ICTSD Programme on Dispute Settlement



Suspension of Concessions in the Services Sector: Legal, Technical and Economic Problems

By Arthur E. Appleton, J.D., Ph.D.
Partner, Appleton Luff - International Lawyers

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FOREWORD

The creation of the WTO dispute settlement system has been called a major achievement by observers and its importance has been echoed from all sides of the multilateral trading system. The Dispute Settlement Understanding (DSU), the agreement that governs the WTO dispute settlement mechanism, seeks to ensure an improved prospect of compliance, given its provisions on compensation and retaliation and thus constitutes a central element in providing security and predictability to the multilateral trade system.

Now in its second decade, the mechanisms and jurisprudence of the World Trade Organization continue to develop as Members gain experience applying the various provisions of the DSU. Although formal provisions exist whereby members may attempt to compel compliance of offending countries, many observers repeatedly identify implementation and enforcement as a continued source of frustration. Of those, one of the most equivocal methods of compelling compliance is the suspension of concessions.

With relatively few arbitral decisions and a notable lack of definitional guidance, member states attempting suspension have been forced to proceed with uncertainty in a continually evolving body of law. Concepts such as equivalence in retaliatory suspensions are not defined by the DSU, while standards of review and evidentiary weight have only been developed through the literal trial and error of members.

Presenting concise legal analysis as well as general overview, this study will assist both experienced practitioners and newcomers with the process of suspension of concessions in the services sector, with particular focus on GATS concessions. This publication provides clear guidance through doctrinal scrutiny and reference to the most recent jurisprudence, with particular reference on the instructive decisions of EC-Bananas (III) and US-Gambling.

This study additionally provides useful discussion on the mechanics of suspending concessions, describing in clear language the exact structure and procedures characterizing the body of law, with particular examination of suspension of specific commitments across the different modes of supply. Furthermore, the study explores the legal, technical and economic problems of retaliatory and cross retaliatory actions, presenting both practical guidance and strategic considerations for those wishing to employ this method of inducing compliance.

Of particular importance is the insight this publication provides to developing nations.

Historically, problems of compliance have often been most poignantly experienced by these countries, which often lack trade leverage over developed nations, and there is a sense among many that formal provisions for inducing DSU compliance continue these systemic inequities.

This study examines the potential reasons developing nations avoid compelling compliance, while offering considerations for those nations wishing to enforce suspension of concessions against the largest trading nations. Noting that in most situations, retaliation is likely to hurt complaining parties, this study identifies the cross-retaliatory suspensions most likely to compel enforcement among developed nations. Arguing that high profile and politically influential service sectors are most vulnerable to trade pressure, this study identifies the potential utility of suspending concessions against the financial service sector through taxation measures.

However, this study extends a message of caution to developing nations attempting to suspend concessions, concluding that in most cases cross-retaliation in services is unlikely to be successful and can be detrimental to the complaining party – particularly to those from developing countries.

This paper is produced under ICTSD's research and dialogue program on Dispute Settlement and Legal Aspects of International Trade which aims to explore realistic strategies to maximize developing countries' capability to engage international dispute settlement systems to defend their trade interest and sustainable development objectives. The author is Dr. Arthur E. Appleton, a partner at Appleton Luff law firm.

We hope you will find this study a useful contribution to the debate on methods of inducing compliance under the DSU.

Ricardo Meléndez-Ortiz
Chief Executive, ICTSD

EXECUTIVE SUMMARY

The WTO Dispute Settlement Understanding[1] may be the "jewel in the crown" of the Uruguay Round, but sometimes jewels need polishing. Implementation and enforcement are the DSU's weakest links. Suspension of concessions or other obligations to induce compliance (also known as retaliation and cross-retaliation) favours the largest trading Members – in particular the European Communities and the United States. Many developing country Members lack the volume of trade and political strength required for retaliation and cross-retaliation to be effective. Other factors also constrain the ability of developing countries to retaliate or cross-retaliate, such as the risk of losing economic assistance or preferential market access granted by developed countries.

As with suspensions of concessions or other obligations in the goods sector, suspensions in the services sector may not exert sufficient leverage to induce compliance with the covered agreements – unless politically powerful (and vulnerable) sectors are targeted. This is because most developing country Members have made relatively few commitments in the services sector pursuant to the General Agreement on Trade in Services (GATS), and few developing countries engage in enough service trade to exert significant leverage over a particular developed country.

Furthermore, suspension of service commitments may disproportionately hurt developing countries, more specifically the employment prospects of their citizens, as well as their consumers and businesses. In particular, suspension in the services sector risks inflicting economic damage on domestic businesses that rely on skilled foreign service providers, on individuals employed by foreign service providers, and on consumers seeking services from foreign service providers. Suspensions also risk chilling the climate for foreign direct investment. Developing countries are particularly susceptible to these risks.

GATS suspensions may also pose difficult questions under national laws (including various constitutions) with respect to the treatment of private rights, and commitments assumed under various bilateral and regional trade and investment agreements. In certain service sectors and modes of supply questions may also arise as to whether a suspension of GATS concessions or other obligations can be administered in conformity with the equivalence requirement in Article 22.4 of the DSU which assures that the trade effects of retaliation and cross-retaliation do not exceed the level of nullification or impairment of an illegal trade measure.

Despite this overall negative assessment, avenues exist for Members intent upon pursuing the suspension of GATS concessions or other obligations, even if such suspensions are likely to remain the exception and not the rule. The "suspension of concessions" or "specific commitments" under Part III of the GATS is the most obvious form of suspension available to complaining parties. The suspension of specific commitments, such as Market Access commitments, is available to complaining parties that have scheduled specific commitments under the GATS. Such suspensions are probably more practicable and more effective in Mode 3 and Mode 4 where enforcement appears easier. Developed countries are likely to place more value on foreign direct investment (establishing the foreign commercial presence of their service suppliers such as banks and insurance companies) and on the temporary presence abroad of their skilled professionals (medical professionals, accountants, lawyers, etc.). Offending parties may be more willing to respond to numerical limitations and other restrictions in Modes 3 and 4, in particular in the financial service sector. In part this is because foreign financial service providers frequently have the political power to influence their government's trade policies.

The suspension of "other obligations", is another viable form of suspension in the services sector. The arbitrators in *US-Gambling* found that Article 22 of the DSU permits a complaining party to suspend application of the GATS MFN obligation in sectors where it has not made specific commitments.[2]

Such a suspension would relieve a complaining party of its obligation to accord "immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country." A suspension of the MFN obligation could permit a complaining party to impose duties and charges (higher taxes and fees), as well as domestic regulations, on services and service providers from the Member violating the covered agreements. Services and service providers from the offending Member would be subject to financial and/or regulatory discrimination. Cross-retaliating in the form of a suspension of MFN commitments depends upon future Article 22.6 arbitrators following the approach to MFN suspensions set forth in *US-Gambling*.

Foreign financial service providers are particularly vulnerable to an MFN suspension since they could be easily affected by tax and regulatory discrimination resulting from a denial of MFN treatment, and because they may be in a position to influence a foreign government's trade policies. If service providers from an offending party are subject to higher taxes and regulatory hurdles, domestic service providers (including those in developing countries), as well as service providers from other Members, could benefit from such discrimination.

When implementing any other form of suspension, including an MFN suspension, the complaining party must assure that the trade effects do not exceed the level of nullification or impairment that result from the illegal trade measure. The equivalence requirement of Article 22.4 of the DSU provides an avenue by which an offending party may limit retaliation and cross-retaliation.

II. INTRODUCTION AND BACKGROUND

A. Article 22 of the DSU

The World Trade Organization (WTO) is now in its second decade and its Members have gained significant experience with the application of the WTO Dispute Settlement Understanding (DSU), including substantial experience inducing compliance (enforcement) with adopted panel and Appellate Body reports. Prompt compliance with the recommendations and rulings of the Dispute Settlement Body (DSB) is the preferred outcome of WTO dispute settlement.[3]

Full implementation of recommendations and rulings is not always feasible. Political obstacles may arise. In the event that a losing party does not fully implement the DSB's recommendations or rulings within a reasonable period of time, and the parties are unable to arrive at a mutually satisfactory solution, Article 22 of the DSU (reproduced as Annex I) sets forth a hierarchy of "temporary" measures to encourage implementation of adopted reports. Article 22 provides for (i) negotiation of "mutually acceptable compensation" (which would be mulitlateralised), and if satisfactory compensation has not been agreed (ii) suspension of "concessions or other obligations" until full implementation of a ruling, i.e., until a Member brings its trade measure into conformity with the covered agreements. Suspension of concessions or other obligations is a mechanism for inducing compliance. The prevailing party must request authorisation from the DSB to suspend concessions and/ or other obligations. Unlike compensation, suspension of concessions or other obligations, if authorized by the DSB, is not granted on an MFN basis. The suspension only applies to the Member losing the dispute.

A suspension of concessions is prospective not retroactive, and the complaining party has no remedy until expiry of the reasonable period of time accorded by the DSB for implementation of a panel or Appellate Body report. If the parties to a dispute are unable to negotiate satisfactory compensation within 20 days of the expiry of the reasonable period of time, suspension of concessions or other obligations may be requested by any party that has invoked the dispute settlement procedures. Suspension is a temporary measure that can only be applied until a mutually satisfactory solution is reached, or until the offending party removes the WTO inconsistent measure, or provides a solution to the nullification or impairment of benefits.[4]

Article 22.6 provides for arbitration if the Member concerned: (i) objects to the level of suspension proposed, or (ii) claims the principles and procedures in Article 22.3 have not been followed. In addition to judging claims that the principles and procedures of Article 22.3 have not been followed, the arbitrators are permitted to establish "if the proposed suspension of concessions or other obligations is allowed under the covered agreement."[5] Although the arbitrators are required to examine if the level of suspension is "equivalent" to the level of nullification or impairment, the arbitrators are not permitted to examine "the nature of the concessions or other obligations to be suspended".[6]

B. Retaliation and Cross-Retaliation

Suspension of concessions can take the form of "retaliation" or "cross-retaliation". Neither term appears in the DSU. Members use these terms to describe two distinct means of inducing Members to comply with the covered agreements. Retaliation is short-hand for a suspension of concessions arising under the same agreement in dispute (goods, services or intellectual property). Cross-retaliation is short-hand for suspending concessions or other obligations arising under a covered agreement not in dispute. Regardless of whether suspension is in the same sector, under the same agreement or under a different agreement, as explained below arbitrators in Article 22.6 proceedings have generally agreed that the purpose of the suspension is to induce compliance with the covered agreements.

C. The Objective of GATS Suspensions: Induce Compliance

In the GATT era contracting parties often viewed suspension of concessions or other obligations in the goods sector as a means to rebalance negotiated concessions.[7] Under WTO rules, arbitrators sitting under Article 22.6 of the DSU generally accept that the suspension of concessions or other obligations is an instrument to "induce compliance" with WTO rules.[8]

Although there is widespread agreement in Article 22.6 arbitrations that the purpose of a suspension is to induce compliance, important questions may arise with respect to whether a suspension would be practicable or effective, and whether the proposed suspension is equivalent to the nullification or impairment. These questions are particularly difficult when suspension of GATS concessions or other obligations is at issue. Many of these difficulties result from the peculiar nature of DSU remedies. Direct financial penalties (fines) do not exist pursuant to WTO rules. Instead, suspension of concessions would usually take the form of temporary tariff increases when trade in goods is involved, and a temporary suspension of certain intellectual property rules if the DSB authorises retaliation or cross-retaliation involving "TRIPs"[9] commitments. Were GATS concessions or other obligations to be suspended, the suspension might take the form of a temporary withdrawal of specific commitments made in various GATS sectors in one or more "modes of supply", or the withdraw of "other obligations", such as MFN treatment, in order to induce compliance.

D. Article 22.6 Decisions

As of January 2009 there have been 17 Article 22.6 arbitrations involving ten distinct disputes. The great majority of these arbitrations (all of which are listed in Annex III) were in the goods sector. The DSB has authorized suspension of concessions related to services in one case[10] and intellectual property rights in two cases.[11] *EC-Bananas III (Ecuador)* involved trade in both goods and services, and the complaining party won the right to suspend GATT, GATS and TRIPs commitments.[12] *US-Gambling* dealt also with trade in services, and again the complaining party won the right to suspend TRIPs commitments.

At the time of writing (February 2009) Brazil is again threatening cross-retaliation in US-Cotton under the GATS and TRIPs Agreements.[13] The *Cotton* case involves trade in goods (cotton) between WTO Members with significant goods trade. This may make it more difficult under Article 22.3 of the DSU for Brazil to win the right to cross-retaliate under either the GATS or TRIPs Agreements.

E. Suspension of GATS Concessions and Other Obligations

Why have there not been more Article 22.6 arbitrations involving suspension of GATS concessions and other obligations? In part, this is (i) a result of the small number of GATS disputes, and (ii) the fact that many developing country WTO Members made few commitments in the services sector. Nevertheless, there are other factors that explain why there have not been more disputes involving GATS suspensions.

This work examines the extent to which suspensions in the service sector are legally, technically and economically feasible. Section III examines the legal rules applicable to suspensions in the service sector. Particular emphasis is given to the "practicable or effective" test set forth in Article 22.3(b) and (c) of the DSU, and the concept of "equivalence" present in Article 22.4 and 22.7. Section IV examines legal, technical and economic problems related to suspensions in the services sector. This analysis includes an examination of the extent to which a suspension of GATS commitments is a viable option for WTO Members, and suspension options suitable for developing country

Members. Section IV also discusses the extent to which suspension of "other obligations" arising under the GATS Agreement is a realistic alternative. Again, attention is given to the identification of suspensions that developing country Members may find effective. Section V concludes with observations on the viability for developing countries of suspensions of WTO concessions and other obligations as a means to induce compliance with DSB decisions.

III. WTO RULES APPLICABLE TO SUSPENSION OF CONCESSIONS IN THE SERVICES SECTOR

This section examines the substantive WTO rules applicable to the suspension of concessions in the services sector. These discussions pave the way for an examination of the viability of the suspension of GATS concessions and other obligations in Section IV.

A. Suspension of Concessions under the DSU and Specific Commitments under the GATS

Article 22.2 of the DSU permits a complaining party to ask the DSB for authorization to suspend "concessions or other obligations" when a Member fails to bring a WTO-inconsistent measure into conformity with a covered agreement. Article XXIII:2 of the GATS allows the DSB to authorize a Member to suspend "obligations and specific commitments in accordance with Article 22 of the DSU." Both provisions use similar but not identical terminology.[14] In the GATS context, "concessions" and "specific commitments" mean the "Specific Commitments" in Part III of the GATS: Market Access (Article XVI – column 2 of the Services Schedule), National Treatment (Article XVII – column 3 of the services schedule) and any Additional Commitments made pursuant to Article XVIII of the GATS (column 4 of the schedule). The terms "obligations" and "other obligations" refer to the General Obligations and Disciplines set forth in Part II of the GATS. Part II includes the MFN obligation.

B. Introduction to Article 22.3 and Article 22.4 of the DSU

Article 22.3 of the DSU sets forth the general rules applicable to suspension of concessions, including the rules applicable to suspension of concessions in the services sector.[15] It provides "a sequence of steps towards WTO-consistent suspension of concessions or other obligations".[16] Article 22.4 sets forth an additional rule (equivalence) that must be followed for all suspensions of concessions or other obligations. The following rules apply:

> 1) The "complaining party should first seek to suspend concessions or other obligations with respect to the same sector(s) as that in which the panel or Appellate Body has found a violation or other nullification or impairment" (retaliation).[17]
>
> 2) If suspension of concessions or other obligations in the same sector is not "practicable or effective", the complaining party may seek "to suspend concessions or other obligations in other sectors under the same agreement".[18]
>
> 3) If suspension in other sectors under the same agreement is not "practicable or effective", and the circumstances are "serious enough", the complaining party "may seek to suspend concessions or other obligations under another covered agreement" (cross-retaliation).[19]
>
> 4) In applying the above principles, a complaining party must consider:
>
> > "(i) the trade in the sector or under the agreement under which the panel or Appellate Body has found a violation or other nullification or impairment, and the importance of such trade to that party[20]; and

(ii) "the broader economic elements related to the nullification or impairment and the broader economic consequences of the suspension of concessions or other obligations".

5) The level of suspension of concessions or other obligations must be "equivalent to the level of the nullification or impairment."[22]

These rules are examined below. The discussion focuses largely on the arbitral decisions in *EC-Bananas III (Ecuador)* and *US-Gambling* – the only two disputes to date where arbitrators have considered suspensions in the services sector pursuant to Article 22.3 of the DSU.[23] While not always in accord, these decisions provide considerable insight into the procedural steps applicable to suspension of concessions and other obligations in the services sector.

C. "Sectors" and "Agreements" in Article 22.3(a)–(c) of the DSU

Article 22.3(a) expresses the preference for suspension of concessions or other obligations in the same sector under the same agreement. Article 22.3(b) provides that if suspension in the same sector is not "practicable or effective", a complaining party may seek to suspend concessions in another sector under the same agreement. Article 22.3(c) provides for suspension of concessions or other obligations under another agreement (cross-retaliation) if suspension under the same agreement is not practicable or effective and the circumstances are "serious enough".

The definitions of the terms "sector" and "agreement" appear in Article 22.3(f) and (g) of the DSU. With respect to services, "sector" means "a principal sector as identified in the current 'Services Sectoral Classification List'" which sets forth twelve distinct sectors.[24] With respect to services, the term "agreement" means the GATS.[25]

In a dispute involving trade in services, a complaining party must first seek to suspend GATS concessions or other obligations in the same service sector in which a panel or the Appellate Body has found a WTO violation or other nullification or impairment (retaliation).[26] Only if suspension in the same service sector would not be "practicable or effective", and if the circumstances are "serious enough",[27] may a complaining party seek to suspend concessions in another GATS sector pursuant to Article 22.3(b). If suspension under the GATS would not be practicable or effective, and the circumstances are serious enough, a complaining party may seek suspension under another "agreement" pursuant to Article 22.3(c).

When a dispute arises under another "agreement",[28] Article 22 of the DSU only permits a suspension in the services sector (cross-retaliation) when a suspension under the agreement where the violation or other nullification or impairment occurred is (i) not practicable or effective, (ii) the circumstances are serious enough, and (iii) the equivalence requirement is met. These conditions are examined below.

D. Practicable or Effective in Article 22.3

Article 22.3(b) and (c) condition suspension of concessions or other obligations in another sector or under another agreement on a finding that suspension in the same sector or under the same agreement is not practicable or effective. This ensures that "the suspension of concessions or other obligations across sectors, or across agreements…remains the exception and does not become the rule."[29] Article 22.3(b)-(d) are the subject of several Article 22.6 arbitrations which are examined below.

1) Practical or Effective: Defined

The *EC-Bananas III (Ecuador)* arbitrators examined the phrase "practicable or effective" as used in Article 22.3(b) and (c) of the DSU. Relying on the Oxford English Dictionary, the *Bananas* arbitrators defined "practicable" as "'available or useful in practice; able to be used'

or 'inclined or suited to action as opposed to speculation etc.'"[30] The arbitrators determined that "an examination of the 'practicability' of an alternative suspension concerns the question whether such an alternative is available for application in practice as well as suited for being used in a particular case."[31]

The arbitrators in *EC-Bananas III (Ecuador)* also found that "the term 'effective' connotes 'powerful in effect', 'making a strong impression', 'having an effect or result'".[32] The arbitrators reached the conclusion that this "criterion empowers the party seeking suspension to ensure that the impact of that suspension is strong and has the desired result, namely to induce compliance…." [33] The arbitrators in US-Gambling found these interpretations to be a "useful starting point" for their assessment.[34]

2) Practical or Effective: The Scope of Review and the Burden of Proof

EC-Bananas III (US), EC-Bananas III (Ecuador) and *US-Gambling* each examined the extent to which the arbitrators must give deference to a determination by the complaining party that a proposed suspension of concessions or other obligations would not be practicable or effective pursuant to Article 22.3.[35] Both Articles 22.3(b) and (c) begin with the phrase "if that party considers that it is not practicable or effective", leaving room to argue that this language vests the complaining party with large discretion to determine the sector in which concessions shall be suspended. Likewise, Article 22.3(a) uses the term "should", suggesting that it may not be mandatory for a complaining party to try to suspend concessions or other obligations in the same sector in which a panel or the Appellate Body found a violation or nullification or impairment. Despite the weak language of Article 22.3, arbitrators have consistently held that the complaining party's discretion is limited. In *US-Gambling* the arbitrators found that subparagraphs (b), (c) and (d) of Article 22.3 "specify the principles and procedures to be followed by a complaining party wishing to seek suspension in another sector, or another agreement…".[36] Quoting *EC-Bananas III (Ecuador)*, the arbitrators in *US-Gambling* agreed that "…Article 22.6 implies *a fortiori* that the authority of Arbitrators includes the power to review whether the principles and procedures set forth in these subparagraphs have been followed by the Member seeking authorization for suspension".[37] They held that:

> [T]he margin of review by the Arbitrators implies the authority to broadly judge whether the complaining party in question has considered the necessary facts objectively and whether, on the basis of these facts, it could plausibly arrive at the conclusion that it was not practicable or effective to seek suspension within the same sector under the same agreements, or only under another agreement provided that the circumstances were serious enough.[38] [emphasis added]

The arbitrators in *US-Gambling* also noted that "…these provisions imply a sequence of steps towards WTO-consistent suspension of concessions or other obligations which respects both a margin of appreciation for the complaining party as well as a margin of review by Arbitrators…"[39] The arbitrators concluded not only that the determinations in *EC-Bananas III (Ecuador)* on this point were correct, but that:

> Article 22.3 sets out specific principles and procedures, that the complaining party must follow, and we understand the role of the arbitrator acting pursuant to Article 22.7 of the DSU to involve a review of whether those principles and procedures have been followed. We agree with the arbitrators in *EC - Bananas III (Ecuador)* that this includes a determination "whether the complaining party in question has considered the necessary facts objectively" and also "whether, on the basis of these facts, it could plausibly arrive at the conclusion that it was not practicable or effective to seek suspension within the same sector

> under the same agreements, or only under another agreement provided that the circumstances were serious enough".[40] [emphasis added]

An examination of whether a particular suspension is practicable or effective will focus on the complaining party's "considerations why it is not practicable or effective" to suspend commitments in the same sector in which a violation was found, or in another sector under the same agreement.[41] The responding party maintains the burden of proving that that the suspension of commitments or other obligations under the same sector or agreement would be practicable and effective.[42] Furthermore, the threshold for considering a request for suspension in another sector under the same agreement pursuant to subparagraph (b) is lower than the threshold for considering a request for suspension under another agreement pursuant to subparagraph (c). "Suspension across sectors under the same agreement is permitted if suspension within the same sector is 'not practicable or effective'". The requirement that a complaining party demonstrate that a suspension in the same sector is not "practicable or effective" applies to other sectors under the same agreement, but not to other sectors under a different agreement.[43] An additional condition applies when the complaining party seeks to suspend concessions across agreements – the circumstances must be "serious enough".[44]

Although the DSU does not provide explicit guidance on the allocation of the burden of proof in Article 22.6 proceedings, decisions on this point are consistent. *US-Gambling* cites previous article 22.6 decisions, in particular *EC-Hormones*, concluding that "the burden of proving that the requirements of the DSU have not been met rests on the party challenging the proposed level of suspension."[45] A Member challenging a proposed suspension must demonstrate that the principles and procedures of Article 22.3 have not been followed. Once that Member has made a *prima facie* case that the principles and procedures of Article 22.3(b)-(d) have not been followed and that the factors listed in subparagraph (d) were not taken into account, the burden shifts to the complaining party to rebut the presumption.[46] The burden of proof thus rests on the party alleging that another Member has not followed the principles and procedures set forth in Article 22.3, or that a measure is not equivalent to the level of nullification or impairment pursuant to Article 22.4.

3) Range of Obligations to Consider

Both *EC-Bananas III (Ecuador)* and *US-Gambling* discussed the range of obligations to be considered in a determination of whether a suspension is practicable or effective. The arbitrators in *EC-Bananas III (Ecuador)* concluded that suspension of commitments or other obligations under the GATS could not be practicable or effective in service sectors in which the complaining party had not entered into specific commitments.[47] The arbitrators also understood that suspension of other obligations, such as the MFN obligation, would only be possible in sectors in which the complaining party had made specific commitments.[48] *US-Gambling* reached the opposite conclusion holding that "the range of obligations to be considered for the purposes of a determination of whether suspension is practicable or effective in the same sector is not limited to those sub-sectors in which specific commitments have been made."[49] The arbitrators understood that Antigua could suspend other obligations under the GATS, such as the MFN obligation, even in sectors in which the complaining party has not made a commitment.[50] This question is returned to in Section IV.

4) Practical or Effective: Inducing Compliance

EC-Bananas III (Ecuador) and *US-Gambling* each found that for a measure to be practical and effective within the meaning of Article 22.3 of the DSU it should induce compliance with the DSB's recommendations and rulings.[51] The suspension must have an appropriate level of strength and power. In *EC-Bananas III (Ecuador)* the arbitrators cautioned that the objective of inducing compliance would be thwarted if a complaining party were required

to select concessions that were not "available in practice or would not be powerful in effect".[52] In *US-Gambling* the arbitrators also emphasised the strength of the measure as a means to induce compliance.[53]

5) Practical or Effective: Factors in Article 22.3(d)

A complaining party is obliged to take into consideration three factors identified in Article 23.3(d) in its assessment of whether a given suspension would be practical or effective: (i) "trade in the sector", (ii) the "broader economic elements" and (iii) the "broader economic consequences".[54] In *US-Gambling*, the arbitrators determined that Antigua had taken into account these elements when it examined "trade volume" in the relevant service sector, and the "potential impact of suspending concessions or other obligations", not only with respect to the party seeking to retaliate, but also with respect to the offending party.[55] The elements of Article 22.3(d) are examined in Section F.

6) Economic Factors

The arbitrators in both *EC-Bananas III (Ecuador)* and *US-Gambling* viewed whether a given suspension was practicable or effective largely from an economic perspective. Although they disagreed on the range of obligations to consider, there was general agreement on the economic factors that would render a proposed suspension not practicable or effective for a developing country Member. This section reviews the economic considerations arising in these two cases. Readers unfamiliar with GATS nomenclature may first wish to read the introduction to Section IV.

a) EC-Bananas III (Ecuador)

Based on their view that Ecuador could only suspend commitments and other obligations in service sectors where it had made specific commitments, the arbitrators in *EC-Bananas III (Ecuador)* limited their analysis to sectors and modes of supply where Ecuador had made commitments. Suspensions in Mode 3 (commercial presence) received considerable attention. Ecuador submitted that were it to suspend commitments in Mode 3 this would distort the investment climate in Ecuador and would be ineffective as the suspension would harm Ecuador more than the EC.[56] Ecuador also argued that a suspension in Mode 3 would not be practicable. Ordering a service supplier that was commercially present to stop its activities or imposing a supplementary tax on their service output could lead to "conflicts with rights" (rights to equal treatment under national laws or rights derived from international treaties) and would entail "substantial administrative difficulties".[57]

The arbitrators found that suspension of commitments in Mode 3 would be particularly detrimental to developing country Members that are highly dependent on foreign direct investment (FDI).[58] They distinguished between FDI in the "pre-establishment stage" and the "post-establishment stage".[59] The arbitrators acknowledged that it did not seem difficult to prevent service suppliers in the pre-establishment stage from establishing themselves in Ecuador.[60] However, potential investors in the pre-establishment stage could easily turn to other host countries thereby avoiding the effect of the suspension of commitments relative to commercial presence.[61]

The arbitrators noted that limitations applicable at the "post-establishment stage" would produce a similar economic result. Suspension would result in EC service suppliers immediately losing "the legal protection, predictability and certainty which the GATS standards provide."[62] If these service providers transferred their investment outside Ecuador, this could result in significant harm to Ecuador's economy.[63] The arbitrators agreed with Ecuador's submission that it would be difficult to prevent locally established foreign service suppliers from supplying services within Ecuador's territory.[64] They also agreed that there might be administrative difficulties to close or limit service output from branch or representative offices and that "legal and administrative difficulties may arise when closing or limiting

the output" of establishments "enjoying legal personality" and "legal protection" under "national or international law".[65]

The arbitrators also noted Ecuador's argument that limiting cross-border supply (Mode 1) would create practical difficulties and would be ineffective in certain service sectors. They recognised Ecuador's concern that the suspension of cross-border supply in some sectors, such as telecommunications, would be practically and technically difficult, and remain ineffective.[66]

The arbitrators accepted that alternative channels of supply exist for many services, and that in many sectors it is "technically feasible" to supply the same services through commercial presence, cross border supply, and consumption abroad (Mode 2). They concluded that if alternate channels of supply exist, a suspension in just one mode could be ineffective and could create practical difficulties.[67]

b) US-Gambling

i) Suspension in the Same GATS Sector

In *US-Gambling* the arbitrators first addressed whether it was practicable or effective for Antigua to suspend concessions in the same sector. They examined service Sub-sector 10.A in which Antigua had made commitments (Entertainment Services).[68] The arbitrators noted that neither party was able to locate statistical sources that would reveal the volume of trade in this sub-sector. The arbitrators also found that no amount was reported under entertainment services in the IMF Balance of Payment Statistics. This led to the arbitrators' finding that it was plausible for Antigua to conclude that the "volume of such trade must be negligible" and that it was not practicable or effective to suspend specific commitments under the GATS in the sub-sector of entertainment services.[69]

The arbitrators turned next to "other obligations" that Antigua could suspend in service Sector 10 (Recreational, Cultural and Sporting Services).[70] The arbitrators noted that: "there is only a limited number of such 'other obligations' under the GATS, that Antigua would be able to suspend…." In their view "the main relevant obligation in this respect is the MFN obligation, contained GATS Article II, which obliges Antigua to accord immediately and unconditionally to US services and service suppliers treatment no less favourable than that it accords to like services and service suppliers of any other country."[71]

Having determined that the MFN obligation of GATS Article II was the most likely of the "other obligations" that Antigua could suspend, the arbitrators recognised: (i) the absence of evidence of "significant volumes of imports" in Sector 10, and (ii) Antigua's argument that due to the disparity of services trade between Antigua and the United States Antigua's consumers would scramble to replace services provided by the United States at uncertain costs, while US service providers would suffer little harm. They also noted that the United States had not contradicted Antigua's assessment on the practicality or effectiveness of a suspension in Sector 10. The arbitrators ruled that Antigua could "plausibly" conclude "that it was not practical or effective for it to suspend concessions or other obligations under the GATS in respect of Sector 10."[72]

ii) Suspension in Other GATS Sector

The arbitrators next examined whether it was plausible for Antigua to conclude that it would not be practicable or effective for Antigua to suspend concessions or other obligations in other GATS sectors. Again they answered "no."[73] In reaching their decision, the arbitrators recalled their determination:

> that an examination of the "practicability" of an alternative suspension concerns the question whether such an alternative is available for application in practice as well as suited for being used in a particular case. We also recall our determination that in contrast, the thrust of the "effectiveness" criterion empowers the party seeking suspension to ensure that the impact of that

> suspension is strong and has the desired result, namely to induce compliance by the Member which fails to bring WTO-inconsistent measures into compliance with DSB recommendations and rulings within a reasonable period of time.[74]

The arbitrators also recalled that it would be "sufficient for Antigua to have determined that suspension under the GATS in respect of other sectors is not effective, even if it is practicable."[75]

In support of its position that a suspension in other GATS sectors would not be practicable or effective, Antigua raised arguments similar to those of Ecuador in *EC-Bananas III*. Antigua provided arguments related to the relative size of the US and Antiguan economies, Antigua's lack of natural resources, and its dependence on goods and services from the United States.[76] It noted that the imposition of additional duties on US goods and services would have "a disproportionate adverse impact … by making these products and services materially more expensive…."[77] Antigua further noted that with respect to most services "covered by Antigua's GATS schedule, suspension of concessions in the form of higher duties, tariff, fees or other restrictions would have a disproportionate impact" on Antigua's economy and virtually no impact on the US economy.[78]

To the extent that Antigua's argument pertained to obligations under the GATS, the arbitrators accepted Antigua's position that, as a small import-dependent economy Antigua could suffer an adverse impact from a suspension of GATS concessions. This concern was pertinent to Antigua's analysis of whether a GATS suspension was practicable or effective. The arbitrators further found that Antigua's circumstances could have an impact on the effectiveness of the proposed suspension.[79]

Quoting from *EC-Bananas III* (Ecuador), the arbitrators recognised that:

> …"where a great imbalance in terms of trade volume and economic power exists between the complaining party seeking suspension and the other party which has failed to bring WTO-inconsistent measures into compliance with WTO law" "and in situations where the complaining party is highly dependent on imports from the other party, it may happen that the suspension of certain concessions or certain other obligations entails more harmful effects for the party seeking suspension than for the other party". In the view of that arbitrator, "in these circumstances, a consideration by the complaining party in which sector or under which agreement suspension may be expected to be least harmful to itself would seem sufficient for us to find a consideration by the complaining party of the effectiveness criterion to be consistent with the requirement to follow the principles and procedures set forth in Article 22.3.[80]

However, the arbitrators agreed with the United States that general statements about the "size of the complaining party's economy or the relative size of the economies of both parties do not justify a departure from the requirements of Article 22.3", and noted that the complaining party is required to follow, in sequence, each of the steps in Article 22.3, and to make a determination with respect to each relevant element. This includes "an explanation of how such circumstances affect the practicability or effectiveness of the proposed suspension".[81] The arbitrators found that Antigua had not just made general assertions, but had explained "how the potential adverse impact of suspension of obligations would manifest itself in various specific sectors".[82]

For example, the arbitrators accepted (as did the United States) that if Antigua were to suspend concessions in tourism services, or other services affecting the tourism industry, this would adversely affect Antigua, not have any perceptible impact on "inducing compliance". The arbitrators concluded that this "may render such a suspension not practicable or effective"….[83]

Lastly with respect to economic factors, the arbitrators recognised that:

> …by their very nature, services transactions are closely woven into a country's domestic economic fabric, with many cross-sectoral linkages. This is typically the case for so-called infrastructural services, such as large segments of the transport, telecommunications and financial services sectors. In our view, it is plausible that suspension of obligations against US firms established in Antigua in such sectors could entail a negative impact for the Antiguan local economy. The risk of economic disruption in case of forced divestiture, or similar measures, is not negligible, in particular for small economies. For instance, it is not clear to what extent Antiguan services suppliers would be able or willing to step in for US services suppliers obliged to suspend their operation or even leave the country. Moreover, legislative and other measures protecting foreign investors may make it difficult in practice to take and enforce action against them.[84]

The arbitrators concluded that Antigua could "plausibly arrive at the conclusion that it was not practicable or effective" to suspend concessions or other obligations in other GATS sectors.[85] In doing so, they set forth a wide range of economic factors that a complaining party seeking to suspend concessions should consider.

E. Seriousness Enough: Article 22.3(c) DSU and Article XXIII:2 GATS

Pursuant to Article 22.3, a suspension across agreements (cross-retaliation) is not conditioned by the requirement that it be practical and effective.[86] Article 22.3(c) of the DSU instead conditions cross-retaliation on a determination that the circumstances are "serious enough". The "serious enough" requirement also appears in a slightly different form in Article XXIII:2 of the GATS[87] which permits the DSB to authorize the suspension of GATS "obligations and specific commitments" if the circumstances are "serious enough to justify such action". Article XXIII:2 of the GATS also requires the DSB to find that circumstances are "serious enough" to justify retaliation in response to GATS violations.

The "serious enough" requirement is the second cumulative condition imposed by Article 22.3 of the DSU which must be met before a complaining party may suspend concessions under another covered agreement (cross-retaliation). Cross-retaliation requires not only that suspension within the same sector and within other sectors under the same agreement are not practicable or effective, but also that the circumstances are serious enough to justify suspension under another agreement.

Neither Article 22.3(c) of the DSU nor Article XXIII:2 of the GATS define "serious enough".[89] The arbitral decisions in *EC-Bananas III (Ecuador)* and *US-Gambling* do however take a consistent approach. First, there is agreement that the task of the arbitrators is to review the complaining party's determination that "'circumstances are serious enough' to warrant suspension across agreements."[90] Second, there is agreement that the factors to be taken into account in Article 22.3(d) of the DSU may provide contextual guidance when determining whether circumstances are serious enough to warrant suspension across agreements. When reviewing the complaining party's determination that circumstances were serious enough to justify suspension across agreements (cross-retaliation), both arbitral tribunals found it relevant to consider "the trade at issue and its importance to the complaining party, as well as the broader economic elements relating to the Member suffering the nullification or impairment and the broader economic consequences of the proposed suspension on the parties..."[91]

Finally, both arbitrations found merit in statistical arguments by the complaining party as to whether the economic circumstances between the parties (inequality between

the parties) were serious enough to justify suspension across agreements. Some of the factors examined by the arbitrators were size of the countries, population, world merchandise trade, world trade in services, exports and imports, natural resources, arable land, agricultural production, dependency of the economy on certain sectors, need for economic diversification, per capita income and GDP per capita.[92] The outcome of both arbitrations was influenced by the "unbalanced nature" of the economic and trade relationship between the parties which made it difficult to find a practicable or effective way to suspend concessions or other obligations in the sector or agreement in dispute.[93]

F. Importance of Such Trade and Broader Economic Elements: Article 22.3(d)

Pursuant to Article 22.3(d), the complaining party seeking to suspend concessions or other obligations (under the GATS or other agreements) must take into account two requirements. First the Member must consider "the trade in the sector or under the agreement under which the panel or the Appellate Body has found a violation or other nullification or impairment, and the importance of such trade to that party". Second the Member must consider "the broader economic elements related to the nullification or impairment, and the broader economic consequences of the suspension of concessions or other obligations". The finding in the *Bananas* and *Gambling* arbitrations relative to these criteria are examined below.

1) Trade in the Sector and the Importance of Such Trade: Article 22.3(d)(i)

The arbitrators in *Bananas* and *Gambling* reached different interpretations with respect to the first criteria. In *EC-Bananas III (Ecuador)* the arbitrators interpreted "trade in the sector" and "importance of such trade" as relating "primarily to the trade nullified or impaired by the WTO-inconsistent measures", more specifically, trade within the same sub-sector in which the violation was found. They considered the importance of the trade in the entire sector in which the violation was found, or in other sectors, to be of subsidiary importance.[94]

In *Gambling*, the arbitrators interpreted "trade in the sector" and the "importance of such trade" to the complaining party to require consideration of the "entirety of 'trade in the sector' under which a violation was found", rather than only "'the trade nullified or impaired by the WTO-inconsistent measure at issue'".[95] They concluded (unlike the *Bananas* arbitrators) that "in order to determine whether suspension is practicable or effective in a certain sector, it is appropriate to take into account all the trade in that sector and its importance to the complaining party."[96] The view of the arbitrators in *Gambling* is preferable as it defines "sector" consistent with the definition in Article 22.3(f)(ii).

2) Broader Economic Elements and Consequences: Article 22.3(d)(ii)

Article 22.3(d)(ii) requires the complaining party to consider "the broader economic elements related to the nullification and impairment and the broader economic consequences of the suspension of concessions or other obligations". The *Bananas* arbitrators found that Article 22.3(d)(ii) "does not require the complaining party to establish a causal connection between nullification or impairment suffered and 'the broader economic elements' to be taken into account." It is sufficient to demonstrate that there is a relation between the "broader economic elements" considered by the complaining party and the nullification and impairment caused by the WTO-inconsistent measure.[97]

The decisions in *Gambling* and *Bananas* found that the "broader economic consequences" of the suspension of concessions or other obligations", includes consequences affecting both the complaining party and the party not in compliance with WTO obligations, "especially where a great imbalance in terms of trade volumes and economic power exists between the two parties…".[98]

G. Equivalence

Article 22.4 limits the suspension of concessions or other obligations, by providing that "The level of the suspension of concessions or other obligations authorized by the DSB shall be equivalent to the level of the nullification or impairment." In setting forth the equivalence standard, Article 22.4 links the level of suspensions with the level of nullification or impairment.[99] Articles 22.6 and 22.7 give effect to the equivalence standard by providing for a determination by the arbitrators as to whether the level of suspension "is equivalent to the level of nullification or impairment."[100] The DSU does not define "equivalence". The arbitral decision in *EC-Bananas III (US)* noted that the ordinary meaning of equivalence is: "'equal in value, significance or meaning', 'having the same effect', 'having the same relative position or function', 'corresponding to', 'something equal in value or worth', also 'something tantamount or virtually identical'."[101] Other Article 22.6 arbitrations have also examined the equivalence requirement.[102] There is agreement that the DSB should not grant authorization "to suspend concessions beyond what is *equivalent* to the level of nullification or impairment", and there is also agreement that Articles 22.4 and 22.7 do not justify "counter-measures of a *punitive* nature."[103]

Establishing equivalence between the nullification or impairment and the level of suspension can be a difficult task in non-subsidy arbitrations. As noted by the WTO Secretariat, "The key challenge for arbitrators usually lies in determining what trade flows would have been *but for* the unlawful measure."[104] The Secretariat has termed the approach used in Article 22.7 (non-SCM) cases to be the "trade effects approach".[105] Equivalence requires a determination that the effect of the suspension on the responding party's trade is equivalent to the effect of the WTO-inconsistent measure on the complaining party's trade.

Article 22.6 arbitrations involving non-subsidy matters are conducted based on "counterfactual trade effects, i.e. the estimation of the level of trade that would occur if the contravening measure was brought into conformity".[106] In the event of disagreement between the parties, there are two components to the arbitrators' assessment: (i) a review of the alleged level of nullification or impairment, and (ii) a review of the level of the proposed suspension to verify that it is equivalent to the nullification or impairment. In carrying out these reviews, the arbitrators are not permitted to examine the nature of the concessions or other obligations to be suspended.[107]

In *EC-Hormones (US)* the arbitrators emphasised the need for a quantitative and not a qualitative assessment of the proposed suspension.[108] They cited with approval the arbitral decision in *EC-Banana III (US)* for the proposition that to give effect to Article 22.4, both the level of nullification or impairment and the level of suspension of concessions or other obligations need to be identified "in a way that allows us to determine equivalence".[109] They then noted that the complaining party was able to identify the products that may be subject to suspension in a way that allowed the tribunal to attribute the "annual trade value" to each of the products when subject to a prohibitive import tariff.[110]

In *EC-Bananas III (Ecuador)* the arbitrators recognised that their mandate was limited to estimating "losses in actual and potential trade and trade opportunities in the relevant goods and service sectors".[111] In evaluating the complaining party's proposed suspension of concessions under the TRIPs Agreement, the arbitrators also set forth a quantitative approach to equivalence. They ruled that the complaining party had considered both the actual impact of the intended suspension as well as the potential impact of the proposed suspension on trade.[112] This quantitative approach to equivalence is reflected in the arbitrators' decision to consider the "entire value of losses of actual trade and of potential trade opportunities" and "the loss of actual and potential distribution service supply".[113] The arbitrators also emphasised that they did not base their "calculations on the losses in profits incurred by banana producers or companies supplying distribution services."[114]

The *US-1916 Act* arbitration was the first Article 22.6 case where a complaining party requested the right to suspend qualitatively equivalent as opposed to quantitatively equivalent obligations.[115] The EC sought authorization to adopt a "mirror" regulation ("mirror legislation") that would have an equivalent effect on imports as that of the US-1916 Act.[116] The EC's request did not contain "quantifiable or monetary limits on how its suspension could be applied in practice. It could apply to an unlimited amount of US exports to the European Communities."[117]

In earlier cases the complaining party provided a quantitative (monetary) figure for the amount of suspension sought.[118] *EC-Hormones* and *EC-Bananas* "found that 'equivalent' had to be determined in quantitative terms."[119] The arbitrators in *US-1916 Act* chose the same approach.[120] Although they did not reject qualitative suspensions outright, they found that a qualitative suspension had to be quantified (through a determination of how it would be applied and the resulting trade or economic effects) in order to ascertain whether it met the equivalence test of Article 22.4.[121] Once this is determined, the complaining party may "implement its suspension up to, but not beyond, this amount." This analysis "necessitates a determination of the trade or economic effects" of the impermissible trade measure "in numerical or monetary terms, which is the only way in which the arbitrators can determine 'equivalence' in the present context."[122] A "suspension of obligations in excess of the level of nullification or impairment would be punitive" and is prohibited by Article 22.4.[123] This approach is consistent with previous Article 22.6 arbitrations.[124] "Whatever the level of nullification or impairment …the "suspension, once applied, must remain capped at or below that level."[125]

The arbitrators in *US-1916 Act* also made important findings concerning the calculation of the nullification or impairment sustained by the complaining party. In determining the nullification or impairment, the arbitrators found that they "need to rely, as much as possible, on credible, factual, and verifiable information. We cannot base any such estimates on speculation."[126] Quoting *EC-Hormones (US)*, the arbitrators recognised that since they were answering a question on a future event, they were empowered to make a "reasoned estimate" based on "certain assumptions". When making these estimates and assumptions, the arbitrators accepted that they would need to "guard against claims of lost opportunities where the causal link with the inconsistent" measure "is less than apparent, i.e. where exports are allegedly foregone not because of the ban but due to other circumstances."[127] The arbitrators decided to "consider the level of nullification or impairment in the present case, while avoiding claims that are 'too remote', 'too speculative', or 'not meaningfully quantified.'"[128]

US-Gambling is particularly instructive for purposes of this study as it dealt with the nullification or impairment of service commitments and potential retaliation in the services sector. With respect to the issue of equivalence, *US-Gambling* is broadly consistent with earlier Article 22.6 arbitrations which generally endorse a quantitative approach to equivalence based on the value of trade nullified or impaired.[129] *US-Gambling* examines both the principle of equivalence and the selection of the counterfactual. In determining whether the proposed level of suspension was equivalent to the level of nullification or impairment, the arbitrators took care "to ensure that the level of suspension is neither reduced to a level lower than the level of nullification or impairment of benefits accruing to the complaining party, such as to adversely affect that party's rights, nor exceeds the level of nullification or impairment of benefits, such that it would become punitive."[130] This consideration guided the arbitrators' assessment of the US challenge to the complaining party's choice of counterfactual.

The issue of equivalence was central to the resolution of this Mode 1 dispute. The counterfactuals presented by the parties were based on the trade effects approach – each

counterfactual estimated Antigua's lost export of gambling services to the United States as a result of the GATS-inconsistent trade measure applied by the United States.[131] *US-Gambling* provides a relatively easy scenario in which to determine equivalence in the services sector. Mode 1 (cross-border supply) is the services sector that most resembles traditional trade (importation) of goods. As a result, it would appear to be less difficult to develop counterfactuals (projections) demonstrating the trade effects of suspensions that affect delivery of services in Mode 1. However, ascribing a quantifiable value to a suspension of commitments or other obligations in the service sector, and determining the trade effects resulting from this a suspension, may be more difficult in the services sector than in the goods sector where it is relatively easy to project the trade effects of tariff increases. Furthermore, in all four modes of supply problems are likely to arise with respect to the collection of accurate statistical data. The decision of the arbitrators in *US-Gambling* hints at the difficulty many Members are likely to experience developing statistical information on trade in services.[132]

For example, calculation of equivalence in Mode 2 (consumption abroad) is more complicated and requires that governments collect and share data. This is because restrictions in Mode 2 are imposed by the Member whose citizens are seeking services abroad and not by the Member receiving the services. Although Members are often aware when their citizens leave their territory, they are not always aware why their citizens are going abroad. Suspensions in Mode 2 require the compilation of statistical information on the money citizens spend abroad for services, such as tourism and medical care, as well as the money spent abroad to maintain or repair goods such as ships and airplanes. Without cooperation between Members, this statistical information may be difficult to develop.

Modes 3 and 4 may be the most difficult service sectors in which to determine whether a suspension has an equivalent trade effect. As discussed in Section IV, suspensions in Modes 3 and 4 are classified as affecting either pre-establishment or post-establishment rights. Suspensions may prevent the establishment of foreign businesses (Mode 3 – commercial presence), and they may prevent the temporary establishment of foreign service providers (Mode 4 – presence of natural persons). Suspensions in Mode 3 and Mode 4 may also affect post-establishment rights thereby restricting or prohibiting the provision of services by foreign service providers already established in the complaining party's territory. Calculation of equivalence in both the pre- and post-establishment phases of Mode 3 and mode 4 may prove difficult in certain situations.

IV. LEGAL, TECHNICAL AND ECONOMIC PROBLEMS OF RETALIATION AND CROSS-RETALIATION UNDER THE GATS

Opportunities and problems related to the suspension of concessions and other obligations in the four modes of supply are examined in the following sections. Section A provides a brief introduction to GATS General Obligations, Specific Commitments, and modes of supply. Sections B and C examine the suspension of commitments in each Mode of Supply, as well as the suspension of General Obligations, in particular the MFN obligation.

A. Introduction to General Obligations and Disciplines, Specific Commitments and Modes of Supply

The GATS distinguishes between "General Obligations and Disciplines" (Part II of GATS) and "Specific Commitments" (Part III of GATS). General Obligations and Disciplines include the most-favoured-nation obligation. General Obligations are applicable regardless of whether a Member has scheduled commitments in specific service sectors. "Specific Commitments"

are comprised of Market Access limitations, National Treatment limitations and Additional Commitments. Specific commitments only apply when a Member makes a commitment in a service sector or sub-sector.

Members schedule specific commitments in each of the twelve service sectors and in a large number of sub-sectors.[133] "Specific commitments" are scheduled based on how a service is delivered. The term "modes of supply" refers to the distinct manner in which a particular service is delivered. The GATS distinguishes between four modes of supply:

- Mode 1 – Cross-border supply,
- Mode 2 – Consumption abroad,
- Mode 3 – Commercial presence, and
- Mode 4 – Presence of natural persons.

The following table illustrates that commitments in Modes 1 and 2 directly affect the service consumer and that commitments in Modes 3 and 4 directly affect the service supplier.[134]

MODES OF SUPPLY

Mode of Supply	Supplier Presence	Other Criteria
Cross border Supply (Mode 1)	Service supplier not present within the territory of the Member making commitments	Service delivered within the territory of the Member making commitments, from the territory of another Member
Consumption Abroad (Mode 2)		Service delivered outside the territory of the Member making commitments, in the territory of another Member, to a service consumer or the goods of the Member
Commercial Presence (Mode 3)	Service supplier present within the territory of the Member making commitments	Service delivered within the territory of the Member making commitments, through the commercial presence of the supplier
Presence of Natural Person (Mode 4)		Service delivered within the territory of the Member making commitments, with supplier present as a natural person

In Modes 1 and 2, the service supplier is not present in the territory of the Member making commitments, while in Modes 3 and 4 the service supplier is present. Many services are capable of being delivered in more than one Mode of Supply. For example, an accounting firm in Member A can provide accountancy services to a client in Member B by email (Mode 1), by receiving the client in its office in Member A (Mode 2), by constructing an office in Member B (Mode 3), or by travelling to Member B (Mode 4). Predicting how retaliation and cross-retaliation might work requires an understanding of the "specific commitments".

B. Suspensions of Specific Commitments in the Four Modes of Supply

The GATS provides for three forms of "Specific Commitments":

- Market Access Limitations: Market access is provided for in Article XVI of the GATS and is scheduled in column 2 of the Service Schedules. Article XVI:1 contains an MFN obligation based on the conditions specified in a Member's schedule. Article XVI:2 provides an exhaustive list of Market Access measures (quantitative restrictions, foreign capital restrictions, and restrictions on the type of legal entity) which must be scheduled if they are to be maintained by a Member. Importantly, although Article XVI provides an exhaustive list, it does not include all market access measures that could restrict market access. In particular, fiscal measures are not covered.[135]

- National Treatment Limitations: National treatment is provided for in Article XVII of the GATS and is scheduled in column 3 of the Service Schedules. Measures that are inconsistent with both the Market Access rules in Article XVI, and the National Treatment rules in Article XVII, are inscribed in column 2.[136] National treatment limitations result in less favourable treatment for foreign services or service suppliers over domestic services and domestic service suppliers. Article XVII does not provide an "exhaustive list" of national treatment limitations. Examples of national treatment measures drawn from Member schedules are set forth in the "Scheduling Guidelines" and include certain tax and financial measures, nationality and residency requirements, technology transfer and training requirements and property ownership requirements.[137]

- Additional Commitments: The possibility of a Member assuming additional commitments is provided for in Article XVIII of the GATS. Additional commitments are scheduled in column 4 of the Service Schedules. They relate to qualifications, technical standards, licensing requirements or procedures, and domestic regulations consistent with Article VI. They are expressed in Member schedule as "undertakings" and not "limitations",[138] with the result that they are less relevant for this study. An example would be when a Member assumes additional commitments pursuant to the telecommunications "Reference Paper".

The suspension of "specific commitments" means the suspension of market access and national treatment commitments that a Member has scheduled in specific service sectors or sub-sectors. If "NONE" appears in the Market Access or National Treatment columns of a Member's service schedule, the Member has undertaken not to impose limitations with respect to the applicable service sector (or sub-sector) and Mode of Supply. This is a "full commitment" in which there are no limitations. A suspension of "specific commitments" (Market Access and National Treatment limitations) is possible in such sectors.

Members may also choose to schedule "limited commitments" (commitments with specific limitations that favour domestic services and service suppliers). In such cases a Member must provide a detailed description of the applicable limitation, i.e. the measures inconsistent with Market Access and/or National Treatment provisions. To the extent that a Member has assumed Market Access and National Treatment obligations, there may be room for suspension of these specific commitments.

Suspensions of specific commitments are not possible when a Member schedules a sector as "UNBOUND" or "UNBOUND*". In both cases there is no specific commitment to suspend – in the first case because the Member has made no commitment and is free to introduce limitations on Market Access or National Treatment; in the second case because no commitment is technically feasible (indicated by the asterisk).[139]

To what extent is a suspension of the specific commitments practicable? The answer depends on the specific commitments scheduled by a Member and how these commitments function.

1) Practical Limitations on the Suspension of Specific Commitments

a) Article XVI

Assume that a complaining party has made specific commitments in a sector or sub-sector and is considering the suspension of these commitments as a form of retaliation or cross-retaliation. Within the category of specific commitments, the withdrawal of Market Access commitments offers the easiest form of retaliation or cross-retaliation. The complaining party's choice of suspensions is, however, circumscribed by the fact that Article XVI only provides a narrow range of permissible market access limitations. They are set forth in an exhaustive list from which the outline of possible suspensions can be drawn.[140] Market Access limitations consist of quantitative restrictions affecting the number of service suppliers, the total value of service operations, the total quantity of service output, limitations on the number of natural persons employed in a particular service sector, and limitations on permitted legal entities and foreign capital limitations. The suspension of Market Access commitments means the imposition or re-imposition of some or all of these quantitative limitations. Other market access limitations, including the imposition of discriminatory taxation regimes, are not authorised by Article XVI.

b) Article XVII

There is some overlap between Articles XVI and XVII.[141] However, unlike Market Access Commitments, the National Treatment provision of Article XVII does not provide an exhaustive list of permissible limitations. Members have scheduled a wide range of conditions and qualifications that favour domestic services and service providers and function to some extent like Market Access limitations. This causes some of the confusion between Articles XVI and XVII.[142] Among the National Treatment measures that Members have scheduled are discriminatory tax and financial measures, nationality and residency requirements, technology transfer and training requirements and property ownership requirements. Members apply measures scheduled under Article XVII on an MFN basis but as these measures derogate from the National Treatment principle, they favour domestic over foreign services and service suppliers. The suspension of National Treatment commitments means the imposition or re-imposition of measures that discriminate in favour of domestic services and service suppliers.

The practicality of suspending National Treatment commitments under Article XVII has been the subject of a lively debate among the trade cognoscenti in Geneva. This author takes the view that a suspension of National Treatment commitments will seldom be desirable in light of the Article 22.6 decision in *US-Gambling* which suggests a far superior remedy for the complaining party – the suspension of "other obligations" (General Obligations), in particular MFN treatment.

First, the MFN obligation is a better source for an Article 22.6 suspension. The suspension of the National Treatment obligation is only viable if a Member has made a full commitment or a limited commitment in a relevant service sector or sub-sector (and Mode) and has not already protected domestic services and service suppliers in the form of a scheduled limitation. Otherwise, the complaining party has no relevant National Treatment obligations. Unlike the National Treatment obligation, MFN is a General Obligation and is applicable regardless of whether the offending party has made a Specific Commitment in a particular sector or sub-sector.[143] The potential scope of an MFN suspension is therefore much greater.

Second, when GATS retaliation and cross-retaliation are discussed, there is sometimes a failure to differentiate between MFN and National Treatment and which way the obligations run in practice. In trade in goods, both MFN and National Treatment function as

General Obligations which together make up the non-discrimination obligation that protects against tax and regulatory discrimination between like foreign products and between like domestic and foreign products. (In fact, when retaliation occurs in the goods sector, the complaining party simply raises tariffs and the debate between MFN and National Treatment is usually avoided.) In trade in services, the MFN obligation is analogous to its GATT relative – it is aimed (in the absence of listed Article II exemptions) at discrimination between all foreign services and service suppliers. However, under GATS, the National Treatment obligation is significantly different. Four points warrant attention.

First, the National Treatment obligation is most effective at preventing discrimination between domestic and foreign services and service suppliers when a full commitment is scheduled in all sub-sectors and all modes of supply. Second, when either full or limited specific commitments are scheduled, foreign services and service suppliers are likely to be subject to Domestic Regulations (Article VI of the GATS) which may be discriminatory in nature. Third, when limited commitments are scheduled, they frequently serve to legalise discrimination in favour of domestic services and service suppliers. Fourth, a complaining party that has made National Treatment commitments has obligations under this principle to other WTO Members. A suspension of its National Treatment commitment would therefore not take the form of a tax credit or a regulatory advantage operating directly in favour of domestic services and service suppliers, but instead can only take the form of a discriminatory tax or regulation imposed on services and service suppliers from the offending party (in derogation of the MFN obligation). Pursuant to the GATS MFN principle, all other WTO Members are going to be able to fill the void left by the reduction in the supply of services once provided by the offending party.

These considerations regarding National Treatment lead to an interesting strategic question. When a developing country seeks to suspend concessions against an offending party's services or service suppliers in the form of higher taxes or an increased regulatory burden, should it suspend the National Treatment or the MFN obligation? Although the answer might depend on the developing country's Service Schedule, for most developing countries the better choice is almost always going to be an MFN suspension. Developing countries made significantly fewer National Treatment commitments than developed countries and in fewer sectors – so they have fewer commitments available for suspension.

Assuming the arbitrators' reasoning in *US-Gambling* on the suspension of general obligations is correct, a complaining party would appear to have no obligation under either the DSU or the GATS to seek a suspension of specific commitments (where they exist) before seeking to suspend other obligations. Article 22.3 does not appear to establish a hierarchy regarding the suspension of specific commitments and the suspension of other obligations.

c) Article XVIII

Article XVIII permits a Member to schedule Additional Commitments. It provides "a legal framework for Members to negotiate and schedule specific commitments...in relation to any measures which do not fall within the scope of Article XVI or XVII."[144] By doing so a Member assumes additional obligations. Article XVIII allows a Member to recognise in its schedule, consistent with Article VI (Domestic Regulation), foreign or international standards, procedures, licenses, and qualifications in sectors or sub-sectors where it has made full or partial commitments.

There are two reasons why the Suspension of Additional Commitments is unlikely. First, the assumption of Additional Commitments is relatively rare, although it is found in the telecommunications sub-sector, and sometimes in the professional services sub-sectors.[145] Second, the suspension of Additional Commitments related to the application of international standards may risk reducing the quality of services provided to and in the complaining party.

2) Application to the Modes of Supply

Assume now that a complaining party has scheduled specific commitments and is considering suspension of these commitments in various modes of supply. The following section discusses the legal, technical and economic problems associated with retaliation and cross-retaliation in each Mode of Supply. Arguments raised in the Article 22.6 arbitral decisions in *US-Gambling* and the *EC-Bananas III (Ecuador)* are incorporated into the analysis. The discussion of taxation schemes is deferred until the discussion of the MFN principle in Section C where General Obligations, in particular MFN suspensions, are addressed.

There are a wide range of legal, technical and economic obstacles that may hinder the viability of a suspension of specific commitments. Overarching issues include:

1) Will the suspension of concessions or other obligations be *equivalent* (as required by Article 22.4 of the DSU) to the level of nullification or impairment? More specifically, will the suspension's effect on trade from the party found to be in violation of the WTO Agreement be equivalent to the nullification or impairment of the complaining party's trade caused by the illegal trade measure? Can equivalence be quantified for certain forms of suspension?

2) Would a proposed suspension have trade effects that endure beyond the date that the WTO-inconsistent measure is withdrawn? By excluding a Member from a market on a short-term basis, would the excluded Member be permanently disadvantaged? To what extent might this violate Article 22.4 of the DSU?

3) Will the suspension of concessions be *impracticable or ineffective?* Is the complaining party a developing country that lacks substantial trade volumes or economic power vis-à-vis the offending Member? Will the suspension be devoid of a significant economic impact on the offending party?

4) Will the suspension bring economic harm to the complaining party? Is the complaining party highly dependent on service imports from the offending party? Will the suspension result in unemployment in the complaining party?

5) What effect will the suspension have on the investment climate in the complaining party and on the complaining party's economic development?

6) Will the suspension of concessions or other obligations violate rights under national laws (including the complaining party's constitution), or under bilateral, regional or other international agreements ratified by the complaining party?

7) Will the complaining party need to enact or change its domestic law to allow retaliation or cross-retaliation in specific sectors and to suspend concessions or other obligations?

8) How should a proposed suspension be distributed or apportioned among service providers or recipients from an offending party (in particular in Modes 3 and 4)?

9) Can the suspension be avoided or circumvented? Do alternative modes of supply exist to supply the service in question?

10) Will consumers and businesses in the complaining party's territory be forced to contract more expensive domestic or foreign service suppliers or providers? (Will the Member shoot itself in the foot by applying the measure?)

11) Will the suspension disrupt the supply chain of various businesses? Will

businesses in a complaining party be less inclined to purchase goods and services from a Member targeted for retaliation or cross-retaliation in the service sector. For example, retaliation imposed on distribution services may affect trade in goods. Businesses in the complaining party may stop purchasing goods from countries whose transport companies are unable to deliver goods on time.

12) Will the suspension disrupt regional efforts towards economic integration? If the complaining party and offending party are Members of a regional trade agreement, retaliation or cross-retaliation may affect regional integration efforts.

These reoccurring questions are frequently present in the discussion of the suspension of specific commitments in the four modes of supply. The following subsections briefly describe each Mode of Supply and examine the possibility of suspending specific commitments in each Mode.[146]

a) Cross-border Supply (Mode 1)

Cross-border supply (Mode 1) refers to "the possibility for non-resident service suppliers to supply services cross-border into the Member's territory."[147] Cross-border supply occurs, for example, when an attorney, medical practitioner, accountant, engineer, architect, or consultant in the territory of one Member delivers an opinion, plans or a report by video link, telephone, fax, email, or post to a recipient in the territory of another Member. Mode 1 also includes services supplied through a physical medium, such as drawings, a USB key, a computer diskette, etc. The Member in which the service is received schedules the specific commitments and limitations. Mode 1 is the only mode of service supply that is "directly comparable" to the "notion of importation" in trade in goods.[148]

The Market Access rules of Article XVI of the GATS provide substantial insight into potential retaliatory measures. Article XVI(a)-(c) suggest several market access limitations that are viable in Mode 1. They include limitations on the number of service suppliers from the offending Member, limitations on the total value of services supplied by the offending party, and limitations on the total number of service operations. A complaining party could apply these limitations to restrict or prohibit the cross-border supply of services in Mode 1 from an offending party. For example, a complaining party could establish a "zero quota" on the cross-border purchase of services from an offending party, such as legal or accountancy services, or fire, automobile, life or property insurance from insurers located in the offending Member. A complaining party applying a limitation on the number or value of services provided by an offending party in Mode 1 would need to assure that the trade effect of the retaliatory measure does not exceed the level of nullification or impairment – in other words that the equivalence requirement is met.

In addition to problems associated with equivalence, there are other problems of a practical nature associated with market access restrictions in Mode 1. The cross-border supply of services, such as legal services by phone, email, fax or post, is often difficult for Members to regulate or control. In many instances services are supplied across borders without the government being aware that a service has been provided. Often WTO Members only learn that a service has been provided in Mode 1 when a foreign service supplier makes a tax declaration related to income tax or VAT, when a bank transfer to a foreign service provider is notified to the authorities, or when the service recipient seeks to deduct payment for the service provided for tax purposes. The success of a suspension of concessions or other obligations in Mode 1 may depend largely on the honesty of service suppliers and service recipients.

The "camouflaged" nature of services delivered in Mode 1 can make an effective suspension in Mode 1 difficult if not impossible. Monitoring the means of delivery in Mode 1 (phone, email,

fax, etc.) to prevent the delivery or receipt of services subject to suspension will often pose technical challenges, and may threaten the privacy and contract rights in both the complaining member and in the offending Member. Suspensions in Mode 1 may also threaten economic interests dependent on delivery of the service sought, and eliminate competition faced by domestic service suppliers – resulting in price increases and reductions in quality of competing domestic services.

The arbitrators in *EC-Bananas III* recognised that a suspension of commitments concerning cross-border supply could create "practical difficulties and remain ineffective in certain service sectors. For example, it would be technically difficult to cut certain service trade across borders such as telecommunications flows."[149]

The arbitrators in *EC-Bananas III (Ecuador)* also recognised that obstacles associated with the availability of alternate modes of supply may make a particular form of retaliation or cross-retaliation ineffective and may pose practical difficulties.[150] When it is technically feasible to provide services through alternative modes of supply, it becomes difficult to implement a suspension of commitments applicable in only one Mode of Supply. A suspension of concessions in Mode 1 risks being impracticable or ineffective if the suspension does not encompass other modes of supply since services delivered in Mode 1 are often capable of being delivered in other Modes. For example, if a complaining party only suspends commitments governing the cross-border supply of legal services in Mode 1, the same service might be provided in Mode 2 if the client travels to the foreign service supplier's office; in Mode 3 if the law firm establishes a commercial presence in the service recipient's territory; and in Mode 4 if the foreign attorney travels to the service recipient's office. In such cases, a suspension in Mode 1 would need to be reinforced by a suspension in other modes of supply if it is to be practicable and effective.[151]

b) Consumption Abroad (Mode 2)

Consumption abroad refers to "the freedom for the Member's residents to purchase services in the territory of another Member."[152] For example when a resident in the territory of one Member is allowed by that Member to consume a service in the territory of another Member – perhaps as a tourist, a patient in a foreign hospital, as a student abroad, or an individual seeking accounting, consulting or legal services. Mode 2 includes servicing one's property in the territory of another Member – for example when a national or a company from one Member has a ship, automobile, computer or airplane repaired in the territory of another Member. In Mode 2, commitments and limitations are scheduled by the Member whose nationals or residents are seeking a particular service abroad, and not by the Member offering the service.

Retaliation or cross-retaliation in Mode 2 assumes that the complaining party has made full or partial commitments in at least one service sector or sub-sector. Retaliation or cross-retaliation in Mode 2 will take different forms depending on whether the physical movement of consumers or the movement of objects is involved. If the movement of consumers is involved, retaliatory measures might consist of Market Access restrictions, such as quantitative limitations on the total value or number of service transactions received by service recipients abroad. Quantitative limitations could take the form of limitations or prohibitions (a zero quota) on the consumption of services by consumers from the complaining party in the offending party.[153] For example, the complaining party could (i) prohibit its residents from travelling as tourists to the offending party, (ii) prohibit its residents from purchasing medical, dental, legal, educational, consulting or other services in the territory of the offending party, or perhaps (iii) prohibit its insurance providers, in particular state insurance providers, from reimbursing residents for medical services received abroad.[154]

When the movement of objects for servicing is involved (for example the service or repair abroad of an automobile, ship, airplane or computer) the transaction itself may be targeted.[155] Measures could include (i) numerical limitations on the total value of repairs consigned by the complaining party to foreign repair facilities in the offending party, (ii) numerical limitations on the number of service operations permitted in the offending party on goods from the complaining party, and perhaps (ii) prohibitions on insurance coverage for goods serviced abroad in the offending party.[156]

Many of the problems associated with retaliation or cross-retaliation in Mode 1 also exist in Mode 2. Establishing equivalence remains an obstacle. In some cases the complaining party may find it difficult to establish that its proposed suspension does not exceed the level of nullification or impairment of the offending party's illegal trade measure. For example, it may be difficult to ascertain the value of medical, dental, tourist or repair services that the complaining party's residents and businesses are receiving in the offending party. Without this statistical information, it will be difficult to establish that the trade effects of the suspension do not exceed the level of nullification or impairment.

On a more practical level, it may prove difficult to prevent residents from travelling abroad to receive services in the offending party. While restrictions are conceivable, for example U.S. law imposes restrictions on the travel of its citizens to Cuba, limiting the travel of US citizens to Cuba through third countries has proven difficult. Furthermore, in some countries, limitations on the free movement of citizens may raise constitutional issues.[157] The same problem may arise with respect to the repair or maintenance of objects in the offending party. Often it will be hard to detect when a ship or plane is serviced abroad.

Mode 2 limitations suffer from other potential shortcomings. Service providers and consumers in the complaining party may object to restrictions on Mode 2 travel. For example, in the United States, health insurers have begun to establish partnerships with foreign hospitals where high quality medical procedures are sometimes offered at a substantially lower cost. Health insurers, and consumers paying health insurance premiums, may benefit from the possibility of travelling abroad for such medical procedures.[158]

Although tourism services and certain medical services may depend upon travel abroad, other professional services (including architectural, engineering and legal services) can often be offered in a different Mode of Supply. Circumvention is again an issue. The decision of the arbitrators in *EC-Bananas III (Ecuador)* discussed this point and made specific mention of Mode 2.[159]

Restrictions on the receipt of services abroad may also cause inconvenience, increase prices and risk harming service recipients. For example, restricting the ability of consumers to obtain services within the territory of the offending party could reduce competition and result in an increase in prices (and a reduction in quality) of services offered in the complaining party. Restrictions on the maintenance of ships and aircraft in the offending party could also result in safety risks for consumers in the complaining party, and elsewhere, who use these ships and aircraft.

c) Commercial Presence (Mode 3)

Commercial presence, known also as Mode 3, refers to "opportunities for foreign service suppliers to establish, operate or expand a commercial presence in the Member's territory, such as a branch, agency, or wholly-owned subsidiary."[160] Commercial presence is a form of foreign direct investment (FDI) in the service sector. The Member in which the service is offered (where the commercial presence is or will be established, i.e. where the investment will occur) schedules the commitments and limitations.

WTO Members divide activity in Mode 3 into two categories: the pre-establishment stage (when the investment flow occurs), and the post-

establishment stage (when the actual service or "output" is provided).[161] An example of Mode 3 in the pre-establishment stage is when a foreign law firm, bank or insurance company opens an office to provide services in the territory of another Member. The post-establishment stage consists of the actual provision of services.

As with the other modes of supply, the Market Access limitations present in Article XVI suggest restrictions that a complaining party may impose as either retaliation or cross-retaliation in sectors and sub-sectors where it has scheduled full or partial commitments. In the pre-establishment stage retaliation or cross-retaliation against an offending party could take the form of: (i) limitations on the number of service suppliers from the offending party permitted to supply services in the complaining party, (ii) limitations on the total number of natural persons that a service supplier from the offending party may employ in the complaining party, (iii) measures that restrict or require service suppliers from the offending party to establish a specific type of legal entity or joint venture through which it will supply services in the complaining party (e.g., limitations on foreign ownership or a requirement that the service supplier from the offending party enter into a joint venture with a local partner), and (iv) limitations on the participation of foreign capital (e.g., maximum percentage limits on investment or ownership by service suppliers from the offending party).

In the post-establishment phase, retaliation or cross-retaliation against an offending party could take the form of (i) limitations on the value of service transactions supplied by service providers from the offending party within the complaining party's territory, and (ii) limitations on the total number of service operations or on the total quantity of service output supplied by the offending party's service suppliers within the complaining party.

In both the pre-establishment and post-establishment stage, the complaining party must assure that the effect of its suspension of specific commitments on the offending party's service sector does not exceed the level of nullification or impairment resulting from the offending party's illegal trade measure. Establishing equivalence in the post-establishment stage is somewhat easier than establishing equivalence in the pre-establishment stage. In the post-establishment stage the trade effects from the suspension are more readily quantifiable – it is easier for the complaining party to project the service trade that the offending party would lose as a result of a suspension. In the pre-establishment stage the trade effects can be more difficult to quantify. While such a calculation may be possible with respect to limitations on the number of service suppliers, and limitations on the number of natural persons that a service supplier may hire, it may be more difficult with respect to suspensions that require the offending party's service suppliers to establish a specific type of legal entity or that impose limitations on investment or ownership.

A suspension of specific commitments in Mode 3 may raise questions pursuant to the national law of the complaining party. For example, would a complaining party be permitted by its national law to retaliate or cross-retaliate in Mode 3 against a foreign-owned service supplier that enjoys legal personality under the complaining party's national laws? Do national laws need to be changed to differentiate between foreign service providers that have acquired rights under domestic law, and local service providers? Why should foreign service providers "legally established" in the complaining party's territory be treated differently from domestic service providers? These questions are difficult because the GATS deals not only with "importation" of services (Mode 1), but also with the "establishment" of foreign service providers (Modes 3 and 4). Furthermore, the GATS definition of a "service supplier" within the context of commercial presence recognises a distinction between foreign and domestic service suppliers established within the same Member's territory.[162]

The suspension of specific commitments in Mode 3 will raise important questions for developing country Members. The practicality and effectiveness of such suspensions was examined

from a developing country perspective in *EC-Bananas III (Ecuador)*. The arbitrators recognised that the effects of a suspension of commitments related to commercial presence could be particularly detrimental to developing country Members if they are "highly dependent on foreign direct investment."[163] In their analysis of developing country implications, the arbitrators distinguished between: (i) suspensions against foreign service suppliers who were potential investors in the complaining party (the "pre-establishment" stage), and (ii) suspensions made against foreign service suppliers who were already commercially present in the complaining party (the "post-establishment" stage). They reasoned that suspensions at both the pre- and post-establishment stage could harm a developing country's economy.[164] Although cross-retaliation at the pre-establishment stage would not be difficult, it would discourage foreign service suppliers from investing in the complaining party and would provide an incentive for foreign service suppliers to take their FDI to another host country where there was no suspension of concessions on commercial presence.[165] Significant harm could be inflicted on the developing country that lost the FDI.

At the post-establishment (or post-investment) stage the complaining party (Ecuador) noted that it could, if authorized by the DSB, order a "commercially present service supplier to stop its activities or impose a supplementary tax on each unit of its service output." Ecuador argued however that this would not be practicable since such actions "against service suppliers of a particular foreign origin" could lead to conflicts with rights such as "equal treatment embodied in national legislation or international treaties and would entail substantial administrative difficulties".[166] The arbitrators reasoned that a suspension of concessions at the post-establishment stage could also be detrimental to a developing country. Foreign service suppliers at the post-establishment stage would lose the "legal protection, predictability and certainty which the GATS standards provide", and the suspension could provide an incentive for commercially present service suppliers to transfer their investment to another country thus causing "significant harm" to Ecuador's economy.[167]

The arbitrators also recognised that at the post-establishment stage it may be difficult to prevent "legally established" foreign service providers from supplying services within a complaining party's territory. They cited the possible legal and administrative difficulties arising under national and international law "to close or limit the service output" of foreign enterprises with legal personality, or branch or representative offices. They noted that such service providers may enjoy legal personality and legal protection under national or international law.[168]

In conclusion, *EC-Bananas III (Ecuador)* suggests several reasons why the suspension of specific commitments in Mode 3 might be impracticable or ineffective for purposes of GATS retaliation:

(1) <u>There is a violations or conflict with national or international law</u>: A foreign service provider who has already established a commercial presence in a complaining party's territory may have property rights under national law, rights to equal treatment under national law, constitutional protections, or rights as an investor under a bilateral investment treaty or other international agreement, any of which may make the imposition of legal restrictions or taxes on commercial presence legally difficult or impracticable.

(2) <u>There are adverse effects on the economy of the Member undertaking cross-retaliation</u>: Suspending or placing limitations on existing or future foreign direct investment may pose administrative difficulties, and may distort the investment climate, discourage foreign direct investment, and have other adverse effects for the economy of the complaining party. A suspension may also cause uncertainty for existing investors and discourage prospective investors. Foreign investors contemplating investment in a country considering cross-retaliation in Mode 3,

or with a history of having implemented cross-retaliation in Mode 3, may view the investment climate as unpredictable.

(3) There is no significant effect on the offending party: A suspension may be impracticable or ineffective if it is harmful to the complaining party or does not have a significant economic effect on the offending party. For example, a suspension affecting the provision of services by foreign engineers could affect domestic production. It could harm the complaining party more than the offending party if no alternative service providers are available at a reasonable price. If the foreign engineers quickly find work in another country, the suspension might also have no effect on the offending party.[169]

(4) There are difficulties establishing equivalence: Suspensions in Mode 3 raise the same questions with regard to equivalence that were discussed with respect to Modes 1 and 2. Arbitrators must estimate the complaining party's "losses in actual or potential trade and trade opportunities in the relevant goods and service sectors."[170]

d) Presence of Natural Persons (Mode 4)

Mode 4 refers to "the possibilities offered for the entry and temporary stay in the Member's territory of foreign individuals in order to supply a service."[171] Pursuant to the GATS, the Member in which the service is offered (in the territory where the natural person offers the service) schedules the commitments and limitations. For example, supply in Mode 4 occurs when a natural person, such as a civil engineer, attorney, architect, lawyer, accountant, or medical professional travels abroad on a temporary basis to render services in the territory of another Member. Like Mode 3, Mode 4 has both a pre-establishment phase and a post-establishment phase.[172]

The suspension of specific commitments in Mode 4 is again likely to be based on the Market Access provisions of Article XVI. Assuming equivalence, at the pre-establishment stage, suspension of specific commitments may include the following limitations imposed by the complaining party on service suppliers (natural persons) from the offending party: (i) numerical limitations on the number of foreign service suppliers (natural persons) permitted to provide temporary services within the complaining party's territory, (ii) limitations on the number of natural persons that may be employed in a particular service sector or that a service supplier may employ within the complaining party's territory, and (iii) measures that restrict or require the creation of specific legal entities or joint ventures through which natural persons from the offending party are permitted to provide services within the complaining party's territory.

Assuming equivalence, at the post-establishment stage, suspension of specific commitments might include the following limitations imposed by the complaining party on service suppliers (natural persons) from the offending party: (i) limitations on the value of services provided by foreign service suppliers within the complaining party's territory or within a particular region in its territory, and (ii) limitations on the number of service operations or on the total quantity of service output.

In addition to problems related to equivalence, suspensions in Mode 4 face obstacles that may limit their effectiveness and practicality. Many of these obstacles are similar to those encountered in Mode 3. Suspension in Mode 4 may violate the private contractual rights of service providers lawfully working in the complaining party's territory. For example, if an engineer signs a contract and receives a visa to work on a construction project, a suspension of concessions relative to the provision of construction services (coupled with the deportation of the engineer) may place the engineer in breach of his or her contract. Faced with such insecure work conditions, a WTO Member, in particular a developing country Member, may find it difficult to attract foreign service suppliers.

Limiting the value of services that a foreign national provides may also have adverse effects, particularly for developing countries. For example, a suspension of specific commitments may lead to uncertainty and insecurity if, due to the suspension, foreign doctor are barred from temporary work in the territory of the complaining party. Such restrictions may also make it more difficult to attract skilled foreign service suppliers to fill temporary contracts.

Suspensions in Mode 4 may also have adverse effects for enterprises offering services in Mode 3. If a foreign hospital builds a clinic in a developing country and occasionally sends foreign experts to provide medical consultations, a suspension of concessions in Mode 4 applicable to temporary visits by foreign doctors from an offending party may lessen the quality of services offered in Mode 3.

In many instances limiting the temporary access of foreign service suppliers may cause more harm than good to a complaining party. In some specialised fields, WTO Members from developing countries are dependent on the knowledge and skills of foreign service suppliers. While in many cases the services offered may be acquired from other foreign suppliers, linguistic, economic, cultural and geographic factors may limit the availability of alternate service suppliers.

C. Suspension of "Other Obligations": The MFN Obligation

This paper has, until now, focused largely on the suspension of specific commitments under the GATS. Article 22.3 of the DSU also permits a complaining party to suspend "other obligations". In the GATS context, "other obligations" are different from specific commitments in one important way – they apply even when a Member has not made commitments in the service sector where the violation occurred, or in another sector under the GATS Agreement. The phrase "other obligations" refers to the list of obligations in Part II of the GATS ("General Obligations and Disciplines"):

> Article II – Most Favoured-Nation Treatment; Article III – Transparency; Article III bis – Disclosure of Confidential Information; Article IV– Increasing Participation of Developing Countries; Article V – Economic Integration; Article V *bis* – Labour Markets Integration Agreements; Article VI – Domestic Regulation; Article VII – Recognition; Article VIII – Monopolies and Exclusive Service Suppliers; Article IX – Business Practices; Article X – Emergency Safeguard Measures; Article XI – Payments and Transfers; Article XII – Restrictions to Safeguard the Balance of Payments; Article XIII – Government Procurement; Article XIV – General Exceptions; Article XIV bis – Security Exceptions; and Article XV – Subsidies.

The MFN obligation, set forth in Article II of the GATS, is among these obligations. Despite the large number of obligations in Part II of the GATS, arbitral decisions on the suspension of "other obligations" have only examined suspension of the MFN obligation.[173] This reflects MFN's importance among the "other obligations". It may also reflect the difficulty of establishing the trade effect of a suspension of most of the "other obligations". For example, it would be very difficult for purposes of establishing equivalence to quantify the effect on trade in services resulting from the complaining party's suspension of the Article III Transparency obligation.

Two Article 22.6 decisions, *EC-Bananas III (Ecuador)* and *US-Gambling*, examined suspension of other obligations (primarily the MFN obligation) but reached different conclusions. In *EC-Bananas III (Ecuador)*, the arbitrators concluded that the complaining party cannot suspend other obligations in sub-sectors where it has not entered into specific commitments.[174] Pursuant to the arbitrators' reasoning, if a Member does not enter into specific commitments in a sub-sector, a complaining party would not be entitled to suspend its application of the MFN obligation in that sub-sector.[175] The arbitrators also found that the same conclusion would apply if the

complaining party "had scheduled exemptions from MFN treatment" under Article II:2 of the GATS.[176]

In *US-Gambling* the arbitrators reached the opposite conclusion. They observed that the text of Article 22.3 of the DSU refers to "concessions *or other obligations*" with respect to the relevant sector, and reasoned that the "entire range" of obligations is relevant when considering whether a suspension is practicable or effective in a sector. This led the arbitrators to conclude that the review of other obligations should include an assessment of whether a suspension of the MFN obligation would be practicable or effective.[177] In reaching their decision, the arbitrators explicitly rejected the finding of EC-Bananas ruling instead that "the scope of the relevant obligations is not limited, in our view, to specific commitments bound in Antigua's GATS schedule".[178]

The reports of arbitrators issued pursuant to Article 22.6 of the DSU are not subject to Appellate Body review, with the result that it is not possible to have a definitive Appellate Body interpretation of Article 22.3 of the DSU. This does not prevent commentators from forming opinions on Article 22.6 reports. On the question of MFN, the view of the arbitrators in *US-Gambling* strikes this commentator as compelling. Not only is *US-Gambling* a more recent decision (seven years after the *EC-Banana III (Ecuador)* arbitration), it also provides a better reasoned and more detailed analysis that gives full meaning to the language of Article 22.3 of the DSU. The arbitrators' interpretation of Article 22.3 of the DSU is also consistent with similar language in Article XXIII:2 of the GATS.[179]

The argument in *EC-Gambling* on the applicability of "General Obligations" in instances when Members have not made specific commitments has its roots in an old debate. When GATT Article III (National Treatment) was negotiated a similar issue arose. Some countries argued that the National Treatment principle should only apply when a country has made tariff concessions pursuant to GATT Article II. The view that prevailed was that a trade agreement should have "certain basic general provisions".[180] The MFN obligation within the GATS can be viewed as one of these "basic general principles".

Pursuant to *US-Gambling*, a suspension of "other obligations" in accord with Article 22.3 of the DSU would permit a complaining party to suspend its Article II MFN obligation regardless of whether it has scheduled specific commitments in a particular sector. Provided that the complaining party has not already listed MFN exceptions in the Annex on Article II Exceptions,[181] a complaining party would be relieved of its Article II:1 obligation to accord "immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country." As with trade in goods, such retaliatory measures are likely to take the form of (i) discriminatory regulations, or (ii) discriminatory duties and charges of any kind (taxes).

In *US-Gambling* the arbitrators reviewed Antigua's determination of the practicality and effectiveness of suspending "concessions or other obligations", first in the sector[182] where the nullification or impairment occurred (Sector 10 – Recreational, Cultural and Sporting Services),[183] and once that was confirmed not to be practicable and effective, then in other GATS sectors.[184] In each case, the arbitrators considered sub-sectors where the complaining party had not made specific commitments on the grounds that the MFN obligation nevertheless applied.[185]

The arbitrators merged their consideration of the suspension of "specific commitments and other obligations" with their analysis of the practicality and effectiveness of a suspension in other sectors under the GATS.[186] The arbitrators noted that the complaining party, in its explanation of how a suspension would work in the services sector, raised the possibility of "higher duties, tariff, [stet] fees or other restrictions".[187] Such measures are examples of potential retaliatory action involving a suspension of the MFN obligation. If authorised

to suspend the MFN obligation, a complaining party would be able to apply discriminatory taxes and regulations against services from the offending party until the effect on the offending party's service trade equalled the level of nullification or impairment.

It is useful to consider how an MFN suspension might work in each of the four modes of supply. In each Mode, the complaining party could apply taxation and regulatory schemes to discriminate against the offending party. The equivalence rule would apply to all measures to assure that the trade effect of a tax or regulatory measure does not exceed the level of nullification or impairment.

In Mode 1, a tax could be imposed by the complaining party on the sale or receipt of services from the offending party. Since trade in services in Mode 1 resembles importation of goods under the Multilateral Agreements on Trade in Goods, the tax that a complaining party would impose is somewhat analogous to a retaliatory tariff increase (retaliation or cross-retaliation) in the goods sector. A similar result would be achieved if instead of a discriminatory tax measures, services exports from the offending party were subject to a discriminatory regulatory requirement. However, taxation schemes do not require conformity assessment measures and would appear easier to apply.

In Mode 2 taxation and regulatory schemes are also both viable. When the movement of consumers is at issue, discrimination against the offending party could take the form of (i) taxes on consumers travelling abroad to receive services, and (ii) regulations limiting or restricting consumption abroad by consumers.[188] More specifically, discriminatory measures could include: (i) restricting or prohibiting a Member's nationals from purchasing medical, dental, legal, consulting or other professional services in the territory of another Member, (ii) exit taxes on nationals travelling abroad to targeted countries as tourists, (iii) limitations on the number of residents allowed to travel to a specific country for tourism, (iv) taxes on nationals travelling abroad to targeted countries for dental work and to receive other professional services, (v) prohibitions on coverage under a Member's public health insurance scheme for medical treatment received abroad, and (vi) a tax on insurance purchased abroad.[189]

When the movement of objects as opposed to consumers is at issue in Mode 2 (for example the service or repair of an automobile, ship, airplane or computer abroad), the complaining party must target the transaction itself.[190] Discriminatory measures that would affect the offending party might include: (i) a prohibition by the complaining party on the use of foreign repair facilities in the offending party, (ii) taxes imposed on the value of maintenance and repairs performed on goods from the complaining party in the offending party, and (iii) limitations on insurance coverage in the complaining party for goods serviced or repaired in the offending party.[191]

In Mode 3 the complaining party could apply discriminatory taxes and regulations at both the pre-establishment and post-establishment stage against the offending party's service suppliers. At the pre-establishment stage, special fees could be assessed before a foreign commercial presence is authorised in the complaining party's territory. At the post-establishment stage, the complaining party could imposes taxes on the offending party's service suppliers operating in its territory based on service output, commercial presence, the number of foreign employees, the amount of capital invested, as well as on many other criteria. Discriminatory regulations, for example a requirement that a foreign firm from the offending party must hire a minimum number of local workers at a set wage, are also feasible, but more difficult to quantify for purposes of assessing equivalence.

Both discriminatory taxation and regulatory measures are also conceivable in Mode 4. A complaining party could impose taxes as a condition of entry (pre-establishment taxes) and on the service output (post-establishment

taxes). A complaining party could also impose regulations limiting the recognition of foreign degrees or qualifications. Likewise the complaining party could require skilled foreign service providers from the offending party to train its nationals,[192] but this may raise questions regarding the establishment of an equivalent trade effect.

In addition to possible difficulties regarding the establishment of equivalent trade effects, there are two other caveats to consider. First, when a developing country complaining party suspends its MFN obligation vis-à-vis an offending party, many of the same economic and political difficulties will arise as when it seeks to suspend its specific commitments. Second, in instances when a complaining party has made commitments relative to Article XVI (Market Access) and Article XVII (National Treatment), the complaining party should consider suspending these commitments in conjunction with an MFN suspension.

V. ADDITIONAL THOUGHTS FOR DEVELOPING COUNTRIES

There is little experience in the WTO with respect to either retaliation or cross-retaliation. The list of Article 22.6 cases is short,[193] only one is particularly recent,[194] and only two squarely address the suspension of GATS obligations.[195] There are no instances where the application of retaliation or cross-retaliation by a developing country has coerced another Member to bring an inconsistent trade measure into conformity with the WTO Agreement, and no instances where a developing country has suspended GATS obligations in accordance with Article 22.3. Since experience with the suspension of GATS specific commitments and other obligations is virtually non-existent, the following thoughts offered to developing countries on GATS retaliation and cross-retaliation are not empirical. They are instead based on an educated view of the process.

Although experience is limited with respect to WTO retaliation and cross-retaliation, it is already apparent that some flaws exist in the WTO enforcement mechanism. These flaws affect both developed and developing countries (but not equally) and can be divided into two categories – economic and practical. From an economic point of view, retaliation and cross-retaliation in either the goods or services sector have the potential to impede trade liberalisation, distort normal trade flows (cause trade diversion), and are likely to reduce competition and result in increased domestic prices in a Member implementing a retaliatory or cross-retaliatory measure. Developing country consumers and businesses, more specifically their service suppliers and service recipients, are the most likely to be harmed by retaliation and cross-retaliation in the services sector.

From a practical point of view, few WTO Members possess the economic leverage to wield the sword of retaliation or cross-retaliation effectively. Countries with low trade volumes, in particular many developing countries, are likely to lack the economic and political clout to apply GATS retaliation or cross-retaliation effectively against developed countries. In addition the potential economic costs for developing countries that retaliate in services may be high and the benefits received, if any, are likely to be low. Fortunately, the sword is seldom necessary since WTO Members frequently bring their illegal trade measures into conformity with the covered agreements – both to sustain the system and to be seen by other Members as good WTO citizens.

There are other factors that may also tie the hands of developing countries. As a result of economic and political considerations, many developing countries often have a great need to maintain good relations with the developed world. First, they frequently depend upon access to the developed world's markets for the export of goods and services. Second, many poorer developing countries do not want to risk losing foreign aid, political support, and preferential market access under arrangements such as GSP. Consequently, many developing country Members are likely to avoid retaliation

and cross-retaliation in the services sector, particularly against the United States or the European Communities.

The practical shortcomings of the WTO enforcement mechanism are of considerable interest to developing country Members. There is a realisation among Geneva-based WTO diplomats that wealthier trading countries are likely to find themselves in a somewhat better position to retaliate and cross-retaliate in both the goods and services sector. The experiences of Antigua and Ecuador in *US-Gambling* and *EC-Bananas* respectively were formative – neither Antigua nor Ecuador were able to find an effective formula for retaliation in either the goods or services sector, and both sought TRIPs-based cross-retaliation as a result. In the aftermath of *US-Gambling* and *EC-Bananas III (Ecuador)*, discussions have continued among developing country delegations on how to improve (either individually or collectively) their ability to retaliate or cross-retaliate.[196]

How then can developing country Members benefit from the existing WTO rules governing retaliation or cross-retaliation in services? Since it is unlikely that most developing country Members (and most WTO Members in general) will be able to exert significant economic influence by suspending GATS concessions, it may be shrewder to seek to exert political influence. Developing countries, as well as any other WTO Member, can target high profile and politically influential service sectors for suspension. By so doing, it may be possible for a developing country Member to pressure a developed country Member to meet its obligations under the covered agreements, or at least to negotiate a mutually satisfactory solution.

Which GATS sector is the most politically influential and promises to be the best target for either retaliation or cross-retaliation? One candidate is the financial services sector. Financial service providers are often capable of mustering the political pressure required to convince a government to change its policies. The financial service sector, in particular the banking and insurance industries, are among the most vulnerable and most easily targeted by developing countries for retaliatory measures. Taxation measures (through a suspension of MFN) are likely to provide the easiest means of influencing existing and potential financial service providers since, if the reasoning in *US-Gambling* is correct, retaliation and cross-retaliation are not dependent on the complaining party having made specific commitment in the financial services sector.

Retaliation or cross-retaliation targeting a Member's financial services sector is most likely to be successful if a Member's financial service industry has a substantial commercial presence (whether or not the developing country has made a specific commitment in Mode 3), and if financial service providers stand to lose important business or important investments as a result of retaliatory measures. This may favour the larger and more prosperous developing countries that host well-established foreign financial service providers. The success of measures taken against the financial service sector will, of course, depend upon the ability of the targeted sector (or targeted companies) to lobby their home governments for a change in trade policy. It will also depend on the permissibility of such measures pursuant to the complaining party's national law, as well as the legality of the measure under applicable regional land international law.

Having said that the financial service sector may be most able to exert political influence over governments, it is prudent to remember that disrupting the financial service sector, through the imposition of retaliatory measures on foreign financial service suppliers, may affect domestic businesses and domestic service providers that rely on the services offered by foreign financial service providers. A cost-benefit analysis should accompany consideration of retaliatory and cross-retaliatory measures.

The result in *EC-Bananas III (Ecuador)* should also be borne in mind. Although Ecuador won the right to cross-retaliate based on TRIPs obligations, it never exercised that right. Instead, the EC helped Ecuador with debt negotiations in the Paris Club in return for

Ecuador not pursing its right to retaliate under the TRIPs Agreement.[197] Although Ecuador was able to negotiate a satisfactory solution as a result of its action under Article 22.6, Ecuador's banana producers remained the ultimate losers. Targeting politically sensitive sectors for cross-retaliation may help produce a negotiated outcome, but it does not always help the business sector affected by a WTO-inconsistent trade measure.

Turning to the specific modes of supply, it is very likely that retaliation and cross-retaliation in Modes 1 and 2 are less likely to be successful than retaliation and cross-retaliation in Modes 3 and 4. As suggested above, retaliatory measures in Modes 1 and 2 are often too easily circumvented to be effective. Frequently, services provided in Modes 1 and 2 escape the attention of national governments entirely. Although retaliation may benefit certain domestic service suppliers (or foreign service suppliers from third countries) often consumer interests and business interests in the retaliating country will be harmed.

Retaliation in Modes 3 and 4 offers greater possibilities for exerting political pressure on an offending party. However, to the extent that the complaining party's nationals work for an entity established in Mode 3, retaliation is likely to cause domestic unemployment. Likewise, while retaliation in Mode 4 may protect domestic jobs, it is also likely to prevent needed professionals from working in the retaliating country. Furthermore, Mode 4 is often difficult to discipline. A large number of consultants, lawyers and accountants enter foreign countries to provide short-term professional services on tourist visas.

Lastly, a word must be said about the suspension of other GATS obligations (MFN) as opposed to the suspension of specific commitments in various modes of supply. Many developing countries made relatively few specific commitments during their accession negotiations. This is particularly true for developing countries that are founding members of the WTO. Provided that arbitrators sustain the reasoning of *US-Gambling* in future Article 22.6 arbitrations, these developing countries are more likely to consider an MFN suspension when considering whether to retaliate or cross-retaliate, particularly when the suspension of specific commitments is not an option.

Despite the lively debate about the possibility of suspending the MFN obligation that *US-Gambling* engendered, it should be borne in mind that the suspension of MFN is not a panacea for developing countries or other Members. In most cases an MFN suspension is likely to produce the same negative economic results for Members (including developing country Members) that would result from a suspension of specific commitments. Using the financial service sector again as an example, regardless of whether retaliation or cross-retaliation takes the form of an MFN suspension or a suspension of specific commitments in Mode 3, the result is likely to be the same: a loss of domestic jobs, a loss of tax revenue, and a dampening of investor confidence due to the increased perception that the complaining party's business climate is unfriendly. In addition to domestic economic hardship, retaliation and cross-retaliation may make it more difficult to attract foreign direct investment.

VI. CONCLUSION

This paper has examined retaliation and cross-retaliation in the services sector, including how it might function, and whether it might provide WTO Members, in particular developing country Members, with a means to induce compliance with DSB decisions. The conclusions of this chapter are not particularly optimistic. In many cases cross-retaliation in services will probably not be sufficient to persuade a Member to bring its trade measures into conformity with the WTO Agreement. There is no WTO case on record where retaliation or cross-retaliation involving GATS commitments or other obligations has persuaded a Member to comply with its WTO

obligations, but admittedly, there are few WTO cases discussing GATS retaliation and cross-retaliation.

Not surprisingly, as with retaliation and cross-retaliation involving goods, retaliation and cross-retaliation involving services is likely to be detrimental to the complaining party. Retaliation and cross-retaliation are likely to raise prices and reduce competition. This is true regardless of whether the complaining party is a developed or developing country, but developing countries may be more affected by price increases and a reduction in competition. Their domestic service suppliers may also be less likely to benefit from any competitive advantages that retaliation or cross-retaliation may produce.

In certain modes of supply fundamental questions exist as to whether a suspension of GATS concessions or other obligations can be administered in conformity with Article 22.4 of the DSU (equivalence). In other instances, basic economic considerations mean that cross-retaliation in services is an unpalatable alternative – either ineffective or impracticable – or both.

Despite this overall negative assessment, avenues do exist for Members intent upon suspending GATS concessions and other obligations. Assuming specific commitments, Article XVI of the GATS provides several ideas for retaliatory measures. Most of the market access restrictions contemplated in Article XVI would appear to be more practicable or effective in Modes 3 and Mode 4 where enforcement is significantly easier and circumvention more difficult. In large part this is because developed countries are likely to place more value on foreign direct investment though Mode 3, and on the temporary presence of skilled professionals in Mode 4. Developed countries may also be more likely to respond to numerical limitations and other restrictions in Modes 3 and 4 (either by bringing their measures into conformity with the covered agreements or by negotiating a mutually agreeable solution). When, however, a developed country chooses to challenge a market access restriction, the complaining party may have difficulties establishing equivalence due to a lack of statistics or difficulties projecting the trade effects.

Suspension of "other obligations" (in particular MFN) may also be effective in certain cases. Suspending the MFN obligation would allow a complaining party to retaliate or cross-retaliate in sectors and sub-sectors regardless of whether it has made specific commitments. Suspension of the MFN obligation could permit a complaining party to impose duties and charges (higher taxes and fees) on services and service suppliers from the Member violating the covered agreements. Service suppliers from other Members, as well as domestic service suppliers, might benefit from this discrimination. An MFN suspension would also allow the complaining party to impose discriminatory restrictions (regulations) on targeted services and service suppliers. However, the trade effects of such retaliatory measures could be more difficult to quantify (for purposes of establishing equivalence) and are only likely to be successful if politically influential sectors, such as the financial service sector, were targeted. Furthermore, retaliatory measures, particularly in Mode 3, risk driving away foreign direct investment, which may mean a loss of domestic jobs and development opportunities.

In conclusion, neither suspension of GATS concessions nor the suspension of other obligations provide an adequate cure for the relative impotence of developing countries seeking to enforce the covered agreements. The problem remains, as Debra Steger, the former Director of the WTO's Appellate Body Secretariat, noted in 2005:

> It is in the area of compliance/implementation that most of the Members' attention should be focused. Suspension of concessions or retaliation is a blunt instrument that realistically only the two most powerful Members, the United States and the European Communities, can use effectively; most Members recognize that other means need to be found to encourage Members to implement when encouragement is needed.[198]

The paradigm of suspending trade concessions and other obligations does little to further trade liberalisation, and is not realistically in reach of most developing country Members. Even in instances when it is in reach, *EC-Bananas III (Ecuador)* suggests that threatening to suspend TRIPs commitments may be a more viable and less painful way of fulfilling developing country objectives. When developing countries suspend GATS concessions and other obligations, they will suffer. When developing countries suspend TRIPs concessions, the developed world is more likely to suffer.

ENDNOTES

1 Understanding on Rules and Procedures Governing the Settlement of Disputes ("Dispute Settlement Understanding" or "DSU").

2 *United States - Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, Recourse to Arbitration by the United States under Article 22.6 of the DSU, Decision by the Arbitrator, WT/DS285/ARB, 21 December 2007. This issue is addressed in Section IV:C of this paper.

3 Article 21.1 of the DSU.

4 Article 22.8 of the DSU.

5 Article 22.7 of the DSU.

6 Article 22.7 of the DSU.

7 Charnovitz, "Should the Teeth Be Pulled? An Analysis of WTO Sanctions", appearing in THE POLITICAL ECONOMY OF INTERNATIONAL TRADE, ESSAYS IN HONOR OF ROBERT E. HUDEC 602, 609, Kennedy and Southwick (eds., 2002).

8 *See European Communities-Regime for the Importation, Sale and Distribution of Bananas-Recourse to Arbitration by the European Communities under Article 22.6 of the DSU ("EC-Ecuador III (US)"),* WT/DS27/ARB, 9 April 1999, para. 6.3; *European Communities-Regime for the Importation, Sale and Distribution of Bananas-Recourse to Arbitration by the European Communities under Article 22.6 of the DSU,* WT/DS27/ARB/ECU, 24 March 2000 (*"EC-Bananas III (Ecuador)"*), paras. 72 and 76; and US-Gambling, para. 2.7.

9 "TRIPs" is the Agreement on Trade-Related Aspects of Intellectual Property Rights.

10 *EC-Bananas III (Ecuador).*

11 *EC-Bananas III (Ecuador)* and *US-Gambling*.

12 The complaining party was awarded the right to suspend goods, services and TRIPs commitments. *See EC-Bananas III (Ecuador)*, para. 173.

13 *United States-Subsidies on Upland Cotton, WT/DS267 ("US-Cotton"); see* "Brazil to Seek US$4 Billion in Sanctions against US", Volume 12 BRIDGES Number 23, 25 June 2008, http://ictsd.net/i/news/bridgesweekly/12271/.

14 Article XXIII:2 of the GATT reads "…to suspend the application to any other contracting party or parties of such concessions or other obligations under this Agreement as they determine to be appropriate in the circumstances." Article 22.2 of the DSU reads "…to suspend the application to the Member concerned of concessions or other obligations under the covered agreements."

15 Article 22.3 of the DSU should be read together with Article XXIII:2 of the GATS which applies the "serious enough" standard to retaliation.

16 *US-Gambling*, para. 4.19, quoting *EC-Bananas III (Ecuador)*, para 55.

17 Article 22.3(a) of the DSU.

18 Article 22.3(b) of the DSU.

19 Article 22.3(c) of the DSU.

20 Article 22.3(d)(i) if the DSU.

21 Article 22.3(d)(ii) of the DSU.

22 Article 22.4 of the DSU.

23 *See also EC-Bananas III (US)*, paras. 3.8-3.10 in which the United States sought to suspend concessions under the GATT while the European Communities argued that the United States should suspend GATS concessions.

24 The "Services Sectoral Classification List" identifies the following twelve service sectors:

> 1. Business Services, 2. Communication Services, 3. Construction and Related Engineering Services, 4. Distribution Services, 5. Educational Services, 6. Environmental Services, 7. Financial Services, 8. Health Related and Social Services, 9. Tourism and Travel Related Services, 10. Recreational, Cultural and Sporting Services, 11. Transport Services, and 12. Other Services Not Included Elsewhere.

The first eleven sectors are the principal sectors. They are divided into sub-sectors. The Services Sectoral Classification List also provides the corresponding Central Product Classification (CPC) code used by the United Nations Statistics Division to classify goods and services. See the Services Sectoral Classification List, WTO Document (MTN.GNS/W/120). *See also* http://unstats.un.org/unsd/cr/registry/regcst.asp?Cl=16 for the CPC Codes.

25 Article 22.3(f)(ii).

26 A complaining party should refer initially to the Services Sectoral Classification List to determine whether a suspension is in the same sector. Since not all WTO Members have based their schedules on the Services Sectoral Classification List, a complaining party must exercise some care when identifying concessions or other obligations for suspension.

27 Article XXIII.2 of the GATS imposes an additional requirement that the circumstances be "serious enough" before the suspension of GATS "obligations and specific commitments" in accordance with Article 22 of the DSU.

28 An agreement other than the GATS as defined in Article 22.3(g) of the DSU.

29 *See EC-Bananas III (US)*, para. 3.7, expressing this "basic rational".

30 *EC-Bananas III (Ecuador)*, para. 70 (footnote omitted).

31 *EC-Bananas III (Ecuador)* para. 70 (footnote omitted).

32 *EC-Bananas III (Ecuador)* para. 72 (footnote omitted).

33 *EC-Bananas III (Ecuador)*, para. 72 (footnote omitted).

34 *US-Gambling*, para. 4.30.

35 *See EC-Bananas III (US)*, paras. 3.4-3.7; *EC-Bananas III (Ecuador)*, paras. 42-61; and *US-Gambling*, paras. 4.10-4.18.

36 *US-Gambling*, para. 4.13.

37 *US-Gambling*, para. 4.15.

38 *US-Gambling*, para. 4.16, citing *EC-Bananas III (Ecuador)*, para. 52 (footnote omitted).

39 *US-Gambling*, para. 4.17, quoting *EC-Bananas III (Ecuador)*, para. 55.

40 *US-Gambling*, para. 4.18.

41 *EC-Bananas III (Ecuador)*, para. 78. The complaining party was the European Communities in this case.

42 *EC-Bananas III (Ecuador)*, para. 78. The responding party was Ecuador in this case.

43 *EC-Bananas III (Ecuador)*, para. 77.

44 *EC-Bananas III (Ecuador)*, para. 80.

45 *US-Gambling*, para. 2.22 (footnote omitted).

46 *US-Gambling*, para. 2.26 *citing EC-Bananas III (Ecuador)*, para. 59.

47 *EC-Bananas III (Ecuador)*, para. 103.

48 *EC-Bananas III (Ecuador)*, para. 103, and note 36. In note 36 the arbitrators concluded that a suspension would not be practicable and effective if a Member had scheduled an MFN exception "with respect to a particular service sector or sub-sector."

49 *US-Gambling*, para. 4.54.

50 *US-Gambling*, para. 4.54.

51 *EC-Bananas III (Ecuador)*, paras. 72 and 76; and *US-Gambling*, paras. 4.29 and 4.84.

52 *EC-Bananas III (Ecuador)*, para. 76.

53 *US-Gambling*, paras. 4.29 and 4.84.

54 *US-Gambling*, paras. 4.61-4.64.

55 *US-Gambling*, paras. 4.62-4.65, and 4.73 (quoting para 4.62).

56 *EC-Bananas III (Ecuador)*, para. 109.

57 *EC-Bananas III (Ecuador)*, para. 113.

58 *EC-Bananas III (Ecuador)*, para. 110.

59 *EC-Bananas III (Ecuador)*, para. 114.

60 *EC-Bananas III (Ecuador)*, para. 114.

61 *EC-Bananas III (Ecuador)*, para. 112.

62 *EC-Bananas III (Ecuador)*, para. 111.

63 *EC-Bananas III (Ecuador)*, para. 111.

64 *EC-Bananas III (Ecuador)*, para. 114.

65 *EC-Bananas III (Ecuador)*, para. 114.

66 *EC-Bananas III (Ecuador)*, para. 115.

67 *EC-Bananas III (Ecuador)*, para. 117.

68 Antigua made commitments in sub-sector 10.A (Entertainment Services). *See US-Gambling*, para. 4.54, and note 308.

69 *US-Gambling*, paras. 4.54-4.56.

70 With respect to the possibility of suspension of other obligations, Antigua responded that:

> "even if this enquiry were carried out to its farthest extent to where Antigua had no obligations to the United States under the GATS at all", "[t]he trade disparity is so great that United States service providers would suffer little harm at all, if any, while Antiguan consumers would be forced to scramble for replacement services at uncertain cost". Antigua also observes that the United States has not argued that Antigua has a practical and effective remedy in respect of "other obligations" under the GATS.

US-Gambling, para. 4.57 (footnotes omitted).

71 *US-Gambling*, para. 4.58.

72 *US-Gambling*, paras. 4.59-4.60. Sector 10 of the Service Sector Classification List comprises "Recreation, Cultural and Sporting Services". (See Section III.C above.)

73 *US-Gambling*, paras. 4.83-4.100.

74 *US-Gambling*, para. 4.84.

75 *US-Gambling*, para. 4.85.

76 *US-Gambling*, paras. 4.86-4.87.

77 *US-Gambling*, para. 4.87 (note that some of the conclusions are directed at the services sector).

78 *US-Gambling*, para. 4.87.

79 *US-Gambling*, para. 4.89.

80 *US-Gambling*, para. 4.90, *quoting EC-Bananas III (Ecuador)*, para. 73 (footnotes omitted).

81 *US-Gambling*, para. 4.91.

82 *US-Gambling*, para. 4.92. For example, Antigua explained how suspension of obligations in telecommunications services would impose "a heavier burden" on Antiguan citizens without having a perceptible impact on the United States. US-Gambling, para. 4.93.

83 *US-Gambling*, para. 4.97.

84 *US-Gambling*, para. 4.98.

85 *US-Gambling*, para. 4.105.

86 *EC-Bananas III (Ecuador)*, para. 127.

87 Article XXIII of the GATS ("Dispute Settlement and Enforcement") is reproduced in Annex II.

88 *See US-Gambling*, para 4.69, noting that:

> Two cumulative conditions therefore have to be met for a complaining party to be able to seek suspension under another agreement: (a) that complaining party considers that it is not practicable or effective for it to suspend concessions or other obligations with respect to other sectors within the same agreement; and (b) that party considers that the circumstances are "serious enough".

89 *See US-Gambling*, para. 4.107.

90 *EC-Bananas III (Ecuador)*, para. 78 and *US-Gambling*, para. 4.106.

91 Quoting *US-Gambling*, para. 4.107; see also *EC-Bananas III (Ecuador)*, paras. 121-122.

92 *US-Gambling*, paras. 4.109-4.111 and *EC-Bananas III (Ecuador)*, paras. 125-126.

93 *See, e.g., US-Gambling*, para. 4.114.

94 *EC-Bananas III (Ecuador)*, paras. 128-129.

95 *See US-Gambling*, para. 4.33.

96 *See US-Gambling*, para. 4.34.

97 *EC-Bananas III (Ecuador)*, para. 133.

98 *EC-Bananas III (Ecuador)*, para. 86 and *US-Gambling*, para. 4.35. The arbitrators in the Bananas proceeding found support for their interpretation of Article 22.3(ii) in Article 21.8 of the DSU which requires the DSB, when "considering which action might be appropriate if a case is brought by a developing country Member, to take into account not only the trade coverage of the measures complained of, but also their impact on the economy of the developing country Members concerned." *EC-Bananas III (Ecuador)*, para. 136

99 Thomas Sebastian, in a paper presented at an Interdisciplinary Workshop, terms this the "equality-of-harm" approach. Thomas Sebastian, "Proportionality Assessments under Article 22.6: The State-of-Play from a Legal Perspective", pp. 32-33. Draft Paper submitted at an Interdisciplinary Workshop on "The Calculation and Design of Trade Sanctions in WTO Dispute Settlement", 18-19 July 2008, Center for Trade and Economic Integration (CTEI), Geneva (on file with the author). This final version of this paper is expected to be published in Joost Pauwelyn and Chad P. Bown (eds.), THE LAW, ECONOMICS AND POLITICS OF TRADE RETALIATION IN WTO DISPUTE SETTLEMENT (2009).

100 Article 22.7 of the DSU. Article 22.7 also prohibits the arbitrators from examining "the nature of the concessions or other obligations to be suspended..."

101 *EC-Bananas III (US)*, para. 4.1 (*quoting* THE NEW SHORTER OXFORD ENGLISH DICTIONARY ON HISTORIC PRINCIPLES (1993) at p.843). The Panel also found that "this meaning connotes a correspondence, identity or balance between two related levels, i.e. between the level of the concessions to be suspended, on the one hand, and the level of the nullification or impairment, on the other. *EC-Bananas III (US)*, para. 4.1.

102 Prohibited subsidy cases are beyond the scope of this paper. Article 4.10 of the Agreement on Subsidies and Countervailing Measures permits a complaining Member "to take appropriate countermeasures" in prohibited subsidies cases in the event that the DSB's recommendations are not followed within the specified time period. Note 9 to this provision prevents "disproportionate" countermeasures.

103 *EC-Bananas III (US)*, para. 6.3. Citing *EC-Bananas III (US)*, *US-Gambling* made a similar finding:

> In approaching this task, we note, as other arbitrators have, that, while the purpose of suspension of concessions or other obligations under the covered agreements as foreseen in Article 22.1 of the DSU is to "induce compliance" by the Member concerned with its obligations under the covered agreements, this does not mean that such suspension may be authorized beyond what is "equivalent" to the level of nullification of impairment". Rather, in setting out the requirement that suspension be "equivalent" to the level of nullification or impairment, Article 22.4 of the DSU requires a degree of "correspondence or identity" between the level of the suspension to be authorized and the level of the nullification or impairment of benefits.

US-Gambling, para. 2.7 (footnotes omitted), citing *EC-Bananas III (US)*, paras, 4.3 and 6.3. *See also United States-Anti-dumping Act of 1916*, (original complaint by the European Communities), Recourse to Arbitration by the United States under Article 22.6 of the DSU, (US-1916 Act), WT/DS136/ARB, 24 February 2004, paras. 5.5, 5.8, 5.21, and 5.22.

104 WTO Secretariat, WORLD TRADE REPORT 2005: EXPLORING THE LINKS BETWEEN TRADE, STANDARDS AND THE WTO, "Quantitative Economics in WTO Dispute Settlement," p.180.

105 WORLD TRADE REPORT 2005, p.180.

106 WORLD TRADE REPORT 2005, p.181.

107 Article 22.7 of the DSU.

108 *European Communities-Measures Concerning Meat and Meat Products (EC-Hormones (US))*, Original Complaint by the United States, Recourse to Arbitration by the European Communities under Article 22.6 of the DSU, Decision by the Arbitrators, WT/DS26/ARB, 12 July 1999, para. 20 (footnote omitted).

109 *EC-Hormones (US)*, para. 20, *quoting EC-Bananas III (US)*, para. 4.2.

110 *EC-Hormones (US)*, para. 21.

111 *EC-Bananas III (Ecuador)*, para. 159.

112 *EC-Bananas III (Ecuador)*, para. 160 and note 52.

113 *EC-Bananas III (Ecuador)*, para. 160, note 52.

114 *EC-Bananas III (Ecuador)*, para. 160, note 52.

115 *United States-Anti-dumping Act of 1916* (Original Complaint By the European Communities), Recourse to Arbitration by the United States under Article 22.6 of the DSU Decision by the Arbitrators, WT/DS136/ARB, (24 Feb. 2004)., at para. 5.17.

116 *US-1916 Act*, para. 2.1. The risk a mirror regulation poses to equivalence is illustrated in paragraph 5.30:

> We agree with the United States that even when identical measures are applied in similar ways, the effects on trade can be dramatically different. The following hypothetical example illustrates this point:
>
> - Member X exports $10 billion dollars worth of goods to Member Y. Member Y decides to impose a 10% ad *valorem* tax on all imported goods from Member X. The total economic or trade impact of such a measure (assuming that exports continued as before, and the tax was paid) would be $1 billion.
>
> - Member Y's 10% ad *valorem* tax is found to be WTO-inconsistent. Following the expiration of the reasonable period of time, Member X seeks to adopt a "qualitatively equivalent" measure by imposing a 10% ad valorem tax on all imports from Member Y.
>
> - Member Y exports $100 billion dollars worth of goods to Member X. The total economic or trade impact of this "qualitatively equivalent" measure, the 10% ad *valorem* tax on all imported goods from Member Y, would be $10 billion.

117 *US-1916 Act*, para. 5.29.

118 *US-1916 Act*, para. 5.17.

119 *US-1916 Act*, para. 5.18-5.19, *citing EC-Hormones (US), EC-Hormones (Canada), (EC-Bananas (US))* and *United States-Tax Treatment for "Foreign Sales Corporations"*, Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the *SCM Agreement*, Decision Of The Arbitrator, WT/DS108/ARB, 30 August 2002.

120 The arbitrators rejected the "the EC argument that the suspension of obligations is somehow 'equivalent' because its proposed measure would replicate, or partially replicate, the 1916 Act." *US-1916 Act*, para. 5.32. They found that the EC suspension had a "potentially unlimited application" and that it was "possible" it could "exceed the level of nullification or impairment when it is applied, and thereby become punitive." They further found that the "EC request does not ensure that the suspension will be limited to the level of nullification it has sustained, as expressed in quantifiable economic or trade terms." *US-1916 Act*, para. 5.34.

121 *US-1916 Act*, paras. 5.21-5.23 and note 48.

122 *US-1916 Act*, para. 5.23.

123 *US-1916 Act*, para. 5.22.

124 *US-1916 Act*, para. 5.24.

125 *US-1916 Act*, para. 5.31.

126 *US-1916 Act*, para. 5.54.

127 *US-1916 Act*, para. 5.54, *quoting EC-Hormones (US)*, para. 41 [emphasis omitted].

128 *US-1916 Act*, paras. 5.57-5.58 (quoting para. 5.57).

129 *US-1916 Act* does not reject a qualitative approach, but would reduce a qualitative approach to quantifiable elements.

130 *US-Gambling*, para. 3.24.

131 *See US-Gambling*, para. 3.27 where the arbitrators found that:

> A counterfactual that would assume a compliance scenario that leads to an implausibly high level of nullification or impairment of benefits would lead to a suspension in excess of the level of nullification or impairment actually suffered. Conversely, a counterfactual that would underestimate the level of benefits accruing to the complaining party would risk leading to an unwarranted reduction of the level of suspension below the level that that complaining party is entitled to seek, namely "equivalence".

132 *See e.g., US-Gambling*, paras. 4.59, 4.81, and 4.100.

133 See Section III:C.

134 This table is adapted from a similar table that appears in Guidelines for the Scheduling of Specific Commitments under the General Agreement on Trade in Services (GATS), Adopted by the Council for Trade in Services on 23 March 2001, S/L/92 (28 March 2001), p.9.

135 *See* Mattoo, National Treatment in the GATS: Corner-stone or Pandora's Box (22 January 1997), http://www.wto.org/english/res_e/reser_e/tisd-96-02.doc.

136 Article XX of the GATS.

137 Guidelines for the Scheduling of Specific Commitments under the General Agreement on Trade in Services (GATS), Adopted by the Council for Trade in Services on 23 March 2001, S/L/92 (28 March 2001), pp.5-6, and pp. 16-18.

138 Guidelines for the Scheduling of Specific Commitments under the General Agreement on Trade in Services (GATS), Adopted by the Council for Trade in Services on 23 March 2001, S/L/92 (28 March 2001), p.7; and Note by the Secretariat, Additional Commitments under Article XVIII of the GATS, S/CSC/W/34 (16 July 2002), p.1.

139 *See* Guidelines for the Scheduling of Specific Commitments under the General Agreement on Trade in Services (GATS), S/L/92 (28 March 2001), p.12.

140 *See* Article XVI:2 of the GATS. These limitations must be scheduled and are due for an eventual phase-out.

141 *See* Mattoo, "National Treatment in the GATS: Corner-stone or Pandora's Box" (22 January 1997), http://www.wto.org/english/res_e/reser_e/tisd-96-02.doc, p.1.

142 Mattoo notes that Article XVI covers "quantitative measures" and Article XVII covers "discriminatory measures", but that there is an overlap between the two provisions which is reflected in the scheduling instruction provided in Article XX:2. Mattoo, "National Treatment in the GATS: Corner-stone or Pandora's Box" (22 January 1997), http://www.wto.org/english/res_e/reser_e/tisd-96-02.doc, p.8.

143 In this case, it does not matter if the complaining party has scheduled exemptions it its Annex on Article II Exemptions.

144 Note by the Secretariat, Additional Commitments under Article XVIII of the GATS, S/CSC/W/34, (16 July 2002), para. 2.

145 Professional licensing and qualifications are frequently treated under Article VI (Domestic Regulations).

146 For an introduction to the four Modes of Supply see the Guidelines for the Scheduling of Specific Commitments under the General Agreement on Trade in Services (GATS), Adopted by the Council for Trade in Services on 23 March 2001, S/L/92 (28 March 2001), pp.9-10; *see also* the WTO Secretariat, Guide to Reading the GATS Schedules of Specific Commitments and the List of Article II (MFN) Exemptions, www.wto.org/english/tratop_e/serv_e/guide1_e.htm.

147 WTO Secretariat, Guide to Reading the GATS Schedules of Specific Commitments and the List of Article II (MFN) Exemptions, http://www.wto.org/english/tratop_e/serv_e/guide1_e.htm. This Guide, although helpful, is not an authoritative legal interpretation of the GATS. See the definition provided in Article 1.2(a) of the GATS for the supply of a service in Mode 1: "from the territory of one Member into the territory of any other Member".

148 A similar point is made in a Note by the Secretariat, "Emergency Safeguard Measures in GATS: The Applicability of Concepts Applied in the WTO Agreement on Safeguards," S/WPGR/W/8, 6 March 1996, para. 4.

149 *EC-Bananas III (Ecuador)*, para. 115.

150 *EC-Bananas III (Ecuador)*, para. 117.

151 A suspension in Mode 1 may have interesting economic consequences. A Member contemplating a suspension in Mode 1 may stand to gain economically if the service provider later chooses to provide the same service through Mode 3 or Mode 4. The same service would be provided on the complaining party's territory.

152 WTO Secretariat, Guide to Reading the GATS Schedules of Specific Commitments and the List of Article II (MFN) Exemptions, http://www.wto.org/english/tratop_e/serv_e/guide1_e.htm. *See* the definition provided in Article 1.2(b) of the GATS for the supply of a service in Mode 3: "in the territory of one Member to the service consumer of any other Member".

153 For an analogous position within the context of services safeguards, see "Emergency Safeguard Measures in GATS: The Applicability of Concepts Applied in the WTO Agreement on Safeguards," S/WPGR/W/8, 6 March 1996, para. 11.

154 This last example is more controversial since the action would be applied against a domestic insurance service provider to affect indirectly the ability of a service consumer to receive medical services abroad. The provision of medical services abroad is distinct from the provision of domestic insurance services.

155 *Cf.* "Emergency Safeguard Measures in GATS: The Applicability of Concepts Applied in the WTO Agreement on Safeguards," S/WPGR/W/8, 6 March 1996, para. 11.

156 *See* Rudolf Adlung and Aaditya Mattoo, Module 1: The GATS, Draft 11.04.04, at p.3, http://siteresources.worldbank.org/INTRANETTRADE/Resources/WBI-Training/288464-1121285527226/AdlungMattooGATS1219f-Paper.pdf.

157 *See e.g.*, Article 5:XV of the Brazilian Constitution.

158 *See, e.g.*, THE ECONOMIST, 16-22 August 2008, pp. 66-68.

159 *EC-Bananas III (Ecuador)*, paras. 115-118.

160 WTO Secretariat, Guide to Reading the GATS Schedules of Specific Commitments and the List of Article II (MFN) Exemptions, http://www.wto.org/english/tratop_e/serv_e/guide1_e.htm. See the definition provided in Article 1.2(c) of the GATS which defines Mode 3 as the supply of a service: "by a service supplier of one Member, through commercial presence in the territory of any other Member".

161 *See e.g.*, "Emergency Safeguard Measures in GATS: The Applicability of Concepts Applied in the WTO Agreement on Safeguards," S/WPGR/W/8, 6 March 1996, para. 11, and *EC-Bananas III (Ecuador)* paras. 6 and 11.

162 *See* Note by the Secretariat, "Issues for Future Discussions on Emergency Safeguards", S/WPGR/W/27/Rev.1 (7 May 1999), paras. 9-11; Communication from Switzerland, "Safeguards and Trade in Services," S/WPGR/W/14 (10 October 1996), p.2; and Note by the Secretariat, "Emergency Safeguard Measures in GATS: The Applicability of Concepts Applied in the WTO Agreement on Safeguards", S/WPGR/W/8 (6 March 1996), paras. 4-6. *See also* the definition of "commercial presence" in Article XXVIII(d) and the definition of the "service of another Member" in Article XXVIII(f)(ii) and (g) of the GATS. See also note 12 to Article XXVIII.

163 *EC-Bananas III (Ecuador)*, para. 110.

164 *EC-Bananas III (Ecuador)*, paras. 111-112.

165 *EC-Bananas III (Ecuador)*, paras. 112 and 114.

166 *EC-Bananas III (Ecuador)*, para. 113.

167 *EC-Bananas III (Ecuador)*, para. 111.

168 *EC-Bananas III (Ecuador)*, para. 114.

169 A suspension of concessions may not be practicable and effective for a developing country when "transitional costs" of changing and adjusting to new service suppliers are high. For an analogous argument related to trade in goods, see *EC-Bananas III (Ecuador)*, para. 94.

170 *See EC-Bananas III (Ecuador)*, para. 159.

171 WTO Secretariat, Guide to Reading the GATS Schedules of Specific Commitments and the List of Article II (MFN) Exemptions, http://www.wto.org/english/tratop_e/serv_e/guide1_e.htm. See Article 1.2(d) which defines Mode 4 as the supply of a service "by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member".

172 Note by the Secretariat, "Emergency Safeguard Measures in GATS: The Applicability of Concepts Applied in the WTO Agreement on Safeguards", S/WPGR/W/8 (6 March 1996), paras. 8 and 11.

173 *See EC-Bananas III (Ecuador)* para. 103 and *US-Gambling* paras. 4.45-4.60.

174 *See EC-Bananas III (Ecuador)*, para. 103 and note 36. *See also* Eric Vranes, "Fundamental WTO Issues", appearing in THE BANANA DISPUTE: AN ECONOMIC AND LEGAL ANALYSIS", Vol. 19 Schriftenreihe des Forschungsinstituts für Europafragen der Wirtschaftsuniversität Wien 93 (Breuss, Griller and Vranes eds., Springer, 2003).

175 The arbitrators found in para. 103 that:

> Ecuador has not entered into specific commitments on market access or national treatment in any of those sub-sectors with the exception of "wholesale trade services". It is, therefore, evident for us that Ecuador cannot suspend commitments or other obligations in sub-sectors of the distribution service sector in respect of which it has not entered into specific commitments in the first place. [footnotes omitted]

176 Pursuant to Article II:2 of the GATS, Members can schedule MFN exemptions at the time of entry into force of the GATS (or the date of their accession). Contrary to the GATS, which uses a positive list approach, the MFN exemptions take the form of a negative list approach (an opt-out). Unlike National Treatment and Market Access exceptions which are made in sectors where Members have made commitments, MFN exemptions can be listed in sectors where Members have not made commitments. Paragraph 6 of the Annex provides that "in principal the exemption should not exceed a period of ten years. In any event, they shall be subject to negotiation in subsequent trade-liberalizing rounds." In practice most MFN exceptions remain in place and more than 80 Members currently maintain such exemptions. They relate primarily to regional trade preferences. The sectors most frequently covered are road transport and audiovisual services, "followed by maritime transport and banking services." *See http://www.wto.org/english/tratop_e/serv_e/cbt_course_e/c2s2p1_e.htm*.

177 *US-Gambling*, paras. 4.45, 4.54 and para 4.58 where the arbitrators found that:

> In considering this matter, we first note that there is only a limited number of such "other obligations" under the GATS, that Antigua would be able to suspend under the whole of Sector 10 […] In our view, the main relevant obligation in this respect is the MFN obligation, contained [stet] GATS Article II, which obliges Antigua to accord immediately and unconditionally to US services and service suppliers treatment no less favourable than that it accords to like services and service suppliers of any other country.

178 *US-Gambling*, para. 4.52, note 305.

179 Article 22.3 of the DSU allows a complaining party to suspend "other obligations". Article XXIII:2 of the GATS allows a Member to suspend "obligations and specific commitments in accordance with Article 22 of the DSU." Article XXIII:2 of the GATS and Article 22 of the DSU can be read together with little difficulty.

180 Mattoo, "National Treatment in the GATS: Corner-stone or Pandora's Box", p. 7 (*citing* John Jackson and A. Ahnlid), http://www.wto.org/english/res_e/reser_e/tisd-96-02.doc (22 January 1997).

181 As noted by the WTO Secretariat in its non-authoritative "Guide to Reading the GATS Schedules of Specific Commitments and the List of Article II (MFN) Exemptions":

> It is a basic principle of the Agreement that specific commitments are applied on an MFN basis. Where commitments are entered, therefore, the effect of an MFN exemption can only be to permit more favourable treatment to be given to the country to which the exemption applies than is given to all other Members. Where there are no commitments, however, an MFN exemption may also permit less favourable treatment to be given.

http://www.wto.org/english/tratop_e/serv_e/guide1_e.htm.

182 Antigua accepted that the entirety of Sector 10 (Recreational, Cultural and Sporting Services) was relevant for determining retaliation in the same sector. *US-Gambling*, para. 4.43. Neither Antigua nor the United States were able to produce statistics demonstrating Antiguan imports of entertainment services from the United States. The arbitrators accepted that such trade was negligible and that it was it was plausible for Antigua to conclude that suspending concessions in Sector 10.A (Entertainment Service), the only sub-sector in which Antigua had made a specific commitment, would not be practicable or effective. *US-Gambling*, paras. 4.52-4.56.

183 *US-Gambling*, paras. 4.39-4.65.

184 *US-Gambling*, paras. 4.66-4.105.

185 *See US-Gambling*, para. 4.76. Antigua and Barbuda made specific commitments in 1. BUSINESS SERVICES (A. Professional Services, B. Computer and Related Services, and C. Research and Development Services), 2. COMMUNICATIONS SERVICES (C. Telecommunications Services), 7. FINANCIAL SERVICES (A. Insurance (c) re-insurance only), 9. TOURISM AND TRAVEL RELATED SERVICES (A. Hotel and Resort Development – construction and management), 10. RECREATIONAL, CULTURAL AND SPORTING SERVICES (A. Entertainment Services), and 11. TRANSPORT SERVICES (A. Maritime Transport Services (b) Freight Transport Services, and (d) Maintenance & repair of vessels). See Antigua and Barbuda, Schedule of Specific Commitments, GATS/SC/2 (15 April 1994) and Schedule of Specific Commitments, Supplement 1, GATS/SC/2/Suppl.1 (11 April 1997).

186 *US-Gambling*, para. 4.76. Antigua position was less precise – discussing the effect of a suspension on both goods and services. *US-Gambling*, para. 4.87.

187 *US-Gambling*, para. 4.87.

188 For an analogous position within the context of services safeguards, see "Emergency Safeguard Measures in GATS: The Applicability of Concepts Applied in the WTO Agreement on Safeguards," S/WPGR/W/8, 6 March 1996, para. 11.

189 The last two examples are more controversial. They indirectly affect the ability of a service consumer to procure medical services abroad. The provision of medical services abroad must be examined separately from the provision of insurance services.

190 *Cf.* "Emergency Safeguard Measures in GATS: The Applicability of Concepts Applied in the WTO Agreement on Safeguards," S/WPGR/W/8, 6 March 1996, para. 11.

191 *See* Rudolf Adlung and Aaditya Mattoo, Module 1: The GATS, Draft 11.04.04, at p.3, http://siteresources.worldbank.org/INTRANETTRADE/Resources/WBI-Training/288464-1121285527226/AdlungMattooGATS1219f-Paper.pdf.

192 *See* Rudolf Adlung and Aaditya Mattoo, Module 1: The GATS, Draft 11.04.04, at p.3, http://siteresources.worldbank.org/INTRANETTRADE/Resources/WBI-Training/288464-1121285527226/AdlungMattooGATS1219f-Paper.pdf.

193 *See* Annex III.

194 The decision in *US-Gambling* was handed down in December 2007.

195 *EC-Bananas III (Ecuador)* and *US-Gambling*.

196 Developing country Members have shown some interest in the idea of collective retaliation or cross-retaliation.

197 Eric Vranes, "Cross Retaliation under GATS and TRIPs – An Optimal Enforcement Device for Developing Countries?" appearing in THE BANANA DISPUTE: AN ECONOMIC AND LEGAL ANALYSIS, Vol. 19 SCHRIFTENREIHE DES FORSCHUNGSINSTITUTS FÜR EUROPAFRAGEN DER WIRTSCHAFTSUNIVERSITÄT WIEN 128, (Breuss, Griller and Vranes eds., Springer, 2003).

198 Debra P. Steger, "WTO Dispute Settlement: Systemic Issues", Roundtable, University of Ottawa Faculty of Law, p.68 (16 February 2005), www.international.gc.ca/eet/research/TPR-2005/TPR-2005_Chapter_03_-_Steger.pdf.

199 Footnotes retained but renumbered.

200 The list in document MTN.GNS/W/120 identifies eleven sectors.

201 The expression "arbitrator" shall be interpreted as referring either to an individual or a group. [footnote renumbered]

202 The expression "arbitrator" shall be interpreted as referring either to an individual or a group or to the members of the original panel when serving in the capacity of arbitrator. [footnote renumbered]

203 Where the provisions of any covered agreement concerning measures taken by regional or local governments or authorities within the territory of a Member contain provisions different from the provisions of this paragraph, the provisions of such covered agreement shall prevail. [footnote renumbered]

204 Source: www.worldtradelaw.net.

ANNEX I

Article 22 of the DSU [199]
Compensation and the Suspension of Concessions

1. Compensation and the suspension of concessions or other obligations are temporary measures available in the event that the recommendations and rulings are not implemented within a reasonable period of time. However, neither compensation nor the suspension of concessions or other obligations is preferred to full implementation of a recommendation to bring a measure into conformity with the covered agreements. Compensation is voluntary and, if granted, shall be consistent with the covered agreements.

2. If the Member concerned fails to bring the measure found to be inconsistent with a covered agreement into compliance therewith or otherwise comply with the recommendations and rulings within the reasonable period of time determined pursuant to paragraph 3 of Article 21, such Member shall, if so requested, and no later than the expiry of the reasonable period of time, enter into negotiations with any party having invoked the dispute settlement procedures, with a view to developing mutually acceptable compensation. If no satisfactory compensation has been agreed within 20 days after the date of expiry of the reasonable period of time, any party having invoked the dispute settlement procedures may request authorization from the DSB to suspend the application to the Member concerned of concessions or other obligations under the covered agreements.

3. In considering what concessions or other obligations to suspend, the complaining party shall apply the following principles and procedures:

(a) the general principle is that the complaining party should first seek to suspend concessions or other obligations with respect to the same sector(s) as that in which the panel or Appellate Body has found a violation or other nullification or impairment;

(b) if that party considers that it is not practicable or effective to suspend concessions or other obligations with respect to the same sector(s), it may seek to suspend concessions or other obligations in other sectors under the same agreement;

(c) if that party considers that it is not practicable or effective to suspend concessions or other obligations with respect to other sectors under the same agreement, and that the circumstances are serious enough, it may seek to suspend concessions or other obligations under another covered agreement;

(d) in applying the above principles, that party shall take into account:

(i) the trade in the sector or under the agreement under which the panel or Appellate Body has found a violation or other nullification or impairment, and the importance of such trade to that party;

(ii) the broader economic elements related to the nullification or impairment and the broader economic consequences of the suspension of concessions or other obligations;

(e) if that party decides to request authorization to suspend concessions or other obligations pursuant to subparagraphs (b) or (c), it shall state the reasons therefore in its request. At the same time as the request is forwarded to the DSB, it also shall be forwarded to the relevant Councils and also, in the case of a request pursuant to subparagraph (b), the relevant sectoral bodies;

(f) for purposes of this paragraph, “sector” means:

(i) with respect to goods, all goods;

(ii) with respect to services, a principal sector as identified in the current "Services Sectoral Classification List" which identifies such sectors;[200]

(iii) with respect to trade-related intellectual property rights, each of the categories of intellectual property rights covered in Section 1, or Section 2, or Section 3, or Section 4, or Section 5, or Section 6, or Section 7 of Part II, or the obligations under Part III, or Part IV of the Agreement on TRIPS;

(g) for purposes of this paragraph, "agreement" means:

(i) with respect to goods, the agreements listed in Annex 1A of the WTO Agreement, taken as a whole as well as the Plurilateral Trade Agreements in so far as the relevant parties to the dispute are parties to these agreements;

(ii) with respect to services, the GATS;

(iii) with respect to intellectual property rights, the Agreement on TRIPS.

4. The level of the suspension of concessions or other obligations authorized by the DSB shall be equivalent to the level of the nullification or impairment.

5. The DSB shall not authorize suspension of concessions or other obligations if a covered agreement prohibits such suspension.

6. When the situation described in paragraph 2 occurs, the DSB, upon request, shall grant authorization to suspend concessions or other obligations within 30 days of the expiry of the reasonable period of time unless the DSB decides by consensus to reject the request. However, if the Member concerned objects to the level of suspension proposed, or claims that the principles and procedures set forth in paragraph 3 have not been followed where a complaining party has requested authorization to suspend concessions or other obligations pursuant to paragraph 3(b) or (c), the matter shall be referred to arbitration. Such arbitration shall be carried out by the original panel, if members are available, or by an arbitrator[201] appointed by the Director-General and shall be completed within 60 days after the date of expiry of the reasonable period of time. Concessions or other obligations shall not be suspended during the course of the arbitration.

7. The arbitrator[202] acting pursuant to paragraph 6 shall not examine the nature of the concessions or other obligations to be suspended but shall determine whether the level of such suspension is equivalent to the level of nullification or impairment. The arbitrator may also determine if the proposed suspension of concessions or other obligations is allowed under the covered agreement. However, if the matter referred to arbitration includes a claim that the principles and procedures set forth in paragraph 3 have not been followed, the arbitrator shall examine that claim. In the event the arbitrator determines that those principles and procedures have not been followed, the complaining party shall apply them consistent with paragraph 3. The parties shall accept the arbitrator's decision as final and the parties concerned shall not seek a second arbitration. The DSB shall be informed promptly of the decision of the arbitrator and shall upon request, grant authorization to suspend concessions or other obligations where the request is consistent with the decision of the arbitrator, unless the DSB decides by consensus to reject the request.

8. The suspension of concessions or other obligations shall be temporary and shall only be applied until such time as the measure found to be inconsistent with a covered agreement has been removed, or the Member that must implement recommendations or rulings provides a solution to the nullification or impairment of benefits, or a mutually satisfactory solution is reached. In accordance with paragraph 6 of Article 21, the DSB shall continue to keep under surveillance the implementation of adopted recommendations or rulings, including those

cases where compensation has been provided or concessions or other obligations have been suspended but the recommendations to bring a measure into conformity with the covered agreements have not been implemented.

9. The dispute settlement provisions of the covered agreements may be invoked in respect of measures affecting their observance taken by regional or local governments or authorities within the territory of a Member. When the DSB has ruled that a provision of a covered agreement has not been observed, the responsible Member shall take such reasonable measures as may be available to it to ensure its observance. The provisions of the covered agreements and this Understanding relating to compensation and suspension of concessions or other obligations apply in cases where it has not been possible to secure such observance.[203]

ANNEX II

Article XXIII of the GATS
Dispute Settlement and Enforcement

1. If any Member should consider that any other Member fails to carry out its obligations or specific commitments under this Agreement, it may with a view to reaching a mutually satisfactory resolution of the matter have recourse to the DSU.

2. If the DSB considers that the circumstances are serious enough to justify such action, it may authorize a Member or Members to suspend the application to any other Member or Members of obligations and specific commitments in accordance with Article 22 of the DSU.

3. If any Member considers that any benefit it could reasonably have expected to accrue to it under a specific commitment of another Member under Part III of this Agreement is being nullified or impaired as a result of the application of any measure which does not conflict with the provisions of this Agreement, it may have recourse to the DSU. If the measure is determined by the DSB to have nullified or impaired such a benefit, the Member affected shall be entitled to a mutually satisfactory adjustment on the basis of paragraph 2 of Article XXI, which may include the modification or withdrawal of the measure. In the event an agreement cannot be reached between the Members concerned, Article 22 of the DSU shall apply.

ANNEX III

Article 22.6 Arbitration Decisions [204]

Dispute Name	DS Number	DSR Citation	Circulation Date
U.S. - Gambling	285		21 December 2007
U.S. - Offset Act ("Byrd Amendment") (Brazil)	217	DSR 2004:IX, 4341	31 August 2004
U.S. - Offset Act ("Byrd Amendment") (Canada)	234	DSR 2004:IX, 4425	31 August 2004
U.S. - Offset Act ("Byrd Amendment") (Chile)	217	DSR 2004:IX, 4511	31 August 2004
U.S. - Offset Act ("Byrd Amendment") (EC)	217	DSR 2004:IX, 4591	31 August 2004
U.S. - Offset Act ("Byrd Amendment") (India)	217	DSR 2004:X, 4691	31 August 2004
U.S. - Offset Act ("Byrd Amendment") (Japan)	217	DSR 2004:X, 4771	31 August 2004
U.S. - Offset Act ("Byrd Amendment") (Korea)	217	DSR 2004:X, 4851	31 August 2004
U.S. - Offset Act ("Byrd Amendment") (Mexico)	234	DSR 2004:X, 4931	31 August 2004
U.S. - 1916 Act	136	DSR 2004:IX, 4269	24 February 2004
Canada - Aircraft II	222	DSR 2003:III, 1187	17 February 2003
U.S. - FSC	108	DSR 2002:VI, 2517	30 August 2002
Brazil - Aircraft	46	DSR 2002:I, 19	28 August 2000
EC - Bananas (Ecuador)	27	DSR 2000:V, 2237	24 March 2000
EC - Hormones (US)	26	DSR 1999:III, 1105	12 July 1999
EC - Hormones (Canada)	48	DSR 1999:III, 1135	12 July 1999
EC - Bananas (US)	27	DSR 1999:II, 725	9 April 1999

Source: www.worldtradelaw.net.

ANNEX IV

Most-Favoured-Nation Treatment (Article II of the GATS)

1. With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country.

2. A Member may maintain a measure inconsistent with paragraph 1 provided that such a measure is listed in, and meets the conditions of, the Annex on Article II Exemptions.

3. The provisions of this Agreement shall not be so construed as to prevent any Member from conferring or according advantages to adjacent countries in order to facilitate exchanges limited to contiguous frontier zones of services that are both locally produced and consumed.

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