracts in excess of 100 UTM (monthly tax units) with CORFO (Corporación de Fomento de la Producción de Chile) registered research centers. The tax break is equivalent to 35 percent of the total amount paid for R&D contracts certified by CORFO.[358]

It remains to be seen whether direct tax exemptions are an effective mechanism for encouraging research and development. The Australian government, for example, initially opted for offering a direct tax allowance of 150 percent for R&D expenses on software development and computing services.[359] But, upon review, the Australian Productivity Commission noted that, although the incentive brought net benefits for the Australian economy, it was of no help to companies that did not generate taxable profits, which is common among IT companies during their first years of operation.[360] A decision was therefore made to offer grants instead of direct tax allowances to fledging and unprofitable IT companies.[361] In the same vein, India set up a National Venture Fund for the Software Industry to facilitate access to capital for BPO provider start-ups.[362]

D. Upgrading the legal framework

One of the fundamental enabling conditions for the growth of the offshore industry is to have in place a modern legal framework suitable for supporting and protecting online business. Key legal areas of this framework should include strict intellectual property laws in the form of patents, copyright trademarks, and trade secrets to protect innovation (including adequate enforcement), data privacy and anti-spam laws, electronic signatures, and cyber crime laws.

For example, in Sri Lanka, the Information and Communication Technology Agency (ICTA**)** has been working on regulatory reforms for the purpose of creating an efficient legal environment for e-government and e-commerce, including the adoption of an electronic transactions

act.[363] Likewise, the Egyptian government has recently embarked on an ambitious legal reform plan. It includes the introduction of a new intellectual property law and an intellectual property rights office responsible for administering a national copyright system (2002) and an e-Signature Law together with the establishment of a regulatory authority responsible for overseeing and facilitating the use of e-signatures (2004). In India, NASSCOM campaigned for the introduction of stronger intellectual property (IP) laws against the wishes of the pharmaceutical industry. Finally, in 2004, the Indian government amended its Patents Act to make it compliant with the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), the World Trade Organization's intellectual property regime.[364]

E. Providing targeted support for the local IT-BPO sector

Governments can play an active role in providing an adequate physical and legal infrastructure, boosting the quality of a country's human capital, creating a supporting environment for research and development, and securing the conditions for a business-friendly environment. Governments can also provide targeted support for local IT-BPO firms to encourage their participation in the non-captive offshore market. This usually includes the provision of direct funds by way of fiscal exemptions or the transfer of grants for a specific group of beneficiary firms.

For example, Argentina has in place a regime for the promotion of the software industry, which includes generous fiscal exemptions for local companies, whose purpose consists of designing, developing, producing, and implementing software.[365] The regime also includes a fund (FONOSOFT) that provides beneficiary companies with financial support for research and development, training of human resources, quality improvement of software development processes, and so forth. Likewise, Brazil adopted a Law on Capacity Building and Competitiveness Enhancement in Information Technology, which also offers a range of fiscal incentives to encourage IT companies to invest in research and development, create new products, and improve the sector's competitiveness.[366] This is complemented by the Programme for the Development of the National Software and Related Software Industry (PROSOFT), funded by the Brazilian Development Bank, which offers a range of financing facilities specifically designed for the IT sector, including IT outsourcing (for instance, data centres), IT-enabled services, and BPO services.[367] *PROSOFT Export* provides financial support for the development of software and IT services for export (BNDES Exim Pré-embarque), as well as financial

support for marketing Brazilian IT products and IT services abroad through the discounting of bills or transfers of receivables relating to exports (BNDES Exim Pós-embarque). In Uruguay, there is a general regime for the promotion and protection of investments that offers a wide range of fiscal incentives for investments declared to be of national interest by the Executive Branch.[368] Software development has been declared an activity of national interest within the meaning of this regime, and hence is entitled to the specific fiscal benefits specified therein.[369]

As mentioned, targeted incentives involving direct transfers of public funds to a specific group of beneficiaries must be used with caution. Governments must strike a delicate balance in finding the right formula to encourage sector growth without introducing market distortions. There are at least two reasons for being extremely careful about using narrowly targeted incentives for promoting local IT-BPO firms. In the context of a dynamic knowledge-based economy where the service sector is constantly evolving, it is very difficult to determine the correct scope of the beneficiaries. Firms that appear today to offer promising prospects for development can lose competitiveness very quickly. By contrast, the bureaucracy responsible for designing, allocating, and administering such incentives does not always has all of the information necessary to decide whether or not incentives should be granted.. It moves slowly, and, once an incentive is granted, it may be subject to pressure by lobbyist groups to keep it running at all costs.

Adequate procedures for the design and management of incentives can prevent, or at least minimize, the risk of market distortions. Such procedures should include, *inter alia*, a mechanism for coordination between the public and private sectors that gives the latter the opportunity to participate in the design, implementation, and evaluation of incentives and, at the same time, is sufficiently transparent to prevent undue pressures and rent-seeking behaviour.[370] Likewise, public bodies should have some degree of discretion to adjust the incentives to respond to changing circumstances, albeit limited by a clearly set legal framework with sufficient checks and balances that reduce the opportunity for inappropriate administrative behaviour.[371] Good management also involves the ongoing evaluation of incentives in light of their efficiency, impact, and relevance.[372]

Governments can also provide targeted support for local offshore service suppliers without the need to offer specific fiscal or financial incentives. For example, the Indian Department of Information Technology set up a center for accreditation and recognition called the Standardisation Testing and Certification (STQC) Directorate in order to support local firms in meeting the quality assurance requirements necessary to break into foreign markets subject to strict quality controls.

The directorate provides quality assurance services in the area of Electronics and IT through a countrywide network of laboratories and centers. It includes six IT centers for Software Quality Testing, Information Security, and IT Service Management that provide assurance services conducting testing, training, auditing, and certifications. It is responsible for maintaining the e-government standards. Two IT test laboratories at Bangalore and Kolkatta are the first outside the United States to receive accreditation from the American Association for Laboratory Accreditation (A2LA).[373] Governmental agencies can also provide marketing assistance for the promotion of local IT-BPO firms in foreign countries, including logistical assistance for attending international fairs and other marketing events, and the provision of marketing intelligence and networking opportunities. For example, the Indian government has a special agency— the Indian Electronic and Software Export Promotion Council —that is expressly dedicated to helping the local IT industry in promoting software exports.[374]

In summary, when it comes to choosing mechanisms for supporting the offshore industry, there is a strong case for government intervention by way of improving IT and communications infrastructure, training the local workforce, encouraging research and development, upgrading the legal framework, and securing a business friendly-environment. Governments can also offer fiscal and financial incentives to specific beneficiaries, but, if they do, they should opt for the types of incentives with a greater chance to deliver value for money and always as part of a broader strategy aimed at putting in place the enabling conditions for the offshore industry to grow.

VI. Conclusions

This paper discussed the suitability of using free zones as a mechanism for the promotion of the offshore industry in MERCOSUR countries, both from a legal and a broader policy perspective. From a legal perspective, the paper examined the consistency of the fiscal incentives offered by MERCOSUR countries' free zone regimes with the WTO agreements. There is no reference to free zones in the WTO agreements. But that does not mean that free zone incentives fall outside the scope of application of WTO disciplines. There are disciplines both on trade in goods and on trade in services that restrict the offering of incentives in a discriminatory way or in other ways that may have trade distorting effects.

Some of the incentives offered by MERCOSUR countries' free zone regimes are inconsistent with the Agreement on Subsidies and Countervailing Measures (ASCM). The most controversial ones are exemptions of direct taxes otherwise due by free zone users, exemptions of customs duties on the import of capital goods, exemptions of payment of social welfare charges, unqualified exemptions on payment of indirect taxes, and the supply of goods or services to free zone users at promotional rates. Since the ASCM is only applicable to trade in goods, this should not affect the consistency of any of these incentives when the beneficiary is a service supplier. However, if challenged, an inconsistency between a free zone incentive and the ASCM could require amendment of the free zone regime, affecting the offshore service suppliers that operate within the free zone. By contrast, no significant inconsistencies between free zone incentives and the General Agreement on Trade in Services (GATS) have been found. The main reason for this is that the GATS commitments of MERCOSUR countries, which determine the scope of application of existing disciplines, are limited to only a very narrow number of service sectors and modes of supply. The situation could change in the future if, as a result of multilateral negotiations, MERCOSUR countries opt for extending their GATS commitments to new sectors and modes of supply. The GATS disciplines on subsidies, which are currently being negotiated, could eventually outlaw some of the current incentives offered by free zone regimes, but no meaningful results are expected from these negotiations in the short to medium term.

From a broader policy perspective, this paper questioned the merits of using free zones for the promotion of the offshore industry. In principle, free zones offer attractive benefits to foreign investors by way of generous fiscal incentives and top-notch infrastructure and services. But a

closer look at the particular needs of multinational corporations seeking an overseas destination for offshoring purposes, the cost of free zone incentives, and the expected benefits from them for the host country raise some concerns about the efficacy of this policy instrument for the promotion of the offshore industry, particularly when a broader support strategy including other type of measures is not in place.

Offshoring is not purely a savings exercise. A multinational corporation would normally decide to outsource part of its business process to an offshore location as a means to boost its competitiveness by saving costs and achieving efficiency gains without undermining the quality of its products or services. Hence, a range of factors influences a corporation's decision whether to offshore and, more importantly, where to offshore part of its business process, including the quality of the IT and communications infrastructure, the availability of a sufficiently large and appropriately trained workforce, a legal framework suitable for e-transactions, and a business-friendly environment. By contrast, free zones offer fiscal incentives such as exemptions of import duties levied on inputs consumed in the production of the exported product as well as simplified customs procedures for exports and exports that are only relevant for the manufacturing industry. Some free zones also offer direct tax exemptions, but they only have a moderate capacity to attract FDI, in particular "footloose" investments, which are not uncommon in the offshore sector due to the relatively low transaction costs associated with relocation. In addition, evidence regarding free zones' achievement of their original policy objectives remains inconclusive in particular because the creation of segregated geographical enclaves limits the possibility for positive spillovers on technology transfer or the improvement of the national business culture.

Since MERCOSUR countries' policies aimed at supporting the offshore industry are relatively new, there is plenty of room for improvement. This paper suggests two areas to focus on. First, bearing in mind the fundamental reasons for outsourcing business processes to overseas territories and the factors affecting the comparative advantages of offshore destinations to attract these processes, there is a need for more comprehensive policies that go beyond the mere waiving of fiscal obligations. Such policies should be aimed at establishing the enabling conditions necessary for the offshore industry to grow, and they should include various types of actions in different areas, with governments playing an active role in providing an adequate IT and communications infrastructure, boosting the quality of the country's human capital, upgrading the legal framework,

creating a supporting environment for research and development, and securing the conditions for a business-friendly environment.

Within this broader approach, one dimension that deserves particular attention is the need to improve the coordination between institutions of higher education and the private sector for training and R&D purposes. The capacity to produce a multi-skilled workforce capable of adapting to changes in technology is crucial for the competitiveness of the offshore sector. Higher education plays a key role in delivering the training skills and producing the knowledge that the industry needs for succeeding in a highly competitive environment. The Indian experience provides compelling evidence regarding the benefits of strong partnerships between universities and the private sector for the offshore industry. MERCOSUR countries have a lot to improve in this area, but there are already promising initiatives that should be further developed such as the agreement between the free zone in the province of Cordoba, Argentina (ZOFRACOR SA) and *Universidad Nacional de Cordoba* for the provision of highly specialised professional services in areas such as electronics, engineering, hydraulics, and transport.

The second area in which there is clear room for improvement is in the use of fiscal incentives. It has been argued that incentives involving the direct allocation of public resources to specific beneficiaries by way of fiscal exemptions or financial grants should be used with caution, weighting the type and number of incentives to be offered against their expected returns, and, more importantly, complementing such incentives with other types of measures aimed at ensuring that the fundamental determinants for an attractive offshore destination are in place. Fiscal exemptions linked to spending on training, research, and development or quality certification are more likely to deliver better value for money than flat exemptions on income taxes and are less likely to be challenged for alleged inconsistencies with multilateral trade disciplines. Governments must set up adequate procedures for the management of the incentives to address the overlap between different support programmes and the lack of coordination between different public bodies responsible for running them. This is particularly relevant for federal systems such as those in Argentina and Brazil, where both the central government and provincial governments may offer incentives. Quite often, there is no coordination between these entities concerning the total package of tax benefits that investors finally receive. [375] Finally, procedures for the ongoing evaluation of incentives in light of their efficiency, impact, and relevance should also be used.

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Acronyms and Abbreviations

A2LA	American Association for Laboratory Accreditation
ABRAZPE	Associação Brasileira de Zonas de Processamento de Exportação
AFIP	Administración Federal de Ingresos Públicos
AFRMM	Import Freight Surcharge for the Renewal of the Merchant Navy
AICTE	All India Council of Technical Education
ARPs	Advanced Research Projects
ASCM	Agreement on Subsidies and Countervailing Measures
BICE	Banco de Inversion y Comercio Exterior
BNDES	Banco Nacional de Desenvolvimento Econômico e Social
BPO	Business Process Outsourcing
BPP	Basic Productive Process
BRASSCOM	Brazilian Association of Information Technology and Communication Companies
CEPAL	Comisión Económica para América Latina
CNIME	National Council of Maquila Export Industries
COFINS	Contribuição para o Financiamento da Seguridade Social
CONATEL	Comisión Nacional de Telecomunicaciones
CONFAZ	Conselho Nacional de Política Fazendária
COPACO	Compañía Paraguaya de Comunicaciones S.A
CORFO	Corporación de Fomento de la Producción de Chile
CZPE	Conselho Nacional das Zonas de Processamento de Exportação
DINAPYME	Direccion Nacional de Artesanias Pequenas Y Mediana Empresas
DIT	Indian Department of Information Technology
DPR	Detailed Project Report
EPZs	Export Processing Zones
EU	European Union
FCO	Fundos Constitucionais de Financiamento do Centro-Oeste
FDI	Foreign Direct Investment
FIESP	Federação das Indústrias do Estado de São Paulo
FLASCO	Faculdade Latino-Americana de Ciências Sociais
FONOSOFT	Fondo Fiduciario de Promoción de la Industria del Software
FTZ	Free Trade Zone
FUNRES	Fundo de Recuperação Econômica do Estado do Espírito Santo
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product

GNI	Gross National Income
GNP	Gross National Product
GPA	Government Procurement Agreement
IADB	Inter-American Development Bank
ICMS	Imposto sobre Circulação de Mercadorias e Serviços
ICT	Information and communication technologies
ICTA	Information and Communication Technology Agency (in Sri Lanka)
IIIT	Indian Institutes of Information Technology
ILO	International Labour Organization
INSS	Instituto Nacional de Segurança Social
INT	Trade and Integration Sector
IPI	Imposto Sobre Productos Industrializados
IPTU	Imposto Predial e Territorial Urbano
IRAE	Impuesto a la Renta de las Actividades Económicas
IRIC	Impuesto a la Renta de Industria y Comercio
IRPF	Impuesto a la Renta de las Personas Físicas
ISS	Imposto Sobre Servicos
ITAC	Information Technology Academia Collaboration (in Egypt)
ITIDA	Information Technology Industry Development Agency (in Egypt)
ITIRs	Information Technology Investment Regions
ITO	Information Technology Outsourcing
ITT	Indian Institutes of Technology
IVA	Impuesto al Valor Agregado
KPO	Knowledge-Process Outsourcing
LATU	Laboratorio Tecnológico del Uruguay
MDIC	Ministério do Desenvolvimento, Indústria e Comércio Exterior
MERCOSUR	Mercado Común del Sur
MFN	Most Favoured-Nation treatment
MNC	Multinational Corporation
NASSCOM	National Association of Software and Services Companies
NFAP	National Foundation for American Policy
NT	National Treatment
OECD	Organisation for Economic Co-operation and Development
PASEP	Programa de Formação do Patrimônio do Servidor Público
PDPs	Product Development Projects
PIS	Programa de Integração Social
PPP	Private-Public Partnership
PROEX	Programa de Financiamento às Exportações Brasileiras

PROSOFT	Programme for the Development of the National Software and Related Software Industry
SELIC	Sistema Especial de Liquidação e Custodia
SEPYME	Subsecretaría de la Pequeña y Mediana Empresa y Desarrollo Regional
SEZ	Special Economic Zone
SMEs	Small and Medium Enterprises
STPs	Software Technology Parks
STQC	Standardisation Testing and Certification
SUDAM	Superintendência do Desenvolvimento da Amazônia
SUDENE	Superintendência do Desenvolvimento do Nordeste
SUFRAMA	Superintendence for the Manaus Free Zone
TRIPS	Agreement on Trade-Related Aspects of Intellectual Property Rights
TPRs	Trade Policy Reviews
UGC	University Grants Commission
UNCTAD	United Nations Conference on Trade and Development
VAT	Value Added Tax
WIR	World Investment Report
WITSA	World Information Technology and Services Alliance
WPGR	Working Party on GATS Rules
WTO	World Trade Organization
ZFM	Manaus Free Trade Zone
ZPE	Zonas de Protección Especial

Endnotes

1 Maurice F. Greaver, "Strategic Outsourcing. A structural approach to outsourcing decisions and initiatives," (1999), American Management Association, New York, cited by World Trade Report (WTO, 2005), p. 266.2

2 E.g., programming, systems integration, application testing, IT infrastructure management and maintenance, IT consulting, software development and implementation services, data processing and database services, IT support services, data warehousing, and content management and development (UNCTAD, Information Economy Report 2009).

3 E.g., "front office services" such as call centres and customer contact centres and "back office centres" such as data entry, human resources, payroll, finance and accounting, procurement, transcription, and insurance claims processing (UNCTAD, Information Economy Report 2009).

4 E.g., financial analysis, data mining, engineering, research and development, architectural design, remote education and publishing, medical diagnostic, and journalism (UNCTAD, Information Economy Report 2009).

5 UNCTAD, Information Economy Report 2009.

6 Ibid.

7 According to UNCTAD's Information Economy Report 2009, in 2004, five countries—Canada, China, India, Ireland, and the Philippines—accounted for as much as 95 percent of the total market for business process offshoring.

8 UNCTAD, Information Economy Report 2009.

9 Ibid.

10 Ibid.

11 Ibid.

12 The expression "MERCOSUR countries" is used for ease of reference to Argentina, Brazil, Paraguay, and Uruguay. Venezuela's application for full MERCOSUR membership is still pending and, hence, this study does not take this country into account.

13 International Convention on the Simplification and Harmonization of Customs Procedures, Revised Kyoto Convention, Annex D, Chapter 2.

14 These types of free zones known as export processing zones have been defined by the International Labour Organization as an "industrial zone with special incentives set up to attract foreign investors, in which imported materials undergo some degree of processing before being exported again." See ILO document (TMEPZ/1998), "Labour and social issues relating to export processing zones," Report for discussion at the Tripartite Meeting of Export Processing Zones – Operating Countries, (Geneva, 1998), p. 3.

15 According to the ILO, in 2006 there were 3,500 Export Processing Zones or similar types of zones distributed in 130 countries and employing 66 million people. See Jean-Pierre Singa Boyenge, "ILO database on export processing zones (revised)," (2007), ILO Working Paper.

16 Raúl A. Torres, "Free Zones and the WTO Agreement on Subsidies and Countervailing Measures," (2007), Global Trade and Customs Journal, Vol. 2.

17 Akinci, G. and J. Crittle (2008), Special Economic Zones: Performance, Lessons Learned, and Implications for Zone Development. Washington DC: The World Bank.

18 Luis Abugattas Majluf, "State Support Measures for Services: An Exploratory Assessment with Scanty data," (2005), UNCTAD Document for Discussion, p 22. In the same vein, Geloso Grosso, Massimo, "Analysis of Subsidies for Services: the Case of Export Subsidies," (2008), OECD Trade Policy Working Papers No. 66, (TAD/TC/WP(2007)15/FINAL), paragraph 71.

19 WTO document (WT/TPR/S/180/Rev.1), Trade Policy Review, Report by the Secretariat, Costa Rica (2006).

20 UNCTAD document (UNCTAD/ITE/IPC/Misc.3), "Tax Incentives and Foreign Direct Investment: A Global Survey," (2000), ASIT Advisory Studies No. 16, p. 84.

21 WTO document (S/WPGR/25/Add.5) "Subsidies for Services Sectors: Information Contained in WTO Trade Policy Reviews," Background Note by the Secretariat, (2007); cited by Geloso Grosso, 2008, op. cit., p. 24.

22 For recent evidence about the positive externalities of BPO, see: ITC Thematic Paper, "Business Process Outsourcing – Lessons for Developing Countries," (2009).

23 See FIAS, "Special Economic Zones Performance, Lessons Learned and Implications for Zone Development," (2008), World Bank; Madani, Dorsati, "A Review of the Role and Impact of Export Processing Zones," (1999), WB Policy Research Working Paper No. 2238; Engman, Michael, Osamu Onodera, Enrico Pinali, "Export Processing Zones – Past and Future Role in Trade and Development," (2007), OECD Trade Policy Working Papers No. 53.

24 ILO document (GB.301/ESP/5), "Report of the InFocus Initiative on export processing zones (EPZs): Latest trends and policy developments in EPZs," (2008).

25 UNCTAD, WIR 2004, p. 208.

26 Ibid.

27 For a shorter version of this section see Gari, Gabriel "Free Zone Incentives in MERCOSUR Countries and WTO Law," *Global Trade and Customs Journal* 5, (2011).

28 The free-zone regulatory framework is also governed by Laws Nos. 5.142 of 22 September 1907, 8.092 of 30 September 1910, 24.756, O.J. of 2 January 1997, 25.005, O.J. of 18 August 1998, and 25.956, O.J. of 2 December 2004; AFIP General Resolution No. 270/1998 and its amendment No. 1879/2005; and MEP Resolution No. 42/2004. In addition, Law No. 19.640, O.J. of 2 Jun. 1972 established the Tierra del Fuego Special Customs Area, which is a different regime, not examined in this paper, which offers different benefits and it is subject to different regulations. The Tierra del Fuego Special Customs Area is allowed to operate until 2013 (WTO Trade Policy Review of Argentina (2007), WT/TPR/S/176/Rev.1, p. 76.

29 Law 24331/1994, Article 2.

30 Ibid, Article 3.

31 Argentinean Customs Code, Article 590.

32 Law 24331/1994, Article 38.

33 Ibid, Article 4.

34 Ibid.

35 Ibid, Article 5.

36 Ibid, Article 6.

37 Ibid, Articles 18 and 19.

38 Ibid, Article 20.

39 See Argentina's notification pursuant to Article XVI.1 of the GATT 1994 and Article 25 of the ASCM of 28 September 2009 (G/SCM/N/186/ARG).

40 Law 24331/1994, Article 21, and AFIP General Resolution 270/1998 of 9 December 1998, Annex II.

41 AFIP General Resolution 270/98 of 9 December 1998, Annex II.

42 See <www.zofracor.ar>, [accessed 25/03/10].

43 Law 24331/1994, Article 24, and AFIP General Resolution 270/1998 of 9 December 1998, Annex VI.I.1.

44 Law 24331/1994, Article 25.

45 Ibid, Article 27.

46 Ibid, Article 28.

47 DGA/AFIP General Instruction No. 6/2004.

48 Ibid, Article 30.

49 Ibid, Article 26.

50 Law 24331/1994, Article 32.

51 Ibid, Article 31.

52 See <http://www.zflapampa.com.ar/english/ZonaFranca/beneficios.php>, [accessed 18/03/10].

53 Law 24331/1994, Article 35.

54 Ibid, Article 8.

55 Ibid, Article 41.

56 Ibid, Article 36.

57 Ibid, Article 6.

58 Ibid, Article 7.

59 AFIP General Resolution 270/1998 of 9 December 1998, Annex VI.II.2.

60 Ibid, Annex VI.II.3.

61 Law 24331/1994, Article 6.

62 Ibid.

63 Ibid, Article 28, and AFIP General Resolution 270/98 of 9 December 1998, Annex VI.II.1 and 2.

64 Law 11508/2008, Article 1.

65 Law No. 2452/1988, of 29 July 1988.

66 Helson C. Braga, President of Associação Brasileira de Zonas de Processamento de Exportação (ABRAZPE), suggests that the opposition against the establishment of EPZs was led by José Serra (former FIESP president, current Mayor of Sao Paulo, and runner up for the Brazilian Presidency), during Fernando Henrique Cardoso's Presidency. See Tribuna do Norte, Sílvia Ribeiro Dantas, "ZPE não garante desenvolvimento," 11 April 2010, <www.tribunadonorte.com.br/noticia/zpe-nao-garante-desenvolvimento/145345>, [accessed 16/04/10].

67 See Law No. 8396/1992 of 2 January 1992 and Law No. 8924/1994 of 29 July 1994, which prohibited the sale of goods manufactured in EPZs in the domestic market. Bill number 146/1996 introduced a proposal to allow companies established in EPZs to sell up to 20 percent of their production to the domestic market, subject to the payment of taxes and duties applicable under normal circumstances. The amendments proposed by the 1996 bill have been incorporated by the current law. Previous laws on EPZs have been totally or partially revoked by Article 28 of Law No. 11508/2007.

68 The regulatory framework for EPZs is complemented by various administrative rules, including, *inter alia*, Decree No. 6634, of 5 November 2008, on the functioning and powers of the CZPE; Decree 6814, of 6 April 2009, on the fiscal, foreign exchange, and administrative regime applicable to companies operating in EPZs and Instrução Normativa RFB No. 952/2009, of 2 July 2009, on the supervision and customs control of goods located in EPZs.

69 Decree 6634/2008, Article 2.1.

70 Law 11508/2007, Article 1.

71 Ibid, Article 2 §1, and Decree 6814, Article 1 § 1.

72 According to Helson C. Braga, since the approval of Law 2452/1988, 17 permits have been granted for the creation of EPZs in the following locations: Barcarena (PA), São Luiz (MA), Parnaíba (PI), Fortaleza (CE), Natal (RN), João Pessoa (PB), Suape (PE), Aracaju (SE), Ilhéus (BA), Vila Velha (ES), Itaguaí (RJ), Teófilo Otoni (MG), Itajai (SC), Rio Grande (RS), Araguaína (TO), Cáceres (MT), and Corumbá (MS). He also mentions the fact that four of the EPZs (Teófilo Ottoni, Itajai, Araguaína, and Rio Grande) have already completed the necessary infrastructure works and are ready to start receiving companies. See Helson C. Braga, Ph.D., Zonas de processamento de exportação: o instrumento que está faltando em nossa política de exportação, (2002), available at <http://www.abrazpe.org.br/DOWNLOADS/helson_braga_08_05_2002.pdf>, [accessed 01/03/10].

73 According to Article 25 of Law 11508, the validity of authorizations for the establishment of EPZs granted before 14 October 1994 is conditioned on the initiation of implementation works by the EPZs within 12 months of the publication of Law 11508.

74 See CZPE Resolutions Nos. 8 and 9 of 17 December 2009. A Presidential Decree authorizing the EPZ in Suape was adopted on 29 January 2010. See <www.softcomex.com.br>, [accessed 25/02/10].

75 Telephone interview with Dr. Helson C. Braga, ABRAZPE President, on 23 February 2010.

76 Law 11508/2007, Article 3, and Decree 6634, Article 2.

77 Law 11508/2007, Article 2 §2.

78 Ibid, Article 2 §3.

79 Instrucao Normativa 952/2009, Article 2, §1.

80 See, *inter alia*, Articles 1 and 8 of Law 11508/2007, and various provisions of Instrucao Normativa 952, which expressly refer to the manufacturing of goods.

81 Telephone interview with Dr. Helson C. Braga, ABRAZPE President, on 23 February 2010.

82 Law 11508/2007, Article 6-A.

83 Ibid.

84 Ibid, Articles 12.II and 13.

85 Ibid, Article 6-A, §1 to §4. This means that companies located in EPZs are not subject to the general restrictions on the import of used machinery and equipment.

86 Ibid, Article 6-A, §5, and Instrucao Normativa 952/2009, Article 26 §1.

87 Law 11508/2007, Article 18.

88 Ibid, Article 6-A, §5.

89 Ibid, Article 6-A, §8.

90 Ibid, Article 18, §4.

91 Ibid, Article 18, §4.II.

92 See Lei Complementar nº 124, of 3 January de 2007 and Lei Complementar nº 125, of 3 January 2007.

93 It is interesting to note that Article 11 of Bill 146/1996 on the fiscal, administrative, and currency regime for EPZs included an exemption on income tax levied on EPZ users' profits during a 5-year period, to be extended for a 10-year period for the EPZ users operating in EPZs located in less-developed regions of the country specifically determined by law. But this incentive was later vetoed by the President (Message from the Presidency No. 524, 20 July 2007).

94 MP No. 2159/70 of 2001, Article 9 (Export Promotion).

95 This tax benefit is restricted to the promotion of goods, i.e., tangible products, and therefore cannot be used for the promotion of services abroad. See Notadez, "IR: Redução de Alíquota Sobre Remessa ao Exterior: Sistema Sisprom: Procedimentos," (29/10/2007) <http://www.notadez.com.br/content/noticias.asp?id=46529>, [accessed 03/03/10].

96 Law 11508/2007, Article 12.I.

97 Article 15 of Law 11508 allows companies located in EPZs to enjoy fiscal benefits contemplated in other legislation under the conditions specified therein.

98 Law 11508/2007, Article 18.

99 Law 11508/2007, Article 18.

100 Decree 6634/2008, Article 2.XV.

101 Law 11508/2007, Article 3.V.

102 Ibid, Article 7, and Instrucao Normativa 952/2009, Article 3.

103 Law 11508/2007, Article 9, and Instrucao Normativa 952/2009, Article 3.

104 Law 11508/2007, Article 5.

105 Decree No. 6634/2008, Articles 2.VI and 2.VIII.

106 Decree 6634/2008, Articles 2.VII and 2.VIII.

107 See Decree Law No. 288 of 28 February 1967, Decree Law No. 356 of 15 August 1968, Decree Law No. 1,435 of 16 December 1975, Law No. 8,387 of 30 December 1991 modified by Law No. 10,176/2001, Law No. 11,077/2004.

108 Decree Law No. 288/1967, Article 1.

109 SUFRAMA online information. Viewed at: <http://www.suframa.gov.br/>, [accessed 06/06/10].

110 WTO document (WT/TPR/S/212), Trade Policy Review, Report by the Secretariat, Brazil, (2009), "Trade policy by measure," paragraph 290.

111 Ibid.

112 Ibid, 'Trade policy by measure', paragraph 289.

113 Ibid, 'Trade policy by measure', paragraph 294.

114 See Law No. 523/1995 of 16 January 1995, as amended by Law No. 2.421/2004, and regulated by Decree No. 15.554/1996 of 29 November 1996, authorizing and establishing the regime; Decree No.19.461/02 of 22 November 2002, approving the rules of operation; Decree No. 20.395/2002, on administrative measures to broaden the regulations on imports from free zones; and Decree No. 21.309/2003 of 10 June 2003, amending certain provisions of the earlier decrees in order to facilitate transit to free zones.

115 Law 523/1995, Article 1.

116 Ibid, Article 2.

117 Ibid, Article 6.

118 The statute prohibits the state from operating free zones or becoming a free zone user, Article 8 of Law 523/1995.

119 Law 523/1995, Article 3.

120 Decree No. 17.003/2002 of 24 April 2002.

121 WTO document (WT/TPR/S/146), Trade Policy Review, Report by the Secretariat, Paraguay, (2005), p. 65.

122 Ibid.

123 Ibid, Article 37.

124 Ibid, Article 13.

125 Ibid.

126 Ibid, Article 13 and Decree 15554/1996, Article 44.

127 Law 523/1995, Article 23.

128 Ibid, Article 27.

129 Ibid, Article 28.

130 Ibid, Article 24.

131 Ibid, Article 12.

132 Ibid, Article 14.

133 Ibid, Article 16.

134 Ibid, Article 17 Law 523/1995, as amended by Article 36:10) of Law 2421/2004.

135 Ibid, Article 20.

136 Ibid.

137 Ibid, Articles 12 and 22.

138 See Law 1064/1997 of 13 May 1997 on the maquila export industry (as subsequently amended by Law No. 2421/2004) and regulated by Decree 9585/2000 of 17 July 2000. A reform process of the current regime aimed at introducing more flexibilities, and new tools are already underway.

139 WTO document (WT/TPR/S/146), Trade Policy Review, Report by the Secretariat, Paraguay, (2005), p. 66.

140 Law 1064/1997, Article 2(c).

141 Articles 33 to 36 of Decree 9585/00 regulate the modality of maquila consisting of the provision of intangible services.

142 Examples of maquiladoras that provide services include Bouncopy S.A., with a turnover of $22 million for 2008 and 750 jobs, and Soluciones de Tecnologyía de Información S.A., which provides call centre services, Todo Maquila, Secretaria Ejecutiva del Consejo Nacional de la Industria Maquiladora de Exportación, (2008), p. 11.

143 Law 1064/1997, Article 10.

144 Ibid, Article 3.

145 Law 1064/1997, Articles 2 (a) and 24.

146 Ibid, Article 2(g).

147 Ibid, Article 29 as amended by Law 2421/2004.

148 Ibid, Article 29 as amended by Law 2421/2004.

149 Ibid, Article 30.

150 Ibid, Article 12.

151 Law 1064/1997, Article 13.

152 Decree 9585, Article 133.

153 Law 1064/1997, Article 15.2.

154 Todo Maquila, Secretaria Ejecutiva del Consejo Nacional de la Industria Maquiladora de Exportación, (2008), p. 13.

155 Law 1064/1997, Article 16.

156 Decree 9585/2000, Article 78.

157 Law 1064/1997, Article 16.

158 Ibid, Article 17.

159 See Law No. 15921, 17 December 1987, as amended by Law 17292, 25 January 2001, and Decree 454/1988, 8 July 1988. A complete list of rules applicable to free zones is available at <www.zfrancas.gub.uy/espanol/legislacion/>, [accessed 16/04/10]

160 Law 15921/1987, Article 2 as amended by Law No. 17292/2001, Article 65.

161 Ibid, Article 1.

162 For a full list of free zones, see http://www.zfrancas.gub.uy/english/ftzuruguay/index.html [accessed 29/10/10].

163 Law 15921/1987, Article 8.

164 Ibid, Article 10.

165 Ibid, Article 11.

166 Ibid, Article 12.

167 Ibid, Article 14.

168 Ibid, Article 15.

169 Ibid, Article 16.

170 Ibid, Article 19.

171 Decree 4541/1988, Article 35.

172 Ibid, Article 39.

173 Ibid, Article 41.

174 Ibid, Article 42.

175 Law 15921/1987, Article 20.

176 Ibid, Article 21.

177 The Aguada Park website includes the "possibility to acquire equipment and supplies (new and used) without having to pay any taxes or customs duties" in the list of incentives offered by the Law on Free Zones. See <www.aguadapark.com/index_en.html>, [accessed 12/04/10].

178 Law 15921/1987, Article 22.

179 Decree 454/1988, Articles 43 and 46.

180 Law 15921/1987, Article 24.

181 Ibid, Article 2.

182 Ibid, Article 23, and Decree 454/1988, Article 49 as amended by Decree 920/1988, Article 14.

183 Law 15291/1987, Article 24.

184 Ibid, Article 40.

185 Ibid, Article 38.

186 Ibid, Article 17.

187 Decree 454/1988, Article 50.

188 Decree 220/1998, Article 34.

189 Ibid, Article 25.

190 Ibid, Article 12.

191 Law 15291/1987, Article 13.

192 Ibid, Article 22, §2.

193 Decree 454/1988, Article 45.

194 Ibid, Article 48.

195 Law 15921/1987, Article 21, §2.

196 Ibid, Article 14, and Decree 454/1988, Article 9.

197 Law 15921/1987, Article 2, literal c).

198 Ibid, Article 2, literal d).

199 Decree 84/2006, Article 1, as amended by Decree 496/2007, Article 1, and Decree 30 November 2009, Article 1.

200 Law 15921/1987, Article 2, literal c).

201 Ibid.

202 Decree 84/2006, Article 2.

203 Law 15921/1987, Article 18.

204 For a shorter version of this section see "Gari, Gabriel "Free Zone Incentives in MERCOSUR Countries and WTO Law," *Global Trade and Customs Journal* 5, (2011)

205 According to the ILO, in 2006 there were 3,500 Export Processing Zones or similar types of zones distributed in 130 countries and employing 66 million people. See Jean-Pierre Singa Boyenge, "ILO database on export processing zones (revised),' (2007), ILO Working Paper.

206 See Gari, Gabriel, "Free Zone Incentives in MERCOSUR Countries and WTO Law," 6 Global Trade and Customs Journal 5, (2011); Torres, Raúl A., "Free Zones and the WTO Agreement on Subsidies and Countervailing Measures," (2007), Global Trade and Customs Journal, Vol. 2; Granados, Jaime, "Export Processing Zones and other special regimes in the context of multilateral and regional trade negotiations," (2003), IADB INTAL-ITD Occasional Paper 20; Akinici, Gokhan, Special Economic Zones Performance, Lessons Learned and Implications for Zone Development, (2008), World Bank; Creskoff, Stephen, and Peter Walkenhorst, "Implications of WTO Disciplines for Special Economic Zones in Developing Countries," (2009), World Bank Policy Research Working Paper No. 4892; and Engman, Michael, Osamu Onodera, Enrico Pinali, "Export Processing Zones. Past and Future Role in Trade and Development," (2007), OECD Trade Policy Working

Papers No. 53.

207 The Illustrative List on Export Subsidies (Annex I to the ASCM) literal (c) prevents governments from providing or mandating internal transport and freight charges on export shipments on terms more favourable than those for domestic shipments; literal (d) prevents governments from supplying services for use in the production of exported goods on terms or conditions more favourable than those for provision of like services for use in the production of goods for domestic consumption; and literal (h) prohibits exemptions of prior-stage cumulative indirect taxes on services used in the production of exported products in excess of the exemption of like prior-stage cumulative indirect taxes on services used in the production of like products when sold for domestic consumption.

208 See, for example, communication including a provisional definition for subsidies in services based on the ASCM submitted by the delegations of Chile, Hong Kong, China, Mexico, Peru, and Switzerland. WTO Room document, JOB(05)/96.

209 As put by the Appellate Body: "In our view, the marketplace provides an appropriate basis for comparison in determining whether a 'benefit' has been 'conferred', because the trade-distorting potential of a 'financial contribution' can be identified by determining whether the recipient has received a 'financial contribution' on terms more favourable than those available to the recipient in the market." *US-Lead and Bismuth II*, (2000), Appellate Body Report (WT/DS138/AB/R), paragraph 67.

210 WTO document (TN/RL/W/236), "New Draft Consolidated Chair Texts of the AD and ASCMs," (19 December 2008), p. 38. The chairman of the group included this (and other) proposals in the draft text since it is an area where some degree of convergence among the Members appeared to exist.

211 ASCM, Articles 1.2 and 2.

212 Ibid, Article 2.1(a).

213 Ibid, Article 2.1(b).

214 Ibid, Article 2(1)(c).

215 Ibid, Article 2(2).

216 Ibid, Article 2(3).

217 Ibid, Article 2(3).

218 Ibid, Article 3.1(a).

219 *Brazil-Aircraft (Article 21.5 – Canada)*, (2000), Appellate Body Report, (WT/DS46/AB/RW).

220 ASCM, Article 3(1)(a), footnote 4.

221 For the three most recent years for which data is available (2005 – 2007), those members are Bolivia, Cameroon, Congo, Côte d'Ivoire, Egypt, Ghana, Guyana, Honduras, India, Indonesia, Kenya, Nicaragua, Nigeria, Pakistan, the Philippines, Senegal, Sri Lanka, and Zimbabwe. WTO Document (G/SCM/110/Add.6), 17 July 2009.

222 ASCM, Article 27.4.

223 WTO document (WT/MIN(01)/17), Ministerial Conference Decision on "Implementation-related Issues and Concerns," (14 November 2001), paragraph 10.6; and WTO document (G/SCM/39), "Procedures for Extensions under Article 27.4 for Certain Developing Country Members," (20 November 2001).

224 Full or partial exemptions from import duties and internal taxes, which came into existence not later than 1 September 2001, and which were provided by developing country Members whose share of world merchandise export trade was not greater than 0.1 percent; whose total Gross National Income ("GNI") for the year 2000, as published by the World Bank, was at or below US$20 billion; that were otherwise eligible to request an extension pursuant to Article 27.4; and that followed the procedures prescribed by the SCM Committee in WTO document G/SCM/39.

225 WTO document (WT/L/691), General Council Decision of 31/07/07. The "last authorised period" referred to in the last sentence of SCM Article 27.4 shall not extend beyond 31 December 2013, and the final two-year phase-out period provided for in the last sentence of SCM Article 27.4 shall end not later than 31 December 2015.

226 The developing countries that relied on Article 27.4 and are currently receiving extensions of the transition period for certain programmes of this type are Barbados, Belize, Costa Rica, Dominica, the Dominican Republic, El Salvador, Fiji, Guatemala, Jamaica, Jordan, Mauritius, Panama, Papua New Guinea, St. Lucia, St. Kitts and Nevis, and Uruguay. Three additional Members that had not provided documentation supporting an extension, Antigua and Barbuda, Grenada, and St. Vincent and the Grenadines, were given additional time by the Committee to submit documentation. In addition, certain Annex VII(b) countries reserved their rights to invoke the same procedures in the event that they subsequently "graduated" from the Annex VII(b) exemption.

227 At least 30 of the 40 programmes for which an extension of the transition period was requested were legislative measures establishing free zone schemes. For instance, Antigua and Barbuda notified its "Free Trade/Processing Zones" programme. Belize notified its "Export Processing Zone Act and Commercial Free Zone Act." Costa Rica notified its "Duty Free Zone regime." The Dominican Republic notified "Law No. 8-90, to Promote the Establishment of Free Trade Zones." Fiji notified

its "Export Processing Factories/Zones Scheme." Guatemala notified "Free Zones" and "Industrial and Free Trade Zones (ZOLIC)." Jamaica notified its "Jamaica Export Free Zone Act." Mauritius notified its "Freeport Scheme." Panama notified its "Export Processing Zone." And St. Lucia notified its "Free Zone Act".

228 ASCM, Article 27.5.

229 Ibid.

230 WTO document (G/SCM/N/74/URY) of 10 January 2002. This extension has been granted to Uruguay annually since 22 November 2002; the last extension was up to 31 December 2009, WTO document (G/SCM/N/192/URY**) (**8 July 2009).

231 ASCM, Article 5.

232 Ibid, Article 7.

233 Ibid, Article 31.

234 WTO document (WT/MIN(01)/17), Ministerial Conference Decision on "Implementation-related Issues and Concerns," (14 November 2001), paragraph 10.2.

235 Ibid. paragraph 13, and WTO document (WT/MIN(01)/DEC/1), Doha Ministerial Declaration, (20 November 2001), paragraph 12.

236 WTO document (WT/MIN(01)/17), Ministerial Conference Decision on "Implementation-related Issues and Concerns," (14 November 2001), paragraph 10.2.

237 Ibid, Article 1(a)(1).

238 Ibid, Article 1(a)(2).

239 Ibid, Article 2.2. Most free zone statutes stipulate that free zones are specifically designated areas, clearly demarcated and isolated from the national customs territory. This is the general practice across the world, although there are some examples of free zone regimes outside MERCOSUR that grant incentives to companies regardless of their location. Torres mentions the cases of free zones in the United States and the Dominican Republic. See Torres, Raúl A., op. cit., footnote 206.

240 The right to operate a free zone is far from automatic. Applications are considered on a case-by-case basis, looking, *inter alia*, at the investment project proposed by the applicant. See Law 15921/1987, Articles 7 and 10, and Decree454/1988, Articles 13 to 16.

241 ASCM footnote 1 and Annex I (g).

242 Ibid, Annex II and footnote 61, which provides that inputs consumed in the production process are those that are physically incorporated into the exported product, as well as energy, fuels, oils, and catalysts.

243 ASCM footnote 1 and Annex I (h).

244 Ibid, Annex II and footnote 61.

245 Ibid, footnote 1 and Annex I(i).

246 Law 11508/2007, Articles 6-A, 12.II, and 13.

247 Ibid, Article 6-A, §1 to §4. This means that companies located in EPZs are not subject to the general restrictions on the import of used machinery and equipment.

248 Some scholars suggest a broader interpretation of the ASCM's exclusions from the meaning of subsidy, which should also cover indirect taxes and import charges on capital goods and production equipment. This interpretation, influenced by the long-established status of free zones in international law as areas outside the national customs territory and their wide use in both developed and developing countries around the world, is based on the following considerations: (1) all goods stored in free zones are duty and tax free; (2) duty and tax exemptions for production equipment are not specifically listed as a prohibited subsidy in ASCM Annex I; and (3) at the end of its useful life in the free zone, production equipment will either be exported duty and tax free; entered into domestic commerce upon payment of applicable duties and taxes; or discarded as scrap. (See Stephen Creskoff and Peter Walkenhorst*,* op. cit., footnote 206). The counterarguments to this position are as follows: (a) the purpose of capital goods and production equipment is not for it to be "stored" in the free zone to be re-exported, but to be used for the production of goods to be exported; (b) while production equipment is not specifically listed as a prohibited subsidy by Annex I, there is Annex II and footnote 61, whose purpose is to specify when an input is consumed during the production process. These provisions make it clear that capital goods and production equipment are not "consumed" during the production process because they are not "physically incorporated into the exported product." There is a consensus among members of the ASCM committee about this interpretation; (c) when the capital goods or production equipment is exported at the end of its useful life, it will be at a much lower value than that paid at the time of its importation precisely because it has reached its useful life. The product being exported is not the same or identical product as the one that has been imported on a duty-free basis. (See Torres, Raúl A. op. cit.. footnote 206, and Engman, Michael, Osamu Onodera, Enrico Pinali, "Export Processing Zones. Past and Future Role in Trade and Development," (2007), OECD Trade Policy Working Papers No. 53, op. cit., footnote 206, p. 46).

249 Law 11508/2007, Article 6-A.

250 ASCM, Annex I, literal (e).

251 Law 11508/2007, Article 18, §4.II.

252 See Lei Complementar no 124, of 3 January de 2007 and Lei Complementar no 125, of 3 January 2007.

253 ASCM, Annex I, literal (e).

254 Law 523/1995, Article 13.

255 Ibid.

256 Ibid, Article 23.

257 Ibid, Article 27.

258 It must be noted that Stephen Creskoff and Peter Walkenhorst hold a different opinion about the consistency of tax incentives on capital goods with the ASCM. See *supra* footnote 248.

259 Law 1064/1997, Article 29 as amended by Law 2421/2004.

260 Law 15921/1987, Article 19.

261 Decree 454/1988, Article 35, provides that free zone users are exempted from IRAE (formerly IRIC) with respect to the activities performed in the free zone.

262 Ibid, Article 41.

263 Law 15921/1987, Article 21.

264 The Aguada Park website includes in the list of incentives offered by the Law on Free Zones the "possibility to acquire equipment and supplies (new and used) without having to pay any taxes or customs duties." <www.aguadapark.com/index_en.html> [accessed 12/04/10].

265 ASCM, Annex I, literal (i).

266 Law 11508/2007, Article 18.

267 ASCM, Article 3

268 Ibid, Article 14.

269 Ibid, Article 16.

270 Ibid, Article 17 Law 523/1995, as amended by Article 36:10) of Law 2421/2004...

271 Law 1064, Article 16.

272 Law 15921/1987, Article 22, second paragraph.

273 See Torres, Raúl A, op. cit., footnote 206, p.219. It is important to state that this is a doctrinal interpretation. As in any legal analysis, different interpretations of particular provisions might be possible, and the ultimate decision on the legality of a particular measure remains subject to the interpretative and dispute settlement procedures stipulated by the WTO agreements. So far, there have not been WTO cases dealing with this issue, or any official interpretation about it.

274 ASCM, Annex I, literal (e).

275 Ibid, Article 5.

276 ASCM, Article 7.

277 Ibid, Article 1.1(a)(1)(iii).

278 Ibid, Article 14(d).

279 Ibid, Annex I(c).

280 Law 15921/1987, Article 24.

281 ASCM, Annex I, literal (d).

282 ASCM, Article 11.

283 Creskoff et al., op. cit., footnote 206. Note, for example, that after SEZ incentive measures were repealed in Ukraine in 2005, subsequent court decisions continued the fiscal measures for certain investors.

284 ASCM, Article 25.8.

285 See, for example, ASCM, Article 27, paragraphs 8 to 10.

286 WTO document (WT/MIN(01)/17), Ministerial Conference Decision on "Implementation-related Issues and Concerns," (14 November 2001), paragraph 10.2

287 For the last notification under Article 25.2, see WTO document (G/SCM/N/186/ARG**),** 28 September 2009.

288 For the last notification under Article 25.2, see WTO document (G/SCM/N/155/BRA**),** 11 October 2007.

289 For the last notification under Article 25.2, see WTO document (G/SCM/N/155/PRY**),** 28 April 2008. The last WTO Secretariat TPR Report on Paraguay notes that the free-zone and maquila regimes have not been notified as providing export subsidies. It further states that, as a developing country, Paraguay had until 2003 to bring its legislation into line with WTO provisions, but it never sought the extension that could have been granted pursuant to the Doha Ministerial Declaration. WTO document (WT/TPR/S/146), Trade Policy Review, Report by the Secretariat, Paraguay, (2005), p. 67.

290 For the last notification under Article 25.2, see WTO document (G/SCM/N/95/URY**),** 6 August 2003.

291 GATS, Article XV.

292 The title of an UNCTAD paper published in 2005 speaks for itself: "State support measures for services: an exploratory assessment with scanty data" (Luis Abugattas Majluf, UNCTAD Document for Discussion). While the paper provides robust evidence confirming the widespread use of state support measures for services worldwide, it falls short in shedding light on the scale and effects of such measures due to the lack of reliable information on this matter.

293 Pursuant to GATS Article XV.2 "[a]ny Member which considers that it is adversely affected by a subsidy of another Member may request consultations with that Member on such matters. Such requests shall be accorded sympathetic consideration." But Members have not yet made use of this instrument.

294 WTO document (S/WPGR/M/65), WPRG – "Report of the Meeting of 6 October 2009," paragraph 2.

295 Ibid.

296 Ibid.

297 Quantitatively speaking, the proportion of international service transactions involving the movement of factors of production or consumers is larger than that corresponding to long-distance trade in services. In fact, the bulk of international service transactions are channeled through the commercial presence of the supplier in the consumer's country. The WTO Secretariat estimated trade flows in services for 2005 according to the mode of supply as follows: 35% cross-border supply, 10-15% consumption abroad, 50% commercial presence, and 1-2% presence of natural persons. In addition, within the cross-border supply category, the sector that represents the majority of this type of trade is Transport not IT or IT-enabled services. See International Trade Statistics 2005.

298 Other provisions that may also affect the legality of subsidies for services are the provisions on transparency (Article III), domestic regulation (Article XI), monopolies and exclusive service suppliers (Article VIII), and non-violation nullification or impairment (Article XXIII).

299 GATS Article XVII.

300 GATS Article XVII.3.

301 *Canada - Autos*, (2000), Appellate Body Report (WT/DS139/AB/R and WT/DS142/AB/R), paragraph 10.307 and 10.308.

302 GATT 1994, Article III (8)(b).

303 GATS, Article XV.

304 Juan Alberto Marchetti, and Petros C. Mavroidis make the following point: if Article XVII includes subsidies and, thus, subsidies are to be granted on a national treatment basis, how could they be distortive? If one were to accept that Article XVII suffices to discipline subsidies, what is the point of Article XV.1 calling for negotiations with a view to develop multilateral disciplines to avoid the trade distorting effects of subsidies? The only way to justify subsidies negotiations, they argue, is to accept that subsidies are by definition discriminatory and, therefore, outside the scope of Article XVII. See Juan Alberto Marchetti, and Petros C. Mavroidis, "Walking the Tightrope. Between Domestic Policy and Globalization: Market Access, Discrimination and Regulatory Intervention Under the GATS," (2006) Mimeo, cited in Mitsuo Matsushita, Thomas Schoenbaum and Petros Mavroidis, "The World Trade Organization Law, Practice, and Policy," (2005), 2 edn, OUP, p. 661.

305 In the relevant part, the guidelines provide as follows: Article XVII applies to subsidies in the same way that it applies to all other measures. Article XV (Subsidies) merely obliges Members to "enter into negotiations with a view to developing the necessary multilateral disciplines" to counter the distortive effects caused by subsidies and does not contain a definition of subsidy. Therefore, any subsidy which is a discriminatory measure within the meaning of Article XVII would have to be either scheduled as a limitation on national treatment or brought into conformity with that Article. Subsidies are also not excluded from the scope of Article II (MFN). In line with the paragraph above, a binding under Article XVII with respect to the granting of a subsidy does not require a Member to offer such a subsidy to a services supplier located in the territory of another Member. See WTO Document (S/L/92), Guidelines for the scheduling of specific commitments under the General Agreement on Trade in Services, 23 March 2001, paragraph 16.

306 *US-Gambling* (2005), Appellate Body Report (WT/DS285/AB/R), paragraph 196.

307 See Note by WTO Secretariat, "Limitations in Members' Schedules Relating to Subsidies," S/WPGR/W/13 of 22 May

1996. Subsequently updated by S/WPGR/W/13/Add.1 of 14 June 2000; and S/WPGR/W/13/Add.2 of 30 August 2004.

308 See Armenia (GATS/SC/137, p. 3).

309 GATS, Article XVII.1.

310 GATS, Article I.1.

311 Panel Reports, (WT/DS27/R/ECU), (WT/DS27/R/MEX), and (WT/DS27/R/USA), paragraph 7.285.

312 *EC-Bananas*, (9 September 1997), Appellate Body Report (WT/DS27/AB/R), paragraph 220.

313 GATS Article XVII.1.

314 See, for example, the horizontal limitations inscribed in the Swiss, Korean, and Armenian schedules of specific commitments mentioned above.

315 The Explanatory Note states that "… there is no obligation in the GATS which requires a Member to take measures outside its territorial jurisdiction. It therefore follows that the national treatment obligation in Article XVII does not require a Member to extend such treatment to a service provider located outside the territory of another Member." WTO document (MTN.GNS/W/164), "GATT Document Scheduling of Initial Commitments in Trade in Services: Explanatory Note," 3 September 1993, paragraph 10.

316 Paragraph 16 of the Guidelines stipulates that a binding under Article XVII with respect to the granting of a subsidy does not require a Member to offer such a subsidy to a services supplier located in the territory of another Member.

317 Paragraph 9 of WTO Document (S/L/92), Guidelines for the scheduling of specific commitments under the General Agreement on Trade in Services, 23 March 2001, stipulates that subsidy type measures are […] not excluded from the scope of Article II MFN.

318 The wider scope of application of the MFN standard also derives from the way the provision is drafted. Whereas Article XVII.1 refers to "all measures affecting the supply of services," Article II refers to "any measure covered by this Agreement."

319 GATS Article II.2.

320 *In Canada-Autos*, Japan and the European Communities claimed that the import duty exemption granted by Canada to some manufacturers/wholesalers of motor vehicles in Canada is, among other things, inconsistent with Canada's obligations under Article II of the GATS. They argued that the import duty exemption grants more favourable treatment to suppliers of wholesale trade services for motor vehicles from the United States compared to like service suppliers from the European Communities and Japan. In the end, the claim was rejected, but the important thing is that the Appellate Body did not object a priori to considering import duty exemptions within the scope of GATS Article I:1. On the contrary, the Appellate Body's reasoning assumes that import duty exemptions can potentially affect trade in services within the meaning of GATS Article I:1. *Canada - Autos*, (2000), Appellate Body Report (WT/DS139/AB/R WT/DS142/AB/R), paragraph 164-167.

321 Law 15921/1987, Article 2, literal c).

322 Law 15921/1987, Article 2, literal d).

323 Decree 84/2006 stipulates that the tax exemptions provided by the Uruguayan Law on Free zones will not be extended to the provision of services by free zone users into the national territory. The Decree provides that, for such part of their activities, free zone users shall be subject to the tax regime in force at the time of the supply of the service. In turn, Article 2, literal c) of the Free Zones Statute provides that services supplied from the free zone to the national customs territory will receive the same tax treatment as those services provided from abroad either as regards to the supplier or to its deductibility by the consumer.

324 For example, a foreign IT company targeting Uruguayan consumers from abroad could challenge the fiscal incentives granted to free zone users that supply IT services to the Uruguayan national customs territory. The counter argument to this claim is the limitation to the territorial application of the National Treatment discipline suggested by the Guidelines for the Scheduling of Specific Commitments under the GATS, according to which there is no obligation in the GATS that requires a Member to extend such treatment to a service provider located outside the territory of another Member (WTO Document (S/L/92)). Nevertheless, it must be remembered that, although these guidelines can shape the interpretation of treaty provisions as a supplementary means of interpretation, they are not part of the treaty. The GATS' National Treatment provision says nothing about its territorial scope. It remains to be seen what an adjudicatory body could say in the event of a claim of this nature.

325 See *supra* footnote 81.

326 Law 24331/1994, Article 21.

327 Article 5, Law 24331.

328 See, for example, A.T. Kearney documents, "Offshoring for long-term advantage, The 2007 A. T. Kearney Global Services Location Index," <http://www.atkearney.com/res/shared/pdf/GSLI_2007.pdf> , [accessed 03/05/10] and The Economist,

The means to compete. Benchmarking IT industry competitiveness. A report from the Economist Intelligence Unit, July 2007.

329 Depending on the type of business process aimed to be outsourced, cultural affinity and geographical proximity can also influence a multinational corporation's offshore location strategies. However, since these are not factors capable of being influenced by governmental policies, no considerations will be made about them.

330 Back in 2004, UNCTAD highlighted the experience of the Czech Republic to show that what works for trade in goods does not necessarily work for trade in services. The Czech investment promotion agency wanted to promote business support services, but noticed that the existing incentive scheme was ill adapted to the needs of service investors. It had been designed principally for investment in manufacturing and, given the relatively high dependence of fixed capital investment in manufacturing, it was inappropriate for business support services. As a consequence, and as part of a broader programme to attract such services and technology centres, a new scheme was initiated, which focused on human (rather than physical) capital. Investors who qualify can now receive a subsidy of up to 50 percent of eligible business expenses (i.e., wage or capital expenditures on tangible and intangible assets), along with a subsidy covering 35 percent of special training (i.e., skills that are not readily transferable from investors' projects) and 60 percent of general training (UNCTAD World Investment Report, 2004, p 200).

331 UNCTAD document (UNCTAD/ITE/IPC/Misc.3), "Tax Incentives and Foreign Direct Investment: A Global Survey," (2000), ASIT Advisory Studies No. 16.

332 Abugattas Majluf, op. cit., 2005.

333 Frank L. Bartels and Suman Lederer, "Outsourcing Markets in Services: International Business Trends, Patterns and Emerging Issues, and the Role of China and India," UNIDO Working Paper 03/2009, p 34.

334 For recent evidence about the positive externalities of BPO see: ITC Thematic Paper, "Business Process Outsourcing – Lessons for Developing Countries," (2009).

335 See "Special Economic Zones Performance, Lessons Learned and Implications for Zone Development," (2008), FIAS; Madani, Dorsati, "A Review of the Role and Impact of Export Processing Zones," (1999) WB Policy Research Working Paper No. 2238; Engman, Michael, Osamu Onodera, Enrico Pinali, op. cit., footnote 206.

336 ILO document (GB.301/ESP/5), "Report of the InFocus Initiative on export processing zones (EPZs): Latest trends and policy developments in EPZs," (2008), p. 9.

337 UNCTAD, World Investment Report 2004, p. 208.

338 Ibid.

339 According to Duncan Tait, UK managing director of UNISYS, "For services that are more commodity-based there will always be somewhere cheaper. A service can be delivered anywhere as long as you have robust processes and a fast enough network." (The Economist, op. cit., p. 17).

340 The Economist, op. cit., p. 17.

341 Source: <http://www.mit.gov.in/> [accessed 27/06/10].

342 Source: <http://www.icta.lk/index.php> [accessed 27/06/10].

343 Rediff, Archana Mohan, 2008, "Private players may play key roles in new IITs," available at: http://www.rediff.com/money/2008/may/23iiit.htm [accessed 08/11/10].

344 Ibid.

345 Despite the fact that, on average, 2.5 million new students graduate per year, 200,000 of them in engineering, an important skill gap affects the IT – offshore industry. According to Kiran Karnik, former CEO of NASSCOM, only 30 percent of these graduates are employable in the IT industry. He mainly criticises India's rigid methods of lecture-based teaching, reducing questioning or critical thinking, and producing graduates unable to give presentations, engage with customers, or articulate new ideas. The Economist, op. cit., p.14.

346 Law 11 908 of March 2009, cited by BRASSCOM, Brazil IT-BPO Book 2008-2009, p. 14.

347 Law 22317/1980.

348 Prieto, Francisco, "Fomento y diversificación de las exportaciones de servicios," (2003), Serie Comercio Internacional 38. Santiago de Chile: CEPAL.

349 UNCTAD, World Investment Report 2004, p. 208.

350 Ibid.

351 The Economist, op. cit., p. 17.

352 Source: <http://www.itida.gov.eg/En/Pages/home.aspx> [accessed 27/06/10].

353 Source: <http://www.mit.gov.in/> [accessed 27/06/10].

354 Xerox, 2010, "Xerox Launches Innovation Hub in India," source: <http://www.xerox.com/news/news-archive/2010/nr-innovation-031710-ind/enin.html> [accessed 07/11/10].

355 Source: <http://www.zofracor.com.ar/servicios%20profesionales.html> [accessed 18/03/10].

356 Law 8248/1991 as amended by Law 10176/2001 and Law 11077/2004.

357 Ibid, Article 11.

358 Source:<http://www.investchile.com/incentives_and_services/additional_incentives >[accessed 20/10/10].

359 Prieto, Francisco, op. cit., 2003.

360 Australia Productivity Commission, "Computer hardware, software and related Service Industries," Report No. 46, June (2005) , cited by Prieto, Francisco, op. cit., 2003, p.26.

361 Prieto, Francisco, op. cit. 2003.

362 Source: <http://sidbiventure.co.in/svc-0201.htm> [accessed 01/07/10].

363 Source: <http://www.icta.lk/index.php> [accessed 27/06/10].

364 NASSCOM, http://www.nasscom.in/Nasscom/templates/NormalPage.aspx?id=22708, [accessed: 07/11/10].

365 Law 25922/2004, regulated by Decree 1594/2004.

366 Law 8248/1991 as amended by Law 10176/2001 and Law 11077/2004.

367 See "Programa BNDES para o Desenvolvimento da Indústria de Software e Serviços de Tecnologia da Informação - BNDES PROSOFT":

<http://www.bndes.gov.br/SiteBNDES/bndes/bndes_pt/Institucional/Apoio_Financeiro/Programas_e_Fundos/Prosoft/#> [accessed 25/04/10].

368 Law 16906/1997.

369 Decree 84/1999.

370 Prieto, Francisco, op. cit., 2003, p. 37.

371 UNCTAD document (UNCTAD/ITE/IPC/Misc.3), "Tax Incentives and Foreign Direct Investment: A Global Survey," (2000), ASIT Advisory Studies No. 16.

372 The OECD has elaborated a checklist with the intention of providing policy makers with a benchmarking tool to assess the costs and benefits of using incentives to attract FDI, which can be used for evaluating targeted incentives for the offshore industry. It provides operational criteria for avoiding wasteful effects and warns against the pitfalls and risks of excessive reliance on incentive-based strategies, including a number of relevant questions to be asked by those responsible for running the support programmes such as the following. For example: Have sound and comprehensive principles for cost-benefit analysis been established?, Is cost-benefit analysis performed with sufficient regularity?, Is additional analysis undertaken to demonstrate the non-quantifiable benefits from investment projects?, Is the process of offering FDI incentives open to scrutiny by policy makers, appropriate parliamentary bodies, and civil society?. See OECD document, "Checklist for foreign direct investment incentive policies (2003)."

373 Source:< http://www.stqc.nic.in/ > [accessed 21/11/10].

374 Source: <http://www.escindia.in/> [accessed 27/06/10].

375 UNCTAD document (UNCTAD/ITE/IPC/Misc.3), "Tax Incentives and Foreign Direct Investment: A Global Survey," (2000), ASIT Advisory Studies No. 16.