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The impact of WTO law on foreign investment: the Walmart/Massmart merger

by Paul Kruger

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www.tralac.org | **info@tralac.org** | **Twitter @tradelawcentre** |

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1. Introduction

The main focus of this paper is the effect that international obligations and commitments can have on the local establishment of foreign companies. The relevance of international commitments made by South Africa at the multilateral level became prevalent during the recent merger between Walmart and Massmart. What is the role, in a merger review process, of international law in domestic proceedings and to what extent should South African Competition Authorities consider the country's obligations made at the multilateral level? The paper aims to answer this question against the backdrop of the Walmart/Massmart merger approval process and the facts applicable in the case. The emphasis is on three pieces of multilateral legislation: the General Agreement on Tariffs and Trade (GATT), the Agreement on Trade-Related Investment Measures (TRIMs) and the General Agreement on Trade in Services (GATS). It was argued during the hearing before the Competition Tribunal that the non-discrimination provisions in GATT Article III and TRIMs Article 2 can have a bearing on the legality of conditions imposed on the merging parties. These provisions deal with trade with goods while GATS Articles II and XVII refer to non-discrimination in the area of trade in services. How do these provisions influence the ability of the South African government to impose performance requirements such as local content on multinationals and foreign companies?

The paper examines the purpose and objectives of the multilateral WTO negotiations and highlights the role of the South African government in the merger review process. It specifically considers investment related obligations and how they relate to the access and treatment of foreign investors and companies. As the merging parties of Walmart and Massmart operate in the wholesale and retail sectors, the relationship between the distribution sector and multilateral agreements is also analysed. The paper considers the extent to which international agreements are part of the domestic regulatory framework in South Africa and how international legislation is domestically incorporated. Specific emphasis is placed on non-discrimination in the context of the multilateral agreements and the behaviour of the host state towards the foreign supplier.

Background

In September 2010, United States based retailer Walmart Stores Inc. made an offer to buy 51 percent of Massmart Holdings, a South African based retailer. The offer of R148 per share valued the deal at around R30 billion. This can be seen as a strategic regional acquisition for expansion into the African market as Massmart is one of the largest distributors of consumer goods in Africa, with a presence in 14 sub-Saharan countries. Due to the size of the deal, competition approval had to be sought in all the countries where Massmart is operating. Despite Massmart's African footprint, South Africa remains by far the most important market in Africa. South Africa is the country of jurisdiction where Massmart is based and listed, and 93 percent of its revenue is generated in this country. From Walmart's own admission, South Africa is believed to be a very sophisticated market with a stable economic, political and regulatory environment and as such seen as an ideal entry point into the region.

In terms of the South African Competition Act (South Africa 1998), a merger occurs when one or more firms directly or indirectly acquire or establish direct or indirect control over the whole or part of the business of another firm. The merger can be achieved through the purchase or lease of shares as was the case with the Walmart offer (Art. 12 (1)). Due to the size of the merger, a certain process is prescribed in the Competition Act to determine the impact of the transaction on competition in the sector. Since the combined turnovers (or assets) of Walmart and Massmart exceed R6.6 billion and the turnover (or assets) of the Massmart (the target firm) is at least R190 million, the merger had to be notified as a large merger. A merger of this size cannot be implemented until it has been approved, with or without conditions by the Competition Commission and the Competition Tribunal (Art. 13A (3)).

After receiving notice of a large merger such as this, the Competition Commission must refer the notice to the Competition Tribunal and Minister of Trade and Industry and within 40 days undertake an investigation to furnish them with a recommendation on the transaction. The Competition Commission must recommend whether the merger should be approved, approved subject to conditions, or prohibited (Art. 14A (1)(b)). In February 2011, the commission concluded its investigation and filed a recommendation that the merger between Walmart and Massmart be approved without conditions. Four trade unions, the South African Commercial, Catering and Allied Workers' Union (SACCAWU), the Food and Allied Workers Union (FAWU), the National Union of

Metalworkers of SA (NUMSA) and the Congress of South African Trade Unions (COSATU), opposed the merger and filed submissions to prohibit the transaction, or alternatively impose conditions to protect employment and local suppliers. Their concern revolved around the 'public interest grounds' as set out in the Competition Act (Art. 12A (3)) and the effect Walmart's entry would have on firms and their employees that are actively involved in the supply chain.

Government also has the right to participate as a party in large merger proceedings to make representation on public interest grounds. However, it did not make any submissions by the deadline for filing recommendations with the tribunal; apparently hoping for certain guarantees to emerge from private discussions between government and Massmart. The tribunal hearing was therefore postponed to May 2011 to allow three government departments – the Economic Development Department, the Department of Trade and Industry and the Department of Agriculture, Forestry and Fisheries – to submit additional discovery applications and expert witness statements. On 31 May 2011, the Competition Tribunal conditionally approved the merger subject to a number of conditions; one of these related to the potential and powerful supply chain practices of Walmart.

Local procurement issues

Local procurement and increased imports were among the issues that were debated before the Competition Commission and Competition Tribunal. There were concerns from the parties opposing the merger that Massmart's use of the Walmart global sourcing model would lead to an increase in direct and indirect imports; there were also concerns about the negative consequence that such a shift would have on local suppliers. It was also feared that competitors in the retail sectors would inevitably have to change their procurement practices and strategy in response to the entry of Walmart, leading to further increases in imports at the expense of local sourcing. To protect the local suppliers, the parties opposing the merger are proposing a preferential procurement quota on the merging parties to source a certain percentage of products locally.

When it comes to the treatment of foreign investment there is an international dimension to the regulation of national markets that has to be considered. During the merger proceedings, it was argued that the restrictions and conditions sought by those opposing the Walmart/Massmart merger would violate GATT Article III and that of the related TRIMs Article II. Another WTO agreement, GATS, was not mentioned during the merger proceedings, despite the fact that South Africa

liberalised its wholesale and retail sectors during the Uruguay Round in the early nineties. The tribunal avoided ruling on the legality of the preferential procurement with respect to WTO law and other trade instruments, except to state that it may add to the problems associated with the imposition of the quotas (Competition Tribunal 2011: par. 112). It is nevertheless important to consider and evaluate the effect of WTO law on the treatment of foreign investment as arguments about international compliance will no doubt arise again.

GATT Article III

GATT Article III sets out the national treatment obligation and prohibits discrimination against imported products, once they are in the domestic market. In general terms, this obligation prohibits WTO member states from treating imported products less favourably than the same domestic products after the products have been imported into the domestic market. The relevant part in GATT Article III(4) states: 'The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable 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'. This section specifically deals with internal regulations as opposed to internal taxes and includes 'laws, regulations and requirements'. The Appellate Body in *Korea – Various measures on Beef* identified three requirements that must be satisfied to test the consistency of an internal regulation: i) the measure must be a 'law, regulation or requirement' as defined in GATT Article III:4; ii) the imported and domestic products must be like products; and iii) the imported products must be treated less favourably than the domestic product.

It can be argued that the preferential sourcing condition pursued by the parties opposing the Walmart/Massmart merger can be classified as a requirement within the meaning of GATT Article III(4). The WTO Panel in *Canada – Foreign Investment Review Act* noted that the manner in which the condition came into being – be that through voluntary submission, encouragement or negotiation – is less important than its enforceability. If the condition formally becomes part of the investment approval process and compliance can be legally enforced, then it will fall under the category of 'requirements'. Investment approval of the Walmart/Massmart merger is conditional on complying with the conditions that are imposed by the Competition Authorities; the tribunal noted in its decision that if there was a material violation of the conditions that would justify the most extreme

remedy – that of divesture – it could easily be achieved by requiring Walmart to sell it shares or part thereof (Competition Tribunal 2011: par.125). One can argue that any condition imposed by the Competition Authorities is monitored and will be enforced if there is not compliance, making it a 'requirement' in the context of GATT Article III:4.

The facts of *Canada – Foreign Investment Review Act* are somewhat similar to the preferential sourcing issue being raised in the Walmart/Massmart merger. The matter concerned the practice of the Canadian government to enter into purchase agreements with foreign investors in which they are expected to set out proposed undertakings on their business conduct after acquisition or establishment. These submissions of undertakings was not required under the Foreign Investment and Review Act but as the administration of the act evolved, the submission became part of nearly all larger investment proposals (WTO Panel Report 1984: par. 2.4). The undertakings with respect to the purchase of goods have been given in a variety of forms and include: best efforts to seek Canadian sources of supply; a certain percentage or amount of Canadian products to be purchased; and the replacement of imports with Canadian made goods (Ibid: par. 2.7). The United States in opposition argued that these written undertakings which oblige investors to purchase goods of Canadian origin in preference to imported goods or in specified amounts or proportions, or to purchase goods from Canadian sources violated GATT Article. III:4 because they constituted requirements giving less favourable treatment to imported products than to like products of national origin (Ibid: par. 3.4).

After determining the meaning of 'requirement' the panel in *Canada – Foreign Investment Review Act* proceeded to examine whether less favourable treatment was accorded to imported products than to like products of Canadian origin in respect of the purchase requirements. In its examination, the panel distinguished between goods of Canadian origin and goods from Canadian sources or suppliers (irrespective of the origin of the goods) and took into account the qualifications 'available', 'reasonably available' and 'competitively available' (WTO Panel Report 1984: par. 105 – 106). The tribunal in the Walmart/Massmart merger also identified the origin problem as the first challenge in establishing if the product is in fact 'locally' produced. The Massmart group supply over 120 000 products of a wide variety, from basic groceries to consumer electronics and building supplies. The tribunal emphasised that determining the extent of local manufacturing per product will be a daunting task (Competition Tribunal 2011: par.104).

As noted in the *Canada – Foreign Investment Review Act* decision, in some cases, the question of less favourable treatment will not arise when like local products are not available (WTO Panel Report 1984: par. 5.8). When these undertakings are conditional on goods being 'competitively available', meaning that in those cases where the imported and domestic products are offered on equivalent terms, the panel found that compliance with such a preferential procurement undertaking would entail giving preference to the domestic product. Whether or not the foreign investor chooses to buy Canadian goods in given practical situations, is not at issue, and the panel noted that the purpose of GATT Article III:4 is not to protect the interests of the foreign investor but to ensure that goods originating in any other contracting party benefit from treatment no less favourable than domestic goods. On the basis of these considerations, the panel found that a requirement to purchase goods of Canadian origin, when subject to 'competitive availability', is contrary to GATT Article III:4. The panel further found that the alternative qualification, 'reasonably available', is also inconsistent with GATT Article III:4, since the undertaking in these cases implies that preference has to be given to Canadian goods even when these are not available on entirely competitive terms (Ibid: par. 5.9). The panel also found that purchase undertakings to buy from Canadian suppliers, regardless of whether the products are from local or foreign origin, would fall foul of GATT Article III:4 (Ibid: par. 5.10).

One key challenge is that the Walmart/Massmart merger case is not dealing with one specific product or group of products, but rather with all the products that Massmart is distributing. To make a determination under GATT Article III, it is likely that each group of products will have to be examined to decide on a course of action. It may therefore be more useful to focus on the actions of the retailer and not on the products themselves.[1]

TRIMs

The *Canada – Foreign Investment Review Act* was decided before the introduction of TRIMs and therefore only dealt with discrimination in the context of GATT Article III. The WTO does not directly deal with the issue of investment, but TRIMs regulates certain investment aspects to a limited degree. The agreement, like GATT, only applied to measures that affect the trade in goods and only insofar as the investment measures have a trade restrictive and distorting effect. TRIMs Article 2 states that no WTO member shall apply a measure that is prohibited by the provisions of GATT Article III (national treatment) or GATT Article XI (quantitative restrictions). Although TRIMs does not

[1] See the section below on 'The relationship between GATT, TRIMs and GATS'.

create any new obligations, it clarifies some of the responsibilities members already have regarding certain performance requirements. The agreement does not define the term 'investment measures' but instead provides an Illustrative list of TRIMs considered to be inconsistent with the GATT provisions. Measures broadly identified in the illustrative list as inconsistent with GATT Article III and IX include requirements for local content, trade balancing, import substitution, foreign exchange, and export limitation requirements. Local content requirements are defined in Article 1(a) of the Illustrative List as the 'TRIMs…which are mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage, and which require: (a) the purchase or use by an enterprise of products of domestic origin or from any domestic source, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production'. Accordingly, local content requirements are not allowed as these will afford foreign products less favourable treatment than those produced domestically.

In analysing the Illustrative List it becomes clear that it not only clarifies GATT Article III:4 but that it also set out a non-exhaustive list of what measures are *per se* inconsistent with GATT Article III:4. The Illustrative List does not provide any additional legal effect but rather defines the types of illegal investment measures (Breuss et al. 2003). When faced with a claim under both GATT Article III:4 and TRIMs Article 2, the Panel in *Indonesia – Autos* decided to first address the claim under TRIMs, as this agreement is more specific than GATT Article III:4. The panel nevertheless found that these two agreements remain distinct and independent sets of provisions under the WTO and even if either of the two sets of provisions were not applicable the other one would remain applicable (WTO Panel Report 1998: par. 14.62). It followed a similar approach as the Appellate Body in *EC – Bananas III*, where the more specific provision was examined first.[2] Therefore each claim has to be addressed separately; if TRIMs does not apply, it is still possible that the measure can be inconsistent with GATT Article III:4. In *Indonesia – Autos,* the panel found the local content requirements of Canada to be inconsistent with TRIMs and therefore viewed it unnecessary to consider the claim under GATT Article III:4. It noted that 'action to remedy the inconsistencies that we have found with Indonesia's

[2] The Appellate Body discussed the relationship between Article X of GATT and Article 1.3 of the Licensing Agreement and concluded that the more specific Licensing Agreement should be applied first.

obligations under the TRIMs Agreement would necessarily remedy any inconsistency that we might find with the provisions of Article III:4 of GATT' (Ibid: par. 14.93).

However, both panels in *Canada – Autos* and *India – Autos* questioned if the TRIMs Agreement can be characterised as being more specific than GATT Article III:4 in respect of the claims raised by the complainants. The panel in *India – Autos* was not convinced that the TRIMs Agreement could inherently be characterised as more specific than the relevant GATT provisions but argued that it might be more specific in that it provides additional rules concerning the specific matter it covers (WTO Panel Report 2001: par. 7.157). It noted, however, that there is nothing improper in either addressing the GATT claims or the TRIMs claims first (Ibid: par. 7.160).

GATS

GATS also addresses investment aspects to a certain extent as it allows WTO member states to impose conditions regarding market entry and participation of foreign investors in the services sectors. Sector-specific policies can therefore be accommodated by listing such conditions in the particular state's 'schedule of specific commitments'. Limitations stipulated as part of these commitments will reserve the right for the government in question to apply certain market access and national treatment measures designed to protect local industries. As part of the GATS negotiations in the early nineties, South Africa was free to decide how far to liberalise its services industries and what restrictions to place on foreign suppliers and services. The distribution sector, which included wholesale and retail services, was identified as a sector to be liberalised, most likely with the hope of attracting foreign investment. In the context of GATS, distribution services include the selling of merchandise to retailers, to industrial, commercial, institutional or other professional business users, or to other wholesalers, or acting as agent or broker (wholesaling services). It further covers the selling of merchandise for personal or household consumption (retailing services).[3]

[3] See Section 6 of the of the Provisional CPC List. Section 6 of the CPC (where wholesale and retail services are defined) is broken down into further groups and sub-groupings. An explanation note is provided for each sub-grouping, and in the case of distribution services, often with another reference to the CPC classification of the goods being distributed. For example, CPC 62221 is the classification for 'Wholesale trade services of fruit and vegetables' and is explained as 'specialized wholesale services of fresh, dried, frozen or canned fruits and vegetables. (Goods classified in CPC 012, 013, 213, 215)'. The goods classification in the explanatory note refers to vegetables (CPC 012), fruit and nuts (CPC 013), prepared and preserved vegetables (CPC 213), and prepared and preserved fruit and nuts (CPC 215). So too is the classification for retail sales of fruit and vegetables (CPC 63101) defined as 'retailing services of fresh, dried, frozen or canned fruits, nuts and vegetables (Goods classified in CPC 012, 013, 213, 215)'. For more information, see the CPC list at United Nations 1989.

GATS regulates trade in services, but it is important to note that 'distribution services' are about the distribution of physical goods, and not the distribution of services.[4] The Appellate Body, in the case of *China – Measures affecting the trading rights and distribution services for certain publications and audiovisual entertainment products* found that distribution services (with reference to China's GATS Schedule) cover the distribution of physical goods (WTO Appellate Body Report 2009: par. 371). The panel in the same case held a similar view and furthermore noted that such an 'approach is enshrined in the W/120 and reproduced by various Members in their schedules of commitments under the GATS' (Ibid: footnote 359). Although Walmart is the biggest retailer in the world, it does not 'make' a single thing. All it makes is a super-efficient supply chain – by distributing goods across the globe involving hundreds of suppliers, distributors, port operations, customs operations, forwards and carriers in a finely tuned supply chain (Friedman 2005).

GATS Mode 3 deals directly with foreign investment through the concept of 'commercial presence' as a means for foreign investors to supply services in the domestic market.[5] Mode 3 is defined in GATS Article I.2(c) as the supply of a service 'by a services supplier of one Member, through commercial presence in the territory of another Member'. Commercial presence is further defined in GATS Article XXVIII as 'any type of business or professional establishment, including through i) the constitution, acquisition or maintenance of a juridical person, or ii) the creation or maintenance of a branch or a representative office'. In the light of this definition the acquisition of Massmart by Walmart seems to fall quite clearly within the scope of services supplied through Mode 3. Looking at the GATS liberalisation commitments made by South Africa, one finds that it has fully liberalised Mode 3 (commercial presence) in the subsectors of wholesale and retail services under the distribution sector. As a result of the liberalisation commitments made in its schedule of specific commitments, the South African government is prohibited from denying market access to foreign wholesalers and retailers, or to discriminate against them once inside the domestic market. Should

[4] It should also be noted that distribution services involve sales from both a fixed location and away from a fixed location. Therefore distribution services would also include electronic commerce to the extent that it covers the online sale of goods that are subsequently delivered or picked-up. It also includes direct selling which generally involve the sale of goods directly to consumers in their homes, away from permanent retail locations. See WTO (2010).

[5] As the conventional definition of trade – where a product crosses the border – would miss out on a whole range of international transactions, GATS takes a wider view of services trade, which is defined to include four modes of supply. The definition in GATS Article I:2 is not only limited to cross-border flows of services (Mode 1) but also includes consumer movements to consume services abroad (Mode 2), the presence of foreign commercial entities within the territory of another member state (Mode 3) and the movement of foreign natural persons to supply services (Mode 4). The inclusion of modes 2, 3 and 4 reflects the need for the supplier and the consumer to be simultaneously present when conducting a transaction. This need for proximity also explains why GATS applies not only to the treatment of services, but also to the treatment of services suppliers.

Walmart's entry into the South African market be refused, or if it is discriminated against, South Africa will in principle be violating its GATS obligations which may lead to dispute settlement proceedings under the WTO.

Subject to a country's specific commitments, GATS Article XVII (national treatment) sets out a three-tier test of consistency to determine the applicability of the national treatment principle and the existence of discrimination. The test is similar to the one for determining inconsistency under GATT Article III and requires the examination of whether: 1) the measure in issue affects trade in services; 2) foreign and domestic services suppliers or services are 'like' services suppliers or services; and 3) foreign services suppliers or services are being granted 'treatment no less favourable'. The national treatment obligation does not have general application; it is conditional only to the extent that member states have committed themselves. Therefore the first question in a dispute would be if South Africa actually committed the relevant subsectors and mode of supply. As set out in the earlier paragraphs, South Africa fully liberalised the relevant mode of supply (Mode 3) of the wholesale and retail trade services, both in the areas of market access and national treatment. These commitments were also approved by parliament in accordance with the Constitution (Section 231).

The second part of an investigation questions whether the measure under consideration affects the supply of trade in services. The Appellate Body in the *Canada – Autos* case recommended that at least two different issues must be examined to determine whether a measure is one affecting trade in services: i) whether there is trade in services in the sense of GATS Article I:2 and ii) whether the measure in fact affects such trade in services within the meaning of GATS Article I:1 (WTO Appellate Body 2000a: par. 155). The Walmart/Massmart merger concerns the commercial establishment (Mode 3) which includes the acquisition of a juridical person while the relevant 'trade in services' in this case is the supply of 'wholesale trade services', 'food retailing services' and 'non-food retailing services' in South Africa. Regarding the second part of the question, it is important to note that GATS takes the broad view in defining a 'measure' and includes 'any measure by a Member, whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form'.[6] The national Competition Act falls within the category of laws and regulations, and the decision of

[6] Recall the determination of the panel in the *EC – Bananas* III case: 'No measures are excluded *a priori* from the scope of the GATS as defined by its provisions. The scope of the GATS encompasses any measure of a Member to the extent it affects the supply of a service regardless of whether such measure directly governs the supply of a service or whether it regulates other matters but nevertheless affects trade in services'. The Appellate Body in *EC – Bananas III* upheld the finding of the panel and added that the focus should be on how the measure affects the supply of the service or the services supplier involved (WTO Appellate body: Report 1997: par. 220).

the Competition Tribunal within the categories of decisions and administrative actions. The scope in GATS is far wider and clearer than the scope set out in GATT (Art. III:4) which only refers to 'regulations, laws and requirements'. It can therefore be argued that in whatever form the preferential procurement or local content requirements are proposed or enforced by the Competition Authorities, it will affect the supply of distribution services. This point of view is shared by Ehlermann and Ehring (2002) who argue that competition law and practices are subject to the application of the dispute settlement system. Both competition laws and their application must comply with the current substantive standards in the WTO agreements and complaints can be brought against both (Ehlermann and Ehring 2002).

The third question that needed to be addressed in order to test consistency with the national treatment principle is whether foreign and domestic services suppliers or services are 'like' services suppliers or services. However, the determination of likeness under GATS gives rise to a wide range of questions and uncertainties due to the more complex nature of the services trade. The intangibility of services, the difficulty to draw a line between products and production of services, the existence of the four modes of supply, the combined reference to services and services suppliers, a lack of a detailed nomenclature and the customised nature of many transactions are some factors complicating the task of establishing likeness in services trade (Cossy 2006). Factors commonly used in GATT practice to determine likeness include the customs classification, end use and properties of the product, and the quality and nature of the product. It can therefore be argued that relevant factors to determine likeness under GATS can include examination on the characteristic of the services and services suppliers; the classification of the services according to the CPC list; and the consumer habits and preferences in consuming the services. Other factors such as the size of the companies, their use of technology, nature of expertise, and regional strategies can also be taken into account.

The final question to address is whether the foreign service of the services supplier is granted treatment that is less favourable than provided for by their domestic counterparts. With regard to trade in goods, this concept of 'treatment no less favourable' has been interpreted to involve an inquiry into whether the conditions of competition have been modified to the disadvantage of the imported product/importer (WTO Appellate Body Report 2000b: par. 144). The Appellate Body in *Japan – Alcoholic Beverages* stated that the question is not whether there is protective effect, in the sense that certain volumes are guaranteed, but the question is rather whether competitive

opportunities are guaranteed. The regulatory distinction may thus lead to less favourable treatment, even if there are no actual changes in trade volumes noticeable (De Meester 2007: footnote 100). GATS case law around 'treatment no less favourable' has not been fully developed but as a general stance the Appellate Body has confirmed that the jurisprudence on a national treatment provision in one WTO agreement may be useful in interpreting a national treatment provision in another WTO agreement, at least where the relevant provisions use similar language (Ortino 2006). Ortino (2006) also argues that the key criterion in determining less favourable treatment is the disproportionate adverse impact a measure has on foreign services and foreign services suppliers. However, in *Canada - Autos* the causal link is emphasised; the measure in issue needs to be the cause of the adverse impact (Ibid).

The examples of GATT, TRIMs and GATS above mainly deal with the adjudication through the panel system which is subject to appeal under the Appellate Body. As a first step, member states which have a grievance are required to enter into consultations with each other (WTO 1994: Art. 4). If the consultations do not lead to a constructive result, the aggrieved member state has the right to request the establishment of a panel to adjudicate upon the matter (Ibid: Art. 6). Other techniques to resolve disputes include good offices, conciliation and mediation and arbitration (Ibid: Art. 5).

The relationship between GATT, TRIMs and GATS

The Appellate Body in *Canada – Periodicals* confirmed that obligations under the GATT and GATS can coexist and that the one does not override the other. In *EC – Bananas III* the Appellate Body agreed with the conclusion reached in *Canada – Periodicals* (WTO Appellate Body 1997: par. 221) and stated:

Given the respective scope of application of the two agreements, they may or may not overlap, depending on the nature of the measures at issue. Certain measures could be found to fall exclusively within the scope of the GATT 1994, when they affect trade in goods as goods. Certain measures could be found to fall exclusively within the scope of the GATS, when they affect the supply of services as services. There is yet a third category of measures that could be found to fall within the scope of both the GATT 1994 and the GATS. These are measures that involve a service relating to a particular good or a service supplied in conjunction with a particular good. In all such cases in this third category, the measure in question could be scrutinized under both the GATT 1994

and the GATS. However, while the same measure could be scrutinized under both agreements, the specific aspects of that measure examined under each agreement could be different. Under the GATT 1994, the focus is on how the measure affects the goods involved. Under the GATS, the focus is on how the measure affects the supply of the service or the service suppliers involved. Whether a certain measure affecting the supply of a service related to a particular good is scrutinized under the GATT 1994 or the GATS, or both, is a matter that can only be determined on a case-by-case basis.

Based on the facts and the preferential procurement proposal in the Walmart/Massmart case, which of the WTO agreements would be more relevant to determine consistency with the rules? The Appellate Body in *EC – Bananas III* devised a test to be applied when deciding on the order of addressing two or more provisions from different WTO agreements that appear *a priori* to apply to the measure in question. According to the Appellate Body, the provision from the agreement that 'deals specifically, and in detail' with the measure, should be analysed first (WTO Appellate Body Report 2008: par, 7.99). Looking at the applicability of the agreements, one finds that GATS is wider in scope; GATT is only concerned with measures affecting the products, while the obligations in GATS not only pertain to the measures affecting the services, but also the measures affecting the services suppliers themselves. TRIMs also explicitly states the agreement only 'applies to investment measures related to trade in goods'. It is implicit that certain investment incentives and performance requirements are excluded from its scope.

One of the issues to address when determining incompatibly with the GATT/TRIMs rules is likeness of the products at issue: the imported and domestic products must be like products. According to the evidence presented in the Walmart/Massmart merger, Massmart currently stocks 120 000 products from 4500 suppliers. The procurement conditions proposed by parties opposing the merger varied during the course of the merger process, but the final proposal by the South African Clothing and Textile Workers Union (SACTWU) team was regarded by the tribunal as the most considered proposal, as it took into account certain criticisms from the merging parties. The principle behind the suggested proposal is to hold the merging parties to the existing volume of local procurement for a certain period of time. It is accepted that the merging parties cannot be subjected to a more stringent regime of local procurement than Massmart currently has, as the conditions must address harms that are merger specific and not pre-existing harms (Competition Tribunal 2011: par. 101 – 102). Therefore one needs to determine Massmart's local procurement level pre-merger and hold that in place for some period of time going forward (Ibid: par. 103). This will be determined on a

whole and won't delve into the detailed product lines. It can be argued that the preferential procurement condition is a restriction placed on the sourcing behaviour of the merging parties themselves, rather than a restriction placed on a particular product or range of products.

For the reasons set out above, it can be argued that based on the facts of the Walmart/Massmart merger, GATS seems to be more directly and specifically applicable than GATT or TRIMs. If South Africa made no commitments in the wholesale and retail sector, the response will differ and it would make sense to approach the matter differently. WTO dispute case law dictates that the sequence should be based on the facts and circumstances of each case. If the court finds no violation in the context of GATS, it will proceed to adjudicate the matter on GATT principles, and even on those of TRIMs in the final instance if necessary. It is merely a procedural issue; and as stated by the Appellate Body, there will be nothing improper in addressing either of the claims first (WTO Panel Report 2001: par. 7.160).

The Congress of South African Trade Unions (COSATU) recently urged all retailers, local and foreign, to carry a 75 percent quota of locally produced products on their shelves. The proposal seems to imitate Malaysian policy where department stores, supermarkets and hypermarkets are required to allocate at least 30 percent of their shelf space to products manufactured by locally owned small- and medium-sized enterprises. This suggestion targets all retailers in general and seems to take into account the criticism of discrimination levelled against the imposing preferential procurement conditions only on foreign entities. This poses the question: would the proposal to impose a preferential procurement quota across the board for local and foreign retailers violate WTO law?

When deciding the consistency of the more recent procurement proposal with GATS, it has to be determined whether the foreign supplier is granted treatment that is less favourable than provided for their domestic counterparts. In this case, because foreign suppliers and domestic suppliers are being treated equally, there will be no discrimination. Foreign retailers as well as domestic retailers are required to source 75 percent of their products in the local market, meaning there is no discrimination between foreign and domestic suppliers. GATS recognises the right of member states to regulate and to introduce new regulations on the supply of services within their territories in order to meet national policy objectives, as long as this is done in line with the obligations of the agreement. This amended proposal considers the GATS inconsistencies, but what about GATT and TRIMs?

In the case of GATT Article III(4), the test is whether the imported product is treated less favourably than the domestic product. The analysis shifts from the services supplier in GATS to the product itself in GATT. Even if there is no discrimination between foreign and domestic suppliers, the possibility remains that there is discrimination between the foreign and domestic products. As discussed in the preceding paragraphs, the panel in *Canada – Foreign Investment Review Act* that found an undertaking by investors to purchase goods from Canadian sources violated GATT Article III:4 because they constituted requirements giving less favourable treatment to imported products than to like products of national origin (Panel Report 1984: par. 3.4 WTO). The Panel in *Japan – Alcoholic Beverages* reiterated that the objective of GATT Article III is to oblige WTO member states to provide equality of competitive conditions for imported products in relation to domestic products. This was confirmed by the panel in *Korea Beef* who agreed that the object of GATT Article III:4 was to guarantee effective market access to imported products and to ensure that the latter are offered the same market opportunities as domestic products. The panel added that regulations providing for the 'segregation of imported products on the domestic market limit the possibility for consumers to compare imported and domestic products and effectively base their consumption choice on the differences in quality, characteristic and prices of products (either domestic or imported). Thereby they reduce opportunities for imported products to compete directly with domestic products'. In both cases the emphasis was on the product itself rather than the producer or distributor of that product. In the context of the TRIMs which is closely related to GATT Article III:4, the panel in *Indonesia – Autos* also found that 'investment measures' in the context of TRIMs are not limited to measures specifically applying to foreign investment. It noted that nothing in the TRIMs Agreement suggests that the nationality of the ownership of enterprises subject to a particular measure is an element in deciding whether that measure is covered by the agreement (WTO Panel Report 1998: par 14.73). For these reasons it can be argued that even the local procurement policy proposed by COSATU that will affect all retailers is also in danger of contravening GATT rules. The proposal may fix the inconsistencies with South Africa's GATS commitments, but compatibility will still have to be tested against GATT Article III:4 and TRIMs Article 2.

However, one cannot help wondering about the Malaysian situation – the guidelines specifically state that department stores, supermarkets and hypermarkets are required to allocate at least 30 percent of their shelf space to products manufactured by locally owned small- and medium-sized enterprises. In the context of GATS, Malaysia is allowed to maintain these discriminatory measures

because it did not make any commitments in the area of distribution services – an important distinction. This means that Malaysia has the necessary policy space to maintain or introduce discriminatory measures in the area of wholesale and retail trade services due to scope of its commitments made at the multilateral level. But what about Malaysia's obligations under GATT; does it contravene the discrimination principle in GATT Article III:4 or TRIMs Article 2?

The Malaysian New Economic Policy (NEP) was a socioeconomic restructuring plan launched in 1971 with the view to redistribute wealth and economic opportunities to the local Bumiputera (literally translated as 'sons of the land'). The goal of the government was that the indigenous people manage at least 30 percent of total the commercial and industrial activities in all categories and scale of operation. The NEP ended in the 1990a and was replaced by the National Development Policy to continue pursuing economic reform; but the 30 percent target remained. One can also assume this is how the shelf allocation of 30 percent was calculated. The Malaysian 'Guidelines on foreign participation in the distributive trade services Malaysia' prescribes certain minimum capital and equity requirements for foreign investment in the distribution sector. Any hypermarket, department store or superstore must provide for at least 30 percent Bumiputera equity while the capital requirements are set between R20 million and R50 million. In addition to the capital and equity requirements, the guidelines also include discriminatory measures such as a) the appointment of Bumiputera director(s); b) the hiring of personnel at all levels, including management, to reflect the racial composition of the Malaysian population; c) the formulation of clear policies and plans to assist Bumiputera participation in the distributive trade sector; d) the hiring of persons with disabilities to make up at least 1 percent of the total hypermarket workforce ; e) an increase in the use of local airports and ports in the export and import of the goods; and f) the utilisation of local companies for legal and other professional services which are available in Malaysia (Malaysian Ministry of Domestic Trade Co-operatives and Consumerism 2010).

The Malaysian government clearly framed these restrictions in the context of trade in services. This can also be inferred from the manner in which Malaysia approached the regional Association of South-East Asian Nations (ASEAN) services negotiations. The above-mentioned restrictions were included in the regional services schedules while this empowerment strategy was explicitly set out in the horizontal section[7]: 'Any measure and special preference granted to Bumiputera, Bumiputera

[7] Reservations in the horizontal section automatically apply across all schedules services sectors.

status companies, trust companies and institutions set up to meet the objectives of the New Economic Policy (NEP) and the National Development Policy (NDP) shall be unbound'. TRIMs deals with investment in trade in goods industries, while GATS deals with investment in trade in services industries. But aside from being an investment issue, a preferential procurement policy also relates to the treatment of foreign products. The distribution sector is unique in the sense that it is actually a service that concerns the trading of physical goods. Therefore, on a literal reading of GATT Article III:4, it can be argued that the lines between the distribution sector in GATS and the treatment of products in GATT become blurred: 'The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable 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' (emphasis added). The question will be whether the restrictions placed on the distribution of the physical product are an internal measure that affords protection to the domestic industry.

The preferential procurement condition in the Malaysian guidelines changed somewhat from the 2004 version where, in addition to the 30 percent required shelf space, stores were also required for at least 30 percent of their sales to consist of Bumiputera products. Here the emphasis was not only on stocking the products but also promoting them effectively to ensure the necessary threshold of sales. This requirement, which did not take into account the discretionary behaviour on the part of the consumers, was scrapped in the 2010 revision of the guidelines. The 30 percent threshold applied in the distribution sector is nevertheless consistent with the affirmative policies applied in other economic sectors; and it can be argued that the preferential procurement requirements are maintained in line with the objectives of Malaysia's affirmative action policies. This is opposed to the across-the-board 75 percent threshold proposal of the South African labour unions. The proposal does not specifically focus on the Historically Disadvantaged Individuals (HDI) as defined in the enabling Black Economic Empowerment (BEE) legislation.

During the appeal hearing, legal counsel for the South African government nevertheless argued that there was scope within the WTO framework to pursue the objective of redressing 'negative economic effects of apartheid by promoting employment among historically disadvantaged groups'. GATT and GATS provide a number of specific instances in which member states may be exempted from WTO rules. However, application of inconsistent measures will not be allowed easily as demonstrated by the chapeau in the introductory paragraphs of both GATT Article XX and GATS

Article XIV: 'Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade...' In principle, South Africa would be able to raise its BEE policy as defence (Kruger 2011), but in this specific instance the basis for such a claim can be questioned. The Malaysian policy is more likely to succeed as an exception since there is evidence to support that the preferential procurement policy was implemented in line with its empowerment objectives. In determining the necessity of the preferential procurement measure, WTO courts will consider a member's characterisation of a measure's objectives and of the effectiveness of its regulatory approach – as evidenced, for example, by texts of statutes, legislative history, and pronouncements of government agencies or officials (Appellate Body Report: par. 304). To finally qualify for an exception, any measure also has to satisfy the requirements of the chapeau, as the introductory part is worded to prevent abuse of the exceptions. Exceptions to WTO rules have been interpreted strictly in past dispute settlement cases and it is unlikely that a claim will succeed based on behaviour that is arbitrary or discriminatory.

Conclusion

Preferential procurement and even 'buy local' policies have the potential to conflict with both GATT and GATS rules. The distribution sector is an interesting case study as it concerns the distribution of physical products and the products themselves. It is therefore possible that a case against South Africa can be brought under GATS, and alternatively under GATT and TRIMs. According to the case law discussed in the paper, it is likely that a claim will first and foremost be decided under the GATS rules as they are more directly and more specifically applicable than the GATT or TRIMs rules. WTO dispute case law dictates that the sequence should be based on the facts and circumstances of each case. If the court finds no violation in the context of GATS, it will proceed to adjudicate the matter on GATT, and even on TRIMs principles in the final instance if necessary. It is merely a procedural issue; and as stated by the Appellate Body, there will be nothing improper in addressing either of the claims first. However, based on the facts in the Walmart/Massmart merger, it can be argued that the GATS rules are more relevant since South Africa made very specific commitments in the area of wholesale and retail trade services. It can further be argued that the preferential procurement condition is a restriction placed on the sourcing behaviour of the merging parties themselves, rather

than a restriction placed on a particular product or range of products, making GATS – which deals with service suppliers – more applicable in this case.

Despite the emphasis being on the manner in which suppliers supply their services, GATT can nevertheless have an impact on investment considerations as illustrated by WTO jurisprudence. The distribution sector is unique in the sense that GATT Article III refers to the 'distribution' of like products, causing some kind of overlap between the two agreements. For that reason the preferential procurement policy of Malaysia as discussed in the final section of the paper must be flagged. Malaysia's situation is however unique, as the local procurement policy seems to be maintained under the auspices of its affirmative action measures. The focus of the Malaysian policy is on small and medium enterprises while the threshold employed is far lower than the one proposed in South Africa. This raises further questions around the trade impact of the preferential policy and whether it affords real protection to the domestic industry. In this context, a claim against Malaysia will have to be decided in the context of GATT and TRIMs as Malaysia excluded the distribution sector from liberalisation under GATS. This can possibly lead to difficulties in the methodology of determining 'like products' as products will have to be compared on a group basis rather than on an item-by-item basis. The Malaysian situation nevertheless remains an interesting case study on implementing and managing a preferential procurement policy.

The fact remains that the international dimension to the regulation of national market cannot be disregarded, as shown by WTO jurisprudence. WTO practice relies on the presumption that member states comply with international obligations in good faith and avoid behaviour that violates international law. South Africa made certain commitments in the context of the WTO, which have a permanent and continued impact on the measures taken by the South African government and authorities, as well as by non-governmental bodies in the exercise of delegated powers. These include measures taken by the Competition Commission and the Competition Tribunal which are statutory bodies constituted in terms of the Competition Act and empowered by the government. Competition laws and their application have to comply with WTO law and ultimately any violation can lead to dispute settlement proceedings under the WTO. This partly explains why the Competition Tribunal was careful to rule on the legality of the preferential procurement with respect to international law. There seems to be a recent trend amongst African countries towards greater protectionism, particularly regarding local content issues, but any strategy or policy still needs to comply with WTO law – a reality that the South African Competition Authorities understand.

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