

**GATS DISPUTE SETTLEMENT CASES: PRACTICAL IMPLICATIONS FOR
DEVELOPING COUNTRIES***

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I. INTRODUCTION

1. Developing countries should be aware of the implications of the WTO dispute settlement reports on *US – Gambling*¹ and *Mexico – Telecommunications*² as they continue participating in the WTO negotiations. The findings in the reports have set precedents on the interpretation of various GATS articles and concepts, including: necessity tests; Article XIV on General Exception; Article IV on Increasing Participation of Developing Countries; and scheduling guidelines.

* This is an updated version of “GATS Dispute Settlement Cases: Practical Implications for Developing Countries”, South Centre Analytical Note, January 2005.

¹ *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, (WT/DS285/AB/R). See also the case analysis titled “Gambling with Market Access Rules” in the *South Centre Quarterly on Trade Disputes: First Quarter 2005*, pp. 2-8, available at <http://www.southcentre.org/GGDP/newtradedisputesquarterly.htm>.

² *Mexico – Measures Affecting Telecommunications Services*, WT/DS204/R.

2. This note briefly discusses the practical implications of these rulings. By doing so, it hopes to inform developing countries of the types of considerations that should be taken into account when formulating initial or subsequent offers, scheduling commitments, negotiating disciplines for rules and domestic regulation, or when involved in a dispute.

II. NECESSITY TESTS

3. The WTO Secretariat has defined a “necessity test” as the means by which an attempt is made to balance between two potentially conflicting priorities: promoting trade liberalization and protecting the regulatory rights of governments.³ It is a process by which a country must prove whether the disputed regulatory measure is “necessary” for fulfilling a policy objective. Necessity is commonly derived from weighing the need for the measure to fulfil a particular policy objective against its impact on trade. There is not one method for performing a necessity test; the tests are referred to in different ways in WTO rulings and appear with varying parameters within agreements. In GATS, for example, a necessity test is found in Articles VI: 4 and XIV.⁴
4. In *Mexico – Telecommunications*, a necessity test was applied to Mexico’s use of: 1) a uniform pricing policy for the policy objective of limiting predatory pricing and fulfilling development objectives, i.e. strengthening domestic telecommunications infrastructure; and 2) higher interconnection rates for the policy objective of universal access. According to the Panel, Mexico failed the necessity test in both instances.
5. Regarding the first instance, the necessity test required evidence to show that existing Mexican competition law was not adequate to deal with predatory pricing. Evidence was also required to show “well-founded” reasons for believing predatory pricing would occur without a uniform pricing policy. In essence, the Panel required proof based on counterfactual information. This is indeed a very difficult exercise. Equally challenging is providing “well-founded” reasons for believing harm would occur in the absence of a certain policy which is designed to prevent that harm. This could involve providing evidence of cases where predatory pricing did occur when the policy was not in place. This type of necessity test is based on the assumption that harm must have already occurred in a country before a new regulation is allowed to be adopted. Following this logic, a Member would not be allowed to be visionary or proactive in developing regulations that prevent or avoid harm. Major

³ Informal WTO Secretariat note “Application of the Necessity Test: Issues for Consideration”, WTO Document Code: Job No. 5929, 19 March 2000.

⁴ Kennet, M., Neumann, J., and Tuerk, E. (2003) “Second Guessing National Level Policy Choices: Necessity, Proportionality and Balance in the WTO Services Negotiations” Center for International Environmental Law, August.

implications from this type of necessity test are: 1) the substantial amount of burden that could be placed on a developing country to justify its domestic policies, and 2) the infringement on the right of a country to adopt a regulation that is visionary.

6. In *US – Gambling*, a necessity test was applied on whether the United States’ ban on internet gambling, which was WTO-inconsistent and had a significant impact on trade, was: 1) necessary for the policy objectives of protecting public morals and maintaining public order; and 2) necessary to secure compliance with other WTO-consistent laws.
7. The analysis for this necessity test involved weighing and balancing several factors, namely: the importance of the interests or values that the measure is intended to protect; the extent to which the challenged measure contributes to the realization of the end pursued; and the trade impact of the measure, including whether a reasonably available WTO-consistent alternative measure exists. The Panel and the Appellate Body held that public morals and public order can be very important societal interests, which can be characterized as vital and important in the highest degree. This puts the two interests at par with the protection of human life and health, which is important because the higher the interest or value pursued by a measure, the more likely it is that the measure will be seen as necessary.⁵
8. As stated above, a measure is considered necessary if there is no reasonably available WTO-consistent alternative. An alternative measure is not “reasonably available” if it is merely theoretical in nature, for example, where the Member is not capable of taking it, or where the measure imposes an undue burden on that Member, such as prohibitive costs or substantial technical difficulties. The Appellate Body did not define what amounts to “substantive technical difficulties”. But, the way the Appellate Body construed “reasonably available” suggests that the regulatory, technical and financial ability of the Member adopting the measure will be examined before deciding whether an alternative measure is reasonably available. This appears to bode well for developing countries because they might not have the financial and technical resources or ability to adopt the least trade-restrictive measure. However, any optimism in this regard should be cautious. Several WTO cases show that it is extremely difficult to prove the necessity of a measure under the general exceptions provisions.

III. CLASSIFICATION AND SCHEDULING

9. The two dispute settlement cases provide useful insight on scheduling and classification issues. The major implication for developing countries is that

⁵ It should be recalled that the footnote to Article XIV (a) provides that the public order exception may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society.

scheduled commitments should be as accurate and clear as possible. This includes being clear about what is and *is not* being committed and explicitly inscribing any conditions that fulfil development objectives.

10. *US – Gambling* showed that, although the W/120 and UN CPC classification are only suggested guidelines, and not obligatory, the documents may be used as supplementary means of interpreting schedules of commitments. They may be resorted to in order to confirm the meaning of the schedules, or to determine the meaning when the ordinary meaning approach to treaty interpretation leaves the meaning obscure or ambiguous, or leads to a result that is manifestly absurd or unreasonable. Thus, even if a country defines its services commitments without utilising the W/120 or the UN CPC classification, any ambiguity may be cleared by referring to the W/120 and the corresponding UN CPC codes of commitments.
11. The Appellate Body report also indicated that an interpreter should go beyond the dictionary definition of the ordinary meaning of the words when interpreting schedules of commitments. The ordinary meaning should be examined in the relevant context. The relevant context when interpreting Schedules is: the Member's Schedule itself; the structure, object and purpose of the GATS; the other covered agreements; and, other Members' Schedules. However, other Members' Schedules must be used cautiously because each Schedule has its own intrinsic logic, which differs from one Schedule to another.
12. The main lesson for WTO Members is that they should always use clear language when they are scheduling commitments so as to lessen the need for resort to supplementary or other means of interpretation. It is advisable for developing countries to refer to the UN CPC classification when scheduling commitments. Listing a UN CPC code may not always be possible; however, corresponding to the closest UN CPC code in some way, for example, whether as a subset of the CPC code or going beyond a CPC code, may prove to be beneficial if a scheduled commitment is subject to a dispute. Utilising a UN CPC code carefully may avoid ambiguity, which may at times be the trigger of a dispute.
13. The GATS allows developing countries to attach liberalisation conditions for development purposes in two different areas. An example of this is Section 5 (g) of the Annex on Telecommunications, which allows developing country Members to place conditions on commitments for the purpose of strengthening domestic telecommunications infrastructure and services capacity, and to increase participation in telecommunications services trade. In *Mexico – Telecommunications*, Mexico argued that its higher rates fulfilled the Section 5 (g) objectives as they were necessary for strengthening its domestic telecommunications infrastructure. The Panel rejected the argument because Mexico had not specified the conditions in its schedule, as is required by the section. This finding is a reminder than in order to invoke development

conditions under Section 5 (g), developing countries must explicitly inscribe them in their commitments.

14. A provision similar to the objective of Section 5 (g) of the Annex on Telecommunications is GATS Article XIX:2. Article XIX:2 allows developing countries to attach conditions to commitments aimed at achieving Article IV objectives, which are for increasing participation of developing countries in world trade. Developing countries should explicitly inscribe Article XIX:2 conditions to its commitments in order to be on the safe side.⁶
15. The Panel finding suggests that Members should be explicit about any conditional limitations to its commitments. However, GATS allows the right to regulate and not all regulatory measures need to be scheduled. According to the Scheduling Guidelines, only commitments, limitations to market access and national treatment, and additional commitments are to be inscribed in a Member's schedule. To this list should also be added conditions for achieving development objectives as provided for by Section 5 (g) of the Annex on Telecommunications and GATS Article XIX: 2 for conditions aimed at achieving Article IV objectives.
16. A final scheduling implication from *Mexico – Telecommunications* relates to a mode 3 market access limitation Mexico had placed whose removal was contingent to the development of future regulations. The Panel found this limitation to have violated Section 5 (b) of the Annex on Telecommunications, which ensures access to foreign suppliers, because Mexico had not developed the regulations after five years of entry into force of GATS. This ruling implies that five years surpasses the maximum time limit for developing such regulations. Regrettably, the Panel did not adequately consider that the development of regulations depends on many variables for each Member. These variables include governmental resources, regulatory priorities, and political situation, among others. Moreover, there are no standard time frames for developing regulations provided anywhere in GATS.
17. There are two main lessons from the Panel ruling. First, developing countries should ensure that their level of regulatory and national development is considered when a Panel is deciding on whether the country is taking too long to develop regulations. Second, it may be advisable for developing countries to not schedule a commitment based on a temporal limitation where the limitation is to be removed based on a future action whose occurrence and time line is uncertain.

⁶ For further discussion on Article XIX: 2 conditions, see South Centre "GATS Conditions to Achieve Developing Country Objectives", T.R.A.D.E Occasional Paper Series 13, available at http://www.southcentre.org/publications/publist_issue_area_TradeInServices_index.htm.

IV. ANTI-COMPETITIVE PRACTICES

18. The Panel in *Mexico – Telecommunications* found that Mexico had acted inconsistently with its Reference Paper (RP) obligations by maintaining measures that prevent anti-competitive practices. It found that practices required under Mexican law were anti-competitive. There are two aspects of the findings that have considerable implications for developing country Members.
19. First, the phrase “anti-competitive practices” was construed very broadly. It was said that the phrase suggests actions that lessen rivalry or competition in the market. Some of the practices it covers include pricing actions, monopolisation or abuse of dominant position in ways that affect prices or supply, horizontal coordination of suppliers, and market sharing agreements. It should be noted that the WTO’s involvement in competition laws is very limited. Given that there is no binding legal instrument defining the types of practices that are deemed anti-competitive, the full scope of the definition cannot be ascertained. This, together with the broad definition given by the Panel, means that developing country business practices that fall under the broad definition of anti-competitive practices could be subject to challenge under the RP.
20. A practical implication stems from the fact that most developing countries’ have limited awareness of, and experience in, competition law. Therefore, before undertaking additional commitments provided for by the RP, developing countries should examine practices in their telecommunications industries to ensure that they do not amount to what has been deemed anti-competitive by this Panel report. Developing countries must also ensure that their domestic regulatory framework can maintain appropriate measures to prevent anti-competitive practices as called for by Article 1.1 of the RP. It would be advisable to sign on to the RP only when these obligations are sure to be met.
21. The second important aspect of the finding relates to the relationship between national legislation and GATS obligations. According to the Panel, the anti-competitive practices commitments taken under GATS are designed to limit the regulatory powers of Members. Since these commitments are obligations owed to all WTO Members, they cannot be eroded unilaterally by a domestic law. Although this may be correct in strict legal terms, it has very broad implications for the telecommunications industry, a sector that is regulated extensively in most countries, both developed and developing. Governments participate in this industry in order to give benefits to certain groups as the service is to some extent, a social good. As such, they not only allow, but also require, practices and economic behaviour that would not occur in a competitive environment. Developing countries should ensure that such

considerations are given the utmost weight in the event of a dispute and should be aware that practices that are lawful or legally required nationally can still be found inconsistent with the RP.

V. DEVELOPMENT PROVISIONS

22. As discussed previously, in *Mexico – Telecommunications*, Mexico unsuccessfully sought to rely on various GATS provisions that give developing countries flexibility to meet development objectives. The Panel rejected Mexico's arguments that development objectives must be considered when deciding whether a developing country is meeting its GATS commitments. These provisions, the Panel's findings, and the implications of those findings are discussed in further detail below.

A. Assessment of whether interconnection rates are cost-oriented

23. Mexico had argued that in assessing whether cost-oriented interconnection rates are reasonable, relevant factors include the state of a WTO Member's telecommunications industry, the coverage and quality of its telecommunications network, the return on investment, and whether the rates derive from an accounting rate regime. Those rates are economically feasible, Mexico further argued, if they are consistent with the efficient use of income and wealth that is suitable, while reflecting the needs of the operator and the policy goals of the country. The essence of these arguments was that developing countries should be allowed to charge such rates as will enable their telecommunications sectors to grow and develop. Foreign investors should contribute to the development of the industry, and to ensure there is universal access to telecommunications services. In other words, the development policy and goals of a country should be allowed to inform the permissible level of regulation and level of rates. The Panel rejected these arguments. The effect of this is that foreign telecommunication services suppliers need not contribute to the development of infrastructure through interconnection rates.⁷ This finding views trade and trade liberalisation as an end in itself, and not a means to other goals, such as national development. It completely negates the fact that for developing countries trade is not an end in itself but a means to achieving developmental goals.

B. The development provisions in Section 5 of the Annex on Telecommunications

24. Section 5(g) of the Annex on Telecommunications allows a developing country to impose reasonable conditions to strengthen its domestic telecommunications infrastructure and service capacity and to increase its participation in international trade in telecommunications services. The Panel

⁷ Ellen Gould, "Telmex Panel Strips WTO of Another Fig Leaf", Canadian Centre for Policy Alternatives Briefing Paper, Trade and Investment Series, Volume 5 Number 2, July 2004 at p.2.

said the section recognises the right of developing countries to inscribe conditions in their schedules for the objectives mentioned in that section. Although Mexico had not inscribed this condition in its schedule and therefore was not able to successfully invoke Section 5 (g) the Panel stated that Members would also have to show that the measures they have taken are reasonable and necessary conditions for enhancing the development objectives in Section 5(g).

25. Having to offer proof of the reasonableness and necessity of conditions for enhancing development objectives suggests a strict application of the provision. By questioning the reasonableness and necessity of the condition, it could be implied that the development objective itself may be questioned. In the event of a dispute, developing countries should ensure development objectives are given the utmost importance and a reasonableness or necessity test should not undermine the availability of development policy choices for crucial industry in developing countries.

C. Refusal to interpret developing countries' commitments in light of paragraph 5 of the GATS preamble and GATS Article IV

26. Paragraph 5 of the GATS preamble and Article IV recognise that developing country Members need to strengthen their domestic services capacity, efficiency and competitiveness. The Panel said these provisions describe the type of commitments that Members should make with respect to developing country Members and do not provide an interpretation of commitments already made by developing countries. This Panel ruling does not seem to be based on any provisions found in the agreement. Some literature suggests that the reason for this interpretation is that it is developed country Members who will be investing in developing country Members. However, nothing in GATS limits the interpretation of Article IV to the formalistic position that these preferential treatment provisions were only intended to encourage developed country Members to give developing countries preferential access to their services markets.⁸ In fact, the obvious implication of the Panel's interpretation is that the scope of this special and differential treatment provision has been unduly limited to the stage of GATS bargaining. Notably, the chapeau of Article IV states that *different Members* are to facilitate the increasing participation of developing country Members. The term "different Members" is not exclusive to developed countries. In contrast, when the GATS wants to refer exclusively to developed country Members, it does so explicitly, as is seen in Article IV:2.

⁸ Dan Sarooshi, "The WTO Telefonos de Mexico, S.A. de C.V. (Telmex) Case: Outcome and Implications", Commonwealth Trade Hot Topics, at p. 6 (available at <http://www.thecommonwealth.org/Templates/Internal.asp?NodeID=36519>) Last accessed on 25 January 2005.

D. No reference to paragraph 4 of the GATS preamble

27. The Panel in *Mexico – Telecommunications* did not refer to paragraph 4 of the GATS Preamble on the right to regulate. Paragraph 4 recognises “...the right of Members to regulate and introduce new regulations on the supply of services within their territories in order to meet national policy objectives... and the particular need of developing countries to exercise this right”. In essence, this paragraph allows a developing country to place regulations on the supply of services within its territory to meet national policy objectives. This important paragraph should have been considered in the Panel proceedings because this case was heavily based on the right to regulate and introduce new regulations and especially since universal access and infrastructure development are important national policy objectives with regards to domestic telecommunications services.
28. Members should insist that paragraph 4 of the GATS Preamble must be seriously considered in disputes. Panel rulings should not constrain policy choices of developing country Members since successful development of a country crucially depends on its ability to make and implement policy choices. A Panel should not be allowed to disregard the GATS Preamble, which upholds Members right to regulate.

VI. GENERAL EXCEPTIONS UNDER ARTICLE XIV

29. Article XIV on General Exceptions allows Members to introduce or maintain measures that are inconsistent with their GATS obligations in order to meet certain policy objectives. This gives policy space for Members to implement non-trade objectives. In *US – Gambling*, the Panel and the Appellate Body examined whether US measures banning cross-border gambling and betting fell within Article XIV. This is the first time in WTO or GATT jurisprudence that a public morals/public order exception, be it in the GATT or the GATS, has been adjudicated on. Thus, the reasoning and findings provide guidance on when and how WTO Members can justify an otherwise GATS inconsistent measure under Article XIV.
30. As discussed above, WTO Members can maintain GATS inconsistent measures if they are necessary to protect public morals or to maintain public order within Article XIV (a) of the GATS. When such measures are challenged in dispute settlement, the WTO Member imposing the measures has to show several things. First, the measure must fall into one or both of the policy objectives, in this case, protecting public morals or maintaining public order. Since there is some overlap between public morals and public order, it is not necessary to qualify whether the policy considerations relate to one or the other. Members have some discretionary scope in defining “public morals” or “public order” because, as the Panel noted, these concepts vary in time and space, depending on social, cultural, ethical, religious and other

values. This approach is commendable because it defers to national determination of what public morals or public order mean. Nonetheless, some guidance may be derived from the statements which defined “public morals” as the standards of right and wrong conduct maintained by or on behalf of a community or nation. Additionally, “public order” was construed as referring to the preservation of fundamental interests of a society, as reflected in public policy and law. These definitions could be used as a starting point for Members who would then develop their own definitions in their territories in accordance with their own systems and scales of values.

31. The Panel also examined Article XIV(c), that is, whether a measure is necessary to secure compliance with a law. A measure will fall within the scope of that Article if: the measure secures compliance with other laws or regulations; those other laws or regulations are consistent with the WTO Agreement; and the measure is “necessary” to secure the compliance. The noteworthy point here is the confirmation that Article XIV(c)’s list of laws is not exhaustive. Thus, laws and regulations other than those falling within the list may be relied upon in justifying a GATS-inconsistent measure provided that those laws and regulations are WTO-consistent. Again, this broadens the scope for Members to maintain measures in pursuance of national policy objectives other than trade.
32. The qualification to the preceding statement is that measures that fall under Articles XIV(a) and XIV(c) must also satisfy the requirements of the chapeau of Article XIV. The chapeau prescribes that measures must be applied in a manner that does not constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services. The purpose of this requirement is to avoid abuse of the general exceptions. It serves to balance the right of a Member to invoke the general exceptions and the duty of that Member to respect the treaty rights of others. It is much harder to meet the requirement of the chapeau than to show that the measure provisionally falls into Article XIV (a) or XIV(c). So, although Members have a rather wide scope in pursuing non-trade objectives, they cannot do so with protectionist intent.

VII. CONCLUSION

33. This note has discussed the various implications of the seminal GATS dispute settlement reports for developing country Members. It is hoped that the note provides practical and useful considerations for developing countries as they proceed in their negotiations on market access, rules and domestic regulations. The note has also highlighted the findings that are pertinent for developing countries seeking to justify measures in dispute settlement proceedings. Developing countries should make use of the flexibility that exists under the GATS, e.g. general exceptions, with the full knowledge of how to do so with utmost care and accuracy and drawing from the lessons learned from these dispute settlement cases.

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Chemin du Champ d’Anier 17

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Switzerland

E-mail: south@southcentre.org

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**Chemin du Champ d'Anier 17
Case postale 228, 1211 Geneva 19
Switzerland**

Telephone: (41 22) 791 8050

Fax: (41 22) 798 8531

Email: south@southcentre.org

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