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## U.S. Response to Gambling Dispute Reveals Weak Hand

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### Introduction

Antigua and Barbuda, a tiny island nation with about 70,000 inhabitants and an annual gross domestic product of \$900 million, would seem to be no match for the United States in any conflict. But the results so far in a landmark World Trade Organization dispute over Internet gambling support Antigua and Barbuda's claim that it is being unfairly treated by U.S. policies.

The dispute centers on U.S. restrictions on gambling over the Internet and whether the United States has fulfilled its obligations to open its market to foreign suppliers of gambling services. Antigua and Barbuda now dispute that recent U.S. policies, including the recently enacted Unlawful Internet Gambling Enforcement Act of 2006, correct the errant policies. A report from the WTO about whether the United States has complied with the original rulings is due mid-November.

The U.S. government restrictions on Internet gambling raise many questions about America's approach to the supply of gambling services over the Internet. To what extent should Congress regulate the private activities of adults? What scope exists for a WTO member to forbid foreigners to export to it services that domestic companies can provide? What forces are behind the recent ban on Internet gaming? And, in the event that a member (in this case, the United States) is found to be acting in a manner that contravenes its obligations under the WTO, what can other countries legitimately do to effect a resolution?

### The Dispute So Far

The dispute between Antigua and Barbuda and the United States started in 2003, when Antigua and Barbuda, following consultations with the United States in a failed attempt to resolve the matter bilaterally, requested the establishment of a WTO panel (a quasi-judicial body of experts who examine the case and make recommendations). The director general of the WTO composed the panel on August 25, 2003.

According to Antigua and Barbuda, the cumulative effect of measures imposed by the United States and various regional and local authorities was to prevent the cross-border supply of gambling and betting services. The American crackdown on Internet gambling was threatening the livelihood of the thriving online betting services industry in Antigua and Barbuda, where Internet gambling is legal. Antigua and Barbuda alleged that the policies of the United States were inconsistent with its obligations under the General Agreement on Trade in Services, and with the specific commitments that the United States had made under the terms of the GATS to open its market in "recreational, cultural and sporting services."<sup>1</sup> The United States, on the other hand, argued that its policy was in place to protect "public morals and public order," an allowable exception to the WTO rules under certain conditions. The most important of those conditions is nondiscrimination: that, should a member wish to prevent certain goods or services from entering its market, then the restrictions apply to domestic as well as foreign suppliers. According to the panel and the subsequent Appellate Body ruling, however, those conditions were not met by the United States, mainly because the Interstate Horseracing Act of 1978 discriminated against foreign providers of Internet gambling services.<sup>2</sup> The WTO gave the United States until April 3, 2006, to fix the errant policy.

### The Legislative Response of the United States

In response to the adverse ruling, the president of the United States signed the Unlawful Internet Gambling Enforcement Act in October 2006. That act, attached to a law on port security, expands the 1961 Wire Act's prohibition on gambling entities' use of wire-based communications for transmitting bets to include the Internet. The act also forces financial institutions to identify and block gambling-related transactions transmitted through their payment systems. According to a recent article, the United States is an important and lucrative part of the global Internet gambling

market, worth \$15.5 billion in “spend” value (the amount that gambling entities win from their clients).<sup>3</sup>

Doubly irritating for foreign-based Internet gambling providers is the exemption the bill grants for transactions made in accordance with the Interstate Horseracing Act (for example, intrastate online bets made on domestic and some overseas horseracing through U.S. sites such as YouBet.com) and remote gambling conducted by Native American tribal groups. Those exemptions would seem to back the claim by Antigua and Barbuda that the U.S. laws are aimed at discriminating against foreign Internet gambling interests rather than at restricting gambling in general. In short, the new law does not appear to lessen the problem that sparked the dispute in the first place.

There are several things wrong with the U.S. response so far. First, it reeks of hypocrisy. Is online gambling any more or less immoral if the server is located abroad? Allowing state and tribal entities to engage in online gambling (not to mention lotteries and horseracing) but prohibiting foreign operators from running essentially identical operations on “moral” grounds is dubious to say the least.

Second, allowing financial institutions to examine and block transactions that are related to gambling seems a gross trespass on citizens’ privacy. To the extent that some aspects of gambling are a government concern at all, surely allowing companies to set up legal sites in the United States, under proper supervision and regulation to prevent, say, children, from accessing sites, is a less blunt way of limiting the “social ills” that politicians insist come from gambling. The British government, for example, has legalized and licensed Internet gambling and recently hosted a gambling summit to discuss regulating the industry to protect children and otherwise prevent fraud and other crimes such as money laundering. The United States did not participate in that summit.<sup>4</sup>

Third, the ban on Internet gambling and the electronic transfer of funds to finance it provides protection from import competition for the domestic gaming industry at the expense of consumers. Offshore online gambling operations would seem, from the domestic industry’s point of view, to cut into their market share. Assuming there is a fixed demand for gambling services, presumably domestic gaming interests would prefer to have a captive audience and less pressure from competitors to increase their payout rate to consumers.

More indirectly, eBay was a chief proponent of the new act that prohibits online gambling and monetary transfers to pay for it.<sup>5</sup> PayPal, a subsidiary of eBay, has already promised lawmakers that it will bar its customers from using PayPal accounts for Internet gambling and other “adult-oriented” goods and services. Having excluded itself from the market for those types of money transfers, PayPal will gain from this act to the extent that it prevents competitors from gaining market share. To be sure they are complying with the new act’s provisions on identifying and eradicating gambling payments, it is possible that many of PayPal’s competitors will simply ban all transactions with offshore financial payment services. As Radley Balko points out, “Offshore companies like Neteller and FirePay . . . are safe and reliable . . . but aren’t subject to U.S. law, and so can be used for all sorts

of goods and services the U.S. government has determined American’s aren’t grown up enough to purchase . . . [including] Internet gambling.”<sup>6</sup> Limiting competition in online financial services will be a boon to PayPal but a loss for U.S. consumers.

### Options for Antigua and Barbuda

The WTO established another panel in August 2006 to rule on whether the United States has complied with the original WTO rulings. No doubt the new panel will consider the provisions of the recently passed Unlawful Internet Gambling Enforcement Act of 2006 in its deliberations. The report of the compliance panel is due mid-November 2006. If, as expected, the compliance panel finds that the United States has not complied with the rulings, then Antigua and Barbuda can proceed to the next stage of dispute settlement—retaliation.

Retaliation, whereby WTO members are given permission to suspend their obligations (such as a commitment not to increase tariffs) under WTO agreements, usually involves increasing tariffs against imports from the noncompliant member. The object of trade retaliation is to pressure the noncompliant member to reform its errant policies; the sectors targeted for retaliatory tariffs will, according to this theory, provide a counteractive lobby for removing the noncompliant measure.

WTO rules encourage complaining parties to suspend obligations in the same sector in which the original violation occurred. That prevents unlawful distortions in one market from spawning distortions in other markets. However, WTO rules allow the complaining party, should it consider it “not practicable or effective” to suspend concessions or obligations in the same sector, to engage in “cross-retaliation”: to suspend obligations under other agreements.

Complaining parties are more likely to receive authorization to cross-retaliate if the injured sector is sufficiently important to the complaining member to justify cross-retaliation and the new distortions it introduces. Gambling and betting services are the second-largest industry in Antigua and Barbuda, after tourism, so it seems likely that the WTO would allow cross-retaliation in order to elicit corrective action from the United States.<sup>7</sup>

Antigua and Barbuda is reportedly planning to ask for permission to allow intellectual property rights violations against U.S. firms to occur unabated on its territory.<sup>8</sup> Antigua and Barbuda is hesitating to impose punitive tariffs in “retaliation” for the United States’ illegal moves because such tariffs would hurt Antigua and Barbuda’s economy more than they would the American economy and would in any case go unnoticed by the United States. Not enforcing intellectual property rights, however, is more likely to elicit a response from the United States because the powerful motion picture industry and software firms that stand to lose from that sort of activity would presumably put pressure on the U.S. government to reform its Internet gambling laws and settle the dispute.

Two drawbacks of retaliating through intellectual property rights may give pause to Antigua and Barbuda. First, if

piracy is indeed a breeding ground for money laundering and terrorist operations, then encouraging the development of a safe haven for intellectual property rights violators may not be in Antigua and Barbuda's interests. Second, Antigua and Barbuda may decide that suspending its obligation to protect the intellectual property rights of American companies is not in its trading interests. As a recipient of preferential access (lower tariff rates than the most-favored-nation, or general, tariff rates) to the United States through the Caribbean Basin Initiative, Antigua and Barbuda is obliged to protect the intellectual property rights of U.S. companies in order to receive the preferences. Because the CBI is a unilateral (voluntary) program, the United States is free to change the conditions of the preferences, or indeed to suspend the program to any country, at its will and without multilateral consequences. The latest report to Congress on the CBI says that "the President is also authorized to give discretionary weight, in designating CBI beneficiaries, to the extent to which a country provides adequate and effective legal means for foreign nationals to secure, exercise, and enforce intellectual property rights and the extent to which a country prohibits its nationals from broadcasting U.S. copyrighted materials without permission."<sup>9</sup>

Antigua and Barbuda may, under these circumstances, decide that its preferential access to the U.S. market through the CBI is too valuable to risk losing through retaliatory action.

## Conclusion

The ban on Internet gambling is a policy that is not in the interests of the United States. It overreaches into the private lives of citizens—telling them what they can do in their own time in their own homes and with their own money. Second, it is probably counterproductive. Banning gambling sites will likely push Internet gambling from jurisdictions where it is legal and regulated into areas where it is not. If the United States legalized online gambling for adults, then it would be more likely to be able to oversee the industry to prevent adverse possibilities, such as children accessing the sites. Third, and on a broader level, failure to comply with

WTO rulings that show U.S. policies to be against the rules that the United States helped to design paints the United States as hypocritical and undermines faith in the system—a system that depends on the perception that all players, rich and poor, big and small, have rights, as well as obligations and responsibilities. The interests of the United States would be better served by legalizing Internet gambling, with appropriate regulations, and allowing foreign as well as domestic entities to serve the market for online gaming services.

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1. United States of America, Schedule of Specific Commitments, GATS/SC/90, 15 April 1994.
  2. United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services, report of the Appellate Body, WT/DS285/AB/R, 7 April 2005.
  3. Jane Wardell, "Britain Criticizes U.S. Online Gaming Ban As It Prepares for International Summit," October 27, 2006, <http://www.signonsandiego.com/news/tech/20061027-0853-britain-onlinegambling.html>.
  4. Ibid.
  5. Radley Balko, "eBay Invites Internet Regulation, Backs Online Gambling Ban," June 7, 2006, <http://www.foxnews.com/story/0,2933,198610,00.html>.
  6. Ibid.
  7. There has been some precedent for the Dispute Settlement Body of the WTO authorizing such cross-retaliation. Ecuador secured the right to suspend obligations to the European Union under the GATT, the GATS, and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) in its long-running dispute over banana tariffs. Ecuador has, however, so far declined to exercise that right.
  8. Paul Blustein, "Against All Odds: Antigua Besting U.S. in Internet Gambling Case at WTO," *Washington Post*, August 4, 2006.
  9. Office of the United States Trade Representative, "Sixth Report to Congress on the Operation of the Caribbean Basin Economic Recovery Act," December 31, 2005, p. 16, [http://www.ustr.gov/assets/Trade\\_Development/Preference\\_Programs/CBI/asset\\_upload\\_file670\\_8672.pdf](http://www.ustr.gov/assets/Trade_Development/Preference_Programs/CBI/asset_upload_file670_8672.pdf).