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The National Treatment Principle in International Trade Law

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THE NATIONAL TREATMENT PRINCIPLE IN INTERNATIONAL TRADE LAW

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I. Introduction

The National Treatment principle, along with the Most-Favoured-Nation (MFN) principle, constitute the two pillars of the non-discrimination principle that is widely seen as the foundation of the GATT/WTO multilateral trading regime.

The National Treatment principle has an ancient genesis in international trade law, arguably dating back to ancient Hebrew Law[1] and then appearing in agreements between Italian city states in the 11th Century[2], in commercial treaties concluded during the 12th Century between England and continental powers and cities[3], and in agreements among German city states constituting the Hanseatic league from the 12th Century onwards[4]. The principle was also adopted in various shipping treaties entered into between European powers in the 17th and 18th centuries[5], and became commonplace in the trade treaties drawn up in large numbers in the latter part of the 19th century[6], as well as appearing in the Paris and Berne Conventions governing intellectual property rights entered into late in the 19th century[7].

While the principle was heavily undermined in the protectionist policies that characterized international trading relations between the two World Wars[8], bilateral trade agreements negotiated by the U.S. with various trading partners pursuant to the Reciprocal Trade Agreements Act of 1934 typically included some form of the National Treatment principle[9], and

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[1] See William Smith Culbertson, *International Economic Policies: A Survey of the Economics of Diplomacy* (D. Appleton Company, 1925), at page 24.
[2] See Michael M. Hart, "The Mercantilist's Lament: National Treatment and Modern Trade Negotiations" in *Journal of World Trade Law*, Vol. 21, No. 6, Dec. 1987, at page 38.
[3] See Georg Schwarzenberger, "The Most-Favoured-Nation Treatment in British State Practice" in *The British Yearbook of International Law*, XXII, 1945, at page 97.
[4]See G. Erler, *Grundprobleme des Internationalen Wirtschaftsrechts* (Gottingen, 1956), page 47, cited by Pieter VerLoren van Themaat in *The Changing Structure of International Economic Law* (Hague: Martinus Nijhoff, 1981), at page 19.
[5] See Georg Schwarzenberger, "The Principles and Standards of International Economic Law", in *RECUEIL DES COURS,* Vol. I, 1966, Academie De Droit International, Hague, at page 80; W. McClure, "German-American Commercial Relations", *American Journal of International Law,* Vol. 19, 1925, at page 692; and William Smith Culbertson, supra note 1.
[6] Ibid; see also Gerard Curzon, *Multilateral Commercial Diplomacy* (London: Michael Joseph, 1965), at page 15, and Pieter VerLoren van Themaat, supra note 4.
[7] See Article 2 of the Paris Convention for the Protection of Industrial Property of March 20, 1883; and Article 5 of the Berne Convention for the Protection of Literary and Artistic Works of September 9, 1886.
[8] Clair Wilcox, *A Charter for World Trade* (Macmillan Company, 1949), at page 3; see also Gerard Curzon, supra note 6, and Michael M. Hart, supra note 2 at page 42.
[9] Henry Joseph Tasca, *The Reciprocal Trade Policy of the United States: A Study in Trade Philosophy* (University of Pennsylvania Press, 1938), at page 18; see also John H. Jackson, *World Trade and the Law of GATT* (The Bobbs-Merrill Company, 1969), at page 37.

the U.S. insisted on its incorporation in the GATT as one of its fundamental principles[10]. The principal initial rationale for the principle was to protect concessions reflected in tariff bindings from being undermined by internal taxes or other regulatory measures that replicated the protectionist effect of the previous tariffs[11]. However, on the insistence of the U.S., the principle of National Treatment was applied not only to cases of imports that were subject to tariff bindings but extended to internal taxes and other regulatory measures that had a protectionist or discriminatory impact on imports[12], even in the absence of such bindings, apparently on the assumption that protectionist policies should be channelled into border measures, especially tariffs, that could then be subject to subsequent negotiated reductions and bindings

During the early years of the GATT, the principal impediment to imports was high tariffs, and the preoccupation of the GATT members was negotiating reductions in these tariffs on an MFN basis[13], leaving a relatively minor role for the National Treatment principle in disciplining protectionism or discrimination in international trade. However, with the success of the GATT in reducing tariffs to very low levels by the 1980s[14], the National Treatment principle began to emerge as an important source of discipline on residual forms of protectionism or discrimination that lay beyond or within each member country's borders.

The principle of National Treatment as embodied in Article III of General Agreement on Tariffs and Trade (GATT) prohibits discrimination between domestic and foreign goods in the application of internal taxation and government regulations after the foreign goods satisfy customs measures at the border. Article III:1 prohibits the application of internal taxes and other internal charges as well as the laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, to imported or domestic products so as to afford protection to domestic production. Article III:2, first sentence, prohibits the direct or indirect application of internal taxes or other internal charges of any kind to imported products in excess of those applied, directly or indirectly, to like domestic products. Article III:2, second sentence, prohibits the

[10] See John H. Jackson; supra note 9, at pages 276-278.
[11] Ibid, see also Kenneth D. Dam, *The GATT Law and International Economic Organization* (University of Chicago Press, 1970), at pages 6-12.
[12] Ibid.
[13] See Michael M. Hart, supra note 2, at pages 44-46, and Michael J. Trebilcock and Robert Howse, *The Regulation of International Trade* (New York: Routledge, 1999), 2nd edition, at Chapter 5, Pages 112-134.
[14] Ibid.

application of internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in Article III:1. The explanatory note added to Article III:2 states that a tax conforming to the requirements of Article III:2, first sentence, would be considered to be inconsistent with the provisions of the second sentence only in cases where competition was involved between, on the one hand, the taxed products and, on the other hand, directly competitive or substitutable products that were not similarly taxed. Article III:4 prohibits the accordance of less favourable treatment to imported products 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.

According to Professor John H. Jackson, "one of the more difficult conceptual problems of GATT rules is the application of the National Treatment obligation in the context of a national regulation or tax which on its face appears to be non-discriminatory, but because of various circumstances of the market place or otherwise has the effect of tilting the scales against imported products"[15]. He claims that because of the language found in GATT Article III paragraph 1 prohibiting taxes or other regulations arranged "so as to afford protection", it could be strongly argued under the GATT that even though a tax (or regulation) appears on its face to be non-discriminatory, if it has the effect of affording protection, and this effect is not essential to a valid regulatory purpose (as suggested in Article XX), then such tax or regulation is inconsistent with GATT obligations.[16] However, in a situation where the discrimination is made not on the basis of origin of products but on the basis of some other characteristics, it is not easy to distinguish between necessary and legitimate discrimination and illegitimate and trade-restrictive discrimination. Aaditya Mattoo and Arvind Subramanian argue that a difficulty lies in distinguishing between two types of situations—one, a non-protectionist government cannot prevent certain domestic policies from incidentally discriminating against foreign competitors; and two, a protectionist government uses a legitimate objective as an excuse to design domestic policies which inhibit foreign competition[17]. They claim that the challenge is to devise

[15] John H. Jackson, "National Treatment Obligations and Non-tariff Barriers", *Michigan Journal of International Law,* Vol. 10, No. 1, Winter 1989, at page 212.
[16] Ibid.
[17] See Aaditya Mattoo and Arvind Subramanian, "Regulatory Autonomy and Multilateral Disciplines: The Dilemma and a Possible Resolution", *Journal of International Economic Law,* Vol. 1, No. 2, at page 303.

international rules which are sensitive to the difference between these two situations, exonerating the former while preventing the latter[18].

Under the GATT and WTO dispute settlement systems, the issues of both explicit discrimination, where internal tax and regulatory measures provide explicitly different standards for foreign products as opposed to the standards applicable to domestic products, and implicit or origin neutral discrimination, where an internal tax or regulatory measure makes no distinction as to the origin of products but such a measure has a disparate or disproportionate impact on imported products, have been challenged before GATT panels as well as WTO panels and the Appellate Body.[19] According to Hudec, the GATT was more preoccupied with explicit or *de jure* discriminatory measures than implicit or *de facto* discrimination[20]. He claims that of the first 207 legal complaints filed with the GATT between 1948 and 1990, only a small number of complaints involved claims of *de facto* discrimination by internal regulatory measures[21]. According to him, the first affirmative ruling sustaining a claim of *de facto* discrimination with regard to an internal regulatory measure was the 1987 panel decision in *Japan – Customs Duties, Taxes And Labelling Practices On Imported Wines And Alcoholic Beverages* (hereinafter Japan Alcoholic Beverages)[22]. However, as Maruyama argues,[23] this trend has changed since 1990 and the WTO dispute settlement system has been more concerned with facially neutral rather than explicitly discriminatory internal tax or regulatory measures.

This paper first reviews the GATT panel case law on facially non-discriminatory internal tax and regulatory measures in Section II and then provides a similar review of more recent WTO panel and Appellate Body case law in Section III. Section IV provides a critique of this case law, arguing that it has inconsistently adopted literalist, regulatory purpose and economic approaches to the interpretation of Article III that have been insufficiently informed by a purposive interpretation of the provisions of Article III, reflecting the anti-protectionist purpose identified in Article I:1. The paper argues for an economically-oriented test of "like products" in Article III:2 and III:4 that turns on an existing or potential competitive relationship between

[18] Ibid.
[19] See Robert Hudec, "GATT/WTO Constrains on National Regulation: Requiem for an 'Aim and Effects' Test" in Hudec, *Essays on the Nature of International Trade Law* (Cameron May, 1999), at page 360.
[20] Ibid, at page 363.
[21] Ibid.
[22] Ibid.
[23] He claims that starting in the mid-1980s, the GATT, and subsequently the WTO, expanded the National Treatment obligation of the GATT to effectively address *de facto* discrimination, see Warren H. Maruyama, "A New Pillar of the WTO: Sound Science" in 32 *International Lawyer* 651 (Fall 1998).

imported and domestic products. Similarly, it argues for an economically-oriented test of less favourable treatment of imported products in Article III:2 and III:4 that focuses on whether challenged measures disturb the competitive equilibrium between imported and domestic products by imposing competitive burdens on the former that are not borne by the latter. Finally, it acknowledges that there may be a need to accommodate incidentally adverse impacts on imported products produced by domestic measures primarily aimed at non-protectionist policy objectives and not at restricting imports but which incidentally and unavoidably have this effect. This paper does not explore, other than incidentally, the relationship between Article III and Article XX (the Exceptions provision), Article III and Article XI (the prohibition on quantitative restrictions), or Article III and the provisions of the WTO TBT, SPS or GATS Agreements.

II. Facially Neutral Tax or Regulatory Measures and the Principle of National Treatment Under the GATT Dispute Settlement System

As noted above, the question of the legitimacy of a regulatory measure that does not explicitly distinguish between foreign and domestic products but distinguishes on the basis of some characteristics or set of characteristics of the products arises when such a measure imposes burdens or has a disparate impact on foreign products. The central issue with regard to such a question is the criteria according to which the burdens or disparate impact on foreign products are determined to be illegitimate or contrary to the principle of National Treatment[24]. According to Hudec, the central finding required in this regard is the conclusion that imports are being treated less favourably than domestic products, and the primary sources of differential impact in facially neutral regulatory measures are the distinctions these measures make between one class of products and another[25]. He claims that the finding of discrimination ultimately rests on a finding that the product distinction is illegitimate[26].

Mattoo and Subramanian also accept that "a determination under Article III hinges on determining whether or not the imported product and its domestic comparator are 'like' each other"[27]. They argue that GATT panels lurched between two different doctrinal approaches,

[24] See Hudec, supra note 19, at page 364.
[25] Ibid.
[26] Ibid.
[27] See Aaditya Mattoo and Arvind Subramanian, supra note 17, at pages 303-304.

which they describe as the 'textual' and 'contextual' approaches, to interpreting 'like products'[28]. They cite the example of the Panel Report in *Japan Alcoholic Beverages* as exemplifying the 'textual approach' in its sharpest form and the example of the Panel Report in *United States- Measures Affecting Alcoholic and Malt Beverages* (hereinafter U.S. Malt Beverages) as having introduced and the unadopted Panel Report in *United States- Taxes on Automobiles* as having fully expressed the 'contextual approach'[29]. According to them, these approaches have the followings features[30]:

> The textual approach has the following features: first, it defines likeness *a priori* in terms of one or a combination of product characteristics, its end use and its tariff classification; second it makes a distinction between 'like' products and 'directly competitive or substitutable' products in a manner faithful to the two sentences in Article III: 2, and applies different standards of discrimination to the two cases; third, it preserves a distinct role for Article XX and other exceptions provisions in that they could come into play once (and only after) a measure is deemed to transgress Articles III.
>
> The contextual approach has the following features: first, it does not attempt to define likeness *a priori*; rather it allows *any* distinction to be made between products on regulatory grounds; and second, the standard for determining whether an infraction of Article III has occurred is to ensure that no protectionist intent underlies the distinction nor that any protectionist effect follows from it. In effect, this gives governments the freedom to define likeness, thereby permitting a larger set of measures to be deemed origin-neutral, and *prima facie*, consistent with Article III.

Japan Alcoholic Beverages[31] was the first significant case brought before the GATT that involved the issue of facially neutral measures and that led to an affirmative ruling sustaining a claim that such measures were contrary to the principle of National Treatment set out in Article III of GATT. The issue in this case was an internal tax measure that classified alcoholic beverages into different categories, sub-categories and grades, based on alcohol content and other qualities, and set different tax rates on each category of alcoholic beverages. The European Communities complained that the Japanese liquor tax system violated the first sentence of

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[28] Ibid.
[29] Ibid, at page 305.
[30] Ibid.
[31] Panel Report adopted on Nov 10, 1987, see GATT, BISD 34S/83; see also Pierre Pescatore, William J. Davey and Andreas F. Lowenfeld (hereinafter Pescatore, Davey and Lowenfeld), *Handbook of WTO/GATT Dispute Settlement* (Transnational Publishers, 2000), Volume 2. For a brief commentary on this case see Robert Hudec, *Enforcing International Trade Law: The Evolution of the Modern GATT Legal System* (Butterworth Legal Publishers, 1993), at pages 212-214.

Article III:2, by taxing imports at higher rates than 'like' domestic products, and the second sentence of Article III:2 by affording protection to 'directly competitive or substitutable' domestic products. Japan responded by arguing that each contracting party to the GATT was free to classify products for tax purposes as it chose and that the 'likeness' or 'directly competitive or substitutable' relationship of imported and domestic products were legally irrelevant to the interpretation of Article III if both of these products were taxed in a non-discriminatory manner, regardless of their origin.

The panel concluded that the ordinary meaning of Article III:2 in the light of its object and purpose[32]supported the practice of examining the conformity of internal taxes with Article III:2 by determining, firstly, whether the taxed imported and domestic products were "like" or "directly competitive or substitutable", and, secondly, whether the taxation was discriminatory (first sentence) or protective (second sentence). The panel began its examination of the 'likeness' of products by noting that GATT contracting parties had never developed a general definition of the term "like products." However, it found the prior GATT decisions on this question were made on a case-by-case basis after examining a number of relevant factors. It cited the Working Party Report on "Border Tax Adjustments" adopted in 1970 (BISD 18S/102) which concluded that problems arising from the interpretation of the terms "like" or "similar" products should be examined on a case-by-case basis using the following criteria: (i) the product's end uses in a given market, (ii) consumers' tastes and habits which change from country to country, and (iii) the product's properties, nature and quality. It applied the above criteria and other criteria recognized in previous GATT practice, such as Customs Co-operation Council nomenclature for the classification of goods in customs tariffs, to determine whether the alcoholic beverages classified by Japanese law into different categories, sub-categories and grades were 'like' products. The panel concluded, in view of their similar properties, end-uses and usually uniform classification in tariff nomenclatures, that imported and Japanese-made gin, vodka, whisky, grape brandy, other fruit brandy, certain classic liqueurs, unsweetened still wine and sparkling wines should be considered as 'like' products in terms of Article III:2 first sentence because such

[32] The panel stated the following in regard to the context, purpose and object of Article III:2:

> Just as Article I:1 was generally construed, in order to protect the competitive benefits accruing from reciprocal tariff bindings, as prohibiting "tariff specialization" discriminating against "like" products, only the literal interpretation of Article III:2 as prohibiting "internal tax specialization" discriminating against "like" products could ensure that the reasonable expectation, protected under GATT Article XXIII, of competitive benefits accruing under tariff concessions would not be nullified or impaired by internal tax discrimination against like products.

'likeness' of these alcoholic beverages were recognized not only by governments for the purposes of tariff and statistical nomenclature, but also by consumers to constitute "each in its end-use a well defined and single product intended for drinking" and that minor differences in taste, colour and other properties did not prevent products from qualifying as 'like products'. The panel did not rule out the possibility of considering other alcoholic beverages as 'like products' and it was of the view that the "likeness" of the products must be examined taking into account not only objective criteria, such as manufacturing and composition processes of products, but also subjective consumer viewpoints, such as consumption and use by consumers. However, the panel cautioned that consumer habits were variable in time and space and differential taxes could be used to crystallize consumer preferences for traditional domestic products. It argued that "like" products do not become "unlike" merely because of differences in local consumer traditions within a country or differences in their prices, which were often influenced by government measures (e.g. customs duties) and market conditions (e.g. supply and demand, sales margins).

The panel further concluded that even if imported alcoholic beverages, e.g. vodka, were not considered to be 'like' Japanese alcoholic beverages, e.g. shochu, flexibility in the use of alcoholic drinks and their common characteristics often offered an alternative choice for consumers leading to a competitive relationship. In the view of the panel, under Article III:2 second sentence, there was direct competition or substitutability[33] between imported and Japanese made distilled liquors including all grades of whiskies/brandies, vodka and shochu, among each other; imported and Japanese-made liqueurs among each other; imported and Japanese-made sweetened and unsweetened wines among each other; and imported and Japanese-made sparkling wines among each other.

After having compared the imported and domestic alcoholic beverages to determine their 'likeness' or 'directly competitive or substitutable relationship', the panel next proceeded to a comparison of the fiscal burdens on the products at issue in the dispute. The panel noted that Article III: 2 first sentence prohibited the direct or indirect imposition of "internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products". Thus, a prohibition of tax discrimination was strict. Even very small tax differentials

[33] According to the panel, the increasing imports of 'Western-style' alcoholic beverages into Japan bore witness to this competitive relationship and to the potential product substitution through trade among various alcoholic beverages.

were prohibited, and a *de minimis* argument based on allegedly minimal trade effects was not relevant. In assessing whether there was tax discrimination, account was to be taken not only of the rate of the applicable internal tax but also of taxation methods (e.g. different kinds of internal taxes, direct taxation of the finished product or indirect taxation by taxing the raw materials used in the product during the various stages of its production) and of the rules for tax collection (e.g. basis of assessment). After having noted that Japanese specific tax rates on imported and Japanese special grade whiskies/brandies were considerably higher than the tax rates on first and second grade whiskies/brandies, the panel found that these tax differentials did not correspond to objective differences between the various distilled liquors, for instance non-discriminatory taxation of their respective alcohol contents. In the opinion of the panel, as a result of this differential taxation of 'like products', almost all whiskies/brandies imported from EEC were subject to the higher rates of taxes whereas more than half of whiskies/brandies produced in Japan benefited from considerably lower rates of taxes, and thus, the whiskies/ brandies imported from the EEC were subject to internal Japanese taxes in excess of those applied to like domestic products in the sense of Article III:2, first sentence.

With regard to the mixed system of specific and *ad valorem* taxes adopted by Japan, the panel was of the view that such a mixed system was not as such inconsistent with Article III:2 because it prohibited only discriminatory or protective taxation of imported products but not the use of differentiated taxation methods, provided the differentiated taxation methods did not result in discriminatory or protective taxation. Since the *ad valorem* taxes were not applied to all liquor categories such as the traditional Japanese products shochu, mirin and sake, the panel found that the differences as to the applicability and non-taxable thresholds of the *ad valorem* taxes were not based on corresponding objective product differences, such as alcohol content, nor formed part of a general system of internal taxation equally applied in a trade-neutral manner to all 'like' or 'directly competitive' liquors. For this reason and for the reason that liquors above the non-taxable thresholds were subjected to *ad valorem* taxes in excess of the specific taxes on 'like' liquors below the threshold, the panel concluded that the imposition of *ad valorem* taxes on wines, spirits and liqueurs imported from EEC was inconsistent with Article III:2, first sentence. Regarding the different methods of calculating *ad valorem* taxes on imported and domestic liquors, the panel agreed that Article III:2 did not prescribe the use of any specific method or system of taxation. There could be objective reasons proper to the tax in question, which could

justify or necessitate differences in the system of taxation for imported and for domestic products. It could be also compatible with Article III: 2 to allow two different methods of calculation of price for tax purposes. What mattered was whether the application of the different taxation methods actually had a discriminatory or protective effect against imported products.

Under the first sentence of Article III:2, the tax on the imported product and the tax on the like domestic product had to be equal in effect, but Article III:2, second sentence, prohibited only the application of internal taxes to imported or domestic products in a manner "so as to afford protection to domestic production." Small tax differentials could influence the competitive relationship between directly competing products, but the existence of protective taxation could be established "only in light of the particular circumstances of each case" and "there could be a *de minimis* level below which a tax difference ceases to have the protective effect" prohibited by Article III: 2, second sentence.

The panel found that the Japanese tax system was applied "so as to afford protection to domestic production" because of considerably lower specific tax rates on domestic products, and the imposition of high *ad valorem* taxes on most imported products but the absence of *ad valorem* taxes on most domestic products. Similarly, the product taxed at lower rates was almost exclusively produced in Japan, and the mutual substitutability of domestic products with imported products was illustrated by increasing imports of like products and consumer use. According to the panel, Article III:2 protects expectations on the competitive relationship between imported and domestic products rather than expectations on trade volumes. Therefore, it was not necessary to examine the quantitative trade effects of these tax differentials for its conclusion that the application of considerably lower internal taxes by Japan on exclusively domestic products than on directly competitive or substitutable imported products had trade-distorting effects affording protection to domestic production contrary to Article III:2, second sentence.

Japan Alcoholic Beverages was related to internal tax measures and to the issues required to be examined in determining the consistency or inconsistency of such a measure with Article III:2. Since the language of Article III:4 which is related to non-tax regulatory measures is different from that of Article III:2, particularly in regard to the treatment required to be provided to the imported products compared to the domestic products, it is necessary to examine

separately how the GATT panels interpreted Article III:4 in the context of determining the consistency of a facially neutral regulatory measure with the National Treatment principle[34].

Although the regulatory measures in dispute were based on the country of origin of products, U.S.- *Section 337 of the Tariff Act of 1930* (hereinafter U.S. – Section 337)[35] was an important GATT case with regard to the issues required to be examined in determining the consistency of a non-tax regulatory measure with Article III:4. In this case, the panel had to determine whether U.S. patent enforcement procedures, which were formally different for imported and domestic products, violated Article III:4.

Since there was no dispute on the 'likeness' of domestic and imported products affected by the measure, the panel mainly examined the meaning of the terms "laws, regulations and requirements" and "no less favourable treatment" as provided in Article III:4, and how an assessment should be made as to whether the regulatory measure in dispute does or does not accord imported products less favourable treatment than that accorded to 'like' domestic products. With regard to the meaning of the terms "laws, regulations and requirements", the panel concluded that not only substantive laws, regulations and requirements but also procedural laws, regulations and requirements are covered by Article III:4. According to the panel, Article III:4 is intended to cover not only the laws and regulations which directly govern the conditions of sale or purchase but also any laws or regulations which might adversely modify the conditions of competition between the domestic and imported products on the internal market.

With regard to the "no less favourable treatment" standard of Article III:4, the panel stated that the "no less favourable treatment" requirement set out in Article III:4 is unqualified as an expression of the underlying principle of equality of treatment of imported products as compared to the treatment given to the domestic products. According to the panel, the words "treatment no less favourable" call for effective equality of opportunities for imported products, as a minimum permissible standard, in respect of the application of laws, regulations and requirements affecting the internal sale, purchase, transportation, distribution or use of products. The panel said:

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[34] We are mindful of the fact that GATT and WTO panels and Appellate Body have not made any distinction as such between the explicit discrimination by regulatory measures based on nationality or country of origin of the products and implicit discrimination by facially neutral regulatory measures in the course of determining the consistency or inconsistency of a regulatory measure with Article III of GATT.

[35] Report of the Panel adopted on November 7, 1989, see GATT, BISD 36S/345, see Pescatore, Davey and Lowenfeld, supra note 31.

> On the one hand, contracting parties may apply to imported products different formal legal requirements if doing so would accord imported products more favourable treatment. On the other hand, it also has to be recognised that there may be cases where the application of formally identical legal provisions would in practice accord less favourable treatment to imported products and a contracting party might thus have to apply different legal provisions to imported products to ensure that the treatment accorded them is in fact no less favourable.

Therefore, according to the panel, the mere fact that imported products are subject to legal provisions that are different from those applying to domestic products is in itself not conclusive in establishing inconsistency with Article III:4. With regard to the issue of how an assessment should be made as to whether the regulatory measure in dispute accords imported products less favourable treatment than that accorded to 'like' domestic products, the panel rejected the respondent's claim that this determination could only be made on the basis of an examination of the actual effects of the regulatory measure. Relying on the previous panel decision in *United States- Taxes on Petroleum and Certain Imported Substances* (GATT, BISD 34S/136, 138, Report of the Panel adopted on June 17, 1987) that the purpose of Article III is to protect expectations on the competitive relationship between imported and domestic products, the panel concluded that in order to establish whether the "no less favourable" treatment standard of Article III:4 is met, it had to assess whether or not the contested regulatory measure in itself may lead to the application to imported products of treatment less favourable than that accorded to domestic products. Any decision in this regard should be based on the distinctions made by the contested measure itself and on its potential impact rather than on the actual consequences for specific imported products or actual trade effects.

United States- Restrictions on Imports of Tuna[36] was a significant, but controversial, GATT case involving the issue of "like products" within the meaning of Article III:4. Although the main contested issue in this case was whether the measures prohibiting certain yellowfin tuna and tuna products from Mexico on the ground that the tunas were caught by a dolphin-unfriendly process were internal quantitative restrictions on imports under Article XI or internal regulations under Article III:4 and the panel concluded that the measures did not constitute internal regulations covered by Article III:4, the panel made an alternate ruling on the issue of the US measures' consistency with Article III:4 and concluded that even if the contested measures were

[36] *United States- Restrictions on Imports of Tuna* (1991) 30 I.L.M. 1594. The Panel ruling in this case was not formally adopted by the GATT Council.

regarded as internal regulations under Article III:4, they would still not meet the requirement of Article III. Giving the reasons for such a conclusion, the panel said:

> Article III:4 calls for a comparison of the treatment of imported tuna as a product with that of domestic tuna as a product. Regulations governing the taking of dolphins incidental to the taking of tuna could not possibly affect tuna as a product. Article III:4 therefore obliges the United States to accord treatment to Mexican tuna no less favourable than that accorded to United States tuna, whether or not the incidental taking of dolphins by Mexican vessels corresponds to that of United States vessels.

The panel in this case clearly implied that that the difference in fishing methods do not make the two tuna products unlike products within the meaning of Article III:4, but the product-process distinction drawn in this case has been the subject of intense subsequent controversy[37], as we discuss further below.

U.S. Malt Beverages case[38] was another significant GATT case involving facially neutral measures. The test applied to determine the consistency or inconsistency of such measures with Article III was significantly different from that applied in the above cases. In this case, Canada had complained, among other things, that a lower tax rate applied by the state of Mississippi to wines made from a certain variety of grape discriminated against 'like' Canadian products and was therefore inconsistent with Article III:1 and Article III:2, and that restrictions on points of sale, distribution and labelling based on the alcohol content of beer above 3.2% by weight maintained by some U.S. states were inconsistent with Article III:4 since all beer, whether containing an alcohol content of above or below the said level, were 'like' products and an alcohol level of 3.2% was entirely arbitrary. The panel in this case considered that Canada's claim depended upon whether wine imported from Canada was 'like' the domestic wine in Mississippi made from the specified variety of grape that qualified for special tax treatment, and noted that past decisions on the question of 'likeness' had been made on a case-by-case basis after examining a number of relevant criteria, such as the product's end-uses in a given market,

[37] See e.g. Robert E. Hudec, "The Product-Process Doctrine in GATT/WTO Jurisprudence," in Marco Bronckers and Reinhard Quick (eds.), *New Directions in International Economic Law: Essays in Honour of John. H Jackson* (Kluwer Law International, 2000); Robert Howse and Donald Regan, "The Product-Process Distinction: An Illusory Basis for Disciplining Unilateralism in Trade Policy," (2000) 11 *European Journal of International Law* 249; and Henry L. Thaggert, "A Closer Look at the Tuna-Dolphin Case: "Like Products" and "Extrajuridictionality" in the Trade and Environment Context" in James Cameron, Paul Demaret and Damien Geradin (ed.), *Trade and the Environment: The Search for Balance* (Wm Gaunt & Sons, 1994), Vol. I, at page 69.

[38] Report of the Panel adopted on 19 June 1992, GATT, BISD 39S/206; see also Pescatore, Davey and Lowenfeld, supra note 31, at DD88/1.

consumers' tastes and habits, and the product's properties, nature and quality. However, it considered that the 'like' product determination under Article III:2 should have regard to the purpose of the Article, which was not to prevent contracting parties from using their fiscal and regulatory powers for purposes other than to afford protection to domestic production. The panel concluded that the purpose of Article III was not to prevent contracting parties from differentiating between different product categories for policy purposes unrelated to the protection of domestic production. Consequently, in determining whether two products subject to different treatment were like products, it was necessary to consider whether such product differentiation was being made "so as to afford protection to domestic production". Unlike *Japan Alcoholic Beverages*, the panel began its examination by looking into the rationality of the product differentiation made by the Mississippi wine tax law. The panel found that the special treatment accorded to wine produced from a particular type of grape grown only in the South-eastern United States and Mediterranean region was a rather exceptional basis for a tax distinction, and that this particular tax treatment implied a geographical distinction which afforded protection to local production of wine to the disadvantage of wine produced where the type of grape could not be grown. Since tariff nomenclatures and tax laws, including those at the U.S. federal and state level, did not generally make such a distinction between still wines on the basis of the variety of grape used in their production, and the U.S. also did not claim any public policy purpose for the tax provision other than to subsidize small local producers, the panel concluded that unsweetened still wines were 'like' products and that the particular distinction in the Mississippi law in favour of still wine of a local variety must be presumed to afford protection to Mississippi vintners. Therefore, according to the panel, the lower rate of excise tax applied by Mississippi to wine produced from the specified variety of grape was inconsistent with Article III:2, first sentence[39].

On the issue of whether the restrictions on points of sale, distribution and labelling based on the alcohol content of beer were inconsistent with Article III:4, the panel again examined, first, the rationality of the regulatory measure in making a distinction between low alcohol beer and high alcohol beer and then, the competitive effects of such regulations. It stated that the

[39] In panel's view, even if the wine produced from the specified variety of grape were to be considered unlike other wine, the two kinds of wine would still have to be regarded as "directly competitive" products in terms of Article III:2, second sentence, and the imposition of a higher tax on directly competing imported wine so as to afford protection to domestic production would have been inconsistent with that provision.

purpose of Article III was not to harmonize the internal taxes and regulations of contracting parties. In the view of panel, it was imperative that the 'like' product determination in the context of Article III be made in such a way that it does not unnecessarily infringe upon the regulatory authority and domestic policy options of contracting parties. Therefore, even if low alcohol beer and high alcohol beer were similar on the basis of their physical characteristics, they need not be considered as 'like' products in terms of Article III:4 if the differentiation in the treatment of low alcohol beer and high alcohol beer was not such 'as to afford protection to domestic production'.

In determining the validity of the regulatory distinction based on the alcohol content of beer, the panel examined the issue of whether the aims and effects of such regulatory measure showed that it was applied so as to favour domestic producers over foreign producers. From the legislative history of relevant laws, the panel found that the policy background of the laws distinguishing alcohol content of beer was the protection of human health and public morals or the promotion of a new source of government revenue, and the alcohol content of beer had not been singled out as a means of favouring domestic producers over foreign producers. With respect to the effects of the regulatory measure, the panel found that Canadian and U.S. beer manufacturers produced both high and low alcohol content beer, and that the regulatory measure did not differentiate between imported and domestic beer as such, so that where a state law limited the points of sale of high alcohol content beer or maintained different labelling requirements for such beer, that law applied to all high alcohol content beer, regardless of its origin. Similarly, the burdens resulting from the measures did not fall more heavily on Canadian than U.S. producers and despite the physical similarities and overlapping in the market for the two types of beer, there was a certain degree of market differentiation or specialization[40]. Therefore, according to the panel, the regulatory measures were consistent with Article III.4.

The "aims-and-effects" approach to determining 'likeness' that was applied for the first time in *U.S. Malt Beverages* was also applied and elaborated on in the unadopted GATT panel decision in *United States: Taxes on Automobiles*[41]. In this case, the EEC had complained against U.S. regulations that imposed a luxury excise tax and gas-guzzler tax on domestic and imported automobiles on the basis of their value and gasoline consumption per mile. The threshold value

[40] In the panel's view, consumers who purchased low alcohol beer might be unlikely to purchase beer with high alcohol and vice-versa, and the advertising and marketing by manufacturers showed such different market segments.
[41] See GATT Doc. DS31/R, 29 September 1994. For an analysis and critique of this case, see Mattoo and Subramanian, supra note 17; and James H. Snelson, "Can GATT Article III Recover From Its Head-On Collision with *United States—Taxes on Automobiles*?" in *5 Minnesota Journal of Global Trade 467* (1998).

of automobiles for the luxury excise tax was $30,000 and the threshold gasoline consumption for the gas-guzzler tax was 22.5 m.p.g.. Automobiles that were above the stated thresholds were subject to higher levels of tax. Most of the automobiles imported to the U.S. from the EEC were more expensive and subject to a higher rate of taxes[42].

The panel proceeded to determine the 'likeness' of the automobiles in question by examining the protective aim and effect of these tax measures. Although there was evidence that the protective effects of these measures had not been ignored during the formulation of regulations providing for one of the taxes, the panel found that these tax measures served a bona fide regulatory purpose and the competitive effects of these measures were neither clear enough nor inherent enough to be considered as protective. Applying the inherence criterion, the panel attempted to evaluate whether the regulations inherently divided products into those of domestic or foreign origin. Using this criterion, the panel found that the threshold set for the gas guzzler tax did not discriminate between automobiles of domestic and foreign origin because the technology to manufacture high fuel-economy automobiles- above the 22.5 m.p.g. threshold- was not 'inherent' to the U.S., nor were low fuel-economy automobiles inherently of foreign origin. Such an advantage would not, therefore, alter the conditions of competition in favour of domestic automobiles, and thereby have the effect of affording protection to domestic production. The panel applied the same 'inherence' test to conclude that the threshold set for the luxury excise tax also did not discriminate between automobiles of domestic and foreign origin because no evidence had been advanced that foreign automobile manufacturers did not in general have the design, production, and marketing capabilities to sell automobiles below the stipulated threshold, or that they did not in general produce such models for other markets.

III. Facially Neutral Tax or Regulatory Measures and the Principle of National Treatment Under the WTO Dispute Settlement System

After the establishment of the World Trade Organization (WTO), in 1995, the panels and Appellate Body under the WTO, as under the GATT dispute settlement system, have also

[42]The EEC claimed that all automobiles were 'like' products and the distinction made on the basis of their value and gasoline consumption resulted in the imposition of internal taxes on imported products in excess of those applied to 'like' domestic products. The U.S. claimed that the tax measures were applied equally to domestic and imported automobiles and the U.S. and EEC producers manufactured automobiles with both the low and high values as well as with high and low gasoline consumption.

addressed various internal tax and regulatory measures which were facially neutral but were claimed to violate the principle of national treatment as set out in Paragraphs 1, 2 and 4 of Article III of GATT. Although the GATT panels had taken two different approaches; i.e. a textual or 'like' product approach as applied in the 1987 *Japan Alcohol* case and a contextual or 'aim-and-effect' approach as applied in *U.S.- Malt Beverages and U.S.- Taxes on Automobiles,* in examining the validity of a facially neutral regulatory measure, the WTO panels and Appellate Body have rejected the 'aims-and-effects' approach to test the validity of any measures which are claimed to violate the provisions of Article III and have accepted that the 'like product' approach taken in the 1987 *Japan Alcohol* case is the proper approach[43].

As there are differences in the national treatment obligations set forth in Article III:2 with respect to internal tax measures and the national treatment obligations set forth in Article III:4 with respect to other regulatory measures, it is appropriate to examine separately he interpretations adopted by WTO panels and the Appellate Body of Article III:2 and Article III:4.

(i) Internal Tax Measures and National Treatment:[44]

The first WTO case under Article III involving a facially neutral internal tax measure is the second *Japan – Taxes on Alcoholic Beverages* case. The requirements set out in this case in order to prove that such a tax measure violates Article III of GATT have been consistently followed by other WTO panels and the Appellate Body in other cases involving internal tax measures, such as *Canada – Certain Measures Concerning Periodicals*, *Korea – Taxes on Alcoholic Beverages*, *Chile – Taxes on Alcoholic Beverages* and *Indonesia – Certain Measures Affecting the Automobile Industry*. According to the Appellate Body's decision in *Japan-Taxes on Alcoholic Beverages*[45], when an issue is raised that an internal tax measure violates the national treatment obligation set out in Article III:2, first sentence, the words of the first sentence require an examination of the conformity of an internal tax measure with Article III by determining, first, whether the taxed imported and domestic products are "like" and, second, whether the taxes applied to the imported products are "in excess of" those applied to the like domestic products. If the imported and domestic products are "like products", and if the taxes

[43] See Robert E. Hudec, supra note 19.

[44] For a recent review of the case-law under Article III pertaining to internal tax discrimination, see Elsa Horn and Petros Mavroides, "Still Hazy After All These Years: The Interpretation of National Treatment in the GATT/WTO Case-Law on Tax Discrimination", December 3, 2002.

[45] *Japan- Taxes on Alcoholic Beverages,* Report of the Panel, WT/DS8/R, WT/DS10/R and WT/DS11/R (11 July 1996) (96-2651); and *Japan- Taxes on Alcoholic Beverages,* Report of the Appellate Body, WT/DS8/AB/R, WT/DS10/AB/R and WT/DS11/AB/R (4 October 1996) (96-3951), AB-1996-2.

applied to the imported products are "in excess of" those applied to the like domestic products, then the measure is inconsistent with Article III:2, first sentence. The Appellate Body claimed that this approach to an examination of Article III:2, first sentence, was consistent with the object and purpose of Article III:2 and with past practice under the GATT 1947.

According to the Appellate Body, if the imported and domestic products are not 'like' products for the purposes of Article III:2, first sentence, then they are not subject to the strictures of Article III:2, first sentence and there is no inconsistency with the requirements of that sentence. However, depending on their nature, and depending on the competitive conditions in the relevant market, those products may well be among the broader category of "directly competitive or substitutable products" that fall within the domain of Article III:2, second sentence. In such a case, a separate examination is required to determine the consistency of an internal tax measure with Article III:2, second sentence. In the view of the Appellate Body, three issues[46] must be established separately in this examination in order to find that a tax measure imposed is inconsistent with Article III:2, second sentence. These three issues are: (i) whether the imported products and domestic products "are directly competitive or substitutable products" (ii) whether the directly competitive or substitutable imported and domestic products are "not similarly taxed"; and (iii) whether the dissimilar taxation of the directly competitive or substitutable imported and domestic products is "applied…so as to afford protection to domestic production".

According to the Appellate Body, Article III of GATT obliges Members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products. The Appellate Body said that it is irrelevant that "the trade effects" of tax differentials between imported and domestic products, as reflected in the volumes of imports, are insignificant or even non-existent, as Article III protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products.

With regard to the difference in the tests for "like" products and "directly competitive or substitutable", the Appellate Body claimed that this is due to the difference in wording of the first and second sentences of Article III:2. Article III:2, first sentence, does not refer specifically to the general principle of national treatment articulated in Article III:1 which requires that

[46] In the panel report, the Panel stated that such an examination requires two determinations: (i) whether the products concerned are 'directly competitive or substitutable', and (ii) if so, whether the treatment afforded to foreign products is contrary to the principles set forth in Article III:1.

internal tax and other regulatory measures should not be applied so as to afford protection to domestic production, whereas the language of Article III:2, second sentence that contains a general prohibition against internal taxes or other internal charges applied to imported or domestic products in a manner contrary to the principles set forth in Article III:1, specifically invokes Article III:1. The Appellate Body argued that the omission of any reference to Article III:1 in Article III:2, first sentence and the specific invocation of Article III:1 in Article III:2, second sentence, must have some meaning, and the meaning is simply that the presence of a protective application need not be established separately from the specific requirements that are included in the first sentence in order to show that a tax measure is inconsistent with the general principle set out in the first sentence. In the view of the Appellate Body, this does not mean that the general principle of Article III:1 does not apply to the first sentence. The first sentence of Article III:2 is, in effect, an application of the general principle set forth in Article III:1.

By establishing the above-mentioned standards for examination of the conformity of an internal tax measure with Article III:2, the Appellate Body seems to have accepted the panel's rejection of an "aims-and-effects" test to determine the validity of an internal tax measure. Although they reached opposite results by applying essentially the same test, both the complainant, the U.S. and the respondent, Japan, had argued at the panel level,[47] as well as before the Appellate Body,[48] that the contested internal tax measure including the product distinction made for tax purposes should be examined in the light of its aims-and-effects in order to determine whether or not it is consistent with Article III:2, and where the aim and effect of the contested tax measure do not operate so as to afford protection to domestic production, no inconsistency with Article III:2 can be established. Such arguments by Japan and U.S. were based upon rulings and findings by the GATT panels in *U.S. Malt Be*verages and *U.S. Taxes on*

[47] The issue in this case was the Japanese Liquor Tax Law that divided all liquors into different categories and sub-categories, and applied different tax rates to each of these categories and sub-categories. The tax rates were expressed as a specific amount in Japanese Yen per litre of beverage, and for each category or sub-category, the Liquor Tax Law laid down a reference alcohol content per litre of beverage and the corresponding reference tax rate. The European Communities complained, inter alia, that Japan had acted inconsistently with Article III:2 of GATT by applying a higher tax rate on the categories of spirits, whisky/brandy and liqueurs than on each of the two subcategories of shochu. Canada and United States complained that the higher rates of taxation on imported alcoholic beverages including whiskies, brandies and other distilled alcoholic beverages and liqueurs than on Japanese shochu imposed under the Liquor Tax Law were inconsistent with Article III:1 and III:2 of GATT.

[48] The issues raised before the Appellate Body were the conclusions reached by the Panel that shochu and vodka are like products and Japan, by taxing the latter in excess of the former, was in violation of its obligation under Article III:2, first sentence, of GATT 1994, and that shochu, whisky, brandy, rum, gin, genever, and liqueurs are "directly competitive or substitutable products" and Japan, by not taxing them similarly, was in violation of its obligation under Article III:2, second sentence, of GATT 1994. Japan and United States appealed against the Panel's findings.

Automobiles cases. The Panel simply rejected the 'aims-and-effects' test applied in these GATT cases, stating that it was not in a position to detect how the 1992 *U.S. Malt Beverages* panel weighed the different criteria that it took into account in order to determine whether the products in dispute were like, and that the panel report in *U.S. Taxes on Automobiles* remained unadopted, and even if a panel could find useful guidance in the reasoning of an unadopted panel report that it considered to be relevant, unadopted panel reports have no legal status in the GATT or WTO system since they have not been endorsed by the Contracting Parties to the GATT or WTO Members[49].

The Panel gave the following reasons for rejecting the 'aims-and-effects' test,: first, such a test is not consistent with the wording of Article III:2, first sentence, as the basis of this test is the words "so as to afford protection" contained in Article III:1, and Article III:2, first sentence, contains no reference to these words; second, the adoption of such test would have important implications for the burden of proof imposed on the complainant because according to this test, the complainant would have the burden of showing not only the effect of a particular measure, which is in principle discernible, but also its aim, which sometimes can be indiscernible; third, very often there is a multiplicity of aims that are sought through enactment of legislation and it would be a difficult exercise to determine which aim or aims should be determinative for the aims-and-effects test; fourth, access to the complete legislative history, which is argued by proponents of this test to be relevant to detect the protective aims, could be difficult or even impossible for a complainant to obtain, and even if the complete legislative history is available, it would be difficult to assess which kinds of legislative history (statements in legislation, in official legislative reports, by individual legislators, or in hearings involving interested parties) should be primarily determinative of the aims of the legislation; and fifth, the list of exceptions contained in Article XX of GATT could become redundant or useless because the aims-and-effects test does not contain a definitive lists of grounds justifying departure from the national treatment obligations incorporated in Article III.[50]

[49]According to the Panel, even if the adopted panels reports have any legal status, it does not necessarily have to follow their reasoning or results. Although the Appellate Body endorsed the Panel's conclusion in regard to un-adopted panel reports and did not agree with the conclusion on the legal status of adopted panel reports, it, however, agreed that adopted panel reports are not binding, except on the parties to the dispute, even if they create legitimate expectations among WTO Members and should be taken into account where they are relevant to any dispute.

[50] According to the Panel, if the 'aim-and-effect' test was applied in regard to Article III, then in principle, a WTO Member could, for example, invoke protection of health in the context of invoking the 'aim-and-effect' test, and if this were the case, then the standard of proof established in Article XX would effectively be circumvented and WTO

With regard to the definition of 'like products' in Article III:2, first sentence, the Appellate Body agreed with the Panel's conclusion that this term should be construed narrowly so as not to condemn measures that its strict terms are not meant to condemn, because the second sentence of Article III:2 provides for a separate and distinctive consideration of the protective aspect of a measure in examining its application to a broader category of products that are not "like products" as contemplated by the first sentence. According to the Appellate Body, how narrowly is a matter that should be determined separately for each tax measure in each case. The Appellate Body agreed with the practice under the GATT 1947 of determining whether imported and domestic products are "like" on a case-by-case basis in accordance with the criteria, including the product's properties, nature and quality, the product's end-uses in a given market, and consumer tastes and habits, which change from country to country, as set out in the 1970 adopted Report of the GATT Working Party on Border Tax Adjustments. However, the Appellate Body cautioned that in applying the criteria cited in the Border Tax Adjustments Report to the facts of any particular case, and in considering other criteria that may also be relevant in certain cases (such as tariff classifications), panels can only apply their best judgement in determining whether in fact products are "like". Although the Appellate Body did not agree with the Panel's observation that distinguishing between "like products" and "directly competitive or substitutable products" under Article III:2 is an arbitrary exercise, it acknowledged that this would always involve an unavoidable element of individual, discretionary judgement, which must be made in considering the various characteristics of products in individual cases. The Appellate Body said:

> No one approach to exercising judgement will be appropriate for all cases. The criteria in Border Tax Adjustments should be examined, but there can be no one precise and absolute definition of what is "like". The concept of "likeness" is a relative one that evokes the image of an accordion. The accordion of "likeness" stretches and squeezes in different places as different provisions of the WTO Agreement are applied. The width of the accordion in any one of those places must be determined by the particular provision in which the term "like" is encountered as well as by the context and the circumstances that prevail in any given case to which that provision may apply. We believe that, in Article III:2, first sentence of the GATT 1994, the accordion of "likeness" is meant to be narrowly squeezed.

Members would not have to prove that a health measure is necessary to achieve its health objective. For a response to the Panel's criticism of the 'aims and effects" test, see Serena B. Wille, *Recapturing a Lost Opportunity: Article III:2 GATT 1994 Japan-Taxes on Alcoholic Beverages*, Jean Monnet Working Paper 11-97, NYU School of Law.

Regarding the relevance of a uniform tariff classification of products in determining "like products", the Appellate Body said that a sufficiently detailed tariff classification could be a helpful sign of product similarity. However, the Appellate Body cautioned that tariff bindings that include a wide range of products may not be a reliable criterion for confirming or determining product "likeness" under Article III:2, and, therefore, the determinations on which tariff bindings provide significant guidance as to the identification of "like products" need to be made on a case-by-case basis[51]. In all other respects, Appellate Body affirmed the findings and the legal conclusions of the Panel with respect to "like products.

According to the Panel, the appropriate test to define whether two products are like or directly competitive or substitutable is the marketplace. In the panel's view, although the decisive criterion in determining whether two products are directly competitive or substitutable is whether they have common end uses*, inter alia*, as shown by the elasticity of substitution in a market where competition exists, commonality of end-uses is a necessary but not sufficient criterion to define 'likeness'. According to the Panel, the term 'like products' suggests that for two products to fall under this category they must share, apart from commonality of end-uses, essentially the same physical characteristics. By applying the above-mentioned criteria for examination of the products at issue, the Panel concluded that vodka and shochu were like products because both vodka and shochu shared most physical characteristics and except for the media used for filtration there was virtual identity in the definition of two products[52]. The Panel, however, did not conclude that shochu and other alcoholic beverages in dispute were 'like products' because substantial noticeable differences in physical characteristics existed between the remaining alcoholic beverages in dispute and shochu that would disqualify them from being regarded as like products.[53]

According to the Appellate Body, after the determination of the 'likeness' of the products at issue, the only remaining step to determine the conformity of internal tax measure with Article III:2, first sentence, is the examination of whether the taxes on imported products are "in excess

[51] According to the Appellate Body, many least-developed countries and developing countries have bindings in their schedules which include broad ranges of products that cut across several different HS tariff headings.
[52] The panel noted that a difference in the physical characteristic of alcoholic strength of two products did not preclude a finding of 'likeness' especially since alcoholic beverages are often drunk in diluted form. The Panel also noted the similar findings in the 1987 *Japan Alcohol* case and that vodka and shochu were classified in the same heading in the Japanese Tariffs bindings.
[53] According to the Panel, the use of additives would disqualify liqueurs, gin and genever; the use of ingredients would disqualify rum; and appearance (arising from manufacturing processes) would disqualify whisky and brandy.

of" those on like domestic products. If so, then the Member that has imposed the tax is not in compliance with Article III. In the view of the Appellate Body, even the smallest amount of "excess" is too much because the prohibition of discriminatory taxes in Article III:2, first sentence, is not conditional on a 'trade effects test' nor is it qualified by a *de minimis* standard. Accordingly, the Appellate Body agreed with the Panel's legal reasoning and with its conclusions[54] on this aspect of the interpretation and application of Article III:2, first sentence.

As noted earlier, even if the imported and domestic products are not “like products”, they may still be "directly competitive or substitutable products". In such a case a three-step test is required to determine the validity of an internal tax measure under the principle of National Treatment. The first step is the determination of "directly competitive or substitutable products". In the Appellate Body’s view, as with "like products", the determination of the appropriate range of "directly competitive or substitutable products" under Article III:2 second sentence must be made on a case-by-case basis, taking into account all the relevant facts. The Appellate Body agreed with the Panel’s approach in this regard. The Panel had emphasized the need to look not only at such matters as physical characteristics, common end-uses, and tariff classifications, but also at the "market place" because the important issues in this regard were factors like market strategies and the responsiveness of consumers to the various products offered in the market. In the view of the Appellate Body, it was not inappropriate to look at competition in the relevant markets as one among a number of means of identifying the broader category of products that might be described as "directly competitive or substitutable". The Appellate Body also agreed with the Panel's view that the decisive criterion in order to determine whether two products are directly competitive or substitutable is whether they have common end-uses, *inter alia*, as shown by elasticity of substitution in the relevant markets[55]. It thus found the Panel's legal analysis of whether the products are "directly competitive or substitutable products" to be correct.

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[54] The Panel concluded that the tax imposed on vodka was in excess of the tax imposed on shochu because vodka was taxed at 377,230 Yen per kilolitre- for an alcoholic strength below 38 degrees – 9,927 Yen per degree of alcohol – whereas shochu A was taxed at 155,700 Yen per kilolitre – for an alcoholic strength between 25 and 26 degrees – 6,228 Yen per degree of alcohol.

[55] Applying the criterion of elasticity of substitution between products, the Panel concluded that shochu, whisky, brandy, rum, gin, genever, and liqueurs were ‘directly competitive or substitutable products’. To find the elasticity of substitution, the Panel relied on the conclusions of the 1987 *Japan Alcohol* case that both white and brown spirits were directly competitive or substitutable products to shochu, the studies put forward by the complainants supporting such elasticity of substitutions, and the evidence submitted by the complainants concerning the 1989 Japanese tax reform which showed that the products in question were essentially competing for the same market.

According to the Appellate Body, after the determination of directly competitive or substitutable products, the next step in the test is whether these products are similarly taxed. In its view, the phrase "not similarly taxed" does not mean the same thing as the phrase "in excess of" in Article III:2, first sentence, because if "in excess of" and "not similarly taxed" were construed to mean one and the same thing, then "like products" and "directly competitive or substitutable products" would also mean one and the same thing[56]. According to the Appellate Body, there may be an amount of excess taxation that may well be more of a burden on imported products than on domestic "directly competitive or substitutable products" but may not be enough to justify a conclusion that such products are "not similarly taxed" for the purposes of Article III:2, second sentence. It agreed with the Panel that the amount of differential taxation must be more than *de minimis* to be deemed "not similarly taxed"; and whether any particular differential amount of taxation is *de minimis* or not must be determined on a case-by-case basis. Thus, to be "not similarly taxed", the tax burden on imported products must be heavier than on "directly competitive or substitutable" domestic products, and that burden must be more than *de minimis* in any given case. The Appellate Body also agreed with the legal reasoning applied by the Panel in determining whether "directly competitive or substitutable" imported and domestic products were "not similarly taxed". However, the Appellate Body also found that the Panel erred in blurring the distinction between that issue and the issue of whether the tax measure in question was applied "so as to afford protection", which, in Appellate Body's view, were entirely different issues that must be addressed separately. The Panel had concluded that the following indicators, *inter alia*, were relevant in determining whether the products in dispute were similarly taxed in Japan: tax per litre of product, tax per degree of alcohol, *ad valorem* taxation, and the tax/price ratio[57].

According to the Appellate Body, if "directly competitive or substitutable products" are "similarly taxed", then there is neither need nor justification under Article III:2, second sentence, for inquiring further as to whether the tax has been applied "so as to afford protection". However, if such products are "not similarly taxed", a further inquiry must necessarily be made. In its view, this third inquiry must determine whether "directly competitive or substitutable products" are

[56] In the view of Appellate Body, this would eviscerate the distinctive meaning that must be respected due to the distinctions in the wordings of the text of Article III:2, first sentence, and Article III:2, second sentence.

[57] The Panel concluded that the products at dispute were not similarly taxed because the differences in the amounts of taxes were not *de minimis* and Japan's Liquor Tax Law did not specifically provide that tax/price ratio was the basis of taxation, as there were significantly different tax/price ratios even within the same product categories.

"not similarly taxed" in a way that affords protection. The Appellate Body argued that this was not an issue of intent and that it was not necessary for a panel to sort through the reasons given by legislators and regulators in imposing the measure in dispute. In its view, if the measure is applied to imported or domestic products so as to afford protection to domestic production, then it is irrelevant that protectionism was not an intended purpose. What is relevant is how the particular tax measure in question is applied. In this respect, the Appellate Body found the approach followed in the 1987 *Japan – Alcohol* case in the examination of the issue of "so as to afford protection" persuasive and concluded that an examination of whether dissimilar taxation has been applied so as to afford protection requires a comprehensive and objective analysis of the structure and application of the measure in question as related to domestic as compared to imported products. In its view, it is possible to examine objectively the underlying criteria used in a particular tax measure, its structure, and its overall application to ascertain whether it is applied in a way that affords protection to domestic products. The Appellate Body argued that even if the aim of a measure may not be easily ascertained, its protective application can most often be discerned from "the design, the architecture, and the revealing structure of a measure," and the very magnitude of the dissimilar taxation in a particular case may be evidence of such a protective application. However, there may be other factors to be considered as well. Therefore, full consideration should be given to all the relevant facts and circumstances in any given case, and in every case, a careful, objective analysis, must be undertaken of each and all such facts and circumstances in order to determine "the existence of protective taxation".

Despite arguing for a separate inquiry on the issue of "so as to afford protection to domestic production" and the rejection of the Panel's conclusion of equating the determination of dissimilar taxation with the separate requirement of demonstrating that the tax measure affords protection to domestic production, the Appellate Body, however, agreed with the Panel's conclusion that the very fact that the substantially dissimilar taxation was applied to directly competitive or substitutable imported and domestic products was enough in this case to conclude that the tax measure in dispute was applied "so as to afford protection."[58]

[58]To support its conclusion, the Appellate Body noted the findings of the Panel that the combination of customs duties and internal taxation in Japan had the impact of making it difficult for foreign-produced shochu to penetrate the Japanese market as well as the impact of not guaranteeing equality of competitive conditions between shochu and the rest of 'white' and 'brown' spirits; and thus, through a combination of high import duties and differentiated internal taxes, Japan managed to "isolate" domestically produced shochu from foreign competition.

The tests outlined by the Appellate Body in *Japan –Taxes on Alcoholic Beverages* have been followed by the panels and the Appellate Body in other cases involving internal taxes as well as other regulatory measures. The practical difficulties in applying these tests[59] were evident in *Canada – Certain Measures Concerning Periodicals*[60] case, where the Panel found that imported split-run periodicals and domestic non split-run periodicals were 'like' products under Article III:2, first sentence, whereas the Appellate Body found that such periodicals were not 'like' products, but were 'directly competitive or substitutable' products under Article III:2, second sentence. In this case, one of the issues in dispute was Part V.I of the Canadian Excise Tax Act which imposed an 80 percent excise tax on advertising in each split-run edition of a periodical[61]. The United States claimed that these provisions of the Excise Tax Act were in violation of the National Treatment obligation enshrined in Article III:2 of GATT because they discriminated between two "like" products, domestic non split-run periodicals and imported split-run periodicals. The Panel concluded that Part V.1 of the Canadian Excise Tax Act was inconsistent with Article III:2, first sentence, of GATT 1994. Canada and the U.S. both appealed[62]. Although the Appellate Body agreed with the application by the Panel of the two-step 'like' products test established by the Appellate Body in *Japan –Taxes on Alcoholic Beverages* case in examining the consistency of a tax measure with Article III:2, first sentence, it did not agree with the panel's conclusion that imported split-run periodicals and domestic non split-run periodicals were 'like' products[63]. According to the Appellate Body, the Panel did not

[59] For various aspects of practical difficulties in applying the tests advocated by the Appellate Body in *Japan-Taxes on Alcoholic Beverages,* see Mattoo and Subramanian, supra note 17 (arguing that this case follows a strict textual interpretation of Article III:2 which is difficult to apply to a range of known situations); Sarah Hogg and Mahmud Nawaz, "Economic Considerations and the DSU" in James Cameron and Karen Campbell (eds.) , *Dispute Resolution in the World Trade Organisation* (Cameron May, 1998) (arguing that the interpretation was focused on *supply side* factors and the key *demand side* question- whether the products concerned competed in the same market- was not considered as important); and Ramon R. Gupta, "Appellate Body Interpretation of the WTO Agreement: A Critique in Light of Japan- Taxes on Alcoholic Beverages" in *6 Pacific Rim Law and Policy Journal 683* (July 1997) (criticising the vague approach in defining "like" and "directly competitive or substitutable" products in light of the importance of predictability and clarity in developing credible dispute settlement procedure).

[60] *Canada – Certain Measures Concerning Periodicals*, Report of the Panel, WT/DS31/R (14 March 1997) (97-0939); and *Canada – Certain Measures Concerning Periodicals*, Report of the Appellate Body, WT/DS31/AB/R (30 June 1997) (97-2653), AB-1997-2.

[61] A split-run edition was one that was distributed in Canada, had more than 20% of editorial material substantially the same as the editorial material that appeared in one or more excluded editions of one or more issues of one or more periodicals, and contained an advertisement that did not appear in identical form in all excluded editions.

[62] Canada claimed, *inter alia*, that the Panel erred in law in finding that imported United States' split-run periodicals and Canadian non-split-run periodicals were like products. The U.S. appeal related to some other issues.

[63] Based on a single hypothetical example constructed using a Canadian-owned magazine *Harrowsmith Country Life*, which was previously a split-run periodical but stopped its U.S. edition as a result of the tax, the Panel compared two editions, before and after the discontinuation of the U.S. edition, of the same magazine, and concluded that

base its findings on the exhibits and evidence before it[64] and the Panel's conclusions lacked proper legal reasoning based on adequate factual analysis. However, the Appellate Body did not determine whether the imported split-run periodicals and domestic non split-run periodicals were 'like' products[65]. Instead, it proceeded to examine the consistency of the tax measure with Article III:2, second sentence[66]. It said that if the answer to the question of whether imported and domestic products are 'like' products is negative, there is then a need to examine the consistency of the measure with the second sentence of Article III:2.

Applying the three step test established by the Appellate Body in *Japan – Taxes on Alcoholic Beverages*, the Appellate Body found that the imported split-run periodicals and Canadian non split-run periodicals were "directly competitive or substitutable" products in so far as they were part of the same segment of the Canadian market for periodicals. This conclusion was based on a study carried out by a Canadian economist, a Task Force Report submitted by Canada, and statements made by the Minister of Canadian Heritage and Canadian officials, all of which had acknowledged the substitutability of, and considerable competition between, imported split-run periodicals and domestic non-split-run periodicals in the Canadian market[67]. Similarly, the Appellate Body concluded that "directly competitive or substitutable" imported split-run periodicals and domestic non-split-run periodicals were "not similarly taxed" by the Canadian Excise Tax Act because it taxed split-run editions of periodicals in an amount equivalent to 80 per cent of the value of all advertisements, whereas domestic non-split-run periodicals were not

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imported split-run periodicals and domestic non-split-run periodicals were 'like' products because the two editions of the said magazine would have common end uses, very similar physical properties, nature and qualities as well as they would have been designed for the same readership with the same tastes and habits.

[64]The Appellate Body particularly noted the facts that the Panel based its findings on a single, incorrect, hypothetical example that involved a comparison between two editions of the same magazine, both imported products, which could not have been in the Canadian market at the same time, but the Panel did not examine the evidence of likeness of TIME, TIME Canada and Maclean's magazines, presented by Canada, and the magazines, Pulp & Paper and Pulp & Paper Canada, presented by the U.S., or the Report of the Task Force on the Canadian Magazine Industry.

[65]In its view, the determination of "likeness" was a delicate process by which legal rules had to be applied to facts, and due to the absence of adequate analysis of facts in the Panel Report in that respect, it was not possible for the Appellate Body to proceed to a determination of 'like' products.

[66]The Appellate Body rejected the argument of Canada that it did not have the jurisdiction to examine a claim under Article III:2, second sentence, as no party had appealed the findings of the Panel on that provision.

[67]The Appellate Body rejected the argument of Canada that the Task Force Report's description of the relationship as one of "imperfect substitutability" characterized the absence of perfect substitutability that was required to prove the direct competitiveness or substitutability of products. In its view, a case of perfect substitutability makes products the 'like' products. It also cautioned that the conclusion that imported split-run periodicals and domestic non-split-run periodicals were "directly competitive or substitutable" did not mean that all periodicals belong to the same relevant market, whatever their editorial content. In its view, a periodical containing mainly current news is not directly competitive or substitutable with a periodical dedicated to gardening, chess, sports, music or cuisine, but newsmagazines, like TIME and Maclean's, are directly competitive or substitutable.

subject to the tax, and the amount of the taxation was far above the *de minimis* threshold specified by the Appellate Body in *Japan–Taxes on Alcoholic Beverages*. Finally, it concluded that the design and structure of Canadian excise tax was clearly "to afford protection to the production of Canadian periodicals". This conclusion was based on the magnitude of dissimilar taxation[68], the evidence of protective purpose from several statements of the Government of Canada's explicit policy objectives in introducing the measure, and the demonstrated actual protective effect of the measure[69]. Thus, the Appellate Body concluded that Part V.1 of Canadian Excise Tax Act was inconsistent with Canada's obligations under Article III:2, second sentence, of the GATT 1994.

The *Canada-Certain Measures Concerning Periodicals* case suggests[70] that it is difficult to prove the 'likeness' of products under Article III:2, first sentence, unless there is a substantial indentity in the physical characteristics and perfect substitutability of the products in question. However, this difficulty has not affected the outcome of the examination of whether a tax measure is inconsistent with the principle of National Treatment because of the availability of a further examination under Article III:2, second sentence, which covers 'directly competitive or substitutable' products, and there is not a single decided case under the WTO where a tax measure has been determined to be consistent with Article III:2, second sentence once the products in question have been found to be 'directly competitive or substitutable'. This is evident from the Appellate Body decisions in *Korea – Taxes on Alcoholic Beverages* and *Chile-Taxes on Alcoholic Beverages*. In both of these cases, the Appellate Body affirmed the findings of the respective Panels which had found both the Korean and Chilean alcohol taxation system to be inconsistent with the National Treatment principle set forth in Article III:2.

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[68]The Appellate Body claimed that the magnitude of the dissimilar taxation was prohibitive.

[69] The effects cited were the moving of the production of a split-run magazine of U.S. for the Canadian market from Canada to the U.S. and the cessation of production of the U. S. edition by a Canadian split-run periodical after the imposition of the tax.

[70]For the analysis of different aspects of the Appellate Body decision in the *Canada Periodicals* case, see Stephen de Boer, " Trading Culture: The Canada-US Magazine Dispute" in James Cameron and Karen Campbell (eds.) , *Dispute Resolution in the World Trade Organisation* (Cameron May, 1998); Sydney M. Cone III, "The Appellate Body and *Harrowsmith Country Life*" in *Journal of World Trade*, Vol. 32, No.2 (April 1998), at pages 102-117; Chi Carmody, "When "Cultural Identity Was Not At Issue": Thinking About *Canada—Certain Measures Concerning Periodicals*" in 30 *Law and Policy in International Business* 231 (1999); Trevor Knight, "The Dual Nature of Cultural Products: An Analysis of the World Trade Organization's Decisions Regarding Canadian Periodicals" in *University of Toronto Faculty of Law Review*, Vol. 57, No. 2 (Spring 1999), at pages165-191; and Richard L. Matheny III, "In the Wake of the Flood: "Like Products" and Cultural Products after the World Trade Organization's Decision in Canada Certain Measures Concerning Periodicals" in 147*University of Pennsylvania Law Review* 245 (November 1998).

In *Korea – Taxes on Alcoholic Beverages*[71], the Appellate Body upheld the findings of the Panel that soju (diluted and distilled), whiskies, brandies, cognac, rum, gin, tequila, liqueurs and admixtures were directly competitive or substitutable products. It also upheld the Panel's conclusion that Korea had taxed the imported products in a dissimilar manner and that the dissimilar taxation was applied so as to afford protection to domestic production. Both the Panel and Appellate Body applied the three-step test established by the Appellate Body in *Japan – Taxes on Alcoholic Beverages*. In the Panel's view, an assessment of whether there is a direct competitive relationship between two products or groups of products requires evidence that consumers consider or could consider the two products or groups of products as alternative ways of satisfying a particular need or taste, and the determination of whether domestic and imported products are directly competitive or substitutable requires evidence of a direct competitive relationship between the products, including comparisons of their physical characteristics, end-uses, channels of distribution and prices. According to the Panel the focus should not be exclusively on the quantitative extent of the competitive overlap. Quantitative analyses and studies of cross-price elasticity are helpful and relevant, but should not be considered necessary and are not exclusive or even decisive in nature because protectionist government policies can distort the competitive relationship between products, causing the quantitative extent of the competitive relationship to be understated. According to the Panel, the assessment of competition has a temporal dimension. Therefore, panels should examine evidence of trends and changes in consumption patterns and make an assessment as to whether such trends and patterns lead to the conclusion that the products in question are either directly competitive now or can reasonably be expected to become directly competitive in the near future[72]. According to the Appellate Body, the context of the competitive relationship between imported and domestic products is necessarily the marketplace since this is the forum where consumers choose between different products. In its view, the word "substitutable" indicates that the requisite relationship may exist between products that are not, at a given moment, considered by consumers to be substitutes but

[71]*Korea – Taxes on Alcoholic Beverages*, Report of the Panel, WT/DS75/R and WT/DS84/R (17 September 1998) (98-3471); and *Korea – Taxes on Alcoholic Beverages,* Report of the Appellate Body, WT/DS75/AB/R and WT/DS84/AB/R (18 January 1999) (99-0100), AB-1998-7. In this case, the U.S. and EEC complained against the Korean tax under the Korean Liquor and Education Tax Laws, as being inconsistent with Article III:2 because it accorded preferential tax treatment to soju, a traditional Korean alcoholic beverage, as compared with certain imported alcoholic beverages.

[72]According to the Panel, trends are particularly important in the context of experience-based consumer items and it would be unrealistic and, indeed, analytically unhelpful to attempt to separate every piece of evidence and disregard that which discusses implications for market structure in the near future.

which are, nonetheless, capable of being substituted for one another. Products are competitive or substitutable when they are interchangeable or if they offer alternative ways of satisfying a particular need or taste.

With regard to the issue of whether or not the Korean liquor taxes were applied so as to afford protection to domestic products, the Panel found that the Korean tax law had very large differences in levels of taxation[73], and that the very magnitude of dissimilar taxation itself was sufficient to conclude that the taxes at issue were applied so as to accord protection to Korean domestic liquors. In addition to the very large levels of tax differentials, the Panel also found the structure of the Liquor Tax Law itself to be discriminatory[74]. The Appellate Body upheld the Panel's conclusions and rejected the arguments of Korea that there were no such protective effects in the market because of the large pre-tax price difference between diluted soju and the imported alcoholic beverages. According to the Appellate Body this argument did not change the pattern of application of the contested measures because Article III is not concerned with trade volumes and therefore it was not incumbent on the complainant to prove that tax measures were capable of producing any particular trade effect.

The Panel and Appellate Body in *Chile- Taxes on Alcoholic Beverages*[75] followed the same approach as followed in *Japan-Taxes on Alcoholic Beverages* and *Korea – Taxes on Alcoholic Beverages* in determining the issues of whether or not pisco, whisky and other spirits are directly competitive or substitutable, whether or not the domestic alcoholic beverages and directly competitive or substitutable imported alcoholic beverages were similarly taxed and, if there were dissimilar taxes above the *de minimis* level, whether or not dissimilar taxes were applied so as to afford protection to domestic products. With regard to the first issue, the Panel looked at evidence of the relationship between the products, including comparisons of their end-uses, physical characteristics, channels of distribution and prices, and found that pisco and other

[73] The Panel found that the total tax on diluted soju was 38.5 percent; on distilled soju and liqueurs 55 percent; on vodka, gin, rum, tequila and admixtures 104 percent; and on whisky, brandy and cognac 130 percent.

[74] According to the Panel, it was based on a very broad generic definition which was defined as soju and then there were specific exceptions corresponding very closely to one or more characteristics of imported beverages that were used to identify products which received higher tax rates. There was virtually no imported soju so the beneficiaries of the tax structure were almost exclusively domestic producers, and the only domestic product which fell into a category with higher tax rates was distilled soju which represented less than one percent of Korean production.

[75] *Chile- Taxes on Alcoholic Beverages*, Report of the Panel, WT/DS87/R and WT/DS110/R (15 June 1999) (99-2313); and *Chile- Taxes on Alcoholic Beverages*, Report of the Appellate Body, WT/DS87/AB/R and WT/DS110/AB/R (13 December 1999) (99-5414), AB-1999-6.

spirits were directly competitive or substitutable products.[76] According to the Panel, products do not have to be substitutable for all purposes at all times to be considered competitive and it is sufficient that they may be substituted for some purposes at some times by some consumers.

In evaluating substitutability in end-uses, the Panel also found it useful to consider consumer theory, which, according to the Panel, holds that "goods are, in the eyes of consumers, never really perceived as commodities that are in themselves direct objects of utility; rather, it is the properties or characteristics of the goods from which utility is derived that are the relevant considerations. It is these characteristics or attributes that yield satisfaction and not the goods as such. Goods may share a common characteristic but may have other characteristics that are qualitatively different, or they may have the same characteristics but in quantitatively different combinations. Substitution possibilities arise because of these shared characteristics." According to the Panel, one hypothetical example in this regard is that of butter, milk and margarine. "Butter and milk are both dairy products and they share important characteristics that margarine does not have. However, butter and margarine each have combinations of characteristics that make them good substitutes as complements for bread, which is not the case with milk. The characteristics of butter and margarine can be expressed as physical properties such as spreadability, taste, colour and consistency. These physical characteristics combine to render both products good substitutes as bread complements. The latter represents the end-use of the commodities as determined by their combination of characteristics derived from certain physical characteristics." In Panel's view, the same type of reasoning can be applied to the substitutability of pisco and other spirits such as whisky, brandy, cognac, etc.[77]

Similarly, the Panel also found that its conclusion on competition or substitutability between pisco and other spirits was consistent with the production and marketing decisions of

[76] In the Panel's view, studies or surveys that reveal the following all serve as evidence of substitutability in end-uses: (i) a tendency among consumers to regard products as substitutes in satisfying a particular need; (ii) that the nature and content of marketing strategies of producers indicate that they are competing for the expenditure of potential consumers in a particular market segment; and (iii) that distribution channels are shared with other goods.

[77] According to the Panel, although whisky and pisco were distilled from different substances, namely barley and grapes respectively, they share the characteristics of being potable liquids with high alcohol content, which was the product of distillation, as well as being receptive to mixing with non-alcoholic beverages. In any event, even the differences in ingredients between whisky and pisco was not sufficient to render these two distilled alcoholic spirits, both of which have a high alcohol content and more or less satisfy a similar need, incapable of being substituted for each other. As for brandy, cognac and some other spirits, the differences in physical characteristics were only post-distillation differences such as colour and smell which were not sufficiently significant to change the basic character of spirits essentially made from grapes or other fruits.

the pisco producers who desired to convey an image of pisco as a drink that competes with the best imported distilled spirits. According to the Panel, when a product is being marketed in ways that suggest that it is in competition with up-market imported distilled spirits, this is evidence of at least potential competition with those imports. Likewise, the Panel also found that the Chilean Central Preventive Commission, in deciding on a merger between two major pisco producers, had stated that pisco faced major competition from other alcoholic beverages, such as wine, beer and whisky, and that these were alternative products which consumers of alcoholic beverages could choose to drink in the market for alcoholic beverages. Thus, the Panel concluded that the totality of the evidence presented supported a finding that the imported distilled spirits and pisco were directly competitive or substitutable.

With respect to the issue of whether or not the imported distilled spirits and directly competitive or substitutable pisco were similarly taxed, the Panel found that both the Transitional and New Systems applied dissimilar taxes to these alcoholic beverages. According to the Panel, the level of difference in taxation between whisky and pisco under the Old System was greater than *de minimis* because whisky was taxed at more than twice the rate of pisco and even if the Transitional System would make the difference in taxation somewhat narrower in the following years, the tax difference still would remain more than *de minimis*, and even with respect to other spirits, the tax difference of five percentage points *ad valorem* was greater than *de minimis*. The New System, which assessed taxes on an *ad valorem* basis that varied according to alcohol content, also applied dissimilar taxes greater than *de minimis* to directly competitive or substitutable imported and domestic products because the difference in taxation between the top (47%) and bottom (27%) levels of *ad valorem* rates of taxation of distilled alcoholic beverages was clearly more than *de minimis* and was so by a very large margin. Similarly, the difference of four percentage points between the various levels of alcohol content also constituted a greater than *de minimis* level of dissimilar taxation. According to the Panel, the question of dissimilar taxation does not involve judgements about the objectives of the laws or regulations involved, nor does it involve an assessment of who benefits from the tax system. It is sufficient for this step of the analysis to find that some of the imports are being taxed dissimilarly from some of the domestic production and the difference is more than *de minimis*. In the view of Panel, a tax system based on taxing value is generally considered not to be applying dissimilar taxation if done on a purely *ad valorem* basis (i.e., a single *ad valorem* rate applied uniformly to all

products). However, the New Chilean System was not strictly *an ad valorem* system because it applied *ad valorem* rates that varied not just by value but also by alcohol content.

On the issue of whether or not the Chilean alcohol taxes were applied so as to afford protection to domestic products, the Panel concluded that both the Transition and New Systems applied dissimilar taxes to domestic products and directly competitive or substitutable imported products so as to afford protection to Chilean domestic products. According to the Panel, the central issue in this regard is the design, architecture and revealing structure of the tax measure and an important question in the determination of protective application is who receives the benefit of the dissimilar taxation. Since the Transitional System assessed tax rates by type of spirits and the lowest tax rate was on pisco which under Chilean law was exclusively a domestic product, it was clear that the beneficiary of the tax structure was the domestic industry. Similarly, the largest category of imports was whisky, which was taxed at a rate of 53% (at its least discriminatory level) compared to pisco's 25%, and pisco accounted for almost 75% of domestic production of distilled spirits. The Panel rejected the argument of Chile that the Transitional System did not have any protective application as it actually reduced the tax rate on whisky. The Panel held that the fact that the Transitional System lessened the protective effect did not vitiate the conclusion that, even at its least discriminatory, it was a system that did and would afford protection to domestic production.

The New System also afforded protection to domestic production because the structure of the New System applied its lowest rate at the level of alcohol content of the large majority of domestic production and its highest rate at the level of the overwhelming majority of imports[78]; the large magnitude of the differentials was applied over a short range of physical difference (27% for 35° versus 47% for 39° of alcohol content); the interaction of the New System with the Chilean regulation which required most of the imports to remain at the highest tax level without losing their generic name and changing their physical characteristics[79]; and the lack of any connection between the stated objectives and the results of the measures[80]. The Panel rejected the

[78]According to the Panel, between 70 and 80 percent of Chilean production consisted of products with less than 35° alcohol content and, therefore, enjoyed the lowest tax rate of 27%. Over 90% of pisco was in this category.

[79]Under Chilean regulations, most of the imported beverages, such as whisky, had generic names that required them to contain at least 40° of alcohol. Thus, almost 95% of imports would be taxed at the highest rate of 47% or would lose their ability to retain their generic name or would be required to change an important physical characteristic, namely their water/alcohol ratio.

[80]Chile argued that its objectives of the tax measure were maintaining revenue collection; eliminating tax distinctions based on the types of alcoholic beverages; discouraging alcohol consumption; and minimizing the

arguments made by Chile to support the non-protective application of the tax measure that any producer whether foreign or domestic could produce spirits at lower levels and benefit from the tax structure; that there was a great deal of spirits produced in the EEC at 35° of alcohol or less which could easily be exported to Chile and enjoy a lower level of taxation; that there was more absolute production of domestic spirits in Chile at the higher levels of taxation than there were imports; that there was not even *de facto* discrimination because the imported product could easily be diluted to take advantage of the lower available tax rates; and that if protection was the goal Chile could have raised tariffs which were currently at 11%, but bound at 25%. The Panel found these factors either to be irrelevant or as demonstrating that there would not be equal competitive conditions unless the foreign producers make certain important changes in their products, changes not justified by any exception or rule of the WTO Agreements. The Appellate Body upheld the findings of the Panel in *Chile – Taxes on Alcoholic Beverages*[81].

In *Indonesia-Certain Measures Affecting the Automobile Industry*[82], Japan, the US and the European Communities complained that the sales tax benefits provided under the February 1996, 1993 and June 1996 Indonesian car programmes violated Article III:2 of GATT. Indonesia argued that the sales tax and luxury tax benefits provided to its national car companies were subsidies and were consistent with the Agreement on Subsidies and Countervailing Measures (SCM Agreement) even if such tax benefits were inconsistent with Article III:2. It argued that there was a conflict between Article III:2 and the SCM Agreement in that the obligations contained in Article III:2 and the SCM Agreement were mutually exclusive because the SCM

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potentially regressive aspects of the reform of the tax system. Examining the relationship between the stated objective and the measure in question, the Panel claimed that there was no rational reason why such a structure as devised by Chile was necessary for the purpose of maintaining revenue neutrality, as Chile had acknowledged that the same revenue result could be achieved with a single *ad valorem* rate at some point between 27% and 47%. Similarly, the Panel claimed that the New System did not achieve the purpose of eliminating type distinctions because the favorable tax treatment accorded to products called "pisco" was removed, but the system was replaced with one providing unfavourable tax treatment for any products called "whisky", "gin," "vodka" or "rum," which happened to be primarily imports. Likewise, the Panel claimed that there was no direct correlation between the objective of discouraging alcohol consumption and measure because the tax differential between products with 35° of alcohol and 39° degrees of alcohol was not the same as the differential between products with, for instance, 40° and 44° of alcohol as the tax rate almost doubled between 35° and 39° but was the same between 40° and 44°. Since the system was based not just on alcohol content, but on *ad valorem* rates qualified by the additional criterion of alcohol content, there appeared to be no correlation between value and alcohol consumption. Finally, minimizing the regressive aspects of the tax reform would be true only if the factual situation were to remain static. In many markets there were quite low priced whiskies sold at the same alcohol content as high priced whisky.

[81] For a brief commentary on the Appellate Body decision in this case, see Raj Bhala and David Gantz, "WTO Case Review 2000" in *Arizona Journal of International and Comparative Law*, Vol. 18, No. 1, at pages 1-101.

[82] *Indonesia-Certain Measures Affecting the Automobile Industry,* Report of the Panel, WT/DS54/R, WT/DS55/R, WT/DS59/R and WT/DS64/R (2 July 1998) (98-2505).

Agreement 'explicitly authorized' Members to provide subsidies that were prohibited by Article III:2. However, the Panel rejected the arguments made by Indonesia and concluded that whether or not the SCM Agreement was considered generally to authorize Members to provide actionable subsidies so long as they did not cause adverse effects to the interests of another Member, the SCM Agreement clearly did not authorize Members to impose discriminatory product taxes. The SCM Agreement and Article III:2 were not mutually exclusive because it was possible for Indonesia to respect its obligations under the SCM Agreement without violating Article III:2 since Article III:2 was concerned with discriminatory product taxation, rather than the provision of subsidies as such.

Once the panel concluded that Article III:2 applied in regard to the Indonesian tax benefit scheme for national car producers, it followed the approach adopted by the Appellate Body in *Japan-Taxes on Alcoholic Beverages*, to test the validity of the Indonesian tax benefit scheme under Article III:2 of GATT. The panel concluded:

> Under the Indonesian car programmes the distinction between the products for tax purposes is based on such factors as the nationality of the producer or the origin of the parts and components contained in the product. An imported vehicle alike in all aspects relevant to a likeness determination would be taxed at a higher rate simply because of its origin or lack of sufficient local content. Such an origin-based distinction in respect of internal taxes suffices in itself to violate Article III:2 without the need to demonstrate the existence of actually traded like products.

(ii) Regulatory Measures and National Treatment:

Article III:4 of GATT, along with the general principle in Article III:1, sets out the national treatment obligations with regard to various internal regulations other than internal tax measures. The significant difference between the national treatment obligations set forth in Article III:4 and Article III:2 is that Article III:4 in its wording only applies to 'like' products and not to 'directly competitive or substitutable' products. Similarly, the required treatment of imported products is "no less favourable than that accorded to 'like' domestic products" and there is no reference to Article III:1 in Article III:4. This means, according to the interpretation of Article III adopted by the Appellate Body in *Japan- Taxes on Alcoholic Beverages* and followed by Panels and the Appellate Body in other cases, such as *Korea –Measures Affecting Imports of Fresh, Chilled and Frozen Beef* (hereinafter *Korea–Measures on Beef*), and *European Communities-Regime for the Importation, Sale and Distribution of Bananas* (hereinafter *EEC-*

Bananas), that no separate inquiry as to whether a regulatory measure has been applied 'so as to afford protection to domestic production' is required to determine the consistency of a regulatory measure with national treatment obligations set out in Article III:4. A determination that the imported and domestic products in question are 'like' and that the regulatory measure in dispute provides less favourable treatment to imported products than that accorded to like domestic products, is sufficient to establish a violation of Article III of the GATT.

The first case under the WTO dispute settlement system where an issue of the violation of Article III:4 was raised is *United States – Standards for Reformulated and Conventional Gasoline*[83]. The regulatory measure in question in this case was explicitly discriminatory[84] and not facially neutral because the gasoline product standard at issue in the case set a different and potentially more onerous standard for foreign suppliers, and the United States' main defence of the gasoline standard was the exceptions to general GATT obligations set out in Article XX. However, the Panel[85] in this case made rulings with regard to the steps in the inquiry required to determine whether a non-tax regulatory measure is consistent with the national treatment obligations set out in Article III:4. According to the Panel, complainants under Article III:4 are required to show the existence of: (a) a law, regulation or requirement affecting the internal sale, offering for sale, purchase, transportation, distribution or use of an imported product; and (b) treatment accorded in respect of the law, regulation or requirement that is less favourable to the imported product than to the 'like' product of national origin. The Panel concluded that the establishment of these two issues were sufficient to determine the inconsistency of a regulatory measure with Article III:4, and there is no need to establish the issue of "so as to afford protection to domestic production" as set forth in Article III:1 because the provision of Article III:1 is a general one and the provision of Article III:4 is more specific.

The Panel began its examination in this regard by the determination of 'like' products. To determine the likeness of products, the Panel followed the criteria suggested by the 1970 GATT Working Party Report on Border Tax Adjustments and considered that the criteria applied in the

[83] *United States – Standards for Reformulated and Conventional Gasoline*, Report of the Panel, WT/DS2/R (29 January 1996) (96-0326).
[84] See Hudec, supra note 19, at page 363. For comments on the Panel and Appellate Body decisions in this case, see Jennifer Schultz, "The Demise of "Green" Protectionism: The WTO Decision on the US Gasoline Rule" in *25 Denver Journal of International Law and Policy 1* (Fall 1996) (arguing that the case was correctly decided).
[85] This case was appealed but Appellate Body did not make any ruling on national treatment because the issue was not raised in the appeal, see *United States – Standards for Reformulated and Conventional Gasoline,* Report of the Appellate Body, WT/DS2/AB/R (26 April 1996) (96-1597), AB-1996-1.

1987 *Japan Alcohol* case in the examination under Article III:2 first sentence of internal tax measures were also applicable to the examination of like products under Article III:4. The Panel found that the domestic and imported gasoline were 'like' products because the chemically-identical imported and domestic gasoline by definition had exactly the same physical characteristics, end-uses, tariff classification, and were perfectly substitutable.

In order to determine whether the treatment provided to the imported products was less favourable than that accorded to like domestic products, the Panel followed the conclusions of the GATT panel in *United States – Section 337*, which had said that the words 'treatment no less favourable' in Article III:4 call for effective equality of opportunities for imported products in respect of laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products. The Panel concluded that the U.S. gasoline regulations treated the imported gasoline less favourably than the domestic gasoline because, under the baseline establishment methods provided in the regulations, the imported gasoline was effectively prevented from benefiting from as favourable sales conditions as were afforded to domestic gasoline. Relying on the conclusions in *United States – Section 337* the Panel also concluded that, under Article III:4, less favourable treatment of particular imported products in some instances could not be balanced by more favourable treatment of other imported products in other instances.

The approach taken by the Panel in *U.S. – Gasoline* in determining the inconsistency of a non-tax regulatory measure with Article III:4 was not fully followed by the Panel in *EEC-Bananas*[86]. In this case, the Panel, citing the Appellate Body's decision in *Japan- Taxes on*

[86]*European Communities- Regimes for the Importation, Sale and Distribution of Bananas,* Report of the Panel, WT/DS27/R (22 May 1997) (97-2069) (97-2070) (97-2077) (97-2078); and *European Communities- Regimes for the Importation, Sale and Distribution of Bananas*, Report of the Appellate Body, WT/DS27/AB/R (9 September 1997) (97-3593), AB-1997-3. The issues at dispute related to Article III:4 of GATT were the EEC procedures and requirements for the distribution of licences for importing bananas among eligible operators within EEC, which provided for the allocation of import licences in regard to 30% tariff quota for third country/ non-traditional ACP imports to the operators that had marketed EC and/ or traditional ACP bananas, on the basis of the average quantities of such bananas marketed in the three most recent years for which data were available, and the issuance of hurricane licences exclusively to EEC producers or operators including or directly representing a producer adversely affected by a tropical storm who was unable to supply the EEC market. These rules were explicitly discriminatory but the main question was whether or not the provisions of Article III:4 applied to these rules. Once it was concluded that Article III:4 did apply in respect of these rules, the discrimination based on the origin of products was evident. The said EEC licensing procedures and requirements were contested as being inconsistent with the national treatment obligations of both GATT Article III and GATS (General Agreement on Trade in Services) Article XVII. Both the Panel and Appellate Body found these licensing procedures as being inconsistent with both the GATT and GATS national treatment obligations. For a brief commentary on this case, see Terence P. Stewart and Mara M. Burr, "The WTO's First Two and a Half Years of Dispute Resolution" in *23 North Carolina Journal of*

Alcoholic Beverages and relying on the GATT panel decision in *United States – Section 337*, also examined the issue of whether the regulatory measure in question was applied so as to afford protection to domestic production, in addition to the two issues examined by the Panel in U.S.- *Gasoline* case. However, the Appellate Body in *EEC- Bananas* rejected this part of the Panel's approach, stating that the Panel misinterpreted its conclusion in *Japan- Taxes on Alcoholic Beverages* and that "a determination of whether there has been a violation of Article III:4 does not require a separate consideration of whether a measure 'affords protection to domestic production'".

The first WTO case on the National Treatment principle involving the issue of facially neutral non-tax regulatory measures was the *Japan-Measures Affecting Consumer Photographic Film and Paper*[87] (hereinafter *Japan-Film*). The Panel in this case followed the same approach as that established by the Panel in U.S.- *Gasoline* to determine whether the various Japanese distribution measures violated the National Treatment principle contained in Article III:4. In this case, the U.S. complained that eight different decisions, reports, guidelines etc. of various Japanese authorities accorded less favourable treatment to imported film and paper than to like domestic film and paper in the Japanese market. In response, Japan argued that the U.S. failed to show how the alleged measures applied less favourable treatment to imported film and paper. The Panel concluded that none of the alleged Japanese distribution measures violated Article III:4. Relying on the Appellate Body's decision in *Japan- Taxes on Alcoholic Beverages*, the Panel held that the standard of effective equality of competitive conditions on the internal market for imported products in relation to domestic products is the standard of national treatment that is required, not only with regard to Article III generally, but also more particularly with regard to the no less favourable treatment standard in Article III:4. According to the Panel, the U.S. failed to show that any of the measures cited by the U.S. discriminated against imported products either in terms of *de jure* discrimination or in terms of *de facto* discrimination. The U.S. had argued that the measures in question were directed at promoting vertical integration in the photographic materials distribution system with a view to impeding market access for foreign products. However, the Panel rejected the U.S. arguments, stating that the Japanese measures were

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International Law and Commercial Regulation 481 (1997/1998). For a detailed discussion on this case, see Raj Bhala, "The Bananas War" in 31 *McGeorge Law Review* 843 (2000).

[87] *Japan-Measures Affecting Consumer Photographic Film and Paper*, Report of the Panel, WT/DS44/R (31 March 1998) (98-0886).

formally neutral as to the origin of products and their application did not have a disparate impact on imported film or paper. The basis of the U.S. claim was the existence of a single brand wholesale distribution system in the Japanese market for film and photographic papers, which according to the U.S., impeded market access for foreign products. The Panel found that the U.S. could not establish a causal link or a meaningful nexus between the challenged measures and this market structure because the market structure existed even prior to the introduction of the measures in question. The Panel also found that a single brand wholesale distribution system was the common market structure- indeed the norm- in most major national film markets, including the U.S. market. The Panel argued that it was unclear why the same economic forces acting to promote single brand wholesale distribution in the U.S. would not also exist in Japan.

Thus the Panel in *Japan–Film* established that a causal link or meaningful nexus between the challenged measures and the competitive conditions in the market must be shown by the complainant in order to prove a violation of Article III:4. However, what constitutes a regulatory measure (that is a law, regulation or requirement affecting the internal sale, offering for sale, purchase, transportation, distribution or use of an imported products) subject to the purview of Article III:4 may itself be a contentious issue. In the *Japan-Film,* the Panel's interpretation of the terms "laws, regulations or requirements" in Article III:4 was not entirely clear. Although it argued that a literal reading of the words "all laws, regulations or requirements" in Article III:4 could suggest that they may have a narrower scope than the word measure in Article XXIII:1 (b) in the context of nullification and impairment, the Panel assumed for the purposes of this case that the terms "laws, regulations or requirements" in Article III:4 should be interpreted as having a meaning similar to the term "measures" in Article XXIII:1(b), and found that only three measures met the definition of "laws, regulations or requirements" within the meaning of Article III:4. However, the Panel also assumed that the remaining five contested measures were also "laws, regulations or requirements" for the sake of completeness of its analysis in examining whether less favourable treatment was accorded to imported products.

The issue as to the meaning of "laws, regulations or requirements" in Article III:4 also arose in *Canada- Certain Measures Affecting the Automotive Industry*[88]. The issues in dispute

[88]*Canada- Certain Measures Affecting the Automotive Industry*, Report of the Panel, WT/DS139/R and WT/DS142/R (11 February 2000) (00-0455); and *Canada- Certain Measures Affecting the Automotive Industry*, Report of the Appellate Body, WT/DS139/AB/R and WT/DS142/AB/R (31 May 2000) (00-2170), AB-2000-2. For

relating to Article III:4 in this case were Canadian measures which accorded to certain motor vehicle manufacturers established in Canada the right to import motor vehicles with an exemption from the generally applicable customs duty. In order to qualify for the exemption, an eligible manufacturer's local production of motor vehicles (including in certain cases the production of parts) must have achieved a minimum amount of Canadian value added (CVA) and its local production must have maintained a minimum production-to-sales ratio with respect to its sales of motor vehicles in Canada. Japan and the European Communities claimed that the CVA and production-to-sales ratio contained in various government Orders as well as the commitment with regard to the CVA expressed by certain manufacturers in Letters of Undertaking to the government were 'requirements' affecting the internal sale, offering for sale, purchase, transportation, distribution or use of an imported products within the meaning of Article III:4 and these requirements accorded less favourable treatment to imported parts, materials and non-permanent equipment for use in the production of motor vehicles. Canada argued that these measures did not affect the "internal sale,….or use" of imported products because they did not in law or in fact require the use of domestic products and therefore played no role in the parts sourcing decisions of manufacturers.

The Panel concluded that Article III:4 applies not only to mandatory measures but also to conditions that an enterprise accepts to receive an advantage, including cases where the advantage is in the form of a benefit with respect to the conditions of importation of a product, and the fact that compliance with the CVA requirements is not mandatory but a condition which must be met in order to obtain an advantage consisting of the right to import certain products duty-free does not preclude application of Article III:4. Similarly, the Panel found that the word 'affecting' in Article III:4 of the GATT has been interpreted to cover not only laws and regulations which directly govern the conditions of sale or purchase but also any laws or regulations which might adversely modify the conditions of competition between domestic and imported products. The Panel concluded that CVA requirements in government Orders must be regarded as measures which 'affect' the "internal sale…or use" of imported products because a measure which provides that an advantage can be obtained by using domestic products but not by using imported products has an impact on the conditions of competition between domestic

a brief history and objectives behind the Canadian measures as well as the analysis and commentary on the Appellate Body decision in this case, see Raj Bhala and David Gantz, supra note 81.

and imported products and thus affects the "internal sale,….or use" of imported products, even if the measure allows for other means to obtain the advantage, such as the use of domestic services rather than products. Similarly, the Panel claimed that neither legal enforceability nor the existence of a link between a private action and an advantage conferred by a government was a necessary condition in order for an action by a private party to constitute a 'requirement'. According to the Panel, a determination of whether private action amounts to a 'requirement' under Article III:4 must necessarily rest on a finding that there is a nexus between that action and the action of a government such that the government must be held responsible for that action. The panel concluded that the commitments expressed in the letters of undertakings were 'requirements' within the meaning of Article III:4[89].

On the issue of whether the CVA requirements accorded less favourable treatment to imported products, the Panel rejected the argument of Canada that these requirements did not in practice accord less favourable treatment to imported products as the CVA levels were so low that they could easily be met on the basis of labour alone. The Panel found that the CVA requirements accorded less favourable treatment within the meaning of Article III:4 to imported parts, materials and non-permanent equipment than to like domestic products because, by conferring an advantage on the use of domestic products , they adversely affected the equality of competitive opportunities of imported products in relation to like domestic products. For the same reasons, the Panel concluded that the commitments contained in the Letters of Undertakings also accorded less favourable treatment to imported products.

Despite distinctions noted in some cases between *de jure* discrimination caused by explicitly discriminatory regulatory measures and *de facto* discrimination caused by facially neutral regulatory measures, the WTO jurisprudence has not developed separate tests to determine the validity of such measures under Article III of the GATT. Although in the context of Article III:2, first sentence, WTO panels and Appellate Body have declared any internal tax

[89]This conclusion was based on the facts that, in making the commitments, the companies acted at the request of the Government of Canada ("the Government"); the anticipated Auto Pact between the U.S. and Canada was a key factor in the decision of the companies to submit these undertakings; the companies accepted responsibility *vis-à-vis* the Government with respect to the implementation of the undertakings contained in the letters, which they described as 'obligations' and in respect of which they undertook to provide information to the Government and indicated their understanding that the Government would conduct yearly audits; and until recently the Government gathered information on an annual basis concerning the implementation of the conditions provided for in the letters. The Panel rejected the Canadian argument that the commitments expressed in the letters of undertaking were not 'requirements' within the meaning of Article III:4 because the Government of Canada did not negotiate for them, and compliance with the letters was neither legally enforceable nor a condition to obtain an advantage.

measure that imposes even slightly different tax rates on imported products compared to like domestic products to be inconsistent with the National Treatment principle on the very basis of such origin-specific differentiation, origin-specific regulatory measures are not *per se* inconsistent with the national treatment. The Appellate Body in *Korea- Measures on Beef* rejected the Panel's conclusion that "any regulatory distinction that is based exclusively on criteria relating to the nationality or the origin of the products is incompatible with Article III and this conclusion can be reached even in the absence of any imports, confirming that there is no need to demonstrate the actual and specific trade effects of a measure for it to be found in violation of Article III" [90]. The Appellate Body stated that a formal difference in treatment between imported and like domestic products is neither necessary nor sufficient to show a violation of Article III:4. In its view, whether or not imported products are treated "less favourably" than like domestic products should be assessed instead by examining whether a measure modifies the conditions of competition in the relevant market to the detriment of imported products.

In this case[91], both the Panel and Appellate Body concluded that Article III:4 is violated if the complainant demonstrates (a) that imported and domestic products are "like"; (b) that the measure at issue is either a law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution, or use; and (c) that the measure provides to imported products treatment less favourable than that accorded to domestic products. As there was no dispute at both the Panel and Appellate Body levels on the 'likeness' of domestic and imported beef and the measure at issue being a law or regulation within the meaning of Article III:4, both the Panel and Appellate Body only examined whether or not the dual retail system for beef in the Korean market provided less favourable treatment to imported beef. Although both the Panel and Appellate Body reached the same conclusion that the retail system for beef in the

[90] *Korea- Measures Affecting Imports of Fresh, Chilled and Frozen Beef,* Report of the Panel, WT/DS161/R and WT/DS169/R (31 July 2000) (00-3025); and *Korea- Measures Affecting Imports of Fresh, Chilled and Frozen Beef,* Report of the Appellate Body, WT/DS161/AB/R and WT/DS169/AB/R (11 December 2000) (00-5347), AB-2000-8.

[91] The measure in dispute was the Government of Korea's Management Guidelines for Imported Beef which specified that imported beef (except for pre-packed imported beef) might only be sold in specialized imported-beef shops and that large-scale distributors (department stores, super-markets, etc) must provide a separate sales area for imported beef. Stores selling imported beef were also mandatorily required to display a "Specialized Imported Beef Store" sign to distinguish them from domestic meat sellers. Australia and the U.S. complained that the Korea's requirement was inconsistent with Article III:4. Korea defended the dual retail system for beef on the grounds that it did not impose less favourable treatment on imported beef as domestic and imported beef both were sold in separate shops and there were no limitations on the number of imported-beef shops that could be opened.

Korean market provided less favourable treatment to imported beef, they based their conclusion on different reasons.

Korea had appealed against the finding of the Panel which concluded that the dual retail system applied by Korea to imported and domestic beef accorded less favourable treatment to imported beef and thus was inconsistent with Article III:4. In addition to the above-mentioned reason based on origin of products that was rejected by the Appellate Body, the finding of the Panel was also based on its assessment of how the dual retail system modified the conditions of competition between imported and like domestic beef in the Korean market. The Panel gave several reasons for why it believed that the dual retail system altered the conditions of competition in the Korean market in favour of domestic beef: first, the dual retail system would "limit the possibility for consumers to compare imported and domestic products", and thereby "reduce opportunities for imported products to compete directly with domestic products"; second, under the dual retail system, "the only way an imported product can get on the shelves is if the retailer agrees to substitute it, not only for one but for all existing like domestic products", and this disadvantage would be more serious when the market share of imports (as is the case with imported beef) is small; third, the dual retail system, by excluding imported beef from "the vast majority of sales outlets" limited the potential market opportunities for imported beef, and this would apply particularly to products "consumed on a daily basis", like beef, where consumers may not be willing to "shop around"; fourth, the dual retail system imposed more costs on the imported product, since the domestic product would tend to continue to be sold from existing retail stores, whereas imported beef would require new stores to be established; fifth, the dual retail system "encourages the perception that imported and domestic beef are different, when they are in fact like products belonging to the same market", which gave a competitive advantage to domestic beef "based on criteria not related to the products themselves"; and sixth, the dual retail system "facilitates the maintenance of a price differential" to the advantage of domestic beef. On appeal, Korea argued that dual retail system does not on its face violate Article III:4, since there was "perfect regulatory symmetry" in the separation of imported and domestic beef at the retail level, and there was "no regulatory barrier" which prevented traders from converting from one type of retail store to another. Korea also argued that the dual retail system did not deny consumers the possibility of making comparisons, and it neither added to the costs of, nor sheltered high prices for, domestic beef.

Relying on the GATT panel decision in U.S. – *Section 337* and its decision in *Japan– Taxes on Alcoholic Beverages*, the Appellate Body stated that "treatment no less favourable" means according conditions of competition no less favourable to the imported product than to the like domestic product and it implies that a measure according formally different treatment to imported products does not *per se* violate Article III:4. The Appellate Body did not agree with Panel that the limitation on the ability of consumers to compare visually two products at the point of sale necessarily reduced the opportunity for the imported product to compete "directly" or on "an equal footing" with the domestic product, nor did it agree that the alleged encouragement provided by the dual retail system to the perception of consumers that imported and domestic beef were "different" necessarily implied a competitive advantage for domestic beef. In its view, although the Korean dual retail system formally separated the selling of imported beef and domestic beef by the requirement of two distinct retail distribution systems, such formal separation, in and of itself, did not necessarily compel the conclusion that the treatment thus accorded to imported beef was less favourable than that accorded to domestic beef. According to the Appellate Body, to determine whether the treatment accorded to imported beef was less favourable than that accorded to domestic beef, it was necessary to inquire into whether or not the Korean dual retail system for beef modified the conditions of competition in the Korean beef market to the disadvantage of the imported product. After examining the beef market structure in Korea, the Appellate Body concluded that the introduction of the dual retail system resulted in the imposition of a drastic reduction of commercial opportunities for imported beef to reach, and hence to generate sales to, the same consumers served by the traditional retail channels for domestic beef[92]. Although it agreed that the dramatic reduction in number of retail outlets for imported beef followed from the decisions of individual retailers who could choose freely to sell the domestic product or the imported product, it found that the legal necessity of making a choice was imposed by the government measure itself and the reduction of access to normal retail channels was, in legal contemplation, the effect of that measure. The Appellate Body concluded, therefore, that the Korean Government's measure was responsible for the resulting establishment of competitive conditions less favourable for the imported product than for the domestic product, and the fact that the WTO-consistent quota for beef was fully utilized

[92]The Appellate Body noted that the reduction of commercial opportunities was reflected in the much smaller number of specialized imported beef shops (around 5,000 shops) as compared with the number of retailers (around 45,000 shops) selling domestic beef.

did not detract from the lack of equality of competitive conditions entailed by the dual retail system[93].

The next significant case involving a facially neutral regulatory measure that was claimed to violate the National Treatment principle in Article III:4 was the *European Communities-Measures Affecting Asbestos and Asbestos-Containing Products* (hereinafter *EEC-Asbestos*)[94]. In this case, the issue was the general ban imposed by a Decree of the French Government on the manufacture, processing, sale, import, placing on the domestic market and transfer under any title whatsoever of all varieties of asbestos fibres. However, on an exceptional and temporary basis, the ban was not to apply to certain existing materials, products or devices containing chrysotile fibre when, to perform an equivalent function, no substitute for that fibre was available which posed a lesser health risk. Canada complained, *inter alia*, that the French Decree violated the National Treatment principle of Article III:4 of the GATT by banning the marketing of chrysotile fibres and chrysotile-cement products because chrysotile fibres and chrysotile-cement products were 'like' polyvinyl alcohol (PVA), cellulose and glass fibres within the meaning of Article III:4 and by prohibiting chrysotile fibres and chrysotile-cement products, the EEC was favouring its national industry of PVA, cellulose and glass fibres (hereinafter 'PCG fibres') and fibro-cement products containing these fibres.

The Panel, following the steps established by WTO Panels and Appellate Body in past cases, began its inquiry by examining whether or not the chrysotile fibres were 'like' PCG fibres, and whether or not cement-based products containing chrysotile asbestos fibres were "like" cement-based products containing one of the PCG fibres. To define the 'likeness' of products, the Panel followed the same approach as that taken by the Panel in U.S.-*Gasoline* which had applied the same criteria suggested by the Appellate Body in *Japan-Taxes on Alcoholic Beverages* for the purposes of determining 'like" products in the context of Article III:2, first

[93]The Appellate Body also stated that it was *not* holding that a dual distribution system that was *not* imposed directly or indirectly by governmental regulation, but was rather solely the result of private entrepreneurs acting on their own calculation of comparative costs and benefits of differentiated distribution systems, was unlawful under Article III:4.

[94]*European Communities-Measures Affecting Asbestos and Asbestos-Containing Products,* Report of the Panel, WT/DS135/R (18 September 2000) (00-3353); and *European Communities-Measures Affecting Asbestos and Asbestos-Containing Products,* Report of the Appellate Body, WT/DS135/AB/R (12 March 2001) (01-1157), AB-2001-11. For analysis of various aspect of this case, see Laura Yavitz, "The World Trade Organization Appellate Body Report, European Communities–Measures Affecting Asbestos and Asbestos-Containing Products, Mar.12, 2001, WT/DS135/AB/R" in *Minnesota Journal of Global Trade*, Winter 2002, at page 43; and Robert Howse and Elisabeth Tuerk, "The WTO Impact on Internal Regulations – A Case Study of the Canada – EC Asbestos Dispute," in G. de Burca and J. Scott (eds.), *The EU and the WTO: Legal and Constitutional Issues* (Oxford: Hart Publishing, 2001).

sentence, and in the context of determining 'like' products under Article III:4. The Panel specifically noted the observations made by the Appellate Body in *Japan-Taxes on Alcoholic Beverages* that the term 'like' products should be examined on a case-by-case, which would inevitably involve a degree of judgment. Despite the acknowledgement that the structure of chrysotile fibres is unique by nature and that none of the substitute fibres has the same structure, either in terms of its form, diameter, length or potential to release particles that possess certain characteristics, and that they do not have the same chemical composition or in purely physical terms the same nature or quality, the Panel still found that chrysotile fibres were 'like' PCG fibres. The basis of the Panel's finding was that, for many industrial uses, PCG fibres have the same applications as chrysotiles. The Panel rejected the narrow definition of 'like product' as applied in other WTO cases, arguing that consideration of only the physical structure, chemical composition and properties of products in the examination of 'likeness' of products would exclude many products from being 'like' even if they had a similar use. The Panel also claimed that the context for the application of Article III:4 is not a scientific classification exercise but is to provide market access for products, and in the context of market access, it is not necessary for domestic products to possess all the physical similarities and properties of the imported products in order to be "like" products. In the view of Panel, the fact that chrysotile fibres and PCG fibres have certain identical or at least similar end uses in cement products was sufficient to consider them as 'like' products even if in other circumstances their end-uses may be different.

The Panel also rejected as irrelevant the argument of the EEC that chrysotile fibres are a widely recognized carcinogen and pose serious threats to human health. The Panel claimed that the risk of a product to human or animal health has never been used as a factor of comparison by panels entrusted with applying the concept of 'likeness' within the meaning of Article III, and introducing a criterion as to the health risks of a product into the analysis of 'likeness' within the meaning of Article III would largely nullify the effect of Article XX (b) which specifically covers the protection of human health and life (under which the Panel went on to uphold the measures in question). The Panel also did not consider the criterion of consumers' tastes and habits, stating that the products concerned were not everyday consumer goods. Similarly, the Panel disregarded the difference in tariff classification of the products in dispute in the Harmonized System stating that differences in the tariff classification were not a decisive criterion in this case.

On the issue of whether or not the EEC measure provided less favourable treatment to imported products than that accorded to like domestic products, the Panel concluded that the terms of the EEC measure themselves established less favourable treatment for asbestos and products containing asbestos as compared to PCG fibres and products containing PCG fibres because the measure imposed a ban on asbestos fibres and did not place an identical ban on PCG fibres and fibro-cement products containing PCG fibres[95]. Thus, the Panel found that EEC measure in regard to asbestos products was inconsistent with Article III:4.

It is evident from the Panel's decision in *EEC-Asbestos* that the determination of the issue of whether or not a regulatory measure is inconsistent with the principle of National Treatment depends very much on whether or not the imported product and its domestic comparator are 'like' each other. As stated by the Appellate Body in *EEC-Asbestos*, the determination of the 'likeness' of two products in the context of Article III:4 rests on how a panel decides three issues: first, which characteristics or qualities are important in assessing the "likeness" of products since most products have many qualities and characteristics, ranging from physical properties such as composition, size, shape, texture, and possibly taste and smell, to the end-uses and applications of the product; second, the degree or extent to which products must share qualities or characteristics in order to be "like" products since products may share only very few characteristics or qualities or they may share many; and third, from whose perspectives 'likeness' should be judged because ultimate consumers may have a view about the likeness of two products which may be very different from that of the inventors, producers or regulators of those products[96]. The Appellate Body attempted to resolve these issues.

The Appellate Body first noted that the appeal from the Panel's decision provided it with its first occasion to examine the meaning of the word 'like' products in Article III:4. Although it observed that the term 'like product' appears in the first sentence of Article III:2 and in Article III:4 in the context of National Treatment principle, and both of these provisions constitute specific expressions of the overarching general principle of national treatment set forth in Article III:1, it concluded that the term 'like products' in Article III:4 should not be construed as narrowly as in the context of Article III:2. The reason for a different approach to interpreting the same words in the context of the National Treatment principle is, according to the Appellate

[95] The Panel simply ignored the arguments of EEC that the measure itself was origin-neutral and did not seek to protect domestic products because France imports most substitute products from various third countries.
[96] Appellate Body in *EEC-Asbestos*, see supra note 93.

Body, that Article III:2 contains two separate obligations in two sentences covering 'like' products and 'directly competitive or substitutable' products respectively and there is a need to interpret these two sentences in a harmonious manner in order to give meaning to both sentences of Article III:2, whereas Article III:4 contains a single obligation that applies solely to 'like' products and the harmony required to be attributed to the two sentences of Article III:2 need not and cannot be replicated in interpreting Article III:4. In the view of the Appellate Body, a determination of 'likeness' under Article III:4 is fundamentally a determination about the nature and extent of a competitive relationship between and among products, even if there is a spectrum of degrees of competitiveness or substitutability of products in the market place and it is difficult, in the abstract, to indicate precisely where on this spectrum the word 'like' in Article III:4 falls. The Appellate Body concluded that the product scope of Article III:4, although broader than the first sentence of Article III:2, is certainly not broader than the combined product scope of the two sentences of Article III:2[97]. After having so defined the scope of 'like' products in Article III:4, the Appellate Body proceeded to outline a framework for analyzing the 'likeness' of particular products in a particular case. It found that past GATT panels as well as WTO Panels and the Appellate Body have developed and followed an approach consisting of four general criteria in order to determine the 'likeness' of products. These four criteria are: (i) the properties, nature and quality of the products, (ii) the end-uses of the products, (iii) consumers' tastes and habits, and (iv) the tariff classification of the products. However, the Appellate Body claimed that these criteria are neither a treaty-mandated nor a closed list of criteria that should determine the legal characterization of products, but are simply tools to assist in the task of sorting and examining the relevant evidence in a particular case. According to the Appellate Body, all the pertinent evidence needs to be examined in each case and the kind of evidence to be examined in assessing the 'likeness' of products depends upon the particular products and the legal provision at issue.

The Appellate Body rejected the approach taken by the Panel in *EEC-Asbestos* to determine the 'likeness' of chrysotile fibres with PCG fibres, and reversed the determination that

[97]Despite the existence of the same word and similar context, the Appellate Body's efforts to avoid for the purpose of Article III:4 the narrow definition of the word 'like' given in the first sentence of Article III:2 seems to be influenced by the possible implication of such interpretation for the objective of the national treatment principle. It stated that there is no sharp distinction between fiscal regulation covered by Article III:2 and non-fiscal regulation covered by Article III:4 because both forms of regulation can often be used to achieve the same ends. According to it, it would be incongruous if, due to a significant difference in the product scope of these two provisions, Members (of WTO) were prevented from using one form of regulation (for instance, fiscal) to protect domestic production of certain products, but were able to use another form of regulation (for instance, non-fiscal) to achieve those results.

chrysotile fibres were ‘like’ PCG fibres and cement-based products containing chrysotile asbestos fibres and cement-based products containing PCG fibres were "like products". It concluded that the Panel should have examined the evidence relating to each of the four criteria and then weighed all of this evidence, along with any other relevant evidence, in making an overall determination of whether the products at issue could be characterized as ‘like’, and it was inappropriate for the Panel to express a conclusion after examining only one of the four criteria (end-uses). According to the Appellate Body, physical properties of products deserve a separate examination which should not be confused with the examination of end-uses, and although not decisive, the extent to which products share common physical properties may be a useful indicator of ‘likeness’ because the physical properties of a product may influence how the product can be used, consumer attitudes about the product, and tariff classification. The evidence relating to the health risks associated with a product may be pertinent to an examination of ‘likeness’ under Article III:4, but need not be examined under a separate criterion and can be evaluated under the criteria of physical properties and of consumers’ tastes and habits.

After reversing the Panel’s conclusion in regard to the ‘likeness’ of chrysotile fibres with PCG fibres and cement-based products containing chrysotile asbestos fibres with cement-based products containing PCG fibres, the Appellate Body proceeded to its own examination of ‘likeness’ of the products at issue on the basis of the evidence available in the Panel’s Report. It first examined the physical properties of chrysotile fibres and PCG fibres and noted the Panel’s conclusion that these fibres are physically very different. Then, it emphasized the fact that was treated as irrelevant although acknowledged by the Panel in examining ‘likeness’ – that chrysotile fibres have been recognized internationally as a known carcinogen because of the particular combination of their molecular structure, chemical composition and fibrillation capacity. The Appellate Body also noted the evidence that PCG fibres are not classified by the World Health Organization at the same level of risk as chrysotile and the experts consulted by the Panel also confirmed that current scientific evidence indicates that PCG fibres do not present the same risk to health as chrysotile fibres. It then concluded that when the evidence relating to properties indicates that the products in question are physically different, then “in order to overcome the indication that products are not like, a high burden is imposed on a complainant to establish that, despite the pronounced physical differences, there is a competitive relationship between the products such that, all the evidence, taken together, demonstrates that the products

are ‘like’ under Article III:4”. The Appellate Body found that the complainant had not satisfied its burden because the end-uses of chrysotile fibres and PCG fibres were the same for only a small number of applications, no evidence was submitted on consumers’ tastes and habits[98] and chrysotile fibres and PCG fibres have different tariff classifications.

Applying the same criteria as in the examination of the “likeness” of chrysotile fibres with PCG fibres, the Appellate Body also examined whether cement-based products containing chrysotile asbestos fibres are "like" cement-based products containing PCG fibres and found that these products were not “like” products. It specifically rejected the contention of Canada that evidence on consumers' tastes and habits concerning cement-based products was irrelevant. According to the Appellate Body, it was of particular importance under Article III to examine evidence relating to competitive relationships in the marketplace, and it was likely that the presence of a known carcinogen in one of the products would have an influence on both intermediate and final consumers' tastes and habits regarding that product. In the view of the Appellate Body, it might be that, although cement-based products containing chrysotile fibres were capable of performing the same functions as other cement-based products, consumers were, to a greater or lesser extent, unwilling to use products containing chrysotile fibres because of the health risks associated with them. However, the Appellate Body considered it as only speculation and did not make any determination on this issue because of lack of evidence. In its view, a determination on the "likeness" of the cement-based products could not be made, under Article III:4, in the absence of an examination of evidence on consumers' tastes and habits.

On the basis of these findings, the Appellate Body concluded that, as Canada had not demonstrated that chrysotile asbestos fibres were "like" PCG fibres or that cement-based products containing chrysotile asbestos fibres were "like" cement-based products containing PCG fibres, it did not succeed in establishing that the EEC measure at issue was inconsistent with Article III:4 of the GATT. The Appellate Body, however, also observed that there is a second element that must be established before a regulatory measure can be held to be inconsistent with Article III:4. Even if two products are "like", the complainant must still establish that the measure accords to the group of "like" imported products "less favourable treatment" than it accords to the group of "like" domestic products. In the view of the Appellate

[98] The Appellate Body also said that where the physical properties are very different, an examination of the evidence relating to consumers’ tastes and habits is an *indispensable*- although not, on its own, sufficient – aspect of any determination that products are ‘like’ under Article III:4.

Body, the term "less favourable treatment" expresses the general principle set out in Article III:1, that internal regulations should not be applied "so as to afford protection to domestic production". It said that if there is "less favourable treatment" of the group of "like" imported products, there is, conversely, "protection" of the group of "like" domestic products. Nevertheless, the Appellate Body also said that distinctions may be drawn between products which have been found to be "like", without, for this reason alone, according to the group of "like" imported products "less favourable treatment" than that accorded to the group of "like" domestic products[99].

It is notable that one Member of the Appellate Body in *EEC-Asbestos* expressed a separate opinion about the approach to be taken in order to determine the "likeness" of two products. He took the view that, considering the nature and quantum of the scientific evidence showing the carcinogenicity of chrysotile asbestos fibres, there was ample basis for a definitive characterization of such fibres as not "like" PCG fibres, and that definitive characterization might and should be made even in the absence of evidence concerning the other two criteria of end-uses and consumers' tastes and habits[100]. He also cautioned that the necessity or appropriateness of adopting a "fundamentally economic" interpretation of the "likeness" of products under Article III:4 was not free from substantial doubt, and in future contexts, the line between a "fundamentally" and "exclusively" economic view of "like products" under Article III:4 might well prove very difficult, as a practical matter, to identify. However, he did not offer any suggestion as to the appropriate approach to the interpretation of the "likeness" of products under Article III:4, but rather he reserved his opinion on this matter.

After the *EEC-Asbestos* case, two other cases, which involve issues pertaining to Article III:4 of the GATT, have been decided by the Dispute Settlement Body of the WTO. However, the tests applied by the Panel and Appellate Body to examine the consistency or inconsistency of the measure in question with Article III:4 in *United States- Tax Treatment for "Foreign Sales*

[99]However, the Appellate Body in this case did not examine further the interpretation of the term "treatment no less favourable" in the context of Article III:4.

[100] He argued that it was difficult for him to imagine what evidence relating to competitive relationships as reflected in end-uses and consumers' tastes and habits could outweigh and set at naught the undisputed deadly nature of chrysotile asbestos fibres, compared with PCG fibres, when inhaled by humans, and thereby compel a characterization of the "likeness" of chrysotile asbestos and PCG fibres. However, he also clarified that he was not suggesting that any kind or degree of health risk, associated with a particular product, would a *priori* negate a finding of the "likeness" of that product with another product, under Article III:4. His suggestion was limited only to the circumstances of *EEC-Asbestos* case, and confined to chrysotile asbestos fibres as compared with PCG fibres.

Corporations"- Recourse to Article 21.5 of the DSU by the European Communities[101](hereinafter *US- FSC (Article 21.5))* and the Panel in *India- Measures Affecting the Automotive Sector*[102] (hereinafter *India- Automotive)* are similar to those followed by the Panel and the Appellate Body in *Canada- Automotive, Korea- Beef* and *EEC-Asbestos.*

In the *US- FSC (Article 21.5)*[103], the Panel cited the rulings of the Panel and Appellate Body in *Canada- Automotive* and *EEC- Asbestos* in respect of the meaning of 'like products' and 'less favourable treatment', and viewed the principal purpose of the 'like product' inquiry under Article III:4 as ascertaining whether any formal differentiation in treatment between an imported and a domestic product could be based upon the fact that the products are different (not like) rather than on the origin of the products involved. According to the Panel, when a regulatory measure of general application makes a distinction between imported and domestic products solely and explicitly on the basis of origin of such products, and applies horizontally to all possible products that can be used for the production of goods that might eventually be a recipient of the benefit accorded by the said regulatory measure, then there is no need to demonstrate the existence of actually traded like products in order to establish a violation of Article III:4. On the issue of when a regulatory measure at issue is considered as one "affecting" the internal sale or use of the products concerned, the Panel said, relying on the rulings in *EEC- Bananas* and *Canada- Automotive,* that the ordinary meaning of the term "affecting" implies a measure that has "an effect on", thereby indicating a broad scope of application. The Panel also noted that the term "affecting" in Article III:4 has been interpreted to cover not only laws and regulations which directly govern the conditions of sale or purchase but also any laws or

[101] *United States- Tax Treatment for "Foreign Sales Corporations"- Recourse to Article 21.5 of the DSU by the European Communities,* Report of the Panel, WT/DS108/RW (20 August 2001).
[102] *India- Measures Affecting the Automotive Sector*, Report of the Panel, WT/DS146/R, WT/DS175/R (21 December 2001) (01-6327).
[103] In this case, the issue relating to Article III:4 was certain provisions of the 2000 *FSC Repeal and Extraterritorial Exclusion Act* of the US which was enacted to comply with the DSB recommendations and rulings in *United States- Tax Treatment for "Foreign Sales Corporations"*. The EEC claimed, *inter alia,* that the provisions of the said Act which excluded certain extraterritorial income derived from the sale or lease of "qualifying foreign trade property" from taxation were contrary to Article III:4 of the GATT. "Qualifying foreign trade property" was the property made within or outside the US, and sold for ultimate use outside the US, no more than 50 percent of the fair market value of which was attributable to "articles manufactured, produced, grown or extracted outside the United States" and "direct costs for labour…performed outside the United States", which meant that the exclusion from taxation provided by the Act was not available in respect of income derived from the sale or lease of property more than 50 percent of the fair market value of which was attributable to articles made, or costs of direct labour performed, outside the US. The EEC argued that this foreign articles/labour limitation was inconsistent with Article III:4 as it was a requirement contained in a law which provided less favourable treatment to imported parts and materials than to like domestic goods with respect to their internal use in the production of goods within the US.

regulations which might adversely modify the conditions of competition between domestic and imported products. The Panel then considered that a measure pursuant to which the use of domestic, but not imported, products contributes to obtaining an advantage has an impact on the conditions of competition between domestic and imported products and thus "affects" the internal "use" of imported products, even if the measure allows for other means to obtain the advantage, such as the use of domestic inputs other than products.

On the issue of "less favourable treatment", the Panel recalled the previous rulings in *Canada- Automotive* and *Korea- Beef* that Article III:4 of the GATT is an obligation addressed to governments requiring that they ensure equality of competitive opportunities to domestic and like imported products, and it does not require a demonstration of trade effects, nor proof that the sourcing decisions of private firms have actually been impacted by the regulatory measure in question. The Panel also stated that any distinction that is based exclusively on criteria relating to the nationality or origin of the product would not necessarily be incompatible with Article III. To be incompatible with the provisions of Article III:4, a measure must accord treatment to imported products that is 'less favourable than' that accorded to like domestic products. According to the Panel, when an advantage is conferred upon the use of domestic products that is not conferred upon the use of imported products, it constitutes a formal differentiation of treatment between imported and like domestic products, which, in the view of the Panel, affords less favourable treatment to imported products than to like domestic products because by conferring an advantage upon the use of domestic products but not upon the use of imported products, it adversely affects the equality of competitive opportunities of imported products in relation to like domestic products. The Appellate Body upheld the rulings of the Panel in this case[104].

In *India- Automotive* case[105], the issues were similar to those in *Canada- Automotive* and *US- FSC (Article 21.5)*. Therefore, the Panel followed the same approach and gave similar

[104]See *United States- Tax Treatment for "Foreign Sales Corporations"- Recourse to Article 21.5 of the DSU by the European Communities*, Report of the Appellate Body, WT/DS108/AB/RW (14 January 2002) (02-0152), AB-2001-8

[105]The issue in this case relating to Article III:4 was the indigenization condition contained in Public Notice No. 60 issued by the Government of India under Foreign Trade (Regulation and Development) Act of 1992 and the MOUs required to be signed by manufacturers in order to gain the right to apply for an import license to import the restricted kits and components. The measure in question required the MOU signatories to commit to achieving a level of indigenization of components up to a minimum level of 50% in the third year or earlier and 70% in the fifth year or earlier, in order to obtain import licenses. The indigenization requirement was, thus, an obligation to use a certain proportion of local parts and components in the manufacture of cars and automotive vehicles. The US and

reasons in determining the inconsistency of the measure in question with Article III:4. On the issue of the meaning of the term "requirement' under Article III:4, the Panel concluded that a binding enforceable condition falls squarely within the ordinary meaning of the word "requirement", in particular as "a condition which must be complied with". According to the Panel, the enforceability of the measure in itself, independently of the means actually used or not to enforce it, is a sufficient basis for a measure to constitute a requirement under Article III:4. Similarly, in respect of the meaning of the term "affecting", the Panel said that this term goes beyond laws and regulations which directly govern the conditions of sale or purchase to cover also any laws or regulations which might adversely modify the conditions of competition between domestic and imported products. On the issue of "less favourable treatment" to imported products, the Panel said that in determining whether imported products are treated less favourably than domestic products, it (the Panel) is obliged to examine whether the contested regulatory measure modifies the conditions of competition in the relevant market to the detriment of imported products. According to the Panel, any requirement that provides an incentive to purchase and use domestic or local products and hence creates a disincentive to use like imported products modifies the conditions of competition between the domestic and imported products in the relevant market within the meaning of Article III:4 because such a requirement creates a situation where imported products cannot compete on an equal footing with domestic products.

IV. Critique of the GATT/WTO Case Law on National Treatment

According to Article 31 of the Vienna Convention on the Law of Treaties, "a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its objective purpose." As the case-law amply demonstrates and as the Appellate Body has acknowledged in several cases, the interpretation and application of key terms in Article III involve an unavoidable element of judgement because the terms have no self-evident "ordinary meaning," thus suggesting the importance of an interpretation of these terms that is consonant with the purpose of the Article. Obviously, merely looking at, touching, feeling, smelling or decomposing two products is unlikely to reveal whether

the EEC argued, *inter alia,* that this requirement accorded less favourable treatment to imported parts and components and therefore was contrary to Article III:4.

they are like products in any legally or policy-relevant sense, suggesting the need for something more purposive than a "smell test." The purpose of Article III is set out in Article III.1 which provides that internal taxes and other internal charges, laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of good … should not be applied to imported or domestic products so as to afford protection to domestic production. Panels and the Appellate Body have not been consistent in their adoption of a purposive interpretation of key elements of Article III:2 and Article III:4. Decisions lurch inconsistently from a literalist, context-independent approach to a regulatory "aims-and-effect" (or regulatory purpose) approach to an economic approach. For example, with respect to Article III:2 first sentence, the Appellate Body in the *Japanese Alcohol* case held that the reference to "like domestic products" in Article III:2 first sentence should be interpreted more narrowly than the reference to "directly competitive or substitutable products" in Article III:2 second sentence by virtue of the Adnote to Article III:2, and in interpreting and applying Article III:2 first sentence "the purpose of Article III set out in Article III:1 "…. so as to afford protection to domestic production" was inapplicable because Article III:2 second sentence expressly incorporates the principles set forth in Article III:1 while Article III:2 first sentence does not. Despite the convoluted efforts of the Appellate Body to maintain a distinction between the interpretation and application of Article III:2 first sentence and Article III:2 second sentence, the distinctions in practice seem of little significance in that internal taxes that cannot be successfully challenged under Article III:2, first sentence, because of its narrower scope, can almost always be successfully challenged under Article III:2 second sentence where these taxes have a protectionist application or effect.

The rejection by the Appellate Body and Panel in the *Japanese Alcohol* case of the "aims-and-effects" test in interpreting both sentences of Article III:2 has somewhat more ambiguous implications. With respect to Article III:2 second sentence which expressly incorporates the principle set forth in Article III:1 "…so as to afford protection to domestic production," the Appellate Body in the *Japanese Alcohol* case seems to have developed an objective purpose test, or perhaps a potential effects test, for establishing protection to domestic production ("the design, the architecture, and the revealing structure of a measure"). What is less clear is whether, despite a potential protectionist effect from an internal tax, a respondent country is able to adduce evidence of a non-protectionist policy purpose, e.g. in order to reduce the social

effects of excessive alcohol consumption, taxing high alcohol content beverages at proportionately higher rates than lower alcohol content beverages. The willingness of the panel in the *Chilean Alcohol* case to evaluate evidence pertaining to whether the structure of the measures in question could be rationally justified in these terms suggests that such an argument may be open under Article III:2 second sentence.

The interpretation of Article III:2 first and second sentence has clearly infected and confused GATT/WTO interpretations of Article III:4 which refers only to "like products" and not "directly competitive or substitutable products," and does not explicitly incorporate any reference to the principle set forth in Article III:1. However, the Appellate Body in *Asbestos* adopted an essentially economic test of "like products" in Article III:4 that focuses on the competitive relationship between imported and domestic products, which largely subsumes the interpretation of like product in Article III:4 into the concept of "directly competitive or substitutable products" in Article III:2 second sentence. Moreover, in interpreting the phrase "treatment no less favourable" in Article III:4, the Appellate Body in *Asbestos* (as it had in the *Korean Beef* case) held that a mere finding of likeness between two products does not oblige the regulatory country to treat them identically in regulation. The complainant must also demonstrate that the differences in regulation amount to "less favourable" treatment as between domestic and imported like products, each taken as a group. In so stating, the Appellate Body recalled the anti-protectionist purpose of Article III and suggested that "less favourable treatment" is equivalent to protectionism, although this is in puzzling conflict with its statement in *EEC-Bananas*, overruling the Panel in this respect, that "a determination of whether there has been a violation of Article III:4 does not require a separate consideration of whether a measure affords protection of domestic production". Assuming, following the Appellate Body's decisions in *Asbestos* and *Korean Beef*, that "treatment no less favourable" under Article III:4 means that the measure in question may not have an objective protective purpose or effect, a similar ambiguity remains to that under Article III:2 second sentence as to whether despite such an effect, a respondent country is free to adduce arguments or evidence that the primary motivation or justification for the measure in question was some non-protectionist policy.

Some commentators have been critical of GATT/WTO decisions, such as that of the Panel in the first *Tuna-Dolphin* case, that Article III:4 in referring to like products refers only to products as such, and not to differences in production or processing methods (PPM's) between

domestic and imported products.[106] While they take some solace from the Appellate Body's decision in *Asbestos* that differences in the health characteristics of domestic and imported products may render these two classes of products "unlike products", the emphasis by the Appellate Body in *Asbestos* on an economic test of "like products" (i.e. whether they are viewed as directly competitive or substitutable by users) would seem largely to rule out differential treatment based on differences in production or process methods that users, i.e. intermediate or final consumers, do not, for the most part, regard as salient in choosing between products in the marketplace, e.g. perhaps, for many consumers, tuna caught by dolphin-friendly or dolphin-unfriendly fishing methods. Focussing on whether consumer preferences or choices in importing countries may be sensitive to differences in production or processing methods raises a number of problems. First, consumers may not be well-informed about differences in production and processing methods and hence ignore them in marketplace choices, hence requiring a somewhat speculative inquiry as to whether these differences would be salient to consumers if they were well-informed of them. Second, even consumers who are well-informed of these differences may not, in many cases, alter their behaviour significantly because of collective action problems – the perceived futility of foregoing purchase of an otherwise better or cheaper imported product if other consumers will seek to free ride on the self-sacrificing decisions of others, leading to a non-cooperative prisoner's dilemma outcome. Third, how many consumers, even if well informed and uninfluenced by collective action problems, would need to change their consumption patterns in the light of differences in production and process methods before one could conclude that imported and domestic products were "unlike products"?[107]

However, abandoning altogether an economically based test of "like products" and allowing Panels and the Appellate Body to deem products "unlike", or allowing importing countries unilaterally to deem products to be "unlike", on account of production or process differences, raises several formidable problems. First, this would centrally contradict the whole theory of comparative advantage, because outside of the category of raw, fungible commodity exports, the comparative advantage that most imports will enjoy will turn on differences in production and processing methods, or inputs more generally. Second, while the exceptions listed in Article XX of the GATT are now over 50 years old and have not been revised since the

[106] See Robert Howse and Donald Regan, supra note 37.
[107] See Michael Trebilcock, "International Trade and Labour Standards," in Stefan Giller, International Economic Governance and Non-Economic Concerns (Spunger-Wien New York, 2003) 289.

inception of the GATT, and are arguably out of date in not incorporating exceptions for e.g. core international labour standards, at least some subset of universal human rights, or more clearly identifying consumer protection and the environment as legitimate exceptions or objectives for trade restricting measures[108], additions to or refinements of the exceptions listed in Article XX are clearly, in many respects, a matter of extremely high politics amongst many WTO members. To view Article III of the GATT as providing a mandate to Panels and the Appellate Body to invent on their own a set of normative justifications for apparently less favourable treatment for imported products relative to directly competitive domestic products is likely to severely strain the internal legitimacy of the WTO dispute settlement process relative to its political institutions. An expansive reading by panels or the Appellate Body of the "public morals" exception in Article XX(a) and a less stringent interpretation of the "necessity" requirement in a number of the Article XX exceptions and of the non-discrimination and non-protectionist conditions in the chapeau to Article XX may be able to accommodate some of these concerns. However, similar issues will arise as to the institutional legitimacy of panels and the Appellate Body engaging in expansive judicial law-making in these respects.

Arguments that actual regulatory purpose (the aims-and-effects test) should be the controlling determinant of the definition of "like products" – that domestic measures motivated by non-protectionist rationales should be exempt from Article III[109] – raise these difficulties in the clearest form. Apart from difficulties in ascertaining the actual intent of legislators or regulators (given the frequency of mixed motivations, as reflected in domestic Baptist – Bootlegger coalitions favouring measures restrictive of imports), what regulatory purposes count as legitimate and what as protectionist? Levelling the competitive playing field, preventing a race to the bottom, unilateral sanctions against foreign countries' violations of international labour standards or international human rights? These are profoundly normative and highly contested rationales for the invocation of trade sanctions and remitting to Panels and the Appellate Body the responsibility for determining their legitimacy and scope would entail a gross usurpation of the political authority of the WTO membership. Moreover, it is likely to promote highly

[108] See Frieder Roessler, "Diverging Domestic Policies and Multilateral Trade Integration" in Jagdish Bhagwati and Robert E. Hudec (eds.), *Fair Trade and Harmonization: Prerequisites for Free Trade?* , Volume Two, Legal Analysis (MIT Press, 1996).

[109] Donald H. Regan, "Regulatory Purpose and "Like Products" in Article III:4 of the GATT (with Additional Remarks on Article III:2)", *Journal of World Trade*, Vol. 36, Issue 3 (June 2002), at pages 443-478; and Donald H. Regan "Further Thoughts on the Role of Regulatory Purpose Under Article III of the General Agreement on Tariffs and Trade: A Tribute to Bob Hudec" in *Journal of World Trade*, Vol. 37, Issue 4 (August 2003), pp. 737-760.

inconsistent decision-making. For example, a violation of Article XI (quantitative restrictions) will require justification under the strictures of Article XX. But a presumptive violation of Article III will be excused if the measure in question has a non-protectionist regulatory purpose that renders domestic and imported products "unlike" in the view of the Panels and the Appellate Body in interpreting and applying Article III. Assuming that exculpatory non-protectionist regulatory purposes are interpreted more broadly under Article III than Article XX, why not convert an import ban vulnerable to challenge under Article XI into internal tax discrimination against imports challengeable only under Article III?

A refined version of the aims-and-effects approach in the form of a means-ends examination to determine the consistency or inconsistency of a facially neutral internal tax or regulation with the provisions of national treatment under Article III has recently been advanced by Gaetan Verhoosel[110], relying in part on the Panel's willingness to examine the relationship between the means and ends of a regulation under Article III in *Chile- Taxes on Alcoholic Beverages* case. Verhoosel supports the domestic 'regulatory autonomy' of a state, which encompasses the state's autonomy as regards the policy objectives it chooses to pursue and as regards the means by which it chooses to pursue such policy objectives, and argues that WTO law should not interfere with either aspect of this autonomy, except to the extent that the free choice of a policy objective amounts to overt protectionism and the free choice of regulatory means amounts to covert protectionism. The author advocates a so-called 'integrated necessity test' which integrates the tests to be carried out under Article III and Article XX into a single test and argues that national treatment should be understood to require a necessity test in the context of facially neutral domestic regulation to determine *de facto* discrimination under Article III. The author claims that *de facto* discrimination can only be revealed in an objective manner by "engaging in an analysis as to whether a particular regulatory instrument (1) specifically and adversely affects imported products as compared with their like domestic counterparts, and (2) is necessary to achieve a purported legitimate policy goal, or, alternatively, whether other, less restrictive, regulatory means are available".

However, this so-called 'integrated necessity test' raises similar problems to those we identified above regarding the consideration of regulatory purposes in determining Article III

[110] See Gaetan Verhoosel, *National Treatment and WTO Dispute Settlement: Adjudicating the Boundaries of Regulatory Autonomy* (Oxford: Hart Publishing, 2002).

issues[111]. In particular, unconstrained expansion of the legitimate policy exceptions list of Article XX by adjudication and interpretation under Article III would entail a gross usurpation of the political authority of the WTO membership and risk serious challenges to the credibility and legitimacy of the dispute settlement mechanism.

In contrast, we favour a much more restricted and less normatively contestable approach to the interpretation and application of Article III that is more consistent with its original purpose. First, we favour an economic approach to the definition of "like products" that is motivated by the need to establish, as a positive threshold issue, a significant competitive relationship between imported and domestic products before any issue of protectionist intent or effect can factually arise under Article III. However, while we endorse the view of the Appellate Body in *Asbestos* that the "like product" requirement should focus on the competitive relationship between domestic and imported products, we believe that this inquiry could be much more tightly structured than is currently the case and could usefully borrow from decades of learning and case law in developed antitrust jurisdictions around the world in defining relevant product markets.[112] One such approach, reflected in the U.S. and Canadian Merger Enforcement Guidelines,[113] is the hypothetical monopolist test where one asks of the hypothesized sole producer of a given class of product whether that producer could sustain a significant (e.g. 5%) increase in the price of that product for a non-transitory period (e.g. one year) without inducing a sufficient number of consumers to substitute to other products so as to render such a price increase unprofitable. If, from empirical evidence, such substitution is likely to occur then the products to which consumers substitute are deemed like products, and then a similar question is posed with respect to this expanded class of products and so on, until a class of products is defined which satisfies this test. A similar test is typically adopted in defining the scope of the relevant geographic market: could a hypothetical monopolist with respect to a relevant class of products raise price by a significant degree for a non-transitory period without inducing consumers to switch to more distant suppliers of these products? While these tests are by no

[111] For a critique, from another perspective, of the type of means-ends test under Article III as advanced by Verhoosel, see Donald Regan; supra note 109, at pp. 745-748.

[112] For similar economic perspectives on Article III, see Won-Mog Choi, *Like Products in International Trade Law* (Oxford University Press, 2003); Damien Neven, "How Should Protection be Evaluated in Article III GATT Disputes?" (2001) 17 *European Journal of Political Economy* 421; and Elsa Horn and Petros Mavroidis, supra note 44.

[113] See Michael Trebilcock, Ralph Winter, Paul Collins and Edward Iacobucci, *The Law and Economics of Canadian Competition Policy* (University of Toronto Press, 2002), Chap. 4.

means easy to operationalize in practice and can be supplemented and refined in various ways, if the key to the "like product" definition in Article III is the competitive relationship between imports and domestic products, as the Appellate Body stated in *Asbestos*, then it is inexplicable that international trade tribunals would not draw much more extensively on the framework of analysis and body of experience that has developed in competition law in many jurisdictions around the world in addressing precisely the same question.

On an economic approach to the definition of "like products", one would take revealed consumer preferences, even if informationally flawed, as given. For example, in Asbestos, if evidence suggests that intermediate and final consumers treat asbestos and other fibres as close substitutes in a significant number of end-uses, we would treat them as like products. Indeed, it is difficult to understand the French ban on the sale of asbestos or cement-based products containing asbestos, or the Canadian complaint about the ban, unless intermediate and final consumers in fact treated them as close substitutes in a significant number of end-uses. If the argument is that well-informed consumers would not do so, this may provide a justification for health and safety measures under Article XX(b), but this is where this issue should be resolved, not Article III.

Assuming that a competitive relationship is established between imports and domestic products, the question that then arises is how Article III:2 second sentence with its reference to " … so as to afford protection to domestic production" in paragraph one, and the phrase "treatment no less favourable" in Article III:4, should be interpreted. Consistent with the economic approach that we favour in interpreting "like product," we favour the adoption of an economic approach to these two requirements similar to that espoused by the GATT panel in *U.S. – Section 337* and the Appellate Body in several decisions reviewed above, which focuses on the preservation of effective equality of competitive opportunities. As to whether a challenged measure disturbs or undermines, actually or potentially, effective equality of competitive opportunities is, as with the like product inquiry, largely a positive empirical and predictive inquiry which, while not requiring identical treatment of imports and domestic products, as the GATT panel recognized in *U.S.-Section 337*, and as the Appellate Body recognized in *Korean Beef* and *Asbestos*, nevertheless must entail treatment that does not impose on foreign exporters competitive burdens that are not imposed on domestic producers. Drawing on the antitrust

literature on raising rivals costs,[114] the inquiry would condemn domestic measures that raise the marginal costs (including opportunity costs) of foreign rivals relative to the marginal costs (including opportunity costs) of domestic rivals so as substantially to lessen competition in the domestic market by rendering it likely that domestic firms will be able profitably to raise prices significantly for a non-transitory period without attracting sufficient entry to render such a strategy unprofitable. This strategy would violate the anti-protectionist rationale of Article III.

Some critics of the product-process distinction have seized on references by the Appellate Body in *Asbestos* to the need to interpret Article III:4 in light of the anti-protectionist purpose of the Article, and recognition by the Appellate Body that this does not require identical treatment of like products, as providing an opening for taking account of differences in production and process methods (PPM's) not in defining "like products" but rather in determining under Article III:2 second sentence whether an internal tax measure has been applied so as to afford protection to domestic production and under Article III:4 whether treatment no less favourable than that accorded to like products of national origin has been accorded to imports[115]. However, there is nothing to date in the Appellate Body's willingness to recognize that "no less favourable treatment" of imports does not require identical treatment to suggest that it had anything in mind other than an examination of the impact of the measure in question on effective equality of competitive opportunities of imports and domestic products – for example, in its analysis of the dual retail store system for beef in the *Korean Beef* case[116]. Its ruling on the issue of "less favourable treatment" under Article III:4 in the recent case -*US-FSC (Article 21.5)*, discussed above, which was decided almost nine months after its decision on *EEC-Asbestos* suggests that the pattern of examination on the issue of "less favourable treatment" of imported products under Article III:4 has not changed since *Korean Beef.* Moreover, simply switching the focus of attempts to incorporate these profoundly normative considerations from the definition of "like product" to the interpretation of "treatment no less favourable" raises all the same objections to attempting such an exercise with respect to the interpretation of "like product".

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[114] See Steven C. Salop and David T. Scheffman, "Raising Rivals' Costs", *The American Economic Review*, Vol. 73, No. 2, Papers and Proceedings of the Ninety-Fifth Annual Meeting of the American Economic Association, (May, 1983), pp. 267-271; and Thomas G. Krattenmaker and Steven Salop, "Ánticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price", 96 *Yale Law Journal* 209 (1986).

[115] See Robert Howse and Elisabeth Tuerk, supra note 94.

[116] Steve Charnovitz also questions the optimism that future WTO panels will tolerate origin-neutral PPMs in the context of Article III, claiming that such optimism "would be unfounded". See Steve Charnovitz, "The Law of Environmental "PPMs" in the WTO: Debunking the Myth of Illegality", *27 The Yale Journal of International Law 59*, at page 92.

This said, it is important to acknowledge that domestic measures that are adopted that simultaneously impose similar constraints on domestic and foreign like products for environmental, labour or other reasons, including domestic measures that are enforced at the border in the case of imported products (thus engaging the Ad note to Article III) may indeed satisfy the test of preserving equality of competitive opportunities. Thus, for example, to take the Tuna/Dolphin case, if domestic measures banning the catching of tuna in dolphin-unfriendly ways are simultaneously imposed on domestic and foreign suppliers of tuna to the U.S. market, and entail similar compliance costs for both (including opportunity costs), the competitive equilibrium between domestic and foreign like products is not disturbed. Similarly, to take the Shrimp/Turtle case, if measures banning the catching of shrimp in turtle-unfriendly ways are simultaneously applied to domestic and foreign suppliers of shrimp to the U.S. market, and entail similar compliance and opportunity tests, foreign goods are not being treated less favourably than domestic like goods. Similarly, again in the case of a simultaneous ban on the sale of domestic and foreign products made with child labour if such a measure imposes similar costs on foreign and domestic producers of like products.

We acknowledge that even this interpretation of Article III may leave open the ambiguity noted above as to whether a measure which is adopted by an importing country for a non-protectionist, non-anticompetitive purpose or policy objective but which has incidental and disproportionately adverse impacts on competing imports might nevertheless be viewed as not violating of Article III:2 second sentence " … so as to afford protection to domestic production" or as not violating the "no less favourable treatment" requirement of Article III:4. Illustrative of the potential problem is the Canada-U.S. FTA panel decision in *Lobsters*[117] where the application of domestic U.S. minimum size requirements to Canadian lobsters was challenged by Canada. The purpose of the measure was to conserve lobster stock by ensuring that young lobster would not be taken before they could breed. However, because Canada has colder waters, its mature lobsters are generally of a smaller size. The U.S. argued that the application of its size requirement to Canadian lobster was necessary to the enforcement of the requirement with respect to American lobster. Since lobsters do not carry passports, it would be costly and impractical to determine whether a lobster was Canadian or American once it had entered the stream of commerce. This difficulty was obviated by applying the size requirement to all lobster

[117] *Lobster from Canada*, Final Report of the FTA Panel (25 May 1990), T.C.T. 8182.

in the market. Another example might be the imposition by the Canadian government of bilingual labelling requirements (English and French) on most products sold in Canada. Because of the pre-existing bilingual capacity of many Canadian producers, this requirement may impose additional costs on many foreign producers of like products.

In our ideal world we would prefer to remit such measures for evaluation under the (perhaps revised and expanded) Article XX Exceptions List. However, even as Article XX is presently framed, most measures that have provoked controversy under Article III with respect to the scope and application of the "aim and effect" and "regulatory purpose" approach to its interpretation are potentially justifiable under Article XX. For example, both the Panel and the Appellate Body in *Asbestos* agreed that the measures in question were justified under Article XX (b) (measures necessary to protect human, animal or plant life or health). While the *Tuna-Dolphin* Panels found violations of Article III and Article XX, the Appellate Body decision in *Shrimp/Turtles*[118] (including its compliance decision) makes it clear that such measures may now be justifiable under Article XX (b) or (g) (conservation of exhaustible natural resources). Similarly, the measures in dispute in *Lobsters* would now likely be justifiable under Article XX (g). Thus, in contrast to recent arguments by Donald Regan[119] for treating a competition test as a necessary but not sufficient test for violation of Article III, requiring in addition proof of actual protectionist regulatory purpose, we favour treating a competition test as a necessary and sufficient test for violations of Article III, remitting justifications for offending measures based on non-protectionist regulatory purposes to Article XX, subject to its "necessity," "arbitrary and unjustifiable discrimination," and "disguised restriction on international trade" constraints. A major virtue of this division of labour between Articles III and XX, beyond preserving the integrity of the limited exceptions list in Article XX, is that it appropriately allocates the burden of proof between the complainant and respondent. The complainant must prove a disparate impact on foreign producers of a domestic measure adopted by the respondent in accordance with the requirements of the competition test that we have proposed. Assuming that this burden is discharged under Article III, the burden of proof then shifts to the respondent to justify a measure within the strictures of Article XX. This burden is properly assigned to the respondent

[118] See *United States- Import Prohibition of Certain Shrimp and Shrimp Products,* Report of the Appellate Body, WT/DS58/AB/R (12 October 1998) (98-3899), AB-1998-4; and *United States- Import Prohibition of Certain Shrimp and Shrimp Products- Recourse to Article 21.5 of the DSU by Malaysia,* Report of the Appellate Body, WT/DS58/AB/RW (22 October 2001), AB-2001-4.

[119] Regan, supra note 109.

because it turns on information uniquely within its possession, in contrast to placing the burden on the complainant of proving protectionist intent on the part of the respondent under Article III.

However, given the limited scope of Article XX, it may be the case that some domestic regulatory measures that are adopted for non-protectionist reasons outside the scope of the Article XX may have incidentally adverse impacts on foreign exporters. Hence, it may be argued that such measures will, for the foreseeable future, have to be evaluated under Article III. Thus, Hudec has argued that it may be impossible to suppress altogether some form of the "aims-and-effects" test, at least in a limited form[120] in interpreting Article III. We consider that there will be few such cases. However, in such cases, beyond the adoption of a *de minimis* requirement of the kind that the Appellate Body has already adopted with respect to Article III:2, second sentence, and the "substantial lessening of competition" test that we propose in interpreting "no less favourable treatment" in Article III.4, one might, adopting a more constrained variant of Verhoosel's proposals, address the problem of incidentally disproportionate impacts on imports by borrowing the test adopted by a GATT panel in the *Herring and Salmon Processing* case[121] in interpreting Article XX(g) of the GATT and ask whether the measure in question was "primarily aimed at" a non-protectionist, non-anticompetitive domestic policy objective and not "primarily aimed at" restricting imports; whether the adverse impact on imports was necessarily incidental to attainment of this domestic policy objective; and whether any less trade restrictive means was reasonably available to achieve that objective (borrowing this test from the WTO TBT and SPS Agreements)[122]. However, in order to avoid compromising the internal and perhaps external political legitimacy of Panels and the Appellate Body,[123] this exception would need to be narrowly defined, respondent countries should clearly bear the burden of proof of satisfying its requirements (in large part because of their superior access to the relevant information on intended policy objectives), and it should be viewed as an interim, second-best option to reforming Article XX of the GATT where all justificatory social rationales for trade-restricting domestic measures should ideally reside. In particular, measures primarily aimed at banning or

[120] See Hudec, supra note 19.
[121] *Canada – Measure Affecting Exports of Unprocessed Herring and Salmon,* BISD.35S (1988) 98.
[122] Similarly, Steve Charnovitz's suggestion for also taking into account the degree of multilateral approval or disapproval of the regulatory measure in question, especially in the PPM measures, as a factor in evaluating the appropriateness of such measures may also be considered in this regard. See Steve Charnovitz; supra note 116, at pages 105-16.
[123] See Joseph H. Weiler, "The Rule of Lawyers and the Ethos of Diplomats: Reflections on the Internal and External Legitimacy of WTO Dispute Settlement," (2001) 35 *Journal of World Trade* 191.

restricting imports, for example on account of PPM's such as labour or environmental standards in the country of origin could not be justified under these qualifications of Article III, but would require justification (if at all) under Article XX. Even so, we remain to be convinced that the risks of recognizing such qualifications to a pure competition-oriented approach to the interpretation of Article III, even on an interim basis, justify the benefits.