WPS3759

Telecommunications and the WTO: the Case of Mexico

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Abstract

The U.S.-Mexico case (2002-2004) was the first (and so far only) case of World Trade Organization (WTO) dispute resolution on telecommunications services and the first on services only. The findings of the Panel charged with settling the dispute contain interpretations of the General Agreement on Trade in Service (GATS), especially its Annex on Telecommunications and the Reference Paper that sets regulatory principles. Although these interpretations strictly apply only to the case examined, they have implications for other countries and sectors and beyond trade law. The following are some of these findings. Telecommunications services originated in one country and terminated in another country are cross-border services under the GATS irrespective of whether the same service provider is present in both countries. The accounting rate regime, whereby operators share revenue from international services provided jointly, is subject to the discipline of cost-based interconnection for countries that have adopted the Reference Paper. Uniform settlement rates and proportional return are anticompetitive practices under the Reference Paper even when they are mandated by law. Lack of implementing regulations does not excuse the country from meeting its commitments under the GATS. Mexico and the U.S., although not in full agreement with the Panel, did not appeal. An agreed plan to address the underlying legal and regulatory issues was successfully implemented by July 2005.

World Bank Policy Research Working Paper 3759, November 2005

Introduction

The U.S.-Mexico case is the first (and so far only) case of World Trade Organization (WTO) dispute resolution on telecommunications services and, indeed, the first on services generally. The findings of the Panel charged with resolving the dispute, formally adopted by the WTO members, contain interpretations of the General Agreement on Trade in Services (GATS). The specific details of any case are unique and the findings in this case apply only to Mexico. Many governments, however, have made market access commitments on telecommunications under the auspices of the GATS, and more intend to do so in the context of the ongoing Doha trade negotiations. Hence, the interpretative elements of the findings have implications beyond those for the case at hand.

The WTO in Brief

The World Trade Organization (WTO) is the international body where global rules for trade among nations are agreed. The WTO was created in 1994 at the conclusion of the Uruguay Round of the General Agreement on Tariffs and Trade (GATT). The GATT agreement and provisional secretariat had administered the rules for much of the world's merchandise trade since 1948. At the center of the new multilateral trade system resulting from the Uruguay Round are agreements on trade in goods, trade in services, trade-related aspects of intellectual property rights, a dispute settlement understanding, and a trade policy review mechanism.[1]

The General Agreement of Trade in Services (GATS) came into force at the conclusion of the Uruguay Round. It consists of the Articles of Agreement and its Annexes, and the schedules of specific commitments (and lists of exemptions from most favored nation treatment, MFN) submitted by member governments.[2] The schedules and exemption lists are integral parts of the GATS. It is by reference to a country's schedule and MFN exemptions that it can be seen under what conditions the basic principles of the GATS (MFN treatment, market access, and national treatment) are applied by the government concerned to particular services.[3] The schedule identifies the service sectors to which the country will apply the market access and national treatment obligations of the GATS and any limitations to these obligations it wishes to maintain. These commitments and limitations are specified separately for each of four modes of supply that constitute the definition of trade in services in the GATS: cross-border supply, consumption abroad, commercial presence, and temporary presence of natural persons.[4] Of these, cross-border and commercial presence are the most relevant for telecommunications.

The GATS Annex on Telecommunications contains obligations regarding telecommunications networks and services. The Annex requires member governments to ensure that their telecommunications suppliers give access to and use of public telecommunications, on reasonable terms and conditions, to service suppliers from other countries supplying any services included in the member country's schedule. The Annex also ensures the freedom of movement of information within and across borders for purposes of providing scheduled services. And it limits the restrictions that can be placed on access and use of public telecommunications to those needed to safeguard public service and the technical integrity of the networks, as well as to prevent the supply of telecommunications services by other countries other than as provided for in the host country's schedule of commitments.

The GATS provides for the resolution of disputes between member countries with respect to compliance with obligations under the GATS, including annexes and specific and additional country commitments. A WTO Dispute Settlement Understanding establishes the procedure to be followed.[5]

On completion of the Uruguay Round in 1994, WTO member countries set up a Negotiating Group on Basic Telecommunications (NGBT) to agree on specific commitments to liberalize the telecommunications markets within the framework of the GATS. Participants in the NGBT also negotiated a common text, called the Reference Paper, that would serve as a template for scheduling additional commitments on regulatory principles for the sector (see Box 1). By the close of negotiations in 1997, 55 schedules had been agreed by 69 countries and were annexed as the Fourth Protocol of the GATS.[6] The collection of specific and additional commitments negotiated under the NGBT is commonly known as the Agreement on Basic Telecommunications Services.[7] A further 24 countries have made specific commitments on basic telecommunications since then, bringing the total to 74 schedules and 88 countries.[8]

Box 1

The Telecommunications Reference Paper

Besides specific commitments to liberalize telecommunications markets, many countries have adopted the Reference Paper as an additional commitment under the GATS. The Reference Paper becomes part of a country’s legally binding obligations only when it is included in its schedule. Most countries (including Mexico) have adopted the Reference Paper *verbatim*, but a few have adopted modified forms.

The Reference Paper is a brief document (2-1/2 pages) that contains definitions and principles on the regulatory framework for basic telecommunications services. The Reference Paper provides broad principles and guidelines but leaves it to individual member countries to interpret this general framework and translate it into specific legislation and regulation.

WTO member countries that adopt the Reference Paper mainly commit to:

- Establish a regulatory authority that is independent of all suppliers of telecommunications services and networks
- Maintain measures that prevent and safeguard against anti-competitive practices by major suppliers
- Require major suppliers to interconnect other suppliers at any technically feasible point on a non-discriminatory, cost-oriented basis following transparent procedures and subject to dispute settlement by an independent body
- Administer universal service programs in a transparent, non-discriminatory, and competitively neutral manner

- Allocate and assign use of scarce resources, including the radio spectrum, numbering blocks, and rights of way, in an objective, timely, transparent, and non-discriminatory manner.

A major supplier is defined as a supplier that, through control of essential facilities or use of market position, can materially affect the price and supply in the relevant market.

Source: WTO 1996

The Dispute on Mexico

WTO handling of the dispute concerning Mexico was initiated in 2000 by the U.S., following many months of bilateral efforts to resolve the issue directly between both countries. In August 2000 the U.S. requested consultations, under WTO auspices, on Mexico's obligations on basic and value-added services under the GATS Annex on Telecommunications and the Reference Paper. Successive rounds of consultations did not resolve the issues raised, and in February 2002 the U.S. formally requested the establishment of a Panel under revised claims (that no longer included value-added services). In August 2002, after several months of negotiation between the parties (the U.S. and Mexican government representatives) on the selection of Panelists, the WTO constituted the Panel. The Panel met initially with the parties and with the third-parties having an interest in the case, and several times thereafter to develop and draft its findings.[9] The Panel issued its final report to the parties in March 2004. Although the parties claimed not to be satisfied with all aspects of the Panel findings, neither party elected to take the Panel decision to the WTO Appellate Body. As a result, the WTO's Dispute Settlement Body adopted the Panel report, by consensus, in June 2004. The parties agreed on, and submitted to the WTO, a plan to redress the underlying problems by July 2005. Table 1 summarizes how the process evolved over time.

Table 1
Milestones of the dispute resolution process

August 2000	U.S. requests WTO consultations on Mexico's GATS telecommunications services obligations
October 2000	Initial consultations. Helpful, but do not resolve disagreement
January 2001	Additional consultations but little progress
February 2002	U.S. files request for formal dispute resolution panel
April 2002	WTO establishes dispute resolution panel
August 2002	Panel members selected
December 2002	First meeting of panel with parties
March 2003	Second meeting with parties
November 2003	Panel submits draft report for review by parties
April 2004	Panel submits final report
June 2004	DSB adopts panel report Parties agree to implementation timetable

The services subject to the U.S. complaint were public voice telephony, circuit-switched data transmission, and facsimile services, provided both on a facilities- and non-facilities basis.[10] Mexico had scheduled telecommunications commitments under the GATS Articles XVI (market access), XVII (national treatment), and XVIII (additional commitments, comprising the Reference Paper). These commitments obliged Mexico, among other things, to ensure cost-based interconnection, prevent anti-competitive practices, and give foreign service suppliers access to Mexican networks. Summarized in plain language, the U.S. claimed that, with respect to the services at issue, Mexico had:

- Failed to ensure that TELMEX, the largest operator, interconnects U.S. cross-border suppliers of these services on cost-oriented, reasonable rates, terms, and conditions. This was inconsistent with Sections 2.1 and 2.2 of its Reference Paper.
- Failed to prevent anticompetitive behavior, as regulations empowered TELMEX to fix rates for international interconnection on behalf of all suppliers in the market, resulting in a cartel. This was inconsistent with Section 1.1 of its Reference Paper.
- Failed to ensure access by U.S. suppliers to public telecommunications networks in Mexico, thus preventing them from providing non-facilities based services within Mexico (through commercial agencies or 'comercializadoras') and international simple resale (through cross-border leased circuits). This was inconsistent with Articles 5a and 5b of the GATS Annex on Telecommunications.

Other telecommunications-related disputes between WTO Members had been under discussion and one or two had nearly come to the WTO before being settled through purely bilateral channels.[11] That this dispute became the first to undergo the formal WTO dispute settlement mechanism was in large part due to the economic significance of the trade concerned. In 2000, Mexico accounted for 16 percent of total outgoing U.S. international telephone traffic. Net international settlements from U.S. operators to foreign correspondents reached a record high $3.9 billion in 2002, of which about 19 percent was paid to Mexican operators. Although settlements had been declining from 1998, they remained high in comparison to more competitive high-traffic routes (such as between the U.S. and Canada and the United Kingdom, see Figure 1) and about double the Federal Communications Commission's benchmark for U.S. operators sending traffic into Mexico. Although Mexico's international long distance market had been open to competition since 1997, by 2000 TELMEX's market share still exceeded 60 percent and was rising again (see Figure 2).

Figure 1

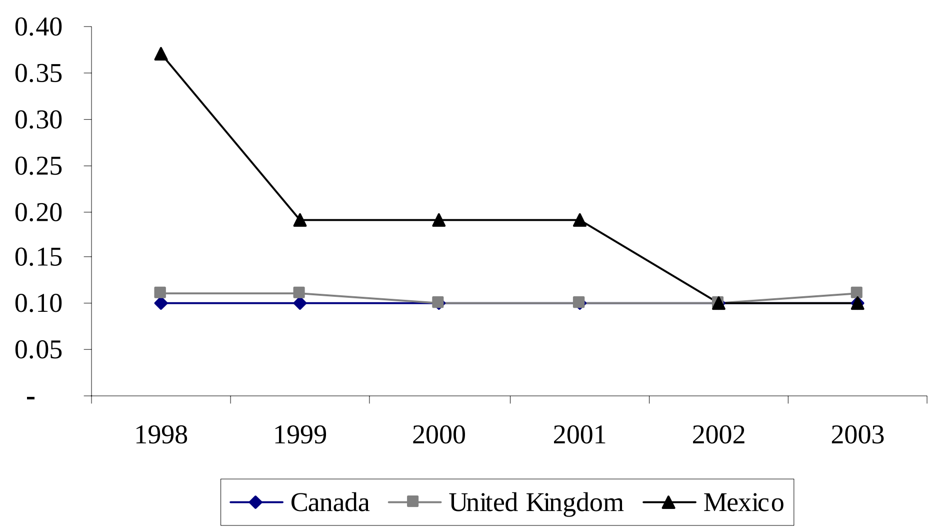
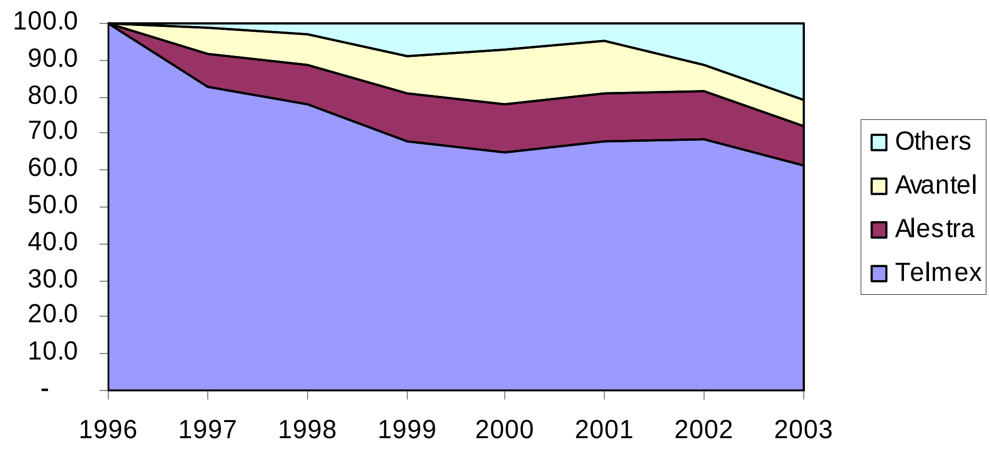


Figure 2



The Panel mostly agreed with the U.S. claims, but found that Mexico had not committed to allow international simple resale and thus was not in violation of its obligations on that count. The final report of 250 pages explains in detail how the Panel reached these conclusions (WTO 2004). For illustration, the following are some of the arguments, related primarily to the Reference Paper, cast in plain language.

Definition of cross-border services. A key question related to compliance with Sections 2.1 and 2.2 of the Reference Paper was whether the services at issue were supplied cross-border, as the U.S. claimed, or, as Mexico argued, were merely services provided by U.S. firms up to the Mexican border from where they were provided by Mexican firms. Article I:2 of the GATS defines four modes of trade in services, of which the first mode, usually referred to as cross-border, comprises "…the supply of a service…from the territory of one Member into the territory of any other Member…". The distinction mattered because Mexico had committed to cross-border market access for the provision of the services at issue.[12]

The Panel concluded that a telephone call originated in the U.S. and terminated in Mexico was indeed a cross-border service irrespective of whether the U.S. firm had its own facilities in Mexico or made arrangements with Mexican firms to carry the call from the border to its final destination. Summarizing part of the argument, the Panel explained that the supply of "…telecommunications services normally involve or require the linking with another operator to complete the service, and the operation, or presence in some way, of the supplier on both ends of the service cannot therefore be a necessary element of the definition of cross-border supply." [13] "More generally, a supplier of services under the GATS is no less of a supplier solely because elements of the service are subcontracted to another firm, or are carried out with assets owned by another firm. What counts is the service that the supplier offers and has agreed to supply to a customer." [14] Had the panel agreed with Mexico's position, there would have been no grounds to consider the U.S. claims and, as a consequence, most cross border traffic flows would have been considered to fall outside the ambit of the GATS.

Cost-oriented interconnection. Section 2.2 of the Reference Paper requires that "Interconnection with a major supplier be ensured at…cost-oriented rates that are transparent, reasonable, having regard to economic feasibility, and sufficiently unbundled so that the supplier need not pay for network components or facilities that it does not require…". The U.S. presented several estimations of the cost incurred in terminating international calls in Mexico, based on available information including TELMEX's domestic interconnection charges, and argued that the settlement rates that U.S. companies were required to pay were above each of these cost estimates - on average 2.5 times higher. Mexico did not offer comments on these cost estimates and settlement charges, and it did not take up the Panel's invitation to submit is own calculations.

The Panel concluded that the difference between the costs presented to it and the settlement rates was "…unlikely to be within the scope of regulatory flexibility allowed by the notion of cost-oriented rates…" of the Reference Paper.[15] In reaching this conclusion, the Panel emphasized that only costs directly incurred in providing interconnection are relevant.[16] Costs for general development of the network and for universal service programs, in particular, were not deemed relevant to determining the cost basis for interconnection rates. The Panel did not endorse any particular costing model, and recognized that more than one costing methodology could be used, but it stated that incremental cost methods, such as the long range average incremental cost methodology prescribed in Mexico's telecommunications law for certain purposes, are consistent with this concept.[17]

Rather than challenge the cost figures presented by the U.S., Mexico argued that the settlement rates pertained to the international accounting rate regime, not an interconnection regime.[18] At the time negotiations on basic telecommunications services came to closure in 1997, an unbinding understanding had been reached among the negotiating parties that accounting rates would not be used as a basis of disputes. Otherwise, most countries would have found it necessary to file exemptions to MFN treatment under GATS Article II.

The Panel, however, found that the accounting rate regime is subject to the discipline of cost-based interconnection for countries that have adopted the Reference Paper. While the 1997 understanding prevented disputes arising under the GATS framework agreement from different accounting rates with different countries, it did not exempt countries from any of their obligations, including cost-based interconnection, once they had also adopted the Reference Paper.

Anti-competitive practices. Section 1.1 of the Reference Paper establishes that "Appropriate measures shall be maintained for the purposes of preventing suppliers who, alone or together, are a major supplier from engaging or continuing anti-competitive practices". The Mexican rules for international telephone service required that the Mexican operator with the largest outgoing traffic over an international route should negotiate the settlement rate for terminating incoming calls over that route, and required this rate to apply to all operators ('uniform settlements rates'). Since TELMEX had the most outgoing traffic in all routes to the U.S., it was in practice the sole negotiator of settlement rates that applied as well to its competitors.[19] The rules also required that incoming calls be distributed for termination among Mexican operators in proportion to each operator's outgoing traffic ('proportional return'). Mexican operators being offered more than their share of incoming calls should route them over to another operator or compensate it for the difference in revenue. The U.S. argued that uniform settlement rates and proportional return resulted in a cartel that fixes prices and market shares, so Mexico had failed to maintain 'appropriate measures' to prevent anti-competitive practices. Mexico argued that the rules had been designed precisely to prevent anti-competitive behavior by large foreign operators playing off Mexican companies against one other down to unsustainable prices.

The Panel found that uniform settlement rates and proportional returns required Mexican operators to engage in practices that were tantamount to a cartel and hence were anti-competitive. Mexico, therefore, had not met its obligation under Section 1 to take measures to prevent such practices. The Panel, furthermore, clarified that the anti-competitive practices concerned fell within the scope of the Reference Paper even when, as in the case of Mexico, they were mandated by government rules. A longstanding international legal principle was thus reinforced, namely that a government must bring its domestic laws and regulations into conformity with the treaty obligations it undertakes.

Application of the Annex on Telecommunications. Article 5(a) of the Annex on Telecommunications states that "Each Member shall ensure that any service supplier of any other Member is accorded access to and use of public telecommunications…on reasonable and non-discriminatory terms and conditions, for the supply of a service included in its Schedule." Article 5(b) adds that "Each Member country shall ensure that service suppliers of any other Member have access to and use of any public telecommunications…network or service offered within or across the border of that Member, including private leased circuits…". This means, essentially, that when a country commits to open up a particular market (e.g. financial services), foreign suppliers of these services are entitled to use the host country's telecommunications networks and services to pursue their business. The U.S. argued that U.S. suppliers should be allowed to interconnect international leased circuits to Mexican networks to terminate incoming calls originated in the U.S. (international simple resale) as well as provide services to Mexican customers through 'comercializadoras' by leasing facilities owned by Mexican concessionaires. The U.S. also argued that the interconnection prices being charged to U.S. suppliers were not 'reasonable'. Mexico held that Articles 5(a) and 5(b) applied only towards meeting the telecommunications needs of suppliers of other services, not the provision of telecommunications services *per se*, and in any case were limited to services for which Mexico had undertaken market access obligations.

The Panel clarified that interconnection and the ability to interconnect and lease circuits were forms of 'access' to the services at issue, and therefore the provisions in the Annex applied to them.[20] The Panel upheld the U.S. position regarding the provision of non-facilities services through 'comercializadoras'. The fact that regulations were not in place to license U.S. (or any other) suppliers to provide this form of service, did not excuse

Mexico from meeting its commitment to market access through commercial presence. The Panel, however, sided with Mexico regarding international simple resale, since Mexico had not undertaken commitments on cross-border market provision of non-facilities based services.

The Panel also found that 'reasonable access and use' of public telecommunications includes prices. Since the Panel had already concluded that Mexico's interconnection prices did not meet the requirement of cost orientation under the Reference Paper, this finding under the Annex did not add anything new in this case.

Initial Effects in Mexico

The agreement reached between Mexico and the U.S. in April 2004 called for the following actions:

- Within two months of adoption of the Panel's report, Mexico will revise its international long distance rules to allow competitive negotiation of settlement rates by eliminating uniform settlement rates, proportional returns, and the requirement that the operator with most outbound traffic negotiate the settlement rate on behalf of all Mexican operators
- Within 13 months, Mexico will have in force regulations to license 'comercializadoras' allowed to resell international switched telecommunications services provided by Mexican concessionaires
- Mexico will continue to restrict international simple resale (use of leased lines to carry cross-border calls)

The Panel report was adopted in June 2004. The agreed implementation plan is well underway.

Rules for international telecommunications services. New international rules applicable to all telecommunications services were approved by Comisión Federal de Telecomunicaciones (COFETEL, the regulatory authority) in June 2004 and published in August 2004.[21] The old uniform settlements and proportional return rules have been abolished. Now Mexican operators of international long distance services are free to negotiate individually the terms and conditions of interconnection with foreign operators, including prices for incoming and outgoing traffic. Foreign operators decide to which Mexican operators they wish to deliver their traffic for termination in Mexico. Thus Mexican operators can compete effectively with one another in the large wholesale market of terminating incoming traffic.

The new rules also allow more effective competition in the retail market of outgoing traffic. The uniform settlement rates had also applied to payments by Mexican operators to foreign operators for terminating outgoing calls in other countries. This largely ruled out price competition in Mexico as a means for any operator to increase its share of outgoing calls. Since the share of incoming settlements was determined by the share of outgoing traffic (rule of proportional returns), the old rules in practice made both the call termination and origination markets largely non-competitive.[22]

The new rules do not say how international interconnection should be priced, nor is this required under the agreement. The rules, however, establish that termination charges in Mexico cannot be below the cost incurred in providing this service.[23] This reflects a provision in the telecommunications law aimed at preventing predatory pricing of any telecommunications service by a major supplier. The rules do not say how cost would be determined, but the law refers explicitly to long run average incremental costs. Also, in the explanation of the new rules, reference is made to ITU recommendations towards cost-based interconnection.

Mexican operators reportedly have started to negotiate individually with their counterparts in the U.S. According to COFETEL, prior approval and publication of these agreements, as well as approval of points of international interconnection, have been simplified and expedited. Processing time is reportedly down to about 16 days. Total incoming international traffic in 2004 increased by 31 percent[24] and TELMEX's by 55 percent (TELMEX 2004). This rapid growth is attributed largely to the new rules having reduced the incentive for illegal bypass.[25] Freeing termination charges and ending proportional returns are seen as the main factors (COFETEL 2004b). It is too early to assess the extent to which competitive interconnection charges result in lower prices to users, traffic growth, or changes in market shares.

These improvements are expected to benefit business and residential users of international services and increase competitiveness of the Mexican economy overall. Mexican operating companies with limited direct involvement in the provision of international services but underutilized domestic networks are likely to develop a substantial business as providers of alternative infrastructures to carry international traffic within Mexico. Some of these companies may use this new cash flow to strengthen their presence in the domestic markets, or may become attractive merger or acquisition targets (Carreño et al.2005).

Rules for licensing 'comercializadoras'. COFETEL has submitted to Secretaría de Comunicaciones y Transporte, the line ministry, a draft of the rules to issue licenses to commercial agencies that would be authorized to provide international telecommunications services using the facilities of Mexican concessionaires. The rules would be issued in June 2005.

International simple resale. Mexico continues to prohibit international simple resale, as agreed. The new rules for international telecommunications services are clear on this, both in the explanatory notes and the rules themselves. International interconnection can only take place at gateways approved by COFETEL. Only Mexican companies that have concessions to install, operate, and exploit public telecommunications networks authorized to provide international services can receive authorization to set up international gateways. These gateways must offer interconnection services to all concessionaires without discrimination.

These remaining restrictions, while consistent with the WTO resolution and the agreement with the U.S., constitute important barriers to entry in the international telecommunications services market. Also, TELMEX is by far the largest operator and has control over major network elements and functions that are essential for completing incoming calls. TELMEX's domestic long distance network is the largest in the country and the only one reaching several hundred mid-size and small towns. TELMEX is still the sole provider of local telephones in many places. Observers note that COFETEL has not been particularly successful so far in containing abuse of market power (Carreño et al. 2005).

Implications for Telecommunications Beyond Mexico

The Panel report states clearly that its findings apply solely to the specific case of Mexico brought to its consideration. But insofar as the Panel's analysis and conclusions clarify aspects of both the Reference Paper and the GATS Annex on Telecommunications, it can be expected to have a significant influence on telecommunications policy and regulation beyond the case of Mexico. The following are some examples.

International accounting rates, according to the Panel report, are subject to cost-based interconnection discipline. While countries can continue to use the accounting rate regime as one of the commercial modalities to compensate companies for jointly providing international service, adoption of the Reference Paper requires that such payments to major suppliers be cost-oriented.[26] This adds pressure towards reducing the level of accounting rates, and more generally replacing the accounting rate regime by an interconnection regime as befits an increasingly competitive global telecommunications market. While things have been moving in this direction for some time driven by economic and technological factors, and reflected in guidelines from the ITU and regional organizations, the Panel's ruling is likely to accelerate change (Guermazi 2004).

Regarding interconnection rates, the Panel determined that only costs related to interconnection itself can be reflected in prices that are required under the Reference Paper to be cost-oriented. It is not that the Reference Paper ignores other costs that the supplier must also recover, such as the cost of general network development or of universal service, but rather that they cannot be financed by distorting interconnection price structures. In fact, the Reference Paper explicitly recognizes the right of member countries to maintain universal service programs, provided they are administered in a transparent, non-discriminatory, and competitively neutral manner and are not excessively burdensome (Reference Paper, Section 3). As to how interconnection costs should be determined, the Panel remained silent but commented that long range incremental cost pricing models are consistent with the principle of reflecting on prices only the costs caused by the service. Also the Panel ruling does not mean that prices must be set equal to costs, but rather that prices should bear a clear and reasonable relationship to costs.

The Panel clarified that the benefits of the Annex on Telecommunications accrue to suppliers of basic telecommunications services. Under the GATS Annex on Telecommunications, foreign banks, insurance companies, hotels, transportation companies, and others allowed to provide services in the country, are assured they can use available public telecommunications on reasonable and non-discriminatory conditions to carry out their business. The Panel clarified that this right applies also to foreign providers of scheduled telecommunications services, including using the incumbent's facilities to compete against it. Moreover, the Panel concluded that under the Annex on Telecommunications, which is an integral part of the GATS, even members that have not committed to the Reference Paper are subjected to a price discipline of sorts, for those telecommunications services included in their schedules.[27]

The Panel's ruling may provide a basis for challenging other telecommunications services in other countries.[28] This could be the case of high fixed-to-mobile termination charges and lack of access to leased lines by mobile and Internet service providers. As mobile communication services grow quickly, the terms and conditions of interconnection with fixed networks become critical.[29] Generally subject to lighter regulation than fixed services, the mobile market has in recent years attracted regulatory attention because of multi-country mergers and acquisitions, high termination charges, non-transparent retail tariffs, and disputes over the division of fixed-to-mobile call revenues and technical access. Lack of local access leased circuits for Internet service providers (ISP), or terms and conditions that discriminate in favor of the incumbent's own Internet operation, coupled to prohibition of competing ISPs from building their own networks, have been major factors holding back Internet development in some parts of the world (Serot et al. 2003).

Implications Beyond Telecommunications

The Panel's findings clarify certain aspects of the GATS that are significant beyond the telecommunications sector.

At the core of the Panel's ruling is its conclusion that cross-border market access commitments under the GATS apply even when the supplier is not present in the country where the service is terminated. What gives the service its cross-border nature is that a service contracted in one country is delivered in another. This applies irrespective of whether the originating service supplier has its own operation in the terminating country or makes arrangements with another to deliver the service.[30] This conclusion has potential implications for other networked services industries, such as electricity, transport services, and postal and courier services. Some observers, however, have argued that the services at issue in the case of Mexico were not cross-border services at all but rather domestic services within the U.S. and export interconnection services from Mexico to the U.S (Neven et al. 2005).[31] A widely accepted understanding of the reach of cross-border delivery would have potential implications for electronically delivered content services (Hauser 2004).

Once commitments are agreed and in place, they are interpreted equally strictly for all countries. The GATS gives developing countries special consideration in terms of the pace at which they commit to liberalization. The Panel clarified, however, that this applies only during the negotiation stage, when specific and additional commitments are being traded off among countries. This emphasizes the need for developing countries to understand clearly what they are committing to do, and make sure that they will be able to stand up to those obligations if challenged. Nonetheless, in ruling against the U.S. claims with regard to international simple resale, the Panel clearly indicated a respect for recognizing the line between services that are committed and those that are not.

The Panel also clarified that lack of implementing rules and regulations cannot be used as excuse to delay the effectiveness of market access commitments undertaken in the schedule. Mexico had committed to commercial presence of foreign service providers through 'comercializadoras', essentially non-facilities based operating companies, indicating in the schedule that licensing of such providers would not begin until the regulations were published. But seven years after this commitment became effective, the rules for licensing 'comercializadoras' had not been enacted so none had been licensed. Although the Panel did not say how soon the implementing rules should be in place, it found that seven years was too long. The broad conclusion is that implementing rules should be in place at the time commitments become effective, or *bona fide* action should be underway to have them soon.

Implications Beyond Trade Law

The Panel adopted a wide interpretation of what constitute anti-competitive practices. It ruled that a cartel is a type of practice against which appropriate preventive measures should be maintained, although it is not explicitly mentioned in the Reference Paper. In this respect, the panel clarified that the scope of the obligation to safeguard against anti-competitive practices was comprehensive.

This has proven to be a highly contentious outcome. Some authors believe that the Panel's report will become a landmark for interpreting GATS commitments and look forward to more cases of similar reach and quality of deliberation (Hauser 2004). Others, however, find the Panel to have been exceedingly weak in terms of economic and competition analysis (Marsden 2004, Sidak et al. 2004), offer alternative interpretations of the issues that would have led to very different conclusions (Neven et al. 2005), or worry that dispute settlement panels may create new commitments to open markets where none have been agreed by negotiators (Marsden 2004, Sharma et al. 2004). Some believe the U.S. operating companies, rather than Mexican or U.S. users, will be the primary beneficiaries of the WTO decision, and that more effective competition among U.S. suppliers pursued in the context of U.S. anti-trust law would have had a greater impact than dispute resolution at the level of international trade treaty (Sidak et al. 2004). These and other reservations deserve serious consideration by telecommunications and trade experts, especially as more developing countries commit to further liberalization and global markets become more competitive. It is beyond this note, however, to comment on the relative merits of these views.

The Panel also found that anti-competitive behavior by suppliers of services for which GATS commitments to competitive supply have been undertaken cannot be excused by national law. Specifically, the cartel led by TELMEX was not only tolerated by the government and regulator but was actually mandated by Mexico's rules for international services. Mexico argued that these provisions had been built into the rules precisely to prevent Mexican firms from being played off against one another by powerful foreign operators often acting together. Although this may have been sensible in the early days of opening its markets, and, in fact, was commonly used by suppliers in competitive markets when dealing with monopoly markets, now it is seen in the context of relations between competitive markets to be unduly restrictive.[32]

<u>Issues for the Doha Round</u>

In the ongoing round of trade negotiations, a number of telecommunications-related issues have been tabled.[33] A major negotiating goal, as revealed by country proposals, is to achieve more widespread liberalization of trade in telecommunications services with more countries undertaking commitments. The proposals also seek to revise existing schedules and significantly reduce the number and scope of limitations to both market access and national treatment. The Reference Paper is receiving considerable attention. All negotiating proposals submitted suggested that more governments should undertake the Reference Paper. One proposal (by a middle-income country) suggested converting the Reference Paper to a GATS Annex, hence applicable to all WTO members. Other proposals invite adapting the Reference Paper model to other services sectors (EU 2000, EU 2003, US 2000a).[34]

As the Doha round is unfolding against the backdrop of spectacular technological developments and convergence of networks and services, many countries have tried to reflect these changes in their tabled offers. Many governments have emphasized the importance of telecommunications to take advantage of e-commerce and information and communication technology. Some countries have included Internet-based services in their telecommunications commitments. Other countries have linked their offers in the telecommunications sector to offers in complementary services such as advertising, express delivery, computer and related services, and financial services (US 2000b). Most developing countries are becoming increasingly aware of the potential for telecommunications liberalization to contribute to economic development strategies. As a result, from the vantage point of a variety of different motivations, the telecommunications sector and the prospect of new and improved commitments on telecommunications reform remain a priority in the Doha negotiations.

The Mexico case adds urgency to addressing the tensions between trade and competition law in the telecommunications sector. No consensus has emerged on whether or how to address competition concerns within a global trade framework (Lloyd 1997, Hoekman 1997). The Reference Paper could be seen as a legal instrument that approaches the problem through sector-specific regulatory commitments with competition policy elements. As the Mexico case showed, however, introducing broad competition policy elements such as the notions of major supplier, dominance, essential facilities, and competitive safeguards, even when limited to one specific sector, can raise serious interpretative disputes. Short of a broad competition agreement, some observers suggest, it should be possible to reach consensus on some specific points by revising the GATS rules or providing more details in the Reference Paper or other sector-specific instruments. For example, it could be agreed whether governments are allowed to impose limitations on competition as part of their commitments, or that the GATS does not prejudge what is a cartel and that this is an issue that falls outside the scope of violation cases and hence cannot be litigated under the WTO. The issue is more complex than the specific case of cartels raised in Mexico, and merits a response in the way of a fresh approach to international lawmaking.

Concluding Comments

Undertaking GATS obligations has broad domestic policy implications. The Mexico case unfolded in the context of domestic tensions that commonly arise, in both developed and developing countries, regarding how far, and how fast, governments should move to institute fully competitive legal frameworks for the telecommunications sector. Commitments under GATS to liberalize markets and follow the Reference Paper provide leverage to keep domestic telecommunications reforms on track and resist the inevitable pressures brought to bear by incumbents to slow down or reverse the process. These commitments, however, have an impact well beyond domestic agendas, and should not be undertaken without serious consideration of the capacity and political will to implement them.

The GATS schedules are legally binding and enforceable treaty obligations. The Mexico case illustrates that undertaking and implementing the Reference Paper needs to be given considerable thought and effort. Governments now negotiating new or improved schedules should encourage their trade and telecommunications authorities to work closely together to make sure the trade commitments are consistent with realistic telecommunications reform agendas.[35] Governments will also need to make an informed decision on applying the GATS and Reference Paper principles to the settlement of international traffic. The Panel's interpretation of the interconnection disciplines of the Reference Paper invites a deeper thinking on the importance of early tariff rebalancing and the fate of the accounting rate regime in the context of global transformation of the sector. Given the complexity of these issues, and to help avoid future WTO-related pitfalls, governments may benefit from drawing upon telecommunications and trade expertise to assist them in the planning and implementation of reforms upon which they wish to commit in GATS.

The Reference Paper is a key element of the WTO framework for telecommunications services. While the Reference Paper leaves up to each member country the translation of guidelines into specific measures, the principles are clear, powerful, and, as illustrated by the Mexico case, ultimately enforceable. The Reference Paper provides an important blueprint of best practice for countries in the early stages of designing telecommunications policy, legislation, and regulation, particularly for countries that seek to join the WTO. In this sense, a minimum common denominator of regulatory practice is building up among WTO member countries. Some authors, however, worry that these practices do not do full justice to the challenges faced by developing countries (Henderson et al. 2005). Not all international trade treaties have such an instrument.[36] The GATS Annex on Telecommunications and the Reference Paper have also been used as templates for bilateral and regional trade agreements. More recently, some free trade agreements have improved on or gone beyond these GATS instruments.

Multinational telecommunications companies take GATS seriously. They are well informed of the rights and benefits to which the GATS entitles them. The Mexico case suggests that suppliers are likely to increasingly use GATS commitments to secure markets and pursue GATS benefits. Indeed, many developing countries undertake the GATS commitments in the hope of attracting foreign investment from just such companies. Once having committed, however, countries will find it increasingly difficult to renege on their promises.

The WTO dispute resolution mechanism will continue to be used only sparingly. It is governments, not companies, that have access to the dispute mechanism. A supplier has to convince its government to file a complaint before even the first formal consultative steps take place in the WTO framework. Large markets and those with serious shortfalls in implementing scheduled commitments can expect to be the most likely candidates for future disputes. Among developing countries, issues regarding China, India, and Morocco have been arising (USTR 2004). Moreover, disputes can be resolved through bilateral efforts, without resort to formal WTO procedures, which are costly in terms of human resources and expert advice. Well-tried practices of private sector dispute resolution offer alternatives for dealing with conflicts among operating companies (Bruce et al. 2002).

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Notes

The authors are grateful to Lee Tuthill, Bernard Hoekman, Philip English, and Charles Kenny for valuable comments and suggestions on drafts of this paper.

[1] Attempts at the end of World War II to create an international trade organization to handle the trade aspects of international economic cooperation (as companion to the World Bank and International Monetary Fund) failed. Twenty-three of the 50 participating countries, however, agreed to negotiate to reduce customs tariffs, give an early boost to trade liberalization, and dismantle protectionist trade practices in place since the 1930s. These negotiations led in 1948 to the General Agreement on Tariffs and Trade (GATT). The GATT remained the only multilateral instrument governing international trade from 1948 until the World Trade Organization (WTO) was established in 1995. Eight rounds of multilateral trade negotiations were held under the auspices of the GATT. The Uruguay Round of 1986-94 was the last and most extensive of all. It led to creating the WTO and a new set of agreements. A new trade round, now under the auspices of the WTO, was initiated in Doha, Qatar in 2001 and is still underway. For an introduction to the WTO and links to all major documents see www.wto.org .

[2] Under the General Agreement on Trade in Services (GATS), banks, insurance firms, telecommunications companies, tour operators, hotel chains, transport companies, and other service providers looking to do business abroad enjoy principles of free and fair trade that originally only applied to trade in goods. The GATS is a fairly concise document, 55 pages long in total, of which the main text has 24 pages and the Annex on Telecommunications has less than four pages. The country schedules add several thousand pages. Further details on the GATS are available on http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm6_e.htm .

[3] In lay terms, *most favored nation treatment* means that a member country will accord services and service suppliers of other member countries a treatment no less favorable than it accords to like services and service suppliers of any other country (whether a member or not). With respect to *market access*, a GATS member country must treat services and service suppliers of other member countries not less favorably than as specified in its schedule of specific commitments. *National treatment* means that, in the sectors inscribed in its schedule, a member country will accord services and service suppliers from other member countries a treatment no less favorable than it accords to like services and service suppliers of its own country.

[4] In lay terms, *cross-border* services are supplied from one country to another. *Consumption abroad* means services supplied in one country to consumers coming from another. *Commercial presence* occurs when entities of one country are located in another country where they provide services. And *temporary presence of natural persons* means services provided by nationals of one country in the territory of any other.

[5] An introduction to the WTO dispute settlement mechanism is available on http://www.wto.org/english/thewto_e/whatis_e/tif_e/disp1_e.htm

[6] The 15 countries of the European Communities shared one schedule.

[7] Despite its name, the ABTS is not a specific document. And it is not limited to basic telecommunications, since over 70 percent of schedules also refer to value-added services. A guide to telecommunications in the WTO is found on http://www.wto.org/english/tratop_e/serv_e/telecom_e/telecom_e.htm .

[8] Ten other countries have made commitments on value added services only.

[9] The third parties were Australia, Brazil, Canada, Cuba, the European Communities, Guatemala, Honduras, India, Japan, and Nicaragua.

[10] Loosely speaking, *facilities-based services* are those provided by suppliers using their own networks. *Non-facilities based services*, often referred to as resale, are provided by suppliers primarily using networks owned by others, through leasing or other commercial arrangements.

[11] Between the U.S. and Japan on interconnection, and between the U.S. and the European Communities on standards for licensing mobile services.

[12] Mexico had scheduled cross-border market access commitments, subject to the limitation that "International traffic must be routed through the facilities of an enterprise that has a concession granted by the Ministry of Communications and Transport." Concession was defined as "The granting of a title to install, operate or use a facilities-based public telecommunications network". See Mexico 2004, Schedule of Specific Commitments, section 2C.

[13] WTO 2004, para 7.40.

[14] WTO 2004, para 7.42.

[15] WTO 2004, para 7.203.

[16] The Panel took this view in part from the ITU's Recommendation ITU-T Rec. D.140 of June 2002, which set guidelines for establishing accounting rates for international telephone services.

[17] Ley Federal de Telecomunicaciones, Art. 63. The law gives Comisión Federal de Telecomunicaciones (COFETEL, the regulator) authority to impose on any concessionaire with substantial market power rates that aim at recovering at least the long run average incremental cost of a service. This measure is aimed at preventing predatory pricing.

[18] The accounting rate is the nominal price per unit of traffic agreed upon between two countries for the joint provision of service. Under this mechanism, operators in the originating country compensate operators in the country of destination for providing international circuits and switching capabilities and domestic routing to deliver the call to the recipient. In case traffic in one direction exceeds the other, the operator with more outbound traffic transfers funds to the other operator. The payment is called settlement payment. It usually equals one-half the accounting rate.

[19] TELMEX's two largest competitors were Alestra, a subsidiary of ATT, and Avantel, a subsidiary of MCI (then WorldCom). ATT and MCI are major U.S. firms that had been excluded from TELMEX's partnership with Sprint, another major U.S. firm.

[20] This dispels the view held by some member countries that the Annex on Telecommunications applies only to value-added services, not basic services.

[21] These rules apply to all services and technologies, with a view to facilitating convergence among and between services and networks. The rules are preceded by a detailed explanation of the background and rationales of the old and new rules. See COFTEL 2004. For a discussion of the new rules from the viewpoints of competition law and economics, see Carreño et al. 2005.

[22] This aspect of the old rules was not argued by the parties in the WTO dispute and thus was not considered by the Panel.

[23] COFETEL 2004, Regla 18.

[24] Outgoing traffic increased by only 9 percent. All traffic figures refer to minutes.

[25] By-pass: U.S. carriers, using cross-border private links, can avoid paying the uniform settlement rate and negotiate lower rates directly with Mexican operators. Although illegal in Mexico, this practice was driven by the large margins between termination costs and settlement rates, and attracted small Mexican operators that, because of the proportional return rule, did not benefit as much from the settlement revenues as the incumbent. Illegal bypass reportedly resulted in TELMEX losing in 2003 around $230 million or 20 percent of its revenues from incoming U.S. calls.

[26] This is consistent with ITU guidelines that recommend that accounting rates should be cost-oriented and also now recognize a wide array of options beyond the traditional accounting rates regime.

[27] This, however, is a more flexible concept than that of cost orientation under the Reference Paper.

[28] For example, the U.S. Office of the Trade Representative has identified high fixed-to-mobile charges in Australia, burdensome licensing requirements in Colombia, poor quality and high prices of local access leased lines in Germany, and access deficit charges used in India to finance rural services as situations that could be addressed supported by the Panel's arguments and findings. See USTR 2004.

[29] Fixed-to-mobile termination charges are still well above costs in many countries. While this may have been justified when mobile service was a nascent premium service, by now in many countries there are more mobile than fixed telephone connections and mobile service accounts for a large proportion of total sector revenue.

[30] The Panel stated, among other arguments, that if such were not the case, cross-border market access could only occur together with commercial presence, yet these two modalities have been defined separately in the GATS.

[31] According to this view, the U.S. operator provides a service to a customer located also in the U.S. and purchases termination services from a Mexican operator. The sale of termination services by the Mexican operator is an export to the U.S.. Mexico had not entered into commitments with respect to the export of telecommunications services. Moreover, the Reference Paper does not apply to cross-border supply at all but only to services supplied through commercial presence. See Neven et al. 2005.

[32] This historical perspective eventually was later also expressed by COFETEL as part of the rationale for Mexico's new rules for international telecommunications services.

[33] Under article XIX of the GATS, WTO members committed to the progressive liberalization of services. A new round of services liberalization was launched in early 2000. This GATS 2000 Round was then incorporated in a wider negotiating round launched during the 2001 Doha Ministerial Meeting.
[34] The Dominican Republic, Honduras, and El Salvador propose that the Reference Paper be applied in the tourism sector.
[35] The need to achieve a constructive dialogue between trade negotiators and sector specialists is key to the success of domestic reform through trade liberalization. It is an important challenge of the Doha Round that these two policy communities work in concert. See Mattoo et al. 2003.
[36] The North American Free Trade Agreement (NAFTA), for example, has only rudimentary provisions on telecommunications services and nothing equivalent to the Reference Paper. It has been argued that, for this reason, NAFTA has had little effect on cross-border telecommunications investment and services between the US and Mexico. Rather, it was only once the WTO telecommunications commitments came into force that US investors were able to enter the Mexican telecommunications markets and call charges between both countries began to drop. See Harris 2002.