

**Statement for the Record of Naotaka Matsukata, Ph.D.  
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To the House Committee on the Judiciary**

International Trade and the Online Gaming Case: Preserving the Rules of the System

I am pleased to submit testimony to the committee on a significant matter that demonstrates the relationship between U.S. domestic regulation and our international obligations in commerce and trade. Speaking as a former director of policy planning under United States Trade Representative Robert B. Zoellick, I am grateful to be able to discuss this matter – it is not very often that a trade advisor has the chance to comment on the largest trade dispute in the history of the World Trade Organization.

That assertion might seem a bit strong, but the scope of the issue, in terms of the economic implications, far outpaces any past dispute settled under the World Trade Organization mechanisms. Well worth evaluating, beyond the commercial sanctions now facing the United States in this case, are the policy implications of the Bush Administration's strategy and methods in both the legal and diplomatic phases of the dispute process. It may yet fall to the Congress to restore U.S. respect for, not to mention within, the multilateral trade system before this dispute may be resolved.

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In March of 2003, the Caribbean nation of Antigua and Barbuda initiated WTO dispute proceedings against U.S. federal and state laws that prohibited foreign participation in U.S. Internet gambling markets. The WTO ruled, in a November 2004 dispute panel report, and an April 2005 appellate body decision, that the combination of four U.S. federal criminal laws, the Wire Act, the Travel Act, the Illegal Gambling Business Act and the Interstate Horseracing Act, effectively prohibited the cross-border supply of gambling services to the American marketplace. This constituted a violation of commitments made by the United States in the WTO General Agreement on Trade in Services.

Since 2005, the parties have continued to pursue the dispute. The U.S. failed, in 2006, to comply with the WTO ruling that it correct the domestic statutes to abide by the WTO General Agreement on Trade in Services (GATS). Frustrated by its inability to win a respite from the WTO, the Administration this year took the extraordinary measure of announcing its intention to revoke its commitments on gambling services under that agreement, ratified by Congress in 1994.

This development immediately expanded the impact of the dispute beyond the U.S. and Antigua; under WTO rules, the Administration's decision to withdraw GATS commitments automatically entitled any fellow WTO member country to request compensation for the benefits lost by the action. Subsequently, the EU, Japan, Macau, Costa Rica, India, Australia and Canada joined original disputant Antigua in requesting economic compensation from the United States for the withdrawn trade commitments.

The deadline for these negotiations, conducted under the auspices of WTO arbitrators, is drawing near. Antigua is seeking \$3.4 billion in compensation, while the requests of other countries could exceed \$100 billion. At this time, those countries minimally impacted by the decision, Canada, Australia and Japan, have already informally settled with USTR. It is likely that, for Canada and Australia, some form of protection was afforded through their respective free trade agreements with the United States. As for the remaining countries, most particularly the European Union, which saw companies lose an estimated \$16 billion overnight through the closure of U.S. markets, the Administration has rebuked attempts at a negotiated settlement.

At each step of the process, the Administration has chosen brinkmanship rather than stewardship of the trade system we've so painstakingly constructed over the past six decades. In certain circumstances, this might not be bad trade diplomacy. In this case however, it is potentially disastrous. The WTO found that U.S. gambling laws violated Antigua's trade rights, and ruled the U.S. must reform its laws to comply with its treaty commitments. Compensation arbitration has been extended to December, but if it fails, the aggrieved parties will be entitled to enact sanctions upon the United States to recover their lost benefits. As I stated before, these sanctions could reasonably reach \$100 billion in damages to the U.S. economy. By comparison, in May 2003 the WTO authorized the European Union to enact \$4.034 billion of sanctions on the United States for the failure to reform the Foreign Sales Corporation tax.

Aside from the financial damage, consider the policy implications. Few WTO members will be pleased with this new protectionist precedent, established by none other than the United States. We may count on some countries, however, to be watching the U.S. response to an adverse ruling with great care. China, for instance, continues to complain that its WTO accession commitments have placed a heavy burden on the country, and would clearly welcome a proven method at reducing its obligations in key areas such as agricultural and services trade. Russia, which is now negotiating entry into the WTO, is likely highly receptive to a precedent which would allow Moscow the ability to unilaterally carve back the "commitments" it is now pledging to make to join the club. We should ask whether or not U.S. actions to withdraw our GATS commitments will facilitate similar actions on the part of other trading partners, and, perhaps more importantly, will this action limit our ability to mount an effective response to foreign protectionism. A global trading order doesn't fall all at once, but one rule at a time.

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Fortunately, the legislative branch still retains Constitutional authority over trade and commerce. And it is clear that, over the course of the past year, the Congress has successfully reasserted a significant degree of oversight on trade. Legislative solutions to WTO compliance issues are not uncommon remedies. Congress passed a tax bill in 2006 that repealed corporate tax breaks deemed by the WTO to be illegal export subsidies; this led the European Union to suspend retaliatory trade sanctions. Similarly, in 2005, the

Deficit Reduction Omnibus Reconciliation Act addressed WTO concerns over U.S. trade remedy laws.

The historical record clearly demonstrates that, in past instances where the United States has lost in WTO disputes, the executive branch has not hesitated to turn to the Congress; and that the legislature has, in fact, proven to be the definitive authority for ultimately resolving conflict between U.S. domestic regulation and international law. The apparent unwillingness of the United States Trade Representative to consult with Congress toward a legislative solution on this matter is unusual, unexplained, and deserving of appropriate scrutiny. Why has the USTR pursued a risky legal and negotiating strategy in this instance, and is it fully aware of the potential costs of failure?

The agency still appears disinterested in Congressional involvement – and yet it is here in the Congress that a solution is already at hand. House Financial Services Committee Chairman Barney Frank developed legislation that would license U.S. and foreign companies to provide online gaming services, but would allow non-discriminatory regulation at the state level. The Internet Gambling Regulation and Enforcement Act (HR 2046) would provide a regulatory approach consistent with WTO rules regarding discrimination and market access, but honor the sovereignty of the states with respect to the types of gaming allowed in the jurisdictions.

Furthermore, the Frank bill would subject foreign and domestic gaming operators alike to a fair barrier to market entry that will ensure competition among responsible service providers. A proper licensing regime is a source of consumer protection, law enforcement, and taxation that would remain consistent with treaty obligations ratified by the United States in its accession to the WTO.

I would encourage the committee to consider a legislative solution to this matter of U.S. compliance with our commitments to the World Trade Organization. There is little need for brinkmanship to take the country into another fruitless trade war, nor should the United States create precedents that will allow others the latitude to undo the bipartisan, sixty-year effort to build a durable, rules-based global trading system. Thank you.