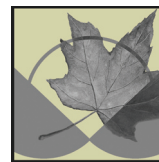


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## Telmex Panel Strips WTO of Another Fig Leaf

by Ellen Gould

In April 2004, a WTO dispute panel ruled in favour of the US in almost all aspects of a case it brought against Mexico. The US successfully claimed that Mexico was violating the General Agreement on Trade in Services and subsidiary GATS agreements in how it regulated the country's major telecommunications supplier, Telmex. The panel dismissed Mexico's arguments that in order to be granted access to the Mexican market, American firms should have to contribute to the development of the country's telecommunications infrastructure. The panel's interpretation of the GATS provides a cautionary tale for governments who believe they can preserve their policy space while taking on more WTO obligations.

The GATS Telecommunications Reference Paper provided most of the grounds for the US win. If a country commits to the Reference Paper, as Mexico has, telecommunications companies cannot "cross-subsidize". This means companies are not allowed to cover the less lucrative aspects of their business - such as the provision of pay telephones that serve poor neighbourhoods - through revenues from their more profitable operations. The Reference Paper also insists that companies be allowed to pay for only those aspects of a network that they want access to (rates charged have to be "unbundled") rather than being required to contribute to the network as a whole.

Both of these provisions militate against governments regulating to ensure access to services by the poor. Developing countries are also particularly disadvantaged because they cannot regulate to encourage the expansion of their domestic infrastructure. Mexico pointed out in the Telmex case that developing countries have different policy objectives than industrialized nations because of the relatively poor state of their basic infrastructure.

There are provisions in the Telecommunications Reference Paper as well as in the GATS Telecommunications Annex that seem to allow an out for governments if their goal is to encourage universal access to services and infrastructure development. The lesson from the Telmex case, however, is that these provisions are in practice worth little.

The US submissions to the panel included particularly ominous statements on the topic of universal service obligations and directly contradict the expansive interpretation suggested by other WTO members. A section of the Telecommunications Reference Paper appears to allow governments the leeway to maintain universal service obligations. This section of the Reference Paper is often cited as evidence that governments can liberalize under the GATS and yet still protect their most vulnerable citizens from being marginalized by market forces. The British government has even claimed that WTO dispute panels will read into *all aspects* of the GATS - not only those covered by the universal service section of the Telecommunications Reference Paper - recognition of the legitimacy of universal service obligations:

"We have already specifically made clear in the GATS that we reserve the right - as do all WTO Members - to define our own universal service obligation in the context of basic telecommunications services. It follows that that right also exists in relation to other sectors, and to issues such as safety, affordability, quality of service, security of supply and other public interest objectives..." (December 2003 UK Government's Reply to the GATS Consultation, <http://www.dti.gov.uk/ewt/gats2000.doc>)

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However, the US argued in the Telmex case that the Telecommunications Reference Paper “is best understood as providing limited exceptions” for universal service. The US detailed how limited these exceptions are due to numerous Reference Paper restrictions on their use, particularly the requirement that universal service regulations must be “no more burdensome than necessary”. Since other countries follow policies different from Mexico’s, that means in the US view Mexico’s policies are not “necessary.” Furthermore, the US said that rather than adopting the Reference Paper as it was drafted, governments should have added their own wording to protect universal service - as the US has done. According to the US, therefore, the universal service regulations of many WTO members can be challenged since almost all who adopted the Reference Paper did so without altering its wording.

Mexico did not try to use the universal service exceptions in the Reference Paper and the panel neither commented on them nor investigated whether Telmex was in fact meeting universal service obligations. The panel, however, unequivocally rejected Mexico’s other arguments related to universal service. The Reference Paper allows rates to be set “having regard to economic feasibility”, and Mexico stated that this meant developing countries “have wide latitude to allow rates that would permit the continued development of needed infrastructure and the achievement of universal service.” The panel did not accept this argument.

Mexico also tried to claim that the “reasonable”, “cost-oriented” rates required by the Reference Paper allowed recovery of the costs of meeting universal service obligations. According to the US: “Cost-oriented pricing, as that term is used in Section 2 of the Reference Paper, does not permit Mexico so-called ‘flexibility’ to implement the national goals that Mexico identified in its submission.” The panel agreed with the US, with the result that foreign companies connecting to Mexican telecommunications infrastructure are freed from having to contribute to meeting Mexico’s social policy objectives.

As Mexico pointed out, the GATS Telecommunications Annex says countries are allowed to impose conditions on access to networks in order to “safeguard the public service responsibilities of suppliers ... to make their networks or services available to the public generally.” The panel said that this clause did not apply because interconnection rates do not qualify as “conditions” of access, and even if they did, rates charged still have to be “reasonable” according to WTO standards.

The panel’s decision is particularly negative from the perspective of developing countries. Mexico drew on a clause in the Annex that says developing countries are allowed to “place reasonable conditions on access to and use of public telecommunications transport networks and services necessary to strengthen its domestic telecommunications infrastructure and service capacity and to increase its participation in international trade in telecommunications services.” The panel stated that in order to be able to benefit from this provision, developing countries would have had to refer to it or to have named their development objectives when they made their telecommunications commitments. Since virtually no developing country has done this, the panel rendered the provision effectively useless.

A particular irony of the Telmex case is that around the same time the WTO ruled in favour of the US against Mexico, the US administration declined to implement the GATS “pro-competitive” model domestically. Firms attempting to challenge entrenched telecommunications companies in the US are now abandoning these efforts because the US has refused to enforce policies guaranteeing affordable rates for access to networks.

### ***Key Quotes from the Telmex Panel***

Para. 7.183: *“The qualification of ‘cost-oriented rates’ by the word ‘reasonable’ would not therefore permit costs to be included in the rate that were not incurred in the supply of the interconnection service. Thus, contrary to Mexico’s position, the general state of the telecommunications industry, the coverage and quality of the network, and whether rates are established under an accounting rate regime, are not relevant to determining a proper cost-oriented rate.”*

Para. 7.214: *“More generally, Mexico argues that commitments made by developing country Members have to be interpreted in the light of paragraph 5 of the preamble to the GATS, and GATS Article IV which recognize that these Members need to ‘strengthen their domestic services capacity and efficiency and competitiveness’. However, we note that these provisions describe the types of commitments that Members should make with respect to developing country Members; they do not provide an interpretation of commitments already made by those developing country Members.”*

Para. 7.244: *“International commitments made under the GATS ‘for the purpose of preventing suppliers*

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*... from engaging in or continuing anti-competitive practices' are...designed to limit the regulatory powers of WTO Members."*

Para. 7.388: *"Section 5(g) recognizes the right of developing countries to inscribe limitations in their schedules for the objectives recognized in Section 5(g). The Panel notes that Mexico's Schedule of Specific Commitments does not include any limitations referring to Section 5(g) or to the development objectives mentioned therein. Without such limitations in Mexico's Schedule, Section 5(g) does not permit a*

*departure from specific commitments which Mexico has voluntarily and explicitly scheduled."*

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