Brooklyn Journal of International Law

Volume 25 | Issue 2 Article 24

3-1-1999

Market Access and Market Contestability: Is the Difference Purely Semantics: A Business Perspective

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MARKET ACCESS AND MARKET CONTESTABILITY: IS THE DIFFERENCE PURELY SEMANTICS? A BUSINESS PERSPECTIVE

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I. EXECUTIVE SUMMARY

This Article recognizes that there are gaps in the system of rules that govern the world trade order, where governmental restraints on trade give rise to an anticompetitive market. We believe that some of the solutions to these problems can be found in the application of antitrust laws. In making this submission, we recognize the different characterization of antitrust and competition law as it is interpreted in the United States and in Europe. We have analyzed restrictive trade laws in many countries, and argued how foreign traders and investors can deal with them, using the World Trade Organization (WTO) and other trade channels.

We advocate:

1. the introduction of antitrust concepts into WTO analysis to ensure that foreign and local products in competition with each other receive equivalent treatment;
2. the enforcement of national antitrust laws by strong, independent antitrust agencies; and
3. meaningful regional institutions or processes to ensure that there is guidance and peer review for new antitrust authorities. Such organizations would also serve to counterbalance the vested interests of domestic producers who might otherwise wield influence with national antitrust agencies.

A sharp line has been drawn in legal, economic, and trade circles between market access on the one hand, considered the province of international trade lawyers, and market contestability on the other, considered the province of antitrust

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lawyers. A schism has developed between the two sides, and the debate, if there is one, is frequently laced with deep levels of hostility and mistrust. It is frequently assumed that the interface between competition law and trade is played out solely in the anti-dumping area, thus guaranteeing that the subject will never be properly and carefully considered. However, the WTO Competition Group has been warned of the subject of anti-dumping and therefore must come face to face with those other areas which warrant consideration at the interface of trade and competition. Clearly the negative impact of the interface of many different competition policies on global trade is one of the subjects being considered. Approximately seventy countries now have competition laws,[1] and these often have very different rules and different merger notification requirements. Their interface presents a considerable barrier to business, particularly in the merger notification area.

There is another area, however, that competition experts could profitably explore with their trade counterparts. Many countries retain trade restrictive legislation, which acts as a non-tariff barrier to trade, but which might not be easily attacked using existing WTO rules. The reason is that most of the WTO rules require some element of favoritism or protection of domestic production in order for the trade rules to apply. Antitrust principles by and large do not recognize nationality, and focus entirely on a particular private conduct and its effect on price. However, we must recognize that there is legislation which positively mandates private anti-competitive conduct, which would be a violation of the competition law of most countries. We must also recognize that antitrust principles which have been honed by over one hundred years of caselaw in the United States may be very usefully included in WTO analysis, which has in the past been criticized as woolly and obscure. As the WTO (especially at the level of Appellate Body decision-making) develops its own body of law, which can be used to predict how its rules will be applied, introduction of some of these concepts where relevant would be very useful in clarifying the application of WTO agreements.

This Article will focus on some of the areas where we ar-

1. *See* UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT, WORLD INVESTMENT REPORT 1997: TRANSNATIONAL CORPORATIONS, MARKET STRUCTURE AND COMPETITION POLICY 290, U.N. Sales No. E.97.II.D.10 (1997).

gue competition rules could be a useful supplement to interpretation of the WTO agreements, and where application of competition law by national governments could assist in dismantling the network of public sector restraints which adversely affect the ability of new entrants to enter markets in a way that is profitable in the long term. This last proposal is not new. It has been attempted before in the first generation of competition laws of the countries of Central and Eastern Europe as they embraced free market reforms:

> In at least one respect the competition laws of many transition countries were unique. They contained a fourth "substantive" violation in addition to abuse of dominance, restrictive agreements and merger control: anticompetitive acts by bodies of government. To be sure, most competition laws apply either explicitly or implicitly to entrepreneurial conduct by government, but these provisions in transition country laws by their terms applied to regulatory and governance functions as well. It is not difficult to understand the historical basis for such provisions. Bodies of government at all levels had been the principal, if not the only, economic actors under central planning. Old habits would die hard. It was considered necessary to explicitly forbid interference by these bodies with the new discipline of the marketplace.[2]

It is not just the countries that are moving away from centrally planned economies that maintain restrictive trade laws, and these principles are very important to consider for non-transition countries also. Many countries maintain laws as a result of a business environment which either tolerates anticompetitive practices or actually mandates such practices through anticompetitive legislation. This is particularly true of developing and semi-industrialized countries, where anticompetitive practices and governmental restraints have been the very reason many of these economies have not been able to develop. These laws were not, generally, designed to protect any particular domestic industry. Instead, the problem with these laws is that they distort the market and are related to the contestability of markets.

Article 7 of the competition law of the Russian Federation

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2. John Clark, *Restraints by Regional and Local Governments on Competition: Lessons From Transition Countries*, 25 BROOK. J. INT'L L. 363, 364-65 (1999).

is a good example of precisely this type of legislation.[3] Article 7 states that:

> Federal organs of executive power, organs of executive power of RF [Russian Federation] subjects, and organs of local self-government shall be prohibited from issuing acts and/or performing actions restricting the independence of business persons and creating discriminatory or, conversely, favorable conditions for the activity of individual business persons, where such acts or actions have resulted or may result in restraint of competition and/or infringement upon the interests of business persons or individuals . . . .[4]

Article 7 prohibits unilateral anticompetitive acts by governmental bodies, including enacting or enforcing anticompetitive legislation.[5] Article 6 of the Ukrainian competition law prohibits, *inter alia*, granting discriminatory tax benefits to particular enterprises.[6] Many other transition countries have had or continue to have such provisions.[7]

Anecdotal evidence suggests, according to the Clark Essay, that there were a substantial number of cases and enforcement actions, and that these laws were useful tools in reducing pub-

3. Law on Competition and Limiting Monopolistic Activities on Commodity Markets, Mar. 22, 1991, *as amended* May 25, 1995, art. 7 (Russ.), *translated in* RUSSIA & THE REPUBLICS LEGAL MATERIALS (John N. Hazard & Vratislav Pechota eds., 1999).

4. *Id.*

5. *See* Clark, *supra* note 2, at 364.

6. Law on Containing Monopolies and Preventing Unfair Competition in Business Activities, Feb. 18, 1992, art. 6 (Ukr.), *translated in* RUSSIA & THE REPUBLICS LEGAL MATERIALS (John N. Hazard & Vratislav Pechota eds., 1999).

7. These include: Georgia, On Monopoly Activity and Competition, June 25, 1996, ch. 5 arts. 16-26 (Geor.); Hungary (prior to its amendment in 1997), Act No. LVII of 1996 on the Prohibition of Unfair and Restrictive Market Practices, June 25, 1996, ch. 8 art. 63 (Hung.); Slovakia, Law on the Protection of Economic Competition, July 8, 1994, art. 18 (Slovk.), *translated in* CENTRAL & EASTERN EUROPEAN LEGAL MATERIALS (Vratislav Pechota ed., 1998); Bulgaria, Protection of Competition Act, May 2, 1991, art. 4 (Bulg.), *translated in* CENTRAL & EASTERN EUROPEAN LEGAL MATERIALS (Vratislav Pechota ed., 1998); Romania, Law on Unfair Competition, Jan. 29, 1991, art. 9 (Rom.), *translated in* CENTRAL & EASTERN EUROPEAN LEGAL MATERIALS (Vratislav Pechota ed., 1998); Lithuania, Law on Competition, Sept. 15, 1992, art. 6 (Lith.), *translated in* CENTRAL & EASTERN EUROPEAN LEGAL MATERIALS (Vratislav Pechota ed., 1999); Latvia, Law on Competition, June 18, 1997, arts. 5-14 (Lat.); and, Estonia, Law on Competition, July 7, 1993, art. 2 (Est.), *translated in* CENTRAL & EASTERN EUROPEAN LEGAL MATERIALS (Vratislav Pechota ed., 1998).

lic sector restraints.[8] Many of the early cases there focused on regulatory discrimination, especially where the government owned assets of entities that were being regulated (for example in the energy and telecommunications sectors).[9] There are interesting parallels here with the newly privatized telecommunications sectors in Latin America in particular, as will be specifically referred to in a case study later in this Article.

So what can be done to deal with these practices where market entry and contestability are adversely affected by anticompetitive law? We believe that the issues of access and contestability are intractably interrelated, and the ability to access a market is completely vitiated if, once entered, the market is not competitive. This Article is intended to be a brief summary of these experiences and a review of how the international trade rules affect these issues. It will also focus on several particular kinds of objectionable trade practices and discuss how more vigorous enforcement of competition policy and introduction of competition concepts into WTO Agreement enforcement might remedy the problems.

II. DISCRIMINATORY TAX TREATMENT OF FOREIGN PRODUCTS

Many countries, particularly though not exclusively in emerging markets, have tax regimes that unfairly discriminate against foreign-sourced products in favor of locally produced products. Sometimes the discrimination is carefully hidden, and not obvious from the surface of the law. The General Agreement on Tariffs and Trade,[10] now the WTO Agreement[11] (GATT 1994), attempts to provide protection against this type of discrimination. However, broadly speaking, these protections apply only when the two products for which different tax treatment applies are "like products." Sometimes this discriminatory tax is so severe that it results in vastly differ-

8. Clark, *supra* note 2, at 367.

9. *Id.*

10. General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194.

11. Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Apr. 15, 1994, LEGAL INSTRUMENTS—RESULTS OF THE URUGUAY ROUND vol. 1 (1994), 33 I.L.M. 1125 (1994) (GATT 1947 was incorporated into the WTO as GATT 1994 in Annex IA to the WTO Agreement) [hereinafter GATT 1994].

ent retail pricing between the domestic and imported product. This large price differential is then used as evidence that the products are not "like products" protected from discriminatory tariffs under the GATT 1994.

Article III, Sections 1 and 2 of the GATT 1994[12] should prevent these discriminatory situations, but they often fail. Article III.2 of the GATT 1994 provides:

> The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.[13]

Article III.1 of the GATT 1994 provides:

> The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.[14]

Notwithstanding these clear rules, problems frequently arise when trying to establish that Article III.2 of the GATT 1994 applies to a particularly discriminatory tax statute, either at a national or local level.

Government price supports for inputs sometimes undercut the GATT's protections against discriminatory tariffs on "like products." These price supports are a hidden tariff on identical imported products. They also skew the analysis of whether

12. *Id.* art. III.1-2.

13. *Id.* art. III.2.

14. *Id.* art. III.1. Article III, paragraph 1 provides that internal taxes by local governments and authorities are subject to Article XXIV. *Id.* Article XXIV.12 provides that "[e]ach contracting party shall take such reasonable measures as may be available to it to ensure observance of the provisions of this Agreement by the regional and local governments and authorities within its territories." *Id.* art. XXIV.12.

substantially similar products are "like products" under the GATT 1994. Prices and consumer preferences are so tilted in favor of the domestic product that substantially similar products are found not to be "like products." Revenues that the government loses at the one end by providing price supports to domestic inputs are recovered in the form of tariffs on imported products no longer protected by the GATT 1994.

The determination of whether products are "like products" is flawed and based on incorrect criteria. The WTO determines which products are "like products" in the following way:

1. The initial determination appears to be whether the products are "similar or identical."
2. Certain factors may be considered, e.g., product's end-uses, consumers' tastes and habits, product's properties, nature, quality, and tariff classification.[15]

In the *Japan—Taxes on Alcoholic Beverages*[16] case, the Panel found that the favored Japanese spirit shochu and foreign-imported vodka were "like products" and were therefore entitled to equivalent tax treatment, applying the first sentence of Article III.2.[17] However, whiskey, gin, rum, brandy, genever, and certain liqueurs were found not to be "like products" under the GATT 1994 test.[18] The Panel found that they were "directly competitive or substitutable"[19] products and that differential tax treatment of shochu, on the one hand, and the other spirits, on the other, was a violation of the second sentence of Article III.2 because this differential treatment was designed "so as to afford protection to domestic production."[20]

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15. *See* World Trade Organization Panel Report on United States—Standards for Reformulated and Conventional Gasoline, Jan. 26, 1996, 35 I.L.M. 274, 294.

16. World Trade Organization Panel Report on Japan—Taxes on Alcoholic Beverages, July 11, 1996, *available in* 1996 WL 406720 [hereinafter Japan Panel].

17. *Id.* at 114.

18. *See id.*

19. *See id.* at 118. The annexed interpretive note to the GATT 1994 art. III.2 states:

> A tax conforming to the requirements of the first sentence of paragraph 2 would be considered to be inconsistent with the provisions of the second sentence only in cases where competition was involved between, on the one hand, the taxed product and, on the other hand, a directly competitive or substitutable product which was not similarly taxed.

GATT 1994, *supra* note 11, *ad* art. III para. 2.

20. Japan Panel, *supra* note 16, at 121 (quoting the GATT 1994, *supra* note

In other words, the Panel said that Article III.2 of the GATT 1994 was violated if there was different tax treatment for "like products," without more, but that a violation of Article III.2 could only be found for the broader class of "directly competitive or substitutable products" if the differential tax was applied *so as* to afford protection to domestic production.[21]

The Panel went a long way in applying (broadly) an antitrust product market analysis to identify which products were directly competitive or substitutable. The *Japan* Panel used a demand-side substitution analysis, using cross-elasticities of demand to determine whether products were "directly competitive or substitutable."[22]

The *Japan* Panel decision was significant because it moved away from the reasoning employed by earlier GATT panels, most significantly in the *U.S.-Measures Affecting Alcoholic and Malt Beverages* decision.[23] There, the GATT Panel said that in order for products to be "like products," the aim of the differential taxation had to be to protect domestic production. This was the "aim and effect test," which the *Japan* Panel overruled. Instead, the *Japan* Panel replaced this by saying that a violation of Article III.2 of the GATT 1994 could be shown if "like products" were receiving differential tax treatment, or if "directly competitive or substitutable products" were receiving differential tax treatment, and the tax was applied so as to favor domestic production.[24] The *Japan* decision implies that the distinction between "like products" and "directly competitive or substitutable" products is less important for Article III.2 analysis because there is Article III.2 protection for "like products" and also for "directly competitive or substitutable products."[25]

We suggest that use of supply and demand substitution analysis commonly used in defining relevant markets for antitrust purposes, if added to the other factors already used in determining what constitutes "like products" (as well as directly competitive and substitutable products) would greatly increase the likelihood that the GATT's purposes will be realized,

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11, art. III.1)

21. *See id.* at 118.

22. *Id.* at 117.

23. GATT Dispute Panel Report on U.S.-Measures Affecting Alcoholic and Malt Beverages, June 19, 1992, GATT B.I.S.D. (39th Supp.) at 206 (1993).

24. Japan Panel, *supra* note 16, at 110-11.

25. *Id.* at 111-12.

and give much needed predictability to GATT analysis. It must be recognized, of course, that the analysis should take into account the effect of the unequal taxation, and so should include other non-price factors as well.

If a small but significant increase in the price of one product will cause consumers to shift to another product, then both products are in the same market and should be considered "like products" for these purposes. Supply side factors should also be important when considering whether two products should be considered "like products." If a supplier of one product could easily "re-tool" to become a supplier of the other, then that would be evidence that the two products are like products. These economic concepts, commonly employed in antitrust analysis, would help ensure that tariffs on imported products and price supports for domestic inputs would not undercut the competitive relationship between imported and local products that the GATT 1994 was intended to protect. In the *Korean—Taxes on Alcoholic Beverages* case, the Appellate Body affirmed much of what was said in the *Japan* case but rejected a pure product market analysis, instead saying that cross-elasticity of demand was not the exclusive or decisive factor.[26] However, the Appellate Body also acknowledged that potential competition had to be considered, especially "where there [were] regulatory barriers to trade or to competition . . . ."[27]

The Appellate Body rejected the notion that products were not in competition if the protective tax effectively put them in different price brackets for consumers.[28] This case clarified that when the purpose of a tax is to decrease competition, the resulting lack of competition cannot be used as a defense to an Article III.2 claim, as this would defeat the purpose of the WTO. Regarding the question of affording protection to domestic products, the case confirmed the *Japan* ruling, and indicated that massive differences in the level of taxation could be evidence of protection to domestic products.[29]

A second difficulty has come to our attention. The GATT

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26. World Trade Organization Appellate Body Report on Korea—Taxes on Alcoholic Beverages, Jan. 18, 1999, WTO Doc. WT/DS75/AB/R, WT/DS84/AB/R (visited Aug. 23, 1999) <http://www.wto.org/wto/dispute/7085.pdf>.

27. *Id.* at 33.

28. *Id.* at 35.

29. *See id.*

1994 applies only to discrimination resulting from a "national" measure. Increasingly, however, discriminatory tax regimes are issued by individual states, provincial, or local governments. If what exists is a patchwork quilt of state or provincial regulations that discriminate against foreign products and are merely tolerated by the national government, then it is difficult to maintain an Article III case, notwithstanding the hortatory recommendation of Article III, paragraph 1 of the notes and supplementary provisions of the GATT 1994, which forces contracting parties to comply with Article XXIV.12 of the GATT 1994.[30] This Article states that contracting parties must use reasonable measures to make local and state governmental activity GATT compliant.[31]

A third difficulty is proving that discriminatory tax measures are intended to protect domestic industries against foreign rivals.[32] Many tax regimes that discriminate against imports as a side-effect were not designed for the purpose of benefitting a particular domestic industry against foreign rivals.[33] Rather, these tax regimes may be intended to benefit a local industry that does not directly compete with foreign rivals.

Exactly what level of protection should be afforded to domestic products is a vexing question in WTO analysis. In *European Communities—Regime for the Importation, Sale and Distribution of Bananas*[34] (*Bananas IV*), the European Community unsuccessfully argued that it must be shown that the policy measure was designed to afford protection to domestic products.[35] The Appellate Body overruled the "aims and effects" test once and for all, and further reaffirmed the proposition advanced in the *Japan* decision, requiring an examination of "the underlying criteria used in a particular . . . measure, its structure, and its overall application to ascertain whether it is applied in a way that affords protection to domestic products."[36]

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30. GATT 1994, *supra* note 11, *ad* art. III para. 1.
31. GATT 1994, *supra* note 11, art. XXIV.12.
32. *See* Japan Panel, *supra* note 16, at 109.
33. *See id.* at 111.
34. World Trade Organization Appellate Body Report on European Communities—Regime for the Importation, Sale and Distribution of Bananas, Sept. 9, 1997, 4 BERNAN'S ANNOTATED REP. 63 (Sept. 1, 1997-Mar. 12, 1998) [hereinafter Bananas IV].
35. *Id.* at 124, 134, 136.
36. *Id.* at 93.

The *Bananas IV* Appellate Body also stated that "the protective application of a measure can most often be discerned from the design, the architecture, and the revealing structure of the measure."[37]

We suggest that discriminatory tax measures, otherwise outside the ambit of the GATT 1994, should be attacked using competition concepts such as those incorporated in the Treaty Establishing the European Community[38] (EC Treaty). A tax break given to local industry and not given to foreign suppliers of competitive products is nothing more than a "state aid" as those terms are used in Article 92 of Treaty on European Union,[39] and should be prohibited as they are by Article 92.

Article 92 provides that:

> Save as otherwise provided in this Treaty, any aid granted by a Member-State or through State resources in any form whatsoever which distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member-States, be incompatible with the common market.[40]

Certain exemptions are granted to promote the economic development of very poor areas, or in line with other European Union objectives.[41] But, generally speaking, if a country in the European Union adopted a discriminatory tax regime, it would be a clear violation of Article 92 of the EC Treaty with consequent redress available for affected private entities.

Indeed, Article 95 of the EC Treaty states that:

> No Member State shall impose, directly or indirectly, on the products of other Member States any internal taxation of any kind in excess of that imposed directly or indirectly on similar domestic products. Furthermore, no Member State shall impose on the products of other Member States any internal

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37. *Id.* at 129.

38. TREATY ESTABLISHING THE EUROPEAN COMMUNITY, Feb. 7, 1992, O.J. (C 224) 1 (1992), [1992] 1 C.M.L.R. 573 (1992) [hereinafter EC TREATY], *amended by* TREATY ON EUROPEAN UNION, Feb. 7, 1992, O.J. (C 224) 1 (1992), [1992] 1 C.M.L.R. 719 (1992), 31 I.L.M. 247 [hereinafter TEU]. The TEU amended the EC TREATY, Mar. 25, 1957, 298 U.N.T.S. 11, *as amended by* SINGLE EUROPEAN ACT, O.J. (L 169), [1987] 2 C.M.L.R. 741 (1987).

39. TEU, *supra* note 38, art. 92.

40. *Id.*

41. *See id.*

> taxation of such a nature as to afford indirect protection to other products.[42]

Hence, discriminatory tax laws (direct or indirect) are violations of the EC Treaty.

We propose that other regional trade agreements have rules similar to those of the EC Treaty which could assist us in dealing with the indirect ways in which governments disadvantage foreign rivals. Only once rules are in place at a regional level, might we proceed to have such rules in the WTO context as well. We recommend that some of the regional trading areas currently being negotiated such as the FTAA,[43] MERCOSUR,[44] and APEC[45] incorporate some element of a competition policy that would enable either their own national competition authorities and/or a broader regional authority to deal with national laws that clearly distort the market in a particular country or in the region itself. National antitrust authorities, of course, face significant pressure from political forces and will need some help in tackling the more politically sensitive issues, of which local discriminatory taxation is a prime example. Unless a regional authority provides specific guidance at an institutional level, it is unlikely that the impetus will come solely from within the country for the reasons stated above. Many of the local interests that are protected under the law have a great deal of political power. A mandate given by regional trade agreements can give credibility to national antitrust agencies seeking to eliminate discriminatory tax laws.

The only realistic way of dealing with this problem is to ensure that within regional trade agreements with competition provisions, there is a mechanism for analyzing and striking down public sector restraints. Enhanced communication between antitrust officials will certainly not be enough.

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42. EC TREATY, *supra* note 38, art. 95.

43. *See* Partnership for Prosperity and Security in the Caribbean, May 10, 1997, 36 I.L.M. 792.

44. *See* Treaty Establishing a Common Market Between the Argentine Republic, the Federative Republic of Brazil, the Republic of Paraguay and the Eastern Republic of Uruguay, (MERCOSUR), Mar. 26, 1991, 30 I.L.M. 1041.

45. *See* Asia-Pacific Economic Cooperation [APEC] Forum: Osaka Action Agenda on Implementation of the Bogor Declaration, Nov. 19, 1995, 35 I.L.M. 1111.

III. DEALER PROTECTION STATUTES

WTO resolution of public sector restraint disputes is also difficult in the area of dealer protection statutes. Although dealer protection statutes vary, common themes run through many if not all of them. Many local dealer protection statutes provide for substantial "termination indemnities" in the event that an agreement with a local distributor is terminated by a foreign supplier. In addition, dealer protection statutes often provide for onerous procedures whereby local dealers may be terminated. Once an exclusive distribution agreement is entered, dealer protection statutes frequently mandate agreements of an indefinite duration. These conditions are wholly intolerable for foreign suppliers. These laws arguably violate Article III.4 of the GATT 1994, and Articles II, XVI, and XVII of the General Agreement on Trade in Services[46] (GATS). It is difficult, however, to maintain WTO cases against these laws.

The first problem is with the GATT 1994 Article III.4 requirement that the law be connected, in some way, with favoring local production.[47] Of course, that is not the main focus of the law. The dealer protection statutes are designed to protect the local distribution interests in the country. The effect of the law is to insulate the distribution sector from competition or even the threat of competition. This leads to distributors maintaining large profit margins and high prices for consumers. Countries that have such laws often have higher product prices than countries which do not have such laws. In certain industries, the failure of the distribution sector means that much needed products, frequently in poor countries, are kept from reaching the poorest people.

Another problem is that the current rules on accession to the GATS require WTO Members to sign onto a positive series of commitments rather than apply to be exempted from certain service sectors (as would be required under NAFTA). Many of the countries which have signed up to the GATS have not signed up to the distribution services commitments at all.

In *Canada—Measures Concerning Periodicals*,[48] an argu-

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46. General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, LEGAL INSTRUMENTS—RESULTS OF THE URUGUAY ROUND vol. 28; 33 I.L.M. 1167.

47. GATT 1994, *supra* note 11, art. III.4.

48. World Trade Organization Appellate Body Report on Canada—Certain

ment was made that the GATT 1994 could not apply to measures whose application affects both goods and services.[49] The decision clearly states that obligations under the GATT 1994 and the GATS can coexist and one does not automatically override the other.[50] Analyzing a tax on Canadian periodicals, the test was to determine whether the tax by its structure and design was a tax on goods or a tax on services. Since it was the supplier of goods that suffered the tax, and not the provider of advertising services, the GATT 1994 was found to apply.[51] Both *Canada—Measures Concerning Periodicals* and *Bananas IV* state that GATT 1994 and GATS commitments must be overlapping to avoid eroding service commitments made in the goods distribution sector.[52]

If these laws were enacted in countries with strong and well-enforced competition laws, they would raise serious competitive concerns, and the activities of the distributors might attract the attention of competition regulators. In many of these countries, multinationals pay large sums of money to buy out local distributors for amounts inflated by the threat of the application of the termination indemnities by the local courts. These multinationals, in turn, are forced to pass these inflated costs on to consumers. In other cases where there is no buyout, the distributors' high profit margin is passed directly onto consumers.

Article III.4 of the GATT 1994 should be applicable to these cases. Article III.4 states that:

> The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favorable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of

Measures Concerning Periodicals, June 30, 1997, 3 BERNAN'S ANNOTATED REP. 1 (June 1, 1997-Aug. 31, 1997).

49. *See id.* at 8.

50. *See id.* at 14.

51. *See id.* at 13.

52. *Id.* at 15; Bananas IV, *supra* note 34, at 65.

transport and not on the nationality of the product.[53]

Article III.4 of the GATT 1994 does not refer to the hortatory provisions of Article III.1 as Article III.2 does in its second sentence.[54] This suggests that there is less of a requirement to show favoring of national production in making an Article III.2 claim. The Panel in *European Communities—Regime for the Importation, Sale and Distribution of Bananas*[55] said that this was determined according to whether the "design, the architecture, and the revealing structure of the measure" suggests a protective application.[56] However, in *Bananas IV*, the Appellate Body took issue with the Panel's reasoning and pointed to the fact that Article III.1 informed the first and second sentences of Article III.2 in different ways, as it had made clear in its *Japan* ruling. Applying this logic to Article III.4, the Appellate Body stated that:

> The same reasoning must be applied to the interpretation of Article III:4. Article III:4 does *not* specifically refer to Article III:1. Therefore, a determination of whether there has been a violation of Article III:4 does *not* require a separate consideration of whether a measure "afford[s] protection to domestic production."[57]

After the *Japan* Panel and the *Bananas IV* Appellate Body rulings, the law seems clear enough. All that is needed to establish an Article III.4 violation is differential treatment between like products based on nationality. It remains to be seen how future panels and governments will interpret these provisions in vigorously pursuing examples of restrictive laws that violate Article III.4. However, national governments frequently argue that some element of the favoring of national production needs to be shown, contrary to what now appears to be the WTO law on the subject.

There are reasons why making such a stipulation not only

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53. GATT 1994, *supra* note 11, art. III.4.

54. *Id.* arts. III.1-2, III.4.

55. World Trade Organization Appellate Body Report on European Communities—Regime for the Importation, Sale and Distribution of Bananas, May 22, 1997, 2 BERNAN'S ANNOTATED REP. 93 (Feb. 26, 1997-May 31, 1997).

56. *Id.* at 437.

57. Bananas IV, *supra* note 34, at 130.

flies in the face of WTO law but also violates the spirit of Article III.4 as well. The effect of dealer protection laws, just as is the case with many trade restrictive laws, is not necessarily to build up a national competitive industry but simply to extract as much as possible from foreign suppliers and to develop an industry of dealers or distributors of foreign supplier's products. The purpose of the trade rules themselves is to ensure that by treating foreign suppliers the same as local suppliers, foreign trade will be encouraged, and this will significantly enhance the economic development of the countries involved. Insofar as these laws are maintained by developing countries there is even more urgency in dealing with them. They contribute directly to the greater disparities in wealth between a privileged few and the poor majority by increasing consumer price and reducing choice by limiting the supply of foreign products to the country. This is a significant reason why developing countries' economic growth has been held back. These laws are another example of legislation which violates both trade rules and competition principles. It is useful at this point to consider the potential application of competition principles to these laws and the private arrangements which they mandate.

Although these laws violate the spirit of the GATT 1994 Article III.4, it is sometimes difficult to show that the effect is to favor local production (although this is sometimes an ancillary result). The effect of the law is to favor local distributors. In sectors where there is no domestic industry, particularly true in developing countries, there is no Article III cause of action. Again, European competition law is useful here:

Article 90 of the EC Treaty[58] states that:

> In the case of public undertakings and *undertakings to which member-States grant special or exclusive rights*, member-States shall neither enact nor maintain in force any measure contrary to the rules contained in this Treaty, in particular to those rules provided for in Article 7 and Articles 85 to 94.[59]

Article 7 provides that: "*any discrimination on the grounds of nationality shall hereby be prohibited.*"[60]

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58. EC TREATY, *supra* note 38, art. 90.
59. *Id.* (emphasis added).
60. *Id.* art. 7 (emphasis added).

The dealer protection statutes with their inherent discrimination against foreign suppliers would be clear violations of the principles enshrined in Article 90 of the EC Treaty.

In addition, those agreements that mandate exclusive relationships of indefinite duration for an entire national market or are terminable only on the payment of a penalty are vertical restraints on trade that would violate section 1 of the Sherman Act[61] or Article 85 of the Treaty of Rome.[62] Under most countries' antitrust or competition systems such agreements would be deemed uncompetitive and struck down. The only difference is that in many countries where these agreements abound, they do so because of governmental regulation and not purely as a result of private behavior.

We maintain that here again some form of regional competition process with a clear mandate from its member states would be a very useful part of regional trade agreements intended to eliminate discriminatory national trade barriers.

A. *Frequent Defenses*

Attempts to remove trade barriers are naturally resisted by powerful vested interests, especially in developing and semi-industrialized countries. Many countries rely on a number of defenses to prevent WTO Rules being used against them. One defensive weapon used frequently is GATT 1994 Article XII and XVIII.B—Restrictions to Safeguard the Balance of Payments.[63] Under Article XII, a country may impose import restrictions in order to safeguard its external financial position and its balance of payments.[64] However, such import restrictions must not exceed those necessary to forestall the imminent threat of a serious decline in its monetary reserves, or achieve a reasonable rate of return on those reserves. Any such restrictions must be progressively relaxed, as conditions improve. They should also be eliminated when they can no longer be justified under Article XII and Article XVIII.[65]

Article XII is the only provision available for developed

61. Sherman Antitrust Act, 15 U.S.C. § 1 (1994).
62. EC TREATY, *supra* note 38, art. 85.
63. GATT 1994, *supra* note 11, arts. XII, XVIII.B.
64. *Id.* art. XII.
65. *Id.* art. XII, XVIII.

countries and allows import restrictions only to the extent necessary either to forestall an imminent threat of, or to stop an imminent decline in, its reserves—or to rebuild reserves that are very low.[66] Article XVIII.B is available to developing countries only. It relaxes these obligations slightly and says that reserves must be inadequate, and a threat need not be imminent for the Balance of Payments defense to be applicable.[67] The *Understanding on the Balance-of-Payments Provisions of the General Agreement on Tariffs and Trade 1994*[68] (*Understanding*) limits the scope of the defense. Members must announce publicly their schedules for phasing out restrictive import measures or provide justification if this is not possible. Restrictions may only be applied to control the general level of imports. The *Understanding* also makes it clear that "essential products" may be excluded from these sectors.[69]

Contracting parties which apply Article XVIII restrictions must not apply those restrictions in such a way as to prevent the importation of goods in minimum commercial quantities, so as not to disturb regular channels of trade. These negotiations are carried out in the Committee on Balance of Payments Restrictions which makes an assessment of Article XVIII compliance. However, the efficacy of this defense has been called into question after the WTO Panel decision in *India—Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products*.[70] In the WTO Panel decision, India's tariff restrictions and non-tariff barriers (particularly its import licensing program) were attacked by the U.S. as being a WTO violation, notwithstanding India's reliance on the Article XII and XVIII defense. The WTO Panel found that India's Balance of Payments did not merit continued use of WTO-violative import licensing rules, relying in part on the IMF's testimony to the Committee on Balance of Payments that India's reserves were not inadequate or threatened by a serious decline. The case was important because it covered all

66. *Id.* art. XII.

67. *See id.* art. XVIII.B.

68. GATT Secretariat, *Understanding on the Balance of Payments Provisions of the General Agreement on Tariffs and Trade 1994*, 33 I.L.M. 1158, 1158 (1994).

69. *Id.* at 1159.

70. World Trade Organization Panel Report on India—Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products, Apr. 6, 1999, WT/DS90/R, (visited Aug. 16, 1999) <http://www.wto.org/wto/dispute/distab.htm>.

aspects of agricultural and industrial goods and was the first time that India's Balance of Payments defense had not succeeded in protecting its WTO-violative import licensing regime.[71]

The WTO Panel made some important comments about the nature of the defense. The Panel ruled that balance of payments compliance under the Balance of Payments Committee under Article XII or XVIII, or under the dispute resolution procedures of Article XXIII were all possible, thus giving future WTO panels the chance to rule on whether a country's balance of payment restrictions satisfy the WTO rules.[72] The Panel specifically ruled that WTO Panels could determine whether a balance of payments situation justified a particular measure.[73] The Panel also responded to India's claim that it did not have jurisdiction over non-legal, technical issues by stating that it could consult experts to make such determinations, and this was in fact what it regularly did in a number of areas.[74] Clearly the Balance of Payments Committee would continue to play such an "expert role."

Regarding the burden of proof, the WTO Panel suggested that where a complaining party has established a prima facie case, the burden of proof is on the defendant to raise a rebuttable presumption that an affirmative defense, such as the Balance of Payments defense, applies.[75] The complainant will fail if it does not raise enough evidence to rebut the presumption. However, the Panel also stated that the complainant cannot limit itself to stating its claim if the Balance of Payments provisions of the WTO Agreements have already been invoked.[76] It is then required to present a prima facie case that the defense is not justified. If it does so, the defendant would then have to respond to rebut that claim. It is not entirely clear how future panels will apply these evidentiary rules, but it is something of a clarification of the somewhat murky way in which former GATT panels carried out their evidential decision-making.

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71. *See id.* at 174.
72. *See id.* at 136.
73. *See id.* at 153.
74. *See id.* at 151.
75. *See id.* at 160.
76. *See id.*

Another much quoted defense is the Differential and More Favorable Treatment Reciprocity and Fuller Participation of Developing Countries.[77] In particular, paragraph 6 states:

> Having regard to the special economic difficulties and the particular development, financial and trade needs of the least-developed countries, the developed countries shall exercise the utmost restraint in seeking any concessions or contributions for commitments made by them to reduce or remove tariffs and other barriers to the trade of such countries, and the least-developed countries shall not be expected to make concessions or contributions that are inconsistent with the recognition of their particular situation and problems.[78]

However, we must be careful in considering this piece of GATT law which should not be used to give *carte blanche* to developing countries to engage in precisely the type of protectionism which has prolonged their economic difficulties. Far from resisting attempts to open markets to foreign trade and investment, there is a greater urgency for transition and developing countries to ensure that their markets are open and their trading regimes liberal. The GATT decision should not stand in the way of such development.

Another method which is used by countries to protect conduct which would otherwise be a violation of the GATT 1994 is the application of waivers to provisions of the WTO Agreements which are given in the case of less-developed countries.[79] Reliance on waivers has been limited after the Understanding in Respect of Waivers of Obligations Under the General Agreement on Tariffs and Trade 1994[80] (Understanding on Waivers) whereby waivers can only be granted or extended if the Member State declares the specific policy objective which the waiver is intended to achieve and the reasons why the Member cannot achieve its policy objectives in compliance with GATT 1994. The Understanding on Waivers also specifically states that Article XXIII dispute resolution may be invoked by

77. Differential and More Favorable Treatment Reciprocity and Fuller Participation of Developing Countries, Nov. 28, 1979, GATT B.I.S.D. (26th Supp.) at 203 (1980).

78. *Id.* at 204.

79. *See* Understanding in Respect of Waivers of Obligation Under the General Agreement on Tariffs and Trade, Apr. 15, 1994, 33 I.L.M. 1125, 1163.

80. *Id.*

Members who consider that the terms and conditions of a waiver are not being complied with, or that it is nullifying or impairing their benefits which have been previously agreed to in the context of a trade agreement.[81]

IV. INTERACTION BETWEEN COMPETITION AND REGULATORY AGENCIES

The final area that we are using as an example of the tension between trade and competition law is the area of regulation of the newly privatized utilities, and the interaction between national regulatory authorities and national antitrust authorities. As an example, we highlight difficulties raised between the Federal Competition Commission (CFC) in Mexico and the sectoral regulatory agencies, in particular COFETEL, the telecommunications regulatory agency.

A. *Summary of Mexican Commitments under Basic Telecommunications Agreement*

Mexico signed onto the Basic Telecommunications Agreement[82] and did not have any exceptions to the national treatment provisions. Mexico also specifically signed up to the Reference Paper[83] associated with the Basic Telecommunications Agreement. The Reference Paper provides for competitive safeguards to prevent anticompetitive practices in the telecommunications industry.[84] Certain practices are specifically precluded, in particular:

- not making available to other services suppliers on a timely basis technical information about essential facilities and commercially relevant information which are necessary for them to provide services;[85]

- interconnection . . . [is also to] be ensured at any technically feasible point in the network. Such interconnec-

81. *Id.*
82. GATS Decision on Commitments in Basic Telecommunications, Apr. 30, 1996, 36 I.L.M. 365.
83. Fourth Protocol to the General Agreement on Trade in Services, Apr. 30, 1996, 36 I.L.M. 366.
84. *Id.*
85. *Id.* at 367.

> tion . . . [must be] non-discriminatory . . . [at rates] no less favorable than that provided for its own like services . . . .[86]

The CFC was ignored when it ruled that the dominant carrier, Telefonos de Mexico (Telmex) was dominant within the meaning of Mexican competition law, and hence eligible for increased regulatory controls.[87] COFETEL, the Mexican telecommunications regulator ignored the ruling of the CFC and has not effectively responded to it.[88] It will be important for national competition commissions to actually have teeth and to ensure that they are not merely trumped by the industry regulatory agency, where the chances of regulatory capture are much higher.

It will also be important for sectoral regulators to apply competition principles in their rulings, as specifically mandated in the Reference Paper, to which Mexico has recently committed itself. The recent actions by COFETEL indicate that this is not the case. In a workshop sponsored by the OECD and the Fair Trade Commission of Japan,[89] the Korean competition agency claimed to have the power to intervene in the activities of the regulatory agency to ensure that the dominant position is not abused.[90]

B. Inter-Relationship Between COFETEL and CFC

The CFC has twice found Telmex to be the dominant carrier and to possess market power in five relevant markets: international long-distance, domestic long-distance, basic local services, access (interconnection), and interurban transport.[91] This ruling should have subjected Telmex to increased regulation, but COFETEL has not done anything substantive. Other complaints have also been brought by Telmex's competitors,

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86. *Id.* at 368.

87. *See* Report of the Comision Federal de Comperencia [on file with author].

88. *See id.*

89. ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, THE ROLE OF THE COMPETITION AGENCY IN REGULATORY REFORM (1997).

90. *See id.* at 85. See the remarks of Byong-Kyun Kim, Standing Commissioner of Korea's Fair Trade Commission. *Id.* at 36, 42, 84-86.

91. *See* ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, CHAPTER 6: REGULATORY REFORM IN THE TELECOMMUNICATIONS INDUSTRY: MEXICO 9 (1999) [hereinafter TELECOMMUNICATIONS REFORM].

including complaints about Telmex's discriminatory treatment of the billing and collection services and private digital services provided to other concessionaires.[92] A 1997 complaint concerned Telmex's high charges for dedicated customer access lines provided to a competitor, Alestra, and a 1997 complaint concerned Telmex's de facto exclusive provision of international 800 services in Mexico.

Additionally, competition in the local telephone market should have begun this year. However, one new entrant has already complained about Telmex's settlement procedures. In its submission to the U.S. Trade Representative under section 1377 of the Trade Act, Megacable Comunicaciones de Mexico (MCM) claimed that Telmex had refused to meet to discuss settlement, and COFETEL had taken several months to resolve the dispute while MCM was charged considerably more than a cost-based settlement rate. Telmex's current prices are regulated by the terms of a 1990 Telmex concession.[93] However, it is clear that COFETEL's regulatory power over Telmex prices was "*subject to a finding by the competition authority that a carrier possessed significant market power*"[94] (i.e., was dominant within the meaning of Mexican competition law). The 1997 CFC decision states quite clearly that Telmex is dominant in five markets.[95] Yet Telmex's prices continue to be regulated by the 1990 Telmex Concession. The price cap methodology used allows the potential for anticompetitive cross-subsidization, in contravention of the competition safeguards in the Reference Paper and general competition principles. The problem stems from the fact that there is the potential for cross-subsidization, which enables Telmex to recoup losses brought about through potentially predatory pricing in the long distance segment by increased prices in the local segment where there is inadequate competition. Since the very high surcharges that new entrants had to pay Telmex (58% surcharge on the interconnection rate) went into Telmex's general revenues and could easily be used for any purpose, it appears that there are no or certainly very limited competitive safeguards.

92. *See id.*
93. *See id.* at 22.
94. *Id.* (emphasis added).
95. *Id.* at 9.

A recent OECD study on telecommunications regulation in Mexico illustrates that Telmex has behaved exactly as a dominant carrier could be expected to behave under these circumstances.[96] When rivals increased market share to 30%, Telmex rapidly cut prices to regain 10% of the long distance market.[97] Hence, the 30% market share of the rivals was short-lived (approximately three to five months).[98] This was possible because Telmex had the potential to recoup lost revenues by increasing local market prices.

Further, CFC has not provided any solution to the problem of dominance that it set out in its November 1997 decision. This problem arises because CFC is not empowered to make these decisions. It should have the power to ensure that dominant entities adhere to the competition rules. CFC should have more of a role in setting out all possible remedies to address the dominance problems in the Mexican market. As long as CFC cannot design remedies for competition abuses in the telecommunications sector, the competitive safeguards which Mexico has already committed to in the Reference Paper will remain nothing more than hot air.

There is also evidence that long distance price reduction has simply been accompanied by local price increases. Remarkably, Telmex's revenues have remained fairly constant despite a significant decrease in long distance prices. Prices for a complete basket of services in Mexico are approximately three times the OECD average.[99] Many of Telmex's arguments relate to the Universal Service commitments in the Reference Paper. However, Mexico appears to have lost ground since the 1990 Concession in its penetration rates. Mexico has only 10 access lines per 100 inhabitants, compared with the next lowest OECD country, Poland, with 20.[100] Despite Telmex and COFETEL's protestations, there is no evidence that this is improving.

This illustrates that the CFC in Mexico is not able to operate in the way that was envisaged at its inception. There are

96. TELECOMMUNICATIONS REFORM, *supra* note 91, at 30.

97. *See id.*

98. *See id.*

99. *See* ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, OECD ECONOMIC SURVEYS 1998-1999: MEXICO 128 (1999).

100. *See id.* at 127-28.

severe problems in implementation of Mexico's WTO Commitments, and in particular the competition safeguards which are mandated in the Reference Paper.

There is always tension between industry regulators and antitrust authorities, but the Mexican situation seems extreme. None of Mexico's commitments, competition safeguards, or other commitments are currently being honored and this could be a systemic fault in the manner in which the CFC is able to operate. The problem arises out of a weakness in the ability of the national competition agency to issue rulings that have greater power than those of the regulatory agency. Any firm ruling by the antitrust authority is liable to meet with significant political opposition in the country. The proposals for reform contained herein are designed to deal with this problem, and take some of the regulatory power out of the hands of sectoral regulators in newly privatizing countries where the risk of regulatory capture is significant. National antitrust authorities in developing countries need to be able to point to some external set of rulings or decisions that will enable them to escape the political pressure of powerful vested interest groups, and properly perform their functions. A significant part of these functions, we argue, is the dismantling of the very public sector restraints which have held these countries' economic development back in the past.

V. PROPOSAL FOR REFORM

We confine our recommendations to the context of the integration process in Latin America and the Caribbean, both internally and with reference to the Free Trade Area of the Americas (FTAA) negotiations. All references to non-national markets are therefore meant to refer to the FTAA market. These concepts might be transferable, however, to other regional trade areas, encompassing emerging or developing country markets.

We think there should be some form of institutionalized process as part of the competition chapter of the FTAA, which would collectively review decisions, publish guidelines, and issue non-binding directives. We advocate a gradual approach, adding areas of competence to this process as they can be agreed upon. However, there are some areas which could be agreed to immediately, and these areas should be dealt with promptly.

While leaving the interpretation of substantive antitrust laws to local agencies, some level of supervening competition rule or general principle, at a regional level, could be useful in making illegal, for example, the following acts or practices:

1. collusive activity between private entities in member countries that injures competition in the national market of a particular member country or the FTAA market as a whole;
2. attempts to monopolize or abuse a dominant position by an entity in a national market or in the FTAA market as a whole
3. national measures that unfairly discriminate against persons or entities from outside the member country;
4. state aids to domestic persons or entities that injure or threaten to injure competition in the member countries or that operate in a way which adversely affects trade between member countries; and
5. taxes on the products of other countries in excess of those imposed, directly or indirectly, on similar domestic products.

These acts or practices are given as examples. Others may also be needed. We do believe that they would be a useful starting point, and would quickly put in place mechanisms and disciplines that could be used to alleviate the damage caused by discriminatory laws. At a time of rapid trade and capital flows, the damage done to free movement of goods and capital by such laws cannot be understated. Without overstating its importance, competition policy provides some of the answers. We advocate that language should be included in any regional trade agreement which includes competition provisions to specifically prohibit the behavior referred to above, and some form of regional process in which all national antitrust agencies have a part. Such a process should have credibility and real teeth, to ensure that the influence of powerful domestic lobbies is counterbalanced for the ultimate benefit of consumers in the regional area.