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How the GATS Undermines the Right to Regulate

Lessons from the US-Gambling Case

By Ellen Gould

Introduction

Given what they have been told by federal trade officials, representatives of subfederal governments in both Canada and the US might be surprised to learn that whenever they prohibit certain services—eg. billboard advertising, pesticide spraying, casino gambling, garbage incineration¹—they are violating commitments their countries may have made under the General Agreement on Trade in Services (the GATS). The WTO Appellate Body's ruling in a GATS case involving US gambling laws opens the door wide to challenges against a broad range of regulations. Calling the decision "a terrible precedent", George Washington University Law School professor Steve Charnovitz said it vindicates "those critics of the WTO around the world who have been saying for years, I always thought wrongly, that the GATS is a threat to legitimate domestic regulations."²

Yet when municipal governments ask "Does GATS threaten our right to regulate?", Canada's International Trade Department responds with a flat "no."³ US trade officials are equally emphatic in their answers to state representatives. A May 2005 letter from the United States Trade Representative's office to state officials repeats eight times that: "nothing in the GATS impedes the ability of a state to maintain or develop regulatory requirements as appropriate to each jurisdiction..."⁴

The GATS is a binding international commercial agreement enforced by the World Trade Organization (WTO)⁵. When nations signed on to the GATS in 1994,

national governments promised to ensure all levels of government conformed with the agreement. National governments are currently negotiating to expand the GATS, not only to have more service sectors governed by its most powerful provisions, but as well to create extensive new restraints on domestic regulation. Yet the true extent of the agreement's existing restrictions on the right to regulate are only now becoming clear through WTO dispute decisions. In Canada and the US, subfederal governments are responsible for many areas of services regulation, so these dispute decisions are of major consequence for state, provincial, and local governments.

In November 2004 a WTO panel ruled largely in favour of Antigua-Barbuda's GATS challenge against US prohibitions on remote gambling.⁶ The panel concluded that the GATS requires regulatory bans to be eliminated when a government fully commits to opening a sector of its services market. In April 2005 the WTO Appellate Body issued a report agreeing with this conclusion.⁷

In its appeal submissions, the US government warned that the panel's interpretation of the GATS "greatly constrains the right of Members to regulate services..."⁸ The US specifically cited bans on billboard advertising as just one example of the regulations that were in jeopardy. The US said the panel's ruling was inconsistent with the introductory wording to the GATS, which recognizes "the right of Members to regulate...the supply of services within their territories in order to meet national policy objectives."⁹ It is this

statement that trade officials repeatedly quote when they claim the agreement does not undercut the right to regulate. The panel however made it clear that a government's right to regulate extends only so far as it does not impair the trading rights of WTO members.¹⁰

The Appellate Body upheld the panel's broad interpretation of the GATS restrictions on regulatory authority. The take home lessons from the US-Gambling ruling for subfederal representatives are:

1. Contrary to what is being stated by trade officials, even "non-discriminatory" regulations—regulations that are even-handed in their treatment of foreign and domestic companies—can violate the GATS.
2. Regulatory bans violate GATS market access commitments, even though they are not specifically identified in the GATS as a prohibited market access barrier.

The ruling has not drawn enough attention because the Appellate Body largely let the US off the hook in this particular case. While agreeing with the panel's finding that US laws on remote gambling violate the GATS, the Appellate Body allowed the US to justify these violations under the exceptions clauses to the agreement.

Exceptions clauses, however, have rarely been of any use to governments trying to defend their regulations at the WTO. The US itself lost in the two previous WTO cases, US-Gasoline and US-Shrimp, when it tried to use exceptions clauses for its defence.

As will be analyzed below, making commitments and then relying on exceptions clauses to preserve the right to regulate is a high-risk gamble given the long string of losses defending governments have suffered. Relying on exceptions clauses also takes the critical decision of whether a regulation is "necessary" out of the hands of elected officials and transfers it to WTO panels. Again, contrary to official assurances that suggest subfederal authority is unaffected by the GATS, in the event of a challenge the WTO dispute settlement body has the last word¹¹ and can authorise trade sanctions to compel changes to subfederal regulations.

The Appellate Body Ruling Contradicts Assurances from Trade Officials

"This may well mean that, with the stroke of a pen, the validity of scores of domestic services regulations, including those that are non-discriminatory, are threatened... This latest Appellate Body ruling should put all WTO Members on notice and induce them to re-read (and in some cases, re-negotiate) their schedules of GATS commitments. If not, more surprises lie just around the corner."¹²

Joost Pauwelyn, Associate Professor of Law, Duke University School of Law and former legal officer with the WTO Secretariat

WTO Appellate Body decisions are significant because the Appellate Body is considered the final arbiter on what WTO treaties mean. US-Gambling was the first case the Appellate Body had ever ruled on based solely on the GATS, and its ruling explained for the first time the meaning of some very ambiguous parts of the agreement.

According to former USTR negotiator Jeffrey Lang: "Virtually every normative provision of the GATS is interesting and even novel. Some of these provisions are so obviously problematic that they cry out for substantive renegotiation."¹³ But rather than clarify the agreement themselves so that their right to regulate could be protected, WTO members have decided to take their chances and leave the job of clarification to dispute panels.

The Appellate Body's decision proves unequivocally that market access under the GATS entails far more than an obligation to provide non-discriminatory treatment—or "national treatment" as it is referred to in trade agreements. This is a key consideration for subfederal governments in deciding whether they need to spend the resources necessary to influence international trade negotiations. Since most subfederal government regulations such as municipal zoning laws apply equally to local and foreign companies, trade provisions that just require equitable treatment do not appear to be much of a threat.

Trade negotiators often attempt to reassure local officials that the GATS does not go beyond requiring national treatment. In its explanation of the GATS,

Canada's trade department claims: "municipalities retain the right to regulate in areas where they have jurisdiction so long as these regulations do not apply in a discriminatory manner."¹⁴ In consulting with state governments, the US Trade Representative has asserted: "Like any trade agreement, GATS simply says that if a state chooses to allow private competition in services, it should give U.S. and foreign firms a chance to compete on an equal footing."¹⁵

Trade officials continue to make these kinds of claims even though the WTO Secretariat highlighted back in 1999 that this view represented a confusion about the GATS. The Secretariat emphasized that the GATS market access provisions prohibit certain government measures "whether they are discriminatory or not."¹⁶ The Appellate Body's ruling in US-Gambling apparently has not prevented trade officials from continuing to say regulations are safe as long as they are non-discriminatory. That is why it is critical for regulators to know what happened in the case.

Equitable Treatment No Defence from Violating GATS Market Access

US officials, in their appeal submissions and statements to the media, repeatedly emphasized that US prohibitions on remote gambling are *non-discriminatory*—they prevent American companies every bit as much as foreign ones from supplying remote gambling services. If equitable treatment is not sufficient to meet a country's GATS obligations, then in the view of the US government's lawyers the agreement would be affording greater rights to foreign service suppliers than domestic suppliers enjoy. The January 2005 submission from the US to the Appellate Body stated:

"In view of the fact that U.S. restrictions on gambling by remote supply are non-discriminatory, the central question in this dispute is whether anything in the GATS requires the United States, in the sensitive field of gambling services, to treat services and suppliers of Antigua more favorably than its own domestic services and suppliers by allowing them to provide gambling by Internet, telephone, and other means of remote supply in ways that domestic suppliers cannot. The answer is that nothing in the GATS requires that result."¹⁷

The answer unfortunately is that the GATS market access article—Article XVI—does require that result. Full market access commitments require governments to eliminate certain restrictions on a service market, *even when these restrictions are applied without discriminating between foreign and local suppliers*. Article XVI means that governments cannot exclude foreign companies from a service market even if a country's laws close that market to domestic companies.

The US protested that the panel ruling would result in a situation where foreign companies would have to be allowed to do what was illegal for domestic companies to do. But Article XVI provides guarantees that when commitments are made certain types of measures—even criminal laws—that limit access to a services market will be removed. It does not say "as long as this does not result in illegal activity."

Canadian trade officials have told Canadian municipalities that "there is nothing in the GATS that exempts foreign service providers from Canadian laws and regulations."¹⁸ However, when a WTO member's laws are found to violate the market opening guarantees it has made to other members, the laws have to be changed to allow this access.

The minutes to the original meetings that led up to the GATS show that trade negotiators have long understood that the GATS would involve more than national treatment. These minutes indicate that while some countries opposed the notion of an agreement that would interfere with non-discriminatory regulations, the US insisted that the GATS had to go beyond non-discrimination. As far back as 1985, US trade negotiators were arguing that: "Where regulations limit the total number of enterprises, national treatment by itself might not assure reasonable market access for foreign enterprises, and additional commitments might therefore be necessary."¹⁹

Background on the US Gambling Case

The US-Gambling case began in July 2003 when the WTO established a dispute panel to hear a complaint by Antigua against US prohibitions on Internet gambling. The panel ruled in November 2004 that the US was violating the GATS and that this violation was not justified by the exceptions clauses in the agreement (the original panel decision is analyzed in the CCPA

report “The GATS US-Gambling Decision—A Wakeup Call for WTO Members”). The US Trade Representative described the panel’s decision as “outrageous”²⁰ and the US government appealed.

The ironies in the dispute were numerous. It was to be the first Appellate Body ruling exclusively based on the GATS and yet it was a case against the US, the country that had been the prime mover behind the agreement. The US had made getting a services agreement a condition of its participation in the round of negotiations that established the WTO. The US relentlessly pressed during these negotiations for the broadest possible services agreement.

The US had even insisted over the objections of other countries on provisions that would go beyond non-discrimination, the very provisions that would lay the foundation for Antigua’s case against US prohibitions on Internet gambling. As often happens in international trade negotiations, there seemed to be a failure of imagination. US trade negotiators were unable to foresee circumstances when the wording they advocated for an agreement would end up being used against their own country.

Despite its importance, the Appellate Body’s ruling in the US-Gambling case was a bit of a non-event in the mass media. The US had essentially dodged a bullet when the Appellate Body overturned those aspects of the earlier panel decision that would have required major changes to US state and federal law affecting gambling. The story quickly lost its newsworthiness due to its lack of dramatic immediate effects. The broader significance of the case was generally ignored.

Overview of the Appellate Body’s Ruling

The Appellate Body overturned the panel’s ruling against the gambling laws of four US states, agreed with the panel’s findings that US federal laws affecting remote gambling violated US GATS obligations, and largely reversed the panel’s decision that these federal violations were unjustifiable. The Appellate Body found that US federal laws affecting remote gambling—once changes were made to the Horse Racing Act—could be justified using the exceptions clauses in the GATS.

Although the US was in many respects lucky that the Appellate Body ruled as it did, the decision still poses

difficulties for the US government. In an August 2005 decision²¹, a WTO arbitrator gave the US until April 2006 to change US federal law to make it consistent with the GATS, despite protests from the US that it would be very difficult for the US Congress to pass the necessary legislation in time.

The aspect of the ruling dealing with state legislation cannot be seen in any way as a “win” for subfederal levels of government. The GATS applies to every level of government, and the fact that state regulations fall within its scope was not disputed in the case. However, the Appellate Body ruled that the panel should not have examined Antigua’s complaint against state gambling laws because Antigua had not prepared a sufficient case against them. Complainants in WTO disputes are required to explain precisely what government measures are at issue, and how these measures violate WTO obligations. Since Antigua did not do this in relation to state regulations, the Appellate Body overturned the panel’s findings against the gambling laws of Louisiana, Massachusetts, South Dakota, and Utah.

In other words, the Appellate Body overturned the panel’s ruling against state laws due to a legal error on the part of Antigua’s lawyers. When the US Trade Representative states that “the Appellate Body specifically rejected each of the panel’s findings against the state-level measures regulating gambling”²² it is important to know that the Appellate Body did this on procedural grounds. The US was thereby able—temporarily at least—to avoid a constitutional crisis over federal pre-emption of state laws that are found to be violations of international trade agreements.

In terms of the complaint against US federal laws, however, the Appellate Body upheld the panel’s opinion that Antigua had presented sufficient arguments to warrant a panel decision. It also agreed with the panel that the US had made gambling “commitments”.

Unintentional Liberalization

The GATS is supposed to be a flexible agreement, allowing governments to undertake liberalization only in areas they choose. But the US-Gambling decision

makes it clear that countries can unintentionally subject entire service sectors to liberalization under the GATS.

Some GATS provisions apply to all services automatically. Others, most significantly Article XVI “Market Access” and Article XVII “National Treatment”, apply when governments make “commitments” of particular services. When countries join the WTO, they provide a list (called a “schedule”) of service sectors they commit to be governed by GATS market access and national treatment rules.

Since the word gambling does not appear in the US schedule, it is not obvious to the uninitiated how the Appellate Body could rule this US commitment nonetheless existed. The US maintained that it never intended to commit gambling, gambling never came up during negotiations over its commitments, and it defied common sense that the US government would have made a commitment in an area that is so sensitive and has been strictly regulated for such a long time.

The United Nations and WTO classification codes used by most WTO members includes gambling under the category of “other recreational services”. While the US schedule does not refer to these codes, the service categories it uses are similar. The Appellate Body ruled that if the US had wanted to exclude gambling from its commitments under “other recreational services”, it should have clearly listed this exemption on its schedule of commitments. The Appellate Body also agreed with the panel that by maintaining laws that prohibited remote gambling, the US violates its market access commitments.

Because the US lost in its attempt to prove it had not violated the GATS, it had to draw on the exceptions clause in the agreement. It did this as a last resort, arguing right up to the appeal stage that it did not need to rely on this escape hatch that allows governments to maintain their measures even if they are found to have violated their obligations under the agreement²³. Given the overwhelming record of defeats governments have had trying to defend their legislation at the WTO on the basis of exceptions clauses, the US was fortunate in how the Appellate Body ruled in this particular case.

What US-Gambling Means for all WTO Members

The finding that the US had committed a multi-billion dollar industry unintentionally is a major loss for the US. Antigua was only challenging its remote gambling laws, which falls under the category of cross-border trade in the four “modes” of trade defined in the GATS²⁴. The Appellate Body’s ruling that the US commitment of “other recreational services” covers gambling means the US has provided full market access under the “commercial presence” mode as well. All US regulations over gambling suppliers based in the US—eg. rules authorizing state lottery monopolies and Indian tribe casinos, or restricting slot machines—are now vulnerable to a WTO challenge since they either place limits on the market and/or give preference to domestic gambling service suppliers.

However, the Appellate Body’s interpretation of the GATS market access clause and reasoning behind why the US had violated this provision essentially shifts the ground under the feet of every WTO member. This interpretation puts a whole field of regulation in jeopardy and could severely restrict the policy space of governments. It means that governments fundamentally did not understand what they were agreeing to when they made their commitments in the first round of GATS negotiations.

Canadian and US government consultation documents suggest federal officials still do not understand the real scope of the agreement even after the Appellate Body’s decision. In sharp contrast with what the US lawyers said in their submissions in the case, trade officials appear to be downplaying the agreement’s disastrous implications for regulatory authority in their drive to expand its coverage and open markets for exporters.²⁵

The GATS market access article is particularly badly worded, causing uncertainty about what a GATS market access commitment actually entails. The specific problems with the article’s wording are analyzed in Annex A. The uncertainty about what market access really means has emerged in the current negotiations designed to expand commitments. For example, countries considering making retail services commitments are getting conflicting answers about whether their regulation of shopping

centre development would be affected by such commitments.²⁶

Broadly speaking, the Appellate Body's decision means the odds have got significantly worse for governments in terms of their ability to defend against market access challenges. On the other hand, governments might read the US-Gambling decision as a license to make extensive new GATS commitments betting that the exceptions clause can be used if they get into trouble. A review of the exceptions rulings, provided in Annex B, indicates this bet should be seen as a long shot.

Undermining the Right to Regulate

A critical aspect of the US-Gambling ruling is the interpretation of Article XVI—Market Access.²⁷ The panel had ruled that by prohibiting a particular service, as the US had done for remote gambling, a country violated its market access commitments. In its appeal, the US objected in the most forceful terms, saying this interpretation greatly constrained the right to regulate.

The US predicted the panel's expansive interpretation of the meaning of GATS market access would result in WTO Members trying to expand each others' commitments not through negotiation, but through the dispute process. The US said it could have a negative impact on the current services negotiations by discouraging WTO members "from making commitments at all for fear that they will be expanded beyond what was agreed."²⁸

Article XVI stipulates that the following specific *forms* of measures cannot be adopted or maintained when full market access commitments are made for a service: economic needs tests, numerical quotas, exclusive suppliers, monopolies, limitations on the number of people employed, joint venture or other kinds of legal entity requirements, and limits on foreign capital. The US argued that only government measures taking *these exact forms* could be violations of market access commitments.

The Appellate Body however upheld the panel's opinion that a regulatory ban such as the US prohibitions on remote gambling also violated market access commitments, even though a ban is not specifically named in Article XVI as a market access barrier. The Appellate Body concluded that a ban

should be viewed as a kind of numerical quota—a "zero quota"—because it limits the number of permitted service suppliers and operations to zero. Since numerical quotas are named in Article XVI as violations of market access when full commitments are made, the US regulations outlawing remote gambling were consequently found to be a violation of its market access commitments.

In its appeal submissions, the US had complained that the panel's interpretation of market access "unreasonably and absurdly deprives Members of a significant component of their right to regulate services by depriving them of the power to prohibit selected activities in sectors where commitments are made."²⁹ The Appellate Body's sanctioning of the panel's interpretation has enormous implications, especially since Appellate Body decisions are essentially the final word on the meaning of WTO agreements.

The US gave the following examples of actual regulations maintained by WTO Members that under the panel's interpretation (confirmed by the Appellate Body) could be challenged as violations of their existing market access commitments:

"a complete ban on unsolicited direct advertising by fax or email, or by use of automated calling machines..."

"a prohibition on highway-side outdoor advertising signs, notwithstanding the fact that that Member has made a full market access commitment for supply of advertising services through commercial presence."³⁰

In other words, the US was identifying actual regulations WTO members maintain that could be challenged successfully at any time based on the US-Gambling precedent.

For local governments, the implications are profound. Many WTO members have already made extensive market access commitments for retail, construction, advertising, and waste management services, all sectors where local governments could be seen as imposing regulatory bans on aspects of the service. The very foundation of zoning involves imposing what are effectively regulatory bans on incompatible kinds of land uses within an area. Some countries appear to have been aware of this jeopardy, and tried to limit

their commitments accordingly. Italy, for example, has limited its hotel and restaurant commitments to stipulate that “authorization can be denied in order to protect areas of particular historic and artistic interest.”³¹ However, neither Canada nor the US has scheduled similar limitations on their commitments for hotel and restaurant development, leaving them open to challenges against prohibitions on development in historic or environmentally sensitive areas.

Breaking Down a Critical Distinction

A bright line is supposed to be drawn in the GATS based on whether a government measure is quantitative—restricting the number of service suppliers or operations—or qualitative—imposing standards and requirements for licenses and qualifications. The Scheduling Guidelines for the GATS explain that the criteria listed in Article XVI—Market Access “do not relate to the quality of the service supplied, or to the ability of the supplier to supply the service (i.e. technical standards or qualification of the supplier).”³²

The consequences of blurring these two kinds of GATS provisions cannot be overstated. When governments make market access commitments, they can only maintain regulations or introduce new ones if they list them as limitations on their commitments. So if governments make market access commitments believing that only quantitative regulations are covered, they will not have listed qualitative regulations they wanted to preserve. If governments have been wrong in this belief, they will have inadvertently exposed a wide field of domestic regulation to GATS challenges. For example, qualitative regulations prohibiting tobacco advertising have not been listed as limitations on market access commitments, even though a number of countries maintain such prohibitions.

The US-Gambling decision opens the door for market access challenges to qualitative regulations in two key ways:

- When a full market commitment is made for a class of service and mode of trade, then all services fitting under these categories are covered by the commitment;

- A qualitative regulation that “in effect” produces a quantitative limitation may be vulnerable to a market access challenge.

The Broadened Scope for Challenges to Non-discriminatory Regulation

The US claimed that its regulations prohibiting remote gambling could not be defined as a market access violation because they addressed the particular *quality* of the services—its remote character—rather than placing limits on the *quantities* of service suppliers or operations. The US described in the starkest terms the consequences of extending GATS market access to restrict government regulations based on the characteristics of a service:

“Much neutral regulation of service activities involves the prohibition of services that have particular characteristics. Indeed, the very concept of regulation of a service typically rests on the power of the state to prohibit services not supplied in accordance with state-imposed norms. In that sense, most regulation involves prohibiting that fraction of the service which, although abstractly possible, does not conform to the relevant norms. Under the Panel’s interpretation of Article XVI, however, it would appear that very little domestic regulation could ‘escape’ Article XVI if it can be described as prohibiting part of a sector or part of a mode of supply.”³³

To illustrate this point, when it appeared before the panel the US gave the example of a market access commitment for the cross-border supply of medical services. The US argued that this commitment would not entail that doctors have to be allowed to diagnose patients over the phone or the Internet, because market access commitments do not mean “that Members lose all rights to restrict particular types of activity in that sector.”³⁴

It turns out that this is exactly what a full market access commitment does mean. For whatever reason, at the appeal stage the US lawyers abandoned their argument about commitments not covering all parts of sectors and “modes” of service supply. The Appellate Body noted this in its report and cited the Panel’s conclusion that:

“(i) as regards a particular service, a Member that has made an unlimited market access

commitment under mode 1 commits itself not to maintain measures that prohibit the use of one, several or all means of delivery of that service; and (ii) a Member that has made a market access commitment in a sector or subsector has committed itself in respect of all services that fall within the relevant sector or subsector.”³⁵

The US therefore failed in the US-Gambling case to establish that “remote supply” of gambling was a qualitative characteristic rather than a mode of service delivery, covered by its commitments. This finding raises doubts about the GATS-consistency of similar types of regulatory restrictions of services across a broad range of sectors.

The Appellate Body stated it would be unnecessary for it to draw a line between what was a quantitative measure falling under GATS market access provisions and what was a qualitative one falling under GATS domestic regulations provisions. But then it went on to state that any regulation that “in effect” created either a monopoly or an “exclusive service supplier” violated market access.³⁶

The case law based on other trade treaties reinforce concerns about the potential consequences of reading “in effect” into the GATS market access article. For example, the European Economic Area Agreement has a clause that prohibits quantitative restrictions on alcohol imports and “all measures having equivalent effect”. Norway’s general prohibition on alcohol advertising was found to be a violation of this clause because, even though it did not explicitly impose quantitative limits on alcohol imports, it would *have the effect of* placing quantitative restrictions on these imports.³⁷

Exceptions Clauses—A Risky Gamble

Given the record of defeats governments have had trying to defend their legislation at the WTO on the basis of exceptions clauses, the US was fortunate in how the Appellate Body’s ruled in the US-Gambling case. The Appellate Body found that the US federal laws affecting remote gambling are measures “‘necessary to protect public morals or maintain public order’, in accordance with paragraph (a) of Article XIV”.³⁸ In allowing the US to justify its GATS violations, the Appellate Body demonstrated a leniency out of step

with its decisions in other cases involving exception clauses.

Making commitments and then counting on exceptions clauses to save regulations in the event of a GATS challenge has major drawbacks, notably:

- **The discretionary authority it assigns to WTO panels.**

The Appellate Body has stated that in assessing whether a measure can be justified, WTO dispute panels need to judge how important the values are that the measure is supposed to protect³⁹. However, WTO dispute panels should not be the ultimate arbiters of the relative importance of WTO members’ policy objectives. For example, on what objective basis could a panel determine whether the values underlying Utah’s total prohibition on gambling are “important” enough?

- **The slim chances of success.**

Most governments have failed when they have tried to use exceptions clauses to defend their regulations. These clauses are fiercely complex, and place the burden on defending parties to overcome three different hurdles to make their case; failure on any one of these means they have lost.

- **The unpredictable nature of the outcomes.**

WTO jurisprudence on exceptions clauses is evolving, but unfortunately not in a way that makes it easier to know what a panel will likely decide. Each new case seems to add an additional twist to what is already a very complicated process. The highly subjective nature of the criteria applied—how “important” a policy objective is, whether alternative measures are “reasonably” available to a government, how much a measure contributes to its objective—suggests that panel decisions on exceptions clauses inevitably will have a wild card character.

The brief discussion under the attached Appendix B of WTO disputes where countries made recourse to exceptions clauses suggests why these clauses are so problematic. They are no substitute for negotiating

changes to agreements so that they cannot be used to attack legitimate regulations.

Conclusion

It is worth understanding the Appellate Body decision in the US-Gambling case in detail and going beyond the superficial headlines announcing the US “won” its appeal. The ruling allows governments to grasp in specific terms how GATS market access commitments threaten their right to regulate. Elected representatives need to intervene in the current GATS talks so that trade negotiators will:

- 1) Change the market access article so that it does not provide scope for challenges to legitimate regulation;
- 2) Suspend their work on new GATS provisions that would create even more grounds for challenges to non-discriminatory regulations.

Some trade experts have criticized the Appellate Body for its US-Gambling decision, saying the Appellate Body interpreted the GATS in a way that was not intended by those who drafted the agreement. The Appellate Body did resolve ambiguities in the GATS so that governments’ regulatory authority is now significantly threatened. But the record shows that it was trade negotiators who handed dispute panels the rope to hang governments. Lack of governmental oversight of negotiators, inadequate consultation with other levels of government, and a near exclusive focus on advancing the interests of exporters made the US-Gambling ruling a predictable rather than an unintended consequence of previous GATS negotiations. A radically different approach to the current GATS negotiations is required.

Appendix A—The Problems with the GATS Market Access Article

The US asked the Appellate Body in the US-Gambling case to see the GATS market access article as only prohibiting certain carefully defined “problematic limitations” that WTO members might place on access to a services market. The US argued that reference in the second paragraph of the article to prohibited limitations taking “the form of” and being “expressed in terms of” meant only measures that closely followed the wording in the agreement could be violations of commitments. The US said that unless limitations

matched “the precisely drawn requirements of the text” they were not covered by Article XVI.

However, where the US claimed precision the Appellate Body found uncertainty. In the Appellate Body’s opinion, the word “form” was ambiguous and could have a broad meaning. It stated that a “rigid mechanical formula” should not be applied to the phrase “in the form of”. Emphasis should be placed not on the form of a measure but on whether it was numerical or quantitative in nature. Since “zero” is numerical in the sense that it has the characteristic of a number, the Appellate Body determined that a regulatory ban setting the permissible number of service suppliers or operations at zero falls under the scope of the article.

Did the panel and the Appellate Body unreasonably stretch the meaning of GATS market access to make it cover regulatory bans? Joost Pauwelyn is sharply critical of their decision. In his analysis of the case, Pauwelyn stated: “Driven to its logical conclusion, the approach in US—Gambling risks WTO intrusion into the regulatory freedom of WTO Members far beyond what was originally agreed to in the WTO treaty.”⁴⁰ Pauwelyn viewed the inclusion of the phrase “designated in numerical units” as being as clear as possible an indication from the agreement’s drafters that regulatory bans were not covered. He said the Appellate Body was wrong to ignore this phrase.

Whether or not the Appellate Body was guilty of judicial activism, there is no question that the GATS article on market access—Article XVI—is badly worded. For example, the requirement that a limitation on service operations or service output has to be expressed in “designated numerical units” to be a market access violation is just not obvious from reading the relevant aspects of the article:

“(L)imitations on the total number of service operations or on the total quantity of service output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test”.

Antigua described this sentence as nonsensical and speculated that its bad syntax might have been the result of typographical errors. The panel had tried to sort out what it might mean by scrutinizing the placement of a comma after “designated numerical

units” in the French and Spanish versions of the agreement. But the panel found that a comparison of the English text with these versions “discloses a difference of meaning.”⁴¹

The Appellate Body concluded the panel’s approach did not help, stating: “Regardless of which language version is analyzed, and of the implications of comma placement (or lack thereof), all three language versions are grammatically ambiguous.”⁴² It seems absurd that government could have let the fate of their regulations—and the regulations of all subfederal governments within their territory—rest on such flawed language in a legally binding international agreement.

Because GATS negotiators left this kind of ambiguity in the actual text of the agreement, dispute panels will have to resort to supplementary documents to divine what GATS negotiators meant. The 1993 GATS Scheduling Guidelines⁴³, agreed to by all WTO Members including the US, fatally undermined the US case that its gambling laws did not violate market access. These guidelines were prepared by the WTO Secretariat to clarify what kinds of government measures were violations of the market access and national treatment provisions of the GATS. The Appellate Body pointed out the Guidelines explicitly gave an example of a “zero quota” on service suppliers being a market access violation.

The US and all other WTO Members had an opportunity to decrease the risk of market access challenges to their regulatory bans by insisting that the “zero quota” example not appear in the 1993 Scheduling Guidelines or in its 2001 update. They could ask at any time for a “Chairperson’s Note” to clarify the meaning of any GATS article. They could use the technical review of the GATS currently underway to sort out the most problematic aspects of the agreement, as the Brazilian delegation has repeatedly proposed. WTO Member governments need to direct their GATS negotiators to do this before new challenges to the right to regulate are launched based on the Appellate Body ruling.

Appendix B—An Overview of WTO Exceptions Rulings

The Appellate Body stated in the US-Gambling case that the exceptions clauses in Article XIV of the GATS

were comparable to those in Article XX in the General Agreement on Tariffs and Trade (the GATT), so the same reasoning could be applied. The Appellate Body has previously described Article XX as affording “limited exceptions” from the obligations created by an agreement.⁴⁴

Since the WTO was established, Article XX of the GATT has been invoked in eleven cases⁴⁵. In only one of these cases, EC-Asbestos⁴⁶, has a defending government been able to win its argument based on exceptions.

The US succeeded in convincing the US-Gambling panel that its laws affecting remote gambling fit the exception permitted in the GATS for measures to “protect public morals or to maintain public order.” But the panel ruled that the US had not proved its laws were “necessary” because it had not consulted with Antigua about measures Antigua might take to address US concerns. The Appellate Body overturned this aspect of the panel’s ruling. The Appellate Body also found that, given the Interstate Horseracing Act which allows domestic remote betting operations, the US had failed to prove it was not unjustifiably discriminating against foreign suppliers of remote gambling services.

In successive cases the Appellate Body has detailed a series of hurdles governments have to overcome when they invoke exceptions clauses:

1. Measures have to be shown to serve one of the specific policy objectives recognized in the exceptions article. Other policy objectives, however worthy they are, cannot be used to justify an agreement violation.⁴⁷
2. Measures have to be demonstrated to be “necessary” according to very complex criteria.
3. As a final step, they have to be shown not to have been applied as a disguised barrier to trade or in an unjustifiably discriminatory manner.

Panels can reject a government’s characterization of the policy objective a measure serves. For example, in the EC—Preferences case⁴⁸, the European Communities tried to use the exception permitted for the protection of life and health to defend its preferential trade arrangements with particular developing countries. These arrangements were intended to foster sustainable development as an alternative to the production of illicit drugs. However, sustainable

development is not a policy objective recognized in exceptions clauses so the EC could not try to justify its measures in relation to that objective.

The EC claimed its preferential trade policies qualified for the health exception because they helped to protect life and health in Europe by stemming the flow of illegal drugs. But the panel stated that since nothing in the legislation mentioned this objective and since no monitoring mechanism was in place to assess whether there were benefits for Europeans' health, the measures did not fall under the scope of the permitted exceptions. Even though a measure's objective may be positive, such as fostering alternatives to the production of illicit drugs, it cannot be used to justify a measure if it does not fit within the specific objectives recognized in exceptions clauses.

The Challenges of Proving "Necessity"

If a government succeeds in convincing a panel its measure is designed to achieve one of the objectives listed in exceptions clauses, it then bears the burden of proving the measure is *necessary*. The Appellate Body has ruled that the test of whether a measure is "necessary" involves weighing and balancing three criteria:

- The relative importance—*in the dispute panel's opinion*—of the values a measure is designed to protect.
- The effectiveness of the measure in accomplishing the ends pursued. The Appellate Body has said a measure has to be closer to being "indispensable" rather than merely "making a contribution" to the ends pursued.⁴⁹
- The trade restrictiveness of a measure. The more trade restrictive a measure is, the harder it is to prove that it is necessary.

In making necessity judgments, WTO dispute panels of a government's measures are assuming the role usually filled by domestic legislators. They are making trade-offs between economic and non-economic objectives—the trade restrictiveness of a measure versus the importance of a policy objective.

Governments are in theory entitled to achieve the level of protection they want in choosing the strictness of a measure. However, in practice dispute panels second-

guess governments. In the Korea—Beef case, for example, the Appellate Body simply dismissed Korea's statement that it was trying to ensure the elimination of fraud in sales of beef, stating "We think it unlikely that Korea intended to establish a level of protection that totally eliminates fraud..."⁵⁰

In the US-Gambling case, the effectiveness of US prohibitions on remote gambling was not actually evaluated. Instead, the panel and the Appellate Body merely assumed that making remote gambling illegal must mean people would be deterred. The evidence that sixty percent of the global revenue from online gambling is estimated to come from US gamblers⁵¹ was not considered in relation to the effectiveness of the contested laws.

However, in its Dominican Republic-Cigarettes decision⁵² released just weeks after US-Gambling, the Appellate Body took a very different approach. The Dominican Republic succeeded in demonstrating that its objectives were important, that its measure did contribute to these objectives, and that the measure did not have much impact on trade. Nonetheless, the Dominican Republic failed to prove necessity to the satisfaction of the Appellate Body. The Appellate Body upheld the panel's ruling that was largely based on the panel's belief that there were better alternatives to achieve the measure's objectives.

A review of the Dominican Republic-Cigarettes decision in the American Society of International Law's newsletter points out the problems associated with WTO panels evaluating the effectiveness of government measures:

"This ruling raises concerns because it is based in part on a subjective judgment by the AB on a matter on which it arguably has less expertise than the government concerned has. The question as to whether a hypothetical WTO-consistent law would have a specified effect on tax avoidance in a particular country is not one on which members of an AB are likely to have expertise, since they are not experts in either tax or the operation of the economy of the Dominican Republic."⁵³

Conflicting Signals Regarding Alternative Measures

WTO jurisprudence on exceptions cases has established that the necessity of a measure depends on whether there is a “WTO-consistent alternative measure which the Member concerned could ‘reasonably be expected to employ’ is available, or whether a less WTO-inconsistent measure is ‘reasonably available.’”⁵⁴

In the US-Gambling case, the Appellate Body found that an alternative was not reasonably available if “it is merely theoretical in nature, for instance, where the responding 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. Moreover, a ‘reasonably available’ alternative measure must be a measure that would preserve for the responding Member its right to achieve its desired level of protection with respect to the objective pursued...”⁵⁵

However, in the Korea-Beef case, the Appellate Body described alternatives as “reasonably available” even though Korea had already explicitly rejected them as failing to achieve its desired level of protection. The existence of less stringent regulations in other areas of Korean law was used against Korea despite Korea’s protests that it was attempting to attain higher standards in the retailing of beef.

Whether the desired level of regulatory protection is achieved by alternative measures is entirely within the discretion of WTO panels, as is whether the costs of alternatives are “prohibitive”, or the difficulties involved “substantial”. Panels have told countries they could “devote more resources” to alternatives and discounted concerns about administrative difficulty.⁵⁶

The Appellate Body stated in the US-Gambling ruling also said that it was not the defending party’s responsibility to show “that there are no reasonably available alternatives to achieve its objectives” and that the complainant had the burden of proposing these alternatives. It is difficult to square this with other rulings, since it has frequently been the panel and not the complainant that has proposed alternatives. The ruling in Dominican Republic-Cigarettes, coming as it did after the US-Gambling report, demonstrates that governments had better be prepared to counter

all arguments that there are reasonably available, less trade restrictive alternatives to their measures.

The Final Pitfalls in Exceptions Clauses

As if the problems involved in proving necessity were not difficult enough, the GATS and GATT exceptions clauses impose three additional requirements in their introductory sentences (called the *chapeau* of the exceptions article). Should a panel agree that a measure meets all the stringent requirements outlined above, they then proceed to examine whether it is applied in a way that creates “arbitrary discrimination”, “unjustifiable discrimination”, or a “disguised restriction” on trade. As a panel has stated, “if the measure for which justification is claimed fails to meet one of them, the measure *ipso facto* fails to satisfy the requirements of the chapeau.”⁵⁷

The US, for example, proceeded down the long legal road of trying to get the Clean Air Act and Gasoline Rule to qualify as exceptions when a case was brought against these regulations by Venezuela and Brazil.⁵⁸ Having first suffered a defeat when a panel had ruled its regulations were not primarily aimed at conservation, the US succeeded in convincing the Appellate Body to overturn this aspect of the panel’s decision.

The Appellate Body accepted the US argument that its legislation was related to the conservation of natural resources, a regulatory objective recognized in GATT exception clauses⁵⁹. But then the Appellate Body faulted the US for not having “pursued the possibility of entering into cooperative arrangements with the governments of Venezuela and Brazil or, if it had, not to the point where it encountered governments that were unwilling to cooperate.”⁶⁰ This omission on the part of the US was one of the reasons the Appellate Body concluded its regulations failed the requirements of the chapeau. The Appellate Body ruled that the way the US applied its regulations to foreign refiners constituted “unjustifiable discrimination” and a “disguised restriction on international trade”.

In the US-Shrimp case, the Appellate Body ruled that a consideration that “bears heavily in any appraisal of justifiable or unjustifiable discrimination” was whether the US had engaged in “serious, across-the-board negotiations” to achieve its conservation objectives.⁶¹ The failure of the US to do this was one of the reasons the Appellate Body found the US guilty of

both arbitrary and unjustifiable discrimination in the application of its regulations.

The Appellate Body, in its US-Gas and US-Shrimp rulings, made good faith negotiations a requirement for proving a measure is applied in a justifiable and non-arbitrary way. In US-Gambling, however, the Appellate Body overturned the panel's finding that engaging in consultations was essential to proving a measure is "necessary." Governments might reasonably be confused about the distinction the Appellate Body made in these cases and uncertain about what they are now required to do to meet the criteria of exceptions clauses.

Notes

¹ The US has committed all four of these services and Canada has committed "refuse disposal", which covers disposal by incineration and other means. These lists of commitments are available on the Internet searching on the document symbol: GATS/SC/90 (the US commitments), and GATS/SC/16 (Canada's commitments) at <http://docsonline.wto.org>, accessed 11 October 2005

² BNA WTO Reporter, "WTO Body Rules on Internet Gambling", 8 April 2005

³ International Trade Canada, "WTO-GATS Negotiations: General GATS Questions", <http://www.dfait-maeci.gc.ca/tna-nac/TS/general-en.asp>, accessed 11 October 2005

⁴ Assistant US Trade Representative, "Summary of Sector-Specific Elements under Consideration for Inclusion in the Update U.S. GATS Submission", attachment to memo on the GATS sent to state points of contact, 3 May 2005

⁵ The GATS is available at http://www.wto.org/english/docs_e/legal_e/26-gats_01_e.htm, accessed 12 October 2005

⁶ World Trade Organization, "United States—Measures Affecting the Cross-border Supply of Gambling and Betting Services—Report Of The Panel", WTO document symbol WT/D285/R, 10 November 2004

⁷ World Trade Organization, "United States—Measures Affecting the Cross-border Supply of Gambling and Betting Services—Report Of The Appellate Body", WTO document symbol WT/D285/AB/R, 7 April 2005

⁸ World Trade Organization, "United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services (AB-2005-1)—Appellant Submission of the United States", 14 January 2005, para. 112, p. 54, available at http://www.ustr.gov/Trade_Agreements/Monitoring_Enforcement/Dispute_Settlement/WTO/Dispute_Settlement_Index_-_Pending.html, accessed 11 October 2005

⁹ *ibid*, para. 126, p. 61

¹⁰ The panel stated: "Members' regulatory sovereignty is an essential pillar of the progressive liberalization of trade in services, but this sovereignty ends whenever rights of other Members under the GATS are impaired." World Trade Organization, "United States—Measures Affecting the Cross-border Supply of Gambling and Betting Services—Report Of The Panel", para. 6.316, p. 209

¹¹ In theory, the WTO membership can refuse to adopt an Appellate Body report. But as this would require rejection of a decision by all members including the party that won the case, it is highly unlikely.

¹² Joost Pauwelyn, "WTO Softens Earlier Condemnation of U.S. Ban on Internet Gambling, but Confirms Broad Reach into Sensitive Domestic Regulation", *The American Society of International Law—Insight*, 12 April 2005, available at <http://www.asil.org/insights/2005/04/insights050412.html#author>, accessed 12 October 2005

¹³ Jeffrey Lang, "The General Agreement on Trade in Services", presentation to symposium "The First Five Years of the WTO", Georgetown University Law Center, Washington, D.C. 21 January 2000

¹⁴ International Trade Canada, "WTO-GATS Negotiations: General GATS Questions"

¹⁵ Assistant US Trade Representative, memo on the GATS to state points of contact, 3 May 2005

¹⁶ World Trade Organization, "A Revision of the Scheduling Guidelines—Note by the Secretariat", WTO document symbol S/CSC/W/19, 5 March 1999

¹⁷ World Trade Organization, "United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services (AB-2005-1)—Appellant Submission of the United States" 14 January 2005, para. 5, p. 2

¹⁸ International Trade Canada, "WTO-Trade in Services Frequently Asked Questions"

¹⁹ General Agreement on Tariffs and Trade, “Trade in Services—Communication from the United States”, GATT document symbol L/5838, 9 July 1985

²⁰ Reuters news service, “WTO gambling decision ‘deeply flawed’ — Zoellick”, 25 March 2004

²¹ World Trade Organization, “United States—Measures Affecting the Cross-border Supply of Gambling and Betting Services—Arbitration”, WTO document symbol WT/DS285/13, 19 August 2005

²² US Trade Representative, letter to the Attorney General of Utah, 22 July 2005

²³ The US stated to the original panel “In closing, the United States wishes to reiterate that there is no need for the panel to reach Article XIV issues in order to resolve this dispute.” World Trade Organization, “United States—Measures Affecting the Cross-border Supply of Gambling and Betting Services—Report Of The Panel”, para. 3.285, p. 111

²⁴ The four modes of trade covered by the GATS are: cross-border, consumption abroad, commercial presence, and “movement of natural persons” (supply of a service by individuals working overseas on a temporary basis).

²⁵ See, for example, the news release issued by USTR the day the ruling was made public. Acting United States Trade Representative Peter F. Allgeier, news release, “U.S. Internet Gambling Restrictions Can Stand as U.S. Wins Key Issues in WTO Dispute”, 7 April 2005, available at http://www.ustr.gov/Document_Library/Press_Releases/2005/April/US_Internet_Gambling_Restrictions_Can_St_as_US_Wins_Key_Issues_in_WTO_Dispute.html, accessed 11 October 2005

²⁶ GATS Committee on Specific Commitments, “Report of the Meeting Held on 27 February 2003”, WTO document symbol S/CSC/M/28, 24 June 2003

²⁷ Because it found the US had violated its market access commitments, for reasons of judicial economy the panel declined to rule on whether the US had also violated its national treatment commitments.

²⁸ World Trade Organization, “United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services (AB-2005-1)—Appellant Submission of the United States” 14 January 2005, para. 92, p. 46

²⁹ *ibid*, para. 129, p. 62

³⁰ *ibid*, para. 128, p. 62

³¹ World Trade Organization, “European Communities and Their Member States—Schedule of Specific Commitments”, WTO document symbol GATS/SC/31, 15 April 1994

³² World Trade Organization, “Guidelines for the Scheduling of Specific Commitments under the GATS”, WTO document symbol S/L/92, 28 March 2001

³³ World Trade Organization, “United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services (AB-2005-1)—Appellant Submission of the United States” 14 January 2005, para. 126, p. 61

³⁴ World Trade Organization, “United States—Measures Affecting the Cross-border Supply of Gambling and Betting Services—Report Of The Panel”, para. 3.132, p. 53

³⁵ World Trade Organization, “United States—Measures Affecting the Cross-border Supply of Gambling and Betting Services—Report Of The Appellate Body”, Footnote 262, p.75

³⁶ *ibid*, p. 78

³⁷ The court in this case ruled “a general prohibition against the advertising of alcoholic beverages such as the one laid down in Section 9-2 of the Alcohol Act constitutes a measure having equivalent effect to a quantitative restriction on imports...” EFTA Court, Judgment of the Court in Case E-4/04, para. 50, 25 February 2005

³⁸ World Trade Organization, “United States—Measures Affecting the Cross-border Supply of Gambling and Betting Services—Report Of The Appellate Body”, p. 126

³⁹ The Appellate Body has stated: “The more vital or important those common interests or values are, the easier it would be to accept as ‘necessary’ a measure designed as an enforcement instrument.” World Trade Organization, “Korea—Measures Affecting Imports of Fresh, Chilled, and Frozen Beef—Report of the Appellate Body”, WTO document symbol WT/DS161/AB/R, 11 December 2000, para. 162, p. 49

⁴⁰ Joost Pauwelyn, “Rien ne Va Plus? Distinguishing domestic regulation from market access in GATT and GATS”, *World Trade Review*, Volume 4, Issue 02, July 2005, pp 131-170

⁴¹ World Trade Organization, “United States—Measures Affecting the Cross-border Supply of Gambling and

Betting Services—Report Of The Panel”, para. 6.344, p. 213

⁴² World Trade Organization, “United States—Measures Affecting the Cross-border Supply of Gambling and Betting Services—Report Of The Appellate Body”, para. 245, p. 82

⁴³ GATT, “Scheduling of Initial Commitments in Trade in Services: Explanatory Note”, GATT document symbol MTN.GNS/W/164, 3 September 1993

⁴⁴ World Trade Organization, “United States—Measure Affecting Imports of Woven Wool Shirts and Blouses from India—Report of the Appellate Body”, WTO document symbol WT/DS33/AB/R, 25 April 1997, p. 16

⁴⁵ The cases involving GATT Article XX are: Argentina-Bovine Hides, Canada-Periodicals, Canada-Wheat, Dominican Republic-Cigarettes, European Communities-Asbestos, European Communities-Preferences, European Communities-Trademarks/GIs, Korea-Beef, Mexico-Taxes on Soft Drinks, US-Gasoline, US-Shrimp

⁴⁶ World Trade Organization, “European Communities—Measures Affecting Asbestos and Asbestos-Containing Products—Report of the Appellate Body”, WTO document symbol WT/DS135/AB/R, 12 March 2001

⁴⁷ The GATT and GATS exceptions articles also allow governments to justify measures if they are necessary to secure compliance with laws and regulations, but the latter cannot be inconsistent with the agreement.

⁴⁸ World Trade Organization, “European Communities—Conditions for the Granting of Tariff Preferences to Developing Countries—Report of the Panel”, WTO document symbol WT/DS246/R, 1 December 2003

⁴⁹ World Trade Organization, “Korea—Measures Affecting Imports of Fresh, Chilled, and Frozen Beef—Report of the Appellate Body”, para. 161, p. 49.

⁵⁰ Ibid, para. 178, p. 54

⁵¹ Ronald Wirtz, “Shopping online for lucky 7’s”, Fedgazette (publication of the Federal Reserve Bank of Minneapolis), March 2003.

⁵² World Trade Organization, “Dominican Republic—Measures Affecting the Importation and Internal Sale of Cigarettes—Report of the Appellate Body”, WTO document symbol WT/DS302/AB/R, 25 April 2005

⁵³ Eliza Patterson, “WTO Appellate Body Rules on Dominican Republic Cigarette Imports”, ASIL Insight, 17 May 2005

⁵⁴ World Trade Organization, “Korea—Measures Affecting Imports of Fresh, Chilled, and Frozen Beef—Report of the Appellate Body”, para. 166, p. 50

⁵⁵ World Trade Organization, “United States—Measures Affecting the Cross-border Supply of Gambling and Betting Services—Report Of The Appellate Body”, para. 308, p. 102

⁵⁶ World Trade Organization, “Korea—Measures Affecting Imports of Fresh, Chilled, and Frozen Beef—Report of the Appellate Body”, para. 180, p. 55

⁵⁷ World Trade Organization, “Argentine—Measures Affecting the Export of Bovine Hides and Import of Finished Leather—Report of the Panel”, WTO document symbol WT/DS155/R, 19 December 2000 para. 11.313, p. 175

⁵⁸ World Trade Organization, “United States—Standards for Reformulated and Conventional Gasoline—Report of the Appellate Body”, WT/DS2/AB/R, 29 April 1996

⁵⁹ The GATS has no similar provision to allow justification of measures on the basis that they serve to conserve natural resources, so governments cannot justify violations of the agreement on environmental grounds.

⁶⁰ World Trade Organization, “United States—Standards for Reformulated and Conventional Gasoline—Report of the Appellate Body”, p. 28

⁶¹ World Trade Organization, “United States—Import Prohibition of Certain Shrimp and Shrimp Products—Report of the Appellate Body”, WTO document symbol WT/DS58/AB/R, 12 October 1998, pp. 65-66