International and Regional Trade Law: The Law of the World Trade Organization

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Unit VI: The Central Legal Discipline of the WTO: National Treatment (Taxation and Regulation)

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This unit focuses on the central discipline of international and regional trade law – National Treatment. If you understand this discipline you understand trade law and the different philosophies underlying it.

Supplementary Reading

Peter van den Bossche, The Law and Policy of the World Trade Organization, 2005, 326-364.

Raj Bhala, Modern GATT Law. A Treatise on the General Agreement on Tariffs and Trade, 2005, 16-42; 95-172.

Michael J. Trebilcock & Robert Howse, The Regulation of International Trade, 3rd ed. 2005, 83-111.

John H. Jackson et al., Legal Problems of International Economic Relation, 4th ed. 2002, 479-531 .

John H. Jackson, The World Trading System, 2nd ed. 1997, 213-228.

I. National Treatment -- Taxation

1. Legal Texts

Article III* (GATT 1994)

National Treatment on Internal Taxation and Regulation

1. The contracting parties recognize that internal taxes and other internal charges, and 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, should not be applied to imported or domestic products so as to afford protection to domestic production.*

2. The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.*

(…)

Interpretative Note Ad Article III

Any internal tax or other internal charge, or any law, regulation or requirement of the kind referred to in paragraph 1 which applies to an imported product and to the like domestic product and is collected or

enforced in the case of the imported product at the time or point of importation, is nevertheless to be regarded as an internal tax or other internal charge, or a law, regulation or requirement of the kind referred to in paragraph 1, and is accordingly subject to the provisions of Article III.

Paragraph 1

(…)

Paragraph 2

A tax conforming to the requirements of the first sentence of paragraph 2 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 product and, on the other hand, a **directly competitive or substitutable product** which was not similarly taxed. (*emphasis added*)

(…)

2. Japan – Taxes on Alcoholic Beverages (Japanese Shochu II)

When reading the reports pay close attention to the different interpretations of the first and second clause of Article III:2.

2-1. Report of the Panel in Japan – Taxes on Alcoholic Beverages, WT/DS8, 10, 11/R, 11 July 1996

Chairman: Mr. Hardeep Puri; Panelists: Mr. Luzius Wasescha, Mr. Hugh McPhail

http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds8_e.htm

(…)

II. Factual Aspects

A. The Japanese Liquor Tax Law

2.1 This dispute concerns the Japanese Liquor Tax Law (Shuzeiho), Law No.6 of 1953 as amended ("Liquor Tax Law"), which lays down a system of internal taxes applicable to all liquors, which are defined as domestically produced or imported beverages having an alcohol content of not less than one degree and which are intended for consumption in Japan.

2.2 The Liquor Tax Law currently classifies the various types of alcoholic beverages into ten categories and additional sub-categories: sake, sake compound, shochu (group A, group B), mirin, beer, wine (wine, sweet wine), whisky/brandy, spirits, liqueurs, miscellaneous (various sub-categories).

(…)

2. Tax Rates

2.3 Pursuant to the Liquor Tax Law, liquors are taxed at the wholesale level. In the case of liquors made in Japan, the tax liability accrues at the time of shipment from the factory, and in the case of imported liquors, at the withdrawal from a customs-bonded area. As explained above, the Liquor Tax Law divides all liquors into ten categories, some of which are divided into sub-categories. Different tax rates are applied to each of the various tax categories and sub-categories defined by the Liquor Tax Law. The rates are expressed as a specific amount in Japanese Yen ("¥") per litre of beverage. For each category or sub-category, the Liquor Tax Law lays down a reference alcohol content per litre of beverage and the corresponding reference tax rate. For whisky, the reference rate uses an alcohol strength of 40 per cent; for spirits the alcohol strength is 37 per cent; for liqueurs the alcohol strength is 12 per cent; for both shochu sub-categories, an alcohol strength of 25 per cent is used. As a result, the liquors covered by the present dispute are subject to the following tax rates:

Shochu A

Alcoholic Strength	Tax Rate (per 1 kilolitre)
(1) 25 to 26 degrees	¥155,700
(2) 26 to 31 degrees	¥155,700 plus ¥9,540 for each degree above 25
(3) 31 degrees and above	¥203,400 plus ¥26,230 for each degree above 30
(4) 21 to 25 degrees	¥155,700 minus ¥9,540 for each degree below 25 (fractions are rounded up to 1 degree)
(5) below 21 degrees	¥108,000

Shochu B

Alcoholic Strength	Tax Rate (per 1 kilolitre)
(1) 25 to 26 degrees	¥102,100
(2) 26 to 31 degrees	¥102,100 plus ¥6,580 for each degree above 25
(3) 31 degrees and above	¥135,000 plus ¥14,910 for each degree above 30
(4) 21 to 25 degrees	¥102,100 minus ¥6,580 for each degree less than 25 (fractions are rounded up to 1 degree)
(5) below 21 degrees	¥69,200

Whisky

Alcoholic Strength	Tax Rate (per 1 kilolitre)
(1) 40 to 41 degrees	¥982,300
(2) 41 degrees and above	¥982,300 plus ¥24,560 for every degree above 40
(3) 38 to 40 degrees	¥982,300 minus ¥24,560 for each degree below 40 (fractions are rounded up to 1 degree)
(4) below 38 degrees	¥908,620

Spirits

Alcoholic Strength	Tax Rate (per 1 kilolitre)

(1) below 38 degrees	¥367,300
(2) 38 degrees and above	¥367,300 plus ¥9,930 for each degree above 37

Liqueurs

Alcoholic Strength	Tax Rate (per 1 kilolitre)
(1) below 13 degrees	¥98,600
(2) 13 degrees and above	¥98,600 plus ¥8,220 for each degree over 12

(…)

III. Claims of the Parties

The three complaining parties, namely the Community, Canada and the United States submitted the following claims against Japan:

3.1 The **Community** claimed that since "spirits" (in particular vodka, gin, (white) rum, genever) are like products to the two categories of shochu, the Liquor Tax Law violates GATT Article III:2, first sentence, by applying a higher tax rate on the category of spirits than on each of the two like products, namely, the two sub-categories of shochu. In the alternative, in the event that all or some of the liquors falling within the category of spirits (mentioned above) were found by the Panel not to be like products to shochu within the meaning of the first sentence of Article III:2, the Community claimed that the Liquor Tax Law violates Article III:2, second sentence, by applying a higher tax rate on all or some of the liquors falling within the category of spirits than on each of the two directly competitive and substitutable products, the two sub-categories of shochu. The Community further claimed that since whisky/brandy and liqueurs are also "directly competitive and substitutable products" to both categories of "shochu", the Liquor Tax Law violates Article III:2, second sentence of GATT 1994, by applying a higher tax rate on the categories of whisky/brandy and liqueurs than on each of the two sub-categories of shochu.
(…)

3.3 The **United States** claimed that the Japanese tax system applicable to distilled spirits has been devised so as to afford protection to production of shochu. For this reason and because "white spirits" and "brown spirits" have similar physical characteristics and end-uses, the United States claimed that "white spirits" and "brown spirits" are "like products" in the sense of the first sentence of Article III:2, and therefore the difference in tax treatment between shochu and vodka, rum, gin, other "white spirits", whisky/brandy and other "brown spirits" is inconsistent with Article III:2, first sentence. If the Panel were not able to make such a finding, the United States requested, in the alternative, that the Panel find that all "white spirits" are "like products" in terms of Article III:2 first sentence, and that all distilled spirits are "directly competitive and substitutable" in terms of Article III:2, second sentence for the same reasons. The United States concluded that irrespective of the legal analysis the Panel adopts, the Liquor Tax Law should be found to be inconsistent with Article III:2.

3.4 The defending party, **Japan**, responded to the claims from the three complaining parties. Japan claimed that the purpose of the tax classification under the Liquor Tax Law is not to afford protection and does not have the effect of protecting domestic production. Therefore, Japan argued that the Liquor Tax Law does not violate Article III:2. According to Japan, spirits, whisky/brandy and liqueurs are not "like products" to either category of shochu, within the meaning of Article III:2, first sentence, nor are they

"directly competitive and substitutable products" to shochu, within the meaning of Article III:2, second sentence. Consequently, Japan claimed that the Liquor Tax Law cannot violate Article III:2.

(…)

IV. Arguments of the Parties

(…)

D. Article III:2, First Sentence

(…)

2. Application to the Present Case of the Legal Analysis Suggested by the Community for Article III:2, First Sentence.

a) The First Step of the Test: Like Products

4.51 In referring to the first step of the legal test it suggested for the first sentence of Article III:2 -- the like product assessment, the **Community** argued that the physical characteristics and manufacturing process of spirits and shochu A and B are similar: The two categories of shochu and most of the liquors falling within the category "spirits" are white/clear beverages with a relatively high alcoholic content made by distillation from the same large variety of raw materials (e.g., grains, potatoes ...). A comparison of the legal definitions of shochu and of the category of "spirits" contained in articles 3.5 and 3.10 of the Liquor Tax Law demonstrates that the only differences between these two categories are that shochu cannot (1) be made from sugar cane and distilled at less than 95 per cent of alcohol (such as rum); (2) have other ingredients added at the time of distillation (such as gin); (3) be filtered with charcoal of white birch (such as vodka); (4) have an alcoholic content in excess of 45 per cent, in the case of shochu B, or 36 per cent, in the case of shochu A. In practice, as mentioned above, both types of shochu typically have an alcoholic strength of 20 per cent to 35 per cent, with 25 per cent being the most common strength. The legal definition of the category of "spirits" does not provide for a maximum alcohol content but in practice, the average alcohol content of the liquors falling within this category is 40 per cent. For the Community, the above differences between shochu and each of the main types of "spirits" are clearly minor and do not prevent all of them from qualifying as like products. Similar differences (if not more significant ones) exist also among the various types of western-style distilled spirits, despite of which all of them have been included into a single category of "spirits" and taxed at a uniform rate. The Community submitted that the differences in alcoholic strength are moreover rendered irrelevant by the drinking habits of the Japanese consumers: both shochu and the liquors falling within the category of "spirits" tend to be drunk heavily diluted with water or other non-alcoholic beverages and end up at roughly the same strength.

4.52 In support of its allegation, that shochu and spirits are like products, the **Community** also argued that shochu and spirits have essentially the same consumers' uses and customs classification. Shochu and "spirits" have essentially the same end-uses. All of them are drunk "straight", "on the rocks" or, more frequently, diluted with water or other non-alcoholic beverages. Moreover, both shochu and "spirits" are widely drunk by all categories of consumers, regardless of age, sex or occupation. In support of its argument, the Community submitted two market studies.[50] Moreover, shochu and all "spirits" other than

[50] A market survey conducted by the Japan Market Research Bureau in December 1994 and a market survey conducted by an ependent research company in May 1994.

gin and rum fall within the same HS sub-heading (HS 2208.90). This confirms that the differences between shochu and the category of "spirits" may be less significant than the differences among the various types of liquors falling within the category of "spirits".

4.53 The **Community** then submitted that a striking illustration of the "likeness" between shochu and "spirits" and, at the same time, of the arbitrariness and artificiality which are inherent to the criteria on the basis of which the Liquor Tax Law attempts to distinguish them, has been recently provided by the change in the tax categorization of the brand "Juhyo". This brand had been traditionally sold by the local manufacturer Suntory as vodka and accounted for almost half of the Japanese production of that liquor. However, as from June 1993, Suntory started to market the same product as "Juhyo shochu". All that was required in order to obtain this change in tax category was to discontinue the use of charcoal of white birch as a filtering material.[51] The Community argued that the change was made with the aim of escaping the higher taxes levied on "spirits" and was followed by an immediate and substantial reduction in the retail prices of "Juhyo". In support of its argument, the Community submitted an article from the Teiin Shkuryo Shinbun. The Community concluded by referring the Panel to the findings of the 1987 Panel Report where it was stated that "Japanese shochu (Group A) and vodka could be considered as like products in terms of Article III:2 because they were both white/clear spirits, made of similar raw materials, and their end-uses were virtually identical (either as straight schnaps type of drinks or in various mixtures)"[52] and that other types of spirits, in addition to shochu A and vodka, could also be like products. For the Community therefore, the liquors falling within the category "spirits" and the two sub-categories of shochu are, in light of all the criteria that have been identified above as relevant, "like products" within the meaning of the first sentence of Article III:2.

4.54 **Japan** argued that in its view the Community acknowledged that the differences in physical characteristics between whisky/brandy and shochu are sufficiently large to prevent the two categories from qualifying as like products. It also noted that the Community's claim of likeness applies only between the category of "spirits" and shochu A and B. Japan argued that, in examining the "likeness" of "spirits" and shochu, the Community looked at the following four criteria: (i) the product's properties, nature and quality, (ii) its end-uses, (iii) consumers' tastes and habits, and (iv) the HS classification. Japan argued that if the Community's four criteria were correctly applied to the facts, "spirits" and shochu A and B would not be "like products", because:

as to (i) the product's properties, nature and quality:

- The alcoholic strength of shochu (mostly 20 to 25 per cent) is closer to wine and sake (12 to 15 per cent) than to "spirits" (around 40 per cent).
- Most shochu does not undergo a post-distillation value-adding process (over 99 per cent is not aged in wooden casks) while "spirits" are characterized by value-addition through flavouring, purification with white birch charcoal or aging; picking a few examples from the vast array of shochu brands should not cloud the overall picture.
- Bulky plastic, glass and paper bottles over 1.8 litres are the most popular containers for shochu while 0.7 litre glass bottles are common for "spirits".

as to (i) end-uses and (ii) consumers' tastes and habits:

[51] In addition, barley and rice were added as raw materials in order to alter the taste of the product. Nevertheless, this change was not required by the Liquor Tax Law in order to make "Juhyo" qualify as shochu.

[52] 1987 Panel Report, para 5.7.

- 60 per cent of consumers drink shochu during meals but 63 per cent drink "spirits" after meals.
- 42 per cent of shochu consumers, but only 4 per cent, 1 per cent, and none of vodka, gin, and rum consumers, respectively, drink the product in question with hot water; and none of shochu consumers but 26 per cent, 32 per cent, and 15 per cent of vodka, gin and rum consumers, respectively, drink the product in question with tonic water, according to the data submitted by the Community.
- The study by ASI Market Research Inc. submitted by the complaining parties concludes that "(s)hochu is not seen as so much of a competitor (i.e., substitutable product) in the eyes of the consumers".
- According to a study, only 6 per cent of shochu consumers responded that they would drink "spirits" if shochu is not available.
- Contrary to the Community's allegation, the evidence submitted by the Community shows that shochu consumers are only as often (not more often) found in the "regular consumers" of premium brands of spirits and liqueurs as are found in all respondents.

and as to iv) classification in the HS:

- The 1996 version of the HS gives separate headings for rum (2208.40), gin (2208.50) and vodka (2208.60), as opposed to shochu (2208.90, "other"). Japan submitted that the HS is established for purposes other than internal taxation and does not offer appropriate criteria by which to judge "likeness" in terms of Article III, but even if "likeness" should be examined on the basis of identity of the HS heading, as the Community and the 1987 Panel Report suggest, shochu and vodka would not be "like" under the 1996 version of the HS.

4.55 The **Community** responded that as far as shochu and "spirits" are concerned, Japan had been able to identify only two main differences in physical characteristics: the alcohol content and the packaging. According to the Community, the differences in alcohol content between shochu and "spirits" are not reflected in their respective legal definitions and, therefore, cannot provide a valid justification for applying different tax rates. There is nothing in the Liquor Tax Law preventing the manufacture of vodka of 25 per cent. In practice, some brands of vodka do have an alcohol strength of 25 per cent as illustrated by the case of Juhyo. On the other hand, shochu B may have an alcoholic strength of up to 45 per cent, whilst the maximum alcohol content of shochu A is set at 36 per cent, i.e., only four degrees below the average strength for spirits. High alcohol shochu is by no means a rarity. In 1994, the sales volume of shochu of 35 per cent was larger than the total sales volume of all types of "spirits". The alleged differences in packaging are irrelevant for a like product determination. The physical properties of shochu remain the same irrespective of the size and the material of the packages in which it is sold.

4.56 **Japan** submitted that such commonality of sales outlets and advertising styles between "spirits" and shochu as pointed out by the Community are also observed among all alcoholic and non-alcoholic beverages and thus fails to demonstrate that products are "like". Though the Community points out similarity in the shochu-based pre-mixes and the pre-mixes made from other liquors, for Japan, such would not be evidence of "likeness" of shochu and "spirits", just as the similarity among tequila-based, wine-based and beer-based "margaritas" in the United States would not render tequila, wine and beer "like". For Japan, "Juhyo Vodka" and "Juhyo Shochu" are two distinct products with different raw materials and different production methods sold under the same established brand name, and are not "like products". Japan also noted that the 1987 Panel Report failed to deliver a clear-cut conclusion on the issue

of "likeness" between shochu A and vodka. Although the panel noted that these "could be considered as like products", these products do not appear on the list of pairs of like products in the Report.

(…)

b) The Second Step of the Test: Discriminatory Taxes

4.59 Concerning the second step of the test it suggested for the application of the first sentence of Article III:2, the assessment of discriminatory taxation, the **Community** submitted evidence according to which the tax rate per litre of shochu B is always lower than the rate on the category of "spirits". The tax rate per litre of shochu A is also lower than the rate per litre of "spirits" for beverages below 36 per cent - 37 per cent. Above that strength, the rate on shochu A is higher. Nevertheless, Article 3.5 of the Liquor Tax Law excludes from the definition of shochu A beverages with an alcohol content of more than 36 per cent. Thus, in practice, the rate on shochu A is always lower than the rate on the category of "spirits". More specifically, the Community argued that the tax discrimination index between shochu B of the most common strength (25 per cent) and "spirits" of the most common strength (40 per cent) is 389 per cent. If the tax rates per litre of pure alcohol, instead of the rates per litre of each beverage, are compared, the tax rate applied to the category of "spirits" is still much higher and the tax discrimination index reached 243 per cent. The Community therefore concluded that the liquors falling within the category of "spirits" and the two sub-categories of shochu being "like products", the Liquor Tax Law violates Article III:2, first sentence, by applying a tax rate to the category of "spirits" which is in excess of the tax rates applied to each of the two sub-categories of shochu.

(…)

4.61 **Japan** called the legal test suggested by the Community a "two-step approach", and disagreed with it. It further argued that even if the "two-step approach" should be adopted, the examination of the second step (discriminatory or not) should be made by the comparison of tax/price ratio between imported "spirits" and domestic shochu. For Japan, the tax/price ratio is the superior yardstick for an examination of the tax burden since it indicates better the impact on consumer choice (and therefore discrimination) than the ratio of tax over volume product or alcohol content. A consumer usually does not buy a product exclusively on the basis of the size of the bottle or on the basis of the alcoholic strength. Consumers choose products by comparing the price and the overall value of a product, which rests upon the taste, flavour and other features and is not confined to the volume and strength.This is why, Japan argued, the tax/price ratio is a better criterion to evaluate the effects of taxes on competitive conditions; and neutrality is achieved when the tax/price ratio is equalized, as is the case with the Japanese tax. Japan submitted that the weighted average of liquor-tax/price ratios for the 20 best-selling brands of domestic shochu A, shochu B, imported vodka, imported rum, and imported gin are 22 per cent, 13 per cent, 18 per cent, 12 per cent, and 18 per cent, respectively. Japan concluded that, even under the "two-step approach", taxes on "spirits" would not be found discriminatory against shochu when an appropriate yardstick is applied.

E. Article III:2, Second Sentence

(…)

2. Application to the Present Case of the Legal Analysis Suggested by the Community and Canada

a) The First Step of the Tests Suggested by the Community and Canada: Directly Competitive and Substitutable Goods

i) Physical characteristics, end-uses, tariff line and availability to the public

4.72 For the **Community**, the two categories of shochu and the liquors falling within the categories of "spirits", "whisky/brandy" and "liqueurs" are directly competitive and substitutable since they share the same essential physical characteristics, have similar end-uses, are similarly available to the public and are marketed in a similar way. Furthermore the prices of shochu and of the other distilled spirits and liqueurs are within a close range, once the liquor taxes are deducted. Moreover, there is evidence that, despite the distorting effects on competition of the Liquor Tax Law, the demand for shochu is largely influenced by the fluctuations in the prices of other types of distilled spirits and liqueurs.

(…)

4.74 The **Community** argued that the differences in physical characteristics and manufacturing methods between the two categories of shochu and the liquors falling within the category of "spirits" are minor. The differences between the physical properties of shochu and of "whisky/brandy" are somewhat more marked. Nonetheless, these two categories share the same essential characteristics: both shochu and "whisky/brandy" are spirits obtained by distillation and with a relatively high alcoholic content. The main differences between the two categories are thus restricted to the fact that neither malted grains nor grapes can be used in the production of shochu. For the Community, this difference is only relative, as most shochu is made, like whisky, from different types of grain, albeit not malted. Other differences are that shochu is, as a general rule, a white/clear spirit, while whisky and brandy are brown-coloured; whisky and brandy are matured/aged and, as a general rule, blended, while shochu is not. These last two differences are becoming irrelevant as an increasing number of shochu brands claim to be blended and aged in barrels and are brown coloured. For the Community, the absence of any fundamental differences between shochu and "whisky/brandy" is attested by the fact that the advertising of many shochu brands tends to emphasize their similarities with whisky and/or brandy in terms of raw materials, ingredients, manufacturing process and tradition. In some cases, this policy has been pursued to the extreme of modifying the traditional manufacturing methods of shochu in a deliberate attempt to confer upon it whisky-like appearance and taste.[65] Concerning "liqueurs", this category is comprised of a very heterogeneous variety of liquors which have as their only common characteristic an extract content in excess of two per cent. The 1987 Panel Report found that differences concerning the level of extract content were minor and did not prevent two products from being like products. *A fortiori*, differences in the extract content are not sufficient in themselves to prevent liquors falling within the category of "liqueurs" from being considered as "directly substitutable and competitive" with "shochu", "spirits" and "whisky/brandy". Moreover, it must be recalled that a major portion of the sales in this category consists of bottled or canned pre-mixes made from "shochu", "spirits" or "whisky/brandy" which are, therefore, identical to home-made mixed beverages from the same liquors.

(…)

4.79 **Japan** argued that "spirits" and "shochu" differ in physical characteristics, end-use, and in tariff lines as is described in paragraph 4.54 above. Japan also argued that whisky/brandy and shochu differ in materials (with malts versus without malts; Bourbon, Tennessee, and Canadian whiskies without malts are classified as "spirits" under the Liquor Tax Law), in the post-distillation processing (aged in wooden casks versus over 99 per cent not aged in wooden casks), in alcoholic strength (around 40 per cent versus

[65] Thus, in May 1988 (i.e., shortly after the adoption of the 1987 Panel Report), the Japanese manufacturer Takara started marketing "Jun Legend", a light amber coloured brand of shochu produced by blending two types of alcohol distilled from barley and corn and maturing them in charred white oak barrels for one to five years. According to Takara, "the most noticeable characteristic of this brand is a flavour and taste similar to whisky". When the new brand was launched, Takara announced its expectations that the new product would appeal to former consumers of second grade whisky which, as a result of the 1987 Panel Report, was expected to become subject to much higher tax rates as from 1989.

20 to 25 per cent), in colour (0.2 to 0.8 of optical density versus 0.08 of optical density) and in containers (0.7 litre glass bottles versus bulky plastic, glass and paper bottles over 1.8 litres). For Japan, they also differ in end-uses: according to a study in Japan, 60 per cent of shochu consumers drink shochu during meals, while 72 per cent of whisky consumers drink whisky after meals; and according to a study submitted by the Community, only eight per cent of consumers of shochu drink the beverage "on the rocks" while 68 per cent of bourbon whisky consumers do. None of bourbon whisky consumers mix such whisky with hot water or juice, while 42 per cent and 37 per cent of shochu consumers do respectively. They also differ in tariff lines: whisky is classified as "2208.30 whisky" while shochu is classified as "2208.90 Other". Japan also argued that the commonality in availability to the public mentioned by the Community exists only to the extent applicable to all alcoholic and non-alcoholic beverages: the menus and promotion leaflets submitted by the Community list not only whisky(ies) and shochu but also sake, wine, beer, juice, coffee and tea side by side. (…)

4.80 **Japan** also noted that the aptitude of the two products to serve the same uses raises the issue of the extent of the sameness. Since the use for quenching the thirst, for example, is common to all beverages, and since the use for enjoying alcohol is common to all alcoholic beverages, the concept of "sameness" should be understood in a narrower sense. According to Japan, the Community argues that sameness in drinking habits between shochu and other distilled liquors is sufficient to meet the criteria. However, Japan's evidence shows a good degree of divergence in drinking habits not only between shochu and spirits but between shochu and Bourbon whisky as well. The aptitude to serve the same uses does not seem to exist beyond what would apply to all alcoholic beverages.

(…)

ii) Cross-price elasticity

4.82 Continuing on the issue as to whether shochu and other imported liquors are directly competitive and substitutable, the **Community** argued that the retail prices of shochu and of the other distilled spirits and liqueurs are within a relatively short range once the liquor taxes and the *ad valorem* consumption taxes are deducted. This, in the Community's view, confirms that all of them are, at least potentially, competitive in terms of price. The retail prices net of taxes per litre of pure alcohol of most western-style liquors are much lower than the corresponding prices for shochu but both shochu and western-style liquors are frequently diluted with non-alcoholic beverages and drunk at roughly the same strength. Therefore, it may be concluded that, but for the discriminatory taxes imposed pursuant to the Liquor Tax Law, many western-style liquors would be less expensive than shochu in real terms. Price competition between shochu and the other spirits and liqueurs is therefore distorted by the lower taxes applied to shochu. Despite these distortions, there are clear indications that the demand for shochu is largely influenced by the fluctuations in the prices of the other distilled spirits and liqueurs. (…)

4.83 In response to the Community's allegation of cross-price elasticity, supported by Canada and the United States' claims, **Japan** submitted a rebuttal to the Community's arguments on the changes in consumption of whisky and shochu since 1989, the response of consumers to questions asked by Shakai-Chosa Kenkyujo (Institute for Social Studies), and the result of the econometric analysis of national household survey statistics.
(…)

b) The Second Step of the Test suggested by the Community for Article III:2, Second Sentence: " ... So as to Afford Protection"

4.94 As to the second step of the legal test it suggested for the second sentence of GATT Article III:2 in

assessing whether a measure imposed on substitutable or directly competitive products is "so as to afford protection", the **Community** reiterated that the following criteria may be relevant in order to determine whether a difference in taxation is "so as to afford protection" to domestic production: 1) The level of the tax differential (but contrary to the first sentence of Article III:2, a tax difference does not lead automatically to a violation of the second sentence of Article III:2); 2) The degree of substitutability and competition between the two products; 3) Whether the less taxed product is produced in other countries. (…)

4.95 For the **Community**, [the following facts] warrant the conclusion that the Liquor Tax Law affords protection to the Japanese domestic production of shochu:

(1) Despite the 1989 and the 1994 tax reforms, the tax rates on shochu A and shochu B are still much lower than the rates on "spirits", "whisky/brandy" and "liqueurs". The taxes on shochu are from 2.45 to 9.6 times lower in terms of rates per litre of beverage and from 2 to 6 times lower in terms of rates per litre of pure alcohol and these differences can thus hardly be considered as *de minimis*. Even though the tax differentials have been reduced in absolute terms since the adoption of the 1987 Panel Report, their protectionist effect has actually become more acute in the context of the current recessionary economy which has made Japanese consumers much more price sensitive.

(2) Shochu continues to be produced almost exclusively in Japan. In 1994 imports of shochu represented 1.7 per cent of the total sales of shochu and barely 1 per cent of the total sales of distilled spirits and "authentic liqueurs". In contrast, during the same year, imports from third countries accounted for 27 per cent of the total sales of whisky, 29 per cent of the total sales of brandy, 18 per cent of the total sales of "spirits" and 78 per cent of the total sales of "authentic liqueurs". Sales of domestically produced shochu account for almost 80 per cent of the total sales of domestically produced distilled spirits and "authentic liqueurs". Thus, by affording protection to shochu, Japan is in fact affording protection to the majority of its domestic production of spirits and liqueurs.

(3) Shochu and other imported liquors are mutually substitutable as evidenced by their cross-price elasticity, argued in paragraphs 4.82 and following above in the Community's discussion of the first step of the legal test it suggested for the second sentence of Article III:2.

The Community also recalled that since Article III:2 protects trade expectations on the competitive relationship between imported and domestic products rather than expectations on
trade volumes, it is not necessary, in order to establish a violation of Article III:2, second sentence, to show that the difference in taxation has had an actual effect on the volume of trade.

4.96 **Japan** responded to the Community's arguments on the three criteria. First, concerning the potential protective effect, Japan submitted that the tax differential should be measured on the basis of the tax/price ratio, as it is a criterion to judge whether or not a tax affords protection, and for Japan, there is no differential in the tax/price ratios. Secondly, for Japan, shochu and other distilled liquors do not show the aptitude of the two products to serve the same uses, and differ in the extent and the form in which the two products are available to the public, beyond what would apply to all alcoholic beverages. Cross-price elasticity of demand does not, therefore, exist. If a directly competitive or substitutable relationship were to be found in this case, it would have to be found between all alcoholic beverages, and, consequently, any liquor taxation currently in force would become inconsistent with Article III, unless all products show the same tax/price ratio. The degree of substitutability and competition between the products is minimal at best. Third, shochu is widely produced in Asian countries, and the third criterion is not met. Thus, Japan concluded that if the Community's interpretation is applied to the facts, one inevitably reaches a

conclusion that Japan's liquor tax is consistent with Article III:2, second sentence.

4.97 **Japan** argued that the Community is criticizing Japan's tax distinction among distilled liquors while dividing wine into six categories in its liquor tax directive and legitimizing Germany's application of four completely different rates to categories of wines. For Japan, a position which holds that champagne and sherry may be distinguished from other wine while shochu and whisky should be treated alike, is equal to turning Article III into an instrument of harmonization of internal taxes with a system of a particular group of countries. Japan reiterated that the purpose of Article III is not to require Members to adopt a particular system of taxes or regulations, nor to harmonize taxation systems. Japan argued that only a small number of WTO Members apply a flat rate to all categories of distilled liquors and a larger number of Members apply more than one rate in one way or another. In Japan's view, the conclusion advocated by the Community in the present case would substantially affect other countries as well. (…)

(…)

F. Application to the Present Case of the Legal Analysis Suggested by the United States for the Interpretation of Article III:2

4.106 As argued in paragraphs 4.24 to 4.32 above, the **United States** submitted that the central concern of Article III is to prohibit the targeting of imports and suggested that application to the Liquor Tax Law of the aim-and-effect test of earlier panel reports would confirm the inconsistency of that measure with the provisions of Article III:2, second sentence, in that the regulatory distinctions made by the legislation are so as to afford protection.

1. The Aim of the Legislation.

4.107 The **United States** argued that the protective aim of the Liquor Tax Law structure is apparent from (1) the stated policy objective and whether it was known at the time the legislation was enacted that it would draw a line between one group of products that would be foreign and another group that would be domestic (*ex-ante* knowledge), (2) the internal inconsistencies of the legislation and its structural incentives, (3) legislative statements and the preparatory work, as well as from (4) the arbitrary and irrational categories of the legislation under scrutiny. The United States continued by stating that:

(1) During the consultations, the Japanese Government asserted that the policy objective of the Liquor Tax Law system was to maximize tax revenue while ensuring that the tax is distributed among consumers in accordance with their "tax-bearing ability". However, this objective is nowhere stated in the law . . . . The official records of deliberations in the Finance Committee of the Diet in March 1994 show that Ministry of Finance Tax Bureau Director Ogawa testified that the reason for the difference in tax treatment was "out of consideration for the higher material costs etc" of shochu B. He also testified that particular attention had been made to coordinate the tax increases with the increased costs of raw materials associated with factors such as the poor rice harvest in the case of refined sake and shochu, especially shochu B. The legislation raising taxes included as well an extension of tax reductions for small-volume producers of shochu A and B, and provision for a subsidy fund for shochu producers. The package in context demonstrates that the operative consideration in passing the legislation was the economic well-being of domestic shochu producers, not a neutral tax policy. The official records of deliberations in the Finance Committee of the Diet in March 1994 show that Ministry of Finance Tax Bureau Director Ogawa testified that the reason for the difference in tax treatment was "out of consideration for the higher material costs etc" of shochu B. He also testified that particular attention had been made to coordinate the tax increases with the increased costs of raw materials associated with factors

such as the poor rice harvest in the case of refined sake and shochu, especially shochu B. The legislation raising taxes included as well an extension of tax reductions for small-volume producers of shochu A and B, and provision for a subsidy fund for shochu producers. The package in context demonstrates that the operative consideration in passing the legislation was the economic well-being of domestic shochu producers, not a neutral tax policy.

(2) According to an article in a Ministry of Finance publication written by one of the Ministry drafters explaining the 1962 revisions,[72] the definitions were changed at that time in order to clarify and reinforce the distinction between shochu, whisky, brandy and spirits. The purpose of the change and the related exception was (a) to exclude certain products which would be classified as whisky, brandy, and spirits, but since dates were already being used as a raw material for shochu in Japan, these would be permitted as a fruit raw material for shochu; (b) to exclude vodka; (c) to exclude rum from the category of shochu, but permit Okinawan awamori made with barrel molasses to remain as shochu; (d) to exclude gin and similar genever-type drinks.

(3) The lack of any policy rationale other than protection is apparent from the otherwise-arbitrary distinctions drawn in the product categories. The only difference between vodka and shochu A is that according to the definition in the Liquor Tax Law, shochu A cannot be filtered with white birch charcoal, although it can be filtered with any other material. Yet the tax rate on vodka is 2.55 times higher than the tax rate on shochu A.
The Japanese government has never claimed that the ban on the use of white birch charcoal in filtering shochu was based on health reasons or any other policy. Thus the distinction cannot have any purpose other than excluding imported vodka from the tax benefits granted to the producers of shochu.

(4) It is also arbitrary to set the maximum alcohol content for shochu made by continuous distillation methods (shochu A) at 36 per cent and the maximum alcohol content for shochu distilled otherwise (shochu B) at 45 per cent. All alcoholic beverages falling within the categories of “shochu”, “whisky/brandy” and “spirits” are classified as “liqueurs” and taxed at a uniform rate whenever they are pre-mixed with a sugared non-alcoholic beverage. However, the same alcoholic beverages, when sold undiluted, are classified within different tax categories and taxed at widely differing rates, even though they are often consumed in home-made mixes made with similar non-alcoholic beverages. Again, in the US view, the Japanese government has claimed no policy justification for this difference in taxation. The only rational explanation for it is that pre-mixes, unlike undiluted alcoholic beverages, are produced almost exclusively in Japan. For the United States, the arbitrariness of the distinction drawn between “spirits” and shochu can be seen in the recent move by Suntory, the producer of “Juhyo” brand vodka, to recharacterize it as shochu A. Before June 1993, Juhyo was sold as vodka, and accounted for almost half of Japanese vodka production. After June 1993, Suntory ceased using birch charcoal as a filtering material, and began selling Juhyo as shochu A, simply in order to reduce the tax burden on the product. Suntory was then able to, and did, reduce the retail price of Juhyo. Of course, because of the substantial tariffs on shochu, it is not possible for foreign vodka producers to do the same. Thus, for the United States, the distinction drawn by the system of Japanese liquor taxation between shochu and all other distilled spirits is arbitrary and contrived.

(…)

[72] Tan Hirosho, “Shuzeiho to no ichibu o kaisei suru horitsu” (The Law Partially Revising the Liquor Tax Law), in *Zeisei Tsushin* (Tax Policy News), June 1962, p. 23ff. The article identifies the author as the Deputy Director of the Ministry of Finance, Second Tax Policy Division.

2. The Effect of the Legislation

4.113 The **United States** went on to argue that the distinction drawn by the Liquor Tax Law also has the effect of affording protection to domestic production. In this regard, data on sales and trade flows are relevant to show changes in the conditions of competition favouring domestic products. Other factors, including the creation of inherently domestic products and foreign products, and whether there is a large difference in rates between categories, also support the conclusion of a protective effect. (…)

4.114 The **United States** pointed out that shochu consumed in Japan continues to be made almost exclusively in Japan. In 1994, imports of shochu were 1.7 per cent of total sales and 1 per cent of total sales of distilled spirits and "authentic distilled spirits". Also, in 1994, imports from third countries accounted for 27 per cent of the total sales of whisky, 29 per cent of the total sales of brandy, 18 per cent of the total sales of spirits and 78 per cent of the total sales of "authentic liqueurs". At the same time, domestically-made shochu accounted for over 80 per cent of all domestic sales of distilled spirits and authentic liqueurs. Thus, the protection given to shochu has had the effect of protection for domestic production.

4.115 On the market shares of shochu and the price-cross elasticity of shochu, the **United States**, in addition to the arguments detailed in paragraphs 4.82 to 4.93 above, noted that there were clear indications that the demand for shochu is largely influenced by fluctuations in demand for other distilled spirits and liqueurs. This could be seen in the rearrangement of the market place for distilled spirits after the 1989 tax reform. The 1989 reform unified tax rates on whisky, abolished the classification of whisky into three classes, and consequently more than tripled the tax rate on second-class whisky while lowering the taxes on other whisky, authentic liquers and spirits. The 1989 law also raised the tax on shochu by a small amount. In particular the United States submitted that:

- Retail prices for second-class whisky almost doubled, and the market share for domestic whisky declined from 27 per cent in 1988 to 19.6 per cent in 1990. This trend has continued: in 1994 the market share of domestic whisky sank further, to only 13.2 per cent. Shochu makers were able to move into the place in the market formerly held by second-class whisky. Sales of Shochu have steadily increased and reached 74.2 per cent of distilled spirits in 1994.

- The prices of imported whisky, liqueurs and spirits declined and their sales rose. However, Japan entered a recession in 1992. The highest-taxed categories, whisky/brandy, authentic liqueurs and spirits, were hit worst and have lost sales both relatively and absolutely since 1992, while the market share of shochu continues to grow at their expense.

- Because the prices of shochu and other distilled spirits have partially converged, their cross-elasticity of demand has risen.

- Shochu continues to be made almost exclusively in Japan. In 1994, imports of shochu were 1.7 per cent of total sales and 1 per cent of total sales of distilled spirits and "authentic distilled spirits." Also in 1994, imports from third countries accounted for 27 per cent of the total sales of whisky, 29 per cent of the total sales of brandy, 18 per cent of the total sales of spirits and 78 per cent of the total sales of "authentic liqueurs". At the same time domestically-made shochu accounted for over 80 per cent of all domestic sales of distilled spirits and authentic liqueurs. Thus, the protection given to shochu has had the effect of protection for domestic production.

(…)

G. Application to the Present Case of the Legal Analysis suggested by Japan for the Interpretation of Article III:2

(…)

4.137 (…)

Figure: Comparison of "Tax Discrimination Indices"

	Per Litre of Beverage		Per Litre of Pure Alcohol		Tax/Price Ratio	
	Liquor Tax	VAT	Liquor Tax	VAT	Liquor Tax	VAT
Shochu A	1.0	1.0	1.0	1.0	1.0	1.0
Imported Vodka	2.7	3.4	1.6	2.0	0.8	1.0
Imported Whisky	7.0	8.0	4.0	4.7	0.9	1.0

Note: Calculated on the basis of weighted average of 20 most selling brands.

4.138 **Japan** argued that this figure demonstrates that i) the liquor tax is similar to VAT in terms of "tax discrimination indices", and that ii) VAT would be regarded more "trade-distortive" than the liquor tax as long as a comparison is made on the basis of the taxes by the tax amount per litre of beverage or of pure alcohol. Japan submitted that VAT is regarded as one of the most trade-neutral indirect taxes and its introduction is one of the conditions to join the European Union. On the other hand, a comparison made with the amount of tax per litre of beverage or of pure alcohol would find such VAT as trade-distortive. In fact it is the use of those two yardsticks as tools of comparing taxes which is problematic, rather than the tax itself. Japan emphasized that a consumer usually does not buy a product exclusively on the basis of the size of the bottle or on the basis of the alcoholic strength. Consumers choose products by comparing the price and the overall value of a product, which depends upon the taste, flavour and other features and is not confined to the volume and strength. Japan argued that this is why the tax/price ratio is a better criterion to evaluate the effects of taxes on competitive conditions, and neutrality is achieved when the tax/price ratio is equalized, as is the case with the Japanese tax.

(…)

4.140 **Japan** argued that the lack of plausible alternatives further testifies to the lack of protective intent. Conceivable alternatives to ensure neutrality and equity are: (i) to raise the *ad valorem* value-added tax to a level comparable to that of the European Union, which applies not only to liquor consumption but to almost all consumption or (ii) to alter the liquor tax into an *ad valorem* tax. However, for Japan, neither of these is practical. First, the decision to raise the *ad valorem* consumption tax from the present three per

cent to five per cent beginning April 1997 was made in 1994 only after a prolonged, heated debate. It is not very likely that the rate would be raised to the Community level in the near future. Second, an *ad valorem* excise tax could easily invite tax evasion by way of transfer-pricing, particularly if applied at the shipping stage. Canada's Federal Manufacturers Sales Tax suffered from the same difficulty and was abolished in 1991. On the other hand, enforcement cost of an *ad valorem* tax would be very substantial if applied at the retail level.

(…)

VI. Findings

(…)

2.Artile III

6.11 The Panel proceeded on the basis of the interpretative rule of the [Vienna Convention on the Law of Treaties] by turning first to the wording of Article III:2. The Panel noted that Article III:2 is concerned with two different factual situations: Article III:2, first sentence, is concerned with the treatment of like products, whereas Article III:2, second sentence, is concerned with the treatment of directly competitive or substitutable products, i.e., products other than like products, since no mention of like products is made in Article III:2, second sentence. In the Panel's view, the inclusion of the words “moreover” and “otherwise” in the second sentence of Article III:2 makes this point clear. The Interpretative Note ad Article III:2 further clarifies this distinction by providing an example where the first sentence of Article III:2 is not violated whereas the second is, thus confirming the existence of two distinct obligations in Article III:2.

6.12 The Panel, having established the basis for interpretation of Article III:2, turned to an examination of its elements. The Panel noted that while Article III:2, second sentence, contains a reference “to the principles set forth in paragraph 1”, no such reference is contained in Article III:2, first sentence. The Panel recalled that according to Article III:1, WTO Members recognize that domestic legislation “should not be applied ... so as to afford protection to domestic production”. In this context, the Panel felt that it was necessary to examine the relationship between Article III:2 and Article III:1. The Panel noted that the latter contains general principles concerning the imposition of internal taxes, internal charges, and laws, regulations and requirements affecting the treatment of imported and domestic products, while the former provides for specific obligations regarding internal taxes and internal charges. The words “recognize” and “should” in Article III:1, as well as the wording of Article III:2, second sentence, (“the principles”), make it clear that Article III:1 does not contain a legally binding obligation but rather states general principles. In contrast, the use of the word “shall” in Article III:2, both sentences, makes it clear that Article III:2 contains two legally binding obligations. Consequently, the starting point for an interpretation of Article III:2 is Article III:2 itself and not Article III:1. Recourse to Article III:1, which constitutes part of the context of Article III:2, will be made to the extent relevant and necessary.

(…)

3.Article III:2, First Sentence

a)Overview

6.14 In light of the foregoing, the Panel then proceeded to an analysis of how the legal obligations imposed by Article III:2, first sentence, should be interpreted. In this context, the Panel recalled the

divergent views of the parties to the dispute: the Panel noted that, with respect to like products, the Community essentially argued in favour of a two-step procedure whereby the Panel should establish first whether the products in question are like and, if so, then proceed to examine whether taxes imposed on foreign products are in excess of those imposed on like domestic products. The Community had stated that physical characteristics of the products concerned, their end-uses, as well as consumer preferences could provide relevant criteria for the Panel to judge whether the products concerned were like. The Panel noted in this respect, that complainants have the burden of proof to show first, that products are like and second, that foreign products are taxed in excess of domestic ones.

6.15 The Panel further took note of the statements by Japan that essentially argued that the Panel should examine the contested legislation in the light of its aim and effect in order to determine whether or not it is consistent with Article III:2. According to this view, in case the aim and effect of the contested legislation do not operate so as to afford protection to domestic production, no inconsistency with Article III:2 can be established. The Panel further took note of the statement by the United States that essentially argued that, in determining whether two products that were taxed differently under a Member's origin-neutral tax measure were nonetheless "like products" for the purposes of Article III:2, the Panel should examine not only the similarity in physical characteristics and end-uses, consumer tastes and preferences, and tariff classifications for each product, but also whether the tax distinction in question was "applied ... so as to afford protection to domestic production": that is, whether the aim and effect of that distinction, considered as a whole, was to afford protection to domestic production. According to this view, if the tax distinction in question is not being applied so as to afford protection to domestic production, the products between which the distinction is drawn are not to be deemed "like products" for the purpose of Article III:2. The Panel noted that the United States and Japan reached opposite results by applying essentially the same test. Japan concluded that its legislation did not have the aim or effect of affording protection, while the United States concluded that the categorization made in that legislation did have such an aim and effect. Lastly in this context, the Panel noted that the United States also argued that independently of the legal test chosen and applied, the Panel should find that Japan in this case is in violation of its obligations under Article III:2. It was also the view of Japan that independently of the legal test chosen and applied, the Panel should find that Japan is not in violation of its obligations under Article III:2.

6.16 The Panel first turned to the test proposed by Japan and the United States. The Panel noted, in this respect, that the proposed aim-and-effect test is not consistent with the wording of Article III:2, first sentence. The Panel recalled that the basis of the aim-and-effect test is found in the words "so as to afford protection" contained in Article III:1.[86] The Panel further recalled that Article III:2, first sentence, contains no reference to those words. Moreover, the adoption of the aim-and-effect test would have important repercussions on the burden of proof imposed on the complainant. The Panel noted in this respect that the complainants, according to the aim-and-effect test, 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. The Panel also noted that 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 applying the aim-and-effect test.[87] Moreover, access to the complete legislative history, which according

[86] See paras. 4.16 - 4.19 and 4.24ff. of the Descriptive Part.

[87] The Panel noted, in this respect, an interesting parallel with the legal status of "supplementary means" of interpretation of treaties -- that comprise preparatory work -- and their relevance for interpreting treaties. The Panel noted that according to Article 32 VCLT recourse to supplementary means of interpretation is required only as an exception in specific circumstances. The Panel noted in this respect the commentary of the International Law Commission: "The Commission considered that the exception must be strictly limited, if it is not to weaken unduly the authority of the ordinary meaning of the terms." The Panel further noted the statement of the International Law Commission that "...the preparatory work...does not, in consequence, have

to the arguments of the parties defending the aim-and-effect test, is relevant to detect protective aims, could be difficult or even impossible for a complaining party to obtain. 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 by interested parties) should be primarily determinative of the aims of the legislation.[88] The Panel recalled in this respect the argument by the United States that the aim-and-effect test should be applicable only with respect to origin-neutral measures. The Panel noted that neither the wording of Article III:2, nor that of Article III:1 support a distinction between origin-neutral and origin-specific measures.

6.17 The Panel further noted that the list of exceptions contained in Article XX of GATT 1994 could become redundant or useless because the aim-and-effect test does not contain a definitive list of grounds justifying departure from the obligations that are otherwise incorporated in Article III.[89] The purpose of Article XX is to provide a list of exceptions, subject to the conditions that they "are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction of international trade", that could justify deviations from the obligations imposed under GATT. Consequently, in principle, a WTO Member could, for example, invoke protection of health in the context of invoking the aim-and-effect test. The Panel noted that if this were the case, then the standard of proof established in Article XX would effectively be circumvented. WTO Members would not have to prove that a health measure is "necessary" to achieve its health objective.[90]90 Moreover, proponents of the aim-and-effect test even shift the burden of proof, arguing that it would be up to the complainant to produce a prima facie case that a measure has both the aim and effect of affording protection to domestic production and, once the complainant has demonstrated that this is the case, only then would the defending party have to present evidence to rebut the claim.[91] In sum, the Panel concluded that for reasons relating to the wording of Article III as well as its context, the aim-and- effect test proposed by Japan and the United States should be rejected.

(…)

6.19 The Panel, having decided not to apply the aim-and-effect test proceeded to develop the legal test that it would apply in this case in order to determine whether Japan had acted inconsistently with its obligations under Article III. More specifically, in the view of the Panel, the wording of Article III:2, first sentence, requires it to make three determinations: (i) whether the products concerned are like, (ii) whether the contested measure is an "internal tax" or "other internal charge" (not an issue in this case) and (iii) if so, whether the tax imposed on foreign products is in excess of the tax imposed on like

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the same authentic character as an element of interpretation, however valuable it may sometimes be in throwing light in the expression of the agreement in the text. Moreover, it is beyond question that the records of treaty negotiations are in many cases incomplete or misleading, so that considerable discretion has to be exercised in determining their value as an element of interpretation. D. Rauschning and R.G. Wetzel, The Vienna Convention on the Law of Treaties, Travaux Préparatoires (Frankfurt: Alfred Metzner Verlag, 1978), pp. 255, 252. The Panel noted that considerable differences exist between preparatory work of international treaties and preparatory work of domestic legislation that preclude the automatic transposition of the reasoning of the International Law Commission to the case before it. Nevertheless, in the Panel's view, the analysis and reasoning of the International Law Commission could be relevant even in the context of preparatory work of domestic legislation.

[88] See para. 4.17 of the Descriptive Part.

[89] In this context, the Panel noted that the Appellate Body in its report on "United States - Standards for Reformulated and Conventional Gasoline", noted that "one of the corollaries of the 'general rule of interpretation' in the Vienna Convention is that interpretation must give meaning and effect to all the terms of a treaty. An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility". WT/DS2/AB/R, at p.23.

[90] See, for example, the panel report on "Thailand - Restrictions on Importation of and Internal Taxes on Cigarettes", adopted on 7 November 1990, BISD 37S/200.

[91] See, for example, the panel report on "Thailand - Restrictions on Importation of and Internal Taxes on Cigarettes", adopted on 7 November 1990, BISD 37S/200.

domestic products. If these three determinations are in the affirmative, such a tax would result in the WTO Member imposing it being in violation of the obligation contained in Article III:2, first sentence. Moreover, in the Panel's view, the only relevant contextual elements supported this interpretation. The Panel recalled in this respect its conclusions reached in paragraph 6.12 concerning the limited relevance of Article III:1 to the interpretation of Article III:2. The Panel further recalled that past GATT panels had followed this approach.[94] Thus, the Panel decided to proceed on the basis outlined in this paragraph.

b)Like Products

6.20 The Panel noted that the term "like product" appears in various GATT provisions. The Panel further noted that it did not necessarily follow that the term had to be interpreted in a uniform way. In this respect, the Panel noted the discrepancy between Article III:2, on the one hand, and Article III:4 on the other: while the former referred to Article III:1 and to like, as well as to directly competitive or substitutable products (see also Article XIX of GATT), the latter referred only to like products. If the coverage[95] of Article III:2 is identical to that of Article III:4, a different interpretation of the term "like product" would be called for in the two paragraphs. Otherwise, if the term "like product" were to be interpreted in an identical way in both instances, the scope of the two paragraphs would be different. This is precisely why, in the Panel's view, its conclusions reached in this dispute are relevant only for the interpretation of the term "like product" as it appears in Article III:2.

6.21 The Panel noted that previous panel and working party reports had unanimously agreed that the term "like product" should be interpreted on a case-by-case basis.[96] The Panel further noted that previous panels had not established a particular test that had to be strictly followed in order to define likeness. Previous panels had used different criteria in order to establish likeness, such as the product's properties, nature and quality, and its end-uses; consumers' tastes and habits, which change from country to country; and the product's classification in tariff nomenclatures.[97] In the Panel's view, "like products" need not be identical in all respects. However, in the Panel's view, the term "like product" should be construed narrowly in the case of Article III:2, first sentence. This approach is dictated, in the Panel's view, by two independent reasons: (i) because Article III:2 distinguishes between like and directly competitive or substitutable products, the latter obviously being a much larger category of products than the former; and (ii) because of the Panel's conclusions reached with respect to then relationship between Articles III and II. As to the first point, the distinction between "like" and "directly competitive or substitutable products" is discussed in paragraph 6.22. As to the second point, as previous panels had noted, one of the main objectives of Article III:2 is to ensure that WTO Members do not frustrate the effect of tariff concessions granted under Article II through internal taxes and other internal charges, it follows that a parallelism should be drawn in this case between the definition of products for purposes of Article II tariff concessions and the term "like product" as it appears in Article III:2. This is so in the Panel's view,

[94]See for example, the panel report on "United States - Taxes on Petroleum and Certain Imported Substances", adopted on 17 June 1987, BISD 34S/136; the 1987 Panel Report; see also the panel report on "United States - Standards for Reformulated and Conventional Gasoline", WT/DS2/R, adopted on 20 May 1996.

[95] By the term "coverage", the Panel means whether Article III:4 regulates the treatment of both categories of products mentioned in Article III:2, namely both "like" and "directly competitive or substitutable" products.

[96] See, for example, the Working Party Report on "Border Tax Adjustments", L/3464, adopted on 2 December 1970, BISD 18S/97, p. 102, para. 18 (hereinafter "the 1970 Working Party report"); the panel report on "United States - Taxes on Petroleum and Certain Imported Substances", adopted on 17 June 1987, BISD 34S/136, pp.154-155, para. 5.1.1; the 1987 Panel Report, pp.113-115, para. 5.5-5.7; the 1992 Malt Beverages report, pp. 276-277, paras. 5.25 - 5.26.

[97] See the 1970 Working Party report on "Border Tax Adjustments", op. cit., at para. 18; the 1987 Panel Report at para. 5.6; the panel report on "United States - Taxes on Petroleum and Certain Imported Substances", op. cit., at para. 5.1.1; the panel report on "EEC - Measures on Animal Feed Proteins", adopted on 14 March 1978, BISD 25S/49, at para. 4.3.

because with respect to two products subject to the same tariff binding and therefore to the same maximum border tax, there is no justification, outside of those mentioned in GATT rules, to tax them in a differentiated way through internal taxation. This does not mean that the determination of whether products are "like" should be based exclusively on the definition of products for tariff bindings, but in the Panel's view, especially where it is sufficiently detailed, a product's description for this purpose is in this case an important criterion for confirming likeness for the purposes of Article III:2. The Panel noted that its proposed interpretation does not unduly restrict the possibility offered to WTO Members to challenge internal taxes that discriminate against foreign products, since Article III:2, second sentence, effectively prohibits the taxation of "directly competitive or substitutable products" "so as to afford protection to domestic production". As explained in the next paragraph, the phrase "directly competitive or substitutable products", should be interpreted more broadly than the phrase "like products". In the Panel's view, its interpretation of Article III:2, first sentence, is in accordance with the requirements of Article 31 VCLT.

6.22 The wording of Article III and of the Interpretative Note ad Article III make it clear that a distinction must be drawn between, on the one hand, like, and, on the other, directly competitive or substitutable products. Such an approach is in conformity with the principle of "effective treaty interpretation" as laid down in the "general rule of interpretation" of the Vienna Convention on the Law of Treaties. The Panel recalled in this respect the conclusions of the Appellate Body in its report on "United States - Standards for Reformulated and Conventional Gasoline" where it stated that "an interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility."[98] In the view of the Panel, like products should be viewed as a subset of directly competitive or substitutable products. The wording ("like products" as opposed to "directly competitive or substitutable products") confirmed this point, in the sense that all like products are, by definition, directly competitive or substitutable products, whereas all directly competitive or substitutable products are not necessarily like products. Giving a narrow meaning to "like products" is also justified by the inescapability of violation in case of taxation of foreign products in excess of like domestic products[99]. Moreover, in the Panel's view, the wording makes it clear that the appropriate test to define whether two products are "like" or "directly competitive or substitutable" is the marketplace. The Panel recalled in this respect the words used in the Interpretative Note ad Article III, paragraph 2, namely "where competition exists": competition exists by definition in markets. In the view of the Panel, to define a precise cut-off point that distinguishes between, on the one hand, like, and on the other, directly competitive or substitutable products requires an arbitrary decision. The Panel decided therefore, to consider criteria on a case-by-case basis in order to determine whether two products are like or directly competitive or substitutable. The Panel recalled, in this respect, that previous panels had pronounced in favour of a case-by-case approach when defining like or directly competitive or substitutable products.[100] In the view of the Panel, descriptions used in the context of tariff classifications and bindings whilst by themselves not providing decisive guidance on likeness, can be used nevertheless in considering the content of "like products" in the context of Article III:2, first sentence. Such an approach is in line with previous panel reports that concluded that the purpose of Article III was to avoid that "the value of the bindings under Article II of the Agreement and of the general rules of non-discrimination as between imported and domestic products could be easily evaded."[101] Previous panels that dealt with the same issue have used a series of criteria in

[98] See WT/DS2/AB/R, at p.23.
[99] The panel report on "United States - Taxes on Petroleum and Certain Imported Substances", op. cit., at para. 5.1.9 made it clear that no *de minimis* defense can be raised in case of taxation of foreign products in excess of domestic like products. The Panel agreed with this statement.
[100] See footnote 96 and accompanying text.

[101] See the panel report on "Italian Discrimination Against Imported Agricultural Machinery", adopted on 23 October 1958, BISD 7S/60 at p.64, para. 15; see also the 1987 Panel Report op. cit.

order to define likeness or substitutability.[102] In the view of the Panel, the wording of the term "directly competitive or substitutable" does not suggest at all that physical resemblance is required in order to establish whether two products fall under this category. This impression, in the Panel's view, was further supported by the words "where competition exists" of the Interpretative Note; competition can and does exist among products that do not necessarily share the same physical characteristics. In the Panel's view, 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. The wording of the term "like products" however, suggests that commonality of end-uses is a necessary but not a sufficient criterion to define likeness. In the view of 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. In the Panel's view its suggested approach has the merit of being functional, although the definition of likeness might appear somewhat "inflexible". Flexibility is required in order to conclude whether two products are directly competitive or substitutable. In the Panel's view, the suggested approach can guarantee the flexibility required, since it permits one to take into account specific characteristics in any single market; consequently, two products could be considered to be directly competitive or substitutable in market A, but the same two products would not necessarily be considered to be directly competitive or substitutable in market B. The Panel proceeded to apply this approach to the products in dispute in the present case.

6.23 The Panel next turned to an examination of whether the products at issue in this case were like products, starting first with vodka and shochu. The Panel noted that vodka and shochu shared most physical characteristics. In the Panel's view, except for filtration, there is virtual identity in the definition of the two products. 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 then noted that essentially the same conclusion had been reached in the 1987 Panel Report, which "... agreed with the arguments submitted to it by the European Communities, Finland and the United States that Japanese shochu (Group A) and vodka could be considered as 'like' products in terms of Article III:2 because they were both white/clean spirits, made of similar raw materials, and the end-uses were virtually identical".[103] Following its independent consideration of the factors mentioned in the 1987 Panel Report, the Panel agreed with this statement. The Panel then recalled its conclusions concerning the relationship between Articles II and III. In this context, it noted that (i) vodka and shochu were currently classified in the same heading in the Japanese tariffs, (although under the new Harmonized System (HS) Classification that entered into force on 1 January 1996 and that Japan plans to implement, shochu appears under tariff heading 2208.90 and vodka under tariff heading 2208.60); and (ii) vodka and shochu were covered by the same Japanese tariff binding at the time of its negotiation. Of the products at issue in this case, only shochu and vodka have the same tariff applied to them in the Japanese tariff schedule (see Annex 1). The Panel noted that, with respect to vodka, Japan offered no further convincing evidence that the conclusion reached by the 1987 Panel Report was wrong, not even that there had been a change in consumers' preferences in this respect. The Panel further noted that Japan's basic argument is not that the two products are unlike, in terms of the criteria applied in the 1987 Panel Report, but rather that they are unlike because the Japanese tax legislation does not have the aim and effect to protect shochu. The Panel noted, however, that it had already rejected the aim-and-effect test. Consequently, in light of the conclusion of the 1987 Panel Report and of its independent consideration of the issue, the

[102] See footnote 96 and accompanying text.
[103] Para. 5.7. The same paragraph further reads: "... the Panel found that the traditional Japanese consumer habits with regard to shochu provided no reason for not considering vodka to be a 'like' product. ... Even if imported alcoholic beverages (e.g vodka) were not considered to be 'like' to Japanese alcoholic beverages (e.g shochu Group A), the flexibility in the use of alcoholic drinks and their common characteristics often offered an alternative choice for consumers leading to a competitive relationship.

Panel concluded that vodka and shochu are like products. In the Panel's view, only vodka could be considered as like product to shochu since, apart from commonality of end-uses, it shared with shochu most physical characteristics. Definitionally, the only difference is in the media used for filtration. Substantial noticeable differences in physical characteristics exist between the rest of the alcoholic beverages at dispute and shochu that would disqualify them from being regarded as like products. More specifically, the use of additives would disqualify liqueurs, gin and genever; the use of ingredients would disqualify rum; lastly, appearance (arising from manufacturing processes) would disqualify whisky and brandy. The Panel therefore decided to examine whether the rest of alcoholic beverages, other than vodka, at dispute in the present case could qualify as directly competitive or substitutable products to shochu. The Panel lastly noted that the 1987 Panel Report had also considered these products only under Article III:2, second sentence.

c)Taxation in Excess of that Imposed on Like Domestic Products

6.24 The Panel then proceeded to examine whether vodka is taxed in excess of the tax imposed on shochu under the Japanese Liquor Tax Law. The Panel noted that what was contested in the Japanese legislation was a system of specific taxes imposed on various alcoholic drinks. In this respect, it noted that vodka was taxed at 377,230 Yen per kilolitre - for an alcoholic strength below 38° - that is 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° - that is 6,228 Yen per degree of alcohol.[104] The Panel further noted that Article III:2 does not contain any presumption in favour of a specific mode of taxation. Under Article III:2, first sentence, WTO Members are free to choose any system of taxation they deem appropriate provided that they do not impose on foreign products taxes in excess of those imposed on like domestic products. The phrase "not in excess of those applied ... to like domestic products" should be interpreted to mean at least identical or better tax treatment. The Japanese taxes on vodka and shochu are calculated on the basis of and vary according to the alcoholic content of the products and, on this basis, it is obvious that the taxes imposed on vodka are higher than those imposed on shochu. Accordingly, the Panel concluded that the tax imposed on vodka is in excess of the tax imposed on shochu.

6.25 The Panel then addressed the argument put forward by Japan that its legislation, by keeping the tax/price ratio "roughly constant", is trade neutral and consequently no protective aim and effect of the legislation can be detected. In this connection, the Panel recalled Japan's argument that its aim was to achieve neutrality and horizontal tax equity.[105] The Panel noted that it had already decided that the existence or non-existence of a protective aim and effect is not relevant in an analysis under Article III:2, first sentence. To the extent that Japan's argument is that its Liquor Tax Law does not impose on foreign products (i.e., vodka) a tax in excess of the tax imposed on domestic like products (i.e., shochu), the Panel rejected the argument for the following reasons:

(i) The benchmark in Article III:2, first sentence, is that internal taxes on foreign products shall not be imposed in excess of those imposed on like domestic products. Consequently, in the context of Article III:2, first sentence, it is irrelevant whether "roughly" the same treatment through, for example, a "roughly constant" tax/price ratio is afforded to domestic and foreign like products or whether neutrality and horizontal tax equity is achieved.

(ii) Even if it were to be accepted that a comparison of tax/price ratios of products could offset the fact that vodka was taxed significantly more heavily than shochu on a volume and alcoholic content basis, there were significant problems with the methodology for calculating tax/price ratios

[104] See para. 2.3 of the Descriptive Part for a complete description of the Japanese liquor tax rates.
[105] See para. 4.132ff. of the Descriptive Part.

submitted by Japan, such that arguments based on that methodology could only be viewed as inconclusive. More particularly, although Japan had argued that the comparison of tax/price ratios should be done on a category-by-category basis, its statistics on which the tax/price ratios were based excluded domestically produced spirits from the calculation of tax/price ratios for spirits and whisky/brandy. Since the prices of the domestic spirits and whisky/brandy are much lower than the prices of the imported goods, this exclusion has the impact of reducing considerably the tax/price ratios cited by Japan for those products. In this connection, the Panel noted that one consequence of the Japanese tax system was to make it more difficult for cheaper imported brands of spirits and whisky/brandy to enter the Japanese market. Moreover, the Panel further noted that the Japanese statistics were based on suggested retail prices and there was evidence in the record[106] that these products were often sold at a discount, at least in Tokyo. To the extent that the prices were unreliable, the resultant tax/price ratios would be unreliable as well.[107]

(iii) Nowhere in the contested legislation was it mentioned that its purpose was to maintain a "roughly constant" tax/price ratio. This was rather an ex post facto rationalization by Japan and at any rate, there are no guarantees in the legislation that the tax/price ratio will always be maintained "roughly constant". Prices change over time and unless an adjustment process is incorporated in the legislation, the tax/price ratio will be affected. Japan admitted that no adjustment process exists in the legislation and that only ex post facto adjustments can occur. The Panel lastly noted that since the modification in 1989 of Japan's Liquor Tax Law there has been only one instance of adjustment.

6.26 The Panel then turned to the arguments put forward by Japan concerning taxation systems in other countries. The Panel noted that its terms of reference were strictly confined to the Japanese legislation. The Panel could not, therefore, consider the domestic taxation systems of other countries since they lie outside its terms of reference.

6.27 Consequently, the Panel concluded that, by taxing vodka in excess of shochu, Japan is in violation of its obligation under Article III:2, first sentence.

4. Article III:2, Second Sentence

a) Directly Competitive or Substitutable Products

6.28 The Panel then turned to an analysis of the issues arising under Article III:2, second sentence. In the view of the Panel, the wording of Article III:2, second sentence, requires it to make two determinations: (i) whether the products concerned (whisky, brandy, gin, genever, rum and liqueurs) are directly competitive or substitutable, and (ii) if so, whether the treatment afforded to foreign products is contrary to the principles set forth in paragraph 1 of Article III.
In the view of the Panel, the complainants have the burden of proof to show first, that the products concerned are directly competitive or substitutable and second, that foreign products are taxed in such a way so as to afford protection to domestic production. The Panel recalled that the term "directly competitive or substitutable product", in accordance with its ordinary meaning, should be interpreted more broadly than the term "like product". In this sense the Interpretative Note ad Article III:2, second sentence, speaks about products "where competition was involved between..." them. The Panel noted, in this respect, that independently of similarities with respect to physical characteristics or classification in

[106] See paras. 4.100, 4.142-4, 4.159, 4.160-1 of the Descriptive Part.
[107] See paras. 4.100, 4.159, 4.160 and 4.165 of the Descriptive Part.

tariff nomenclatures, greater emphasis should be placed on elasticity of substitution. In this context, factors like marketing strategies could also prove to be relevant criteria, since what is at issue is the responsiveness of consumers to the various products offered in the market. Such responsiveness, the Panel recalled, may vary from country to country,[108] but should not be influenced or determined by internal taxation.[109] The Panel noted the conclusions in the 1987 Panel Report,[110] that a tax system that discriminates against imports has the consequence of creating and even freezing preferences for domestic goods. In the Panel's view, this meant that consumer surveys in a country with such a tax system would likely understate the degree of potential competitiveness between substitutable products.

6.29 (…) Turning to the evidence in this case, the Panel noted that the complainants had submitted a study (the ASI study) that concludes that there is a high degree of price-elasticity between shochu, on the one hand, and five brown spirits (Scotch whisky, Japanese whisky, Japanese brandy, cognac, North American whisky) and three white spirits (gin, vodka and rum), on the other.[112] Japan questioned the relevance of this ASI study by noting that consumers were not allowed to choose other than the mentioned eight products (for example, they were not allowed to choose, beer, sake or wine) and also argued that if choices are too limited even such disparate products as hamburger and ice cream could be argued to be directly competitive or substitutable products. In the Panel's view, however, price-elasticity between the mentioned products is not altered by the fact that consumers were presented with a limited choice. At best, the argument by Japan, if proven, could eventually lead to the conclusion that the three products mentioned by Japan have a greater degree of price-elasticity with shochu. It would not, however, in the Panel's view, amount to a rejection of the existence of a significant directly competitive or substitutable relationship between shochu and the examined eight products.

6.30 (…) In the Panel's view, the fact that foreign produced whisky and shochu were competing for the same market is evidence that there was elasticity of substitution between them.

6.31 The Panel noted Japan's argument that there is no elasticity of substitution between shochu and the rest of the alcoholic drinks in dispute in this case. If at all, according to Japan, the evidence the complainants provided to the Panel shows elasticity of substitution between shochu and beer. Japan based its argument on a survey conducted among consumers that showed, according to Japan, that in case shochu were not available 6 per cent of the consumers would switch to spirits whereas only 4 per cent to whisky; if whisky were not available, 32 per cent of the consumers would choose brandy and only 10 per cent would choose shochu. Japan submitted this survey to the Panel. The Panel did not accept Japan's argument on the grounds that Japan, in conducting this survey, failed to take into account price distortions caused by internal taxation. In other words, consumers' choices were sought within the existing price regime (which is the subject matter of the current dispute), and not independently of it. Moreover, in the Panel's view, the inadequacies of the survey notwithstanding, in case of non-availability of shochu, 10 per cent of the consumers would switch to spirits and whisky. This, in the Panel's view, was proof of significant elasticity of substitution between shochu, on the one hand, and whisky and spirits, on the other. (…)

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[108] See the 1970 Working Party report, op. cit., at para. 18.

[109] In this respect, note para. 5.7 of the 1987 Panel Report "since consumer habits are variable in time and space and the aim of Article III:2 of ensuring neutrality of internal taxation as regards competition between imported and domestic like products could not be achieved if differential taxes could be used to crystallize consumer preferences for traditional domestic products, the Panel found that the traditional Japanese consumer habits with regard to shochu provided no reason for not considering vodka to be a like product". (emphasis added).

[110] See the 1987 Panel Report, op. cit., at para. 5.9.

[112] See paras. 4.171ff. of the Descriptive Part.

(…)

b)"…So as to Afford Protection"

6.33 The Panel turned to the question whether Japan was violating its obligations under Article III:2, second sentence. In this respect, the Panel recalled the Interpretative Note ad Article III:2 that states:

"A tax conforming to the requirements of the first sentence of paragraph 2 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 product and, on the other hand, a directly competitive or substitutable product which was not similarly taxed".

In the Panel's view, the Interpretative Note ad Article III:2 explains how a national measure operates "so as to afford protection to domestic production" and thus runs counter to the principles set forth in Article III:1. In other words, if directly competitive or substitutable products are not "similarly taxed", and if it were found that the tax favours domestic products, then protection would be afforded to such products, and Article III:2, second sentence, is violated. Although the 1987 Panel Report did not focus on the Interpretative Note, its conclusions on the issue of "so as to afford protection" was essentially the same, as it concluded that the higher (i.e., dissimilar) Japanese taxes on imported alcoholic beverages and the existence of substitutability were "sufficient evidence of fiscal distortions of the competitive relationship between imported distilled liquors and domestic shochu affording protection to domestic producers of shochu".[117] The Panel agrees with this conclusion. In this connection, the Panel noted that for it to conclude that dissimilar taxation afforded protection, it would be sufficient for it to find that the dissimilarity in taxation is not *de minimis*.[118] In the Panel's view, it is appropriate to conclude, as have other GATT panels including the 1987 panel, that it is not necessary to show an adverse effect on the level of imports, as Article III generally is aimed at providing imports with "effective equality of opportunities" in "conditions of competition".[119] In line with these interpretations of Article III, the Panel concluded that it is not necessary for complainants to establish the purpose or aim of tax legislation in order for the Panel to conclude that dissimilar taxation affords protection to domestic production. In the Panel's view, the Interpretative Note interpreted in this respect the term "so as to afford protection" which appears in Article III:1. The Panel took the view that "similarly taxed" is the appropriate benchmark in order to determine whether a violation of Article III:2, second sentence, has occurred as opposed to "in excess of" that constitutes the appropriate benchmark to determine whether a violation of Article III:2, first sentence, has occurred. In the Panel's view, the following indicators, *inter alia*, are relevant in determining whether the products in dispute are similarly taxed in this case: tax per litre of product, tax per degree of alcohol, *ad valorem* taxation, and the tax/price ratio.

a) With respect to taxation per kilolitre of product the Panel noted that the amounts were:[120]

Shochu A (25°)	¥ 155,700
Shochu B (25°)	¥ 102,100
Whisky (40°)	¥ 982,300
Brandy (40°)	¥ 982,300

[117] See the 1987 Panel Report, op. cit., para. 5.11.
[118] The Panel decided that it did not have to further define "*de minimis*", because in this case the differences in taxation were significant.
[119] See the panel report on "United States - Taxes on Petroleum and Certain Imported Substances", op. cit., para. 5.1.9; see also the panel report on "Italian Discrimination Against Imported Agricultural Machinery", op. cit., para. 12.
[120] See para. 2.3 of the Descriptive Part.

Spirits (38°)	¥ 377,230	(gin, rum, vodka)
Liqueurs (40°)	¥ 328,760	

The Panel concluded that the amounts of tax are not similar and that the differences are not de minimis.

b) With respect to taxation per degree of alcohol the Panel noted that the amounts were:[121]

Shochu A (25°)	¥ 6,228	
Shochu B (25°)	¥ 4,084	
Whisky (40°)	¥ 24,558	
Brandy (40°)	¥ 24,558	
Spirits (38°)	¥ 9,927	(gin, rum, vodka)
Liqueurs (40°)	¥ 8,219	

The Panel concluded that the amounts of tax are not similar and that the differences are not de minimis. Since the Japanese taxes at issue were calculated on the basis of the alcohol content of the various products, the Panel considered this dissimilarity to be particularly dispositive for its analysis under Article III:2, second sentence.

c) The Panel noted that Japan's Liquor Tax Law does not provide for ad valorem taxation and this criterion is, consequently, irrelevant in this case.

d) With respect to the tax/price ratio, the Panel noted that the statistics submitted by Japan show that significant differences exist between shochu and the other directly competitive or substitutable products and also noted that there are significantly different tax/price ratios within the same product categories. Moreover, there were significant problems with the methodology for calculating tax/price ratios submitted by Japan, such that arguments based on that methodology could only be viewed as inconclusive. More particularly, although Japan had argued that the comparison of tax/price ratios should be done on a category-by-category basis, its statistics on which the tax/price ratios were based excluded domestically produced spirits and whisky/brandy from the calculation of tax/price ratios for spirits and whisky/brandy. Since the prices of the domestic spirits and whisky/brandy are much lower than the prices of the imported ones, this exclusion has the impact of reducing considerably the tax/prices ratios cited by Japan for those products. In this connection, the Panel noted that one consequence of the Japanese tax system was to make it more difficult for cheaper imported brands of spirits and whisky/brandy to enter the market. Moreover, the Panel noted that the Japanese statistics were based on suggested retail prices and there was evidence in the record that these products were often sold at a discount, at least in Tokyo. To the extent that the prices were unreliable, the resultant tax/price ratios would be unreliable as well.

The Panel consequently concluded that the products in dispute are not similarly taxed and the taxes on shochu are lower than the taxes on the other products subject to dispute, leading the Panel to the conclusion that protection is afforded to shochu inconsistently with Japan’s obligations under Article III:2, second sentence.

6.35 The Panel took note, in this context, of the statement by Japan that the 1987 Panel Report erred when it concluded that shochu is essentially a Japanese product. The Panel accepted the evidence submitted by Japan according to which a shochu-like product is produced in various countries outside Japan, including the Republic of Korea, the People's Republic of China and Singapore. The Panel noted,

[121] Based on calculations upon information included in para. 2.3 of the Descriptive Part.

however, that Japanese import duties on shochu are set at 17.9 per cent. At any rate what is at stake, in the Panel's view, is the market share of the domestic shochu market in Japan that was occupied by Japanese-made shochu. The high import duties on foreign-produced shochu resulted in a significant share of the Japanese shochu market held by Japanese shochu producers. Consequently, in the Panel's view, the combination of customs duties and internal taxation in Japan has the following impact: on the one hand, it makes it difficult for foreign-produced shochu to penetrate the Japanese market and, on the other, it does not guarantee equality of competitive conditions between shochu and the rest of "white" and "brown" spirits. Thus, through a combination of high import duties and differentiated internal taxes, Japan manages to "isolate" domestically produced shochu from foreign competition, be it foreign produced shochu or any other of the mentioned white and brown spirits. In the Panel's view, the table in Annex I illustrates this point.

VII.Conclusions

7.1 In light of the findings above, the Panel reached the following conclusions:

(i) Shochu and vodka are like products and Japan, by taxing the latter in excess of the former, is in violation of its obligation under Article III:2, first sentence, of the General Agreement on Tariffs and Trade 1994.

(ii) Shochu, whisky, brandy, rum, gin, genever, and liqueurs are "directly competitive or substitutable products" and Japan, by not taxing them similarly, is in violation of its obligation under Article III:2, second sentence, of the General Agreement on Tariffs and Trade 1994.

7.2 The Panel recommends that the Dispute Settlement Body request Japan to bring the Liquor Tax Law into conformity with its obligations under the General Agreement on Tariffs and Trade 1994.

2-2. Appeal by the U.S.

When reading the following excerpts from the United States' Appeal, think about what was so important to the US to appeal even though the panel decided in their favor.

SUBMISSION BY THE UNITED STATES (Appellant), August 23, 1996

(…)

IV. Legal Discussion

A. Introduction
(…)
36. The Panel has found that "likeness" is to be determined purely on the basis of physical characteristics, consumer uses and the tariff classification of the products in question. This limited set of criteria removes from the analysis all other factors that may be relevant in the case before the panel. If two products are "like" according to these criteria, and if products produced domestically happen to fall in the lower-taxed category, then under the Panel's reasoning there is an automatic violation of Article III:2, first sentence, regardless of whether the purpose of the tax distinction is protectionist or even has anything to do with trade. For instance, if a Member chooses to tax automobiles sold for business use at a higher rate than automobiles sold for personal use, the Member applies the same tariff to all automobiles, a few business-use automobiles are imported and there is domestic production of cars sold for personal use, then according to the Panel report the Member in question is automatically in violation of its obligations under Article III:2, first sentence.

37. These findings do not just improperly limit the tax sovereignty of all Members. In doing so, they place the international trading rules in a needless conflict with domestic policy. They misinterpret the GATT as a matter of treaty law, and distort the system of national treatment guarantees under the GATT and the GATS.

(…)
B. The interpretation of "like product" by the Malt Beverages panel: "aim and effect of affording protection to domestic production"

(…)

43. The *Malt Beverages* panel examined the distinctions made in these two origin-neutral measures by taking into account not only the text of Articles III:2 and III:4, but also the context and the object and purpose of Article III as definitively stated by Article III:1. It examined these distinctions in the light of *all* relevant circumstances — not just physical characteristics, end-uses and tariff treatment but also other factors and circumstances relevant to these distinctions. In order to discern whether the distinctions were being drawn for protectionist purposes, the panel examined both the effect of these distinctions and their aim in accordance with Article III:1. In the case of the Mississippi tax law, it determined that both the aim and effect were protective in nature, and in the case of laws distinguishing low and high alcohol beer it determined that their aim and effect were not protective. Contrary to the picture presented in the present Panel decision, none of these determinations depended on an examination of the subjective motivations of

the legislature; rather, the *Malt Beverages* panel's discussion of protective aim was based on the design of the measure in question and the incentive structure provided by it.
Metaphorically speaking, the focus was on the direction in which the gun was pointing, rather than whether the person holding the gun even wanted to pull the trigger.

44. The 1987 Panel Report concerning Japan's liquor taxes took a similar approach. The 1987 Panel Report was the first GATT panel decision ever to apply the national treatment obligation of Article III to origin-neutral product distinctions, and in working through these difficult issues the panel attempted to square its findings with the mechanical and ad-hoc "like product" analysis in earlier panel decisions involving tariff discrimination. Nonetheless, the central findings of the 1987 Panel Report were fully consistent with the analysis in the *Malt Beverages* panel decision.

(…)
C. The Panel's reasons for rejecting the Malt Beverages interpretation were in error

1. *The Panel's refusal to interpret Article III:2 in the light of Article III:1 is contrary to accepted principles of treaty interpretation*

56. The manner in which the Panel has interpreted Article III:2, and in particular its failure to interpret Article III:2, first sentence in the light of Article III:I, is inconsistent with the general international principles of treaty interpretation, as reflected in the Vienna Convention and the Appellate Body's first report. The Panel should have taken into account all relevant elements: the text, the context, the object and purpose, and the indications of the intentions of the drafters in relevant drafting history. Instead: the Panel has refused to look beyond the text of Article III:2, first sentence at all; the Panel has disregarded Article III:I, which is part of the context for Article III:2 and Article III generally; and the Panel has disregarded the object and purpose of Article III as definitively stated in Article III:I. The misinterpretation of Article III:2 is thus inconsistent with the 'customary rules of interpretation of public international law' which the Panel should faithfully have applied under Article 3(2) of the DSU. It departs from the intentions of the parties and amounts to an alteration of the rights and obligations of Members contrary to the provisions of Article 3(2) of the DSU.
(…)

2. *Interpreting Article III:2 in the light of Article III:I does not require evaluation of the subjective motivations behind government measures*

60. Moreover, it is clear that a legal analysis that ignores the issue of purpose must either produce absurd decisions prohibiting harmless measures or, more likely, resort to non-transparent manipulation of which physical and end-use characteristics are dispositive in each particular case in order to avoid such absurd results. The *Malt Beverages* panel evaluated laws that distinguish between low alcohol beer and high alcohol beer. Such laws exist in many other countries, including the member States of the European Communities. If panels cannot consider all the relevant circumstances surrounding such measures, including the purpose of the measures, the only way to avoid a GATT prohibition under the "like product" standard of Article III:2, first sentence, would be to rule that the physical characteristics of low and high alcohol beer are not "like" — a conclusion that would be completely inconsistent with the conclusion in paragraph 6.23 of the present Panel report that the physical characteristics of vodka and shochu make them "like" regardless of difference in alcoholic strength. If panels resort to such manipulation of the "like product" concept to avoid absurd results, they will in fact be using the perceived purpose of measures as a criterion for their reaction, but they will be doing so covertly, in the guise of applying "product

characteristics." It is this type of manipulation and covert reasoning, not the discerning of a measure's purpose, that create the risk of arbitrary decisions in this area.
(…)

D. The Panel erred by failing to interpret Article III:2 in light of Article III:1

1. *The Panel's failure to take Article III:I into account in interpreting national treatment obligations is also inconsistent with past panel reports and the intentions of the drafters of Article III*

71. For instance, in initial discussions of the provisions in Article 18 of the draft Charter on national treatment in regard to internal taxes, it was clarified that "... there was nothing in Article 18 to prevent taxes being imposed on privately owned motor-cars, but not on those used for public transportation." Similarly. it was clarified that it would not be permissible for the United States to impose a tax on imported natural rubber "in order to assist the production of synthetic rubber" (emphasis added). A working party then added the text of the present Article III:1 back into the text of Article 18, as a package with revisions made to the provisions corresponding to Article III:2. When the text of the revised article was adopted, one of the drafters stated that "The interpretative note narrowed the scope of paragraph 2 .... A Member could only allege a breach of the second sentence of paragraph 2, i.e., that the tax was designed to protect the domestic product, when the latter was directly competitive or substitutable" (emphasis added). In response, another of the drafters suggested that "a decision could not be made as to whether any two products were directly competitive or substitutable except in relation to a factual situation. It might be held that a tax on coal was in a particular case designed to protect the fuel oil industry, but that would have to be determined in relation to the particular case" (emphasis added).
(…)

2. *Failure to interpret Article III in the light of Article III:1 will lead to results that are unpredictable and unacceptable for the trading system*

74. Physical characteristics are only a small sub-set of the legitimate distinctions that exist. For instance, a WTO Member may tax different types of cups differently, and thereby draw a distinction between them. A cup may be taxed differently because it is a non-recyclable beverage container (subject to an environmental tax), a material producing toxic gas when incinerated (subject to regulation), or a household utensil (subject to reduction in VAT). If a panel compares the two objects as cups when they are not distinguished by the WTO Member as cups, this reflects an arbitrary distinction imposed by the panel.

3. *The Panel's failure to find that all distilled spirits were "like products" in this case was in error; the Panel's inconsistent application of its interpretation of the "like product" concept illustrates the impossibility of making meaningful product distinctions based on that interpretation*

(…)

83. Paragraph 6.23 of the Panel report states that "substantial differences in physical characteristics exist" between shochu and non-vodka distilled spirits. This determination only repeats and endorses the protectionist nature of the Japanese liquor tax classification scheme. For instance, the definition of "shochu" excludes spirits made with sugar such as rum, except for spirits made with certain sugars designated by government ordinance; evidence was presented during the panel proceeding that this exclusion to the exclusion was designed to permit Okinawan *awamori* shochu made with molasses to qualify for the low tax rates accorded to shochu. Yet the Panel has found that "the use of ingredients

would disqualify rum". In fact, there is no difference between the use of sugar as an ingredient in rum and the use of sugar as an ingredient in *awamori* shochu. Similarly, some shochu has a brown appearance (resulting from manufacturing processes), yet the Panel has found that the appearance of whisky and brandy would disqualify it as a like product to shochu. (…)

4. *The connection drawn by the Panel between national treatment obligations and tariff bindings is erroneous and should be eliminated*

(…)

88. The Panel starts by making the conclusive judgment in paragraph 6.13 that "one of the main purposes of Article III is to guarantee that WTO Members will not undermine through internal measures their commitments under Article II." This statement is supported by two quotations taken out of context. Having assigned Article III this mistaken tariff-protecting purpose, the Panel report then draws the conclusion that "a parallelism should be drawn between the definition of products for the purposes of Article II and the term "like product" as it appears in Article III:2" (para. 6.21). This analogy is false. The scope of a tariff binding is completely within the discretion of a Member; concepts such as value-break tariffs or seasonal tariffs have been widely tolerated in GATT practice because there is no obligation under GATT to reduce tariff at all. (…)

E. <u>The Panel erred in its interpretation of the second sentence of Article III:2</u>

1. *The Panel's analysis of the reference to Article III:I in the second sentence of Article III:2 is in error*

95. The Panel concluded that tax measures applicable to "directly competitive or substitutable" products could be found inconsistent with "the principles set forth in the first paragraph [of Article III]" whenever there was a dissimilarity in the taxation of such products that was not *de minimis*. Thus, if the tax difference between products in such a pair is greater than *de minimis*, and if products produced domestically happen to fall in the lower-taxed category, then under the Panel's reasoning there is an automatic violation of Article III:2, second sentence, regardless of whether the purpose of the tax distinction has anything to do with affording "protection to domestic production." The Panel's failure to consider the purpose of such tax distinctions would lead panels to prohibit tax distinctions that clearly have no protective purpose. (…)

2. *The Panel's use of cross-price elasticity as the "decisive criterion" for whether products are "directly competitive or substitutable" was in error*

101. Cross-elasticity is an important concept for understanding demand relationships in the abstract, but because of its inherent limitations and difficulties in implementing its use, use of cross-elasticity as "the decisive criterion" for determining rights and obligations under Article III:2 is completely inappropriate. The most basic objection is that making the legal rights and obligations of governments dependent on the level of cross-elasticity of demand between two products makes governments legally responsible (and vulnerable to trade retaliation) for matters that are beyond their control.

IV. Conclusion

117. The United States requests that the Appellate Body find that the distinctions between the various types of distilled spirits under Japan's Liquor Tax Law are not supported by any non-protectionist purpose, and that therefore these distilled spirits should all be deemed to be "like products" for the purpose of Article III:2, first sentence. It should therefore find that by taxing other distilled spirits in excess of shochu, Japan is in violation of Article III:2, first sentence. The Appellate Body should also modify the Panel's interpretation of Article III as indicated above.

* * *

2-3. Appellate Body Report in Japan – Taxes on Alcoholic Beverages, WT/DS8, 10, 11/AB/R, 4 October 1996

Present: Lacarte-Muró, Presiding Member; Bacchus, Member; El-Naggar, Member

(…)

C. Issues Raised in the Appeal

The appellants, Japan and the United States, have raised the following issues in this appeal:

1. Japan

   (a) whether the Panel erred in failing to interpret Article III:2, first and second sentences, in the light of Article III:1;

   (b) whether the Panel erred in rejecting an "aim-and-effect" test in establishing whether the Liquor Tax Law is applied "so as to afford protection to domestic production";

   (c) whether the Panel erred in failing to examine the effect of affording protection to domestic production from the perspective of the linkage between the origin of products and their treatment under the Liquor Tax Law;

   (d) whether the Panel failed to give proper weight to tax/price ratios as a yardstick for comparing tax burdens under Article III:2, first and second sentences;

   (e) whether the Panel erred in interpreting and applying Article III:2, second sentence, by equating the language "not similarly taxed" in *Ad* Article III:2, second sentence, with "so as to afford protection" in Article III:1; and

   (f) whether the Panel erred in placing excessive emphasis on tariff classification as a criterion for determining "like products".

2. United States

   (a) whether the Panel erred in failing to interpret Article III:2, first and second sentences, in the light of Article III:1;

   (b) whether the Panel erred in failing to find that all distilled spirits are "like products";

   (c) whether the Panel erred in drawing a connection between national treatment obligations and tariff bindings;

   (d) whether the Panel erred in interpreting and applying Article III:2, second sentence, by equating the language "not similarly taxed" in *Ad* Article III:2, second sentence, with "so as to afford protection" in Article III:1;

   (e) whether the Panel erred in its conclusions on "directly competitive or substitutable products" by examining cross-price elasticity as "the decisive criterion";

(f) whether the Panel erred in failing to maintain consistency between the conclusions in paragraph 7.1(ii) of the Panel Report on "directly competitive or substitutable products" and the conclusions in paragraphs 6.32-6.33 of the Panel Report, and whether the Panel erred in failing to address the full scope of products subject of this dispute;

(g) whether the Panel erred in finding that the coverage of Article III:2 and Article III:4 are not equivalent; and

(h) whether the Panel erred in its characterization of panel reports adopted by the GATT CONTRACTING PARTIES and the WTO Dispute Settlement Body as "subsequent practice in a specific case by virtue of the decision to adopt them".

D. Treaty Interpretation

Article 3.2 of the *DSU* directs the Appellate Body to clarify the provisions of GATT 1994 and the other "covered agreements" of the *WTO Agreement* "in accordance with customary rules of interpretation of public international law". Following this mandate, in *United States - Standards for Reformulated and Conventional Gasoline*,[1] we stressed the need to achieve such clarification by reference to the fundamental rule of treaty interpretation set out in Article 31(1) of the *Vienna Convention*. We stressed there that this general rule of interpretation "has attained the status of a rule of customary or general international law".[2] There can be no doubt that Article 32 of the *Vienna Convention*, dealing with the role of supplementary means of interpretation, has also attained the same status.[3]

Article 31, as a whole, and Article 32 are each highly pertinent to the present appeal. They provide as follows:

ARTICLE 31
General rule of interpretation

1. 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 object and purpose.

2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

[1]Adopted 20 May 1996, WT/DS2/9.

[2]*Ibid.*, at p. 17.

[3]See *e.g.*: Jiménez de Aréchaga, "International Law in the Past Third of a Century" (1978-I) 159 Recueil des Cours p.1 at 42; *Territorial Dispute (Libyan Arab Jamahiriya/Chad), Judgment*, (1994), I.C.J. Reports, p. 6 at 20; *Maritime Delimitation and Territorial Questions between Qatar and Bahrain, Jurisdiction and Admissibility, Judgment*, (1995), I.C.J.Reports, p. 6 at 18; *Interpretation of the Convention of 1919 Concerning Employment of Women during the Night* (1932), P.C.I.J., Series A/B, No. 50, p. 365 at 380; cf. the *Serbian and Brazilian Loans Cases* (1929), P.C.I.J., Series A, Nos. 20-21, p. 5 at 30; *Constitution of the Maritime Safety Committee of the IMCO* (1960), I.C.J. Reports, p. 150 at 161; *Air Transport Services Agreement Arbitration* (*United States of America v. France*) (1963), International Law Reports, 38, p. 182 at 235-43.

(a) any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;
(b) any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

3. There shall be taken into account together with the context:

(a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
(b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
(c) any relevant rules of international law applicable in the relations between the parties.

4. A special meaning shall be given to a term if it is established that the parties so intended.

ARTICLE 32
Supplementary means of interpretation

Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

(a) leaves the meaning ambiguous or obscure; or
(b) leads to a result which is manifestly absurd or unreasonable.

Article 31 of the *Vienna Convention* provides that the words of the treaty form the foundation for the interpretive process: "interpretation must be based above all upon the text of the treaty".[4] The provisions of the treaty are to be given their ordinary meaning in their context.[5] The object and purpose of the treaty are also to be taken into account in determining the meaning of its provisions.[6] A fundamental tenet of

[4]*Territorial Dispute (Libyan Arab Jamahiriya/Chad), Judgment*, (1994) I.C.J. Reports, p. 6 at 20; *Maritime Delimitation and Territorial Questions between Qatar and Bahrain, Jurisdiction and Admissibility, Judgment*, (1995) I.C.J.Reports, p. 6 at 18.

[5]See, *e.g., Competence of the General Assembly for the Admission of a State to the United Nations* (*Second Admissions Case*) (1950), I.C.J. Reports, p. 4 at 8, in which the International Court of Justice stated: "The Court considers it necessary to say that the first duty of a tribunal which is called upon to interpret and apply the provisions of a treaty, is to endeavour to give effect to them in their natural and ordinary meaning and in the context in which they occur".

[6]That is, the treaty's "object and purpose" is to be referred to in determining the meaning of the "terms of the treaty" and not as an independent basis for interpretation: Harris, Cases and Materials on International Law (4th ed., 1991) p. 770; Jiménez de Aréchaga, "International Law in the Past Third of a Century" (1978-I) 159 Recueil des Cours p. 1 at 44; Sinclair, *The Vienna Convention and*

treaty interpretation flowing from the general rule of interpretation set out in Article 31 is the principle of effectiveness (*ut res magis valeat quam pereat*).[7] In *United States - Standards for Reformulated and Conventional Gasoline*, we noted that "[o]ne of the corollaries of the 'general rule of interpretation' in the *Vienna Convention* is that interpretation must give meaning and effect to all the terms of the treaty. An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility".[8]

E. Status of Adopted Panel Reports

In this case, the Panel concluded that,

> ...panel reports adopted by the GATT CONTRACTING PARTIES and the WTO Dispute Settlement Body constitute subsequent practice in a specific case by virtue of the decision to adopt them. Article 1(b)(iv) of GATT 1994 provides institutional recognition that adopted panel reports constitute subsequent practice. Such reports are an integral part of GATT 1994, since they constitute "other decisions of the CONTRACTING PARTIES to GATT 1947".[9]

Article 31(3)(b) of the *Vienna Convention* states that "any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation" is to be "taken into account together with the context" in interpreting the terms of the treaty. Generally, in international law, the essence of subsequent practice in interpreting a treaty has been recognized as a "concordant, common and consistent" sequence of acts or pronouncements which is sufficient to establish a discernable pattern implying the agreement of the parties regarding its interpretation.[10] An isolated act is generally not sufficient to establish subsequent practice;[11] it is a sequence of acts establishing the agreement of the parties that is relevant.[12]

Although GATT 1947[13] panel reports were adopted by decisions of the CONTRACTING PARTIES[14], a decision to adopt a panel report did not under GATT 1947 constitute agreement by the CONTRACTING PARTIES on the legal reasoning in that panel report. The generally-accepted view under

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the Law of Treaties (2nd ed, 1984), p. 130. See *e.g.* Oppenheims' International Law (9th ed., Jennings and Watts, eds., 1992) Vol. I, p.1273; *Competence of the ILO to Regulate the Personal Work of the Employer* (1926), P.C.I.J., Series B, No. 13, p. 6 at 18; *International Status of South West Africa* (1962), I.C.J. Reports, p. 128 at 336; *Re Competence of Conciliation Commission* (1955), 22 International Law Reports, p. 867 at 871.

[7]See also (1966) Yearbook of the International Law Commission, Vol. II, p. 219: "When a treaty is open to two interpretations one of which does and the other does not enable the treaty to have appropriate effects, good faith and the objects and purposes of the treaty demand that the former interpretation should be adopted."

[8]*United States - Standards for Reformulated and Conventional Gasoline*, WT/DS2/9, adopted 20 May 1996, p. 23.

[9]Panel Report, para. 6.10.

[10]Sinclair, *The Vienna Convention on the Law of Treaties* (2nd ed., 1984), p. 137; Yasseen, "L'interprétation des traités d'après la Convention de Vienne sur le Droit des Traités" (1976-III) 151 Recueil des Cours p. 1 at 48.

[11]Sinclair, *supra.*, footnote 24, p. 137.

[12](1966) Yearbook of the International Law Commission, Vol. II, p. 222; Sinclair, *supra.*, footnote 24, p. 138.

[13]By GATT 1947, we refer throughout to the General Agreement on Tariffs and Trade, dated 30 October 1947, annexed to the Final Act Adopted at the Conclusion of the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment, as subsequently rectified, amended or modified.

[14]By CONTRACTING PARTIES, we refer throughout to the CONTRACTING PARTIES of GATT 1947.

GATT 1947 was that the conclusions and recommendations in an adopted panel report bound the parties to the dispute in that particular case, but subsequent panels did not feel legally bound by the details and reasoning of a previous panel report.[15]

We do not believe that the CONTRACTING PARTIES, in deciding to adopt a panel report, intended that their decision would constitute a definitive interpretation of the relevant provisions of GATT 1947. Nor do we believe that this is contemplated under GATT 1994. There is specific cause for this conclusion in the *WTO Agreement*. Article IX:2 of the *WTO Agreement* provides: "The Ministerial Conference and the General Council shall have the exclusive authority to adopt interpretations of this Agreement and of the Multilateral Trade Agreements". Article IX:2 provides further that such decisions "shall be taken by a three-fourths majority of the Members". The fact that such an "exclusive authority" in interpreting the treaty has been established so specifically in the *WTO Agreement* is reason enough to conclude that such authority does not exist by implication or by inadvertence elsewhere.

Historically, the decisions to adopt panel reports under Article XXIII of the GATT 1947 were different from joint action by the CONTRACTING PARTIES under Article XXV of the GATT 1947. Today, their nature continues to differ from interpretations of the GATT 1994 and the other Multilateral Trade Agreements under the *WTO Agreement* by the WTO Ministerial Conference or the General Council. This is clear from a reading of Article 3.9 of the *DSU*, which states:

> The provisions of this Understanding are without prejudice to the rights of Members to seek authoritative interpretation of provisions of a covered agreement through decision-making under the WTO Agreement or a covered agreement which is a Plurilateral Trade Agreement.

Article XVI:1 of the *WTO Agreement* and paragraph 1(b)(iv) of the language of Annex 1A incorporating the GATT 1994 into the *WTO Agreement* bring the legal history and experience under the GATT 1947 into the new realm of the WTO in a way that ensures continuity and consistency in a smooth transition from the GATT 1947 system. This affirms the importance to the Members of the WTO of the experience acquired by the CONTRACTING PARTIES to the GATT 1947 -- and acknowledges the continuing relevance of that experience to the new trading system served by the WTO. Adopted panel reports are an important part of the GATT *acquis*. They are often considered by subsequent panels. They create legitimate expectations among WTO Members, and, therefore, should be taken into account where they are relevant to any dispute. However, they are not binding, except with respect to resolving the particular dispute between the parties to that dispute.[16] In short, their character and their legal status have not been changed by the coming into force of the *WTO Agreement*.

For these reasons, we do not agree with the Panel's conclusion in paragraph 6.10 of the Panel Report that "panel reports adopted by the GATT CONTRACTING PARTIES and the WTO Dispute Settlement Body constitute subsequent practice in a specific case" as the phrase "subsequent practice" is used in Article 31 of the *Vienna Convention*. Further, we do not agree with the Panel's conclusion in the same paragraph of the Panel Report that adopted panel reports in themselves constitute "other decisions of the CONTRACTING PARTIES to GATT 1947" for the purposes of paragraph 1(b)(iv) of the language of Annex 1A incorporating the GATT 1994 into the *WTO Agreement*.

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[15] *European Economic Community - Restrictions on Imports of Dessert Apples*, BISD 36S/93, para. 12.1.

[16] It is worth noting that the Statute of the International Court of Justice has an explicit provision, Article 59, to the same effect. This has not inhibited the development by that Court (and its predecessor) of a body of case law in which considerable reliance on the value of previous decisions is readily discernible.

However, we agree with the Panel's conclusion in that same paragraph of the Panel Report that *unadopted* panel reports "have no legal status in the GATT or WTO system since they have not been endorsed through decisions by the CONTRACTING PARTIES to GATT or WTO Members".[17] Likewise, we agree that "a panel could nevertheless find useful guidance in the reasoning of an unadopted panel report that it considered to be relevant".[18]

F. Interpretation of Article III

The *WTO Agreement* is a treaty -- the international equivalent of a contract. It is self-evident that in an exercise of their sovereignty, and in pursuit of their own respective national interests, the Members of the WTO have made a bargain. In exchange for the benefits they expect to derive as Members of the WTO, they have agreed to exercise their sovereignty according to the commitments they have made in the *WTO Agreement.*

(…)

The broad and fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures. More specifically, the purpose of Article III "is to ensure that internal measures 'not be applied to imported or domestic products so as to afford protection to domestic production'".[19] Toward this end, Article III obliges Members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products.[20] "[T]he intention of the drafters of the Agreement was clearly to treat the imported products in the same way as the like domestic products once they had been cleared through customs. Otherwise indirect protection could be given".[21] Moreover, it is irrelevant that "the trade effects" of the tax differential between imported and domestic products, as reflected in the volumes of imports, are insignificant or even non-existent; Article III protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products.[22] Members of the WTO are free to pursue their own domestic goals through internal taxation or regulation so long as they do not do so in a way that violates Article III or any of the other commitments they have made in the *WTO Agreement.*

The broad purpose of Article III of avoiding protectionism must be remembered when considering the relationship between Article III and other provisions of the *WTO Agreement.* Although the protection of negotiated tariff concessions is certainly one purpose of Article III,[23] the statement in Paragraph 6.13 of the Panel Report that "one of the main purposes of Article III is to guarantee that WTO Members will not undermine through internal measures their commitments under Article II" should not be overemphasized. The sheltering scope of Article III is not limited to products that are the subject of tariff concessions under Article II. The Article III national treatment obligation is a general prohibition on the use of internal taxes and other internal regulatory measures so as to afford protection to domestic production. This obligation

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[17]Panel Report, para. 6.10.

[18]*Ibid.*

[19]*United States - Section 337 of the Tariff Act of 1930,* BISD 36S/345, para. 5.10.

[20]*United States - Taxes on Petroleum and Certain Imported Substances*, BISD 34S/136, para. 5.1.9; *Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83, para. 5.5(b).

[21]*Italian Discrimination Against Imported Agricultural Machinery*, BISD 7S/60, para. 11.

[22]*United States - Taxes on Petroleum and Certain Imported Substances*, BISD 34S/136, para. 5.1.9.

[23]*Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83, para. 5.5(b); *Canada - Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies*, BISD 39S/27, para. 5.30.

clearly extends also to products not bound under Article II.[24] This is confirmed by the negotiating history of Article III.[25]

G. Article III:1

The terms of Article III must be given their ordinary meaning -- in their context and in the light of the overall object and purpose of the *WTO Agreement*. Thus, the words actually used in the Article provide the basis for an interpretation that must give meaning and effect to all its terms. The proper interpretation of the Article is, first of all, a textual interpretation. Consequently, the Panel is correct in seeing a distinction between Article III:1, which "contains general principles", and Article III:2, which "provides for specific obligations regarding internal taxes and internal charges".[26] Article III:1 articulates a general principle that internal measures should not be applied so as to afford protection to domestic production. This general principle informs the rest of Article III. The purpose of Article III:1 is to establish this general principle as a guide to understanding and interpreting the specific obligations contained in Article III:2 and in the other paragraphs of Article III, while respecting, and not diminishing in any way, the meaning of the words actually used in the texts of those other paragraphs. In short, Article III:1 constitutes part of the context of Article III:2, in the same way that it constitutes part of the context of each of the other paragraphs in Article III. Any other reading of Article III would have the effect of rendering the words of Article III:1 meaningless, thereby violating the fundamental principle of effectiveness in treaty interpretation. Consistent with this principle of effectiveness, and with the textual differences in the two sentences, we believe that Article III:1 informs the first sentence and the second sentence of Article III:2 in different ways.

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[24]*Brazilian Internal Taxes*, BISD II/181, para. 4; *United States - Taxes on Petroleum and Certain Imported Substances*, BISD 34S/136, para. 5.1.9; *EEC - Regulation on Imports of Parts and Components*, BISD 37S/132, para. 5.4.

[25]At the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment, held in 1947, delegates in the Tariff Agreement Committee addressed the issue of whether to include the national treatment clause from the draft Charter for an International Trade Organization ("ITO Charter") in the GATT 1947. One delegate noted:

> This Article in the Charter had two purposes, as I understand it. The first purpose was to protect the items in the Schedule or any other Schedule concluded as a result of any subsequent negotiations and agreements - that is, to ensure that a country offering a tariff concession could not nullify that tariff concession by imposing an internal tax on the commodity, which had an equivalent effect. If that were the sole purpose and content of this Article, there could really be no objection to its inclusion in the General Agreement. But the Article in the Charter had an additional purpose. That purpose was to prevent the use of internal taxes as a system of protection. It was part of a series of Articles designed to concentrate national protective measures into the forms permitted under the Charter, i.e. subsidies and tariffs, and since we have taken over this Article from the Charter, we are, by including the Article, doing two things: so far as the countries become parties to the Agreement, we are, first of all, ensuring that the tariff concessions they grant one another cannot be nullified by the imposition of corresponding internal taxes; but we are also ensuring that those countries which become parties to the Agreement undertake not to use internal taxes as a system of protection.

This view is reinforced by the following statement of another delegate:

> ... [Article III] is necessary to protect not only scheduled items in the Agreement, but, indeed, all items for all our exports and the exports of any country. If that is not done, then every item which does not appear in the Schedule would have to be reconsidered and possibly tariff negotiations re-opened if Article III were changed to permit any action on these non-scheduled items.

See EPCT/TAC/PV.10, pp. 3 and 33.

[26]Panel Report, para. 6.12.

H. Article III:2

1. First Sentence

Article III:1 informs Article III:2, first sentence, by establishing that if imported products are taxed in excess of like domestic products, then that tax measure is inconsistent with Article III. Article III:2, first sentence does not refer specifically to Article III:1. There is no specific invocation in this first sentence of the general principle in Article III:1 that admonishes Members of the WTO not to apply measures "so as to afford protection". This omission must have some meaning. We believe 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. However, this does not mean that the general principle of Article III:1 does not apply to this sentence. To the contrary, we believe the first sentence of Article III:2 is, in effect, an application of this general principle. The ordinary meaning of the words of Article III:2, first sentence leads inevitably to this conclusion. Read in their context and in the light of the overall object and purpose of the *WTO Agreement*, 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 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.[27]

This approach to an examination of Article III:2, first sentence, is consistent with past practice under the GATT 1947.[28] Moreover, it is consistent with the object and purpose of Article III:2, which the panel in the predecessor to this case dealing with an earlier version of the Liquor Tax Law, *Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages* ("*1987 Japan - Alcohol*"), rightly stated as "promoting non-discriminatory competition among imported and like domestic products [which] could not be achieved if Article III:2 were construed in a manner allowing discriminatory and protective internal taxation of imported products in excess of like domestic products".[29]

(a) *"Like Products"*

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, we agree with the Panel that the first sentence of Article III:2 must be construed narrowly so as not to condemn measures that its strict terms are not meant to

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[27]In accordance with Article 3.8 of the *DSU*, such a violation is *prima facie* presumed to nullify or impair benefits under Article XXIII of the GATT 1994. Article 3.8 reads as follows:

> In cases where there is an infringement of the obligations assumed under a covered agreement, the action is considered *prima facie* to constitute a case of nullification or impairment. This means that there is normally a presumption that a breach of the rules has an adverse impact on other Members parties to that covered agreement, and in such cases, it shall be up to the Member against whom the complaint has been brought to rebut the charge.

[28]See *Brazilian Internal Taxes*, BISD II/181, para. 14; *Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83, para. 5.5(d); *United States - Taxes on Petroleum and Certain Imported Substances*, BISD 34S/136, para. 5.1.1; *United States - Measures Affecting the Importation, Internal Sale and Use of Tobacco*, DS44/R, adopted on 4 October 1994.

[29]*Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83, para 5.5(c).

condemn. Consequently, we agree with the Panel also that the definition of "like products" in Article III:2, first sentence, should be construed narrowly.[30]

How narrowly is a matter that should be determined separately for each tax measure in each case. We agree with the practice under the GATT 1947 of determining whether imported and domestic products are "like" on a case-by-case basis. The Report of the Working Party on *Border Tax Adjustments*, adopted by the CONTRACTING PARTIES in 1970, set out the basic approach for interpreting "like or similar products" generally in the various provisions of the GATT 1947:

> ... the interpretation of the term should be examined on a case-by-case basis. This would allow a fair assessment in each case of the different elements that constitute a "similar" product. Some criteria were suggested for determining, on a case-by-case basis, whether a product is "similar": the product's end-uses in a given market; consumers' tastes and habits, which change from country to country; the product's properties, nature and quality.[31]

This approach was followed in almost all adopted panel reports after *Border Tax Adjustments*.[32] This approach should be helpful in identifying on a case-by-case basis the range of "like products" that fall within the narrow limits of Article III:2, first sentence in the GATT 1994. Yet this approach will be most helpful if decision makers keep ever in mind how narrow the range of "like products" in Article III:2, first sentence is meant to be as opposed to the range of "like" products contemplated in some other provisions of the GATT 1994 and other Multilateral Trade Agreements of the *WTO Agreement*. In applying the criteria cited in *Border Tax Adjustments* to the facts of any particular case, and in considering other criteria that may also be relevant in certain cases, panels can only apply their best judgement in determining whether in fact products are "like". This will always involve an unavoidable element of individual, discretionary judgement. We do not agree with the Panel's observation in paragraph 6.22 of the Panel Report that distinguishing between "like products" and "directly competitive or substitutable products" under Article III:2 is "an arbitrary decision". Rather, we think it is a discretionary decision that must be made in considering the various characteristics of products in individual cases.

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

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[30]We note the argument on appeal that the Panel suggested in paragraph 6.20 of the Panel Report that the product coverage of Article III:2 is not identical to the coverage of Article III:4. That is not what the Panel said. The Panel said the following:

> *If* the coverage of Article III:2 is identical to that of Article III:4, a different interpretation of the term "like product" would be called for in the two paragraphs. Otherwise, if the term "like product" were to be interpreted in an identical way in both instances, the scope of the two paragraphs would be different. (emphasis added)

This was merely a hypothetical statement.

[31]Report of the Working Party on *Border Tax Adjustments*, BISD 18S/97, para. 18.

[32]*The Australian Subsidy on Ammonium Sulphate*, BISD II/188; *EEC - Measures on Animal Feed Proteins*, BISD 25S/49; *Spain - Tariff Treatment of Unroasted Coffee*, BISD 28S/102; *Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83; *United States - Taxes on Petroleum and Certain Imported Substances*, BISD 34S/136. Also see *United States - Standards for Reformulated and Conventional Gasoline*, WT/DS2/9, adopted on 20 May 1996.

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.

The Panel determined in this case that shochu and vodka are "like products" for the purposes of Article III:2, first sentence. We note that the determination of whether vodka is a "like product" to shochu under Article III:2, first sentence, or a "directly competitive or substitutable product" to shochu under Article III:2, second sentence, does not materially affect the outcome of this case.

A uniform tariff classification of products can be relevant in determining what are "like products". If sufficiently detailed, tariff classification can be a helpful sign of product similarity. Tariff classification has been used as a criterion for determining "like products" in several previous adopted panel reports.[33] For example, in the *1987 Japan - Alcohol* Panel Report, the panel examined certain wines and alcoholic beverages on a "product-by-product basis" by applying the criteria listed in the Working Party Report on *Border Tax Adjustments*,

> ... as well as others recognized in previous GATT practice (see BISD 25S/49, 63), such as the Customs Cooperation Council Nomenclature (CCCN) for the classification of goods in customs tariffs which has been accepted by Japan.[34]

Uniform classification in tariff nomenclatures based on the Harmonized System (the "HS") was recognized in GATT 1947 practice as providing a useful basis for confirming "likeness" in products. However, there is a major difference between tariff classification nomenclature and tariff bindings or concessions made by Members of the WTO under Article II of the GATT 1994. There are risks in using tariff bindings that are too broad as a measure of product "likeness". Many of the least-developed country Members of the WTO submitted schedules of concessions and commitments as annexes to the GATT 1994 for the first time as required by Article XI of the *WTO Agreement*. Many of these least-developed countries, as well as other developing countries, have bindings in their schedules which include broad ranges of products that cut across several different HS tariff headings. For example, many of these countries have very broad uniform bindings on non-agricultural products.[35] This does not necessarily indicate similarity of the products covered by a binding. Rather, it represents the results of trade concessions negotiated among Members of the WTO.

It is true that there are numerous tariff bindings which are in fact extremely precise with regard to product description and which, therefore, can provide significant guidance as to the identification of "like products". Clearly enough, these determinations need to be made on a case-by-case basis. However, tariff bindings that include a wide range of products are not a reliable criterion for determining or confirming product "likeness" under Article III:2.[36]

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[33]*EEC - Measures on Animal Feed Proteins*, BISD 25S/49; *Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83; *United States - Standards for Reformulated and Conventional Gasoline*, WT/DS2/9, adopted on 20 May 1996.

[34]*Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83, para. 5.6.

[35]For example, Jamaica has bound tariffs on the majority of non-agricultural products at 50%. Trinidad and Tobago have bound tariffs on the majority of products falling within HS Chapters 25-97 at 50%. Peru has bound all non-agricultural products at 30%, and Costa Rica, El Salvador, Guatemala, Morocco, Paraguay, Uruguay and Venezuela have broad uniform bindings on non-agricultural products, with a few listed exceptions.

[36]We believe, therefore, that statements relating to any relationship between tariff bindings and "likeness" must be made cautiously. For example, the Panel stated in paragraph 6.21 of the Panel Report that "... with respect to two products subject to the same tariff binding and therefore to the same maximum border tax, there is no justification, outside of those mentioned in GATT

With these modifications to the legal reasoning in the Panel Report, we affirm the legal conclusions and the findings of the Panel with respect to "like products" in all other respects.

(b) *"In Excess Of"*

The only remaining issue under Article III:2, first sentence, is whether the taxes on imported products are "in excess of" those on like domestic products. If so, then the Member that has imposed the tax is not in compliance with Article III. Even the smallest amount of "excess" is too much. "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."[37] We agree with the Panel's legal reasoning and with its conclusions on this aspect of the interpretation and application of Article III:2, first sentence.

2. Second Sentence

Article III:1 informs Article III:2, second sentence, through specific reference. Article III:2, second sentence, 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 paragraph 1". As mentioned before, Article III:1 states that internal taxes and other internal charges "should not be applied to imported or domestic products so as to afford protection to domestic production". Again, *Ad* Article III:2 states as follows:

> A tax conforming to the requirements of the first sentence of paragraph 2 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 product and, on the other hand, a directly competitive or substitutable product which was not similarly taxed.

Article III:2, second sentence, and the accompanying *Ad* Article have equivalent legal status in that both are treaty language which was negotiated and agreed at the same time.[38] The *Ad* Article does not replace or modify the language contained in Article III:2, second sentence, but, in fact, clarifies its meaning. Accordingly, the language of the second sentence and the *Ad* Article must be read together in order to give them their proper meaning.

Unlike that of Article III:2, first sentence, the language of Article III:2, second sentence, specifically invokes Article III:1. The significance of this distinction lies in the fact that whereas Article III:1 acts implicitly in addressing the two issues that must be considered in applying the first sentence, it acts explicitly as an entirely separate issue that must be addressed along with two other issues that are raised in applying the second sentence. Giving full meaning to the text and to its context, three separate issues must be addressed to determine whether an internal tax measure is inconsistent with Article III:2, second sentence. These three issues are whether:

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rules, to tax them in a differentiated way through internal taxation". This is incorrect.

[37]*United States - Measures Affecting Alcoholic and Malt Beverages*, BISD 39S/206, para 5.6; see also *Brazilian Internal Taxes*, BISD II/181, para. 16; *United States - Taxes on Petroleum and Certain Imported Substances*, BISD 34S/136, para. 5.1.9; *Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83, para. 5.8.

[38]The negotiating history of Article III:2 confirms that the second sentence and the *Ad* Article were added during the Havana Conference, along with other provisions and interpretative notes concerning Article 18 of the draft ITO Charter. When introducing these amendments to delegates, the relevant Sub-Committee reported that: "The new form of the Article makes clearer than did the Geneva text the intention that internal taxes on goods should not be used as a means of protection. The details have been relegated to interpretative notes so that it would be easier for Members to ascertain the precise scope of their obligations under the Article." E/CONF.2/C.3/59, page 8. Article 18 of the draft ITO Charter subsequently became Article III of the GATT pursuant to the Protocol Modifying Part II and Article XXVI, which entered into force on 14 December 1948.

(1) the imported products and the domestic products *are "directly competitive or substitutable products" which are in competition with each other*;
(2) the directly competitive or substitutable imported and domestic products *are "not similarly taxed*"; and
(3) the dissimilar taxation of the directly competitive or substitutable imported domestic products *is "applied ... so as to afford protection to domestic production*".

Again, these are three separate issues. Each must be established separately by the complainant for a panel to find that a tax measure imposed by a Member of the WTO is inconsistent with Article III:2, second sentence.

(a) *"Directly Competitive or Substitutable Products*"

If imported and domestic products are not "like products" for the narrow purposes of Article III:2, first sentence, then they are not subject to the strictures of that 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 same 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. How much broader that category of "directly competitive or substitutable products" may be in any given case is a matter for the panel to determine based on all the relevant facts in that case. As with "like products" under the first sentence, the determination of the appropriate range of "directly competitive or substitutable products" under the second sentence must be made on a case-by-case basis.

In this case, the Panel 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".[39] This seems appropriate. The GATT 1994 is a commercial agreement, and the WTO is concerned, after all, with markets. It does not seem 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".

Nor does it seem inappropriate to examine elasticity of substitution as one means of examining those relevant markets. The Panel did not say that cross-price elasticity of demand is "*the* decisive criterion"[40] for determining whether products are "directly competitive or substitutable". The Panel stated the following:

> In the Panel's view, 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.[41]

We agree. And, we find the Panel's legal analysis of whether the products are "directly competitive or substitutable products" in paragraphs 6.28-6.32 of the Panel Report to be correct.
(…)

(b) *"Not Similarly Taxed"*

[39]Panel Report, para. 6.22.

[40]United States Appellant's Submission, dated 23 August 1996, para. 98, p.63. (emphasis added)

[41]Panel Report, para 6.22.

To give due meaning to the distinctions in the wording of Article III:2, first sentence, and Article III:2, second sentence, the phrase "not similarly taxed" in the *Ad* Article to the second sentence must not be construed so as to mean the same thing as the phrase "in excess of" in the first sentence. On its face, the phrase "in excess of" in the first sentence means *any* amount of tax on imported products "in excess of" the tax on domestic "like products". The phrase "not similarly taxed" in the *Ad* Article to the second sentence must therefore mean something else. It requires a different standard, just as "directly competitive or substitutable products" requires a different standard as compared to "like products" for these same interpretive purposes.

Reinforcing this conclusion is the need to give due meaning to the distinction between "like products" in the first sentence and "directly competitive or substitutable products" in the *Ad* Article to the second sentence. If "in excess of" in the first sentence and "not similarly taxed" in the *Ad* Article to the second sentence were construed to mean one and the same thing, then "like products" in the first sentence and "directly competitive or substitutable products" in the *Ad* Article to the second sentence would also mean one and the same thing. This would eviscerate the distinctive meaning that must be respected in the words of the text.

To interpret "in excess of" and "not similarly taxed" identically would deny any distinction between the first and second sentences of Article III:2. Thus, in any given case, there may be some amount of taxation on imported products that may well be "in excess of" the tax on domestic "like products" but may not be so much as to compel a conclusion that "directly competitive or substitutable" imported and domestic products are "not similarly taxed" for the purposes of the *Ad* Article to Article III:2, second sentence. In other words, 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 nevertheless not be enough to justify a conclusion that such products are "not similarly taxed" for the purposes of Article III:2, second sentence. We agree with the Panel that this amount of differential taxation must be more than *de minimis* to be deemed "not similarly taxed" in any given case.[42] And, like the Panel, we believe that whether any particular differential amount of taxation is *de minimis* or is not *de minimis* must, here too, 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.

In this case, the Panel applied the correct legal reasoning in determining whether "directly competitive or substitutable" imported and domestic products were "not similarly taxed". However, the Panel erred in blurring the distinction between that issue and the entirely separate issue of whether the tax measure in question was applied "so as to afford protection". Again, these are separate issues that must be addressed individually. If "directly competitive or substitutable products" are *not* "not 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". But if such products are "not similarly taxed", a further inquiry must necessarily be made.

(c) *"So As To Afford Protection"*

This third inquiry under Article III:2, second sentence, must determine whether "directly competitive or substitutable products" are "not similarly taxed" in a way that affords protection. This is not an issue of intent. It is not necessary for a panel to sort through the many reasons legislators and regulators

[42]Panel Report, para. 6.33.

often have for what they do and weigh the relative significance of those reasons to establish legislative or regulatory intent. If the measure is applied to imported or domestic products so as to afford protection to domestic production, then it does not matter that there may not have been any desire to engage in protectionism in the minds of the legislators or the regulators who imposed the measure. It is irrelevant that protectionism was not an intended objective if the particular tax measure in question is nevertheless, to echo Article III:1, "*applied* to imported or domestic products so as to afford protection to domestic production".[43] This is an issue of how the measure in question is *applied.*
(…)

As in [the 1987] case, we believe that an examination in any case 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 on domestic as compared to imported products. We believe 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.

Although it is true that the aim of a measure may not be easily ascertained, nevertheless its protective application can most often be discerned from the design, the architecture, and the revealing structure of a measure. The very magnitude of the dissimilar taxation in a particular case may be evidence of such a protective application, as the Panel rightly concluded in this case. Most often, there will be other factors to be considered as well. In conducting this inquiry, panels should give full consideration to all the relevant facts and all the relevant circumstances in any given case.

In this respect, we note and agree with the panel's acknowledgment in the *1987 Japan - Alcohol* Report:

> ... that Article III:2 does 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. The Panel found that it could also be compatible with Article III:2 to allow two different methods of calculation of price for tax purposes. Since Article III:2 prohibited only discriminatory or protective tax burdens on imported products, what mattered was, in the view of the Panel, whether the application of the different taxation methods actually had a discriminatory or protective effect against imported products.[44]

We have reviewed the Panel's reasoning in this case as well as its conclusions on the issue of "so as to afford protection" in paragraphs 6.33 - 6.35 of the Panel Report. We find cause for thorough examination. The Panel began in paragraph 6.33 by describing its approach as follows:

> ... if directly competitive or substitutable products are not "similarly taxed", and if it were found that the tax favours domestic products, then protection would be afforded to such products, and Article III:2, second sentence, is violated.

This statement of the reasoning required under Article III:2, second sentence is correct.

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[43]Emphasis added.

[44]*Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages,* BISD 34S/83, para. 5.9(c).

However, the Panel went on to note:

> ... for it to conclude that dissimilar taxation afforded protection, it would be sufficient for it to find that the dissimilarity in taxation is not *de minimis*. ... the Panel took the view that "similarly taxed" is the appropriate benchmark in order to determine whether a violation of Article III:2, second sentence, has occurred as opposed to "in excess of" that constitutes the appropriate benchmark to determine whether a violation of Article III:2, first sentence, has occurred.[45]

In paragraph 6.34, the Panel added:

> (i) The benchmark in Article III:2, second sentence, is whether internal taxes operate "so as to afford protection to domestic production", a term which has been further interpreted in the Interpretative Note ad Article III:2, paragraph 2, to mean dissimilar taxation of domestic and foreign directly competitive or substitutable products.

And, furthermore, in its conclusions, in paragraph 7.1(ii), the Panel concluded that:

> (ii) Shochu, whisky, brandy, rum, gin, genever, and liqueurs are "directly competitive or substitutable products" and Japan, by not taxing them similarly, is in violation of its obligation under Article III:2, second sentence, of the General Agreement on Tariffs and Trade 1994.

Thus, having stated the correct legal approach to apply with respect to Article III:2, second sentence, the Panel then equated dissimilar taxation above a *de minimis* level with the separate and distinct requirement of demonstrating that the tax measure "affords protection to domestic production". As previously stated, a finding that "directly competitive or substitutable products" are "not similarly taxed" is necessary to find a violation of Article III:2, second sentence. Yet this is not enough. The dissimilar taxation must be more than *de minimis*. It may be so much more that it will be clear from that very differential that the dissimilar taxation was applied "so as to afford protection". In some cases, that may be enough to show a violation. In this case, the Panel concluded that it was enough. Yet in other cases, there may be other factors that will be just as relevant or more relevant to demonstrating that the dissimilar taxation at issue was applied "so as to afford protection". In any case, the three issues that must be addressed in determining whether there is such a violation must be addressed clearly and separately in each case and on a case-by-case basis. And, in every case, a careful, objective analysis, must be done of each and all relevant facts and all the relevant circumstances in order to determine "the existence of protective taxation".[46] Although the Panel blurred its legal reasoning in this respect, nevertheless we conclude that it reasoned correctly that in this case, the Liquor Tax Law is not in compliance with Article III:2. As the Panel did, we note that:

> ...the combination of customs duties and internal taxation in Japan has the following impact: on the one hand, it makes it difficult for foreign-

[45]Panel Report, para 6.33.

[46]*Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83, para. 5.11.

> produced shochu to penetrate the Japanese market and, on the other, it does not guarantee equality of competitive conditions between shochu and the rest of 'white' and 'brown' spirits. Thus, through a combination of high import duties and differentiated internal taxes, Japan manages to "isolate" domestically produced shochu from foreign competition, be it foreign produced shochu or any other of the mentioned white and brown spirits.[47]

Our interpretation of Article III is faithful to the "customary rules of interpretation of public international law".[48] WTO rules are reliable, comprehensible and enforceable. WTO rules are not so rigid or so inflexible as not to leave room for reasoned judgements in confronting the endless and ever-changing ebb and flow of real facts in real cases in the real world. They will serve the multilateral trading system best if they are interpreted with that in mind. In that way, we will achieve the "security and predictability" sought for the multilateral trading system by the Members of the WTO through the establishment of the dispute settlement system.[49]

I. Conclusions and Recommendations

For the reasons set out in the preceding sections of this report, the Appellate Body has reached the following conclusions:

(a) the Panel erred in law in its conclusion that "panel reports adopted by the GATT CONTRACTING PARTIES and the WTO Dispute Settlement Body constitute subsequent practice in a specific case by virtue of the decision to adopt them";

(b) the Panel erred in law in failing to take into account Article III:1 in interpreting Article III:2, first and second sentences;

(c) the Panel erred in law in limiting its conclusions in paragraph 7.1(ii) on "directly competitive or substitutable products" to "shochu, whisky, brandy, rum, gin, genever, and liqueurs", which is not consistent with the Panel's Terms of Reference; and

(d) the Panel erred in law in failing to examine "so as to afford protection" in Article III:1 as a separate inquiry from "not similarly taxed" in the *Ad* Article to Article III:2, second sentence.

With the modifications to the Panel's legal findings and conclusions set out in this report, the Appellate Body affirms the Panel's conclusions that shochu and vodka are like products and that Japan, by taxing imported products in excess of like domestic products, is in violation of its obligations under Article III:2, first sentence, of the General Agreement on Tariffs and Trade 1994. Moreover, the Appellate Body concludes that shochu and other distilled spirits and liqueurs listed in HS 2208, except for vodka, are "directly competitive or substitutable products", and that Japan, in the application of the Liquor Tax Law, does not similarly tax imported and directly competitive or substitutable domestic products and affords protection to domestic production in violation of Article III:2, second sentence, of the General Agreement on Tariffs and Trade 1994.

[47]Panel Report, para. 6.35.

[48]Article 3.2 of the *DSU*.

[49]*Ibid.*

The Appellate Body *recommends* that the Dispute Settlement Body request Japan to bring the Liquor Tax Law into conformity with its obligations under the General Agreement on Tariffs and Trade 1994.

II. National Treatment – Regulation

When you study the following reports ask yourself how the requirements of national treatment differ with respect to taxation and regulation.

1. Asbestos

The measure at issue in this dispute is the French ban on the production and sale of asbestos and asbestos products. One important question in relation to Art. III is whether the analysis of likeness of asbestos and substitute products can take account of the health risk associated with the former. Pay particular attention to the reasoning with which the panel and the Appellate Body came to different results on that account. Also note the approach the panel takes to the condition of less favorable treatment and the Appellate Body's statement on this requirement.

1-1. Panel Report in *European Communities -- Measures Affecting Asbestos and Asbestos –Containing Products*, WT/DS135/R, 18 September 2000

Adrian Macey, Chairman; William Ehlers, Member; Åke Lindén, Member.

http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds135_e.htm

(…)

II. Factual Aspects

(…)

2.3 On 24 December 1996, the French Government adopted Decree No. 96-1133 banning asbestos, issued pursuant to the Labour Code and the Consumer Code (*décret no. 96-1133 relatif à l'interdiction de l'amiante, pris en application du code de travail et du code de la consommation*) (hereinafter "the Decree")[50]. The Decree entered into force on 1 January 1997. The following are its principal provisions:

2.4 Article 1 provides for a ban on asbestos in the following terms:

> "I. – For the purpose of protecting workers, […] the manufacture, processing, sale, import, placing on the domestic market and transfer under any title whatsoever of all varieties of asbestos fibres shall be prohibited, regardless of whether these substances have been incorporated into materials, products or devices.
>
> II. – For the purpose of protecting consumers, […] the manufacture, import, domestic marketing, exportation, possession for sale, offer, sale and transfer under any title whatsoever of all varieties of asbestos fibres or product containing asbestos fibres shall be prohibited […]."

[50] *Journal officiel* of 26 December 1996. See Annex I to this report.

2.5 Article 2 of the Decree allows some exceptions to the ban in Article 1.

> "I. – On an exceptional and temporary basis, the bans instituted under Article 1 shall not apply to certain existing materials, products or devices containing chrysotile fibre when, to perform an equivalent function, no substitute for that fibre is available which:
>
> - On the one hand, in the present state of scientific knowledge, poses a lesser occupational health risk than chrysotile fibre to workers handling those materials, products or devices;
>
> - on the other, provides all technical guarantees of safety corresponding to the ultimate purpose of the use […]."

VIII. Findings

(…)

2. Main claims by the parties[7]

(a) Main claims by Canada

8.3 Canada claims, firstly that the Decree is a technical regulation covered by the Agreement on Technical Barriers to Trade.[51] As such, it is incompatible with paras. 1, 2, 4 and 8 of Article 2 of the TBT Agreement.

8.4 Secondly, Canada claims that the Decree is incompatible with Articles XI and III:4 of the GATT 1994.

8.5 Lastly, Canada requests that, in the event that the Panel is unable to find a violation of Article XXIII:1(a) of the GATT 1994, it nevertheless finds that the provisions of Article XXIII:1(b) of the GATT 1994 apply.

(b) Main claims by the European Communities

8.6 The European Communities[52] ask the Panel to find that the Decree is not covered by the TBT Agreement and that, in any case, it complies with the relevant provisions of that Agreement.

8.7 With regard to the GATT 1994, the EC request the Panel to confirm that either the Decree does not establish less favourable treatment for imported products than for like domestic products within the meaning of Article III:4 or that the Decree is necessary to protect human health within the meaning of Article XX(b). Lastly, the EC ask the Panel to find that Article XXIII:1(b) of the GATT 1994 does not apply.

(…)

E. APPLICATION OF THE GATT 1994 TO THE DECREE

[7] The full text of the claims by the parties can be found in section III.A above.
[51] Hereinafter the "TBT Agreement".
[52] Hereinafter the "EC".

I. Preliminary questions

(c) Application of Article III:4 and/or Article XI of the GATT 1994

(…)
(ii) Analysis[62]

8.86 The Panel notes that the relevant provisions of Article III:4 provide the following:

> "The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use."

Note *Ad Article III* in the Notes and Supplementary Provisions in Annex I to the GATT 1994 states the following:

> "Any internal tax or other internal charge, or any law, regulation or requirement of the kind referred to in paragraph 1 which applies to an imported product and to the like domestic product and is collected or enforced in the case of the imported product at the time or point of importation, is nevertheless to be regarded as an internal tax or other internal charge, or a law, regulation or requirement of the kind referred to in paragraph 1, and is accordingly subject to the provisions of Article III."

Article XI:1 of the GATT 1994 states the following:

> "No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party."

8.87 The Panel notes first of all that the parties agree that Article III:4 applies to that aspect of the Decree which bans in particular the sale, domestic marketing and transfer under any title of all varieties of asbestos fibres and any product containing them. This aspect concerns the "treatment accorded to products […] in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use" within the meaning of Article III:4. Canada, on the other hand, considers that Article XI:1 applies to the ban on imports affecting products from Canada.[53]

8.88 The Panel draws attention to Note *Ad Article III*, which specifically covers a situation in which a law, regulation or requirement applies both to an imported product and to the like domestic product and is enforced in the case of the imported product at the time or point of importation. The latter is in fact the case. Consequently, the Panel considers it proper to commence its analysis by determining whether the Note *Ad Article III* applies to this case. As neither of the parties contests the fact that the measure applicable to the imported product is imposed at the time or point of importation, it is necessary to examine whether the Decree "applies to an imported product and to the like domestic product".

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[62] The arguments of the parties are set out in detail in Section III above.
[53] It is only if the Panel rejects Canada's first interpretation that the Decree comes in part under Article III:4 and in part under Article XI.1 that Canada considers that the whole of the Decree should fall under Article XI:1 or, if the Panel also rejects this approach, Article III:4.

8.89 In Canada's view, interpretative Note *Ad Article III* only applies if the measure is applicable to the imported product and to the domestic product. The explicit import ban does not, however, apply to the domestic product because the domestic product is obviously not imported. Moreover, as France neither produces nor mines asbestos fibres on its territory, the ban on manufacturing, processing, selling and domestic marketing is, in practical terms, equivalent to a ban on importing chrysotile asbestos fibre.

8.90 For the EC, the import ban is merely the logical corollary of the general prohibition on the use of asbestos and asbestos-containing products. Article III:4 must be assessed in the light of the interpretative Note relating to it. When a domestic measure applies to both domestic and imported products, Article III must apply.

8.91 The Panel notes that the word "comme" in the French text of Note *Ad Article III* ["and" in the English text] implies in the first place that the measure applies to the imported product and to the like domestic product.[54] The Panel notes in this connection that the fact that France no longer produces asbestos or asbestos-containing products does not suffice to make the Decree a measure falling under Article XI:1. It is in fact because the Decree prohibits the manufacture and processing of asbestos fibres that there is no longer any French production. The cessation of French production is the consequence of the Decree and not the reverse. Consequently, the Decree is a measure which "applies to an imported product and to the like domestic product" within the meaning of Note *Ad Article III*.

8.92 Secondly, the Panel notes that the words "any law, regulation or requirement […] which applies to an imported product and ["comme" in the French text] to the like domestic product" in the Note *Ad Article III* could also mean that the same regime must apply to the imported product and the domestic product.[55] In this case, under the Decree, the domestic product may not be sold, placed on the domestic market or transferred under any title, possessed for sale, offered or exported. If we follow Canada's reasoning, products from third countries are subject to a different regime because, as they cannot be imported, they cannot be sold, placed on the domestic market, transferred under any title, possessed for sale or offered. Firstly, the regulations applicable to domestic products and foreign products lead to the same result: the halting of the spread of asbestos and asbestos-containing products on French territory. In practice, in one case (domestic products), they cannot be placed on the domestic market because they cannot be transferred under any title. In the other (imported products), the import ban also prevents their marketing.

8.93 For the following reasons, we also consider that the wording of Note *Ad Article III* and practice in the GATT 1947 in this respect do not support Canada's approach that an *identical* measure must be applied to the domestic product and the like imported product if the measure applicable to the imported product is to fall under Article III.

8.94 We note that the relevant part of the English text of Note *Ad Article III* reads as follows: "Any […] law, regulation or requirement […] which applies to an imported product *and* to the like domestic product".[56] The word "and" does not have the same meaning as "in the same way as", which can be another meaning for the word "comme" in the French text. We therefore consider that the word "comme" cannot be interpreted as requiring an identical measure to be applied to imported products and domestic products if Article III is to apply.

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[54] Le Nouveau Petit Robert, op. cit., p. 411.

[55] "In the same way as", "to the same extent as" are among the alternative meanings for the word "comme" in the French text (Le Nouveau Petit Robert, op. cit., p. 411). [In the English text the word is "and"].

[56] Emphasis added. In the place of "and" and "comme", the Spanish version uses the conjunction "y" ("et" in French).

8.95 We note that our interpretation is confirmed by practice under the GATT 1947. In *United States – Section 337 of the Tariff Act of 1930*[57], the Panel had to examine measures specifically applicable to imported products suspected of violating an American patent right. In this case, referring to Note *Ad Article III*, the Panel considered that the provisions of Article III:4 did apply to the special procedures prescribed for imported products suspected of violating a patent protected in the United States because these procedures were considered to be "laws, regulations and requirements" affecting the internal sale of the imported products, within the meaning of Article III of the GATT. It should be noted that in this case the procedures examined were not the same as the equivalent procedures applicable to domestic products.[58]

8.96 Canada also claims that the import ban is not an internal measure imposed at the border, for administrative reasons. We consider that an internal charge applied to a domestic product must also be imposed on an imported product. Nevertheless, if it is deemed appropriate to impose the charge at the border rather than waiting until the imported product is actually marketed, the same logic applies in the case of a regulatory measure prescribing a ban on marketing. Is it not equally preferable from the administrative point of view and in the interests of the importers themselves to prevent the entry of the like product into the country applying the measure rather than waiting until it is placed in a warehouse before banning its sale?

(…)

For the foregoing reasons, we consider that Article III:4 of the GATT 1994 applies to the ban on importing asbestos and asbestos-containing products imposed by the Decree. On the basis of the grounds for this conclusion, we do not consider it necessary to examine further Canada's arguments on the exclusive application of Article XI:1.

(…)

1. Violation of Article III of the GATT 1994

(a) Arguments of the parties[59]

8.101 According to Canada the likeness of products should be assessed on a case-by-case basis, considering, in particular, the end-use of the product, consumers' tastes and habits, and the properties,

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[57] See the Report of the Panel in *United States – Section 337 of the Tariff Act of 1930*, adopted on 7 November 1989, BISD 36S/345, (hereinafter "*United States – Section 337*").

[58] The Panel gave the grounds for its decision in para. 5.10 as follows:

> "The fact that Section 337 is used as a means for the enforcement of United States Patent Law at the border does not provide an escape from the applicability of Article III:4; the interpretative Note to Article III states that any law, regulation or requirement affecting the internal sale of products that is enforced in the case of the imported product at the time or point of importation is nevertheless subject to the provisions of Article III. Nor could the applicability of Article III:4 be denied on the ground that most of the procedures in the case before the Panel are applied to persons rather than products, since the factor determining whether persons might be susceptible to Section 337 proceedings or federal district court procedures is the source of the challenged products, that is whether they are of United States origin or imported. For these reasons, the Panel found that the procedures under Section 337 come within the concept of 'laws, regulations and requirements' affecting the internal sale of imported products, as set out in Article III of the General Agreement."

[59] The arguments of the parties are set out in detail in Section III above.

nature and quality of the product. To these should be added tariff classification. Precedents under the GATT 1947 and the GATT 1994 do not, however, require that all the criteria be applied when evaluating the likeness of given products. Moreover, "like" does not mean "identical", it is a matter of showing that the products compared share many similar features. For Canada, applying the criteria in the precedents confirms the likeness of polyvinyl alcohol (hereinafter "PVA"), cellulose and glass fibres and chrysotile fibre, on the one hand, and fibro-cement and chrysotile-cement products on the other.

8.102 The EC contend that asbestos and asbestos-containing products, on the one hand, and substitute products, on the other, are not like products within the meaning of Article III:4 of the GATT 1994. Four criteria in particular can be used to assess the likeness of products: (a) their properties, nature and quality; (b) their tariff classification; (c) their end-use; and (d) consumers' tastes and habits. In this case, three criteria are relevant: the properties, nature and quality; the tariff classification and the end-use of the product. In the EC's view Canada is confusing the concept of "like" product in Article III:4 with that of "competitive" or "directly substitutable" product in Article III:2, read in conjunction with the relevant interpretative Note. In this case, although certain fibrous products are indeed "substitutable" for chrysotile asbestos and products containing it, they are nevertheless not "like" products. Asbestos has unique physical characteristics and properties that make it difficult to replace for certain industrial purposes. This is why the Decree envisages exceptions. As asbestos has so many uses, there is no single natural or synthetic product which, alone, could replace it in all the products and materials that contain asbestos.

(…)

(d) Analysis of likeness

(i) Introductory remarks

8.112 We note that both Canada and the EC refer to the Report of the Working Party on *Border Tax Adjustments*, which, using the terms of the Appellate Body in *Japan – Alcoholic Beverages*, lays down the fundamental principle for interpreting the words "like products" in general in the various provisions of the GATT 1947. This Report states the following:

> " … the interpretation of the term ['like products'] should be examined on a case-by-case basis. This would allow a fair assessment in each case of the different elements that constitute a 'similar' product. Some criteria were suggested for determining, on a case-by-case basis, whether a product is 'similar': the product's end-uses in a given market: consumers' tastes and habits, which change from country to country; the product's properties, nature and quality".[60]

8.113 The Panel and the Appellate Body in *Japan – Alcoholic Beverages* recognized the relevance of this list and added tariff classification in the Harmonized System ("HS"). The Appellate Body also pointed out that the principle elaborated by the Working Party in *Border Tax Adjustments* had been followed in almost all the reports of subsequent panels. We note in this connection that the panel in *United States – Gasoline*, in the context of the GATT 1994, applied this principle when examining likeness in relation to Article III:4.[61]

8.114 Finally we note that in *Japan – Alcoholic Beverages* the Appellate Body reaffirmed that panels must use their best judgement when determining whether, products are in fact like products, and this

[60] Op. cit., para. 18.
[61] Op. cit., paras. 6.8 and 6.9.

would always inevitably involve a degree of discretionary judgement. The Appellate Body also confirmed that, when making an assessment, no single approach would be appropriate to every single case. The circumstances peculiar to each case must be taken into account. The criteria outlined in the report on *Border Tax Adjustments* should be examined, but there could be no precise and absolute definition of like.

8.115 We would add that even though, for reasons of clarity, each criterion has to be examined separately, it is more than likely that they are largely interdependent. In other words, it does not appear appropriate to examine each of the criteria in isolation. Our examination should be based on an assessment of each criterion in its context, that is to say in the light of the other criteria deemed relevant in this case.

8.116 Having defined the approach to be used, we commence our analysis by examining the likeness of fibres.

(ii) Likeness of asbestos fibres and substitute fibres

8.117 We note that, in their arguments, the parties have not always distinguished between fibres as such and products containing such fibres.[62] In this section, therefore, we shall examine the relevant criteria provided that they can be related specifically to the fibres.

Properties, nature and quality of the products

8.118 Canada considers that the nature of chrysotile and substitute fibres is the same because they are all fibres. Even if the length, diameter and width-diameter ratio have an effect on pathogenicity, this does not mean that fibres of different dimensions cannot be like fibres. The dimensional parameters set by the WHO do not constitute the criterion of the nature, quality and properties according to which the likeness of fibrous products is determined. Too much importance should not be attached to the special nature of asbestos fibres claimed by the EC. Even if substitute fibres are more costly than chrysotile fibres and have other uses, chrysotile-cement or fibro-cement manufacturers use them for the same purposes and the likeness of the manufacturing processes for chrysotile-cement and fibro-cement shows the similarities of the properties and the nature of these fibres. In order to offer the same technical guarantees as chrysotile-cement products (one of the conditions for substitutability in the Decree), fibro-cement products must indubitably have the same properties, quality and nature. Similarly, the "lower" pathogenicity of substitute fibres should not preclude the conclusion that they are like asbestos. Products may be considered like despite their differing impact on health. There is no contradiction between distinguishing two types of fibre in scientific terms and according to their pathogenicity, on the one hand, and, on the other, applying the criteria derived from WTO and GATT practice for determining whether products are like. The toxicity of a product is not recognized as a criterion for the evaluation of likeness.

8.119 The EC consider that the properties, nature and quality of products are important when assessing likeness within the meaning of Article III:4. Unlike other criteria, this criterion has always been used by panels in connection with Article III:4. In the light of this criterion, the products are in any case different. Asbestos fibres have a very particular fibrous texture (bundles of fibrils that can easily be separated lengthways and have a very small diameter). The physical and chemical characteristics of substitute fibres are not the same as those of asbestos fibres (for example, their diameter is much bigger and their fibrillation capacity is more limited). No single natural or synthetic substitute product is able to combine, or combines, all the properties of asbestos, bearing in mind the unique nature of the characteristics of

[62] See, for example, the arguments of the parties on the concept of "like products", Section III.C. 2(b)(i) above.

asbestos fibres. These characteristics also make asbestos fibres particularly dangerous for health. Since 1977, the WHO has classified asbestos fibres in category 1 of proven carcinogens. The EC point out that, in contrast, none of the substitute products for chrysotile asbestos is classified as a proven carcinogen for humans. The nature, composition, physical properties and proven effects on human health of chrysotile make it radically different from substitute products. In such a situation, the health risk posed by the product must necessarily be taken into account. A dangerous product should be regarded as being different in nature and quality from a harmless or less dangerous product.

8.120 The Panel considers that, in addition to the factual elements, the parties' arguments raise a first issue, namely, in what context should the criterion of the properties, nature and quality of the fibres be taken into account for the likeness test within the meaning of Article III:4? The parties in fact basically take up the question of the way in which the properties, nature and quality of the fibres should be taken into account by the Panel.

8.121 The Panel notes that no party contests that the structure of chrysotile fibres is unique by nature and in comparison with artificial fibres that can replace chrysotile asbestos. The parties agree that none of the substitute fibres mentioned by Canada in connection with Article III:4 has the same structure, either in terms of its form, its diameter, its length or its potential to release particles that possess certain characteristics.[63] Moreover, they do not have the same chemical composition[64], which means that, in purely physical terms, none of them has the same nature or quality. It could therefore be concluded that they are not like products.

8.122 It should be recalled, nevertheless, that the context for the application of Article III:4 is not a scientific classification exercise. The objective of Article III concerns market access for products.[65] Its purpose is to prevent internal measures from being applied in such a way as to protect domestic production.[66] Article III:4 upholds this objective in respect of laws, regulations and requirements affecting the sale, marketing, purchase, transportation, distribution and use of products on the domestic market. We also note that the criterion includes the concept of the "quality" of a product, which is indicative of a commercial approach, otherwise the word "quality" would no doubt have been used in the plural, in which case it would have been the same as "properties" in the sense of a particular quality of a product.[67] It is thus with a view to market access that the properties, nature and quality of imported and domestic products have to be evaluated.

8.123 Although we share Canada's view that all the products are "fibres" and thus like products, we do not consider that the examination of the physical structure and chemical composition (which in our view relate to the nature of the product) should be taken to the other extreme, even though it has been argued that other panels followed a narrower approach in this respect.[68] If such an approach was adopted, many

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[63] In this connection, we note the observation by one of the experts consulted by the Panel that the characteristics of some artificial substitute fibres can be altered by industry if necessary (Dr. Henderson, para. 5.383 above).
[64] Regarding the chemical composition of asbestos, see the table provided by the EC in reply to question 29 by the Panel, para. 106.
[65] See the Report of the Panel in *United States – Measures Affecting Alcoholic and Malt Beverages*, adopted on 19 June 1992, BISD 39S/206, para. 5.25.
[66] Ibid., para. 5.71. See also the Report of the Panel in *Italian Discrimination Against Imported Agricultural Machinery*, adopted on 23 October 1958, 7S/60, para. 11, and the Report of the Panel *United States – Section 337 of the Tariff Act of 1930*, adopted on 7 November 1989, 36S/345, para. 5.10.
[67] In this connection, we note that the English text of the Report on *Border Tax Adjustments*, op. cit., para. 18, uses the words "properties" and "quality".
[68] See the EC's arguments in para. 3.44 above concerning the Report of the Panel in *EEC – Measures on Animal Feed Proteins*, adopted on 14 March 1978, BISD 25S/49. The Panel does not consider that the factual elements

products would never be like in respect of their nature, even if they had a similar use. On the other hand, products which bore no relation to each other in terms of their use in everyday life could be considered as like products because of their chemical composition. As mentioned in para. 8.114 above, we note the need to evaluate these criteria on a case-by-case basis, in other words, bearing in mind the factual circumstances. In this particular case, because of its physical and chemical characteristics, asbestos is a unique product. We note, nevertheless, that for many industrial uses other products have the same applications as asbestos. If the chemical and physical characteristics were to be recognized as decisive in this case, we would have to disregard all the other criteria and this does not appear to us to be consistent with the flexibility given to panels by the Appellate Body when examining the principle of likeness.

8.124 As regards properties, we note that no substitute fibre alone combines all the properties and qualities of chrysotile fibre itself. Article 2, paragraph I, second sub-paragraph of the Decree recognizes this by basing the criteria for substitution *inter alia* on "all technical guarantees of safety corresponding to the ultimate purpose of the use thereof". A narrow interpretation of the concept of like product might perhaps lead us to exclude the likeness of products which do not always show the same properties in all circumstances. In the context of market access, it is not necessary for domestic products to possess all the properties of the imported product in order to be a like product. It suffices that, for a given utilization, the properties are the same to the extent that one product can replace the other. If the properties of products always had to be the same, the category of like products would be very small, sometimes even just one product. We note in this connection that the Panel in *Japan – Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*[69] considered that gin, vodka, whisky, brandy, liqueurs, still wine and sparkling wine should be considered as like products within the meaning of Article III:2 in view of their similar properties and end-uses[70] we consider that this Report upholds our approach. If products whose nature is not exactly the same and whose properties are not always identical, for example wine on the one hand and whisky on the other, can be considered like products, the same approach can be followed pursuant to Article III:4 for chrysotile fibres on the one hand and PVA, cellulose and glass fibres on the other.

8.125 In this case, even if the end-uses of chrysotile fibres on the one hand and PVA, cellulose and glass fibres on the other are only the same for a small number of their respective applications, in some cases the applications are similar. Their properties are then equivalent, if not identical. This is the juncture of interest to us, the moment when the products are used for the same purpose. As we have already mentioned above, the criteria proposed for determining likeness should not be examined in isolation. In this particular case, we consider that the end-use of the products should affect the way in which we examine the properties of the fibres compared, inasmuch as none of the fibres mentioned by Canada always fulfils the same functions.

8.126 We therefore conclude that, taking into account the properties criterion, chrysotile fibres are like PVA, cellulose and glass fibres. With regard to nature and quality, we consider that these criteria should not be applied narrowly in the factual circumstances of the present case. Consequently, the fact that chrysotile fibres do not have the same structure or chemical composition as PVA, cellulose or glass fibres cannot be decisive for the evaluation of the likeness of these products.

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peculiar to this affair and the conclusions of the Panel (see para. 4.2) make it possible to draw the conclusions suggested by the EC in the present case.

[69] Adopted on 10 November 1987, BISD 34S/84, hereinafter "*Japan – Alcoholic Beverages (1987)*".

[70] Ibid., para. 5.6.

8.127 The second question that must be answered in relation to the application of the properties, nature and quality criterion is that of the relevance of the risk of the product raised by the EC.[71]

8.128 The Panel has noted the EC's argument that the capacity of chrysotile fibres to break up into extremely fine particles that can penetrate the pulmonary alveoli gave these fibres a property which meant that they were not like because this property was the basis for chrysotile's potential to cause diseases of the lung and the pleura, mainly lung cancers and mesotheliomas.[72]

8.129 We note first of all that the risk of a product for 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. In addition to the fact that no other panel has probably ever been called upon to examine a question similar to the one before us, in our view the reason is to be found in the *economy* of the GATT 1994. Its primordial role is to ensure that a certain number of disciplines are applied to domestic trade regulations. Article XX of the GATT, however, recognizes that certain interests may take precedence over the rules governing international trade and authorizes the adoption of trade measures aimed at preserving these interests while at the same time observing certain criteria.[73]

8.130 We consider that introducing a criterion on the risk of a product into the analysis of likeness within the meaning of Article III would largely nullify the effect of Article XX(b).[74] The protection of human health and life is specifically covered by this Article. Article III, on the other hand, does not refer to this. The burden of proof would not of course be greatly modified because the EC would still have to prove the risk of the product, applying the principle of *probatio incumbit ejus que dixit.* We nevertheless consider that other aspects that form part of the rights and obligations negotiated by the Members would be affected. Introducing the protection of human health and life into the likeness criteria would allow the Member concerned to avoid the obligations in Article XX, particularly the test of necessity for the measure under paragraph (b) and the control exerted by the introductory clause to Article XX concerning any abuse of Article XX(b) when applying the measure. As the Appellate Body has emphasized on a number of occasions[75], all these provisions in the WTO Agreement must be given meaning. Introducing a risk criterion into the examination of likeness under Article III would be contrary to this basic principle of interpretation.

8.131 Finally, if such a criterion was applied, it would make all the other criteria mentioned by the Working Party on *Border Tax Adjustments*[76] totally redundant because it would become decisive when assessing the likeness of products in every case in which it was invoked, irrespective of the other criteria applied.

8.132 We therefore conclude that, bearing in mind the overall economy of the WTO Agreement, in particular the relationship between Article III and Article XX(b), it is not appropriate to apply the "risk"

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[71] We note that the EC draw attention to the risk posed by chrysotile fibres not only in connection with the properties, nature and quality criterion but also in relation to the end-use and the tastes and habits of consumers. In this subsection, however, we examine the criterion of the risk of a product inasmuch as the EC, in its arguments, referred to this criterion mainly in relation to the criterion of the properties, nature and quality of asbestos fibres. The conclusions of our examination, however, will apply to all the circumstances in which the EC refer to the risk of a product in relation to the determination of likeness within the meaning of Article III:4 of the GATT 1994.

[72] Mesothelioma is a form of pleural cancer. See for example the description by Dr. Henderson, para. 5.29 above.

[73] See the report of the Panel in *Canada – Measures on Export of Unprocessed Herring and Salmon*, adopted on 22 March 1988, BISD 35S/98, para. 4.6.

[74] See the discussion on the concept of effectiveness, footnote 22 above.

[75] See in particular *Argentina – Safeguards*, op. cit; *Brazil – Desiccated Coconut*, op. cit.

[76] See para. 8.112 above.

criterion proposed by the EC, neither in the criterion relating to the properties, nature and quality of the product, nor in the other likeness criteria invoked by the parties.

End-use

(…)

8.136 We have already found above[77] that the respective properties of chrysotile fibres on the one hand and PVA, cellulose or glass fibres on the other allowed certain identical or at least similar end-uses. We do not therefore deem it necessary to elaborate this further, except to recall that, in our view, the fact that all the end-uses of these fibres are not like uses does not mean that the products are not like products.

Consumers' tastes and habits

(…)

8.139 We note first of all that the parties do not consider it useful or necessary for us to take this criterion into account. In our view, this is not in itself sufficient reason for us not to take it into account. We do not agree either, that, in view of Article III:4, there are reasons for excluding consideration of this criterion a priori.[78] We consider that it is up to the Panel to decide whether one of the criteria applicable to determining the "likeness" of the products concerned is relevant or not.[79] What is important is to ensure that our analysis takes into account all the relevant elements. In this particular case, we note first of all that, when determining the tastes and habits of consumers, it is necessary to place oneself at the time prior to the entry into force of the ban in the Decree. Even if we do place ourselves prior to that date, however, it would be difficult to determine precisely what were the tastes and habits of consumers at that time. The groups of consumers to be taken into account are very varied and their tastes and habits based on an equally wide variety of considerations. Because this criterion would not provide clear results, the Panel considers that it is not relevant to take it into account in the special circumstances of this case.

8.140 We shall therefore refrain from taking a position on the impact of this criterion on the likeness of the products considered.

Tariff classification

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[77] See para. 8.125 above.

[78] In the cases cited by the EC – to which Canada also refers – we do not find any legal reasons relating to Article III:4 to justify excluding the criterion of consumers' tastes and habits. In *Measures Affecting Alcoholic and Malt Beverages* (adopted on 19 June 1992, BISD 39S/206), para. 5.73, the panel indeed did not agree that low alcohol beer and high alcohol beer were like products on the basis of consumers' tastes and habits, but it did nevertheless use this criterion. In *EEC – Measures on Animal Feed Proteins* (adopted on 14 March 1978, BISD 25S/49), para. 4.2, the panel did not exclude the applicability of consumers' tastes, noting:

> "[…] in this case, such factors as the number of products and tariff items carrying different duty rates and tariff bindings, the varying protein contents and the different vegetable, animal and synthetic origins of the protein products before the Panel – not all of which were subject to the EEC measures".

In view of the terms used by the panel in this case, it does not seem that the panel in principle rejected the relevance of consumers' tastes and habits. In *United States – Gasoline*, op. cit., even though the panel did not mention the criterion of consumers' tastes and habits in its conclusions in para. 6.9, in para. 6.8 it nonetheless recalled the applicability under Article III:4 of the criteria summarized by the Working Party in *Border Tax Adjustments*, op. cit., which include consumers' tastes and habits. We have not found any reason either to restrict the meaning of the word "consumers" solely to the end-consumers of chrysotile-cement products, i.e. individual consumers.

[79] See the Report of the Appellate Body in *Japan – Alcoholic Beverages*, op. cit., p. 24.

(…)

8.143 We do not consider that the fact that asbestos fibres are classified in their own heading is decisive in this case. PVA, cellulose and glass fibres respectively are also classified in different tariff headings. We note, however, that such a classification reflects the difference in their nature, whether they are mineral or vegetable, artificial or natural. We have already found that this factor did not affect the fact that their properties and end-use are the same under certain circumstances.[80]

Conclusion

8.144 Above we concluded that chrysotile fibres, on the one hand, and PVA, cellulose and glass fibres, on the other, are, in certain circumstances, similar in properties, nature and quality. We also concluded that these products have similar end-uses. From this it follows that chrysotile fibres, on the one hand, and PVA, cellulose and glass fibres, on the other, are like products within the meaning of Article III:4 of the GATT 1994.

(iii) Likeness between products containing asbestos and certain other products

8.145 The Panel considers that many of the arguments put forward in relation to asbestos, PVA, cellulose and glass fibres are applicable *mutatis mutandis* to products containing those fibres. Thus, if a fibro-cement product, for example, a tile, is compared with a similar tile of chrysotile-cement, the only difference between the products concerned is the presence of either chrysotile or a substitute fibre in the tile, the product itself being a tile and the other component of the material being in both cases cement. It is the presence of chrysotile or some other fibre that gives the cement product its specific function: mechanical strength, resistance to heat, compression, etc.

8.146 Moreover, we note that, in Canada's opinion, chrysotile-cement and fibro-cement products are both industrial products which cannot be distinguished on the basis of their external appearance. From the standpoint of the tastes and habits of the French consumer, they are interchangeable. According to the EC, informed users would not use products containing asbestos after the international organizations had decided that asbestos was a proven carcinogen.

8.147 Consequently, we consider that in fact the likeness between a chrysotile-cement product and a fibro-cement product depends on two factors: (a) the nature of the product itself and (b) the presence of chrysotile fibres or of PVA, cellulose or glass fibres in the product.

8.148 Using the criteria adopted by the Panel and the Appellate Body in *Japan – Alcoholic Beverages,* we note, first of all, that the HS tariff classification (heading 68.11) is the same for articles of asbestos-cement, of cellulose fibro-cement or the like. This heading covers hardened articles consisting essentially of an intimate mixture of fibres (for example, asbestos, cellulose or other vegetable fibres, synthetic polymer or glass fibres) and cement or other hydraulic binders, the fibres acting as strengthening agents.

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[80] Asbestos in its natural state falls in heading 25.24. Polyvinyl alcohol falls in heading 39.05, cellulose in 39.12 and glass fibre in 70.19. We note that in *Japan – Alcoholic Beverages (1987)*, the Panel referred to the "Nomenclature of the Customs Cooperation Council (CCCN) for the classification of goods in customs tariffs". We also note that the Appellate Body in *Japan – Alcoholic Beverages* op. cit. p. 24 reaffirmed that that tariff classification, if sufficiently detailed, was a useful basis for confirming the likeness of products. We note that in this case the parties based themselves on the tariff classification in the Harmonized System, and not on tariff bindings, which the Appellate Body urges should be used with caution. We do not consider however, that the particular circumstances of this case justify that, when determining the likeness or absence of likeness of asbestos, PVA, cellulose and glass fibres, overriding significance should be attached to the fact that the products fall in different tariff headings of the HS.

Other products may fall into different tariff headings. However, many of the products mentioned by Canada appear to fall within this subdivision.[81]

8.149 We consider, moreover, that one of the EC's main arguments against the likeness between fibro-cement and chrysotile-cement products with respect to their properties, nature and quality and their end-use is based on the risk associated with the chrysotile which they contain. To the extent that in paragraph 8.132 we concluded that the "risk" criterion cannot be included among the criteria applicable to the determination of likeness under Article III:4, we do not consider it necessary to discuss the applicability of this criterion with respect to chrysotile-cement products. The same applies with respect to consumers' tastes and habits.

8.150 We therefore conclude that chrysotile-fibre products and fibro-cement products are like products within the meaning of Article III:4 of the GATT 1994.

(e) Less favourable treatment of Canadian products[82]

8.151 With respect to the existence of less favourable treatment, Canada argues that the Decree alters the conditions of competition between, on the one hand, substitute fibres and products containing them of French origin and, on the other hand, chrysotile fibre and products containing it from Canada. The Decree does not afford chrysotile fibre imported from Canada and products containing it effective equality of opportunities for imported products in respect of the application of laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products. Not only does the ban apply only to asbestos fibre and products containing it but it is applicable only if there are products like to chrysotile fibre or to the products containing it. Thus, the Decree imposes less favourable treatment in all cases where like products exist. Accordingly, the Decree constitutes *de jure* discrimination between chrysotile fibres and products containing them, on the one hand, and like products (PVA, cellulose or glass fibres and fibro-cement products containing them), on the other.

8.152 Canada also alleges de facto discrimination. The French PVA fibres industry is in better shape than ever. Moreover, it is not because France has imported a marginal additional quantity of Canadian cellulose fibres that the French domestic industry has not benefited from the ban. The Decree does indeed impose a choice on the French consumer who is now prevented from using chrysotile fibre or products containing it.

8.153 The EC maintain that the contested measure accords with the fundamental purpose of Article III, which is to prevent protectionism, and is not discriminatory, neither *de jure* nor de facto, inasmuch as it guarantees effective equality of opportunities for domestic and imported products. The context in which the Decree was adopted and its provisions show that the intention of the French authorities was in no way

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[81] In fact, the HS Explanatory Notes describe the products that fall within heading 68.11 ("Articles of asbestos-cement, of cellulose fibro-cement or the like") as follows:

> "This heading covers hardened articles consisting essentially of an intimate mixture of fibres (for example, asbestos, cellulose or other vegetable fibres, synthetic polymer, glass or metallic fibres) and cement or other hydraulic binders, the fibres acting as strengthening agents. […]
>
> The heading includes sheets of all sizes and thicknesses, obtained as described above, and also articles made by cutting these sheets or by pressing, moulding or bending them before they have set, e.g., roofing, facing or partition sheets and tiles; sheets for making furniture; window sills; sign-plates, letters and numbers; barrier bars; corrugated sheets; reservoirs, troughs, basins, sinks; tubing joints; packing washers and joints; panels imitating carving; ridge tiles, gutters, window frames; flower-pots; ventilation or other tubing, cable conduits; chimney cowls, etc.
>
> All these articles may be coloured in the mass, varnished, printed, enamelled, decorated, drilled, filed, planed, smoothed, polished or otherwise worked; they may also be reinforced with metal, etc."

[82] The arguments of the parties are set out in detail in Section III above.

to protect domestic substitute products but to protect human health against the risks associated with asbestos. They also show that the Decree makes no distinction between imported and domestic products, whether it be a question of substitute or asbestos products, and that neither its object nor its effect is to protect domestic production. The Decree does not create any de facto discrimination, since in France most substitute products are imported from various third countries. Moreover, France has a negative trade balance in substitute products. The ban on the use of asbestos on public health grounds has required a painful changeover, in human and financial terms, including the loss of external outlets for French industry. Finally, the Decree is "neutral" in respect of the choices that businesses can make concerning replacement products.

8.154 We note that with regard to the establishment of the existence of less favourable treatment, it is first necessary to determine, as we have done, whether there is a likeness between the imported and the domestic products. Above, both with regard to chrysotile fibres, on the one hand, and PVA, cellulose and glass fibres, on the other[83], and with regard to products made of chrysotile-cement, on the one hand, and fibro-cement, on the other, we concluded that they were "like" within the meaning of Article III:4. With respect to the treatment of these products as compared with the like domestic products, we note, first of all, that France does produce substitutes for chrysotile fibres and chrysotile-cement products. We next note that the terms of the Decree in themselves establish less favourable treatment for asbestos and products containing asbestos as compared with substitute fibres and products containing substitute fibres. Thus, paragraphs I and II of Article 1 of the Decree read as follows:

> "I. For the purpose of protecting workers, and pursuant to Article L. 231-7 of the Labour Code, the manufacture, processing, sale, import, placing on the domestic market and transfer under any title whatsoever of all varieties of asbestos fibres shall be prohibited, regardless of whether these substances have been incorporated into materials, products or devices.
>
> II. For the purpose of protecting consumers, and pursuant to Article L. 221.3 of the Consumer Code, the manufacture, import, domestic marketing, exportation, possession for sale, offer, sale and transfer under any title whatsoever of all varieties of asbestos fibres or any product containing asbestos fibres shall be prohibited."

8.155 Inasmuch as the Decree does not place an identical ban on PVA, cellulose or glass fibre and fibro-cement products containing PVA, cellulose or glass fibres, we must conclude that *de jure* it treats imported chrysotile fibres and chrysotile-cement products less favourably than domestic PVA, cellulose or glass fibre and fibro-cement products.

8.156 Having established *de jure* discrimination on the basis of the Decree and, moreover, the European Communities not having submitted any evidence that might lead us to believe that the Decree is applied in such a way as not to introduce less favourable treatment for chrysotile fibres and chrysotile-cement products as compared with PVA, cellulose and glass fibres and fibro-cement products containing PVA, cellulose or glass fibres[84], we do not consider it necessary to determine whether there is any *de facto* discrimination between these products.

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[83] We note, incidentally, that Canada has not made any allegation concerning the less favourable treatment of Canadian chrysotile fibres as compared with domestic chrysotile fibres. Accordingly, we shall not make any finding in this respect.

[84] See the Report of the Panel in *United States – Sections 301-310 of the Trade Act of 1974*, op. cit., para. 7.27.

8.157 For these reasons, we conclude that the Decree applies to chrysotile and chrysotile-cement products a treatment less favourable than that which it applies to PVA, cellulose and glass fibres and products containing them, within the meaning of Article III:4.

(f) Conclusion

8.158 On the basis of the above, we find that the provisions of the Decree relating to the prohibiting of the marketing of chrysotile fibres and chrysotile-cement products violate Article III:4 of the GATT 1994.

Violation of Article XI of the GATT 1994

8.159 In the light of our observations on the applicability of Article III:4 of the GATT 1994 to the border measures imposed on chrysotile fibres and chrysotile-cement products and considering our findings with regard to the violation of Article III:4 by the Decree, we conclude that it is not necessary to examine the Canadian argument concerning the violation of Article XI:1 of the GATT 1994.

Applicability of Article XX of the GATT 1994

Arguments of the parties[85]
(…)
8.162 The European Communities argue that asbestos fibres and products containing them are a proven hazard for human health. The risks linked to the use of these fibres are recognized both by scientists and international organizations. By prohibiting the marketing and use of asbestos and asbestos-containing products, the Decree seeks to halt the spread of these risks, in particular for people occasionally and often unwittingly exposed to asbestos, and thereby reduce the number of deaths among the French population. It is the only measure capable of preventing the spread of the risks due to asbestos exposure. According to the EC, the review in the light of Article XX cannot be allowed to undermine the health protection goal set by the Member concerned. Its sole purpose must be to assess whether the trade measure adopted is necessary to attain that goal. This test concerns the trade measure and not the level of protection set by the Member.
(…)

(c) Application of Article XX(b) of the GATT 1994 to the Decree

(i) "Protection of human life and health"

8.184 In accordance with the approach defined by the Panel in *United States – Gasoline*, we must first establish whether the policy in respect of the measure for which the provisions of Article XX(b) were invoked falls within the range of policies designed to protect human life or health. As we have already pointed out, the use of the word "protection" implies the existence of a risk. Accordingly, we must begin by identifying a risk for public health. In the light of the comments of the panel in *United States – Gasoline* and our own remarks in paragraph 8.182, we must also take into account the fact that it is a public health policy that we have to assess.

8.185 First of all, we note that the EC argue that in prohibiting the placing on the market and use of asbestos and products containing it, the Decree seeks to halt the spread of the risks due to asbestos, particularly for those exposed occasionally and very often unwittingly to asbestos when working on

[85] The arguments of the parties are set out in detail in Section III above.

asbestos-containing products. France considers that it can thereby reduce the number of deaths due to exposure to asbestos fibres among the French population, whether by asbestosis, lung cancer or mesothelioma.[86]

8.186 In principle, a policy that seeks to reduce exposure to a risk should fall within the range of policies designed to protect human life or health, insofar as a risk exists. According to the EC, the international scientific community appears to be generally of the opinion that chrysotile fibres as such are carcinogens. In this connection, we note the EC's argument that, since 1977, the International Agency for Research on Cancer (IARC) has classified chrysotile among the proven carcinogens.

(…)

8.188 First of all, we note that the carcinogenicity of chrysotile fibres has been acknowledged for some time by international bodies.[87] This carcinogenicity was confirmed by the experts consulted by the Panel, with respect to both lung cancers and mesotheliomas[88], even though the experts appear to acknowledge that chrysotile is less likely to cause mesotheliomas than amphiboles.[89] We also note that the experts confirmed that the types of cancer concerned had a mortality rate of close to 100 per cent.[90] We therefore consider that we have sufficient evidence that there is in fact a serious carcinogenic risk associated with the inhalation of chrysotile fibres. Moreover, in the light of the comments made by one of the experts[91], the doubts expressed by Canada with respect to the direct effects of chrysotile on mesotheliomas and lung cancers are not sufficient to conclude that an official responsible for public health policy would find that there was not enough evidence of the existence of a public health risk.

8.189 We note, however, that Canada makes a distinction between chrysotile fibres and chrysotile encapsulated in a cement matrix. In fact, Canada challenges the Decree insofar as it prohibits, *inter alia*, the use of chrysotile-cement products. In this connection, we note that the experts consulted by the Panel agreed that the risks of fibres being dispersed due to the degradation of chrysotile-cement were limited. However, the experts acknowledged that working with non-friable products containing chrysotile might result in the dispersion of large quantities of fibres and that those fibres pose a definite health risk.[92] The experts also noted that even though the risk might be lower than for production or processing workers, it concerned a much larger group.[93]

(…)

8.193 The Panel therefore considers that the evidence before it tends to show that handling chrysotile-cement products constitutes a risk to health rather than the opposite. Accordingly, a decision-maker

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[86] With regard to the group of pathologies that asbestos can cause, see Dr. Henderson, para. 5.28.

[87] Since 1977 by the IARC (see *List of Agents Carcinogenic to Humans, Overall Evaluations of Carcinogenicity to Humans*, Monographs of the International Agency for Research on Cancer, Volumes 1-63), see also WHO, *IPCS Environmental Health Criteria (203) on Chrysotile*, Geneva (1998), cited in para. 5.584 above. On the development of knowledge of the risks associated with asbestos, see Dr. Henderson, para. 5.595.

[88] See, in particular, Dr. Henderson, paras. 5.29 to 5.34; 5.142 to 5.165; Dr. Infante, paras. 5.267, 5.290-5.298; Dr. de Klerk, para. 5.288.

[89] See, for example, the ratios suggested by Dr. Henderson, paras. 5.103, 5.141, 5.415, 5.589 and his remarks, paras. 5.265-5.266; see also Dr. de Klerk, para. 5.264; Dr. Infante, paras. 5.267-5.268 and Annex VI, para. 19 of the transcript of the meeting with experts.

[90] Dr. Henderson, meeting with experts, Annex VI, para. 182.

[91] See the comments made by Dr. Henderson, paras. 5.153-5.157 concerning the link between fibrosis and lung cancer.

[92] See the replies of the experts to the Panel's question 1.(b), paras. 5.196-5.209.

[93] See Dr. Henderson, paras. 5.176, 5.183; Dr. de Klerk, para. 5.185.

responsible for taking public health measures might reasonably conclude that the presence of chrysotile-cement products posed a risk because of the risks involved in working with those products.

8.194 Accordingly, the Panel concludes that the EC has made a prima facie case for the existence of a health risk in connection with the use of chrysotile, in particular as regards lung cancer and mesothelioma in the occupational sectors downstream of production and processing and for the public in general in relation to chrysotile-cement products. This prima facie case has not been rebutted by Canada. Moreover, the Panel considers that the comments by the experts confirm the health risk associated with exposure to chrysotile in its various uses. The Panel therefore considers that the EC have shown that the policy of prohibiting chrysotile asbestos implemented by the Decree falls within the range of policies designed to protect human life or health. On the other hand, Canada has not succeeded in rebutting the presumption established on the basis of the evidence submitted by the EC and confirmed by the experts. The Panel concludes therefore that the French policy of prohibiting chrysotile asbestos falls within the range of policies designed to protect human life or health, within the meaning of Article XX(b) of the GATT 1994.

8.195 Accordingly, the Panel will now turn to the question of whether the measure is "necessary" within the meaning of Article XX(b).

(ii) "Necessary"

The ban on chrysotile asbestos in its various forms
(…)

8.198 We note that in *Thailand – Cigarettes* the Panel defined the test of necessity applicable under Article XX(b):

> "The import restrictions imposed by Thailand could be considered to be 'necessary' in terms of Article XX(b) only if there were no alternative measure consistent with the General Agreement, or less inconsistent with it, which Thailand could reasonably be expected to employ to achieve its health policy objectives."[94]

8.199 This test has been applied in other disputes[95], in order to apply the test defined in *Thailand – Cigarettes*, we must (a) establish *the scope* of the health policy objectives pursued by France and (b) consider the existence of measures consistent, or less inconsistent, with the GATT 1994.

8.200 First of all, we note that the risk due to chrysotile is important to the extent that, as confirmed in the previous section, it can generate lung cancers and mesotheliomas which are still difficult to cure or even incurable.[96] The populations potentially at risk in France are very numerous, since products containing chrysotile, in particular, chrysotile-cement, have many applications in industrial, commercial and residential buildings. The fields of activity concerned include building workers (several hundred thousand) and DIY enthusiasts[97] These are areas in which health controls are difficult to apply, as the comments of the experts have shown.[98]

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[94] BISD 37S/200, para. 75.
[95] See, for example, the Report of the Panel in *United States – Section 337*, op. cit., para. 5.26, and the Report of the Panel in *United States – Gasoline*, op. cit., para. 6.24.
[96] See Dr. Henderson, para. 5.29 and the transcript of the meeting with experts, Annex VI, end of para. 182.
[97] See Dr. Infante, para. 5.183; Dr. de Klerk, para. 5.185.
[98] See Dr. Infante for the United States (para. 161 of the transcript of the meeting with experts); Dr. de Klerk and

8.201 The experts also confirmed that the intensive use of asbestos (in France, mainly chrysotile) over several decades has resulted in the risks of exposure being displaced from the mining and processing industry towards other sectors further downstream and, indeed, the general public.[99] In this context, the Panel finds that the European Communities have shown that a risk exists for a very broad sector of the French population.

8.202 The Panel notes that the exposure of these groups is generally lower. However, the experts confirm the position of the European Communities according to which it has not been possible to identify any threshold below which exposure to chrysotile would have no effect.[100] The experts are also agreed that the linear relationship model, which does not identify any minimum exposure threshold, is appropriate for assessing the existence of a risk.[101] We find therefore that no minimum threshold of level of exposure or duration of exposure has been identified with regard to the risk of pathologies associated with chrysotile, except for asbestosis. Consequently, the possibility remains that low exposure over a fairly long period of time could lead to lung cancer or mesothelioma. Similarly, high-level exposure over a short period could also result in lung cancer or mesothelioma. These two possibilities were confirmed by the experts.[102] The Panel therefore concludes that even though some trades or the French population in general are only intermittently exposed to low levels of asbestos, a decision-maker responsible for public health policy might reasonably conclude that there was nevertheless a real risk for these categories.

8.203 In the light of the above, the Panel concludes that, in addition to the risk presented by low-density friable products, there is an undeniable public health risk in relation to the chrysotile contained in high-density chrysotile-cement products. This risk exists even at low or intermittent exposure levels and can affect a broad section of the population.

8.204 We also note that France's objective is to halt the spread of this risk which, considering the risk identified and its extent, could in principle justify strict measures. However, it is necessary to consider whether there is not, as Canada alleges, a measure that would be consistent, or less inconsistent, with the GATT 1994 and would allow the objective pursued by France to be achieved. Canada refers to the possibility of controlled use which consists in taking precautionary measures to restrict the release of fibres (use of special tools, high-density products and special methods of handling asbestos products) and protect the airways and in adopting methods of decontaminating equipment and work clothing. This controlled or safe use would be based on international standards.

8.205 We note that, according to the EC, controlled use does not work in certain occupational sectors such as those connected with building.[103] Moreover, if the international standards suggested by Canada (in particular, ISO 7337) were applied, the exposure rate would still be higher than the level of risk that France considers acceptable.[104] The EC also stress that the consistent or less inconsistent measures must be "technically and economically feasible."[105]

Dr. Henderson for Australia (paras. 222 and 225, respectively, of the transcript of the meeting with experts).

[99] See Dr. Henderson, paras. 5.174–5.181; Dr. Infante, paras. 5.182-5.183, 5.190.

[100] See Dr. Henderson, para. 5.312; Dr. Infante, paras. 5.313-5.315.

[101] See Dr. de Klerk, para. 5.317; Dr. Henderson, para. 5.318; Dr. Infante, paras. 5.321-5.323; Dr. Musk, para. 5.324.

[102] See, for example, Dr. Infante, para. 5.304.

[103] See, in particular, Annex II, reply by the EC to Canada's question No. 6, para. 168

[104] See Annex II, reply by the EC to Canada's question No. 5, para. 167.

[105] The European Communities refer to Article 5.6 of the Agreement on the Application of Sanitary and Phytosanitary Measures. They consider that the principle incorporated in that provision should also be applied in the context of Article XX.

8.206 We note that the EC do not dispute that controlled use could constitute a measure consistent, or less inconsistent, with the GATT 1994. They nevertheless consider that it would not allow the public health objectives pursued by France to be achieved. Insofar as Canada refers solely to controlled or safe use as an alternative to outright prohibition, we will focus our attention on this possibility.[106] However, before continuing with our analysis of whether measures consistent, or less inconsistent, with the GATT are available in the present case, we consider it pertinent, in the light of the contradictory arguments put forward by the parties, to return to the question of the applicability of the feasibility test suggested by the EC.

8.207 We note that in *United States – Section 337,* the Panel stated that:

> "A contracting party cannot justify a measure inconsistent with another GATT provision as 'necessary' in terms of Articles XX(d) if an alternative measure *which it could reasonably be expected to employ* and which is not inconsistent with other GATT provisions is available to it. By the same token, in cases where a measure consistent with other GATT provisions *is not reasonably available*, a contracting party is bound to use, *among the measures reasonably available to it*, that which entails the least degree of inconsistency with other GATT provisions."[107]

We therefore find that in order to determine whether a measure is necessary it is important to assess whether consistent or less inconsistent measures are *reasonably* available. The term "reasonably" has not been defined as such by the panels that have referred to it in the context of Article XX. It suggests, however, that the availability of a measure should not be examined theoretically or in absolute terms. Nevertheless, in the light of the reasoning of these panels, we find the word "reasonably" should not be interpreted loosely either. The fact that, administratively, one measure may be easier to implement than another does not mean that the other measure is not reasonably available.[108] We consider that the existence of a reasonably available measure must be assessed in the light of the economic and administrative realities facing the Member concerned but also by taking into account the fact that the State must provide itself with the means of implementing its policies. Thus, the Panel considers that it is legitimate to expect a country such as France with advanced labour legislation and specialized administrative services to deploy administrative resources proportionate to its public health objectives and to be prepared to incur the necessary expenditure.

8.208 After clarifying this point, we will now proceed to examine whether controlled use (a) is sufficiently effective in the light of France's health policy objectives and (b) whether it constitutes a reasonably available measure.

8.209 In relation to the first of these considerations, we note, first of all, that although controlled use is applied in some countries, such as the United States or Canada, and has also been applied by France, in general in certain sectors its efficacity still remains to be demonstrated. This is confirmed by a number of studies[109], as well as by the comments of the experts.[110] Thus, even though it seems possible to apply

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[106] In this respect, we note that the experts likewise did not mention any alternatives other than controlled use. Moreover, in the light of the approach defined by the Appellate Body in *Australia – Salmon*, op. cit. (see Section VIII E.1.(b) above), we consider that we do not need to ascertain whether other measures were possible.
[107] Op. cit., para. 5.26.
[108] See *United States – Gasoline*, op. cit., paras. 6.26 to 6.28.
[109] See Peto *et al: Continuing Increase in Mesothelioma Mortality in Britain, The Lancet*, volume 345, 535-539 (1995). See also Dr. Henderson, citing EHC 203, paras. 5.365-5.368; Dr. Infante, paras. 5.351-5.352 and 5.369.
[110] See the comments of the experts on controlled use and its feasibility, paras. 5.335-5.373.

controlled use successfully upstream (mining and manufacturing) or downstream (removal and destruction) of product use, it would seem to be much less easy to apply it in the building sector, which is one of the areas more particularly targeted by the measures contained in the Decree. The Panel therefore concludes that, in view of the difficulties of application of controlled use, an official in charge of public health policy might reasonably consider that controlled use did not provide protection that was adequate in relation to the policy objectives.

8.210 Moreover, Canada refers to the existence of international standards for the protection of workers in contact with chrysotile.[111] First of all, we find that the international standards cover only the precautions to be taken if a worker has to handle asbestos. They contain neither a guarantee of free access for asbestos nor an incentive to use asbestos. On the contrary, the international conventions suggest that, as far as possible, asbestos should be replaced by less hazardous materials.[112] Next, we note that the levels of protection obtained by following international standards, whether it be the ISO standard or the WHO Convention, are lower than those established by France, including those applicable before the introduction of the Decree. Considering the high level of risk identified, France's objective – which the Panel cannot question -[113] justifies the adoption of exposure ceilings lower than those for which the international conventions provide. We therefore find that controlled use based on international standards would not seem to make it possible to achieve the level of protection sought by France.

8.211 The Panel is aware that in some sectors controlled or safe use could be envisaged with greater certainty that it would prove effective. However, as confirmed by the experts[114], the circumstances of use must be controllable. These circumstances are extremely varied and we note that the safety measures that would make possible results at least equivalent to the exposure level (0.1 f/ml) applied by France before the ban (restrictions on the number of workers and working areas and total containment of the product) exceed the requirements of the international standards and considerably limit the number of industrial sectors that could apply them.[115] Even in these cases, according to one of the experts, the level of exposure is still high enough for there to be a significant residual risk of developing asbestos-related diseases.[116] According to another, it is not possible to guarantee that fibre concentrations will never exceed 0.1 f/ml.[117] In addition, we note that for the application of controlled use to satisfy France's public health objectives, mined or processed products should never be handled by anyone outside the mining and processing industries. If these products were subsequently to be handled by unprotected persons, the fact that they could be mined and processed and then destroyed using controlled use techniques would not be sufficient to meet those objectives. We therefore find that a decision-maker responsible for establishing a health policy might have reasonable doubts about the possibility of ensuring the achievement of France's health policy objectives by relying on controlled use, even in sectors which might lend themselves more readily to these practices.[118]

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[111] See, for example, ISO 7337.

[112] See International Labour Organization, Geneva, Convention Concerning Safety in the Use of Asbestos (hereinafter "Convention 162", adopted on 24 June 1986).

[113] See *United States – Gasoline*, op. cit., para. 6.22. The Panel also notes that XX(b) does not impose the same constraints as Article 3.3 of the SPS Agreement on Members wishing to apply measures that involve a level of protection higher than that which would be obtained with measures based on the relevant international standards.

[114] Dr. Henderson, paras. 5.336-5.341.

[115] Ibid., paras. 5.337-5.339.

[116] Dr. Infante, para. 5.343 referring to an opinion given by the United States Occupational Safety and Health Administration (OSHA). See also Dr. Infante, paras. 5.358-5.362.

[117] Dr. Henderson, paras. 5.355-5.357.

[118] In any event, in the light of the opinion of one of the experts (Dr. Henderson, para 5.658 and footnote), the sectors in which effective controlled use is feasible appear to be extremely few and concern applications for which, at this stage, there are no chrysotile substitutes, an area in which the Decree provides for exceptions to the

8.212 *A fortiori* and for the following reasons, we consider that controlled use is not a reasonably available alternative in all the other sectors in which workers may be exposed to chrysotile.

(…)

Conclusion

8.222 In the light of France's public health objectives as presented by the European Communities, the Panel concludes that the EC has made a prima facie case for the non-existence of a reasonably available alternative to the banning of chrysotile and chrysotile-cement products and recourse to substitute products. Canada has not rebutted the presumption established by the EC. We also consider that the EC's position is confirmed by the comments of the experts consulted in the course of this proceeding.

8.223 At this stage, we conclude that the Decree satisfies the conditions of Article XX(b) of the GATT 1994.

(d) Application of the introductory clause (chapeau) of Article XX of the GATT 1994 to the application of the Decree

(i) "Means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail"

(…)

8.226 The Panel notes that under the first of the alternatives mentioned in the introductory clause of Article XX it is required to examine whether the *application* of the Decree constitutes a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail.[119] The Panel considers that, within the context of this alternative, its first step should be to determine whether the measure is "discriminatory" in its application.[120] If the application of the measure is found to be discriminatory, it still remains to be seen whether it is *arbitrary* and/or *unjustifiable* between countries where the same conditions prevail. It is in this context, and not in the stage of the existence of discrimination – which is an objective fact, that we shall determine whether the measures falling within the particular exceptions of Article XX(b) – in this case the initial Decree as applied – have been applied reasonably, with due regard to both the legal duties of the party claiming the exception and the legal rights of the other parties concerned.[121]

8.227 The Panel also notes that, in *United States – Gasoline*, the Appellate Body stated that the word "discrimination" in the introductory clause of Article XX covers both discrimination between products from different supplier countries and discrimination between domestic and imported products. Finally, in

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prohibition on the use of chrysotile.

[119] See the Reports of the Appellate Body in *United States – Gasoline*, op. cit., p. 25, and *United States – Shrimp*, op. cit., para. 115.

[120] The Panel considers that what is prohibited by the introductory clause to Article XX is a particular form of discrimination (that which is arbitrary or unjustifiable between countries where the same conditions prevail) and not all forms of discrimination. If the measure is not discriminatory in general in its application, then *a fortiori* it cannot constitute arbitrary or unjustifiable discrimination between countries where the same conditions prevail. See also the Report of the Panel in *United States – Imports of Certain Automotive Spring Assemblies*, adopted on 26 May 1983, BISD 30S/107 (hereinafter "*United States – Automotive Springs*"), para. 55.

[121] Report of the Appellate Body in *United States – Gasoline*, op. cit., p. 22.

the same case, the Appellate Body ruled that "the provisions of the chapeau [of Article XX] cannot logically refer to the same standard(s) by which a violation of a substantive rule has been determined to have occurred."[122] In other words, we cannot conclude that discrimination exists on the basis of the violation of Article III:4 identified above. This means that the less favourable treatment of asbestos as compared with substitute fibres identified by Canada is not relevant for establishing the existence of discrimination under Article XX. The question is therefore confined to the suppliers of asbestos, whether domestic or foreign. However, we understand that another form of discrimination, for example between supplier countries, not invoked by Canada as its principal argument, could be taken into consideration under the introductory clause of Article XX. It is on this dual basis that we shall examine whether the measure is being applied in a "discriminatory" manner.

8.228 The Panel notes that the European Communities consider the Decree to concern products originating in any country, including France, where the same conditions prevail. The text of the Decree as such appears to confirm this. Only the product in question is mentioned, without any reference to its origin. Even Articles 2 and 3, which concern the establishment and administration of exceptions, do not contain any expressly discriminatory provision. It should be borne in mind, however, that the introductory clause of Article XX concerns the application of the measure. It would therefore be possible for Canadian exports of chrysotile or products containing it to receive less favourable treatment than imports from other countries or French production with respect to the way in which the exceptions are administered by the French authorities. For example, the minister responsible might use the powers of notice under Article 3:III of the Decree to discriminate against an operator qualifying for an exception who imports chrysotile fibres from Canada. However, we note that Canada has not argued that this was or had been the case. Canada merely recalls that it has demonstrated the existence of discrimination under Article III:4. For the reasons set out above, we consider that this demonstration is not relevant in terms of the introductory clause of Article XX.

8.229 We therefore conclude that, although this is a heavier task than that involved in showing that an exception falling within one of the paragraphs of Article XX encompasses the measure at issue, the EC have made a prima facie case for their argument that the Decree does not constitute, in its application, arbitrary or unjustifiable discrimination. We do not consider that Canada has rebutted the presumption established by the prima facie case made by the EC, according to which the Decree does not introduce discrimination.

8.230 In accordance with our approach, since discrimination has not been established in relation to the application of the Decree, there is no need to consider the question of its arbitrariness or unjustifiability.

(ii) "Disguised restriction on international trade"

(…)
8.233 The Panel notes, first of all, that the actual scope of the words "disguised restriction on international trade" has not been clearly defined. Under the GATT 1947, panels seem mainly to have considered that a disguised restriction on international trade was a restriction that had not been taken in the form of a trade measure or had not been announced beforehand[123] or formed the subject of a publication, or even had not been the subject of an investigation.[124]

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[122] Ibid.

[123] The Report of the Panel in *United States – Prohibition of Imports of Tuna and Tuna Products from Canada,* adopted on 22 February 1982, BISD 29S/91 (hereinafter "*United States – Tuna (1982)"),* states, in para. 4.8:

> "[The Panel] furthermore felt that the United States action should not be considered to be a disguised restriction on international trade, noting that the United States prohibition of imports of tuna and tuna

8.234 In *United States – Gasoline*, the Appellate Body considered "that concealed or unannounced restriction … in international trade does not exhaust the meaning of 'disguised restriction'." This seems to imply that a measure that was not published would not satisfy the requirements of the second proposition of the introductory clause of Article XX. We note that the Decree was published in the Official Journal of the French Republic on 26 December 1996 and entered into force on 1 January 1997. We also note that it applies unequivocally to international trade, since as far as asbestos is concerned both importation and exportation are prohibited. In this sense, the criteria developed in *United States – Tuna (1982)* and in *United States – Automotive Springs* have already been satisfied.

8.235 However, the remark made by the Appellate Body in *United States – Gasoline* also implies that the expression "disguised restriction on international trade" covers other requirements. In the same case, the Appellate Body mentions that "'disguised restriction' includes disguised *discrimination* in international trade". This appears to signify that the word "restriction" should not be given a narrow meaning. In paragraph 8.229 above, we found that the Decree did not constitute discrimination within the meaning of the first condition of the introductory clause of Article XX. We consider that our conclusion can also be used for determining whether the Decree constitutes a disguised restriction. In this respect, we note that in the above-mentioned case the Appellate Body considered that:

> "'disguised restriction', whatever else it covers, may properly be read as embracing restrictions amounting to arbitrary or unjustifiable discrimination in international trade taken under the guise of a measure formally within the terms of an exception listed in Article XX. Put in a somewhat different manner, the kinds of considerations pertinent in deciding whether the application of a particular measure amounts to 'arbitrary or unjustifiable discrimination', may also be taken into account in determining the presence of a 'disguised restriction' on international trade. The fundamental theme is to be found in the purpose and object of avoiding abuse or illegitimate use of the exceptions to substantive rules available in Article XX."[125]

8.236 Referring also to the remark made by the Appellate Body in the same case according to which "the provisions of the chapeau [of Article XX] cannot logically refer to the same standard(s) by which a violation of the substantive rule has been determined to have occurred", we consider that the key to understanding what is covered by "disguised restriction on international trade" is not so much the word

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> products from Canada had been taken as a trade measure and publicly announced as such. The Panel therefore considered it appropriate to examine further the United States import prohibition of tuna and tuna produce from Canada in the light of the list of specific types of measures contained in Article XX and notably in Article XX(g)."

[124] The Report of the Panel in *United States – Automotive Springs*, op. cit., states in para. 56:

> "The Panel then considered whether or not the exclusion order was "applied in a manner which would constitute … a disguised restriction on international trade". The Panel noted that the preamble of Article XX made it clear that it was the application of the measure and not the measure itself that needed to be examined. Notice of the exclusion order was published in the Federal Register and the order was enforced by the United States customs at the border. The Panel also noted that the ITC proceedings in this particular case were directed against the importation of automotive spring assemblies produced in violation of a valid United States patent and that, before an exclusion order could be issued under Section 337, both the validity of the patent and its infringement by a foreign manufacturer had to be clearly established. Furthermore, the exclusion order would not prohibit the importation of automotive spring assemblies produced by any producer outside the United States who had a licence from Kuhlman Corporation to produce these goods. Consequently, the Panel found that the exclusion order had not been applied in a manner which constituted a disguised restriction on international trade."

[125] *United States – Gasoline*, op. cit., p. 25.

"restriction", inasmuch as, in essence, any measure falling within Article XX is a restriction on international trade, but the word "disguised". In accordance with the approach defined in Article 31 of the Vienna Convention, we note that, as ordinarily understood, the verb "to disguise" implies an *intention*. Thus, "to disguise" (*déguiser*) means, in particular, "conceal beneath deceptive appearances, counterfeit", "alter so as to deceive", "misrepresent", "dissimulate".[126] Accordingly, a restriction which formally meets the requirements of Article XX(b) will constitute an abuse if such compliance is in fact only a disguise to conceal the pursuit of trade-restrictive objectives. However, as the Appellate Body acknowledged in *Japan – Alcoholic Beverages*, the aim of a measure may not be easily ascertained.[127] Nevertheless, we note that, in the same case, the Appellate Body suggested that the protective application of a measure can most often be discerned from its design, architecture and revealing structure.[128]

8.237 It is on this basis that we shall analyse Canada's argument according to which the Decree favours the French domestic industry producing substitutes for chrysotile and chrysotile-containing products.[129] We have already found that the Decree was necessary to achieve a public health objective and did not, in its application, constitute arbitrary or unjustifiable discrimination. We recall that in *United States – Gasoline*, the Appellate Body considered that the kinds of considerations pertinent in deciding whether the application of a particular measure amounts to "arbitrary or unjustifiable discrimination" may also be taken into account in determining the presence of a "disguised restriction" on international trade. Since we have not identified discrimination, we consider it is unnecessary to determine whether we are faced with discrimination that might constitute a disguised restriction on international trade.

8.238 As far as the design, architecture and revealing structure of the Decree are concerned, we find nothing that might lead us to conclude that the Decree has protectionist objectives. Canada implicitly admits as much when it asserts that the Decree is a response of the French authorities to panicked public opinion and other health scares implicating officials and members of the government.[130] If this was the case, it seems difficult to reconcile the Decree being adopted in great haste with the idea that it was the result of a premeditated intention to protect French industry.

8.239 Admittedly, there is always the possibility that measures such as those contained in the Decree might have the effect of favouring the domestic substitute product manufacturers. This is a natural consequence of prohibiting a given product and in itself cannot justify the conclusion that the measure has a protectionist aim, as long as it remains within certain limits. In fact, the information made available to the Panel does not suggest that the import ban has benefited the French substitute fibre industry, to the detriment of third country producers, to such an extent as to lead to the conclusion that the Decree has been so applied as to constitute a disguised restriction on international trade.[131]

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[126] Petit Larousse Illustré (1986), p. 292; Le Nouveau Petit Robert (1994), p. 572.
[127] Op. cit., p. 31.
[128] Ibid. Although this approach was developed in relation to Article III:4 of the GATT 1994, we see no reason why it should not be applicable in other circumstances where it is necessary to determine whether a measure is being applied for protective purposes.
[129] In this respect, we consider the EC to have satisfied the burden of proof as regards the introductory clause of Article XX. We shall therefore treat Canada's argument as an attempt to rebut the presumption established in favour of the EC.
[130] See Canada's arguments, para. 3.27. Canada refers to a study entitled *L'amiante dans l'environnement, ses conséquences et son avenir*, Office parlementaire d'évaluation des choix scientifiques et technologiques, National Assembly No. 329/Senate No. 41, p. 57.
[131] See, in particular, the reply of the European Communities to the Panel's question No. 30, paras. 113-115, Annex II.

8.240 Consequently, we conclude that the Decree satisfies the conditions of the introductory clause of Article XX.

Conclusion

8.241 In the light of the above, the Panel concludes that the provisions of the Decree which violate Article III:4 of the GATT 1994 are justified under Article XX(b).

1-2. Appellate Body Report in *European Communities -- Measures Affecting Asbestos and Asbestos –Containing Products*, WT/DS135/AB/R, 12 March 2001

Feliciano, Presiding Member; Bacchus, Member; Ehlermann, Member

(…)

III. Preliminary Procedural Matter

50. On 27 October 2000, we wrote to the parties and the third parties indicating that we were mindful that, in the proceedings before the Panel in this case, the Panel received five written submissions from non-governmental organizations, two of which the Panel decided to take into account. [132] In our letter, we recognized the possibility that we might receive submissions in this appeal from persons other than the parties and the third parties to this dispute, and stated that we were of the view that the fair and orderly conduct of this appeal could be facilitated by the adoption of appropriate procedures, for the purposes of this appeal only, pursuant to Rule 16(1) of the *Working Procedures*, to deal with any possible submissions received from such persons (…)

51. On 7 November 2000, and after consultations among all seven Members of the Appellate Body, we adopted, pursuant to Rule 16(1) of the *Working Procedures*, an additional procedure, *for the purposes of this appeal only*, to deal with written submissions received from persons other than the parties and third parties to this dispute (the "Additional Procedure").

(…)

52. The Additional Procedure provided:

> 1. In the interests of fairness and orderly procedure in the conduct of this appeal, the Division hearing this appeal has decided to adopt, pursuant to Rule 16(1) of the *Working Procedures for Appellate Review*, and after consultations with the parties and third parties to this dispute, the following additional procedure for purposes of this appeal only.
>
> 2. Any person, whether natural or legal, other than a party or a third party to this dispute, wishing to file a written brief with the Appellate Body, must apply for leave to file such a brief from the Appellate Body *by noon* on *Thursday, 16 November 2000*.
>
> 3. An application for leave to file such a written brief shall:
>
> (a) be made in writing, be dated and signed by the applicant, and include the address and other contact details of the applicant;
>
> (b) be in no case longer than three typed pages;

[132] Panel Report, paras. 6.1-6.4 and 8.12-8.14.

(c) contain a description of the applicant, including a statement of the membership and legal status of the applicant, the general objectives pursued by the applicant, the nature of the activities of the applicant, and the sources of financing of the applicant;

(d) specify the nature of the interest the applicant has in this appeal;

(e) identify the specific issues of law covered in the Panel Report and legal interpretations developed by the Panel that are the subject of this appeal, as set forth in the Notice of Appeal (WT/DS135/8) dated 23 October 2000, which the applicant intends to address in its written brief;

(f) state why it would be desirable, in the interests of achieving a satisfactory settlement of the matter at issue, in accordance with the rights and obligations of WTO Members under the DSU and the other covered agreements, for the Appellate Body to grant the applicant leave to file a written brief in this appeal; and indicate, in particular, in what way the applicant will make a contribution to the resolution of this dispute that is not likely to be repetitive of what has been already submitted by a party or third party to this dispute; and

(g) contain a statement disclosing whether the applicant has any relationship, direct or indirect, with any party or any third party to this dispute, as well as whether it has, or will, receive any assistance, financial or otherwise, from a party or a third party to this dispute in the preparation of its application for leave or its written brief.

4. The Appellate Body will review and consider each application for leave to file a written brief and will, without delay, render a decision whether to grant or deny such leave.

5. The grant of leave to file a brief by the Appellate Body does not imply that the Appellate Body will address, in its Report, the legal arguments made in such a brief.

6. Any person, other than a party or a third party to this dispute, granted leave to file a written brief with the Appellate Body, must file its brief with the Appellate Body Secretariat *by noon* on *Monday, 27 November 2000*.

7. A written brief filed with the Appellate Body by an applicant granted leave to file such a brief shall:

(a) be dated and signed by the person filing the brief;

(b) be concise and in no case longer than 20 typed pages, including any appendices; and

(c) set out a precise statement, strictly limited to legal arguments, supporting the applicant's legal position on the issues of law or legal interpretations in the Panel Report with respect to which the applicant has been granted leave to file a written brief.

8. An applicant granted leave shall, in addition to filing its written brief with the Appellate Body Secretariat, also serve a copy of its brief on all the parties and third parties to the dispute *by noon* on *Monday, 27 November 2000*.

9. The parties and the third parties to this dispute will be given a full and adequate opportunity by the Appellate Body to comment on and respond to any written brief filed with the Appellate Body by an applicant granted leave under this procedure. (original emphasis)

(…)

56. The Appellate Body received 11 applications for leave to file a written brief in this appeal within the time limits specified in paragraph 2 of the Additional Procedure.[133] We carefully reviewed and considered each of these applications in accordance with the Additional Procedure and, in each case, decided to deny leave to file a written brief. Each applicant was sent a copy of our decision denying its application for leave for failure to comply sufficiently with all the requirements set forth in paragraph 3 of the Additional Procedure.

(…)

IV. Issues Raised in this Appeal

58. This appeal raises the following issues:

(…)

(b) whether the Panel erred in its interpretation and application of the term "like products" in Article III:4 of the GATT 1994 in finding, in paragraph 8.144 of the Panel Report, that

[133]Applications from the following persons were received by the Division within the deadline specified in the Additional Procedure for receipt of such applications: Professor Robert Lloyd Howse (United States); Occupational & Environmental Diseases Association (United Kingdom); American Public Health Association (United States); Centro de Estudios Comunitarios de la Universidad Nacional de Rosario (Argentina); Only Nature Endures (India); Korea Asbestos Association (Korea); International Council on Metals and the Environment and American Chemistry Council (United States); European Chemical Industry Council (Belgium); Australian Centre for Environmental Law at the Australian National University (Australia); Associate Professor Jan McDonald and Mr. Don Anton (Australia); and a joint application from Foundation for Environmental Law and Development (United Kingdom), Center for International Environmental Law (Switzerland), International Ban Asbestos Secretariat (United Kingdom), Ban Asbestos International and Virtual Network (France), Greenpeace International (The Netherlands), World Wide Fund for Nature, International (Switzerland), and Lutheran World Federation (Switzerland).

chrysotile asbestos fibres are "like" PVA, cellulose and glass fibres, and in finding, in paragraph 8.150 of the Panel Report, that cement-based products containing chrysotile asbestos fibres are "like" cement-based products containing polyvinyl alcohol, cellulose and glass fibres;

(c) whether the Panel erred in finding that the measure at issue is "necessary to protect human … life or health" under Article XX(b) of the GATT 1994, and whether, in carrying out its examination under Article XX(b) of the GATT 1994, the Panel failed to make an objective assessment of the matter under Article 11 of the DSU; and

(…)

VI. "Like Products" in Article III:4 of the GATT 1994

A. Background

(…)

86. On appeal, the European Communities requests that we reverse the Panel's findings that the two sets of products examined by the Panel are "like products" under Article III:4 of the GATT 1994, and requests, in consequence, that we reverse the Panel's finding that the measure is inconsistent with Article III:4 of the GATT 1994. The European Communities contends that the Panel erred in its interpretation and application of the concept of "like products", in particular, in excluding from its analysis consideration of the health risks associated with chrysotile asbestos fibres. According to the European Communities, in this case, Article III:4 calls for an analysis of the health objective of the regulatory distinction made in the measure between asbestos fibres, and between products containing asbestos fibres, and all other products. The European Communities argues that, under Article III:4, products should not be regarded as "like" unless the regulatory distinction drawn between them "entails [a] shift in the competitive opportunities" in favour of domestic products. [134]

B. Meaning of the Term "Like Products" in Article III:4 of the GATT 1994

(…)

88. The European Communities' appeal on this point turns on the interpretation of the word "like" in the term "like products" in Article III:4 of the GATT 1994. Thus, this appeal provides us with our first occasion to examine the meaning of the word "like" in *Article III:4* of the GATT 1994. [135] Yet, this appeal is, of course, not the first time that the term "like products" has been addressed in GATT or WTO dispute settlement proceedings. [136] Indeed, the term "like product" appears in many different provisions

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[134]European Communities' other appellant's submission, para. 45.

[135]We have already had occasion to interpret other aspects of Article III:4 of the GATT 1994 in two other appeals, but in neither appeal were we asked to address the meaning of the term "like products" (see Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, adopted 25 September 1997, and Appellate Body Report, *Korea – Beef, supra*, footnote 49).

[136]See, for instance, Working Party Report, *Brazilian Internal Taxes*, adopted 30 June 1949, BISD II/181, (Article III:2 of the GATT 1947); Working Party Report, *The Australian Subsidy on Ammonium Sulphate* ("*Australia – Ammonium Sulphate*"), adopted 3 April 1950, BISD II/188 (Articles I and III:4 of the GATT 1947); Panel Report, *Treatment by Germany of Imports of Sardines* ("*Germany – Sardines*"), adopted 31 October 1952, BISD 1S/53 (Articles I and XIII of the GATT 1947); Working Party Report, *Border Tax Adjustments*, *supra*, footnote 54 (Articles II, III and XVI of the GATT 1947); Panel Report, *EEC – Measures on Animal Feed Proteins* ("*EEC – Animal Feed*"), adopted 14 March 1978, BISD 25S/49 (Articles I, III:2 and III:4 of the GATT 1947); Panel Report, *Spain – Tariff Treatment of Unroasted Coffee*, adopted 11 June 1981, BISD 28S/102 (Article I:1 of the GATT 1947); Panel Report, *Spain – Measures Concerning Domestic Sale of Soyabean Oil* ("*Spain – Soyabean*"), L/5142, 17 June 1981, unadopted (Article

of the covered agreements, for example, in Articles I:1, II:2, III:2, III:4, VI:1, IX:1, XI:2(c), XIII:1, XVI:4 and XIX:1 of the GATT 1994. [137] The term is also a key concept in the *Agreement on Subsidies and Countervailing Measures*, the *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994* (the "*Anti-Dumping Agreement*"), the *Agreement on Safeguards* and other covered agreements. In some cases, such as in Article 2.6 of the *Anti-Dumping Agreement*, the term is given a specific meaning to be used "[t]hroughout [the] Agreement", while in others, it is not. In each of the provisions where the term "like products" is used, the term must be interpreted in light of the context, and of the object and purpose, of the provision at issue, and of the object and purpose of the covered agreement in which the provision appears. Accordingly, and as we observed in an earlier case concerning Article III:2 of the GATT 1994:

> … 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*. … [138] (emphasis added)

III:4 of the GATT 1947); Panel Report, *Canada – Measures Affecting the Sale of Gold Coins*, L/5863, 17 September 1985, unadopted (Article III:2 of the GATT 1947); Panel Report, *United States – Taxes on Petroleum and Certain Imported Substances*, adopted 17 June 1987, BISD 34S/136 (Article III:2 of the GATT 1947); Panel Report, *Japan – Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages* ("*1987 Japan – Alcoholic Beverages*"), adopted 10 November 1987, BISD 34S/83 (Article III:2 of the GATT 1947); Panel Report, *Canada/Japan – Tariff on Imports of Spruce, Pine, Fir (SPF) Dimension Lumber*, adopted 19 July 1989, BISD 36S/167 (Article I:1 of the GATT 1947); Panel Report, *United States – Definition of Industry Concerning Wine and Grape Products*, adopted 28 April 1992, BISD 39S/436 (Article VI of the GATT 1947); Panel Report, *United States – Denial of Most-favoured-nation Treatment as to Non-rubber Footwear from Brazil*, adopted 19 June 1992, BISD 39S/128 (Article I:1 of the GATT 1947); Panel Report, *United States – Measures Affecting Alcoholic and Malt Beverages*, adopted 19 June 1992, BISD 39S/206 (Article III:2 and III:4 of the GATT 1947); Panel Report, *United States – Taxes on Automobiles*, DS31/R, 11 October 1994, unadopted (Article III:2 and III:4 of the GATT 1947); Panel Report, *United States – Gasoline*, *supra*, footnote 15 (Article III:4 of the GATT 1994); Panel Report, *Japan – Taxes on Alcoholic Beverages* ("*Japan – Alcoholic Beverages*"), WT/DS8/R, WT/DS10/R, WT/DS11/R, adopted 1 November 1996, as modified by the Appellate Body Report, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, DSR 1996:I, 125 (Article III:2 of the GATT 1994); Appellate Body Report, *Japan – Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, DSR 1996:I, 97 (Article III:2 of the GATT 1994); Panel Report, *Canada – Periodicals*, WT/DS31/R, adopted 30 July 1997, as modified by the Appellate Body Report, WT/DS31/AB/R, DSR 1997:I, 481 (Articles III:2 and III:4 of the GATT 1994); Appellate Body Report, *Canada – Periodicals*; *supra*, footnote 48 (Article III:2 of the GATT 1994); Panel Report, *Indonesia – Certain Measures Affecting the Automobile Industry*, WT/DS54/R, WT/DS55/R, WT/DS59/R, WTDS64/R, adopted 23 July 1998 (Articles I:1 and III:2 of the GATT 1994); Panel Report, *Korea – Taxes on Alcoholic Beverages* ("*Korea – Alcoholic Beverages*"), WT/DS75/R, WT/DS84/R, adopted 17 February 1999, as modified by the Appellate Body Report, WT/DS75/AB/R, WT/DS84/AB/R (Article III:2 of the GATT 1994); Appellate Body Report, *Korea – Alcoholic Beverages*, WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 February 1999 (Article III:2 of the GATT 1994); Panel Report, *Chile – Taxes on Alcoholic Beverages*, WT/DS87/R, WT/DS110/R, adopted 12 January 2000, as modified by the Appellate Body Report, WT/DS87/AB/R, WT/DS110/AB/R (Article III:2 of the GATT 1994).

[137]In addition, the term "like commodity" appears in Article VI:7 and the term "like merchandise" is used in Article VII:2 of the GATT 1994.

[138]Appellate Body Report, *Japan – Alcoholic Beverages*, *supra*, footnote 58, at 114. We also cautioned against the

89. It follows that, while the meaning attributed to the term "like products" in other provisions of the GATT 1994, or in other covered agreements, may be relevant context in interpreting Article III:4 of the GATT 1994, the interpretation of "like products" in Article III:4 need not be identical, in all respects, to those other meanings.

90. Bearing these considerations in mind, we turn now to the ordinary meaning of the word "like" in the term "like products" in Article III:4. According to one dictionary, "like" means:

> Having the same characteristics or qualities as some other … thing; of approximately identical shape, size, etc., with something else; similar. [139]

91. This meaning suggests that "like" products are products that share a number of identical or similar characteristics or qualities. The reference to "similar" as a synonym of "like" also echoes the language of the French version of Article III:4, "*produits similaires*", and the Spanish version, "*productos similares*", which, together with the English version, are equally authentic. [140]

92. However, as we have previously observed, "dictionary meanings leave many interpretive questions open." [141] In particular, this definition does not resolve three issues of interpretation. First, this dictionary definition of "like" does not indicate *which characteristics or qualities are important* in assessing the "likeness" of products under Article III:4. For instance, most products will 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, this dictionary definition provides no guidance in determining the *degree or extent to which products must share qualities or characteristics* in order to be "like products" under Article III:4. Products may share only very few characteristics or qualities, or they may share many. Thus, in the abstract, the term "like" can encompass a spectrum of differing degrees of "likeness" or "similarity". Third, this dictionary definition of "like" does not indicate *from whose perspective* "likeness" should be judged. For instance, ultimate consumers may have a view about the "likeness" of two products that is very different from that of the inventors or producers of those products.

93. To begin to resolve these issues, we turn to the relevant context of Article III:4 of the GATT 1994. In that respect, we observe that Article III:2 of the GATT 1994, which deals with the internal tax treatment of imported and domestic products, prevents Members, through its first sentence, from imposing internal taxes on imported products "in excess of those applied … to *like* domestic products." (emphasis added) In previous Reports, we have held that the scope of "like" products in this sentence is to be construed "narrowly". [142] This reading of "like" in Article III:2 might be taken to suggest a similarly narrow reading of "like" in Article III:4, since both provisions form part of the same Article. However, both of these paragraphs of Article III constitute specific expressions of the overarching, "general principle", set forth

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automatic transposition of the interpretation of "likeness" under the first sentence of Article III:2 to other provisions where the phrase "like products" is used (p. 113).

[139]*The New Shorter Oxford English Dictionary*, Lesley Brown (ed.) (Clarendon Press, 1993), Vol. I, p. 1588.

[140]*WTO Agreement*, final, authenticating clause. See, also, Article 33(1) of the *Vienna Convention of the Law of the Treaties*, done at Vienna, 23 May 1969, 1155 U.N.T.S. 331; 8 International Legal Materials 679.

[141]Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999, para. 153.

[142]Appellate Body Report, *Japan – Alcoholic Beverages*, *supra*, footnote 58, at 112 and 113. See, also, Appellate Body Report, *Canada – Periodicals*, *supra*, footnote 48, at 473.

in Article III:1 of the GATT 1994.[143] As we have previously said, the "general principle" set forth in Article III:1 "informs" the rest of Article III and acts "as a guide to understanding and interpreting the specific obligations contained" in the other paragraphs of Article III, including paragraph 4.[144] Thus, in our view, Article III:1 has particular contextual significance in interpreting Article III:4, as it sets forth the "general principle" pursued by that provision. Accordingly, in interpreting the term "like products" in Article III:4, we must turn, first, to the "general principle" in Article III:1, rather than to the term "like products" in Article III:2.

94. In addition, we observe that, although the obligations in Articles III:2 and III:4 both apply to "like products", the text of Article III:2 differs in one important respect from the text of Article III:4. Article III:2 contains *two separate* sentences, each imposing *distinct* obligations: the first lays down obligations in respect of "like products", while the second lays down obligations in respect of "directly competitive or substitutable" products.[145] By contrast, Article III:4 applies only to "like products" and does not include a provision equivalent to the second sentence of Article III:2. We note that, in this dispute, the Panel did not examine, at all, the significance of this textual difference between paragraphs 2 and 4 of Article III.

95. For us, this textual difference between paragraphs 2 and 4 of Article III has considerable implications for the meaning of the term "like products" in these two provisions. In *Japan – Alcoholic Beverages*, we concluded, in construing Article III:2, that the two separate obligations in the two sentences of Article III:2 must be interpreted in a harmonious manner that gives meaning to *both* sentences in that provision. We observed there that the interpretation of one of the sentences necessarily affects the interpretation of the other. Thus, the scope of the term "like products" in the first sentence of Article III:2 affects, and is affected by, the scope of the phrase "directly competitive or substitutable" products in the second sentence of that provision. We said in *Japan – Alcoholic Beverages*:

> 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, we agree with the Panel that the first sentence of Article III:2 must be construed narrowly so as not to condemn measures that its strict terms are not meant to condemn. Consequently, we agree with the Panel also that the definition of "like products" in Article III:2, first sentence, should be construed narrowly.[146]

96. In construing Article III:4, the same interpretive considerations do not arise, because the "general principle" articulated in Article III:1 is expressed in Article III:4, not through two distinct obligations, as in the two sentences in Article III:2, but instead through a single obligation that applies solely to "like products". Therefore, the harmony that we have attributed to the two sentences of Article III:2 need not and, indeed, cannot be replicated in interpreting Article III:4. Thus, we conclude that, given the textual

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[143]Appellate Body Report, *Japan – Alcoholic Beverages*, *supra*, footnote 58, at 111.

[144]*Ibid.*

[145]The meaning of the second sentence of Article III:2 is elaborated upon in the Interpretative Note to that provision. This note indicates that the second sentence of Article III:2 applies to "directly competitive or substitutable product[s]".

[146]*Supra*, footnote 58, at 112 and 113.

difference between Articles III:2 and III:4, the "accordion" of "likeness" stretches in a different way in Article III:4.

97. We have previously described the "general principle" articulated in Article III:1 as follows:

> The broad and fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures. More specifically, the purpose of Article III "is to ensure that internal measures 'not be applied to imported and domestic products so as to afford protection to domestic production'". Toward this end, Article III obliges Members of the WTO to provide *equality of competitive conditions for imported products in relation to domestic products*. … Article III protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products. … [147] (emphasis added)

98. As we have said, although this "general principle" is not explicitly invoked in Article III:4, nevertheless, it "informs" that provision. [148] Therefore, the term "like product" in Article III:4 must be interpreted to give proper scope and meaning to this principle. In short, there must be consonance between the objective pursued by Article III, as enunciated in the "general principle" articulated in Article III:1, and the interpretation of the specific expression of this principle in the text of Article III:4. This interpretation must, therefore, reflect that, in endeavouring to ensure "equality of competitive conditions", the "general principle" in Article III seeks to prevent Members from applying internal taxes and regulations in a manner which affects the competitive relationship, in the marketplace, *between the domestic and imported products involved*, "so as to afford protection to domestic production."

99. As products that are in a competitive relationship in the marketplace could be affected through treatment of *imports* "less favourable" than the treatment accorded to *domestic* products, it follows that the word "like" in Article III:4 is to be interpreted to apply to products that are in such a competitive relationship. Thus, 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. In saying this, we are mindful that there is a spectrum of degrees of "competitiveness" or "substitutability" of products in the marketplace, and that it is difficult, if not impossible, in the abstract, to indicate precisely where on this spectrum the word "like" in Article III:4 of the GATT 1994 falls. We are not saying that *all* products which are in *some* competitive relationship are "like products" under Article III:4. In ruling on the measure at issue, we also do not attempt to define the precise scope of the word "like" in Article III:4. Nor do we wish to decide if the scope of "like products" in Article III:4 is co-extensive with the combined scope of "like" and "directly competitive or substitutable" products in Article III:2. However, we recognize that the relationship between these two provisions is important, because there is no sharp distinction between fiscal regulation, covered by Article III:2, and non-fiscal regulation, covered by Article III:4. Both forms of regulation can often be used to achieve the same ends. It would be incongruous if, due to a significant difference in the product scope of these two provisions, Members 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 ends. This would frustrate a consistent application of the "general principle" in Article III:1. For these reasons, we conclude that the scope of "like" in Article III:4 is broader than the scope of "like" in

[147] Appellate Body Report, *Japan – Alcoholic Beverages*, *supra*, footnote 58, at 109 and 110.

[148] *Ibid.*, at 111.

Article III:2, first sentence. Nonetheless, we note, once more, that Article III:2 extends not only to "like products", but also to products which are "directly competitive or substitutable", and that Article III:4 extends only to "like products". In view of this different language, and although we need not rule, and do not rule, on the precise product scope of Article III:4, we do conclude 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 of the GATT 1994.

100. We recognize that, by interpreting the term "like products" in Article III:4 in this way, we give that provision a relatively broad product scope – although no broader than the product scope of Article III:2. In so doing, we observe that there is a second element that must be established before a measure can be held to be inconsistent with Article III:4. Thus, even if two products are "like", that does not mean that a measure is inconsistent with Article III:4. A complaining Member 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. The term "less favourable treatment" expresses the general principle, in Article III:1, that internal regulations "should not be applied … so as to afford protection to domestic production". If there is "less favourable treatment" of the group of "like" imported products, there is, conversely, "protection" of the group of "like" domestic products. However, a Member may draw distinctions 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. In this case, we do not examine further the interpretation of the term "treatment no less favourable" in Article III:4, as the Panel's findings on this issue have not been appealed or, indeed, argued before us.

C. Examining the "Likeness" of Products under Article III:4 of the GATT 1994

101. We turn to consideration of how a treaty interpreter should proceed in determining whether products are "like" under Article III:4. As in Article III:2, in this determination, "[n]o one approach … will be appropriate for all cases." [149] Rather, an assessment utilizing "an unavoidable element of individual, discretionary judgement" [150] has to be made on a case-by-case basis. The Report of the Working Party on *Border Tax Adjustments* outlined an approach for analyzing "likeness" that has been followed and developed since by several panels and the Appellate Body. [151] This approach has, in the main, consisted of employing four general criteria in analyzing "likeness": (i) the properties, nature and quality of the products; (ii) the end-uses of the products; (iii) consumers' tastes and habits – more comprehensively termed consumers' perceptions and behaviour – in respect of the products; and (iv) the tariff classification of the products. [152] We note that these four criteria comprise four categories of "characteristics" that the products involved might share: (i) the physical properties of the products; (ii) the extent to which the products are capable of serving the same or similar end-uses; (iii) the extent to which consumers perceive and treat the products as alternative means of performing particular functions

[149]Appellate Body Report, *Japan – Alcoholic Beverages*, *supra*, footnote 58, at 114.

[150]Appellate Body Report, *Japan – Alcoholic Beverages*, *supra*, footnote 58, at 113.

[151]See, further, Appellate Body Report, *Japan – Alcoholic Beverages*, *supra*, footnote 58, at 113 and, in particular, footnote 46. See, also, Panel Report, *United States – Gasoline*, *supra*, footnote 15, para. 6.8, where the approach set forth in the *Border Tax Adjustment* case was adopted in a dispute concerning Article III:4 of the GATT 1994 by a panel. This point was not appealed in that case.

[152]The fourth criterion, tariff classification, was not mentioned by the Working Party on *Border Tax Adjustments*, but was included by subsequent panels (see, for instance, *EEC – Animal Feed*, *supra*, footnote 58, para. 4.2, and *1987 Japan – Alcoholic Beverages*, *supra*, footnote 58, para. 5.6).

in order to satisfy a particular want or demand; and (iv) the international classification of the products for tariff purposes.

(…)

2. Chrysotile and PCG fibres

109. In our analysis of this issue on appeal, we begin with the Panel's findings on the "likeness" of *chrysotile asbestos and PCG fibres* and, in particular, with the Panel's overall approach to examining the "likeness" of these fibres. It is our view that, having adopted an approach based on the four criteria set forth in *Border Tax Adjustments*, the Panel should have examined the evidence relating to *each* of those four criteria and, then, weighed *all* of that evidence, along with any other relevant evidence, in making an *overall* determination of whether the products at issue could be characterized as "like". Yet, the Panel expressed a "conclusion" that the products were "like" after examining only the *first* of the four criteria. The Panel then repeated that conclusion under the second criterion – without further analysis – before dismissing altogether the relevance of the third criterion and also before rejecting the differing tariff classifications under the fourth criterion. In our view, it was inappropriate for the Panel to express a "conclusion" after examining only one of the four criteria. [153] By reaching a "conclusion" without examining all of the criteria it had decided to examine, the Panel, in reality, expressed a conclusion after examining only some of the evidence. Yet, a determination on the "likeness" of products cannot be made on the basis of a partial analysis of the evidence, after examination of just one of the criteria the Panel said it would examine. For this reason, we doubt whether the Panel's overall approach has allowed the Panel to make a proper characterization of the "likeness" of the fibres at issue.

110. We must next examine more closely the Panel's treatment of the four individual criteria. We see the first criterion, "properties, nature and quality", as intended to cover the physical qualities and characteristics of the products. In analyzing the "properties" of the products, the Panel said that, "because of its physical and chemical characteristics, *asbestos is a unique product*." [154] (emphasis added) The Panel expressly acknowledged that, based on physical properties alone, "[i]t could … be concluded that [the fibres] are *not* like products." [155] (emphasis added) However, to overcome that fact, the Panel adopted a "market access" approach to this first criterion. [156] Thus, in the course of its examination of "*properties*", the Panel went on to rely on "*end-uses*" – the second criterion – and on the fact that, in a "small number" of cases, the products have the "same applications" and can "replace" each other. [157] The Panel then stated:

> We therefore conclude that, taking into account the properties criterion, chrysotile fibres are like PVA, cellulose and glass fibres. [158]

111. We believe that physical properties deserve a separate examination that should not be confused with the examination of end-uses. Although not decisive, the extent to which products share common physical properties may be a useful indicator of "likeness". Furthermore, the physical properties of a product may

[153] *Ibid.*, para. 8.126.

[154] Panel Report, para. 8.123.

[155] *Ibid.*, para. 8.121.

[156] *Ibid.*, paras. 8.122 and 8.124.

[157] *Ibid.*, paras. 8.123 and 8.125.

[158] *Ibid.*, para. 8.126.

also influence how the product can be used, consumer attitudes about the product, and tariff classification. It is, therefore, important for a panel to examine fully the physical character of a product. We are also concerned that it will be difficult for a panel to draw the appropriate conclusions from the evidence examined under each criterion if a panel's approach does not clearly address each criterion separately, but rather entwines different, and distinct, elements of the analysis along the way.

112. In addition, we do not share the Panel's conviction that when two products can be used for the same end-use, their "*properties* are then *equivalent*, if not identical." [159] (emphasis added) Products with quite different physical properties may, in some situations, be capable of performing similar or identical end-uses. Although the *end-uses* are then "*equivalent*", the physical properties of the products are not thereby altered; they remain different. Thus, the physical "uniqueness" of asbestos that the Panel noted does not change depending on the particular use that is made of asbestos.

113. The European Communities argues that the inquiry into the physical properties of products must include a consideration of the risks posed by the product to human health. In examining the physical properties of the product at issue in this dispute, the Panel found that "it was not appropriate to apply the 'risk' criterion proposed by the EC". [160] The Panel said that to do so "would largely nullify the effect of Article XX(b)" of the GATT 1994. [161] In reviewing this finding by the Panel, we note that neither the text of Article III:4 nor the practice of panels and the Appellate Body suggest that any evidence should be excluded *a priori* from a panel's examination of "likeness". Moreover, as we have said, in examining the "likeness" of products, panels must evaluate *all* of the relevant evidence. We are very much of the view that evidence relating to the health risks associated with a product may be pertinent in an examination of "likeness" under Article III:4 of the GATT 1994. We do not, however, consider that the evidence relating to the health risks associated with chrysotile asbestos fibres need be examined under a *separate* criterion, because we believe that this evidence can be evaluated under the existing criteria of physical properties, and of consumers' tastes and habits, to which we will come below.

114. Panels must examine fully the physical properties of products. In particular, panels must examine those physical properties of products that are likely to influence the competitive relationship between products in the marketplace. In the case of chrysotile asbestos fibres, their molecular structure, chemical composition, and fibrillation capacity are important because the microscopic particles and filaments of chrysotile asbestos fibres are carcinogenic in humans, following inhalation. (…) This carcinogenicity, or toxicity, constitutes, as we see it, a defining aspect of the physical properties of chrysotile asbestos fibres. The evidence indicates that PCG fibres, in contrast, do not share these properties, at least to the same extent. [162] We do not see how this highly significant physical difference *cannot* be a consideration in examining the physical properties of a product as part of a determination of "likeness" under Article III:4 of the GATT 1994.

115. We do not agree with the Panel that considering evidence relating to the health risks associated with a product, under Article III:4, nullifies the effect of Article XX(b) of the GATT 1994. Article XX(b) allows a Member to "adopt and enforce" a measure, *inter alia*, necessary to protect human life or health, even though that measure is inconsistent with another provision of the GATT 1994. Article III:4 and Article XX(b) are distinct and independent provisions of the GATT 1994 each to be interpreted on its

[159] *Ibid.*, para. 8.125.

[160] Panel Report, para. 8.132.

[161] *Ibid.*, para. 8.130.

[162] Panel Report, para. 8.220.

own. The scope and meaning of Article III:4 should not be broadened or restricted beyond what is required by the normal customary international law rules of treaty interpretation, simply because Article XX(b) exists and may be available to justify measures inconsistent with Article III:4. The fact that an interpretation of Article III:4, under those rules, implies a less frequent recourse to Article XX(b) does not deprive the exception in Article XX(b) of *effet utile*. Article XX(b) would only be deprived of *effet utile* if that provision could *not* serve to allow a Member to "adopt and enforce" measures "necessary to protect human … life or health". Evaluating evidence relating to the health risks arising from the physical properties of a product does not prevent a measure which is inconsistent with Article III:4 from being justified under Article XX(b). We note, in this regard, that, different inquiries occur under these two very different Articles. Under Article III:4, evidence relating to health risks may be relevant in assessing the *competitive relationship in the marketplace* between allegedly "like" products. The same, or similar, evidence serves a different purpose under Article XX(b), namely, that of assessing whether a *Member* has a sufficient basis for "adopting or enforcing" a WTO-inconsistent measure on the grounds of human health.

116. We, therefore, find that the Panel erred, in paragraph 8.132 of the Panel Report, in excluding the health risks associated with chrysotile asbestos fibres from its examination of the physical properties of that product.

117. Before examining the Panel's findings under the second and third criteria, we note that these two criteria involve certain of the key elements relating to the competitive relationship between products: first, the extent to which products are capable of performing the same, or similar, functions (end-uses), and, second, the extent to which consumers are willing to use the products to perform these functions (consumers' tastes and habits). Evidence of this type is of particular importance under Article III of the GATT 1994, precisely because that provision is concerned with competitive relationships in the marketplace. If there is – or could be – *no* competitive relationship between products, a Member cannot intervene, through internal taxation or regulation, to protect domestic production. Thus, evidence about the extent to which products can serve the same end-uses, and the extent to which consumers are – or would be – willing to choose one product instead of another to perform those end-uses, is highly relevant evidence in assessing the "likeness" of those products under Article III:4 of the GATT 1994.

118. We consider this to be especially so in cases where the evidence relating to properties establishes that the products at issue are physically quite different. In such cases, in order to overcome this indication that products are *not* "like", a higher burden is placed on complaining Members to establish that, despite the pronounced physical differences, there is a competitive relationship between the products such that *all* of the evidence, taken together, demonstrates that the products are "like" under Article III:4 of the GATT 1994. In this case, where it is clear that the fibres have very different properties, in particular, because chrysotile is a known carcinogen, a very heavy burden is placed on Canada to show, under the second and third criteria, that the chrysotile asbestos and PCG fibres are in such a competitive relationship.

119. With this in mind, we turn to the Panel's evaluation of the second criterion, end-uses. The Panel's evaluation of this criterion is far from comprehensive. First, as we have said, the Panel entwined its analysis of "end-uses" with its analysis of "physical properties" and, in purporting to examine "end-uses" as a distinct criterion, essentially referred to its analysis of "properties".[163] This makes it difficult to assess precisely how the Panel evaluated the end-uses criterion. Second, the Panel's analysis of end-uses is based on a "small number of applications" for which the products are substitutable. Indeed, the Panel

[163]Panel Report, para. 8.136.

stated that "[i]t suffices that, for a *given utilization*, the properties are the same to the extent that one product can replace the other." [164] (emphasis added) Although we agree that it is certainly relevant that products have similar end-uses for a "small number of … applications", or even for a "given utilization", we think that a panel must also examine the other, *different* end-uses for products. [165] It is only by forming a complete picture of the various end-uses of a product that a panel can assess the significance of the fact that products share a limited number of end-uses. In this case, the Panel did not provide such a complete picture of the various end-uses of the different fibres. The Panel did not explain, or elaborate in any way on, the "small number of … applications" for which the various fibres have similar end-uses. Nor did the Panel examine the end-uses for these products which were not similar. In these circumstances, we believe that the Panel did not adequately examine the evidence relating to end-uses.

(…)

122. In this case especially, we are also persuaded that evidence relating to consumers' tastes and habits would establish that the health risks associated with chrysotile asbestos fibres influence consumers' behaviour with respect to the different fibres at issue. [166] We observe that, as regards *chrysotile asbestos and PCG fibres*, the consumer of the fibres is a *manufacturer* who incorporates the fibres into another product, such as cement-based products or brake linings. We do not wish to speculate on what the evidence regarding these consumers would have indicated; rather, we wish to highlight that consumers' tastes and habits regarding *fibres*, even in the case of commercial parties, such as manufacturers, are very likely to be shaped by the health risks associated with a product which is known to be highly carcinogenic. [167] A manufacturer cannot, for instance, ignore the preferences of the ultimate consumer of its products. If the risks posed by a particular product are sufficiently great, the ultimate consumer may simply cease to buy that product. This would, undoubtedly, affect a manufacturer's decisions in the marketplace. Moreover, in the case of products posing risks to human health, we think it likely that manufacturers' decisions will be influenced by other factors, such as the potential civil liability that might flow from marketing products posing a health risk to the ultimate consumer, or the additional costs associated with safety procedures required to use such products in the manufacturing process.

123. Finally, we note that, although we consider consumers' tastes and habits significant in determining "likeness" in this dispute, at the oral hearing, Canada indicated that it considers this criterion to be *irrelevant*, in this dispute, because the existence of the measure has disturbed normal conditions of competition between the products. In our Report in *Korea – Alcoholic Beverages*, we observed that, "[p]articularly in a market where there are regulatory barriers to trade or to competition, there may well be latent demand" for a product. [168] We noted that, in such situations, "it may be highly relevant to examine latent demand" that is suppressed by regulatory barriers. [169] In addition, we said that "evidence from other markets may be pertinent to the examination of the market at issue, particularly when demand

[164] *Ibid.*, para. 8.124.

[165] *Ibid.*, paras. 8.124 and 8.125.

[166] We have already noted the health risks associated with chrysotile asbestos fibres in our consideration of properties (*supra*, para. 114).

[167] We recognize that consumers' reactions to products posing a risk to human health vary considerably depending on the product, and on the consumer. Some dangerous products, such as tobacco, are widely used, despite the known health risks. The influence known dangers have on consumers' tastes and habits is, therefore, unlikely to be uniform or entirely predictable.

[168] *Supra*, footnote 58, para. 115.

[169] *Ibid.*, para. 120. We added that "studies of cross-price elasticity … involve an assessment of latent demand" (para. 121).

on that market has been influenced by regulatory barriers to trade or to competition." [170] We, therefore, do not accept Canada's contention that, in markets where normal conditions of competition have been disturbed by regulatory or fiscal barriers, consumers' tastes and habits cease to be relevant. In such situations, a Member may submit evidence of latent, or suppressed, consumer demand in that market, or it may submit evidence of substitutability from some relevant third market. In making this point, we do not wish to be taken to suggest that there *is* latent demand for chrysotile asbestos fibres. Our point is simply that the existence of the measure does not render consumers' tastes and habits irrelevant, as Canada contends.

(…)

125. In sum, in our view, the Panel reached the conclusion that *chrysotile asbestos and PCG fibres* are "like products" under Article III:4 of the GATT 1994 on the following basis: the Panel disregarded the quite different "properties, nature and quality" of chrysotile asbestos and PCG fibres, as well as the different tariff classification of these fibres; it considered no evidence on consumers' tastes and habits; and it found that, for a "small number" of the many applications of these fibres, they are substitutable, but it did not consider the many other end-uses for the fibres that are different. Thus, the only evidence supporting the Panel's finding of "likeness" is the "small number" of shared end-uses of the fibres.

126. For the reasons we have given, we find this insufficient to justify the conclusion that the chrysotile asbestos and PCG fibres are "like products" and we, therefore, reverse the Panel's conclusion, in paragraph 8.144 of the Panel Report, "that chrysotile fibres, on the one hand, and PVA, cellulose and glass fibres, on the other, are 'like products' within the meaning of Article III:4 of the GATT 1994."

(…)

E. Completing the "Like Product" Analysis under Article III:4 of the GATT 1994

133. As we have reversed both of the Panel's conclusions on "likeness" under Article III:4 of the GATT 1994, we think it appropriate to complete the analysis, on the basis of the factual findings of the Panel and of the undisputed facts in the Panel record. We have already examined the meaning of the term "like products", and we have also approved the approach for inquiring into "likeness" that is based on the Report of the Working Party in *Border Tax Adjustments* and that was also approved, though not entirely followed, by the Panel in this case. Under that approach, the evidence is to be examined under four criteria: physical properties; end-uses; consumers' tastes and habits; and tariff classification.

1. Chrysotile and PCG fibres

134. We address first the "likeness" of *chrysotile asbestos fibres* and *PCG fibres*. As regards the physical properties of these fibres, we recall that the Panel stated that:

[170] *Supra*, footnote 58, para. 137.

> The Panel notes that no party contests that the structure of chrysotile fibres is unique by nature and in comparison with artificial fibres that can replace chrysotile asbestos. The parties agree that none of the substitute fibres mentioned by Canada in connection with Article III:4 has the same structure, either in terms of its form, its diameter, its length or its potential to release particles that possess certain characteristics. Moreover, they do not have the same chemical composition, which means that, in purely physical terms, none of them has the same nature or quality. … [171]

135. We also see it as important to take into account that, since 1977, chrysotile asbestos fibres have been recognized internationally as a known carcinogen because of the particular combination of their molecular structure, chemical composition, and fibrillation capacity. [172] In that respect, the Panel noted that:

> … the carcinogenicity of chrysotile fibres has been acknowledged for some time by international bodies. This carcinogenicity was confirmed by the experts consulted by the Panel, with respect to both lung cancers and mesotheliomas, even though the experts appear to acknowledge that chrysotile is less likely to cause mesotheliomas than amphiboles. We also note that the experts confirmed that the types of cancer concerned had a mortality rate of close to 100 per cent. We therefore consider that we have sufficient evidence that there is in fact a serious carcinogenic risk associated with the inhalation of chrysotile fibres. … [173]

In contrast, the Panel found that the PCG fibres "are not classified by the WHO at the same level of risk as chrysotile." [174] The experts also confirmed, as the Panel reported, that current scientific evidence indicates that PCG fibres do "not present the same risk to health as chrysotile" asbestos fibres. [175]

136. It follows that the evidence relating to properties indicates that, physically, chrysotile asbestos and PCG fibres are very different. As we said earlier, in such cases, in order to overcome this indication that products are *not* "like", a high burden is imposed on a complaining Member to establish that, despite the pronounced physical differences, there is a competitive relationship between the products such that, *all* of the evidence, taken together, demonstrates that the products are "like" under Article III:4 of the GATT 1994.

137. The Panel observed that the end-uses of chrysotile asbestos and PCG fibres are the same "for a small number" of applications. [176] The Panel simply adverted to these overlapping end-uses and offered no elaboration on their nature and character. We note that Canada argued before the Panel that there are some 3,000 commercial applications for asbestos fibres. [177] Canada and the European Communities

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[171]Panel Report, para. 8.121.

[172]*Supra*, para. 114.

[173]Panel Report, para. 8.188.

[174]*Ibid*., para. 8.220.

[175]*Ibid.*

[176]Panel Report, para. 8.125.

[177]*Ibid*., para. 3.21.

indicated that the most important end-uses for asbestos fibres include, in no particular order, incorporation into: cement-based products; insulation; and various forms of friction lining. [178] Canada noted that 90 percent, by quantity, of French imports of chrysotile asbestos were used in the production of cement-based products. [179] This evidence suggests that chrysotile asbestos and PCG fibres share a small number of similar end-uses and, that, as Canada asserted, for chrysotile asbestos, these overlapping end-uses represent an important proportion of the end-uses made of chrysotile asbestos, measured in terms of quantity.

138. There is, however, no evidence on the record regarding the nature and extent of the many end-uses for chrysotile asbestos and PCG fibres which are *not* overlapping. Thus, we do not know what proportion of all end-uses for chrysotile asbestos and PCG fibres overlap. Where products have a wide range of end-uses, only some of which overlap, we do not believe that it is sufficient to rely solely on evidence regarding the overlapping end-uses, without also examining evidence of the nature and importance of these end-uses in relation to all of the other possible end-uses for the products. In the absence of such evidence, we cannot determine the significance of the fact that chrysotile asbestos and PCG fibres share a small number of similar end-uses.

139. As we have already stated, Canada took the view, both before the Panel and before us, that consumers' tastes and habits have no relevance to the inquiry into the "likeness" of the fibres. [180] We have already addressed, and dismissed, the arguments advanced by Canada in support of this contention. [181] We have also stated that, in a case such as this one, where the physical properties of the fibres 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 of the GATT 1994. [182] If there is no evidence on this aspect of the nature and extent of the competitive relationship between the fibres, there is no basis for overcoming the inference, drawn from the different physical properties, that the products are not "like". However, in keeping with its argument that this criterion is irrelevant, Canada presented *no* evidence on consumers' tastes and habits regarding chrysotile asbestos and PCG fibres. [183]

140. Finally, we note that chrysotile asbestos fibres and the various PCG fibres all have different tariff classifications. While this element is not, on its own, decisive, it does tend to indicate that chrysotile and PCG fibres are not "like products" under Article III:4 of the GATT 1994.

141. Taken together, in our view, all of this evidence is certainly far from sufficient to satisfy Canada's burden of proving that chrysotile asbestos fibres are "like" PCG fibres under Article III:4 of the GATT 1994. Indeed, this evidence rather tends to suggest that these products are not "like products" for the purposes of Article III:4 of the GATT 1994.

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[178] *Ibid*., paras. 3.21 (Canada) and 3.23 (European Communities). The lists of important uses given by the parties is not identical in all respects and we have distilled from each list the common elements.

[179] Panel Report, para. 3.21, footnote 7.

[180] *Supra*, paras. 120 and 123.

[181] *Ibid*.

[182] Our reasons for reaching this conclusion are set forth, *supra*, in paras. 117, 118, 121 and 122.

[183] Canada did present evidence that the impact of the Decree was to reduce demand for chrysotile (Panel Report, paras. 3.20 and 3.422). However, as Canada recognized, this is a necessary consequence of the prohibition on chrysotile and is not evidence of consumers' attitudes and choices regarding the products at issue. As we have said, regulatory measures *may* suppress latent consumer demand for a product (*supra*, para. 123).

(…)

149. One Member of the Division hearing this appeal wishes to make a concurring statement. At the outset, I would like to make it abundantly clear that I agree with the findings and conclusions reached, and the reasoning set out in support thereof, by the Division, in: Section V (*TBT Agreement*); Section VII (Article XX(b) of the GATT 1994 and Article 11 of the DSU); Section VIII (Article XXIII:1(b) of the GATT 1994); and Section IX (Findings and Conclusions) of the Report. This concurring statement, in other words, relates only to Section VI ("Like Products" in Article III:4 of the GATT 1994) of the Report.

(…)

151. In paragraph 113 of the Report, we state that "[w]e are very much of the view that evidence relating to the health risks associated with a product may be pertinent in an examination of 'likeness' under Article III:4 of the GATT 1994." We also point out, in paragraph 114, that "[p]anels must examine fully the physical properties of products. In particular, … those physical properties of products that are likely to influence the competitive relationship between products in the market place. In the cases of chrysotile asbestos fibres, their molecular structure, chemical composition, and fibrillation capacity are important because the microscopic particles and filaments of chrysotile asbestos fibres are carcinogenic in humans, following inhalation." This carcinogenicity we describe as "a defining aspect of the physical properties of chrysotile asbestos fibres" [184], which property is not shared by the PCG fibres, "at least to the same extent." [185] We express our inability to "see how this highly significant physical difference *cannot* be a consideration in examining the physical properties of a product as part of a determination of 'likeness' under Article III:4 of the GATT 1994." [186] (emphasis in the original) We observe also that the Panel, after noting that the carcinogenicity of chrysotile asbestos fibres has been acknowledged by international bodies and confirmed by the experts the Panel consulted, ruled that it "[has] sufficient evidence that *there is in fact a serious carcinogenic risk associated with the inhalation of chrysotile fibres*." [187] (emphasis added) In fact, the scientific evidence of record for this finding of carcinogenicity of chrysotile asbestos fibres is so clear, voluminous, and is confirmed, a number of times, by a variety of international organizations, as to be practically overwhelming.

152. In the present appeal, considering the nature and quantum of the scientific evidence showing that the physical properties and qualities of chrysotile asbestos fibres include or result in carcinogenicity, my submission is that there is ample basis for a definitive characterization, on completion of the legal analysis, of such fibres as *not* "like" PCG fibres. PCG fibres, it may be recalled, have not been shown by Canada to have the same lethal properties as chrysotile asbestos fibres. That definitive characterization, it is further submitted, may and should be made even in the absence of evidence concerning the other two *Border Tax Adjustments* criteria (categories of "potentially shared characteristics") of end-uses and consumers' tastes and habits. It is difficult for me to imagine what evidence relating to economic 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 "likeness" of chrysotile asbestos and PCG fibres.

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[184] *Supra*, para. 114.

[185] *Ibid.*

[186] *Ibid.*

[187] Panel Report, para. 8.188. See, *supra*, para. 114.

153. The suggestion I make is not 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 of the GATT 1994. The suggestion is a very narrow one, limited only to the circumstances of this case, and confined to chrysotile asbestos fibres as compared with PCG fibres. To hold that these fibres are not "like" one another in view of the undisputed carcinogenic nature of chrysotile asbestos fibres appears to me to be but a small and modest step forward from mere reversal of the Panel's ruling that chrysotile asbestos and PCG fibres are "like", especially since our holding in completing the analysis is that Canada failed to satisfy a complainant's burden of proving that PCG fibres are "like" chrysotile asbestos fibres under Article III:4. That small step, however, the other Members of the Division feel unable to take because of their conception of the "fundamental", perhaps decisive, role of economic competitive relationships in the determination of the "likeness" of products under Article III:4.

154. My second point is that the necessity or appropriateness of adopting a "fundamentally" economic interpretation of the "likeness" of products under Article III:4 of the GATT 1994 does not appear to me to be free from substantial doubt. Moreover, in future concrete contexts, the line between a "fundamentally" and "exclusively" economic view of "like products" under Article III:4 may well prove very difficult, as a practical matter, to identify. It seems to me the better part of valour to reserve one's opinion on such an important, indeed, philosophical matter, which may have unforeseeable implications, and to leave that matter for another appeal and another day, or perhaps other appeals and other days. I so reserve my opinion on this matter.

VII. Article XX(b) of the GATT 1994 and Article 11 of the DSU

155. Under Article XX(b) of the GATT 1994, the Panel examined, first, whether the use of chrysotile-cement products poses a risk to human health and, second, whether the measure at issue is "necessary to protect human … life or health". Canada contends that the Panel erred in law in its findings on both these issues. (…)

A. "To Protect Human Life or Health"

(…)

158. According to Canada, the Panel deduced that there was a risk to human life or health associated with manipulation of chrysotile-cement products from seven factors. [188] These seven factors all relate to the scientific evidence which was before the Panel, including the opinion of the scientific experts. Canada argues that the Panel erred in law by deducing from these seven factors that chrysotile-cement products pose a risk to human life or health. [189]

(…)

161. (…) The Panel enjoyed a margin of discretion in assessing the value of the evidence, and the weight to be ascribed to that evidence. The Panel was entitled, in the exercise of its discretion, to determine that certain elements of evidence should be accorded more weight than other elements – that is the essence of the task of appreciating the evidence.

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[188]Canada's appellant's submission, para. 170. The seven factors Canada relies upon are identified in para. 19 of this Report.

[189]Canada's appellant's submission, para. 171.

162. With this in mind, we have examined the seven factors on which Canada relies in asserting that the Panel erred in concluding that there exists a human health risk associated with the manipulation of chrysotile-cement products. We see Canada's appeal on this point as, in reality, a challenge to the Panel's assessment of the credibility and weight to be ascribed to the scientific evidence before it. Canada contests the conclusions that the Panel drew both from the evidence of the scientific experts and from scientific reports before it. As we have noted, we will interfere with the Panel's appreciation of the evidence only when we are "satisfied that the panel has *exceeded the bounds of its discretion*, as the trier of facts, in its appreciation of the evidence." [190] (emphasis added) In this case, nothing suggests that the Panel exceeded the bounds of its lawful discretion. To the contrary, all four of the scientific experts consulted by the Panel concurred that chrysotile asbestos fibres, and chrysotile-cement products, constitute a risk to human health, and the Panel's conclusions on this point are faithful to the views expressed by the four scientists. In addition, the Panel noted that the carcinogenic nature of chrysotile asbestos fibres has been acknowledged since 1977 by international bodies, such as the International Agency for Research on Cancer and the World Health Organization. [191] In these circumstances, we find that the Panel remained well within the bounds of its discretion in finding that chrysotile-cement products pose a risk to human life or health.

163. Accordingly, we uphold the Panel's finding, in paragraph 8.194 of the Panel Report, that the measure "protect[s] human … life or health", within the meaning of Article XX(b) of the GATT 1994.

B. "Necessary"

(…)

165. Canada argues that the Panel erred in applying the "necessity" test under Article XX(b) of the GATT 1994 "by stating that there is a high enough risk associated with the manipulation of chrysotile-cement products that it could in principle justify strict measures such as the Decree." [192] Canada advances four arguments in support of this part of its appeal. First, Canada argues that the Panel erred in finding, on the basis of the scientific evidence before it, that chrysotile-cement products pose a risk to human health. [193] Second, Canada contends that the Panel had an obligation to "quantify" itself the risk associated with chrysotile-cement products and that it could not simply "rely" on the "hypotheses" of the French authorities. [194] Third, Canada asserts that the Panel erred by postulating that the level of protection of health inherent in the Decree is a halt to the spread of asbestos-related health risks. According to Canada, this "premise is false because it does not take into account the risk associated with the use of substitute products without a framework for controlled use." [195] Fourth, and finally, Canada claims that the Panel erred in finding that "controlled use" is not a reasonably available alternative to the Decree.

166. With respect to Canada's first argument, we note simply that we have already dismissed Canada's contention that the evidence before the Panel did not support the Panel's findings. [196] We are satisfied that

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[190] Appellate Body Report, *United States – Wheat Gluten*, *supra*, footnote 48, para. 151.

[191] Panel Report, para. 8.188.

[192] Canada's appellant's submission, para. 187.

[193] *Ibid.*, paras. 188 and 189.

[194] *Ibid.*, para. 193.

[195] *Ibid.*, para. 195.

[196] *Supra*, paras. 159-163.

the Panel had a more than sufficient basis to conclude that chrysotile-cement products do pose a significant risk to human life or health.

167. As for Canada's second argument, relating to "quantification" of the risk, we consider that, as with the *SPS Agreement*, there is no requirement under Article XX(b) of the GATT 1994 to *quantify*, as such, the risk to human life or health. [197] A risk may be evaluated either in quantitative or qualitative terms. In this case, contrary to what is suggested by Canada, the Panel assessed the nature and the character of the risk posed by chrysotile-cement products. The Panel found, on the basis of the scientific evidence, that "no minimum threshold of level of exposure or duration of exposure has been identified with regard to the risk of pathologies associated with chrysotile, except for asbestosis." [198] The pathologies which the Panel identified as being associated with chrysotile are of a very serious nature, namely lung cancer and mesothelioma, which is also a form of cancer. [199] Therefore, we do not agree with Canada that the Panel merely relied on the French authorities' "hypotheses" of the risk.

168. As to Canada's third argument, relating to the level of protection, we note that it is undisputed that WTO Members have the right to determine the level of protection of health that they consider appropriate in a given situation. France has determined, and the Panel accepted [200], that the chosen level of health protection by France is a "halt" to the spread of *asbestos*-related health risks. By prohibiting all forms of amphibole asbestos, and by severely restricting the use of chrysotile asbestos, the measure at issue is clearly designed and apt to achieve that level of health protection. Our conclusion is not altered by the fact that PCG fibres might pose a risk to health. The scientific evidence before the Panel indicated that the risk posed by the PCG fibres is, in any case, *less* than the risk posed by chrysotile asbestos fibres [201], although that evidence did *not* indicate that the risk posed by PCG fibres is non-existent. Accordingly, it seems to us perfectly legitimate for a Member to seek to halt the spread of a highly risky product while allowing the use of a less risky product in its place. In short, we do not agree with Canada's third argument.

169. In its fourth argument, Canada asserts that the Panel erred in finding that "controlled use" is not a reasonably available alternative to the Decree. This last argument is based on Canada's assertion that, in *United States – Gasoline*, both we and the panel held that an alternative measure "can only be ruled out if it is shown to be impossible to implement." [202] (…)

170. Looking at this issue now, we believe that, in determining whether a suggested alternative measure is "reasonably available", several factors must be taken into account, besides the difficulty of implementation. In *Thailand – Restrictions on Importation of and Internal Taxes on Cigarettes*, the panel made the following observations on the applicable standard for evaluating whether a measure is "necessary" under Article XX(b):

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[197] Appellate Body Report, *European Communities – Hormones*, *supra*, footnote 48, para. 186.

[198] Panel Report, para. 8.202.

[199] *Ibid*., para. 8.188. See Panel Report, para. 5.29, for a description of mesothelioma given by Dr. Henderson.

[200] *Ibid*., para. 8.204.

[201] *Ibid*., para. 8.220.

[202] Canada's appellant's submission, para. 202, referring to, *inter alia*, para. 130 of that submission.

> The import restrictions imposed by Thailand could be considered to be "necessary" in terms of Article XX(b) only if there were no alternative measure consistent with the General Agreement, or less inconsistent with it, which Thailand could *reasonably be expected to employ to achieve its health policy objectives.* [203] (emphasis added)

171. In our Report in *Korea –Beef,* we addressed the issue of "necessity" under Article XX(d) of the GATT 1994. [204] In that appeal, we found that the panel was correct in following the standard set forth by the panel in *United States – Section 337 of the Tariff Act of 1930*:

> It was clear to the Panel that a contracting party cannot justify a measure inconsistent with another GATT provision as "necessary" in terms of Article XX(d) if an alternative measure which it could reasonably be expected to employ and which is not inconsistent with other GATT provisions is available to it. By the same token, in cases where a measure consistent with other GATT provisions is not reasonably available, a contracting party is bound to use, among the measures reasonably available to it, that which entails the least degree of inconsistency with other GATT provisions. [205]

172. We indicated in *Korea – Beef* that one aspect of the "weighing and balancing process … comprehended in the determination of whether a WTO-consistent alternative measure" is reasonably available is the extent to which the alternative measure "contributes to the realization of the end pursued". [206] In addition, we observed, in that case, that "[t]he more vital or important [the] common interests or values" pursued, the easier it would be to accept as "necessary" measures designed to achieve those ends. [207] In this case, the objective pursued by the measure is the preservation of human life and health through the elimination, or reduction, of the well-known, and life-threatening, health risks posed by asbestos fibres. The value pursued is both vital and important in the highest degree. The remaining question, then, is whether there is an alternative measure that would achieve the same end and that is less restrictive of trade than a prohibition.

173. Canada asserts that "controlled use" represents a "reasonably available" measure that would serve the same end. The issue is, thus, whether France could reasonably be expected to employ "controlled use" practices to achieve its chosen level of health protection – a halt in the spread of asbestos-related health risks.

174. In our view, France could not reasonably be expected to employ *any* alternative measure if that measure would involve a continuation of the very risk that the Decree seeks to "halt". Such an alternative measure would, in effect, prevent France from achieving its chosen level of health protection. On the basis of the scientific evidence before it, the Panel found that, in general, the efficacy of "controlled use"

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[203] Adopted 20 February 1990, BISD 37S/200, para. 75.

[204] *Supra*, footnote 49, paras. 159 ff.

[205] Adopted 7 November 1989, BISD 36S/345, para. 5.26; we expressly affirmed this standard in our Report in *Korea – Beef*, *supra*, footnote 49, para. 166.

[206] Appellate Body Report, *Korea – Beef*, *supra*, footnote 49, paras. 166 and 163.

[207] *Ibid*., para. 162.

remains to be demonstrated.[208] Moreover, even in cases where "controlled use" practices are applied "with greater certainty", the scientific evidence suggests that the level of exposure can, in some circumstances, still be high enough for there to be a "significant residual risk of developing asbestos-related diseases."[209] The Panel found too that the efficacy of "controlled use" is particularly doubtful for the building industry and for DIY enthusiasts, which are the most important users of cement-based products containing chrysotile asbestos.[210] Given these factual findings by the Panel, we believe that "controlled use" would not allow France to achieve its chosen level of health protection by halting the spread of asbestos-related health risks. "Controlled use" would, thus, not be an alternative measure that would achieve the end sought by France.

175. For these reasons, we uphold the Panel's finding, in paragraph 8.222 of the Panel Report, that the European Communities has demonstrated a *prima facie* case that there was no "reasonably available alternative" to the prohibition inherent in the Decree. As a result, we also uphold the Panel's conclusion, in paragraph 8.223 of the Panel Report, that the Decree is "necessary to protect human … life or health" within the meaning of Article XX(b) of the GATT 1994.

(…)

IX. Findings and Conclusions

192. For the reasons set out in this Report, the Appellate Body:

(…)

(b) reverses the Panel's findings, in paragraphs 8.132 and 8.149 of the Panel Report, that "it is not appropriate" to take into consideration the health risks associated with chrysotile asbestos fibres in examining the "likeness", under Article III:4 of the GATT 1994, of those fibres and PCG fibres, and, also, in examining the "likeness", under that provision, of cement-based products containing chrysotile asbestos fibres or PCG fibres;

(c) reverses the Panel's finding, in paragraph 8.144 of the Panel Report, that chrysotile asbestos fibres and PCG fibres are "like products" under Article III:4 of the GATT 1994; and finds that Canada has not satisfied its burden of proving that these fibres are "like products" under that provision;

(d) reverses the Panel's finding, in paragraph 8.150 of the Panel Report, that cement-based products containing chrysotile asbestos fibres and cement-based products containing PCG fibres are "like products" under Article III:4 of the GATT 1994; and finds that Canada has not satisfied its burden of proving that these cement-based products are "like products" under Article III:4 of the GATT 1994;

(e) reverses, in consequence, the Panel's finding, in paragraph 8.158 of the Panel Report, that the measure is inconsistent with Article III:4 of the GATT 1994;

(f) upholds the Panel's finding, in paragraphs 8.194, 8.222 and 8.223 of the Panel Report, that the measure at issue is "necessary to protect human … life or health", within the meaning of Article XX(b) of the GATT 1994; and, finds that the Panel acted consistently with Article 11 of the DSU in reaching this conclusion;

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[208]Panel Report, para. 8.209.

[209]*Ibid.*, paras. 8.209 and 8.211.

[210]*Ibid.*, paras. 8.213 and 8.214.

(…)

It follows from our findings that Canada has not succeeded in establishing that the measure at issue is inconsistent with the obligations of the European Communities under the covered agreements and, accordingly, we do not make any recommendations to the DSB under Article 19.1 of the DSU.

2. Korea Beef

This dispute concerns -- among other measures – measures applied by Korea to the retail sale of imported beef. These are described in para. 26 of the Panel Report:

"The Government of Korea regulates retail outlets through the *Management Guidelines for Imported Beef* which came into effect on 1 October 1999 and prior to that date through the *Guidelines Concerning Registration and Operation of Specialized Imported Beef Stores.* The *Management Guideline for Imported Beef* specifies that imported beef (except for pre-packed imported beef) may only be sold in specialized imported-beef shops.[211] It also specifies that large-scale distributors (department stores, supermarkets, etc) must provide a separate sales area for imported beef.[212] Stores selling imported beef must display a "Specialized Imported Beef Store" sign to distinguish them from domestic meat sellers."

Appellate Body Report in *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161, 169/AB/R, 11 December 2000

Present: Ehlermann, Presiding Member; Abi-Saab, Member; Feliciano, Member

http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds169_e.htm

I. Introduction

1. Korea appeals certain issues of law and legal interpretations in the Panel Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef* (the "Panel Report").[213] The Panel was established to consider a complaint by Australia and the United States with respect to Korean measures that affect the importation of certain beef products. The aspects of these measures relevant for this appeal relate to, first, domestic support provided to the beef industry and to the Korean agriculture sector more generally, and, second, the separate retail distribution channels that exist for certain imported and domestic beef products (the so-called "dual retail system") and related measures. The dual retail system is given legal effect by the *Management Guideline for Imported Beef* (the "*Management Guideline*").[214]
(…)

(…)

[211] *Management Guideline for Imported Beef*, Article 15.
[212] *Ibid*, Article 9.5.
[213] WT/DS161/R, WT/DS169/R, 31 July 2000.

[214] The essential features of the Korean dual retail system for beef are found in the *Guidelines Concerning Registration and Operation of Specialized Imported Beef Stores*, (61550-81) 29 January 1990, modified on 15 March 1994; and the *Regulations Concerning Sales of Imported Beef*, (51550-100), modified on 27 March 1993, 7 April 1994, and 29 June 1998. On 1 October 1999, these two instruments were replaced by the *Management Guideline for Imported Beef*, (Ministry of Agriculture Notice 1999-67), which maintained, however, the basic principles of the dual retail system. The *Management Guideline* is an elaboration of Article 25 of the *Livestock Act (Revised)*, as amended by Act No. 5720 on 29 January 1999.

3. The Panel also considered claims by the United States that Korea's requirement that imported beef be sold only in specialized imported beef stores, and its laws and regulations restricting the resale and distribution of imported beef by SBS super-groups, retailers, customers, and end-users are inconsistent with its obligations under Article III:4 of the GATT 1994; (…)

5. The Panel concluded (…) that the dual retail system for beef (including the obligation for department stores and supermarkets authorized to sell imported beef to hold a separate display, and the obligation for foreign beef shops to bear a sign with the words "Specialized Imported Beef Store") is inconsistent with the provisions of Article III:4 of the GATT 1994 in that it treats imported beef less favourably than domestic beef, and cannot be justified pursuant to Article XX(d) of the GATT 1994; that the requirement that the supply of beef from the LPMO's wholesale market be limited to specialized imported beef stores is inconsistent with Article III:4 of the GATT 1994 and cannot be justified pursuant to Article XX(d) of the GATT 1994; (…)

6. The Panel recommended that the Dispute Settlement Body ("DSB") request Korea to bring its measures into conformity with its obligations under the *WTO Agreement.* [215]

(…)

III. Issues Raised in this Appeal

75. The issues raised in this appeal are the following:
(…)

(c) whether the "dual retail system", which requires the sale of imported beef in specialized stores, was inconsistent with Article III:4 of the GATT 1994; and

(d) whether the "dual retail system", if inconsistent with Article III:4 of the GATT 1994, can nevertheless be justified under Article XX(d).

(…)

VI. Dual Retail System

A. Article III:4 of the GATT 1994

130. The Panel found that Korea's dual retail system for beef accords treatment less favourable to imported beef than to like Korean beef, and is, thus, inconsistent with Article III:4 of the GATT 1994. This finding was based on the Panel's view that any measure based exclusively on criteria relating to the origin of a product is inconsistent with Article III:4. [216] The finding was also based on the Panel's assessment of how the dual retail system modifies the conditions of competition between imported and like domestic beef in the Korean market. [217]

131. Korea argues on appeal that the dual retail system does not accord treatment less favourable to imported beef than to like domestic beef. For Korea, the dual retail system does not *on its face* violate

[215]Panel Report, para. 847.

[216]Panel Report, para. 627.

[217]*Ibid.*, paras. 631-637.

Article III:4, since there is "perfect regulatory symmetry" in the separation of imported and domestic beef at the retail level, and there is "no regulatory barrier" which prevents traders from converting from one type of retail store to another. [218] Nor, Korea argues, does the dual retail system violate Article III:4 *de facto*, and the Panel's conclusion to the contrary was not based on a proper empirical analysis of the Korean beef market. [219]

132. Article III:4 of the GATT 1994 reads in relevant part:

> The products of the territory of any Member imported into the territory of any other Member shall be accorded *treatment no less favourable* than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. (emphasis added)

133. For a violation of Article III:4 to be established, three elements must be satisfied: that the imported and domestic products at issue are "like products"; that the measure at issue is a "law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution, or use"; and that the imported products are accorded "less favourable" treatment than that accorded to like domestic products. Only the last element – "less favourable" treatment – is disputed by the parties and is at issue in this appeal.

134. The Panel began its analysis of the phrase "treatment no less favourable" by reviewing past GATT and WTO cases. It found that "treatment no less favourable" under Article III:4 requires that a Member accord to imported products "effective equality of opportunities" with like domestic products in respect of the application of laws, regulations and requirements. **[220]** The Panel concluded its review of the case law by stating:

> 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 (as hypothetical imports can be used to reach this conclusion) 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. The object of Article III:4 is, thus, to guarantee effective market access to imported products and to ensure that the latter are offered the same market opportunities as domestic products. [221]

[218]Korea's appellant's submission, paras. 119-126.

[219]*Ibid*., paras. 127-156.

[220]Panel Report, para. 624.

[221]*Ibid*., para. 627. (footnotes omitted)

135. The Panel stated that "any regulatory distinction that is based exclusively on criteria relating to the nationality or origin" of products is incompatible with Article III:4. We observe, however, that Article III:4 requires only that a measure accord treatment to imported products that is "no less favourable" than that accorded to like domestic products. A measure that provides treatment to imported products that is *different* from that accorded to like domestic products is not necessarily inconsistent with Article III:4, as long as the treatment provided by the measure is "no less favourable". According "treatment no less favourable" means, as we have previously said, according *conditions of competition* no less favourable to the imported product than to the like domestic product. In *Japan – Taxes on Alcoholic Beverages*, we described the legal standard in Article III as follows:

> The broad and fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures. More specifically, the purpose of Article III "is to ensure that internal measures 'not be applied to imported or domestic products so as to afford protection to domestic production'". Toward this end, Article III obliges Members of the WTO to provide *equality of competitive conditions* for imported products in relation to domestic products. "[T]he intention of the drafters of the Agreement was clearly to treat the imported products in the same way as the like domestic products once they had been cleared through customs. Otherwise indirect protection could be given".[222] (emphasis added)

136. This interpretation, which focuses on the *conditions of competition* between imported and domestic like products, implies that a measure according formally *different* treatment to imported products does not *per se*, that is, necessarily, violate Article III:4. In *United States – Section 337*, this point was persuasively made. In that case, the panel had to determine whether United States patent enforcement procedures, which were formally different for imported and for domestic products, violated Article III:4. That panel said:

[222]Appellate Body Report, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, pp. 16-17. The original passage contains footnotes. The second sentence is footnoted to *United States - Section 337 of the Tariff Act of 1930* ("*United States – Section 337*"), BISD 36S/345, para. 5.10. The third sentence is footnoted to *United States – Taxes on Petroleum and Certain Imported Substances*, BISD 34S/136, para. 5.1.9; and *Japan – Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83, para. 5.5(b). The fifth sentence is footnoted to *Italian Discrimination Against Imported Agricultural Machinery*, BISD 7S/60, para. 11.

> 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. For these reasons, the mere fact that imported products are subject under Section 337 to legal provisions that are different from those applying to products of national origin is in itself not conclusive in establishing inconsistency with Article III:4. [223] (emphasis added)

137. A formal difference in treatment between imported and like domestic products is thus neither necessary, nor sufficient, to show a violation of Article III:4. 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.

138. We conclude that the Panel erred in its general interpretation that "[a]ny regulatory distinction that is based exclusively on criteria relating to the nationality or the origin of the products is incompatible with Article III." [224]

139. The Panel went on, however, to examine the conditions of competition between imported and like domestic beef in the Korean market. The Panel gave several reasons why it believed that the dual retail system alters the conditions of competition in the Korean market in favour of domestic beef. First, it found that 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". [225] Second, the Panel found that, 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." This disadvantage would be more serious when the market share of imports (as is the case with imported beef) is small. [226] Third, the Panel found that the dual retail system, by excluding imported beef from "the vast majority of sales outlets", limits the potential market opportunities for imported beef. This would apply particularly to products "consumed on a daily basis", like beef, where consumers may not be willing to "shop around". [227] Fourth, the Panel found that the dual retail system imposes more costs on the imported product, since the domestic product will tend to continue to be sold from existing retail stores, whereas imported beef will require new stores to be established. [228] Fifth, the Panel found that 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 gives a competitive advantage to domestic beef, "based on criteria not related to the products

[223] *United States – Section 337, supra*, footnote 69, paragraph 5.11.

[224] Panel Report, para. 627.

[225] *Ibid*., para. 631.

[226] *Ibid*., para. 632.

[227] Panel Report, para. 633.

[228] *Ibid*., para. 634.

themselves". [229] Sixth, the Panel found that the dual retail system "facilitates the maintenance of a price differential" to the advantage of domestic beef. [230]

140. On appeal, Korea argues that the Panel's analysis of the conditions of competition in the Korean market is seriously flawed, relying largely on speculation rather than on factual analysis. Korea maintains that the dual retail system does not deny consumers the possibility to make comparisons, and the numbers of outlets selling imported beef, as compared with outlets selling domestic beef, does not support the Panel's findings. Korea argues, furthermore, that the dual retail system neither adds to the costs of, nor shelters high prices for, domestic beef. [231]

141. It will be seen below that we share the ultimate conclusion of the Panel in respect of the consistency of the dual retail system for beef with Article III:4 of the GATT 1994. Portions, however, of the Panel's analysis *en route* to that conclusion appear to us problematic. For instance, while limitation of the ability to compare visually two products, local and imported, at the point of sale may have resulted from the dual retail system, such limitation does not, in our view, necessarily reduce the opportunity for the imported product to compete "directly" or on "an equal footing" with the domestic product. [232] Again, even if we were to accept that the dual retail system "encourages" the perception of consumers that imported and domestic beef are "different", we do not think it has been demonstrated that such encouragement necessarily implies a competitive advantage for domestic beef. [233] Circumstances like limitation of "side-by-side" comparison and "encouragement" of consumer perceptions of "differences" may be simply incidental effects of the dual retail system without decisive implications for the issue of consistency with Article III:4.

142. We believe that a more direct, and perhaps simpler, approach to the dual retail system of Korea may be usefully followed in the present case. In the following paragraphs, we seek to focus on what appears to us to be the fundamental thrust and effect of the measure itself.

143. Korean law in effect requires the existence of two distinct retail distribution systems so far as beef is concerned: one system for the retail sale of domestic beef and another system for the retail sale of imported beef. [234] A small retailer (that is, a non-supermarket or non-department store) which is a "Specialized Imported Beef Store" may sell any meat *except domestic beef*; any other small retailer may sell any meat *except imported beef*. [235] A large retailer (that is, a supermarket or department store) may sell both imported and domestic beef, as long as the imported beef and domestic beef are sold in separate

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[229] *Ibid.*

[230] *Ibid.*

[231] Korea's appellant's submission, paras. 101, 127-156.

[232] See Panel Report, para. 633.

[233] *Ibid.*, para. 634.

[234] The essential features of the Korean dual retail system for beef are found in the *Guidelines Concerning Registration and Operation of Specialized Imported Beef Stores*, (61550-81) 29 January 1990, modified on 15 March 1994; and the *Regulations Concerning Sales of Imported Beef*, (51550-100), modified on 27 March 1993, 7 April 1994, and 29 June 1998. On 1 October 1999, these two instruments were replaced by the *Management Guideline for Imported Beef*, (Ministry of Agriculture Notice 1999-67), which maintained, however, the basic principles of the dual retail system.

[235] *Guidelines Concerning Registration and Operation of Specialized Imported Beef Stores* Art. 5(C); *Regulations Concerning Sales of Imported Beef*, Art. 14(5); *Management Guideline for Imported Beef*, Art. 15.

sales areas.[236] A retailer selling imported beef is required to display a sign reading "Specialized Imported Beef Store".[237]

144. Thus, the Korean measure formally separates the selling of imported beef and domestic beef. However, that formal separation, *in and of itself*, does not necessarily compel the conclusion that the treatment thus accorded to imported beef is less favourable than the treatment accorded to domestic beef.[238] To determine whether the treatment given to imported beef is less favourable than that given to domestic beef, we must, as earlier indicated, inquire into whether or not the Korean dual retail system for beef modifies the *conditions of competition* in the Korean beef market to the disadvantage of the imported product.

145. When beef was first imported into Korea in 1988, the new product simply entered into the pre-existing distribution system that had been handling domestic beef. The beef retail system was a unitary one, and the conditions of competition affecting the sale of beef were the same for both the domestic and the imported product. In 1990, Korea promulgated its dual retail system for beef.[239] Accordingly, the existing small retailers had to choose between, on the one hand, continuing to sell domestic beef and renouncing the sale of imported beef or, on the other hand, ceasing to sell domestic beef in order to be allowed to sell the imported product. Apparently, the vast majority of the small meat retailers chose the first option.[240] The result was the virtual exclusion of imported beef from the retail distribution channels through which domestic beef (and until then, imported beef, too) was distributed to Korean households and other consumers throughout the country. Accordingly, a new and separate retail system had to be established and gradually built from the ground up for bringing the imported product to the same households and other consumers if the imported product was to compete at all with the domestic product. Put in slightly different terms, the putting into legal effect of the dual retail system for beef meant, in direct practical effect, so far as imported beef was concerned, the sudden cutting off of access to the normal, that is, the previously existing, distribution outlets through which the domestic product continued to flow to consumers in the urban centers and countryside that make up the Korean national territory. The central consequence of the dual retail system can only be reasonably construed, in our view, as the imposition of a drastic reduction of commercial opportunity to reach, and hence to generate sales to, the same consumers served by the traditional retail channels for domestic beef. In 1998, when this case began, eight years after the dual retail system was first prescribed, the consequent reduction of commercial opportunity was reflected in the much smaller number of specialized imported beef shops (approximately 5,000 shops) as compared with the number of retailers (approximately 45,000 shops) selling domestic beef.[241]

146. We are aware 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

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[236] *Guidelines Concerning Registration and Operation of Specialized Imported Beef Stores*, Art. 3(A); *Management Guideline for Imported Beef*, Art. 9(5).

[237] *Guidelines Concerning Registration and Operation of Specialized Imported Beef Stores*, Art. 5(A); *Regulations Concerning Sales of Imported Beef*, Art. 14(5); *Management Guideline for Imported Beef*, Art. 9(6).

[238] Apart from the display sign requirement, dealt with in para. 151.

[239] See Panel Report, para. 630.

[240] Panel Report, para. 633.

[241] The number of imported beef shops is noted by the Panel in footnote 347 of the Panel Report; the number of domestic beef shops has been provided by the United States in para. 175 of the Panel Report, and has not been contested by Korea.

imported product. The legal necessity of making a choice was, however, imposed by the measure itself. The restricted nature of that choice should be noted. The choice given to the meat retailers was *not* an option between remaining with the pre-existing unified distribution set-up or going to a dual retail system. The choice was limited to selling domestic beef only or imported beef only. Thus, the reduction of access to normal retail channels is, in legal contemplation, the effect of that measure. In these circumstances, the intervention of some element of private choice does not relieve Korea of responsibility under the GATT 1994 for the resulting establishment of competitive conditions less favourable for the imported product than for the domestic product.

147. We also note that the reduction of competitive opportunity through the restriction of access to consumers results from the imposition of the dual retail system for beef, notwithstanding the "perfect regulatory symmetry" of that system[242], and is not a function of the limited volume of foreign beef actually imported into Korea. The fact that the WTO-consistent quota for beef has, save for two years, been fully utilized does not detract from the lack of equality of competitive conditions entailed by the dual retail system.

148. We believe, and so hold, that the treatment accorded to imported beef, as a consequence of the dual retail system established for beef by Korean law and regulation, is less favourable than the treatment given to like domestic beef and is, accordingly, not consistent with the requirements of Article III:4 of the GATT 1994.

(…)

150. Finally, we note that Korea requires that imported beef be sold in a store displaying a sign declaring "Specialized Imported Beef Store". The Panel found that the sign requirement was "essentially ancillary to the dual retail system", and, since the dual retail system was inconsistent with Article III:4, the Panel found that the sign requirement was as well.[243] The Panel found also that, since the sign requirement went beyond an obligation to indicate origin, it was inconsistent with statements contained in a 1956 GATT Working Party Report.[244] On appeal, Korea claims that the Panel used "erroneous logic" in its conclusion based on the ancillary character of the sign requirement, and that the statement in the Working Party Report did not apply to the sign requirement.[245]

151. Without a system of specialized imported beef stores, the sign requirement would have no meaning and would not be required. When considered independently from a dual retail system, a sign requirement might or might not be characterized legally as consistent with Article III:4 of the GATT 1994. On the other hand, when considered simply as a detail of the dual retail system, the sign requirement partakes of the legal characterization given to that system itself. We believe it unnecessary to pass upon separately the consistency of the display sign requirement with Article III:4 of the GATT 1994.

B. Article XX(d) of the GATT 1994

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[242]The notion of "perfect regulatory symmetry" is set out in Korea's appellant's submission, para. 95. See also *supra*, para. 17.

[243]Panel Report, para. 641.

[244]Working Party Report, *Certificates of Origin, Marks of Origin, Consular Formalities*, adopted 17 November 1956, BISD 5S/102, para. 13.

[245]Korea's appellant's submission, paras. 206-213.

152. The Panel went on to conclude that the dual retail system, which it found to be inconsistent with Article III:4, could not be justified pursuant to Article XX(d) of the GATT 1994. The Panel found that the dual retail system is a disproportionate measure not necessary to secure compliance with the Korean law against deceptive practices. [246]

153. The Panel began its examination of Korea's dual retail system under Article XX(d) by finding that the dual retail system was designed to "secure compliance" with the Unfair Competition Act, a law consistent on its face with WTO provisions. [247] The Panel then focused on whether the dual retail system is "necessary" to secure compliance with that law. It examined enforcement measures taken by Korea for related products where fraudulent misrepresentation or passing of one product for another has occurred, and found that in these areas a dual retail system was not used. Instead, in respect of such product areas, Korea uses traditional enforcement measures, consistent with WTO rules, which include record-keeping, investigations, policing and fines. The Panel next inquired into whether these alternative, WTO-consistent measures were "reasonably available" to Korea to meet Korea's desired level of enforcement of laws against fraudulent misrepresentation in the retail beef sector. The Panel concluded that these measures are "reasonably available" alternative measures, and that Korea therefore cannot justify the dual retail system as "necessary" under Article XX(d). [248]

154. Korea appeals the Panel's conclusion. Korea argues that the Panel incorrectly interpreted the term "necessary" in Article XX(d) as requiring consistency among enforcement measures taken in related product areas. [249] Further, according to Korea, the Panel neglected to take into account the level of enforcement that Korea sought with respect to preventing the fraudulent sale of imported beef. [250]

155. Article XX(d), together with the introductory clause of Article XX, reads as follows:

> *Article XX*
>
> *General Exceptions*
>
> Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures:
>
> …
>
> (*d*) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including those relating to customs enforcement, the enforcement of monopolies operated under paragraph 4 of Article II and Article XVII, the protection of patents, trade marks and copyrights, and the prevention of deceptive practices;

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[246]Panel Report, para. 675.

[247]*Ibid*., para. 658.

[248]*Ibid*., paras. 660-674.

[249]Korea's appellant's submission, paras. 166-180.

[250]*Ibid*., paras. 181-193.

156. We note that in examining the Korean dual retail system under Article XX, the Panel followed the appropriate sequence of steps outlined in *United States – Standards for Reformulated and Conventional Gasoline* ("*United States – Gasoline*"). There we said:

> In order that the justifying protection of Article XX may be extended to it, the measure at issue must not only come under one or another of the particular exceptions -- paragraphs (a) to (j) -- listed under Article XX; it must also satisfy the requirements imposed by the opening clauses of Article XX. *The analysis is, in other words, two-tiered: first, provisional justification by reason of characterization of the measure under XX(g); second, further appraisal of the same measure under the introductory clauses of Article XX*. [251] (emphasis added)

The Panel concentrated its analysis on paragraph (d), that is, the first-tier analysis. Having found that the dual retail system did not fulfill the requirements of paragraph (d), the Panel correctly considered that it did not need to proceed to the second-tier analysis, that is, to examine the application in this case of the requirements of the introductory clause of Article XX.

157. For a measure, otherwise inconsistent with GATT 1994, to be justified provisionally under paragraph (d) of Article XX, two elements must be shown. First, the measure must be one designed to "secure compliance" with laws or regulations that are not themselves inconsistent with some provision of the GATT 1994. Second, the measure must be "necessary" to secure such compliance. A Member who invokes Article XX(d) as a justification has the burden of demonstrating that these two requirements are met. [252]

158. The Panel examined these two aspects one after the other. The Panel found, "despite … troublesome aspects, … that the dual retail system was put in place, at least in part, in order to secure compliance with the Korean legislation against deceptive practices to the extent that it serves to prevent acts inconsistent with the *Unfair Competition Act*." [253] It recognized that the system was established at a time when acts of misrepresentation of origin were widespread in the beef sector. It also acknowledged that the dual retail system "does appear to reduce the opportunities and thus the temptations for butchers to misrepresent [less expensive] foreign beef for [more expensive] domestic beef ". [254] The parties did not appeal these findings of the Panel.

159. We turn, therefore, to the question of whether the dual retail system is "necessary" to secure compliance with the *Unfair Competition Act*. Once again, we look first to the ordinary meaning of the word "necessary", in its context and in the light of the object and purpose of Article XX, in accordance with Article 31(1) of the *Vienna Convention.*

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[251]Appellate Body Report, WT/DS2/AB/R, adopted 20 May 1996, p. 22. See also, Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products* ("*United States – Shrimp*"), WT/DS58/AB/R, adopted 6 November 1998, paras. 119-121.

[252]Appellate Body Report, *United States – Gasoline*, *supra*, footnote 98, pp. 22-23; Appellate Body Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R, adopted 23 May 1997, pp. 14-16; Panel report, *United States – Section 337*, *supra*, footnote 69, para. 5.27.

[253]Panel Report, para. 658.

[254]*Ibid.*

160. The word "necessary" normally denotes something "that cannot be dispensed with or done without, requisite, essential, needful". [255] We note, however, that a standard law dictionary cautions that:

> [t]his word must be considered in the connection in which it is used, as it is a word susceptible of various meanings. It may import absolute physical necessity or inevitability, or it may import that which is only convenient, useful, appropriate, suitable, proper, or conducive to the end sought. It is an adjective expressing degrees, and may express mere convenience or that which is indispensable or an absolute physical necessity". [256]

161. We believe that, as used in the context of Article XX(d), the reach of the word "necessary" is not limited to that which is "indispensable" or "of absolute necessity" or "inevitable". Measures which are indispensable or of absolute necessity or inevitable to secure compliance certainly fulfil the requirements of Article XX(d). But other measures, too, may fall within the ambit of this exception. As used in Article XX(d), the term "necessary" refers, in our view, to a range of degrees of necessity. At one end of this continuum lies "necessary" understood as "indispensable"; at the other end, is "necessary" taken to mean as "making a contribution to." We consider that a "necessary" measure is, in this continuum, located significantly closer to the pole of "indispensable" than to the opposite pole of simply "making a contribution to". [257]

162. In appraising the "necessity" of a measure in these terms, it is useful to bear in mind the context in which "necessary" is found in Article XX(d). The measure at stake has to be "necessary to ensure compliance with laws and regulations … , *including* those relating to customs enforcement, the enforcement of [lawful] monopolies … , the protection of patents, trade marks and copyrights, and the prevention of deceptive practices". (emphasis added) Clearly, Article XX(d) is susceptible of application in respect of a wide variety of "laws and regulations" to be enforced. It seems to us that a treaty interpreter assessing a measure claimed to be necessary to secure compliance of a WTO-consistent law or regulation may, in appropriate cases, take into account the relative importance of the common interests or values that the law or regulation to be enforced is intended to protect. The more vital or important those common interests or values are, the easier it would be to accept as "necessary" a measure designed as an enforcement instrument.

163. There are other aspects of the enforcement measure to be considered in evaluating that measure as "necessary". One is the extent to which the measure contributes to the realization of the end pursued, the securing of compliance with the law or regulation at issue. The greater the contribution, the more easily a measure might be considered to be "necessary". Another aspect is the extent to which the compliance measure produces restrictive effects on international commerce [258], that is, in respect of a

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[255] *The New Shorter Oxford English Dictionary*, (Clarendon Press, 1993), Vol. II, p. 1895.

[256] *Black's Law Dictionary*, (West Publishing, 1995), p. 1029.

[257] We recall that we have twice interpreted Article XX(g), which requires a measure "*relating* to the conservation of exhaustible natural resources". (emphasis added). This requirement is more flexible textually than the "necessity" requirement found in Article XX(d). We note that, under the more flexible "*relating to*" standard of Article XX(g), we accepted in *United States – Gasoline* a measure because it presented a "*substantial* relationship", (emphasis added) i.e., *a close and genuine* relationship of ends and means, with the conservation of clean air. *Supra*, footnote 98, p.19. In *United States – Shrimp* we accepted a measure because it was "*reasonably related*" to the protection and conservation of sea turtles. *Supra*, footnote 98, at para. 141.

[258] We recall that the last paragraph of the Preamble of the GATT of 1994 reads as follows: "Being desirous of contributing to these objectives by entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade *and to the elimination of discriminatory treatment in international commerce*". (emphasis added)

measure inconsistent with Article III:4, restrictive effects *on imported goods*. A measure with a relatively slight impact upon imported products might more easily be considered as "necessary" than a measure with intense or broader restrictive effects.

164. In sum, determination of whether a measure, which is not "indispensable", may nevertheless be "necessary" within the contemplation of Article XX(d), involves in every case a process of weighing and balancing a series of factors which prominently include the contribution made by the compliance measure to the enforcement of the law or regulation at issue, the importance of the common interests or values protected by that law or regulation, and the accompanying impact of the law or regulation on imports or exports.

165. The panel in *United States – Section 337* described the applicable standard for evaluating whether a measure is "necessary" under Article XX(d) in the following terms:

> It was clear to the Panel that a contracting party cannot justify a measure inconsistent with another GATT provision as "necessary" in terms of Article XX(d) if an alternative measure which it could reasonably be expected to employ and which is not inconsistent with other GATT provisions is available to it. By the same token, in cases where a measure consistent with other GATT provisions is not reasonably available, a contracting party is bound to use, among the measures reasonably available to it, that which entails the least degree of inconsistency with other GATT provisions. [259]

166. The standard described by the panel in *United States – Section 337* encapsulates the general considerations we have adverted to above. In our view, the weighing and balancing process we have outlined is comprehended in the determination of whether a WTO-consistent alternative measure which the Member concerned could "reasonably be expected to employ" is available, or whether a less WTO-inconsistent measure is "reasonably available".

167. The Panel followed the standard identified by the panel in *United States – Section 337*. It started scrutinizing whether the dual retail system is "necessary" under paragraph (d) of Article XX by stating:

> Korea has to convince the Panel that, contrary to what was alleged by Australia and the United States, no alternative measure consistent with the WTO Agreement is reasonably available at present in order to deal with misrepresentation in the retail market as to the origin of beef. [260]

168. The Panel first considered a range of possible alternative measures, by examining measures taken by Korea with respect to situations involving, or which could involve, deceptive practices similar to those which in 1989-1990 had affected the retail sale of foreign beef. The Panel found that Korea does not require a dual retail system in *related product areas*, but relies instead on traditional enforcement procedures. There is no requirement, for example, for a dual retail system separating domestic Hanwoo beef from domestic dairy cattle beef. [261] Nor is there a requirement for a dual retail system for any other

[259]Panel report, *United States – Section 337*, *supra*, footnote 69, para. 5.26.

[260]Panel Report, para. 659.

[261]In 1998, domestic dairy cattle beef amounted to 12 percent of total beef consumption in Korea. Panel Report, para. 661.

meat or food product, such as pork or seafood.[262] Finally, there is no requirement for a system of separate restaurants, depending on whether they serve domestic or imported beef, even though approximately 45 per cent of the beef imported into Korea is sold in restaurants.[263] Yet, in all of these cases, the Panel found that there were numerous cases of fraudulent misrepresentation.[264] For the Panel, these examples indicated that misrepresentation of origin could, in principle, be dealt with "on the basis of basic methods … such as normal policing under the Korean *Unfair Competition Act*."[265]

169. Korea argues, on appeal, that the Panel, by drawing conclusions from the absence of any requirement for a dual retail system in related product areas, introduces an illegitimate "consistency test" into Article XX(d). For Korea, the proper test for "necessary" under Article XX(d):

> … is to see whether another means exists which is less restrictive than the one used and which can reach the objective sought. Whether such means will be applied *consistently* to other products or not is not a matter of concern for the necessity requirement under Article XX(d).[266]

170. Examining enforcement measures applicable to the same illegal behaviour relating to like, or at least similar, products does not necessarily imply the introduction of a "consistency" requirement into the "necessary" concept of Article XX(d). Examining such enforcement measures may provide useful input in the course of determining whether an alternative measure which could "reasonably be expected" to be utilized, is available or not.

171. The enforcement measures that the Panel examined were measures taken to enforce the same law, the *Unfair Competition Act*.[267] This law provides for penal and other sanctions[268] against any "unfair competitive act", which includes any:

> *Act misleading the public to understand the place of origin of any goods* either by falsely marking that place on any commercial document or communication, in said goods or any advertisement thereof *or in any manner of misleading the general public*, or by selling, distributing, importing or exporting goods bearing such mark;[269] (emphasis added)

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[262]*Ibid*., para. 662.

[263]*Ibid*., para. 663.

[264]*Ibid*., paras. 661-663, including footnote 366, in which the Panel noted "that the Livestock Times reported that the deceptive beef marketing practice was widespread in restaurants (where price differential was 58 per cent)".

[265]*Ibid*., para. 664.

[266]Korea's appellant's submission, para. 167.

[267]In GATT case law, comparisons have been made between enforcement measures taken in different *jurisdictions*. In the *United States – Measures Affecting Alcoholic and Malt Beverages* case, the panel said that "[t]he fact that not all fifty states maintain discriminatory distribution systems indicates to the Panel that alternative measure for enforcement of state excise tax laws do indeed exist." Adopted 19 June 1992, BISD 39S/206, para. 5.43. In the *United States – Section 337* case, the panel "did not consider that a different scheme for imports alleged to infringe process patents is necessary, since many countries grant to their civil courts jurisdiction over imports of products manufactured abroad under processes protected by patents of the importing country". *Supra*, footnote 69, para. 5.28.

[268]*Unfair Competition Prevention and Business Secret Protection Act*, Article 2(1)(c), Article 8.

[269]*Unfair Competition Prevention and Business Secret Protection Act*, Article 2(1)(c) (from translation provided by Korea as Exhibit 28 of its second submission to the Panel.

The language used in this law to define an "unfair competitive act" – "any manner of misleading the general public" – is broad. It applies to all the examples raised by the Panel – domestic dairy beef sold as Hanwoo beef, foreign pork or seafood sold as domestic product, as well as to imported beef served as domestic beef in restaurants.

172. The application by a Member of WTO-*compatible* enforcement measures to the same kind of illegal behaviour – the passing off of one product for another – for like or at least similar products, provides a suggestive indication that an alternative measure which could "reasonably be expected" to be employed may well be available. The application of such measures for the control of the same illegal behaviour for like, or at least similar, products raises doubts with respect to the objective *necessity* of a different, much stricter, and WTO-inconsistent enforcement measure. The Panel was, in our opinion, entitled to consider that the "examples taken from outside as well as within the beef sector indicate that misrepresentation of origin can indeed be dealt with on the basis of basic methods, consistent with the *WTO Agreement*, and thus less trade restrictive and less market intrusive, such as normal policing under the Korean *Unfair Competition Act*." [270]

173. Having found that possible alternative enforcement measures, consistent with the *WTO Agreement*, existed in other related product areas, the Panel went on to state that:

> … it is for Korea to demonstrate that such an alternative measure is not reasonably available or is unreasonably burdensome, financially or technically, taking into account a variety of factors including the domestic costs of such alternative measure, to ensure that consumers are not misled as to the origin of beef. [271]

174. The Panel proceeded to examine whether the alternative measures or "basic methods" – investigations, prosecutions, fines, and record-keeping – which were used in related product areas, were "reasonably available" to Korea to secure compliance with the *Unfair Competition Act*. The Panel concluded "that Korea has not demonstrated to the satisfaction of the Panel that alternative measures consistent with the WTO Agreement were not reasonably available". [272] Thus, as noted at the outset, the Panel found that the dual retail system was "a disproportionate measure not necessary to secure compliance with the Korean law against deceptive practices". [273] The dual retail system was, therefore, not justified under Article XX(d). [274]

175. Korea also argues on appeal that the Panel erred in applying Article XX(d) because it did not "pay due attention to the level of enforcement sought." [275] For Korea, under Article XX(d), a panel must:

> … examine whether a means reasonably available to the WTO Member could have been used in order to reach the objective sought without putting into question the level of enforcement sought. [276]

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[270]Panel Report, para. 664.

[271]Panel Report, para. 665.

[272]*Ibid*., para. 674.

[273]*Ibid*., para 675.

[274]*Ibid*.

[275]Korea's appellant's submission, para. 182.

[276]*Ibid*., para. 181.

For Korea, alternative measures must not only be reasonably available, but must also *guarantee* the level of enforcement sought which, in the case of the dual retail system, is the *elimination* of fraud in the beef retail market. [277] With respect to investigations, Korea argues that this tool can only reveal fraud *ex post*, whereas the dual retail system can combat fraudulent practices *ex ante*. [278] Korea contends that *ex post* investigations do not *guarantee* the level of enforcement that Korea has chosen, and therefore should not be considered. With respect to policing, Korea believes that this option is not "reasonably available", because Korea lacks the resources to police thousands of shops on a round-the-clock basis.

176. It is not open to doubt that Members of the WTO have the right to determine for themselves the level of enforcement of their WTO-consistent laws and regulations. We note that this has also been recognized by the panel in *United States – Section 337*, where it said: "The Panel wished to make it clear that this [the obligation to choose a reasonably available GATT-consistent or less inconsistent measure] does not mean that a contracting party could be asked to change its substantive patent law or its desired *level of enforcement* of that law …. ". (emphasis added) The panel added, however, the caveat that "provided that such law and such *level of enforcement* are the same for imported and domestically-produced products". [279]

177. We recognize that, in establishing the dual retail system, Korea could well have intended to secure a higher level of enforcement of the prohibition, provided by the *Unfair Competition Act*, of acts misleading the public *about the origin of beef* (domestic or imported) *sold by retailers*, than the level of enforcement of the same prohibition of the *Unfair Competition Act* with respect to *beef served in restaurants*, or the sale by *retailers* of *other meat or food products*, such as *pork or seafood*.

178. We think it unlikely that Korea intended to establish a level of protection that *totally eliminates* fraud with respect to the origin of beef (domestic or foreign) sold by retailers. The total elimination of fraud would probably require a total ban of imports. Consequently, we assume that in effect Korea intended to *reduce considerably* the number of cases of fraud occurring with respect to the origin of beef sold by retailers. The Panel did find that the dual retail system "does appear to reduce the opportunities and thus the temptations for butchers to misrepresent foreign beef for domestic beef ". [280] And we accept Korea's argument that the dual retail system *facilitates* control and permits combatting fraudulent practices *ex ante*. Nevertheless, it must be noted that the dual retail system is only an *instrument* to achieve a significant reduction of violations of the *Unfair Competition Act*. Therefore, the question remains whether other, conventional and WTO-consistent instruments can not reasonably be expected to be employed to achieve the same result.

179. Turning to investigations, the Panel found that Korea, in the past, had been able to distinguish imported beef from domestic beef, and had, in fact, published figures on the amount of imported beef fraudulently sold as domestic beef. This meant that Korea was able, in fact, to detect fraud. [281] On fines, the Panel found that these could be an effective deterrent, as long as they outweighed the potential profits from fraud. [282] On record-keeping, the Panel felt that if beef traders at all levels were required to keep

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[277] *Ibid*., paras. 181, 185.

[278] *Ibid*., para. 192.

[279] Panel report, *United States – Section 337, supra*, footnote 69, para. 5.26.

[280] Panel Report, para. 658.

[281] *Ibid*., para. 668.

[282] Panel Report, para. 669

records of their transactions, then effective investigations could be carried out. [283] Finally, on policing, the Panel noted that Korea had not demonstrated that the costs would be too high. [284] For all these reasons, the Panel considered "that Korea has not demonstrated to the satisfaction of the Panel that alternative measures consistent with the WTO Agreement were not reasonably available". [285] Thus, as already noted, the Panel found that the dual retail system was "a disproportionate measure not necessary to secure compliance with the Korean law against deceptive practices". [286]

180. We share the Panel's conclusion. We are not persuaded that Korea could not achieve its desired level of enforcement of the *Unfair Competition Act* with respect to the origin of beef sold by retailers by using conventional WTO-consistent enforcement measures, if Korea would devote more resources to its enforcement efforts on the beef sector. It might also be added that Korea's argument about the lack of resources to police thousands of shops on a round-the-clock basis is, in the end, not sufficiently persuasive. Violations of laws and regulations like the Korean *Unfair Competition Act* can be expected to be routinely investigated and detected through selective, but well-targeted, controls of potential wrongdoers. The control of records will assist in selecting the shops to which the police could pay particular attention.

181. There is still another aspect that should be noted relating to both the method actually chosen by Korea – its dual retail system for beef – and alternative traditional enforcement measures. Securing through conventional, WTO-consistent measures a higher level of enforcement of the *Unfair Competition Act* with respect to the retail sale of beef, could well entail higher enforcement costs for the national budget. It is pertinent to observe that, through its dual retail system, Korea has in effect shifted all, or the great bulk, of these potential costs of enforcement (translated into a drastic reduction of competitive access to consumers) to imported goods and retailers of imported goods, instead of evenly distributing such costs between the domestic and imported products. In contrast, the more conventional, WTO-consistent measures of enforcement do not involve such onerous shifting of enforcement costs which ordinarily are borne by the Member's public purse.

182. For these reasons, we uphold the conclusion of the Panel that Korea has not discharged its burden of demonstrating under Article XX(d) that alternative WTO-consistent measures were not "reasonably available" in order to detect and suppress deceptive practices in the beef retail sector [287], and that the dual retail system is therefore not justified by Article XX(d). [288]

183. Korea further argues, on appeal, that the Panel did not make a separate finding on whether the display sign requirement was justified by Article XX(d), and requests that, should the Appellate Body uphold the Panel's finding that the sign requirement was inconsistent with Article III:4, it should proceed to consider the issue of its justification under Article XX(d). [289]

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[283] *Ibid*., para. 672.

[284] *Ibid*., para. 673.

[285] *Ibid*., para. 674.

[286] *Ibid*., para. 675.

[287] Panel Report, para. 674.

[288] *Ibid*., para. 675.

[289] Korea's appellant's submission, paras. 217-223.

184. We recall that Korean law requires an imported beef retailer to display a sign reading "Specialized Imported Beef Store". [290] Since the Panel correctly regarded the sign requirement as merely ancillary to the dual retail system, we consider that it is unnecessary to examine separately whether the display sign requirement can be justified under Article XX(d).

185. In sum, we uphold the Panel's conclusion that the dual retail system, which is inconsistent with Article III:4, is not justified under Article XX(d) of the GATT 1994.

VII. Findings and Conclusions

186. For the reasons set out in this Report, the Appellate Body:
(…)

(e) upholds the Panel's ultimate conclusion that Korea's dual retail system for beef is inconsistent with Article III:4 of the GATT 1994;

(f) upholds the Panel's conclusion that Korea's dual retail system for beef is not justified under Article XX(d) of the GATT 1994; and

(g) finds it unnecessary to pass upon separately whether the ancillary sign requirement is consistent with Article III:4 or justified under Article XX(d) of the GATT 1994.

187.The Appellate Body recommends that the DSB request that Korea bring its measures found in this Report, and in the Panel Report as modified by this Report, to be inconsistent with Korea's obligations under the GATT 1994 and the *Agreement on Agriculture* into conformity with its obligations under those Agreements.

[290]Panel Report, paras. 642-643.

III. Optional Reading

1. Taxation

1-1. Unites States – Measures Affecting Alcoholic and Malt Beverages (*Malt Beverages*)

Report of the Panel adopted on 19 June 1992, DS23/R - 39S/206
http://www.wto.org/english/tratop_e/dispu_e/gt47ds_e.htm

The Malt Beverages panel report dealt with numerous state measures in the U.S.A. relating to the marketing and taxation of alcoholic beverages. The report is one of the two only GATT decisions, both from the first half of the nineties, to apply the national treatment obligation according to the "aim and effects" theory. In the assessment of likeness or afforded protection, this theory requires the consideration of the legislative purpose. In your reading of the Malt Beverages panel report reflect on the desirability of this alternative approach. Consider also the compatibility of the "aim and effects" approach with the wording of GATT Art. III and remember the statements of the panel and Appellate Body in the Japan – Alcohol dispute on that account.

(…) [I]rrespective of whether the policy background to 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, both the statements of the parties and the legislative history suggest that the alcohol content of beer has not been singled out as a means of favouring domestic producers over foreign producers. (…)

Thus, for the purposes of its examination under Article III, (…) the Panel considered that low alcohol content beer and high alcohol content beer need not be considered as like products in terms of Article III:4.

1-2. Case Note on Korea-Taxes on Alcoholic Beverages

Joel P. Trachtman
http://www.ejil.org/journal/curdevs/sr1.html

WTO Appellate Body Report, ***Korea-Taxes on Alcoholic Beverages,*** AB-1998-7, WT/DS75/AB/R; WT/DS84/AB/R (99-0010), adopted by Dispute Settlement Body, 17 February 1999. Korea, Appellant; European Communities and the United States, Appellees, Mexico, Third Participant. Division: Matsushita, Ehlermann and Feliciano.

Abstract

This case, following the Appellate Body Report on *Japan -- Taxes on Alcoholic Beverages II*, applied the prohibition on discriminatory taxation under art. III:2 of GATT to the Korean liquor tax regime. Specifically, the panel and Appellate Body found that Korea had applied its liquor tax regime in a discriminatory fashion among imported and domestic directly competitive or

substitutable products, so as to afford protection to domestic production. This measure was thus found to violate the second sentence of art. III:2. While this decision broke little new ground, it confirmed and articulated some of the Appellate Body's earlier holdings. In the current decision, the Appellate Body found that a panel may consider potential competition, or latent consumer demand, in order to determine whether products are "directly competitive or substitutable."

1-3. Case Note on Chile – Taxes on Alcoholic Beverages (Chilean Pisco)

Joel P. Trachtman
http://www.ejil.org/journal/curdevs/sr9.html

WTO Appellate Body Report: ***Chile—Taxes on Alcoholic Beverages,*** AB-1999-6, WT/DS87/AB/R, WT/DS110/AB/R, (99-5414), adopted by Dispute Settlement Body, 12 January, 2000. Chile, Appellant; European Communities, Appellee; Third Participants: Mexico and United States. Division: Feliciano, Ehlermann and Lacarte-Muró. **Major topics addressed by Appellate Body: De Facto Discrimination under Article III(2) of GATT 1994**.

1. Abstract

This case concerned Chile's Special Sales Tax on Spirits, as modified by the Additional Tax on Alcoholic Beverages. The panel found that approximately 75% of domestic spirits would be taxed at 27% under this regime, while over 95% of imported spirits would be taxed at 47%. The Appellate Body upheld the panel's decision that the Chilean regime violated Article III(2) of GATT 1994. The Appellate Body's decision provides a further articulation of the jurisprudence developed in Japan—Alcoholic Beverages and Korea—Alcoholic Beverages. It is notable for its extension of the critiques of domestic regulatory categories structured around types of beverages in the previous decisions to regulatory categories structured around alcohol content. It is also notable for its clarification of the role of legislative intent in decision-making under Article III. It is permissible to consider aim and effects, but only as evidenced by the actual structure of the measure.

2. Facts

This case concerned Chile's Special Sales Tax on Spirits, as modified by the Additional Tax on Alcoholic Beverages. The new Chilean system, scheduled to be implemented from 1 December 2000, provides for taxation of spirits at varying *ad valorem* rates based on their alcohol content as follows: for alcohol content of 35 degrees or less, the rate is 27%, and the rate increases by 4 percentage points per additional degree of alcohol, up to a maximum of 47% for spirits over 39 degrees. The panel found that approximately 75% of domestic spirits would be taxed at 27% under this regime, while over 95% of imported spirits would be taxed at 47%.[291] The European Communities (EC) argued that the Chilean system violates Article III:2, second sentence, of GATT, because it provides preferential treatment to a domestic alcoholic beverage, pisco. The panel found that the imported distilled beverages were 'directly competitive or substitutable' with domestic products.

3. Analysis of the Appellate Body Report

[291] Panel Report, *Chile—Taxes on Alcoholic Beverages*, WT/DS87/R; WT/DS110/R, 15 June 1999, para. 7.158. The panelists were Wilhelm Meier, Mohan Kumar and Colin McCarthy.

Chile argued that the panel erred by virtue of its failure to evaluate the new Chilean system as a 'hybrid' system, combining features of an *ad valorem* and a specific tariff and referring to *both* alcohol content *and* price. Chile argued that if looked at as an *ad valorem* tax at a fixed rate *dependent* on the alcoholic content, the new system is not discriminatory. The question Chile raises is whether WTO law accepts the alcohol content-based categories that its new system establishes. Chile argued that the panel had improperly evaluated the 'efficiency' of its regulatory structure.[292] Chile argued that, unlike the systems criticized in *Japan—Taxes on Alcoholic Beverages* and *Korea—Taxes on Alchoholic Beverages*, the Chilean system does not use product names as categories. Chile argued that the panel erred in its interpretation of Article III(2), second sentence, as it considered discriminatory effect. Chile argued that the panel should have ended its inquiry once it found facially neutral categories.

The European Communities argued that Article III(2), second sentence, requires a comparison of the relative tax burdens on imported and domestic products.[293] The products subject to comparison are those that are directly competitive or substitutable. Facial neutrality is not sufficient to withstand scrutiny under this provision. The fact that some imports are in the lowest tax category, and some domestic spirits are in the highest, does not insulate a measure from scrutiny.[294]

The United States suggested application of an 'aim and effects test' under the 'so as to afford protection' language of Article III(2), second sentence. The United States argued that there was evidence revealing a 'protective structure'.

The Appellate Body, following *Japan—Alcoholic Beverages*, first examined whether the domestic and imported products are 'directly competitive or substitutable products' in competition with each other. As Chile did not appeal the panel's finding that the relevant beverages were 'directly competitive or substitutable products', the Appellate Body was required to base its reasoning on this finding.[295]

Following *Japan—Alcoholic Beverages*, the Appellate Body turned to the question of whether these products were 'not similarly taxed'. It rejected Chile's request that it respect Chile's fiscal categories, refusing to confine its comparison to imported and domestic products within a single fiscal category. Rather, the Appellate Body applied the clear language of Article III(2), second sentence, finding that its comparison must be among all 'directly competitive or substitutable products', regardless of the domestic fiscal categories.[296] The Appellate Body considered '*all* the distilled alcoholic beverages in *each and every* fiscal category'.[297] The Appellate Body upheld the panel's finding that these goods were not similarly taxed within the meaning of *ad* Article III(2) of GATT 1994.

The Appellate Body also followed *Japan—Alcoholic Beverages* in its evaluation of whether the Chilean measure was applied 'so as to afford protection'. Here, the Appellate Body held that states are free to structure their tax systems as Chile had done, distinguishing beverages on the basis of alcohol content, so long as these classifications are not applied so as to protect domestic production.[298] The

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[292] Appellate Body Report, para. 14.
[293] Appellate Body Report, para. 22.
[294] Appellate Body Report, para. 27, citing *Japan—Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/, WT/DS11/AB/R, adopted 1 November 1996; *Korea—Taxes on Alcoholic Beverages*, WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 February 1999.
[295] Appellate Body Report, para. 48.
[296] Appellate Body Report, para. 52.
[297] *Ibid*, emphasis in original.
[298] Appellate Body Report, para. 60.

Appellate Body rejected consideration of the subjective intentions of legislators or regulators. Rather, the 'protective application can most often be discerned from the design, the architecture, and the revealing structure of a measure.'[299] '[A] measure's purposes, objectively manifested in the design, architecture and structure of a tax measure, *are* intensely pertinent to the task of evaluating whether or not that measure is applied so as to afford protection to domestic production'.[300] Thus, the Appellate Body directs that attention be focused on a particular kind of evidence of intent. Given the evidence of a discriminatory structure, it was for Chile to present countervailing explanations.[301] The Appellate Body approved the panel's application of a kind of means-ends rationality test, implying that a necessity test might have exceeded the panel's authority under Article III(2).

The Appellate Body found that :

In practice . . . the New Chilean System will operate largely as if there were only two tax brackets: the first applying a rate of 27 per cent *ad valorem* which ends at the point at which most domestic beverages, by volume, are found, and the second applying a rate of 47 per cent *ad valorem* which begins at the point at which most imports, by volume, are found.[302]

However, this fact alone was not decisive as a basis for characterization of the Chilean system.

4. Conclusions

This decision provides a further articulation of the jurisprudence developed in Japan—Alcoholic Beverages and Korea—Alcoholic Beverages. It is notable for its extension of the critiques of domestic regulatory categories structured around types of beverages in the previous decisions to regulatory categories structured around alcohol content. It is also notable for its clarification of the role of legislative intent in decision-making under Article III. It is permissible to consider aim and effects, but only as evidenced by the actual structure of the measure.

2. National Treatment

2-1. Robert Howse & Donald Regan, The Product/Process Distinction - An Illusory Basis for Disciplining 'Unilateralism'

In: 11 Eur. J. Int'l L (2000) 249-289.

2-2. H. Horn, J.H.H. Weiler, European Communities – Measures Affecting Asbestos and Asbestos-Containing Products

In: *Principles of International Trade Law: The WTO Case Law of 2001*, Henrik Horn and Petros C. Mavroidis (eds), Cambridge University Press, 2004.

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[299] Appellate Body Report, para. 62, quoting *Japan—Taxes on Alcoholic Beverages*, at 29.
[300] Appellate Body Report, para. 71.
[301] *Ibid.*
[302] Appellate Body Report, para. 66.

ASBESTOS

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1 *Asbestos* as Watershed

Some cases attain 'landmark' status because they constitute a jurisprudential paradigm shift. Others attain such status because in them a decisor, usually a supreme jurisdiction, renders a definitive, 'canonical,' ruling. Sometime it is both reasons. Sometimes, rarely, it is neither. *Asbestos* is such a rare case. It may well qualify as a landmark. It has, justifiably, attracted huge attention and, understandably, considerable controversy. Its reasoning, however, is so decidedly non-definitive that it is not, consequently, possible to say whether it represents a veritable paradigm shift or is just another badly reasoned case by the Appellate Body (AB) with an oddball result. It is a rare, indeed unique, instance that embedded in the decision itself a Member of the Appellate Body Division which decided the case, expresses "substantial doubt" as to the core reasoning of the decision[1]

The importance of *Asbestos* must initially be found in its factual matrix, a French Government Decree of 1966[2] providing, *inter alia*, in its first article as follows:

> I. – For the purpose of protecting workers, […] the manufacture, processing, sale, import, placing on the domestic market and transfer under any title whatsoever of all varieties of asbestos fibres shall be prohibited, regardless of whether these substances have been incorporated into materials, products or devices.
>
> II. – For the purpose of protecting consumers, […] the manufacture, import, domestic marketing, exportation, possession for sale, offer, sale and transfer under any title whatsoever of all varieties of asbestos fibres or product containing asbestos fibres shall be prohibited […]."

This is a most typical (arguably the most typical) kind of government measure in the field of consumer and workplace protection taken in Member countries rich or poor, North or South,

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[1] In Recital 154 of the AB decision, the anonymous Separate Opinion opines: "My second point is that the necessity or appropriateness of adopting a "fundamentally" economic interpretation of the "likeness" of products under Article III:4 of the GATT 1994 does not appear to me to be free from substantial doubt. Moreover, in future concrete contexts, the line between a "fundamentally" and "exclusively" economic view of "like products" under Article III:4 may well prove very difficult, as a practical matter, to identify. It seems to me the better part of valour to reserve one's opinion on such an important, indeed, philosophical matter, which may have unforeseeable implications, and to leave that matter for another appeal and another day, or perhaps other appeals and other days. I so reserve my opinion on this matter."

[2] *Décret no. 96-1133 relatif à l'interdiction de l'amiante, pris en application du code de travail et du code de la consommation, Journal officiel* of 26 December 1996.

West or East. *Asbestos* thus affects the physiognomy, not the pathology, of government regulation and its entanglement with GATT trade rules.

It is also a case that implicates what is arguably the most central of GATT disciplines: National Treatment in the field of Regulation (and, by implication, taxation.) There was never a serious doubt as to the material outcome of this case: Validating the legality of the French measure. (Many suspect that the Canadian government could not have seriously believed the WTO would overturn a ban on asbestos, but that it needed the result as a matter of domestic politics.) And even if the reasoning of the AB is, as argued, not a model of lucidity it did reject the methodology adopted by the Panel even if coming to the same material result. This, thus, is not a case about outcomes but about reasoning: The proper way for regulators and adjudicators to think of the application of the most central of GATT disciplines to the most central of government regulatory activity.

It is our belief that the case does not settle this question definitively but is extremely important in challenging the previously extant methodology. It is veritably a watershed case – the full significance of which will emerge in the light of subsequent jurisprudence.

Our own methodology will be as follows. The outcome of *Asbestos* is hardly in doubt here. It is as noted the framework of methodologies that should become the central discussion point regarding *Asbestos*. For it will provide a normative yardstick with which both to evaluate the specific decision in this case and to prescribe future evolution. We shall therefore first expound three possible approaches that *Asbestos* has opened up for interpreting the ambit of the National Treatment provision in GATT as it applies to regulation. We will then discuss the main findings by the Panel and the AB in the light of these approaches.

2 Three Methodologies for Dealing with Regulation under GATT 1994

In order to structure the discussion of the adjudicating bodies' rulings in *Asbestos,* we find it useful to distinguish between three possible Methods of interpreting GATT 1994, as it applies to

health (and other regulatory) measures. These three approaches – or Methodologies -- do not perhaps correspond exactly to the views put forth by any particular body or individual, but each seems to capture the essence of a distinguishable way of reasoning. It should be emphasized however, that they are not meant to exhaust the set of possible interpretations. We believe that each of the three represents a plausible way of approaching the issues in Asbestos and, in fact, we see traces of all three in the decision of the Panel and Appellate Body. One reason Asbestos has attracted so much attention is precisely because it represents a methodological crossways. The essential textual matrix of the case in relation to which the three approaches will be examined is as follows:

Article III(1) – the Chapeau – applies both to taxation and regulation and provides as follows:

> 1. The contracting parties recognize that internal taxes and other internal charges, and 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, should not be applied to imported or domestic products so as to afford protection to domestic production.

Article III(4) applying specifically to regulation provides:

> 4. The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.

Article III(2) applying specifically to taxation provides:

> 2. The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.

An *ad* to Article III(2) explicates:

> A tax conforming to the requirements of the first sentence of paragraph 2 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 product and, on the other hand, a directly competitive or substitutable product which was not similarly taxed.

Finally, Article XX provides as follows:

> *General Exceptions*
>
> Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:
>
> (*a*) necessary to protect public morals;
>
> (*b*) necessary to protect human, animal or plant life or health;
>
> ……

Though *Asbestos* concerns legislation, the fact that the relevant legislation applies jointly to regulation and taxation is not without significance.

All three methodologies share a premise as to the reach of the GATT in this area: Members retain fiscal and regulatory autonomy under the GATT. In the exercise of their fiscal and regulatory autonomy they may not violate the principle of National Treatment as expressed in the legal matrix outlined above.

The interpretation of Article III as it applies to regulation hence hinges principally on the interpretation of three terms:

- "like";
- "so as to afford protection"; and
- "treatment not less favorable".

The three stylized approaches we are to define and discuss differ in their interpretations of these three terms and their relationship to Article XX.

2.1 Methodology I: The 'Objective' Approach

As will be argued below, this is the methodology used essentially by the Panel in *Asbestos*. We are not trying to summarize the decision of the Panel here, but to present as a matter of theory a methodology which in our view underlies the approach by the Panel. It has also been employed by various panels and the AB in other cases, notably in the area of taxation. The 'Objective'

approach may be synthesized thus: As mentioned, Members retain fiscal and regulatory autonomy. They may impose taxation or adopt regulation as an expression of their specific socio-economic preferences. These may, and usually will, differ from country to country. Violation of National Treatment takes place when their tax or regulatory regimes distort competition between imported and domestic products in favor of the latter. In the words of the AB in *Japan – Taxes on Alcoholic Beverages*:[3]

> Article III obliges Members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products .… Article III protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products. …[4]

The distinguishing feature of the first methodology is to understand the problematic turn of phrase in Article III(1) – *so as* – whereby domestic taxation and regulation

> **…**should not be applied to imported or domestic products so as to afford protection to domestic production.

as indicative of an *objective general prohibition*: Taxation and regulation may not be applied in a way that *results* in protection being afforded to domestic production. This prohibition applies also to taxation and regulation which, on its face, is origin neutral. Critically, the entire phrase "should not be applied to imported or domestic products so as to afford protection to domestic production" is understood on this methodology as applying to the result of the tax or regulatory regime – to its *effect* on the competitive relationship between domestic and imported products and not to the intention or purpose of the tax and regulatory regime.

On this approach, a regulatory (or tax) regime which was adopted with the explicit intention of distorting competition in favor of domestic production but which, owing, say, to the stupidity of the regulator did not have that effect, would not be in violation of Article III. The contrary would be equally true: A regulatory regime adopted on an origin neutral basis with no protectionist purpose at all, but which, nonetheless, happened to "… afford protection to domestic production" would be caught by Article III.

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[3] WTO WT/DS88,10,11/AB/R, Oct 1996.
[4] AB Report, *Japan – Taxes on Alcoholic Beverages*, *supra*, footnote 58, at 109 and 110.

Under this method, a regulatory or tax measure that afforded protection to domestic production, would if it were to be retained, have to be justified in accordance with Article XX.

Articles III(2) and III(4) on this reading set out the precise legal conditions which would trigger a legal violation of the general principle enunciated in the Chapeau in the case of taxation and regulation respectively. Specifically, in relation to regulation

> The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.

Two issues in particular require elucidation: Which products are covered by the non-discrimination discipline? What conduct amounts to a violation of that discipline?

The first condition relates to the products – domestic and imported – to which the discipline applies. Article III(4) speaks of 'like' products. Article III(2)(i) also refers to 'like' products and Article III(2)(ii) glossed by the ad note includes as a second category 'directly competitive or substitutable products.' Consequently, "likeness" in Article III(2) has been construed narrowly. The AB is emphatic in *Asbestos* that the "like" products in Article III(4) may not be the same as the "like" products in Article III(2) and must be interpreted far more broadly. In fact, in order for Article III(4) successfully to give expression to the general principle enunciated in the Chapeau, "like" products in III(4) must be understood as covering products which are competitive and/or substitutable even if in terms of their characteristics they may not be quite so like as products under the first sentence of Article III(2). Whilst their surely will be, according to the AB, some products whose degree of substitutability is so insignificant as to exclude them from the discipline of Article III(4), under the first approach, any appreciable degree of competition would bring the products within the purview of Article III(4).

Under Methodology I, 'likeness' for the purposes of Article III(4) is thus to be determined in the market place: It is only when products are in an appreciable (i.e. not *de-minimis*) competitive relationship that a less favorable treatment of an imported product can have the effect of

protecting a domestic product. We will not deal here with the means for determining the existence of a competitive relationship in the market.[5]

Once established that two products are in such a competitive relationship and are, thus, 'like' products and subject to the discipline of Article III(4), the second legal condition relates to the conduct or content of the measure that will amount to a violation, by forbidding *less favorable treatment* of like imported products. Put differently, Article III(4) gives specific expression (to use a term employed by the AB) to the general principle enunciated in III(1) that regulation may not be applied *so as to afford protection* to domestic production by instructing that imported products "… shall be accorded treatment no less favourable…."

It is important at this juncture to explore further the comparison of the Which and What between Article III(2) and III(4).

As noted above, Article III(2) provides two replies to the Which question: The discipline of national treatment applies to Like Products *simpliciter* as well as products which are in direct competition or are substitutable even if not "like" in a narrow sense. Like products in the sense of Article III(2) has according to the AB to be interpreted narrowly and, thus, denotes products

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[5] Usually a high degree of functional substitutability between two products would result in a competitive relationship within the market. Thus, in normal situations actual consumer preference and market behavior should be of reliable probative value for determining a competitive relationship that in turn could determine likeness.

Tantalizingly, the Ad to Article III speaks of direct competition *or* substitutability. Could there be a situation where substitutable products would not be in competition with each other? We think that such a situation might just exist, provided that 'substitutable' is taken to be measured at some future date, after consumers have been exposed to consumption of the product in question. For instance, after some time, Kiwis are recognized by most consumers as a valid substitution to many other "juicy fruits" and finds itself in a competitive relationship with such fruit. But that might not be the case at the moment of introduction into the market. Moreover, in *Korea – Alcoholic Beverages* the AB speaks of "latent demand" alluding to the situation where the very tax or regulatory regime under consideration would have shaped consumer preferences in a way that as an empirical matter two products which could (as evidenced in, say, some other market) be considered as objectively substitutable do not appear to engender robust competition and thus would not be considered under the objective test as like products and thus in turn would allow further differentiated treatment even more deeply shaping consumer preference. In some respects a similar phenomenon exists in relation to any new product, though functional similarity is much easier to communicate to potential consumers than taste.

It is clear that the relevant measure of substitutability should in principle take into account such effects, at least to the extent that the phrase 'directly competitive or substitutable' is meant to limit the ambit of Article III to situations where less favorable treatment has significant negative impact on imports. It is much less clear how this should be done in practice, however.

which are very substitutable, in a high degree of competition and sharing physical and other characteristics. Products caught by the second sentence of Article III(2) may not share as many physical and other characteristics and the degree of substitutability and/or competition may not be quite as high.

What difference does it make? Critically, under the First Methodology in the case of Article III(2) 'like' products, the trigger for violation is *any* taxation on the imported product in excess of that imposed on the like domestic product. Any taxation in excess: Even the smallest difference would constitute a violation. Any taxation in excess: Whatever its intention and purpose.

In relation to the other broader category of products in Article III(2) this is arguably not the case. When products are "merely" in competition with each other but not amounting to 'like' products, Article III(2) contemplates the possibility of a tax on the imported products in excess of the domestic one which does not constitute a violation. Instead it says, in relation to that category the trigger will only be taxation which is inconsistent with the principles of Article III(1) – notably "… so as to afford protection to domestic production." What is the logic of the text which tells us that when products are "like" – meaning very, very similar to each other, any excess tax, even the smallest, would affect the competitive relationship and hence constitute a violation, but when products are not so similar though in competition with each other or being substitutable, a small difference in tax even in excess may not affect the competitive relationship and hence not constitute a violation? Arguably, it would not make sense to avoid a subjective-intention test for "like products" but to introduce, through the words "so as to afford protection" such a test for products which are not "like" but are in competition with each other. Instead, it is more plausible on this reading to argue that the distinction turns on a different reasoning. It may have been thought that when products are not so similar and are only partially substitutable, a small difference in taxation would not affect consumer preferences more than marginally and hence not affect the competitive relationship between products in any significant way. Only a difference in tax which was sufficiently big to noticeably "afford protection" would be caught. What is important is that this distinction may seem to give some support to the hermeneutics of the Objective Methodology – since one possible way of reading it is to say, that in relation to the

broader category, only a difference in taxation which has the effect (e.g. by being big enough) to afford protection between products which are only partially in competition, will trigger a violation. This reading would it could be argued constitute another reason not to read purpose or intent into the phrase "…so as to afford protection" but to see it as indicating an objective state reflecting a tax or regulation which distort competition whether intended or otherwise.

To conclude, under the Objective Methodology of Article III:

- Likeness measures the degree to which products are in competition in the market place.
- The yardstick for determining whether "less favorable treatment" has been rendered does not take into account any rationale for differential treatment, such as differences in health impact, but only captures the effect of the measure.
- Such less favorable treatment to imported products is a necessary and sufficient requirement for the measure to be such So As To Afford Protection.

2.2 Methodology II: The 'Effect and Purpose' Approach[6]

The second approach to interpreting Article III shares one important feature with Interpretation I: Products must be in competition with each other for Article III(4) to apply at all. And the measure in question, at least *ipso facto,* would have to give some advantage to the domestic product and so afford protection to domestic production. But these would be only necessary conditions, not sufficient ones for a finding of an Article III violation. Methodology II maintains that any advantage given by origin neutral regulation (or taxation) to domestic production must have been applied *with that purpose in mind,* to be illegal.

On this reading, the mutual promise among all Members ex Article III was not to refrain from any taxation or regulation which would merely have the effect of giving protection to domestic production, but to refrain from imposing such regulation or taxation with that purpose.

[6] We avoid "aims & effect" because that has attained a certain canonical meaning in doctrine from which we prefer to be unencumbered. Of course our Methodology II share much with aims and effect.

A hard version of Interpretation II would insist on detecting such purpose, almost as a "*mens rea*" test in the regulatory process. A weaker, arguably more workable and defensible, version, adopted by the United States in *Japan – Taxes on Alcoholic Beverages* would be more holistic:[7] The failure of the importing country State to provide at the adjudicatory stage a plausible explanation to the measure producing the disparate impact, would create a presumption of bad purpose.

Applied to *Asbestos*, this approach would result in a finding of no violation of Article III since on the hard version it would be hard to impute bad purpose to the French measure. On the soft version, France could plausibly (and realistically) explain that its origin neutral measure was not applied so as to afford protection to domestic production but so as to afford protection to consumers and workers. The case would not on this reading every reach Article XX.

It should be noted that under Methodology I, a state seeking to justify a measure that was facially in violation of Article III, would be subjected in almost all situations to the Least Restrictive Measure test – it would not be allowed to keep the measure in place, as written, if it could be shown that the objective sanctioned by Article XX could be reasonably achieved in a manner which was less burdensome to trade. Under the Effect and Purpose methodology this examination is folded into the Article III analysis. The non-choice by the State of readily available less restrictive measures would need to be justified unless the presumption of bad purpose were triggered.

To summarize, according to Methodology II:

- Likeness measures the degree to which products are in actual or potential competition in the market place.
- The yardstick for determining whether 'less favorable treatment' has been rendered does not take into account any rationale for differential treatment, such as differences in health impact, but only captures the effect of the measure.

[7] Submission of the United States of August 23, 1996 in the Appeal to *Japan - Taxes on Alcoholic Beverages* (AB 1996-2)

- For a measure to be caught by the So As To Afford Protection requirement, it is necessary that it *intentionally* provides such less favorable treatment (or that the State cannot give an adequate rational explanation for such treatment whereby intention will be implied.

The difference compared to Methodology I is hence the requirement of not only protective effect, but also such intent. If the Purpose and Effect approach were to be applied in *Asbestos*, the measure would most likely be accepted, since it would be found to lack protective intent.

2.3 Methodology III: The 'Alternative Comparators' Approach

Methodology II introduced one source of difference to Methodology I: the subjective requirement of purpose as a condition for illegality. Methodology III is a variation, but an important one, on Methodology II. Purpose is an important component also in Methodology III. But Methodology III takes a further step away from Methodology I, since it operates on a different trajectory of reasoning with regard to the determination of likeness.

Every determination of likeness for the purpose of determining the existence of discrimination embodies, explicitly or implicitly, a comparator. In case of, say, gender or race discrimination, I take as the comparator the essential humanity of the subjects. In the light of that comparator men and women, or whites and blacks, or Jews and Gentiles, are held to be "like" and the norm of "like" treatment is triggered. Differently put, I exclude as comparator color of skin, or gender, or race and religion: As a matter of policy those are determined to be irrelevant comparators. If color of skin were a legitimate comparator, then for the purposes of that comparator whites and blacks would be "unlike" and could (and even should) be treated differently since to treating the "unlike" in a like manner is equally discriminatory to treating the "like" in an unlike manner.

Under Methodologies One and Two, the implicit comparator is market functionality of the product. It is the comparator reflective of the vocabulary of substitutability, competition, consumer preference. Products are considered "like" and subject to the discipline of National Treatment because they meet similar needs of the consumer and hence compete with each other

in the eyes of consumer on the market. Methodology One and Two share the same conception of likeness deriving from the same market place comparator.

Method One and Two differ in the way they treat the plea of the State that the less favorable treatment accorded the imported product was in pursuance of a legitimate purpose.

Under Method One such a plea of legitimate purpose will exculpate the overall illegality of the State measure if found to fall within the parameters of Article XX. The State will have been found to discriminate since two “like” products were treated in an unlike manner and thus Article III was violated, but the discrimination will be considered justified in pursuance of an overriding other policy sanctioned under Article XX.

Under Method Two there is no finding of discrimination and thus of violation of Article III since even though like products have been treated in an unlike manner, discrimination is construed as occurring only when the less favorable treatment is imposed with the purpose of protecting domestic production.

Under the Third Methodology, the very comparator is put into question. To illustrate: In a famous tax case, Italy had a high tax on refined engine oil and a low tax on recycled engine oil. It did so for ecological reasons – to provide an economic incentive to recycle oil thus enhancing conservation and responsible disposable of used oil. From a market functional perspective refined oil and recycled oil meet the very same needs of the consumer and are in competition with each other. Indeed, in their properties they are so similar, they are indistinguishable. The user can not, from its properties, tell the difference between refined and recycled oil. Taxing imported refined oil at a high rate and domestic recycled oil at a low rate would certainly amount to treating a like imported product in a less favorable way.

Using Method One – Article III will have been held to have been violated, but the State may justify its measure under Article XX(g).

Under Method Two, since the purpose of the tax was not to protect domestic production (even if this was its effect) but to protect the environment, no violation of Article III will have taken place.

Under Method Three the two products are not considered like, because the implicit comparator of the measure is not market functionability but an alternative comparator -- ecological efficiency: Ecologically efficient products (such as recycled oil) are taxed at a low rate and ecologically inefficient products (refined oil) are taxed at a high rate. Under this methodology, by employing an alternative comparator, refined oil and recycled oil simply do not come under the discipline of national treatment and Article III – any more than diamonds and oranges would.

Note that under Method III it is not set of values of the Adjudicator which determine the outcome. It is the choice of comparator by the regulating state. In this respect the role of the adjudicator under Method III is no different to his or her role under Method II: The adjudicator has to decide whether the State has made a convincing argument concerning the choice of comparator underlying the regulatory or tax distinction. Note too that under method III once the comparator is defined, the test of less favorable treatment and So As To Afford Protection do not differ from Method I – they are market based and look at effects of the measure on the competitive relationship between the like products (defined according to the relevant comparator).

Applied to Asbestos, the comparator implicit in the French Decree is health risk or more specifically carcinogenic potential. The Decree, on this reading, differentiates (in origin neutral fashion) between carcinogenic and cancer risk free products. By reference to the comparator of cancer risk the two products are simply unlike products and not caught by the discipline of national treatment and non-discrimination.
To summarize, the complaint will typically be triggered by a situation where a “like” imported product, defined in market terms is treated less favorably than its domestic counter part. Under method III

- Likeness is defined by reference to the implicit or explicit comparator underlying the measure.

- A product is understood to be treated less favorably in the traditional way – with reference to the effect of the measure on the competitive relationship between the like products (defined by the appropriate comparator)
- Protection is afforded when a like imported products (defined by the appropriate comparator) is treated less favorably.

2.4 Reflections on the Three Methodologies: What's in the Choice?

We do not here take position but are more concerned to explain the choices made by the adjudicating bodies of the GATT and WTO. Historically, and certainly since the advent of the WTO, GATT decisors (panels and AB) have demonstrated a clear preference for Methodology One or some variant of it. Methodology Two has been forcefully articulated in the literature and argued in some case but generally not found favor and at times rejected explicitly. Occasionally, traces of Method Two can be found creeping in through the backdoor in the reasoning of Panels and the AB.(e.g. *Chile Piscor*).

Method Three has not featured, as such, in either literature or jurisprudence, though one can find strands of its reasoning intertwined in the articulation of Method Two. Both methods are, after all, conceptually linked.

Instead of trying to argue which approach, hermeneutically or from a policy perspective is the "right" or "correct" approach, we would rather assess some of the arguments and, more importantly, try and explain the attachment to Method One which, in our view, persists in Asbestos too.

One hermeneutic argument should be dispelled quickly enough, that to employ Method Two (or Three) would render Article XX redundant. Article XX would retain its place in relation to other Articles of the GATT such as Article XI as well as to those situations where there actually was purposeful discrimination under Article III in where, for example, the State employs non origin neutral regulations.

It is also often stated that one big difference between the Method One and Two concerns burden of proof. Formally, this would seem to be the case. Under Method One, once it is established that a violation of Article III has taken place by reason of an imported product receiving less favorable treatment than a "like" domestic product (likeness objectively determined), the burden of justification falls on the defending State. It is usually thought, that under Method Two, the burden on the complaining State would be much greater since not only would the complaining State have to prove likeness and less favorite treatment, but also bad purpose. Forensically we think this argument is often overstated. If one takes the American Appellate brief in Japan Alcoholic Beverages as a bench mark for the actual operationability of Method Two it would seem that in practice once less favorable treatment of the imported like product were established, there would be a presumption of protectionist purpose unless, very much in Article XX fashion, the defending state did not justify its practice by reference to a legitimate purpose.

The differences between the two methods seems to rest elsewhere – both practically and conceptually.

One alleged practical consequence would be the range of policies available to the State. Under the Method One, this range would be limited to the policies of Article XX. Under Method Two (and Three) other policies could be employed. In particular it may be thought, that given the great difficulty of amending the Agreements, it would be unwise to force States to lock themselves into a list of policies which may remain static for decades. In our view from a practical point of view this difference seems more illusory than real. Article XX is broad and sufficiently open textured to cater for most exigencies and the WTO decisors have shown themselves ready to adopt such a dynamic hermeneutics in interpreting the provisions of Article XX. To the extent that Panels and the AB have resisted Method Two (and Three) it is not because they feared that actual policies unsanctioned by Article XX would have to be validated under the second methodology.

Two other considerations may have played a role in explaining the reluctance to move away from Method One. The first is the perception by panels and the AB of their own legitimacy. The

obsessive rhetorical (though not substantive) reliance of the AB on the plain and ordinary meaning of words in an indication of legitimacy anxiety by a new body in a new adjudicatory situation. The Panels and the Appellate Body may simply feel more comfortable in legitimating State action which treats imported products less favorably when anchored in the explicit text of Article XX than in the more abstract legitimation process ex Article III.

They also may feel that to link the justification to Article XX enhances, and is thus, preferable, the *multilateral* dimension of the WTO whereas to employ the other Methods enhances the autonomy, sovereignty "unilateral" dimension of the Agreement.

The strongest argument for the other Methodologies are not, in our view, of a crude pragmatic nature – i.e. leading to tangible different results but in the realms of concept and symbol.

First there is something that comes under the concept of "naming and shaming." It is wrong, it can be argued, to deal with the case of a State which adopts an origin neutral measure for a totally legitimate purpose but which has the coincidental effect of giving an advantage to domestic production, as a violation of a non-discrimination provision requiring justification. Even if the result is the same, there is value in having cases dealt with in a correct normative context and not diluting the notion of discrimination with activities which should not be so branded.

There is, it is also argued, a 'truth' based argument which goes beyond the lexical hermeneutics of the text of Article III, namely that there can be no discussion of discrimination which does not imply in some way and at some level examination of purpose and an agreed comparator.

We may agree that there should be no discrimination between men and women, which means that we exclude gender as a relevant comparator for different treatment. But, assuming that we want to write our laws in a way which would, say take account of the fact that women, not men fall pregnant. We might, in view of this fact, want to have special provisions in our labor code concerning leave, grounds of dismissal and the like which would, of course, treat men and women differently. One way would be to say that such law were discriminatory but where

exculpated by an overriding justification. Another way, perhaps with more conceptual coherence would be to argue that for the purposes of child birth men and woman are not "like" and therefore treating them differently is not a matter of discrimination at all. The question is not which is the advisable policy (maternity leave and/or paternity leave etc.) but the understanding that what we are doing in relation to these issues is to discuss the legitimacy of alternative comparators, and/or the legitimacy of the purpose of the legislation which presumes a difference or results in a difference.

At an even deeper level, the difference between Method One and Methods Two/Three can go to the very symbolism of political identity. Method One – even if very solicitous to diverse socio-economic choices in the construction of Article XX, establishes a normative hierarchy whereby the default norm is liberalized trade, and for competing norms to prevail, they have to be justified. This is not a question of technical burden of proof. It is a question of constitutional identity, the way a society wants to understand its internal hierarch of values. Methods Two and Three reverse that default. The default value is autonomy of political and moral identity which requires justification only if purposefully abused.

In our view the Agreements in general and Article III specifically can be read in a way which would sustain either of these understandings.

This, however, might lead us to yet another *contingent* reason for the attachment to Method One. For the decisor, Method One does not involve a value judgment at the level of comparator – it takes as a default competitive relationship in the market. This is akin to the adjudicatory comfort argument mentioned above when it comes to violation.

But there is yet another consideration. At the end of the day, the GATT norms are addressed principally to regulators. Very often the very same regulators which just yesteryear where responsible for articulating, implementing and justifying protectionist regimes. It may be wise in such a circumstance, as a contingent matter, to aim for an 'objective' regime determining both likeness (competitive relationship in the market place) and violation (less favorable treatment leading to a protective effect) precisely for the 'naming and shaming' effect. As a means of

habituating the transition generation of national regulators to take the regime of non-discrimination seriously; to have their hand shake, so to speak, every time a regulation is made, or defended which would treat competing imported products differently. One can envision, on this reading, that with time, with the internalization of the norms of equal treatment, a different approach may be adopted.

3 *Asbestos* in the Light of the Three Methodologies

We will now turn to a discussion of the Panel and AB reports in *Asbestos*, from the perspective of the three approaches identified above.

3.1 The Panel Report

Generally speaking, the Panel in *Asbestos* employed Method I. It found first that the products were like on a market based test. Consequently the French measure violated Article III since it had the effect of providing less favorable treatment to imported products and thus was such as to afford protection to the domestic producers. It then found that the measure was justified under Article XX(b).

Applied to *Asbestos*, according to Interpretation I, there would be an entire range of products, notably in the building and do-it-yourself sectors where different technologies would be used to give certain materials an insulating capacity, asbestos being one of such technologies. Accordingly, most of these products, from a functional point of view, would be appreciably substitutable and at least in partial competition with each other and, hence, caught within the definition of likeness ex Article III(4). The violative trigger would be easily applied here since the effect of the State measure in question is not simply to burden the competing import but to exclude it entirely from the market place. The violation of Article III(4) would thus be relatively easily established and the State would have to justify the maintenance of such measures ex Article XX(b) – not a difficult task given the serious risk factor of asbestos.

3.2 The AB Report

The AB report devotes considerable attention to the determination of whether asbestos products are “like” other products not affected by the French *Decret*. We believe that the essential points made by the AB are the following (the number in parenthesis refers to the respective recital):[8]

1. 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. (99)
2. The four criteria listed in the *Border Tax Adjustment* (BTA) dispute can be used to assess likeness, but do not constitute a closed list. (102)
3. The Panel did not correctly employ these criteria, since having adopted the BTA procedure, the Panel should have considered *all* four criteria separately. (109) Instead the Panel:
    (i) confused the discussion of physical characteristics and end-uses; (111)
    (ii) failed to take into account the physical differences between asbestos products and other products; (114)
    (iii) did not provide a complete picture on differences in end-uses; (119)
    (iv) did not appropriately consider differences in consumers’ tastes and habits; (120-121) and
    (v) did not fully analyze the implication of different tariff classification. (124)
4. Health risk should in general be included in the determination of likeness. But in the case of asbestos products, this could be addressed when assessing physical properties and consumer perceptions. (113)
5. Panels must examine fully the physical properties of products, and in particular those that are likely to influence the competitive relationship in the marketplace. (114)
6. The carcinogenicity of asbestos products is a main factor making it physically different from substitute materials, and has to be taken into account when examining likeness. (114)

[8] We concentrate on the relationship between cement-based products containing chrysotile asbestos fibres and those containing PCG fibres.

7. Under Article III:4, evidence relating to health risks may be relevant in assessing the *competitive relationship in the marketplace* between allegedly "like" products. Same evidence should be used under Article XX(b) to assess whether sufficient basis for adopting or enforcing a WTO-inconsistent measure on the grounds of human health. (115)
8. The end-use, and consumer habits and tastes, criteria involve certain of the key elements relating to the competitive relationship between products. Evidence of this type is of particular importance under Article III of the GATT 1994, precisely because that provision is concerned with competitive relationships in the marketplace. If there is – or could be – *no* competitive relationship between products, it is not possible legally for a Member through internal taxation or regulation, to protect domestic production. (117)
9. Had the Panel performed the analysis of consumers' tastes and habits, it would have found that consumers did not view products as like. The reason is that consumers are in this case manufacturers, and "[a] manufacturer cannot, for instance, ignore the preferences of the ultimate consumer of its products. If the risks posed by a particular product are sufficiently great, the ultimate consumer may simply cease to buy that product." (122)
10. Employing the BTA approach, the AB finds that the products are physically different. A heavy burden is consequently placed on Canada to show a competitive relationship, in order to overcome a non-likeness finding. (136) Failing to provide such evidence, products are found to be not like, and the AB thus reverses Panel's finding that the products are like. (141)

3.2.1 Which Interpretation did the AB Employ?

Given its previous case law, our presumption would have been that that the AB would use Method I also in *Asbestos*. But, by rejecting a finding of violation of Article III, the AB in *Asbestos* seemed to be moving away from a robust version of Interpretation I. In Recital 100 we even find the following statement:

> [E]ven if two products are "like", that does not mean that a measure is inconsistent with Article III:4. A complaining Member 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. The term "less favourable treatment" expresses the general principle, in Article III:1, that internal regulations "should

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> not be applied … so as to afford protection to domestic production". If there is "less favourable treatment" of the group of "like" imported products, there is, conversely, "protection" of the group of "like" domestic products. However, a Member may draw distinctions 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.

This statement could indeed be a platform from which to embrace an intent test along the lines of Methods II or even III. Here comes the tantalizing phrase whereby a Member *may draw distinctions between products which have found to be like* without that resulting in less favorable treatment and hence violative of Article III. What could the AB possibly have in mind? If, after all, from a market point of view the imported products are “like” the domestic products and are given less favorable treatment, how could that not amount to protection? Let us go back in mind to the recycled oil case: Recycled oil and refined oil are, from a market point of view, like products. But, to use the language in Recital 100, by drawing a distinction based on ecological efficiency between these two products which have been found to be like from a functional/market sense and taxing them or regulating them according to this distinction, would not, for this reason alone accord the imported product less favorable treatment than that accorded the domestic product. This is not the rhetoric and reasoning of Method I, nor is it the rhetoric and reasoning of method II (since under method II there is a finding of less favorable treatment). Could it be that there is no less favorable treatment because in accordance with the distinction drawn by the state there is, indeed, no less favorable treatment? This would be the rhetoric and reasoning of Method III. Given the ambiguity of the language used by the Court one is ultimately left guessing.

While the enigmatic statement in Recital 100 might be read in that way, there is little else to indicate a shift in approach. The reason the AB reached a different result to that of the Panel was not because of a different methodology but because, within the parameters of Method I it came to the conclusion that the two products were not like products. It could come to that conclusion by looking at the health consideration not as a factor in determining the purpose of the measure, or the basis of the comparator, but as a means to determine, factually, whether there was a competitive relationship between the two products. Here is a typical quote:

> Under Article III:4, evidence relating to health risks may be relevant in assessing the *competitive relationship in the marketplace* between allegedly "like" products. (emphasis in the original)

Weighing heavily in the AB's finding of unlikeness was the fact that asbestos was a *well known* carcinogenic, the presence of which would surely affect the competitive relationship in the market place.

The AB might thus have argued as follows:

1. The test for likeness is in the market place, since absent likeness there can be no protection. (99, 117)
2. The market view of likeness is not directly observable, so we instead have to rely on various indicators providing partial information about the relationship. The BTA list contains some possible indicators, all of which are informative of the relationship. (102)
3. It is well known that the products involved in the dispute are very different in their health impact, due to their different physical properties. (114, 136)
4. The end-use criterion is difficult to evaluate since it is not clear to what extent there is overlap in the use between asbestos-containing products and substitute products. (138)
5. The consumers' habits and tastes criterion is also hard to employ, since no evidence is presented by Canada on this point. (139) However, the fact that the differences between products in riskiness are well known, combined with the economic incentives of buyers to take into account final consumers' aversion to dangerous products (122), suggest that products would indeed be found to be unlike from buyers point of view, if this analysis were to be performed.
6. With strong evidence on differences in risk, and with little or no evidence on end-uses and consumers' tastes and habits, one is led to conclude that products are not like in the market place.

3.3 Concluding Remarks

The outcome of Asbestos is not at issue. Clearly the French measure to ban asbestos is justified under the Agreements. Methodologically, however, both legally and economically the case is not without serious problems.

Technically, and this is our first point, the case turned on burden of proof – Canada failed the burden necessary to establish likeness. That is an unsatisfactory basis for the decision. Should the result of the case have been different if Canada simply provided evidence that *some* consumers would still buy the products, risk notwithstanding, and maybe even comforted by the fact that in the age of Government regulation the absence of a prohibition gives some indication that "The Government" does not consider the product truly beyond a reasonable consumer choice?

An important link in the reasoning above, showing how the AB likeness criterion might be viewed as only concerning market relations, was that buyers in this market would take risk differences into account. This was based on an amazingly naïve belief in working of market, according to which the buyers (who are not end users) had to do this since they would otherwise lose customers. We do not want to suggest that this knowledge on the preferences of the ultimate consumers would not be an important factor limiting the usage of asbestos products. But there are a number of arguments to suggest the potential willingness of industry to accept a level of exposure to asbestos which might be higher than socially desirable. For instance, because of costly information one should not expect all final consumers to be fully informed about all hazards. There are likely to be severe negative externalities associated with asbestos products, since final users of asbestos products may not care about the negative health impact of their use of asbestos-containing products for third parties. For instance, asbestos in the brakes of an auto may not cause much of a health hazard to the owner, but contributes to the spreading of asbestos in the air. Market failures are also likely to arise from fixed costs in litigation. For instance, the health damage from exposure to asbestos from a particular building might be limited, if it is a building in which most people spend a very limited time. But being exposed to asbestos in many such buildings may have severe negative consequences. But since each individual only suffers minor damage from any particular building, it might not pay to litigate. Or, the possibility of being sheltered by bankruptcy may adversely affect buyer behavior. For all these reasons one should expect that

products containing asbestos are over-consumed relative to what would be socially efficient if the market is left unregulated. This indeed precisely why the government intervention is needed. It is the fact that buyers tend to treat the products as closer substitutes than they actually are, that motivates the regulation.

Was not the very fact that the products are considered substitutable and in competition with other and that at least to some degree the risky product would be used, that was among the reasons which prompted the French government to institute the ban? If so, was it not a bit too emphatic to claim that there was no evidence of a competitive relationship in the market place? Moreover, in Recital 121 the AB criticizes the Panel for concluding that products are like without examining evidence on consumer habits and tastes, and with weak evidence on end uses (119) which

> "…involve certain of the key elements relating to the competitive relationship between products…"(117).

On the basis of the same material, the AB is able to conclude that products are *not* like. This determination comes as a result of the presumption for likeness created by physical differences, and Canada's unwillingness/inability to provide evidence on consumers' tastes and habits. While the latter obviously weakens Canada's case, it is hard to see how this can be taken as evidence of lack of likeness, rather than of the fact that the issue is unresolved. Once again we confront the systemic weakness of the Dispute Settlement Understanding which does not allow the AB to remand a case back to the Panel for a new factual determination. But we doubt very much if the AB is truly serious about this point and whether it has not simply decided that in some essentialist sense, independently of the market, carcinogenic and non-carcinogenic products cannot be "like."

Third, the logic of the AB reasoning may lead to the following very puzzling result: When a product has a well known risk factor and the State regulates on that basis, there is no violation of Article III. But imagine another product which is equally dangerous and where the state takes an identical regulation to protect consumers. The only difference being that in the second case the

nature of the risk is less well known by the public. Should this fact alone determine that in the second case there was a violation of Article III?

Fourth, would the AB reasoning allow France simply to tax the imported product more highly without violating Article III(2) since the products have been determined not to be like products. Imagine such an occurrence resulting in a marketplace in which carcinogenic asbestos containing products were sold alongside non carcinogenic asbestos free products at the same price. This could be the result of competitive market conditions, where the imported product yields a smaller profit because of the need to absorb the higher tax in order to remain price competitive. In such a case there would be no health impact of the measure, which would only serve as a revenue-generating tax on imports.[9] And yet, under the reasoning of *Asbestos* it would be permitted.

Finally, although the AB reaches a result that differs from the Panel, it is in the same methodological ball park. One cannot escape the feeling that although the surface language of the AB is concerned with the alleged preferences of consumers and the competitive relationship in the market place of the two products, the deep structure of its discourse is very different: The belief of the AB that it simply cannot be that under the WTO a State cannot accord different treatment to carcinogenic and non-carcinogenic products without being branded as violating the principle of national treatment and having to justify itself ex Article XX.

Caught up by some of the considerations discussed in our analysis of the three methods, the AB could not bring itself to say that the products are not "like" because the State may legitimately employ in its tax and regulatory regimes non market comparators (such as health risk or ecological efficiency) or instead, that although the products were like products, the measure of the State itself according less favorable treatment to one over the other was not a violation of Article III since it was not applied with the purpose of affording protection to domestic production but with the purpose of affording protection to would-be users of the product. It thus reverted to an attempt to push these other concepts into the straightjacket of market competition.

The result, to quote again the anonymous Member of the Appellate Body is

[9] Since the definition of likeness under III(4) seems to overlap with the combined definition of likeness of III(2).

> that the necessity or appropriateness of adopting a "fundamentally" economic interpretation of the "likeness" of products under Article III:4 of the GATT 1994 does not appear to … be free from substantial doubt.

The result is a decision that while correct in terms of outcome, has added to the uncertainty concerning the method by which to determine the legality of domestic regulations under the WTO contract.