WORLD TRADE ORGANIZATION

WT/DS308/R
7 October 2005

(05-4310)

Original: English

MEXICO – TAX MEASURES ON SOFT DRINKS AND OTHER BEVERAGES

Report of the Panel

TABLE OF CONTENTS

LIST OF ANNEXES

ANNEX A

REQUEST FOR ESTABLISHMENT OF A PANEL

ANNEX B

FAX TO THE PARTIES AND THIRD PARTIES

ANNEX C

RESPONSES AND COMMENTS BY THE PARTIES AND THIRD PARTIES TO QUESTIONS POSED BY THE PANEL AND OTHER PARTIES

TABLE OF WTO CASES CITED IN THIS REPORT

Short Title	Full Case Title and Citation
Argentina – Poultry Anti-Dumping Duties	Panel Report, *Argentina – Definitive Anti-Dumping Duties on Poultry from Brazil*, WT/DS241/R, adopted 19 May 2003
Argentina – Textiles and Apparel	Panel Report, Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items, WT/DS56/R, adopted 22 April 1998, as modified by the Appellate Body Report, WT/DS56/AB/R, DSR 1998:III, 1033
Australia – Salmon	Appellate Body Report, *Australia – Measures Affecting Importation of Salmon*, WT/DS18/AB/R, adopted 6 November 1998, DSR 1998:VIII, 3327
Australia – Salmon	Panel Report, *Australia – Measures Affecting Importation of Salmon*, WT/DS18/R and Corr.1, adopted 6 November 1998, as modified by the Appellate Body Report, WT/DS18/AB/R, DSR 1998:VIII, 3407
Australia – Salmon (Article 21.5 – Canada)	Panel Report, *Australia – Measures Affecting Importation of Salmon – Recourse to Article 21.5 of the DSU by Canada*, WT/DS18/RW, adopted 20 March 2000, DSR 2000:IV, 2031
Canada – Aircraft	Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377
Canada - Autos	Panel Report, Canada – Certain Measures Affecting the Automotive Industry, WT/DS139/R, WT/DS142/R, adopted 19 June 2000, as modified by the Appellate Body Report, WT/DS139/AB/R, WT/DS142/AB/R, DSR 2000:VII, 3043
Canada - Periodicals	Appellate Body Report, Canada – Certain Measures Concerning Periodicals, WT/DS31/AB/R, adopted 30 July 1997, DSR 1997:I, 449
Canada - Periodicals	Panel Report, Canada – Certain Measures Concerning Periodicals, WT/DS31/R and Corr. 1, adopted 30 July 1997, as modified by the Appellate Body Report, WT/DS31/AB/R, DSR 1997:I, 481
Canada – Wheat Exports and Grain Imports	Panel Report, *Canada – Measures Relating to Exports of Wheat and Treatment of Imported Grain*, WT/DS276/R, adopted 27 September 2004, as upheld by the Appellate Body Report, WT/DS276/AB/R.
Chile – Price Band System	Panel Report, Chile – Price Band System and safeguard Measures Relating to Certain Agricultural Products, WT/DS207/R, adopted 23 October 2002, as modified by the Appellate Body Report, WT/DS207/AB/R
Chile – Alcoholic Beverages	Appellate Body Report, Appellate Body Report, *Chile – Taxes on Alcoholic Beverages*, WT/DS87/AB/R, WT/DS110/AB/R, adopted 12 January 2000, DSR 2000:I, 281
Chile – Alcoholic Beverages	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, DSR 2000:I, 303
EC – Asbestos	Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, adopted 5 April 2001, DSR 2001:VII, 3243
EC – Bananas III	Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, adopted 25 September 1997, DSR 1997:II, 591
EC – Hormones	Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, DSR 1998:I, 135

Short Title	Full Case Title and Citation
India – Patents (US)	Appellate Body Report, *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, WT/DS50/AB/R, adopted 16 January 1998, DSR 1998:I, 9
India – Patents (US)	Panel Report, *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products, Complaint by the United States*, WT/DS50/R, adopted 16 January 1998, as modified by the Appellate Body Report, WT/DS50/AB/R, DSR 1998:I, 41
India – Quantitative Restrictions	Appellate Body Report, *India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products*, WT/DS90/AB/R, adopted 22 September 1999, DSR 1999:IV, 1763
India – Quantitative Restrictions	Panel Report, *India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products*, WT/DS90/R, adopted 22 September 1999, as upheld by the Appellate Body Report, WT/DS90/AB/R, DSR 1999:V, 1799
Indonesia - Autos	Panel Report, *Indonesia – Certain Measures Affecting the Automobile Industry*, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R and Corr. 1, 2, 3, 4, adopted 23 July 1998, DSR 1998:VI, 2201
Japan – Alcoholic Beverages II	Appellate Body Report, *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, DSR 1996:I, 97
Japan – Alcoholic Beverages II	Panel Report, *Japan – Taxes on 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
Korea – Various Measures on Beef	Appellate Body Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161/AB/R, WT/DS169/AB/R, adopted 10 January 2001, DSR 2001:I, 5
Korea – Alcoholic Beverages	Appellate Body Report, *Korea – Taxes on Alcoholic Beverages*, WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 February 1999, DSR 1999:I, 3
Korea – Various Measures on Beef	Panel Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161/R, WT/DS169/R, adopted 10 January 2001, as modified by the Appellate Body Report, WT/DS161/AB/R, WT/DS169/AB/R, DSR 2001:I, 59
Mexico – Corn Syrup	Panel Report, *Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States*, WT/DS132/R and Corr.1, adopted 24 February 2000, DSR 2000:III, 1345
Mexico – Corn Syrup (Article 21.5 – US)	Appellate Body Report, Appellate Body Report, *Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States – Recourse to Article 21.5 of the DSU by the United States*, WT/DS132/AB/RW, adopted 21 November 2001, DSR 2001:XIII, 6675
Turkey – Textiles	Appellate Body Report, *Turkey – Restrictions on Imports of Textile and Clothing Products*, WT/DS34/AB/R, adopted 19 November 1999, DSR 1999:VI, 2345
Turkey – Textiles	Panel Report, *Turkey – Restrictions on Imports of Textile and Clothing Products*, WT/DS34/R, adopted 19 November 1999, as modified by the Appellate Body Report, WT/DS34/AB/R, DSR 1999:VI, 2363
US – 1916 Act	Appellate Body Report, *United States – Anti-Dumping Act of 1916*, WT/DS136/AB/R, WT/DS162/AB/R, adopted 26 September 2000, DSR 2000:X, 4793
US – Certain EC Products	Panel Report, *United States – Import Measures on Certain Products from the European Communities*, WT/DS165/R and Add. 1, adopted 10 January 2001, as modified by the Appellate Body Report, WT/DS165/AB/R, DSR 20001:II, 413

Short Title	Full Case Title and Citation
US – Gasoline	Panel Report, *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/R, adopted 20 May 1996, as modified by the Appellate Body Report, WT/DS2/AB/R, DSR 1996:I, 29
US – Gasoline	Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted 20 May 1996, DSR 1996:I, 3
US – Section 301 Trade Act	Panel Report, *United States – Sections 301-310 of the Trade Act of 1974*, WT/DS152/R, adopted 27 January 2000, DSR 2000:II, 815
US – Shrimp	Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, adopted 6 November 1998, DSR 1998:VII, 2755
US – Shrimp	Panel Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/R and Corr.1, adopted 6 November 1998, as modified by the Appellate Body Report, WT/DS58/AB/R, DSR 1998:VII, 2821
US – Shrimp (Article 21.5 – Malaysia)	Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products – Recourse to Article 21.5 of the DSU by Malaysia*, WT/DS58/AB/RW, adopted 21 November 2001, DSR 2001:XIII, 6481
US – Shrimp (Article 21.5 – Malaysia)	Panel Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products – Recourse to Article 21.5 of the DSU by Malaysia*, WT/DS58/RW, adopted 21 November 2001, as upheld by the Appellate Body Report, WT/DS58/AB/RW, DSR 2001:XIII, 6529
US – Gambling	Appellate Body Report, *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/DS285/AB/R, adopted 20 April 2005.
US – Wool Shirts and Blouses	Panel Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/R, adopted 23 May 1997, as upheld by the Appellate Body Report, WT/DS33/AB/R, DSR 1997:I, 343
US – Wool Shirts and Blouses	Appellate Body Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R and Corr.1, adopted 23 May 1997, DSR 1997:I, 323

TABLE OF GATT CASES CITED IN THIS REPORT

Short title	Full Case Title and Citation
Brazil – Internal Taxes	Working Party Report, *Brazilian Internal Taxes*, adopted 30 June 1949, BISD II/181 and 186
Italy – Agricultural Machinery	Panel Report, Italian Discrimination Against Imported Agricultural Machinery, adopted 23 October 1958, BISD 7S/60
Japan – Alcoholic Beverages I	Panel Report, *Japan – Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, adopted 10 November 1987, BISD 34S/83
US – Malt Beverages	Panel Report, *United States – Measures Affecting Alcoholic and Malt Beverages*, adopted 19 June 1992, BISD 39S/206
US – Nicaraguan Trade	Panel Report, *United States – Trade Measures Affecting Nicaragua*, 13 October 1986, unadopted, L/6053
US – Section 337	Panel Report, United States Section 337 of the Tariff Act of 1930, adopted 7 November 1989, BISD 36S/345
US – Sugar Quota	Panel Report, *United States – Imports of Sugar from Nicaragua*, adopted 13 March 1984, BISD 31S/67
US – Superfund	Panel Report, *United States – Taxes on Petroleum and Certain Imported Substances*, adopted 17 June 1987, BISD 34S/136
US – Tuna (EEC)	Panel Report, *United States – Restrictions on Imports of Tuna*, 16 June 1994, unadopted, DS29/R

TABLE OF ABBREVIATIONS USED IN THIS REPORT

CFC	*Comisión Federal de Competencia* (Federal Competition Commission)
DSB	Dispute Settlement Body
DSU	Dispute Settlement Understanding
EC	European Communities
GATT	General Agreement on Tariffs and Trade
GATT 1947	General Agreement on Tariffs and Trade 1947
GATT 1994	General Agreement on Tariffs and Trade 1994
HFCS	High-Fructose Corn Syrup
IEPS	*Impuesto Especial sobre Producción y Servicios* (Special Tax on Production and Services)
LIEPS	*Ley del Impuesto Especial sobre Producción y Servicios* (Law on the Special Tax on Production and Services)
MFN	Most-Favoured Nation
NAFTA	North American Free Trade Agreement
WTO	World Trade Organization

I. INTRODUCTION

1.1 In a communication, dated 16 March 2004, the United States requested consultations with Mexico pursuant to Articles 1 and 4 of the DSU and Article XXII:1 of the GATT 1994, regarding tax measures imposed by Mexico on soft drinks and other beverages that use any sweetener other than cane sugar.[1]

1.2 The United States stated that it believed that these taxes were inconsistent with Mexico's national treatment obligations under Article III of the GATT 1994. In particular, they appeared to be inconsistent with Article III:2 of the GATT 1994, first and second sentences, and Article III:4 of the GATT 1994.

1.3 The consultations took place on 13 May 2004. Pursuant to its request, Canada was joined in those consultations. However the parties failed to reach a mutually satisfactory resolution to this dispute.

1.4 On 10 June 2004, the United States requested the establishment of a panel pursuant to Article 6 of the DSU.[2] The DSB considered this request at its meetings of 22 June and 6 July 2004, and established the Panel on 6 July with standard terms of reference as follows:

> "To examine, in the light of the relevant provisions of the covered agreements cited by the United States in document WT/DS308/4, the matter referred to the DSB by the United States in that document, and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements."[3]

1.5 On 18 August 2004, the parties agreed to the following composition of the Panel:

Chairman: Mr Ronald Saborío Soto

Members: Mr Edmond McGovern
Mr David Walker

1.6 Canada, China, the European Communities, Guatemala and Japan reserved their rights to participate in the panel proceedings as third parties.[4]

1.7 The Panel met with the parties on 2 and 3 December 2004 and 23 and 24 February 2005. It met with the third parties on 3 December 2004.

1.8 The Panel submitted its interim report to the parties on 27 June 2005. The final report was issued to the parties on 8 August 2005.

---

[1] WT/DS308/1.
[2] WT/DS308/4.
[3] WT/DS308/5/Rev.1.
[4] Pakistan had reserved its third-party rights at the DSB meeting on 6 July 2004. However, on 20 August 2004, Pakistan informed the DSB that it did not want to participate as a third-party in the panel proceedings.

II. FACTUAL ASPECTS

A. THE MEASURES

2.1 This dispute concerns certain tax measures imposed by Mexico on soft drinks and other beverages that use any sweetener other than cane sugar.

2.2 The tax measures concerned include: (i) a 20 per cent tax on the transfer or, as applicable, the importation of soft drinks and other beverages that use any sweetener other than cane sugar ("soft drink tax"); (ii) a 20 per cent tax on specific services (commission, mediation, agency, representation, brokerage, consignment and distribution), when provided for the purpose of transferring products such as soft drinks and other beverages that use any sweetener other than cane sugar ("distribution tax"); and, (iii) a number of requirements imposed on taxpayers subject to the "soft drink tax" and to the "distribution tax" ("bookkeeping requirements").

B. RELEVANT MEASURES

2.3 The soft drink tax, the distribution tax and the bookkeeping requirements are set out in the following measures, which are at issue in this dispute: (1) the *Ley del Impuesto Especial sobre Producción y Servicios* (Law on the Special Tax on Production and Services, or LIEPS), as amended effective 1 January 2002, and its subsequent amendments published on 30 December 2002, and 31 December 2003; and (2) related or implementing regulations, contained in the *Reglamento de la Ley del Impuesto Especial sobre Producción y Servicios* (Regulations of the Law on the Special Tax on Production and Services), the *Resolución Miscelánea Fiscal para 2003* (Miscellaneous Fiscal Resolution for the year 2003), and the *Resolución Miscelánea Fiscal para 2004* (Miscellaneous Fiscal Resolution for the year 2004).

2.4 The measures were introduced in the Mexican legislation as a result of the amendments to the LIEPS approved by the Congress of Mexico and published in the Mexican Official Journal (*Diario Oficial*) on 1 January 2002. Since that date, the LIEPS has been amended on three occasions. The amendments were published in the Official Journal on 30 December 2002, on 31 December 2003, and on 1 December 2004.

2.5 The measures are further regulated in the *Reglamento de la Ley del Impuesto Especial sobre Producción y Servicios* (Regulations of the Law on the Special Tax on Production and Services) published in the Official Journal on 15 May 1990, in Title 6 of the *Resolución Miscelánea Fiscal para 2004* (Miscellaneous Fiscal Resolution for the year 2004) published in the Official Journal on 30 April 2004, and in Title 6 of the *Resolución Miscelánea Fiscal para 2003* (Miscellaneous Fiscal Resolution for the year 2003) published in the Official Journal on 31 March 2003, which identify, *inter alia*, details on the scope, calculation, payment and bookkeeping and recording requirements of the IEPS.

C. PRODUCTS INVOLVED

2.6 The dispute concerns two categories of products. First, the products that will be generally referred to as "soft drinks and syrups". Second, the sweeteners used in the preparation of such "soft drinks and syrups" and, particularly, three types of sweeteners: cane sugar, beet sugar and HFCS.

- Soft drinks and syrups: With respect to the challenged measures, this broad category includes soft drinks; hydrating or rehydrating drinks; concentrates, powders, syrups, essences or flavour extracts that can be diluted to produce soft drinks and hydrating or rehydrating drinks; and, syrups or concentrates for preparing soft drinks sold in open containers which use automatic, electric or mechanical equipment. The category does not include other drinks such

as alcoholic beverages, beers, wine, fruit juices, vegetable juices, water or mineral water. According to the available information, the Mexican market for soft drinks is – as in other parts of the world – dominated by multinational companies, such as *Coca Cola* and *Pepsi Cola*. *Coca Cola* controls around 71.9 per cent of the Mexican carbonated soft drink market, while *Pepsi Cola* controls around 15.1 per cent. The Peruvian-owned company *Kola Real* holds around 4 per cent of the market and *Cadbury Schweppes* around 2 per cent.[5]

- Cane sugar: Cane sugar is a form of sucrose. Sucrose is a disaccharide composed of 50 percent glucose and 50 percent fructose bonded together.[6] According to the Food and Agriculture Organization of the United Nations (FAO), cane sugar is a non-refined, crystallized material derived from the juices of sugar-cane stalk and consisting either wholly or essentially of sucrose.[7]

- Beet sugar: Beet sugar is another form of sucrose. In technical terms, and although derived from a different source, beet sugar may be considered to be both chemically and functionally identical to cane sugar.[8] The FAO defines beet sugar as a non-refined, crystallized material derived from the juices extracted from the root of the sugar beet and consisting either wholly or essentially of sucrose.[9]

- High-Fructose Corn Syrup (HFCS): This is a corn-based liquid sweetener made using a multi-stage production process. It is high in fructose in relation to ordinary corn syrup. HFCS is a liquid, composed of a monosaccharide mixture of varying amounts of glucose and fructose, as well as small amounts of other saccharides. HFCS exists in the following three grades: HFCS-55 is the primary grade of HFCS used in soft drink production. HFCS-42, while used in soft drink and juice production, is also used in the production of bakery products, canned goods, dairy products and other foods. HFCS-90 is typically blended with HFCS-42 to make HFCS-55, but it is also used as a sweetener in juices, candies, bakeries, and food processing.[10] According to the FAO, HFCS is part of the products known as isoglucose, a type of starch syrups where glucose has been isomerised to fructose by using one or more isomerising enzymes. Other syrups of this group are HFSS (high-fructose starch syrup) and HFGS (high-fructose glucose syrup). HFCS is manufactured from corn starch, and is widely used in the production of food and soft drinks.[11]

III. PARTIES' REQUESTS FOR FINDINGS AND RECOMMENDATIONS

3.1 The United States requests the Panel to find that the challenged tax measures are:

– inconsistent with GATT Article III:2, first sentence, as a tax applied on imported soft drinks and syrups "in excess of those applied to like domestic products" (soft drink tax and distribution tax);

---

[5] United States' first written submission, para. 31 and exhibit US-18.
[6] United States' first written submission, para. 22.
[7] United Nations Economic Commission for Europe, at http://www.unece.org/stats/econ/iwg.agri/handbook.sugar.html (site consulted on 14 February 2005).
[8] United States' first written submission, para. 22.
[9] United Nations Economic Commission for Europe, at http://www.unece.org/stats/econ/iwg.agri/handbook.sugar.html (site consulted on 14 February 2005).
[10] United States' first written submission, paras. 9-12.
[11] United Nations Economic Commission for Europe, at http://www.unece.org/stats/econ/iwg.agri/handbook.sugar.html (site consulted on 14 February 2005).

– inconsistent with GATT Article III:2, second sentence, as a tax applied on imported soft drinks and syrups which are "not similarly taxed" to the "directly competitive or substitutable" Mexican products (soft drink tax and distribution tax);

– inconsistent with GATT Article III:2, first sentence, as a tax applied on imported beet sugar "in excess of those applied to like domestic products" (soft drink tax and distribution tax);

– inconsistent with GATT Article III:2, second sentence, as a tax applied on imported HFCS which is "not similarly taxed" to the "directly competitive or substitutable" Mexican cane sugar (soft drink tax and distribution tax);

– inconsistent with GATT Article III:4 as a law that affects the internal use of imported HFCS and accords HFCS "treatment ... less favourable than that accorded to like products of national origin" by:

  (a) taxing soft drinks and syrups that use HFCS as a sweetener (soft drink tax),

  (b) taxing the agency, representation, brokerage, consignment and distribution of soft drinks and syrups sweetened with HFCS (distribution tax), and

  (c) subjecting soft drinks and syrups sweetened with HFCS to various bookkeeping and reporting requirements (bookkeeping requirements)

– inconsistent with GATT Article III:4 as a law that affects the internal use of imported beet sugar and accords beet sugar "treatment ... less favourable than that accorded to like products of national origin" by:

  (a) taxing soft drinks and syrups that use beet sugar as a sweetener (soft drink tax),

  (b) taxing the agency, representation, brokerage, consignment and distribution of soft drinks and syrups sweetened with beet sugar (distribution tax), and

  (c) subjecting soft drinks and syrups sweetened with beet sugar to various bookkeeping and reporting requirements (bookkeeping requirements).

3.2 Mexico requests the Panel to:

– decline to exercise its jurisdiction and recommend to the parties that they submit their respective grievances to an Arbitral Panel, under Chapter Twenty of the NAFTA, which can address both Mexico's concern with respect to market access for Mexican cane sugar in the United States under the NAFTA and the United States' concern with respect to Mexico's tax measures.

– In the event that the Panel does decide to exercise its jurisdiction, Mexico requests it:

  (a) to pay particular attention to the circumstances that gave rise to the measures at issue in this case to accord particular weight to Mexico's status as a developing country, especially in the context of the broader dispute concerning trade in sweeteners between Mexico and the United States, and to find that the Mexican measures are justified under Article XX of the GATT 1994.

(b) to employ particular care in terms of how it formulates its findings and recommendations. In particular, Mexico requests the Panel to record that whatever the parties' legal rights may be under other applicable rules of international law, its findings apply solely to the parties' respective rights and obligations under the WTO agreements and cannot be taken to pre-judge such other legal rights;

(c) to recommend that the parties take steps to resolve the sweeteners trade dispute within the NAFTA framework; and

(d) to make certain determinations of facts.[12]

IV. ARGUMENTS OF THE PARTIES

4.1 The arguments presented by the parties in their written submissions and oral statements are reflected below.[13] The parties' answers to questions and comments on each other's responses are reproduced in Annex C.

A. REQUEST FOR PRELIMINARY RULING

4.2 In its first written submission, Mexico made a request that the Panel decline to exercise its jurisdiction in this case. Mexico asked that the Panel make this decision through a preliminary ruling. On 18 January 2005, the Chairman of the Panel wrote to the representatives of the parties giving the Panel's response to this request (see Annex B).

B. FIRST WRITTEN SUBMISSION OF THE UNITED STATES

1. Introduction

4.3 Since 1 January 2002, Mexico has imposed discriminatory tax measures on soft drinks and syrups that favour its domestic cane sugar industry, in violation of its obligations under Articles III:2 and III:4 of the GATT 1994. Specifically, in December 2001, the Mexican Congress approved an amendment of the IEPS adding a 20 per cent tax on soft drinks and syrups that use HFCS or any sweetener other than cane sugar ("HFCS soft drink tax"), as well as a 20 per cent tax on the representation, brokerage, agency, consignment and distribution of such products ("distribution tax").

4.4 The HFCS soft drink and distribution tax is embodied in the following measures, which are the measures at issue in this dispute: (1) the IEPS, as amended effective 1 January 2002, and its subsequent amendments published on 30 December 2002, and 31 December 2003; and (2) related or implementing measures, contained in the *Reglamento de la Ley del Impuesto Especial sobre Producción y Servicios,* the *Resolución Miscelánea Fiscal para 2003,* and the *Resolución Miscelánea Fiscal para 2004.*

2. Legal argument

4.5 For purposes of sweetening soft drinks and syrups, cane sugar is directly competitive and substitutable with HFCS. In Mexico, cane sugar is the overwhelmingly dominant sweetener, with the

[12] Written version of Mexico's oral statement during second substantive meeting of the Panel with the parties, para. 36.

[13] The summaries of the parties' arguments are based on the executive summaries submitted by the parties to the Panel.

vast majority of soft drinks and syrups produced in Mexico being sweetened with cane sugar. Conversely, in the United States the sweetener of choice for soft drink and syrup production is HFCS. Further, cane sugar comprises over 95 per cent of Mexican sweetener production; whereas HFCS before the discriminatory tax comprised nearly 100 per cent of Mexican sweetener imports from the United States. Because the tax exempts cane sugar and soft dinks and syrups sweetened with cane sugar, it clearly favours domestic cane sugar production over imports.

(a) The IEPS is an internal tax

4.6 The Ad Note to GATT Article III clarifies that an internal tax that applies to imported products at the time of importation is, nonetheless, an internal tax within the meaning of GATT Article III. The HFCS soft drink tax applies to imported soft drinks and syrups at the time of importation and like domestic products upon their internal transfer. The HFCS soft drink tax also applies to subsequent transfers of imported soft drinks and syrups in Mexico. The distribution tax taxes the agency, representation, brokerage, consignment and distribution of soft drinks and syrups sweetened with HFCS in Mexico. The HFCS soft drink tax and distribution tax are, thus, internal taxes within the meaning of GATT Article III.

(b) The HFCS soft drink tax and distribution tax are inconsistent with GATT Article III:2, first sentence

4.7 A determination of an internal tax's inconsistency with GATT Article III:2, first sentence, is a two step process: First, the imported and domestic products at issue must be "like". Second, the internal tax must be applied to imported products "in excess of" those applied to the like domestic products.

(i) Soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are like products

4.8 "Like" products need not be identical in all respects. For example, vodka and shochu were found in a previous dispute to be like products within the meaning of GATT Article III:2, first sentence. Soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are like products because they have virtually identical physical properties, end-uses and tariff classifications and are equally preferred by consumers.

Physical characteristics

4.9 Soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are physically identical in virtually all respects. First, soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are identical in physical appearance. Second, soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are virtually indistinguishable by the human body as both contain the same number of calories and are digested and absorbed by the human body in the same manner.

4.10 Third, soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar have nearly the same chemical composition. Cane sugar and HFCS are similarly mixtures of fructose and glucose. Thus, the only difference between an HFCS-sweetened and a cane sugar-sweetened soft drink or syrup is the exact ratio of the fructose-glucose mixture.

4.11 Fourth, per the Mexican regulation, a soft drink or syrup sweetened with HFCS and one sweetened with cane sugar bear the same ingredient on the label: "azúcares" ("sugars"). "Azúcares", per Mexico's regulation, is defined as all mono- or disaccharide sugars. This definition captures both the monosaccharide sugar, HFCS, and the disaccharide sugar, cane sugar.

End-uses and channels of distribution

4.12 Soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar share identical end-uses and channels of distribution. A soft drink or syrup's sweetener does not affect its end-use. There is no evidence that, when Mexican bottlers, such as Coca-Cola Femsa, switched to a blend of HFCS and sugar (or when United States bottlers switched in the 1980s), these end-uses in any way changed.

4.13 For similar reasons, whether a soft drink or syrup is sweetened with HFCS or sugar does not affect its channels of distribution. Major bottlers do not mentioned a soft drink or syrup's sweetener as in any way affecting its channels of distribution. There is no evidence that channels of distribution for soft drinks or syrups in Mexico changed in the period from the late 1990s through 2001 when bottlers such as Coca-Cola Femsa had switched to a blend of HFCS and sugar for soft drink production, nor that they changed again when, because of the HFCS soft drink tax and distribution tax, bottlers switched back to 100 per cent cane sugar.

Consumer preferences

4.14 Prior to switching to use of HFCS, United States soft drink bottlers undertook extensive consumer surveys to determine the consumer acceptability of soft drinks sweetened with HFCS. These surveys revealed that overall HFCS-sweetened and sugar-sweetened soft drinks were equally acceptable to consumers. Other surveys conducted were based on head-to-head comparisons of HFCS- and sugar-sweetened soft drinks and showed no consistent pattern of preference for sugar-sweetened soft drinks versus HFCS-sweetened soft drinks. Today, Coca-Cola reports "there is no noticeable taste difference."

4.15 In the course of its anti-dumping determination on HFCS from the United States, the Mexican Government noted that a panel of 30 tasters did not detect any significant difference in sweetness or any pattern of preference. That same determination concluded overall: "These possible differences in products manufactured with the two sweeteners in question may prove that these sweeteners are not identical, but this does not mean that they do not have an extremely similar taste." As a result of positive consumer testing, United States manufacturers of soft drinks and syrups switched from sugar to 100 per cent HFCS by the mid-1980s. Similarly, in the late 1990s in Mexico, Mexican soft drink producers began increasingly to substitute HFCS for cane sugar.

4.16 In addition, with the exception of a handful of niche products, soft drinks are simply not marketed on the basis of whether they contain sugar or HFCS as a sweetener.

Tariff classification

4.17 The tariff classification system in Mexico does not separately break out soft drinks and syrups based on whether they are sweetened with sugar (whether cane or beet) or HFCS.

4.18 In sum, HFCS-sweetened and cane sugar-sweetened soft drinks are like products within the meaning of GATT Article III:2, first sentence.

(ii) Soft drinks and syrups sweetened with HFCS are taxed in excess of soft drinks and syrups sweetened with cane sugar

HFCS soft drink tax

4.19 The HFCS soft drink tax applies a 20 per cent tax on soft drinks and syrups. Only internal transfers of soft drinks and syrups sweetened exclusively with cane sugar are exempt from the IEPS.

Thus, with respect to imports, the IEPS taxes (1) all soft drinks and syrups upon their importation – regardless of the sweetener used – and then (2) taxes their subsequent internal transfer if they use any sweetener other than cane sugar.

4.20 Virtually all regular soft drinks and syrups produced in the United States are sweetened with HFCS, while all regular soft drinks and syrups produced in Mexico are sweetened with cane sugar. Therefore, by exempting soft drinks and syrups sweetened with only cane sugar, the IEPS successfully exempts all regular soft drinks and syrups produced in Mexico from payment of the 20 per cent tax. A 20 per cent tax that applies to imported soft drinks and syrups but not to soft drinks and syrups produced domestically is a tax "in excess" of that applied to like domestic products. Therefore, as applied at the time of importation and upon internal transfers, the HFCS soft drink tax is inconsistent with GATT Article III:2, first sentence.

Distribution tax

4.21 The IEPS also applies a 20 per cent tax on the representation, brokerage, agency, consignment and distribution of soft drinks and syrups sweetened with HFCS. Soft drinks and syrups sweetened with cane sugar are exempt from the distribution tax. A tax applied on the representation, brokerage, agency, consignment and distribution of a good is, in effect, a tax on the good itself. Therefore, by taxing the representation, brokerage, agency, consignment and distribution of soft drinks and syrups sweetened with HFCS at 20 per cent while completely exempting soft drinks and syrups sweetened only with cane sugar, the IEPS subjects HFCS-sweetened soft drinks and syrups to taxes "in excess of" of those applied on like domestic products – soft drinks and syrups made with cane sugar. Accordingly, the distribution tax is also inconsistent with GATT Article III:2, first sentence.

(c) The IEPS is inconsistent with Article III:2, second sentence, of GATT 1994

4.22 A measure is inconsistent with GATT Article III:2, second sentence, if (1) the imported product and domestic product are "directly competitive or substitutable products;" (2) the directly competitive or substitutable imported and domestic products are "not similarly taxed;" and (3) the dissimilar taxation is applied "so as to afford protection to domestic production." The IEPS as a tax on soft drinks and syrups made with HFCS, as well as a tax on the use of HFCS itself, meets each of these elements such that the IEPS is inconsistent with Mexico's obligations under GATT Article III:2, second sentence.

(i) The HFCS soft drink tax as applied to HFCS is inconsistent with GATT Article III:2, second sentence

4.23 By imposing a 20 per cent tax on soft drinks and syrups sweetened with HFCS, Mexico has, in effect, imposed a prohibitive tax on the use of HFCS.

HFCS and cane sugar are directly competitive or substitutable products

4.24 HFCS and cane sugar are directly competitive or substitutable products. Whether two products are "directly competitive or substitutable" must be determined on a case-by-case basis and in light of all the relevant facts in the case. An assessment of whether there is a direct competitive relationship between two products or groups of products requires evidence that consumers consider or could consider the two products or groups of products as alternative ways of satisfying a particular need or taste. This requires evidence of the direct competitive relationship between the domestic and imported products, including comparisons of their physical characteristics, end-uses, channels of distribution and prices. Moreover, the category of directly competitive or substitutable products is broader than the category of "like products": even imperfectly substitutable products can fall under the second sentence of Article III:2. Products do not have to be substitutable for all purposes at all

times to be considered competitive. It is sufficient that there is a pattern that they may be substituted for some purposes at some times by some consumers.

Physical characteristics

4.25 HFCS and cane sugar for use in soft drinks and syrups have substantially the same physical characteristics. This analysis should focus on the defining physical characteristics of HFCS and cane sugar for the purpose of competition in the marketplace. Because the HFCS soft drink tax applies on the use of HFCS in soft drinks and syrups, the relevant "marketplace" is the soft drink and syrup industry.

4.26 HFCS is a liquid sweetener that has substantially the same chemical characteristics as cane sugar. Both HFCS and cane sugar are composed of a combination of glucose and fructose molecules and, when in a soft drink or syrup, both exist as monosaccharides within three to four weeks of bottling. HFCS-55 contains just five per cent more fructose than cane sugar; HFCS-42 contains just eight per cent less. The similar chemical composition of HFCS and cane sugar is not accidental. In fact, when HFCS was developed, it was calibrated to be just as sweet as sugar as a sweetener for soft drinks. This was done by developing a fructose-glucose ratio that closely mimicked that of cane sugar.

4.27 Because the chemical constituents of sugar and HFCS are so similar, the taste perceptions in soft drink and syrup formulations are extremely similar. This is especially true after the sugar in a soft drink has inverted, or broken down to a monosaccharide solution of fructose and glucose molecules just as the molecules exist in HFCS. Testing conducted by the soft drink and HFCS industries found that HFCS-sweetened soft drinks and sugar-sweetened soft drinks were comparable and of equal acceptability to the consumer. HFCS and cane sugar are also physically similar when it comes to smell and colour. Both HFCS and cane sugar are odourless and, as liquids, both are colourless.

4.28 HFCS's form as a liquid sweetener does not distinguish it from cane sugar as a sweetener for soft drinks and syrups. First, some producers of soft drinks and syrups actually use cane sugar in its liquid form. Second, part of the bottling process when using cane sugar as a sweetener is mixing the cane sugar with water to produce a sugar syrup, which is then mixed with other ingredients to produce a soft drink.

4.29 In the context of the SECOFI anti-dumping investigation of HFCS in 1997-98, the Mexican Government has also determined that cane sugar and HFCS share the same essential physical characteristics and concluded that HFCS-55, HFCS-42 and sugar are "like products" for the purposes of Mexico's anti-dumping law and Article 2.6 of the Anti-Dumping Agreement.

4.30 When this anti-dumping determination was challenged in binational panel proceedings under NAFTA Chapter 19, the binational panel agreed with Mexico that sugar and HFCS are "like products."

End uses and consumer preferences

4.31 Overlap in end-use is important in determining direct competitiveness or substitutability. The existence of mixtures, and the use of two products in varying mixtures, also testifies to their overlap in uses and to their commercial interchangeability. Commonality of end-uses in foreign markets and consumer tastes are also relevant. For HFCS itself or sugar, the relevant consumers are sweetener users of HFCS in the bottling industry and elsewhere. The end-uses of HFCS and cane sugar, and consumer tastes for these products, demonstrate their competitiveness or substitutability.

4.32 The evidence submitted by the United States shows that HFCS was developed with the end-use of soft drink bottling as its major objective. Mexican soft drink producers have used varying mixtures of HFCS and cane sugar, and have converted from cane sugar to mixtures of HFCS and then back again. This free variation between sweeteners testifies to the commercial interchangeability of HFCS and cane sugar in Mexican soft drink production. When a soft drink bottler uses a blend of HFCS and sugar, the bottler is using both sweeteners for the same purpose, in the same plant, for the same brand of the same soft drink.

4.33 In addition, because the HFCS soft drink tax does not apply to fruit or vegetable juices, major juice bottlers can, and do, use as much HFCS in their sweetened juices as they wish – up to 100 per cent of sweetener in some cases. Mexican bottlers' reaction to the HFCS soft drink tax was to switch back to 100 per cent sugar. The former use of HFCS and sugar in mixtures, and the use of up to 100 per cent HFCS by bottlers who are not subject to a prohibitive tax, testify to the distortion of market choices created by the HFCS tax. In the United States and Canada, soft drink and syrup producers have shifted almost entirely from sugar to HFCS over time.

4.34 Switching between HFCS and sugar is not expensive or difficult. Switching from HFCS to sugar is more difficult and costly, and Mexican bottlers would not have done so if they had not been forced to by the 20 per cent tax. In the early 1980s in the United States when United States bottlers were using blends of HFCS and sugar, varying the HFCS-sugar ratio in a given batch of soft drinks could be done with relative ease.

4.35 Also, Mexican labelling regulations do not distinguish between "sugars" as a food or beverage ingredient. Thus, a bottler can move between different mixtures of HFCS and sugar without changing its labelling.

4.36 The Mexican Government has recognized the overlap in end-uses and consumer tastes between HFCS and cane sugar. As noted above, in the final anti-dumping determination of January 1998, SECOFI found that HFCS and sugar "fulfil the same functions and are commercially interchangeable in the marketplace." SECOFI noted the ample proofs presented that consumers "perceive no difference at all" between sugar, invert sugar and HFCS. The determination also notes that a panel of 30 tasters did not detect any significant difference in sweetness or any pattern of preference for HFCS-55, refined sugar or invert sugar and that an examination of a range of food and beverage industries showed a practice that substitution of HFCS for sugar was not promoted as a change in brand or a "new flavour."

4.37 During the review of this determination by the binational panel under Chapter 19, Mexico argued that "technical studies and testimonies of representatives of the [soft drink] industry show that HFCS and sugar are both used interchangeably in the industry without affecting the quality of soft drink products," and that "HFCS and sugar while not perfect substitutes possess characteristics and composition sufficiently similar that they serve a great number of similar functions. This allows them to be commercially interchangeable in such a great variety of sub-sectors of the beverages and food sectors." The Chapter 19 binational panel concluded that sugar and HFCS are commercially interchangeable.

4.38 Sugar and HFCS are therefore directly competitive or substitutable and in direct competition in the marketplace.

Channels of distribution

4.39 The channels of distribution for HFCS and cane sugar, and for soft drinks sweetened with them, provide additional evidence that these products are directly competitive or substitutable. HFCS

and sugar are sold through similar channels from producers to industrial bottlers, and in some cases the same company sells both HFCS and sugar to similar customers.

4.40 HFCS of United States origin has been sold to Mexican customers through two channels: on an f.o.b. basis directly from the United States exporter and terminals built by HFCS exporters in Mexico. The latter received HFCS exports from plants in the United States and then sold the HFCS to customers in Mexico. Mexican bottlers buy Mexican cane sugar directly from the sugar mill or from a distributor. Any difference in distribution channels is, thus, attributable to the fact that HFCS is the imported sweetener and cane sugar is the domestic sweetener. Both sweeteners are sold directly from the sweetener producer to the end-user, which with respect to this dispute are soft drink and syrup bottlers.

4.41 In the anti-dumping investigation on HFCS from the United States, SECOFI examined distribution channels for HFCS and sugar and found that they were the same, and were targeted at the same customers.

Tariff classification

4.42 The classification of these products in the Mexican tariff schedule also supports the conclusion that these are directly competitive or substitutable products. Although cane sugar is generally classified under heading 1701 and HFCS under heading 1702, some cane sugar products (i.e., liquid cane sugar and invert cane sugar) are classified under heading 1702.

4.43 With respect to soft drinks and syrups sweetened with either HFCS or cane sugar, as recounted above, the tariff classification system in Mexico does not separately break out soft drinks and syrups based on whether they are sweetened with cane sugar or HFCS.

Price relationships and competition in the marketplace

4.44 The price relationships between HFCS and cane sugar in soft drink use also demonstrate that they are directly competitive or substitutable products. The connection between the price, or availability, of HFCS and the price of sugar has been amply demonstrated by the real-world economic experiment of the HFCS soft drink tax. In the three days following the enactment of the tax, for example, 30 Mexican bottlers cancelled all orders for HFCS. By mid-January 2002, the HFCS soft drink tax had resulted in a 8 per cent increase in Mexican sugar prices.

4.45 Because of the HFCS tax, and the collapse of demand for HFCS from bottlers, importers shuttered their terminals or otherwise virtually ceased imports of HFCS for soft drink and syrup production, and domestic HFCS producers partially or totally idled their production. Yet demand for sweeteners has remained constant or growing with annual growth in population and GDP. As sugar replaced HFCS in soft drink and syrup production, the additional demand for sugar artificially created a sugar shortage. The Secretariat of Economy explained its decision to provide an extraordinary cupo (market access quota) for sugar imports during the latter part of 2003: "This plan results from various complaints about shortage problems in sugar, presented to the Secretariat of Economy by producers who use sugar in their production processes. These concerns are fundamentally a consequence of the entry into force of the *Impuesto Especial sobre Producción y Servicios* (IEPS) for soft drinks made with fructose, which has generated a substitution of sugar for fructose ..."

4.46 The Mexican Government *Comisión Federal de Competencia* (CFC, or Federal Competition Commission) has also recognized that sugar and HFCS are directly competitive with each other in the marketplace, in two separate decisions regarding competition in the sugar industry. These decisions were based on an examination of the detailed facts of competition in the Mexican sweeteners market and found that HFCS is a close substitute for refined sugar in carbonated drinks. As the panel in *Chile*

– *Alcoholic Beverages* noted: the question of competition from an anti-trust perspective generally utilizes narrower market definitions than used when analysing markets pursuant to Article III:2, second sentence and it seems logical that competitive conditions sufficient for defining an appropriate market with respect to anti-trust analysis would a fortiori suffice for an Article III analysis. The Panel in this dispute should read the findings of the CFC to confirm that cane sugar and HFCS are directly competitive or substitutable products in the Mexican market.

Summary on direct competition and substitutability

4.47 To set the HFCS-sugar comparison in perspective, the Panel might consider the WTO disputes regarding discrimination in taxation of distilled spirits. Each of these disputes concerned a situation of long-standing tax discrimination, in which tax barriers largely foreclosed the market to the imported product. The panel and the parties in each of these cases had to place a particular focus on potential competition and latent demand, since actual discrimination was so severe and so long-standing.

4.48 In the present case, there is not just potential competition between imported HFCS and domestic cane sugar: the Panel has available to it data on actual competition between these products including product switching before and just after the HFCS soft drink tax was imposed. HFCS itself was developed to mimic and improve on cane sugar in soft drink bottling operations, and its success in the marketplace of the bottling industry testifies to how close a substitute it is for sugar. Indeed, if HFCS were not quite so successful at competing with cane sugar, the Mexican Government might not have acted to protect the Mexican sugar industry by enacting the HFCS soft drink tax to expel imported HFCS from the soft drink and syrup market in Mexico.

4.49 For all these reasons, the Panel should find that for purposes of sweetening soft drinks, imported HFCS and Mexican cane sugar are directly competitive or substitutable products, and compete directly in the soft drink and syrups sweeteners marketplace in Mexico.

HFCS and cane sugar are not similarly taxed

4.50 There can be no question that the HFCS soft drink tax taxes HFCS and cane sugar dissimilarly. When contained in a soft drink or syrup, HFCS results in a 20 per cent tax on the value of the finished soft drink or syrup. Use of exclusively cane sugar in that same soft drink or syrup results in no tax at all. As applied to HFCS, however, the impact of the tax differential actually far exceeds a 20 percentage point difference. This is because the HFCS soft drink tax is calculated on the value of the finished soft drink or syrup such that the tax results in a tax that is four times the value of the HFCS – or in other words, a 400 per cent tax on HFCS. With a tax liability of 400 percent, the HFCS producer cannot even provide HFCS to its customer for free: the producer would have to pay the customer to take it. The HFCS soft drink tax is essentially a prohibitive tax on the use of HFCS in soft drinks and syrups. Needless to say, a prohibitive tax applied to the imported product that is not applied to the directly competitive or substitutable domestic product is a dissimilar tax within the meaning of GATT Article III:2, second sentence.

HFCS soft drink tax is applied so as to afford protection to domestic production

4.51 The protective application of a measure is to be discerned from the structure of the measure itself, including the very magnitude of the dissimilar taxation involved. A measure's purpose, to the extent it is "objectively manifested in the design, architecture and structure of the measure" may also be "intensely pertinent to the task of evaluating whether or not that measure is applied so as to afford protection to domestic production."

4.52 Mexico's tax on the use of HFCS is applied "so as to afford protection" to Mexican cane sugar production. The HFCS soft drink tax is structured such that all soft drinks and syrups are taxed 20 percent, except those sweetened exclusively with cane sugar. Cane sugar is a domestically-produced sweetener in Mexico. Since Mexico does not import sugar – or does so in only very small amounts – this is a benefit bestowed nearly exclusively on domestic producers. Domestic producers have, thus, benefited from being placed in an un-taxed category, while their greatest commercial rival, the imports of HFCS, remain subjected to taxation.

4.53 Moreover, as indicated above, HFCS remains not only subject to taxation but taxation at a prohibitive rate. As stated, a 20 per cent tax on the value of the finished soft drink or syrup results in a 400 per cent tax on the use of HFCS itself. The enormity of this dissimilar taxation has effectively excluded imported HFCS from the Mexican sweeteners market. Dissimilar taxation of this magnitude and nature objectively manifests the intention of the tax to protect Mexican cane sugar production.

4.54 Further, the structure of the HFCS soft drink tax is such that the low-taxed product is almost exclusively domestically-produced, while the high-taxed product, prior to imposition of the discriminatory tax, comprised virtually all directly competitive or substitutable imports. Indeed, in 2001 HFCS accounted for 99.7 per cent of Mexican nutritive sweetener imports. By contrast, in 2001 cane sugar comprised somewhere between 90 and 95 per cent of domestically produced sweeteners in Mexico. Thus, at the time of its imposition, the HFCS soft drink tax applied to nearly 100 per cent of sweetener imports but less than ten per cent of Mexican production. The Appellate Body addressed a similar situation in *Chile – Alcoholic Beverages*.

4.55 The protectionist structure of the IEPS is confirmed by a remarkable series of judicial and political pronouncements that the purpose of the tax is to "protect the sugar industry." For example, the highest interpretative authority in Mexico, the Supreme Court, has definitively and conclusively characterized Mexico's tax scheme as designed to protect Mexican domestic production of cane sugar.

4.56 In sum, the HFCS soft drink tax, as a tax on HFCS but not the directly competitive or substitutable domestic product cane sugar, is applied in a manner so as to afford protection to domestic production, and, therefore, is inconsistent with Mexico's obligations under GATT Article III:2, second sentence.

(ii) The HFCS soft drink tax and distribution tax as applied to soft drinks and syrups is inconsistent with GATT Article III:2, second sentence

Soft drinks and syrups sweetened with cane sugar are directly competitive or substitutable with soft drinks and syrups sweetened with HFCS

4.57 The category of "like" products is a subset of those products which are directly competitive or substitutable. Therefore, as soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are like products they are necessarily directly competitive or substitutable products.

4.58 Moreover, soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are directly competitive or substitutable products for many of the same reasons they are "like". First, with respect to physical appearance, end-uses and channels of distribution, consumer preferences and tariff classification, soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are virtually the same. Second, HFCS-sweetened and sugar-sweetened soft drinks and syrups compete in the same market and for the same customers. For these reasons, as well as others examined in more detail above, soft drinks and syrups sweetened with HFCS and soft drinks sweetened with cane sugar are directly competitive or substitutable products within the meaning of GATT Article III:2, second sentence.

Soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are not similarly taxed

4.59 As stated above, the HFCS soft drink tax imposes a tax at a rate of 20 per cent on (1) all importations of soft drinks and syrups from the United States and (2) subsequent internal transfers of such soft drinks and syrups if they are sweetened with HFCS. The IEPS exempts from the latter soft drinks and syrups sweetened with cane sugar. As also stated, all regular soft drinks and syrups produced in Mexico are sweetened with cane sugar, such that the exemption successfully excludes all regular soft drinks and syrups produced in Mexico from payment of the tax. Consequently, the HFCS soft drink tax results in a 20 per cent tax on imported soft drinks and syrups, and their subsequent internal transfer if sweetened with HFCS, that is not similarly applied to directly competitive or substitutable products. Imposing a 20-percentage point differential between the tax on the imported product and the tax on the directly competitive or substitutable product clearly means that the products are not "similarly taxed". Accordingly, the HFCS soft drink tax as applied to soft drinks and syrups – both at the time of importation and on subsequent transfers – results in the type of dissimilar taxation captured under GATT Article III:2, second sentence.

4.60 In addition, the distribution tax also results in dissimilar taxation of imported soft drinks and syrups. Like the tax on internal transfers, the IEPS exemption for soft drinks and syrups sweetened with cane sugar, also successfully excludes all regular soft drinks and syrups produced in Mexico from payment of the distribution tax. Because virtually all regular soft drinks and syrups produced in the United States are sweetened with HFCS, imported soft drinks and syrups do not enjoy the same exemption. As a consequence, the distribution tax taxes the representation, brokerage, agency, consignment and distribution of imported soft drinks and syrups but not the representation, brokerage, agency, consignment and distribution of soft drinks and syrups produced in Mexico. A tax on the representation, brokerage, agency, consignment and distribution of a good, is in effect, a tax on the good itself. Therefore, the distribution tax constitutes a tax applied on imported soft drinks and syrups that is not similarly applied to directly competitive or substitutable products produced in Mexico.

The HFCS soft drink and distribution tax is applied so as to afford protection to domestic production

4.61 As stated above, whether a measure is "applied so as to afford protection to domestic production" is "an issue of how the measure in question is applied." The IEPS – both its HFCS soft drink tax and its distribution tax – is applied such that it affords protection to domestic production. Under the IEPS, soft drinks and syrups sweetened with HFCS are taxed at 20 per cent (whether on their importation, internal transfer or in connection with their representation, brokerage, agency, consignment or distribution), whereas soft drinks and syrups sweetened with cane sugar are not. As discussed above, soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are directly competitive or substitutable products. Moreover, as also explained above, all regular soft drinks and syrups produced in Mexico are sweetened with cane sugar, whereas virtually all soft drinks and syrups produced in the United States are sweetened with HFCS. Therefore, the structure of the IEPS, is to apply a 20 per cent tax on soft drinks and syrups imported from the United States and no tax on directly competitive or substitutable soft drinks and syrups produced in Mexico.

4.62 The structure of the IEPS is precisely the type of structure that has been found on prior occasions to constitute persuasive evidence that a measure is applied "so as to afford protection." Furthermore, if viewed on an order of magnitude basis the 20-percentage point difference in this dispute far exceeds the tax differential examined in the other WTO alcoholic beverages disputes. Moreover, the IEPS applies not only on the importation and internal transfer(s) of soft drinks and syrups themselves but also on their representation, brokerage, agency, consignment and distribution.

Thus, the tax differential is not just 20 per cent on the value of the soft drink or syrup but an additional 20 per cent on the value of any representation, brokerage, agency, consignment or distribution used to effectuate that soft drink or syrup's transfer.

4.63 As a tax on imported soft drinks and syrups that is not similarly applied to directly competitive or substitutable soft drinks and syrups produced in Mexico, the IEPS (HFCS soft drink tax and distribution tax) is inconsistent with Mexico's obligations under GATT Article III:2, second sentence.

(d) The HFCS soft drink tax, distribution tax and reporting requirements applied on the use of HFCS are inconsistent with GATT Article III:4

4.64 In examining a claim under GATT Article III:4, the Appellate Body has identified three distinct elements required to establish a violation: (1) the imported and domestic products are "like products;" (2) the measure is a law, regulation, or requirement affecting the internal sale, offering for sale, purchase, transportation, distribution, or use of the imported and domestic like products; and (3) the imported product is accorded less favourable treatment than the domestic like product. The IEPS meets each of these criteria as a tax on the use of HFCS by (1) taxing the transfer of soft drinks and syrups made with HFCS at 20 per cent (HFCS soft drink tax); (2) taxing the representation, brokerage, agency, consignment and distribution of soft drinks and syrups made with HFCS (distribution tax); and (3) subjecting soft drinks and syrups made with HFCS to numerous bookkeeping and reporting requirements (reporting requirements). These measures are not imposed on cane sugar or soft drinks and syrups made only with cane sugar.

(i) HFCS and cane sugar are like products

4.65 As the details provided above reveal, HFCS and cane sugar compete head-to-head as sweeteners for soft drinks and syrups. Indeed, as a sweetener in soft drinks and syrups, HFCS and cane sugar are near perfect substitutes. This is demonstrated by the facts reviewed above and, in particular, by the fact that prior to imposition of the IEPS, soft drink and syrup producers were, in rapidly increasing amounts, actually substituting HFCS for cane sugar. These facts overwhelmingly support a finding that HFCS and cane sugar are "directly competitive or substitutable" products for purposes of sweetening soft drinks and syrups within the meaning of GATT Article III:2. They are also more than adequate to support a finding that HFCS and cane sugar are "like" products within the meaning of GATT Article III:4.

4.66 First, the analysis provided with respect to the GATT Article III:2, second sentence claim thoroughly establishes that, prior to the discriminatory tax, HFCS competed directly with cane sugar as a sweetener for soft drinks and syrups in Mexico. Second, HFCS and cane sugar overlap in the ways deemed relevant to the like product inquiry: (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 in order to satisfy a particular want or demand; and (iv) the international classification of the products for tariff purposes. Each of these elements was addressed in relation to the claim under GATT Article III:2, second sentence, and support a determination that, for purposes of GATT Article III:4, HFCS and cane sugar are "like" products as sweeteners for soft drinks and syrups.

(ii) IEPS is a law affecting the use of HFCS

4.67 The term "affecting" in GATT Article III:4 is broad in scope. This broad scope, as articulated by several panels and affirmed by the Appellate Body, "cover[s] not only laws and regulations which directly govern the conditions of sale or purchase but also any laws or regulations which might adversely modify the conditions of competition between domestic and imported products."

4.68 The IEPS "affects" the use of HFCS by conditioning access to an advantage on use of the domestic sweetener, cane sugar. Specifically, under the IEPS, soft drink and syrup producers who use exclusively cane sugar to sweeten their products are wholly exempt from the HFCS soft drink tax, the distribution tax and the reporting requirements. Soft drink and syrup producers who use HFCS to sweeten their products do not enjoy the same advantage. Instead, soft drink and syrup producers who use HFCS to sweeten their products must (1) pay a 20 per cent tax on the transfer of their products (HFCS soft drink tax); (2) pay a 20 per cent tax on representation, brokerage, agency, consignment or distribution of their products; and (3) track and report commercially sensitive information, including their products' top 50 customers and suppliers, to the Mexican authorities (reporting requirements). The added burdens imposed on the use of HFCS not only "influence" producers' choice of sweeteners but, because of the prohibitive nature of the tax (four times the value of the sweetener itself), economically compel producers to use domestically-produced cane sugar over HFCS. It is difficult to imagine evidence more telling of this, than the fact after imposition of the IEPS every Mexican bottler using HFCS reverted to a 100 per cent use of cane sugar. The IEPS is, thus, a law "affecting" the "internal ... use" of HFCS.

(iii) IEPS accords less favourable treatment to HFCS

4.69 The IEPS undoubtedly affords "less favourable treatment" to imports than "accorded like products of national origin." In Mexico cane sugar is almost exclusively a domestically-produced sweetener. The IEPS bestows a real and substantive advantage on the use of cane sugar that is not accorded to HFCS – a product which prior to application of the IEPS to soft drinks and syrups accounted for nearly 100 per cent of United States sweetener imports. While soft drinks and syrups using exclusively cane sugar as a sweetener are wholly exempt from the IEPS, those sweetened, even partially, with HFCS are subject by virtue of the IEPS to (1) a 20 per cent tax on their transfer (HFCS soft drink tax); (2) a 20 per cent tax on their representation, brokerage, agency, consignment and distribution (distribution tax); and (3) bookkeeping and reporting requirements concerning commercially sensitive information (reporting requirements). The first of these alone – as a tax four times the value of the input – is sufficient to work as a prohibition on the use of HFCS. In sum, the IEPS by virtue of its HFCS soft drink tax, distribution tax and reporting requirements is inconsistent with GATT Article III:4 as a law affecting the internal use of HFCS and affording imported HFCS less favourable treatment than the like product of national origin.

3. Conclusion

4.70 For the reasons set out above, the United States respectfully requests the Panel to find that the IEPS is:

- inconsistent with GATT Article III:2, first sentence, as a tax applied on imported soft drinks and syrups "in excess of those applied to like domestic products" (HFCS soft drink tax);

- inconsistent with GATT Article III:2, first sentence, as a tax applied on the agency, representation, brokerage, consignment and distribution of soft drinks and syrups sweetened with HFCS "in excess of those applied to like domestic products" (distribution tax);

- inconsistent with GATT Article III:2, second sentence, as a tax applied on imported HFCS which is "directly competitive or substitutable" with Mexican cane sugar which is "not similarly taxed" (HFCS soft drink tax);

– inconsistent with GATT Article III:2, second sentence, as a tax applied on imported soft drinks and syrups which are directly competitive or substitutable with domestic soft drinks and syrups which are "not similarly taxed" (HFCS soft drink tax)[14];

– inconsistent with GATT Article III:2, second sentence, as a tax applied on the agency, representation, brokerage, consignment and distribution of soft drinks and syrups sweetened with HFCS which are directly competitive or substitutable with domestic soft drinks and syrups which are "not similarly taxed" (distribution tax); and

– inconsistent with GATT Article III:4 as a law that affects the internal use of imported HFCS and accords HFCS "treatment ... less favourable than that accorded to like products of national origin" by:

(a) taxing soft drinks and syrups that use HFCS as a sweetener (HFCS soft drink tax),

(b) taxing the agency, representation, brokerage, consignment and distribution of soft drinks and syrups sweetened with HFCS (distribution tax), and

(c) subjecting soft drinks and syrups sweetened with HFCS to various bookkeeping and reporting requirements (reporting requirements).[15]

C. FIRST WRITTEN SUBMISSION OF MEXICO

1. Introduction

4.71 The United States' first submission presents an incomplete and one-sided account of the factual context in which the Mexican fiscal measures at issue in this proceeding arose. Viewed in the light of all relevant facts, this is a dispute arising under a regional free trade agreement and it would be inappropriate for this Panel to hear it. Mexico maintains that the Panel should decline to exercise its jurisdiction to resolve the present dispute and should recommend that the parties resort to the NAFTA dispute settlement mechanism to resolve in an integral manner the broader sweeteners trade dispute. Should the Panel elect to proceed with the examination of the merits of this dispute, it should pay particular attention to certain novel issues concerning the legal relationship between the WTO agreements and efforts to liberalize trade at the regional level.

4.72 Mexico and the United States negotiated under the NAFTA a balanced sweetener trade regime that mainly includes sugar and HFCS, which compete with each other in certain market segments in both countries. The Mexican Congress introduced the tax in response to: (i) the United States' continued refusal to address Mexico's repeatedly stated concern that the United States had breached its NAFTA market access commitments regarding trade in sugar, negotiated as part of the NAFTA, while HFCS continued to enjoy preferential access to the Mexican market, severely

[14] The IEPS is also inconsistent as a tax on HFCS with Article III:2, first sentence, of GATT. However, because the IEPS so clearly taxes a directly competitive or substitutable imported product in a manner so as to afford protection to domestic production, the United States, in the interest of brevity, has chosen to focus its submission on the second sentence.

[15] The IEPS is also inconsistent with Article III:4 of GATT 1994 as a law that affects "the internal sale, offering for sale, purchase, transportation, [and] distribution" of imported soft drinks and syrups and accords them "treatment ... less favourable than that accorded to like products of national origin" by taxing their agency, representation, brokerage, consignment and distribution (distribution tax). However, because the IEPS also so plainly violates GATT Article III:2, the United States, in the interest of brevity, has focus this submission on analysis under GATT Article III:2 with respect to the distribution tax as applied to soft drinks and syrups.

affecting the sugar sector in Mexico; (ii) the United States' continued refusal to submit to NAFTA dispute settlement to resolve the dispute; and (iii) the ineffectiveness of bilateral negotiations that the parties have conducted over several years.

4.73 The United States' first submission has omitted all reference to the complex history of the bilateral sweetener dispute under the NAFTA. Nonetheless, there does exist a genuine dispute between the States over the meaning and scope of the NAFTA provisions governing the trade in sweeteners, as recognized by the United States Department of Agriculture (USDA).

4.74 Mexico has duly submitted to the jurisdiction of multiple international panels and international tribunals convened at the behest of the United States or its nationals. Meanwhile, no forum is presently available in which Mexico's grievance can be heard.

4.75 Accordingly, Mexico will request this Panel to decline to exercise its jurisdiction and recommend to the parties that, as a matter of urgency, they submit their respective grievances to a NAFTA Chapter Twenty Panel which can address the dispute as a whole.

4.76 If the Panel refuses Mexico's request that it decline to exercise its jurisdiction, in view of the fact that there are parallel international proceedings in which substantial monetary damages are being claimed against it, Mexico will request the Panel to refrain from making certain findings that could jeopardize its ability to mount a proper defence in such proceedings. This is of fundamental importance.

2. Facts

(a) The importance of the Mexican sugar industry

4.77 The sugar sector spans 15 of Mexico's 32 states and is a key component of economic and social development in many rural areas of the country. The Mexican sugar industry is smaller and more fragmented in comparison to international standards and in particular to the United States' sugar and HFCS industries. It is characterized by a relatively large number of small and medium-sized sugar mills. However, it must be recognized that in addition to the fact that Mexico is a developing country facing a significant and profound structural lag in comparison to the United States, the existing Mexican sugar industry, in particular, is an emerging private industry rooted in an agricultural system that has a peculiar land tenure regime that itself resulted from significant structural changes made after the Mexican Revolution. Successive governments' efforts to provide social benefits and rural employment to some of Mexico's poorest citizens through this crop must also be recognized. These characteristics of the sugarcane industry long pre-dated Mexico's accession to the GATT as well as its accession to NAFTA.

(b) The NAFTA negotiations

4.78 During the NAFTA negotiations (1991-92), the three Parties initially sought to negotiate a trilateral agriculture chapter. The Uruguay Round of Multilateral Trade Negotiations was then under way and trade in agricultural products was being addressed there. Ultimately, the Parties recognized that most agricultural issues would be addressed in the multilateral negotiations. Accordingly, only certain general rules were established at a trilateral level and the specific commitments were established by means of bilateral negotiations.

4.79 In Section A of Annex 703.2 of the NAFTA, the United States and Mexico agreed on the rules dealing with trade in sugar and sugar syrups.[16] They agreed to move towards a common

[16] It does not include HFCS. See Section C of Annex 703.2.

regional market by establishing a common external tariff and removing all tariffs and other barriers to bilateral trade as between each other.

4.80 A key issue during the transition period was the definition of "net production surplus", which was defined by Annex 703.2(26) to mean "the quantity by which a Party's domestic production of sugar exceeds its total consumption of sugar during a marketing year…"

4.81 The effect of this agreement was that Mexico would have a guaranteed minimum duty-free access; above this minimum level it would be able to export its net production surpluses duty-free within certain limits, until free trade was reached in 2008. However, if Mexico achieved net production surplus status for two consecutive marketing years, it would be able to export the total amount of its net surplus to the United States.

4.82 Although HFCS is a sugar substitute in certain industrial applications, it was not addressed in Annex 703.2. However, the parties were well aware that sugar and HFCS were part of the same market, the sweeteners market.

(i) The United States requests changes

4.83 The United States' sugar industry believed that the Mexican sugar industry's ability to export its surpluses to the United States would put pressure on the domestic price of sugar and thereby reduce its profitability. Therefore, it commenced strenuous lobbying efforts in Washington, D.C. in opposition to the NAFTA.

4.84 There was a recognition that the Mexican soft drink industry had used sugar exclusively, but that there was a potential for it to shift to lower-cost HFCS and that a displacement of sugar by HFCS could increase Mexico's net production surplus. Accordingly, the United States proposed the exchange of letters.

4.85 The meeting resulted in two draft letters (in English and Spanish) that were initialled by the lead negotiators from both countries, but not signed by Ministers who were the intended signatories.[17] The United States submitted both letters to its Congress as part of the NAFTA implementing package.

4.86 Mexico advised the United States that the draft letters did not reflect the agreement reached. In particular, Mexico stated that the drafts included a phrase providing that paragraph 16 of Annex 703.2 – the paragraph of the NAFTA that provides that Mexico had the right to export all of its surpluses if it became a net surplus producer for two consecutive years – would not apply, and that had not been part of the agreement.[18]

4.87 The United States responded that inclusion of that phrase had been agreed and requested that the exchange of letters be formalized. For that purpose, the United States attached a letter signed by its Minister that reflected its understanding of the agreement.[19] Mexico replied with a letter signed by its Minister that contained its own understanding.[20] In particular, it did not include the phrase that provided that paragraph 16 of Annex 703.2 would not apply. Thus, there was no meeting of the minds. Mexico has maintained that the text of the NAFTA as originally signed by the leaders of the three countries prevails.

[17] Exhibit MEX-11.
[18] Exhibit MEX-12.
[19] Exhibit MEX-13.
[20] Exhibit MEX-14.

(ii) Subsequent developments

4.88 Mexico moved from being a net importer of sugar to being a surplus producer.[21] First, the privatization of the sugar mills led to new investment in the mills' physical plant and consequent improvements in productivity.[22] Second, encouraged by new mill owners, the cane growers sought to increase their own productivity and also increased the number of hectares cultivated.[23] Third, growing imports of United States-originating HFCS into Mexico began to undercut higher-priced Mexican sugar and to displace it in certain market segments, particularly the soft drinks segment.[24] Fourth, there was a general expectation in the Mexican industry that it would be able to export the full surpluses to the United States market. This did not occur because the United States applied its own understanding of the sweetener agreement, based on the English version of the initialled draft letter that it had submitted to the Congress on 4 November 1993.

4.89 The rapid emergence and growth of the sugar surplus exacerbated the financial condition of the industry in Mexico. Even before the NAFTA entered into force, the government had found it necessary to restructure the debt of the privatized mills and extend new credit to them. In such circumstances, the terms of Mexico's negotiated access to the United States' sugar market took on particular significance.

(iii) Throughout this time, the United States recognized the existence of a genuine dispute

4.90 It is important to note that throughout this time, the USDA, an agency of the United States' Executive Branch, repeatedly acknowledged in its publications that there was a dispute between the two States over their bilateral trade in sweeteners. In October 2000, the USDA commented in its report entitled "Mexico: Sugar Semi-Annual 2000":

> "According to NAFTA, the duty-free access quantity for sugar for MY 2000 will increase. The United States and the Mexican governments went through difficult negotiations because of the confusion between the original NAFTA document and a 'side letter' allowing different quantities of Mexican sugar to be exported to the United States As of the writing of this report, no agreement has been reached and Mexico has already filed for a NAFTA dispute resolution panel under Chapter XX of NAFTA. The Undersecretary of SECOFI, Luis de la Calle, stated that if the NAFTA Agreement conditions are not respected there will be no other solution than to appeal to the dispute resolution panel. On the other hand, the Mexican sugar producers have repeatedly mentioned that if NAFTA is not respected, they will request the Mexican

[21] From 1985 to 1988, Mexico had a sugar surplus. From 1989 to 1994 it had a deficit. Mexico has generated production surpluses from 1995 until 2002. See "*Resumen Anualizado de Balance Azucarero de México", Evolución histórica por año calendario a partir de 1989.* Exhibit MEX-15.

[22] The USDA noted in 1996 that the industry was increasing its output due to better harvesting and post-harvest technology as well as higher factory yields. See USDA, "Mexican Sugar Output Forecast to Decrease", September 17, 1996, p. 1. Exhibit MEX-16.

[23] The USDA noted in its report entitled "Mexican Sugar Exports to Increase", April 10, 1998, p. 3, that the *cañeros* (Mexican sugar cane growers) had been making technical improvements. Sugarcane yields per hectare increased from an average of 68 MT/ha in 1990 to about 72 MT/ha in 1997 due to technical improvements. Exhibit MEX-17.

[24] The United States HFCS industry has, to use the USDA's words, "been plagued with excess capacity" and the Mexican market was seen as an attractive nearby market in which to export excess production. See USDA Economic Research Service, "United States Mexican Sweeteners Trade Mired in Dispute", *Agricultural Outlook*, September 1999, p. 18. The USDA noted that although HFCS sales in the United States increased by 13 per cent in the 1994-1997 period, the increase was not large enough to absorb the production surplus. "As a result, the sector faced tough adjustments, with some smaller operations leaving the business and others selling to or attracting investors from among larger companies." Exhibit MEX-18.

> government to apply safeguards to close the border to United States HFCS. On September 19, 2000, however, USDA announced the Fiscal 2001 tariff-rate quotas for sugar, where Mexico was allocated 105,788 MT of quota to comply with the United States' NAFTA obligation. The Mexican government will have to wait for the NAFTA dispute resolution panel decision. Mexico still believes it should have complete access for all of its excess sugar, which it estimates at over 500,000 MT."[25] (emphasis added)

(iv) The United States' refusal to submit to dispute settlement

4.91 Mexico and the United States disagreed over the letters exchanged in 1993. Mexico had generated a surplus and believed that it had a right to export larger amounts of sugar to the United States' market than the United States was prepared to admit. Mexico therefore took steps during the late 1990s to resolve the dispute through the NAFTA general dispute settlement mechanism stipulated in Chapter XX. Unfortunately, the critical element of automaticity that differentiates the WTO's dispute settlement process from that of the GATT 1947 was not present in the NAFTA. Mexico therefore requested that the United States give its consent for the establishment of an arbitral panel.

4.92 Mexico submitted a formal request for consultations, which took place but did not lead to a resolution of the dispute. Mexico then requested a meeting of the Free Trade Commission, the second step of the proceeding, which took place as well, but it too failed to resolve the dispute. Finally, Mexico formally requested the establishment of an arbitral panel, but the United States refused its establishment. To date, the United States has blocked Mexico's efforts to resolve the dispute through the NAFTA institutional mechanisms.

4.93 Mexico and the United States have also held consultations and negotiations at various times over the past decade. However, they have been unable to reach an agreement through that channel either. It warrants noting that it was in the interests of certain parties to prolong the dispute. As long as the Mexican market remained in a state of disequilibrium, the Mexican industry would be subject to greater financial stress and exits from the Mexican sugar industry would be that much more likely. This in turn could be expected to reduce Mexico's ability to generate a surplus. Thus, the longer it would take to resolve this dispute, the better for certain United States interests.

(c) The decision to impose the IEPS on certain beverages

4.94 On 3 September 2001, the Government was confronted with an urgent need to respond to the prospect that, due to depressed market conditions, many mills would be unable to finance the planting of the next year's crop. The Government therefore deemed it necessary to expropriate 27 of the nation's 61 sugar mills.

4.95 Although the government intervention assisted in resolving some of the financial problems caused by the domestic surplus, Mexico still faced the fact that HFCS was displacing Mexican sugar from the soft drinks segment and Mexico was unable to export the displaced surplus sugar to the United States.

4.96 The Congress' action therefore was intended to rebalance the situation so that surplus sugar that should have been exportable to the United States could be sold in the domestic market. The tax, which is a temporary and proportionate measure, is intended to return the Mexican market to the *status quo ante* pending a resolution of the dispute on the bilateral agreement governing trade in sweeteners.

[25] USDA, *Mexico Sugar Semi-Annual 2000*, 10 October 2000, p. 4. Exhibit MEX-20.

4.97 Mexico respectfully requests the Panel to bear these facts in mind as it considers the United States' complaint.

3. Legal arguments

(a) This dispute arises out of a dispute under the NAFTA regarding bilateral trade in sweeteners

4.98 There is a genuine dispute concerning the volume of sugar that can be exported to the United States duty-free. According to the NAFTA, Mexico has the right to dispose of its total net sugar production surplus, which is particularly important given the displacement of sugar by HFCS in the Mexican market.

4.99 Insofar as the United States' complaint about the IEPS tax is concerned, it is important for this Panel to understand that the NAFTA's chapter on trade in goods is derived from the GATT. Indeed, the NAFTA obligation that deals with internal taxes is precisely Article III of the GATT 1994.

4.100 The United States claims that the measures adopted by Mexico violate only Article III of the GATT 1994. This has been explicitly incorporated in the NAFTA's rules governing trade in goods.

4.101 There is, therefore, a forum available to hear all of the parties' claims together.

(b) Mexico requests a preliminary ruling: the Panel should decline to exercise its jurisdiction

4.102 Mexico recognizes that the Panel has prima facie jurisdiction to hear and decide the United States' claims even though they are inextricably linked to a larger dispute concerning compliance with its own obligations under the NAFTA.[26] Mexico submits, however, that the Panel also has jurisdiction to decide whether to exercise its substantive jurisdiction in the circumstances of a dispute such as the instant case.

4.103 Like any other international court or tribunal, this Panel has certain implied jurisdictional powers that derive from its nature as an adjudicative body. This implied or incidental jurisdiction includes the jurisdiction to decide whether it should refrain from exercising substantive jurisdiction that has been validly established.

4.104 The power to refrain from exercising jurisdiction should be used sparingly and only in the most extraordinary circumstances; but it can be employed when the underlying or predominant elements of a dispute derive from rules of international law under which claims cannot be judicially enforced in the WTO, such as the NAFTA provisions. It warrants noting that in the GATT 1947 dispute on *US – Sugar Quota*, the United States argued against the Panel taking jurisdiction because its measures concerning sugar imports from Nicaragua were only one aspect of a larger State-to-State dispute. The United States stated that "it was neither invoking any exceptions under the provision of the General Agreement nor intending to defend its actions in GATT terms". It also stressed that its reduction in Nicaragua's sugar import quota "was fully justified in the context in which it was taken" and concluded:

> "The United States was of the view that attempting to discuss this issue in purely trade terms within the GATT, divorced from the broader context of the dispute, would be disingenuous. The resolution of that dispute was certainly desirable, and

[26] Under NAFTA Article 2005, the Parties agreed that, subject to certain conditions, " … disputes regarding any matter arising under both this Agreement and the *General Agreement on Tariffs and Trade*, any agreement negotiated thereunder, or any successor agreement (GATT), may be settled in either forum at the discretion of the complaining Party".

> would also result in the lifting of the action which Nicaragua had challenged before the Panel, but the United States did not believe that the review and resolution of that broader dispute was within the ambit of the GATT."[27]

4.105 A WTO panel should also refrain from exercising its jurisdiction when one of the disputing parties refuses to take the matter to the appropriate forum.

4.106 The history, prior procedures, and substantive content of the bilateral sweeteners trade dispute demonstrate that the measures challenged by the United States before the WTO are inseparable from the non-WTO claims over which the Panel has no jurisdiction. There is a forum available that could be seized with both disputing parties' claims and which could consider all the relevant facts. But this Panel will only be presented with a slice of the facts and legal issues at dispute in the NAFTA context.

4.107 The United States would suffer no prejudice from having its GATT Article III claim heard as NAFTA Article 301 claims. On the other hand, Mexico suffers prejudice from having its measure examined by the Panel alone:

- The United States is rewarded for its obstructionism which undermines the regional free trade agreement's dispute settlement process and undermines the international legal system;
- Mexico continues to be unable to have its legitimate grievance considered; and
- defences and exceptions that are available to Mexico in the other forum may not be available to it here.

4.108 In these circumstances, addressing the United States' claims would be inconsistent with the basic aim of WTO dispute settlement, namely, to "secure a positive solution to a dispute".[28] Since this Panel cannot resolve all the matters at issue in this dispute, this important objective cannot be achieved.

(c) Request for specific recommendation

4.109 If the Panel decides to take jurisdiction over this complaint, Mexico will request that it give special consideration to the formulation of its recommendations. In particular, Mexico will request that the Panel recommend that the parties take steps to resolve the sweeteners trade dispute within the NAFTA framework.

4.110 Mexico would also request the Panel, in the course of its deliberations, to give the fullest weight to Mexico's status as a developing country and to the fact that agrarian reform entails a lengthy process of adjustment, the social consequences of which are ignored by governments at their peril. Although Mexico has made great progress over the last two decades, it remains a developing nation and its long-standing structural problems of poverty in the rural economy cannot be brushed aside. There are very real social consequences to this dispute for Mexico's agrarian society. The WTO agreements contain principles and rules that are intended to accord more favourable treatment to developing countries and the necessary latitude needed to advance economically without provoking social crises.

---

[27] Panel report adopted on 13 March 1984, BISD 31S/67, paragraphs 3.10 and 3.11. In that dispute, while the panel noted that the measures were only one aspect of a broader problem, it proceeded to examine the claims of Nicaragua solely in the light of the GATT provisions. In Mexico's view, this reflected a pre-WTO approach to questions of international law that should be revisited.

[28] Article 3.7 of the DSU.

4.111 Finally, Mexico also requests the Panel, if it takes jurisdiction, to employ particular care in terms of how it formulates its findings and recommendations. In particular, the Panel should take special care to record that whatever the respective States' legal rights may be under applicable rules of international law, its findings apply solely to the parties' respective rights and obligations under the WTO agreements and cannot be taken to pre-judge such other legal rights.

(d) The measure was not intended to afford protection to domestic production within the meaning of Article III of the GATT 1994

4.112 The parties are in agreement that the measures at issue are tax measures that apply to specific goods. The parties also agree that they were imposed to "stop the displacement of domestic cane sugar by imported HFCS and soft drinks and syrups sweetened with HFCS".[29]

4.113 Mexico concedes that HFCS and cane sugar are substitutable products in certain applications. It was because of their substitutability that Mexico sought to protect its interests by ensuring that if HFCS displaced sugar in a market segment such as the soft drinks segment, Mexico would be able to export the displaced surplus sugar to the United States, so as to avoid an adverse effect on its sugar market. When the United States blocked this possibility, Mexico took action to protect its interests and to return to the *status quo ante*.

4.114 In assessing the matter before it, Mexico submits that the Panel must consider the legitimate objective that the Mexican Congress was pursuing in introducing the tax at issue.

4.115 In light of the unique circumstances of this dispute and the arguments discussed above, Mexico will not respond to the United States' claims that the measures at issue are inconsistent with GATT 1994 Article III.

(e) In the event of any inconsistency, the measure is justifiable under Article XX(d)

4.116 Even if the IEPS tax were found prima facie to violate Article III, the measure is justifiable under Article XX of GATT 1994, which provides:

> "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 the contracting party of measures:
>
> ...
>
> (d) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement … "

4.117 It is established that in order to demonstrate that a measure is justified under Article XX, the following sequence of steps applies: first, provisional justification by the characterization of the measure as being covered under one of the paragraphs of GATT Article XX; and second, appraisal of the measure under the chapeau of GATT Article XX.[30] Mexico will address each in turn. The measures at issue can be justified under Article XX(d) for the following reasons.

[29] *Id*., para. 3.
[30] Report of the Appellate Body on *US – Gasoline*, p. 24, DSR 1996:1, 3, at 22.

4.118 The measures are "necessary to secure compliance with laws and regulations which are not inconsistent with the provisions" of the GATT 1994. In *Korea – Various Measures on Beef*, referring to its Report on *US – Gasoline*, the Appellate Body set forth the following two elements for paragraph (d) of Article XX:

> "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."[31]

4.119 For the reasons set out in the factual section of this submission, the measures are "designed to" secure the United States' compliance with the NAFTA. The NAFTA, an international agreement, is a law that is not inconsistent with the provisions of the GATT 1994.

4.120 GATT Article XXIV expressly permits contracting parties to establish free trade areas and customs unions. Far from being "inconsistent with the provisions" of the GATT 1994, agreements that establish free trade areas are expressly contemplated and authorized by the GATT 1994.

4.121 Such agreements routinely include mechanisms to resolve disputes concerning the rights and obligations provided for therein. The NAFTA contains detailed dispute settlement procedures.

4.122 The measure at issue was also 'necessary' to secure the United States' compliance with the NAFTA. It is important to note that in order to be deemed 'necessary' within the meaning of Article XX(d) of the GATT 1994, a measure need not be the only alternative available to attain a Member's legitimate objective to secure compliance with laws or regulations which are not inconsistent with the provisions of the GATT. The Appellate Body made this clear in *Korea – Various Measures on Beef*:

> "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' taken to mean as 'making a contribution to'.
>
> 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

[31] Report of the Appellate Body on *Korea – Various Measures on Beef*, para. 157.

> 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."[32]

4.123 The measure at issue was "necessary" within the meaning of the review conducted by the Appellate Body.

(a) *First*, owing to the nature of the trade, it was deemed necessary that an internal tax be imposed;

(b) *Second*, ensuring that NAFTA obligations be correctly interpreted and applied is a vital interest of Mexico;

(c) *Third*, notwithstanding Mexico's repeated attempts to resolve its grievance, the United States has refused to submit to dispute settlement in compliance with its NAFTA obligations, and has preferred to drag on bilateral discussions that therefore have not resulted in an alternative solution . At the same time, HFCS has enjoyed the benefits of market access in Mexico, while the Mexican sugar industry is unable to exercise what Mexico believes to be its right to export significant sugar surpluses to the United States. The economic damage caused by the United States' continued refusal is manifest and, in the circumstances, it was necessary to take action to protect Mexico's legal interests and secure the United States' compliance, not only with its market access commitments, but more importantly, with the institutional mechanisms that are fundamental to the NAFTA's proper operation;

(d) *Fourth*, if the United States is able to successfully challenge Mexico's measures in this proceeding, while simultaneously refusing to have its own measures examined by a NAFTA Panel, an important object of the measures, i.e., creating a dynamic that has the possibility of inducing the United States to submit to NAFTA dispute settlement or otherwise resolving the dispute, will be defeated.

4.124 In Mexico's view, therefore, even if the IEPS tax contravened Article III, it is necessary to secure United States' compliance with its NAFTA obligations, in circumstances in which the ordinary means to accomplish that are not available, precisely because the United States has blocked recourse to such means.

4.125 Mexico notes that the United States has long insisted on its legal right to take action when another State impedes the operation of a treaty's dispute settlement mechanism:

> "Wherever it could, the United States would challenge unfair practices under the dispute settlement provisions of the General Agreement or the Tokyo Round Codes, but where other contracting parties prevented or impeded that process or blocked efforts to ensure that their practices were covered by multilateral disciplines, the United States would act to protect its interests. <u>If such action was considered unilateral, it should be nevertheless recognized as perfectly justifiable, responsive action necessitated by the failure of bilateral or multilateral efforts to address a problem</u>."[33] (emphasis added)

4.126 Since the measure is provisionally justified under paragraph (d) of Article XX, Mexico will now establish that it also meets the requirements of the chapeau of that provision.

---

[32] *Id*., paras. 161-162.
[33] GATT document C/163 of 16 March 1989, p. 4. Exhibit MEX-29.

(i) There was no "arbitrary or unjustifiable discrimination between countries where the same conditions prevail"

4.127 The Mexican market for HFCS has been dominated almost exclusively by HFCS imported from the United States or produced domestically from corn imported from the United States. The Appellate Body has had occasion to consider when the General Agreement will permit a Member to take unilateral action that might otherwise be contrary to the GATT under the chapeau of Article XX. The Appellate Body's Report on *US – Shrimp* (*Article 21.5 – Malaysia*[34]) concerned the United States' attempt to justify otherwise GATT-inconsistent extra-territorial measures under Article XX of the GATT 1994. The United States conditioned certain trade advantages to exporting developing countries to the adoption of certain domestic policies and restrictions on imports of goods from countries that did not adopt such policies.

4.128 *US – Shrimp* originally produced a decision against the United States, but then, after changes in United States' policy, the Appellate Body upheld the United States' restrictions, ordinarily contrary to GATT Article XI, on imports of shrimp imposed to save turtles.

4.129 The key issue before the Appellate Body, when considering the revised measure, was whether the new United States' policy was applied in a manner that no longer constituted a means of "arbitrary or unjustifiable discrimination" between "countries where the same conditions prevail" in the sense of the Article XX chapeau. The Appellate Body confirmed that unilateral measures may, in certain circumstances, withstand scrutiny under Article XX.

4.130 In doing so, the Appellate Body rejected Malaysia's argument that demonstrating serious, good faith efforts to negotiate an international agreement for the protection and conservation of sea turtles was not sufficient to meet the requirements of the chapeau of Article XX. Malaysia maintained that the chapeau actually required that such an international agreement be concluded. On this issue, the Appellate Body stated:

> "Under the chapeau of Article XX, an importing Member may not treat its trading partners in a manner that would constitute 'arbitrary or unjustifiable discrimination'. With respect to this measure, the United States could conceivably respect this obligation, and the conclusion of an international agreement might nevertheless not be possible despite the serious, good faith efforts of the United States. Requiring that a multilateral agreement be concluded by the United States in order to avoid 'arbitrary or unjustifiable discrimination' in applying its measure would mean that any country party to the negotiations with the United States, whether a WTO Member or not, would have, in effect, a veto over whether the United States could fulfil its WTO obligations. Such a requirement would not be reasonable. For a variety of reasons, it may be possible to conclude an agreement with one group of countries but not another. The conclusion of a multilateral agreement requires the cooperation and commitment of many countries. In our view, the United States cannot be held to have engaged in 'arbitrary or unjustifiable discrimination' under Article XX solely because one international negotiation resulted in an agreement while another did not.
>
> As we stated in *US – Shrimp* [the original dispute], 'the protection and conservation of highly migratory species of sea turtles […] demands concerted and cooperative efforts on the part of the many countries whose waters are traversed in the course of recurrent sea turtle migrations'. [Footnote omitted] Further, the 'need for, and the appropriateness of, such efforts have been recognized in the WTO itself as well as in a significant number of other international instruments and declarations'. [Footnote

[34] *US – Shrimp (Article 21.5 – Malaysia).*

> omitted] For example, Principle 12 of the Rio Declaration on Environment and Development states, in part, that '[e]nvironmental measures addressing transboundary or global environmental problems should, as far as possible, be based on international consensus'. [Footnote omitted] Clearly, and 'as far as possible', a multilateral approach is strongly preferred. Yet it is one thing to prefer a multilateral approach in the application of a measure that is provisionally justified under one of the subparagraphs of Article XX of the GATT 1994; it is another to require the conclusion of a multilateral agreement as a condition of avoiding 'arbitrary or unjustifiable discrimination' under the chapeau of Article XX. We see, in this case, no such requirement."[35] (emphasis added)

4.131 The Appellate Body then upheld the Article 21.5 panel's reliance on a non-WTO treaty, the Inter-American Convention for the Protection and Conservation of Marine Turtles, as a factual reference or point of comparison when deciding that the new United States' policy was no longer discriminatory in the sense of the chapeau of GATT Article XX:

> "Thus, in the previous case, in examining the original measure, we relied on the Inter-American Convention in two ways. First, we used the Inter-American Convention to show that 'consensual and multilateral procedures are available and feasible for the establishment of programmes for the conservation of sea turtles.' [Footnote omitted]. In other words, we saw the Inter-American Convention as evidence that an alternative course of action based on cooperation and consensus was reasonably open to the United States. Second, we used the Inter-American Convention to show the existence of 'unjustifiable discrimination'. The Inter-American Convention was the result of serious, good faith efforts to negotiate a regional agreement on the protection and conservation of turtles, including efforts made by the United States. In the original proceedings, we saw a clear contrast between the efforts made by the United States to conclude the Inter-American Convention and the absence of serious efforts on the part of the United States to negotiate other similar agreements with other WTO Members. We concluded there that such a disparity in efforts to negotiate an international agreement amounted to 'unjustifiable discrimination'. [Footnote omitted.]
>
> With this in mind, we examine what the Panel did here. In its analysis of the Inter-American Convention in the context of Malaysia's argument on 'unjustifiable discrimination', the Panel relied on our original Report to state that 'the Inter-American Convention is evidence that the efforts made by the United States to negotiate with the complainants before imposing the original measure were largely insufficient'. [Footnote omitted.] The Panel went on to say that 'the Inter-American Convention can reasonably be considered as a benchmark of what can be achieved through multilateral negotiations in the field of protection and conservation.' [Footnote omitted.]
>
> At no time in *US – Shrimp* did we refer to the Inter-American Convention as a 'benchmark'. The Panel might have chosen another and better word – perhaps, as suggested by Malaysia, 'example'. [Footnote omitted.] Yet it seems to us that the Panel did all that it should have done with respect to the Inter-American Convention, and did so consistently with our approach in United States – Shrimp. The Panel compared the efforts of the United States to negotiate the Inter-American Convention with one group of exporting WTO Members with the efforts made by the United States to negotiate a similar agreement with another group of exporting WTO

[35] *US – Shrimp (Article 21.5 – Malaysia)*, paras. 123-124.

> Members. The Panel rightly used the Inter-American Convention as a factual reference in this exercise of comparison. It was all the more relevant to do so given that the Inter-American Convention was the only international agreement that the Panel could have used in such a comparison. As we read the Panel Report, it is clear to us that the Panel attached a relative value to the Inter-American Convention in making this comparison, but did not view the Inter-American Convention in any way as an absolute standard. Thus, we disagree with Malaysia's submission that the Panel raised the Inter-American Convention to the rank of a 'legal standard'. The mere use by the Panel of the Inter-American Convention *as a basis for a comparison* did not transform the Inter-American Convention into a 'legal standard'. Furthermore, although the Panel could have chosen a more appropriate word than 'benchmark' to express its views, Malaysia is mistaken in equating the mere use of the word 'benchmark', as it was used by the Panel, with the establishment of a legal standard".[36]

4.132 The Appellate Body's analysis is of assistance in this proceeding. It examined actions taken by the respondent in relation to a subject falling outside of the WTO Agreements. It did not require the United States to conclude an international agreement in that subject area, but rather required it to demonstrate that it had used serious, good faith efforts to do so. That was sufficient because if, for reasons outside of the United States' control, such an agreement could not be reached, another State would have a veto over the United States' compliance with its WTO obligations.

4.133 The parallels with the present case are obvious:

- the United States made market access commitments for Mexican sugar in the NAFTA, a subject that falls outside of the WTO agreements (although expressly permitted by Article XXIV of the GATT 1994);
- a disagreement arose as to the nature of those commitments;
- Mexico has constantly sought a resolution of the disagreement, including through its request for the establishment of a NAFTA dispute settlement panel and numerous efforts to achieve a negotiated solution;
- the United States has refused to consent to submit to dispute settlement proceedings and bilateral negotiations have proved fruitless; and
- therefore, the United States has essentially vetoed Mexico's ability to have its grievance resolved.

4.134 In such circumstances, Mexico exercised its international law rights to rebalance the situation in a proportionate fashion.

(ii) The measure is not a "disguised restriction on international trade"

4.135 As the United States' first submission repeatedly points out, the purpose of the measure has been stated by members of Congress and analysed by the Supreme Court of Justice. The United States omitted to inform this Panel of the long-standing bilateral dispute and Mexico's continued efforts to resolve it, of its refusal to submit to dispute settlement under the NAFTA, and of the ineffectiveness of bilateral negotiations. The United States also failed to inform the Panel of the social and economic context of sugar production in Mexico, the crisis that the industry underwent, due, in large part, to a lopsided situation generated unilaterally by the United States, given the

[36] *Id.*, pp. 128-130.

Mexican industry's inability to export sugar surpluses to its market, while at the same time imports of United States' HFCS and domestically produced HFCS from corn imported from the United States contributed greatly to generate such surpluses.

4.136 Thus, the United States failed to explain precisely why the Congress acted as it did. There has been no disguised restriction on trade. Mexico's measures constitute a proportionate, legitimate, and legally justified response to actions and omissions of the United States. The Panel should also not lose sight that this is a particularly sensitive sector, the social and economic implications of which cannot be ignored, especially given Mexico's status as a developing nation, and thus the greater difficulties that Mexico faces in addressing problems that arise in ordinary circumstances, let alone in the extraordinary circumstances arising out of the dispute concerning bilateral trade in sugar.

4.137 In Mexico's view, therefore, even if the IEPS tax contravened Article III, it is necessary to secure the United States' compliance with its NAFTA obligations and does not constitute a "disguised restriction on international trade".

4. Conclusion

4.138 Mexico respectfully requests the Panel to decline to exercise its jurisdiction for the reasons set out in this Submission. In the event that the Panel does decide to exercise its jurisdiction, Mexico respectfully requests it to pay particular attention to the circumstances that gave rise to the measures at issue in this case, in light of the complex social and economic problems of the sugar sector in Mexico, which were aggravated precisely by acts and omissions of the United States. The Panel should also accord particular weight to Mexico's status as a developing country, especially in the context of the broader dispute concerning trade in sweeteners between Mexico and the United States, and should take note of the singular importance that sugar production plays in supporting a significant number of Mexican farmers and their families. Finally, the Panel should recognize the United States' intransigence in resolving this matter of crucial importance to Mexico. Mexico requests the Panel to find that, in the extraordinary circumstances of this case, where in the face of an acknowledged dispute, the United States has refused to submit to NAFTA dispute settlement, having exhausted all possibilities for third party dispute resolution, and where years of seeking a negotiated settlement have been unsuccessful, the Mexican measures are justified under Article XX of the GATT 1994.

D. OPENING STATEMENT OF THE UNITED STATES AT THE FIRST MEETING OF THE PANEL

4.139 This dispute is about a 20 per cent tax Mexico enacted, effective 1 January 2002, on soft drinks and syrups other than those sweetened exclusively with cane sugar. This tax – which is embodied in the IEPS – was imposed to stop the displacement of Mexican cane sugar by imported HFCS in Mexican soft drink production. That is what the Mexican Supreme Court has said, and what Mexico concedes in its first submission.[37] This tax has had the desired effect. Today, despite the fact that Mexico is the second largest consumer of soft drinks in the world, imports of HFCS for soft drink use have ceased; total HFCS exports from the United States are just barely four per cent of their pre-tax levels.

4.140 HFCS and cane sugar are directly competitive and substitutable products as sweeteners for soft drink and syrup production: Mexico concedes this point in its first submission.[38] Cane sugar and HFCS are not similarly taxed: the tax is not imposed on soft drinks and syrups sweetened only with cane sugar, and it is prohibitively high, over four times the cost of the HFCS used in a typical soft drink.[39] Mexico's tax is inconsistent with Mexico's obligations under the second sentence of

[37] Mexico first written submission, para. 111.
[38] Mexico's first written submission, paras. 5, 34, 112.
[39] United States' first written submission, para. 45.

Article III:2 as a tax on HFCS and soft drinks and syrups sweetened with HFCS. Similarly, Mexico's tax discriminates in favour of Mexican soft drinks and syrups sweetened with cane sugar, and against soft drinks and syrups sweetened with HFCS, in breach of the first sentence of Article III:2. In addition, the tax rewards Mexican soft drink producers for using domestic cane sugar and punishes them for using HFCS, in breach of Article III:4.

4.141 The United States first submission presents a complete and documented prima facie case, including evidence and argument sufficient to establish a presumption that Mexico has infringed its Article III obligations. The United States has met its burden of proof.

4.142 In its first submission, rather than contesting the United States prima facie case under Article III, Mexico attempts to change the subject by raising issues that are irrelevant or otherwise outside the Panel's terms of reference – including the economic importance of the Mexican sugar industry, bilateral negotiations on sugar trade, and bilateral obligations under the NAFTA. The Panel need not and should not engage itself on these issues. These issues are outside the Panel's terms of reference.

4.143 In light of its extended discussion of issues irrelevant to this dispute, Mexico's first submission, while lengthy, appears actually to narrow the issues before the Panel. In fact, Mexico affirmatively states that it "will not respond" to the United States' Article III claims.[40] That in effect leaves Mexico's so-called request for a "preliminary ruling" and its Article XX(d) defence as the only contested issues before the Panel today. For that reason, the United States will not repeat in its statement the extensive arguments in its first submission detailing Mexico's breach of its obligations under Articles III:2 and III:4 of the GATT 1994. Instead, having established a prima facie case, the United States will operate on the assumption – as Mexico does in its first submission – that Mexico's tax is in breach of Article III and proceed to address Mexico's Article XX(d) defence of that breach and its preliminary ruling request.

1. Article XX(d)

4.144 Turning first to Article XX(d), Mexico asserts that alleged United States non-compliance with NAFTA obligations can justify action by Mexico in violation of its WTO obligations. There is absolutely no basis in Article XX(d), the DSU, or elsewhere in the WTO Agreement for Mexico's proposition. Simply nothing in those agreements supports the contention that a WTO Member may violate its WTO obligations in order to punish another Member because it thinks that Member has not complied with its obligations under another international agreement.

4.145 Accordingly, Mexico cannot possibly satisfy the burden of demonstrating that its tax satisfies the conditions for justification under Article XX(d). While Article XX(d) permits a Member to maintain measures that are "necessary to secure compliance with laws or regulations which are not inconsistent" with the provisions of the GATT 1994, NAFTA is not a "law or regulation," and Mexico's tax is not "necessary to secure compliance."

4.146 In the first instance, international obligations owed Mexico by other countries under the NAFTA and other international agreements are not "laws" or "regulations" within the meaning of Article XX(d). Rather, Article XX(d) allows a Member, under certain conditions, to adopt or enforce measures necessary to secure compliance with that Member's own laws and regulations – for example, those laws and regulations Mexico may have in place to implement its own NAFTA obligations. It does not, however, permit a Member to claim an Article XX(d) exception for measures to secure compliance by another Member with its obligations under an international agreement. It should go without saying that an "international agreement" is distinct from a "law" or "regulation."

[40] Mexico's first written submission, para. 114.

4.147 For these reasons and others which the United States can elaborate further in subsequent submissions, Mexico has wholly failed to meet its burden of establishing a prima facie basis for its Article XX(d) defence. There is simply nothing in the WTO Agreement to support its claim.

2. Developing countries

4.148 Separately, Mexico asserts that the Panel must take into account that the "WTO Agreement contains principles and provisions the purpose of which is to grant more favourable treatment to developing countries." While the covered agreements do in fact contain certain provisions that accord special and differential treatment to developing countries, Mexico has not identified any provision that might permit Mexico to accord less favourable treatment to products of another WTO Member than it accords to its own like products or to discriminate against directly competitive or substitutable products of another Member in favour of domestic production.

3. Recommendations

4.149 Mexico also asks the Panel to make a specific recommendation that "the parties in this dispute take steps under NAFTA to resolve the entire dispute relating to trade in sweeteners." It is unclear in what context Mexico proposes the Panel make such a recommendation. As the DSU makes clear under Article 19.1, a panel only makes a recommendation after having found a Member's measure inconsistent with that Member's WTO obligations and, even then, may only recommend that the Member bring its WTO-inconsistent measure into conformity.[41] Panel suggestions under Article 19.1 are likewise limited to being directed at the Member whose measure was found to be WTO-inconsistent. The Panel should reject Mexico's request.

4. Preliminary ruling request

4.150 Turning to Mexico's so-called "preliminary ruling" request, first this is not a request for a "preliminary ruling." If anything, it is a request for a "non-ruling" and there would be nothing "preliminary" about it. Mexico seeks to resolve the entire dispute on a definitive basis in this manner. It is not that Mexico questions the Panel's jurisdiction and seeks a preliminary ruling in order to clarify that jurisdiction for purposes of this proceeding. Rather, Mexico admits that the Panel has jurisdiction to hear and decide the United States claims, but asks the Panel to refrain from exercising that jurisdiction.[42] Let the United States present the situation plainly and clearly: Mexico admits that it imposed the IEPS – a measure it does not contest is in breach of Article III – to stop the displacement of Mexican cane sugar by imported HFCS. Mexico then claims that it has done so to coerce its desired solution to a bilateral dispute. And now Mexico wishes the Panel to assist it in this WTO-inconsistent action by denying the United States its right to WTO dispute settlement.

4.151 There is absolutely no basis for Mexico's request. In fact, the DSU and the Panel's terms of reference in this dispute specifically preclude it. Article 7.2 of the DSU states that panels "shall address the relevant provisions in any covered agreement or agreements cited by the parties" to a dispute. The DSU further instructs panels in Article 11 to make an "objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements."[43] In this respect, the Dispute Settlement Body ("DSB") has defined the Panel's terms of reference in this dispute as follows:

> "To examine, in the light of the relevant provisions of the covered agreements cited by the United States in document WT/DS308/4, the matter referred to the DSB by the

[41] *See* DSU Articles 11, 19.1.
[42] Mexico's first written submission, para. 93.
[43] *See also* DSU Article 12.7.

> United States in that document, and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements."[44]

4.152 The "matter referred to the DSB by the United States" in its panel request covers Mexico's tax on HFCS and soft drinks and syrups sweetened with HFCS, and the consistency of that tax with Mexico's obligations under Article III of the GATT 1994. Given the explicit instructions set forth in the DSU and the Panel's terms of reference, Mexico's argument that the Panel should simply decline to exercise jurisdiction over this dispute is untenable.

4.153 Mexico's attempt to liken its request for the Panel to decline jurisdiction to past panels' use of "judicial economy" is misplaced.[45] Judicial economy is a concept under which panels have declined to address certain claims raised by a party when resolution of such claims is not needed for the Panel to resolve the matter at issue in the dispute. Judicial economy is typically used by panels when a complaining party alleges that a measure breaches several provisions of the WTO Agreement, but a finding of breach with respect to some, but not all, of the provisions is sufficient for the DSB to recommend that the measure be brought into conformity with the WTO Agreement.[46] It is not a concept a panel may draw upon as a basis for declining to exercise jurisdiction over each and every claim raised by the complaining party. For a panel to decline jurisdiction over each and every claim raised would, of course, leave the DSB unable to make any recommendations or rulings with respect to the matter. Such an outcome is clearly incompatible with the function of panels to "assist the DSB in making the recommendations and . . . rulings provided for in the covered agreements." As the Appellate Body found in *Australia – Salmon*, under the DSU panels are obligated "to address those claims on which a finding is necessary in order to enable the DSB to make sufficiently precise recommendations and rulings so as to allow for prompt compliance by a Member with those recommendations and rulings."[47]

4.154 Equally unsupported by the DSU is Mexico's argument that the Panel's exercise of jurisdiction would be incompatible with the "aim of the dispute settlement mechanism to secure a positive solution to a dispute." In Mexico's view, "a positive solution" to the dispute can only be found before a NAFTA panel. However, this "dispute" is a WTO dispute that has been brought before this WTO dispute settlement Panel to resolve a dispute over Mexico's obligations under the covered agreements. Although Mexico attempts to recast this dispute as involving United States' obligations under the NAFTA, it is Mexico's WTO obligations that comprise the matter in dispute. The NAFTA is not a covered agreement, nor is it within this Panel's terms of reference. Accordingly, the United States has not cited to the NAFTA. The United States notes, however, that it has a markedly different view than Mexico of the relevant NAFTA provisions and the series of events transpiring under the NAFTA. And that is just the point – this Panel is not in a position to make findings on those NAFTA issues, so there is no reason to elaborate on the parties' differing positions on those issues. Moreover, although not relevant to this dispute, the United States notes that neither Mexico nor the United States have agreed in the NAFTA to prejudice their WTO rights. Indeed, under the NAFTA the parties begin by affirming their GATT rights and obligations.

4.155 Mexico also argues that although the Panel has prima facie jurisdiction over the present dispute, the more "appropriate" forum for its resolution is before a NAFTA panel.[48] Again, Mexico's proposition finds no basis in the DSU or elsewhere in the WTO Agreement. That WTO Members may choose to settle disputes involving a mixture of WTO and non-WTO rules in other fora, as

---

[44] WT/DS308/5/Rev.1.
[45] Mexico's first written submission, para. 94.
[46] *See, e.g.*, Appellate Body Report on *US – Wool Shirts and Blouses* p. 17, DSR 1997:I, 323, at 339.
[47] *See, e.g.*, Appellate Body Report on *Australia – Salmon*, para 223.
[48] Mexico's first written submission, para. 97.

Mexico observes, hardly justifies a WTO panel refusing to exercise jurisdiction over the dispute for which it was established.

4.156 One party's determination that another forum is more "appropriate" similarly does not justify such a refusal to exercise jurisdiction.[49] In fact, in *India – Quantitative Restrictions*, the Appellate Body dismissed India's arguments that the panel lacked jurisdiction to decide claims that India thought more appropriately resolved before the WTO Balance of Payments Committee. The Appellate Body stated:

> "According to Article XXIII, any Member which considers that a benefit accruing to it directly or indirectly under the GATT 1994 is being nullified or impaired as a result of the failure of another Member to carry out its obligations, may resort to the dispute settlement procedures of Article XXIII. The United States considers that a benefit accruing to it under GATT 1994 was nullified or impaired as a result of India's alleged failure to carry out its obligations regarding balance of payments restrictions under Article XVIII:B of the GATT 1994. Therefore, the United States was entitled to have recourse to the dispute settlement procedures of Article XXIII with regard to the dispute."

4.157 Likewise, the United States is entitled to have recourse to the dispute settlement procedures of Article XXIII and the DSU with respect to Mexico's failure to carry out its obligations under Article III of the GATT. For this reason, and others mentioned, the Panel should deny Mexico's request for it to decline jurisdiction in this dispute.

E. OPENING STATEMENT OF MEXICO AT THE FIRST MEETING OF THE PANEL

1. Introduction

4.158 The United States' claims raise a question of singular complexity and significance:

(a) Mexico and the United States established a particular regime for bilateral trade in sweeteners, mainly sugar and HFCS.

(b) These products are substitutes for each other in certain uses and, thus, compete in an important segment of the Mexican market.

(c) A dispute exists between the two countries with regard to the access of Mexican sugar to the United States market. Mexico considers that, in accordance with NAFTA, it has the right to export all of its sugar surpluses; the United States considers that Mexico has the right to export a lesser amount and, since the United States controls imports of Mexican sugar into its market, it has limited the amount of sugar that can gain access to that market through the allocation of import quotas.

(d) Mexican sugar surpluses depend on sugar and HFCS production in Mexico as well as Mexican HFCS imports from the United States, so with regard to the consumption of both products, the generation of sugar surpluses is, in part, dependent on HFCS production and importation.

[49] Appellate Body Report on *India – Quantitative Restrictions* para. 84; *see also* Panel Report on *Turkey – Textiles*, paras. 9.15-9.17.

(e) Consequently, Mexican HFCS production and imports, in addition to the United States' restrictions on imports of Mexican sugar, has had a significant economic impact on Mexico's sugar industry.

(f) The NAFTA establishes a mechanism for resolving disputes related to the interpretation and application of the treaty or in circumstances in which one of the Parties considers that a measure of the other Party is or could be inconsistent with the Treaty's provisions.

(g) Mexico activated the dispute settlement mechanism and requested the establishment of an arbitral panel to resolve the dispute relating to Mexican sugar exports. The United States has refused to submit to this mechanism.

(h) Mexico has also been seeking a negotiated solution of the dispute, but these efforts have been fruitless as well.

4.159 Mexico considers that in these extraordinary circumstances it has the right to protect its interests. Indeed, the Mexican measures at issue in this dispute cannot be understood without bearing in mind that they were implemented in response to unilateral restrictions imposed by the United States on Mexican sugar imports, in addition to its refusal to submit to the NAFTA dispute settlement mechanism, and the inability to achieve a solution through other means.

4.160 In submitting this claim in the framework of the WTO, the United States apparently believes that a WTO Member must simply suffer the economic and social distress caused by another Member's intransigence; this appears to constitute a departure from the United States' long-held position. As discussed in Mexico's first written submission, the United States has in the past claimed the right to take unilateral action when another State impedes the operation of a treaty's dispute settlement mechanism.

4.161 In the light of the United States' previously stated position, let us consider what the United States would have done if it was Mexico that had vetoed the United States' attempt to have a legitimate NAFTA grievance resolved. Would it have stood idly by if its most important agricultural sector experienced a crisis as a result of Mexico's refusal to liberalize its import restrictions? It does not seem likely. Likewise, Mexico could not afford not to respond to unilateral measures and simply let its agriculture suffer the consequences of United States restrictions.

4.162 Mexico had to act to rebalance the situation, to return to the *status quo ante*.

4.163 Article 3.7 of the Dispute Settlement Understanding (DSU) stresses two key points: "Before bringing a case, a Member shall exercise its judgement as to whether action under these procedures would be fruitful". In addition, the "aim of the dispute settlement mechanism is to secure a positive solution to a dispute". In Mexico's view, the United States' complaint clearly fails to meet both of these requirements. It is obvious that by any objective standard, the United States' claim is aimed at forcing all of the adjustments in NAFTA sweeteners trade onto Mexico. Now that the Panel is more fully informed of the history of this dispute, it can see for itself that by presenting a "slice" of the dispute to the WTO, it is evident that the United States has not exercised the judgement required by Article 3.7 of the DSU.

4.164 Nor for that matter will this proceeding "secure a positive solution to the dispute". Mexico attaches the greatest importance to the WTO and to the DSU, but it would like to state, with the utmost respect that, whether or not the Panel determines that the IEPS tax is inconsistent with Article III of GATT 1994 or is not covered by the Article XX exceptions, there will be no positive

solution to this dispute, and there cannot be one until all the issues of importance to both sides are comprehensively resolved.

4.165 It is for that reason that Mexico urges the Panel to decline to exercise jurisdiction since there is another forum available to both parties where the dispute can be heard in its entirety in light of all of the facts and all of the relevant legal rights and obligations. Rather than seeking to avoid submission to the settlement of the complaint filed by the United States, Mexico is looking for the appropriate forum to resolve the existing dispute between the two countries in a comprehensive manner.

4.166 Mexico also again invites the Panel to consider its status as a developing country and, since the sugar industry is a key element of its rural economy, to take into account the real economic and social consequences of this dispute for the Mexican rural sector.

4.167 In this submission, Mexico will address four points. First, it will begin by demonstrating that the IEPS tax is part of, and inseparable from, a long-standing dispute arising under the NAFTA. This is particularly important given that the United States' first written submission does not contain a single word in this regard.

4.168 The United States has also ignored other crucial facts, including its own acts and omissions in the events that gave rise to the measures at issue and the adverse impact of its restrictions on imports of Mexican sugar on a particularly sensitive sector of the Mexican economy. The serious problems of the Mexican sugar industry are real and have been aggravated by the United States' unilateral decision to limit Mexico's ability to export sugar surpluses to its market.

4.169 Mexico insists that the Panel must take these important facts into consideration. In the light of all the relevant facts, it is clear that Mexico enacted the IEPS tax as an absolutely last resort.

4.170 Second, Mexico will address the basis for its request that the Panel decline to exercise its jurisdiction. Mexico recognizes that its request for a preliminary ruling is unusual, but submits that this Panel has the authority to accept it, and should do so given the exceptional nature of this dispute.

4.171 Third, Mexico will refer to its arguments to the effect that, if the Panel decides to make findings on the merits of the dispute, it should find that the measures at issue are justified under Article XX(d) of the GATT 1994.

4.172 Finally, Mexico will offer some brief preliminary remarks on certain issues raised by the European Communities in its third party submission.

2. The origin of the IEPS tax and the importance for providing relief for the Mexican sugar industry

4.173 Mexico describes the sugar industry's importance in paragraphs 15 to 26 of its first written submission, where Mexico also explains that the viability of the sugar industry constitutes a political and social imperative. The Mexican industry is characterized by certain structural problems which the government cannot ignore. For example, sugarcane is grown on thousands of small plots and the farmers depend on the proximity of a sugar mill to sell their crop. The sugar milling companies have typically encountered financial problems as a result of the substantial debts incurred when they acquired the mills in Mexico's privatization process during the 1990s as well due to low sales margins. This situation has forced the Mexican government to intervene in different ways to prevent bankruptcies which would have had immediate adverse consequences for the sugarcane growers that supply the mills.

4.174 Simply put, it remains a great challenge for Mexico to ensure the viability of the sugar milling companies and to promote a higher living standard for the sugarcane growers, one of the poorest sectors in the country. For obvious reasons, the financial situation of the sugar industry is a major concern for the Mexican government.

4.175 Moreover, it is no secret that the world sugar industry is one of the most economically distorted and that government intervention is widespread in this sector. Governments frequently intervene to support the prices of agricultural producers (i.e. of the producers of sugarcane or sugar beet). This automatically makes substitute products, for example HFCS, more competitive in certain market segments.

4.176 Countries that are net importers of sweeteners can support domestic prices by, *inter alia*, limiting imports. However, in the six years leading up to the imposition of the IEPS tax, Mexico was a net surplus producer: the production of sugar exceeded its consumption.

4.177 Low world market prices, the surplus on the Mexican market aggravated by the displacement of sugar by HFCS and the lack of access to the United States market have made things difficult for the industry. While the Mexican Government has made great efforts to improve the situation, it has encountered considerable difficulties.

4.178 In the recent final award made by the arbitral panel established under NAFTA Chapter Eleven in *GAMI Investments, Inc. v. The Government of the United Mexican States*[50] these facts were discussed. The members of the tribunal were Jan Paulsson, Michael Reisman, and Julio Lacarte Muró, whom the Panel will know for his long-standing and distinguished work in the GATT and the WTO, including his membership of the Appellate Body. The award, dated 15 November 2004, contains findings of fact as to the very serious market conditions faced by the sugar mills from the mid-1990s through 2002.

4.179 When the Panel reviews the award, it will see that the tribunal accepted many of the facts that Mexico has asserted in its first written submission in this proceeding: the special historical significance of sugar growing in Mexico, the large number of Mexican people who depend upon the industry, the distortions in the world market, Mexico's efforts to assist the industry in its distress, the lack of access to the United States market, and Mexico's attempt to resolve the matter under NAFTA's general dispute settlement procedures (see in this regard, paragraphs 45-52, 67, 77, and 78). The Panel will also see that the tribunal found that Mexico's rebalancing of market conditions dramatically improved its sugar industry's situation.

4.180 There is no question that the fact that Mexico was prevented from exporting its surplus sugar to the United States exacerbated the serious problems that the Mexican sugar industry faced throughout the relevant period. The Government of Mexico could not ignore the substantial economic damage caused as a result of the United States' failure to open up its market as expected.

4.181 In presenting its case, the United States also creates a false impression regarding the intent behind Mexico's measures. It is important that the record be set straight. To cite just a few examples:

– At the outset of its first written submission, the United States asserts that the Mexican sugar industry and its supporters in Congress wished to prevent the displacement of sugar by HFCS in its soft drink market and implies that they were motivated merely by a protectionist intent. This gives the impression that the Mexican government is against the use of HFCS under any circumstances, which is simply incorrect. The Mexican government's real and urgent concern is not that substantial quantities of

[50] Exhibit MEX-30.

HFCS might displace Mexican sugar from a traditionally important segment of the domestic sugar market; rather it is that such a displacement would greatly contribute to the generation and growth of sugar surpluses in Mexico, as long as the United States maintained restrictions on those surpluses' entry into its market to protect its own industry, leaving the impact to be absorbed entirely by the Mexican sugar market. It should not be forgotten that this was precisely the original concern of the United States after the signature of the NAFTA and that motivated its request for clarification through an exchange of letters between the two governments: the United States' concern then was that HFCS imports from the United States would generate surpluses which, if exported to the United States, would unbalance its market. The enactment of the measure at issue was intended to restore equilibrium. Regarding the United States' argument that the measure has a solely protectionist intent, Mexico will refer the Panel to the statement by the United States Department of Agriculture quoted in paragraph 61 of Mexico's first submission: "*…Basically, the Mexican sugar industry is not against United States HFCS imports into Mexico; what they want is to gain access for more than the 25,000 MT of sugar currently allowed under the TRQ for Mexico. With the high levels of imported HFCS and higher levels of sugar production, the sugar industry claims there is a danger of closing of 15 to 20 mills, resulting in layoff of about 100,000 workers*." These are the words of the United States, not Mexico.

– The United States also implies in its written submission that Mexico's decision to impose the IEPS tax is permanent, motivated by a firm desire to stop imports of HFCS and to terminate the use of HFCS in soft drinks and syrups. This is not so. Mexico's measure is a temporary response to the acts and omissions of the United States and, as Mexico has explained, the aim is to rebalance the situation between Mexico and the United States pending a comprehensive resolution.

– According to the United States, the purpose of the IEPS tax is simply to protect the Mexican sugar producers from import competition. Again, this characterization is also inaccurate because it ignores the legitimate objective behind the measure at issue. The United States knows perfectly well why the Mexican Congress acted as it did.

4.182 Before turning to its legal arguments, Mexico urges the Panel not to lose sight of the great difficulties that Mexico faces in addressing the problems of its sugar industry because of the extraordinary circumstances resulting from the United States' refusal to address Mexico's market access complaints under the NAFTA. It would simply not be equitable to reward the United States for actions that undermine the NAFTA's dispute settlement process.

3. Mexico's request for a preliminary ruling

4.183 Mexico set out the legal basis for its request that the Panel decline to exercise its jurisdiction in paragraphs 93 to 103 of its first written submission. In this statement, it will emphasize a few key points.

4.184 First, Mexico wishes to make clear that it does not contest that the Panel has prima facie jurisdiction to examine the United States' claims under Article III of the GATT 1994. However, the mere conclusion that the Panel has substantive jurisdiction to hear the case brought by the United States does not exhaust all issues relevant to the Panel's competence in this dispute.

4.185 The reason is that even though the substantive jurisdiction of any international court or tribunal may be granted explicitly by treaty, once such a forum has been seized of a specific matter, it

has certain implied jurisdictional powers that derive from its nature as an adjudicative body. Some elements of this incidental jurisdiction include the power to:

- Interpret the parties' submissions to "isolate the real issue in the case and to identify the object of the claim"[51];
- determine whether it has substantive jurisdiction to settle a claim or any aspect of it (this is sometimes referred to as the principle of jurisdiction over jurisdiction);
- decide all matters linked to the exercise of substantive jurisdiction that are inherent in the adjudicative function (i.e., decide claims under rules on the burden of proof, good faith, estoppel, due process, treatment of confidential information, etc.);
- apply the principle of "judicial economy", referred to by Mexico in its first written submission;
- and, crucially in this case, the power to decide whether it should refrain from exercising its validly established substantive jurisdiction.

4.186 A review of WTO jurisprudence also indicates that WTO panels and the Appellate Body have implied or incidental jurisdictional powers. For example, in *US – 1916 Act*, the Appellate Body explicitly confirmed that a WTO panel can determine whether it has substantive jurisdiction to decide a matter. Specifically, the Appellate Body referred to the "widely accepted rule that an *international tribunal* is entitled to consider the issue of its own jurisdiction on its own initiative, and to satisfy itself that it has jurisdiction in any case that comes before it".[52]

4.187 In other instances, WTO panels have relied on the implied jurisdiction to rule on matters inherent in the adjudicative function on which the DSU or other WTO covered agreements are silent. In *US – Wool Shirts and Blouses*, the Appellate Body found that "the party who asserts a fact, whether the claimant or the respondent, is responsible for providing proof thereof" and the "burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence".[53] The Appellate Body did so largely because these rules have been "generally and consistently accepted and applied" by "*various international tribunals*, including the International Court of Justice."[54]

4.188 Mexico recognizes that there is no WTO precedent in which a panel has declined to exercise its jurisdiction over all of the claims made by a Member. Mexico is not arguing that the Panel could decline to exercise its jurisdiction solely on the basis of the notion of "judicial economy", contrary to what is suggested in the EC's third party submission.

4.189 In its first written submission, Mexico referred to the principle of "judicial economy" as an example of situations where WTO panels have refrained from exercising validly established substantive jurisdiction over certain claims brought before them. In Mexico's view, this example illustrates that in spite of the apparent requirement of Article 7.2 of the DSU, which stipulates that "[p]anels shall address the relevant provisions in any covered agreement or agreements cited by the parties to the dispute", WTO panels can decide not to address certain claims. In the light of this example and others already mentioned, there can be no question that WTO panels have an implicit or inherent jurisdiction.

---

[51] See Nuclear Tests (*Australia v. France; New Zealand v. France*), 1974 ICJ Reports 253, page 262.
[52] Appellate Body Report on *US – 1916 Act*, para. 54 and footnote 30 (emphasis added).
[53] Appellate Body Report on *US – Wool Shirts and Blouses*, p. 14, DSR 1997:I, 323, at 335.
[54] *Id.* (emphasis added)

4.190 Mexico believes that such jurisdiction includes the power to decline to exercise jurisdiction in the extraordinary circumstances of this case since there is an available forum for both parties to solve the dispute in a comprehensive manner. Mexico's request is not simply that the Panel decline its jurisdiction, but that it decline it in favour of that forum.

4.191 Mexico's request is compatible with the objective of the WTO dispute settlement mechanism to "secure a positive solution to a dispute". In this case, the underlying difference is broader than submitted by the United States before the DSB.

4.192 As a final point. Mexico wishes to make clear that it is not arguing that the Panel's power to refrain from exercising jurisdiction should be used liberally. However, this case presents exceptional circumstances, that is to say, a broader dispute exists, as recognized by both parties, the United States and Mexico, but the United States has frustrated the Mexican right to have recourse to the appropriate dispute settlement mechanism in order to resolve its grievance.

4.193 In its submission, the European Communities pointed out that in the *Argentina – Poultry Anti-Dumping Duties* case a WTO panel considered the dispute despite the fact that the same measures had previously been the subject of dispute settlement under Mercosur. Nonetheless, in Mexico's view, *Argentina – Poultry Anti-Dumping Duties*, differs from this case in various relevant respects and cannot be used as a precedent.

4.194 In Mexico's opinion, it would be not appropriate under the circumstances of this case for the Panel to exercise its substantive jurisdiction.

4. Mexico's defence under Article XX(d) of the GATT 1994

4.195 Should the Panel decide to exercise its jurisdiction and find that the measures at issue are inconsistent with Article III:4 of the GATT 1994, Mexico believes that it should find them justified under Article XX(d). In paragraphs 115 to 138 of its first written submission, Mexico explains that the measures at issue meet all the requirements of Article XX(d).

4.196 Mexico will respond to the United States' arguments concerning Article XX(d) in its second written submission. At this point, Mexico would simply like to make a couple of observations.

4.197 In paragraph 38 of its submission, the European Communities points out that the reference to "laws or regulations" must be to laws or regulations applicable in the internal legal order of the WTO Member in question. The European Communities does not cite any previous GATT or WTO jurisprudence in support of its contention. Indeed, it could not do so because the unusual facts of this case have not previously been addressed in GATT or WTO dispute settlement proceedings.

4.198 While it is true that Article XX(d) contains an illustrative list of laws, compliance with which could give rise to measures otherwise inconsistent with the GATT, the list is illustrative and not exhaustive and it cannot be concluded that it excludes international treaties. Neither can it be concluded that GATT negotiators had the intention of excluding international treaties. There is no reason in principle why the term "laws" should exclude international treaties.

4.199 Paragraph (d) of Article XX does not refer to measures "necessary to secure compliance with internal laws or regulations" or "[measures] necessary to secure compliance with laws or regulations *of a Member's internal legal order*" as suggested by the reading proposed by the EC. The Panel will

observe that the rules of treaty interpretation "neither require nor condone the imputation into a treaty of words that are not there".[55]

4.200 Nothing in the text of the article compels the restrictive interpretation urged by the European Communities. In light of the rapid development of international law and treaty-making in the last decade, why in principle should international treaties be excluded?

4.201 Mexico has done no more than try to induce the United States to comply with its NAFTA obligations and to submit to dispute settlement under the NAFTA. The record demonstrates that Mexico has at all times sought to resolve the dispute through consultation, negotiation, and dispute settlement mechanisms. Nonetheless, there comes a time when it must be recognized that all avenues for international cooperation have been exhausted and a State may then resort to its own devices. It was not until all other means had failed that Mexico took the measures to which objection has now been made. Mexico, nevertheless, has not closed the door against finding a solution through cooperation, and even since adopting the measure, it has continued with consultations and negotiations, although these have failed to yield results.

4.202 As a matter of policy, if Mexico's defence were accepted, there would be no risk of trade restrictive measures that were not tied to *bona fide* efforts to resolve disputes being successfully justified under Article XX(d).

5. Response to the European Communities' third party submission

4.203 Mexico has read the European Communities' third party submission with interest. Mexico has already addressed various specific points made by the European Communities, and it would now like to turn to certain other remarks made in that submission with which Mexico agrees:

– In paragraph 20, the European Communities points out that the function of the Panel is to make findings in the light of the provisions of the covered agreements. It then states that this does not mean that the Panel cannot take into account other provisions of international law, when such provisions are relevant to the dispute before it. It points out that the Appellate Body has confirmed that the WTO Agreements are not to be read in "clinical isolation" from public international law. The European Communities expresses its view that it is therefore not excluded that applicable rules of international law may also include bilateral or multilateral agreements between Members, when such rules are relevant for settling a dispute before a panel.

Mexico agrees with the European Communities' submission in this regard.

– At paragraph 21, the European Communities notes that "Mexico has so far not invoked any specific provision of NAFTA or general rules of public international law in its defence against the claims of the United States" and that the Panel "may therefore not need to address the complex question of the relationship between the WTO agreements and other bilateral or multilateral agreements".

This observation is correct.

– Mexico should point out, however, that it considers that not only must the WTO agreements be interpreted in accordance with the rules of customary international law, but that these rules, in general, continue to operate within the context of the WTO and other obligations under Members' regional trade agreements. When, due to

[55] Report of the Appellate Body on *India – Patents (US)*, para. 45.

> a State's conduct, the dispute settlement mechanisms of such agreements fail to operate as foreseen, the affected State must be allowed to take action under customary international law.

However, there are three reasons why Mexico has so far not referred to such rights:

4.204 The first reason is that Mexico considers that its measure is justified under Article XX(d) of GATT 1994.

4.205 Secondly, Mexico also wishes to see the United States' response to its first submission. In particular, Mexico would like to know whether the United States continues to adhere to the view expressed in the quotation in paragraph 126 of Mexico's first written submission:

> "Wherever it could the United States would challenge unfair practices under the dispute settlement provisions of the General Agreement or the Tokyo Round Codes, but where other contracting parties prevented or impeded that process or blocked efforts to ensure that their practices were covered by multilateral disciplines, the United States would act to protect its interests. If such an action was considered unilateral it should be nevertheless recognized as perfectly justifiable, responsive action necessitated by the failure of bilateral or multilateral efforts to address a problem."[56]

4.206 Mexico's third concern about invoking its rights at general international law in this WTO proceeding is that this Panel does not have before it all the facts and relevant legal issues. Mexico recognizes that a WTO panel has jurisdiction only over the covered agreements; that it cannot take jurisdiction over issues raised under the NAFTA. In such circumstances, given the prospect of parallel international proceedings in which substantial monetary damages are being claimed against it, Mexico cannot, without having all the relevant facts and obligations before it, run the risk of its defence under international law being prejudiced in these other proceedings.

4.207 The Panel has only been presented with a "slice" of the dispute, that "slice" which the United States considers might be to its advantage to present; this is why Mexico has lodged its preliminary jurisdictional objection.

4.208 Mexico wishes to draw the attention of the Panel to one important point in this regard: assuming *arguendo* that the United States demonstrated that the tax at issue violated Article III of the GATT, there is a real prospect that another international tribunal might reach a contrary finding with regard to the identical provision incorporated in NAFTA Article 301. Mexico believes that the United States and the Panel should ponder how possible conflicting decisions on Article III could "secure a positive solution" to the dispute.

4.209 However, Mexico believes that its measures are, in any event, justified under international law.

6. Conclusions

4.210 For the reasons set out in Mexico's first written submission and those which it has put forward in this occasion, Mexico requests the Panel to decline to exercise its jurisdiction in these proceedings. Should the Panel decide to reject Mexico's request for a preliminary ruling, Mexico requests that the Panel find that Mexico's measures are justified under Article XX(d) of the GATT 1994.

[56] GATT document C/163 of 16 March 1989, page 4. Exhibit MEX-29.

F. CLOSING STATEMENT OF THE UNITED STATES AT THE FIRST MEETING OF THE PANEL

4.211 As discussed in some detail, the United States has established a prima facie case that Mexico's tax on HFCS and soft drinks and syrups sweetened with HFCS is inconsistent with Mexico's obligations under Articles III:2 and III:4 of the GATT 1994. In the opening session, Mexico confirmed for the Panel that it has not rebutted that case, and does not intend to rebut that case in the context of these proceedings. While the Panel must itself confirm that the legal requirements for a breach of Article III exist, the United States is confident that the prima facie case established in its written submission and confirmed by its remarks in the opening session will enable the Panel to do that.

4.212 This is in stark contrast to the two bases on which Mexico has decided to defend its breach of Article III: its request for the Panel to decline jurisdiction and its Article XX(d) defence. Mexico has not met its burden of proof with respect to either of these bases. Rather than reiterate the points discussed in this regard in its opening statement, the United States will focus its closing remarks on a couple of admissions made or clarified by Mexico's oral statement and responses to questions.

4.213 First, with regard to Mexico's request for the Panel to decline jurisdiction over this dispute, Mexico admits that its request finds no basis in the text of the DSU or elsewhere in the WTO Agreement. Instead, Mexico asserts that some undefined principle of international law which "is not written down" overrides the explicit text of the DSU and the Panel's terms of reference. This is simply not credible.

4.214 Second, with respect to Article XX(d), Mexico admits that it is not aware of any past panel or Appellate Body report nor any statements in the negotiating history to support its novel contention that the words "laws or regulations" as used in Article XX(d) actually mean – as was framed in the opening session by the Chairman of the Panel – "another Member's obligations under a non-WTO agreement." This is in addition to the fact that Mexico is unable to point to any textual basis in the GATT or elsewhere in the WTO Agreement to support its contention. However, because Mexico as the party asserting this defence bears the burden of proving it, it is up to Mexico to come forward with the factual evidence and legal arguments in support of its claim. Such legal and factual support must arise from something more than the mere absence of a prior WTO finding or any negotiating history on the subject.

4.215 Having not established that another Member's obligations under an international agreement are "laws or regulations" under Article XX(d), the Panel need not reach the issue of whether Mexico's tax "secures compliance" or is "necessary." Nevertheless, the United States would point out Mexico's rather flexible use of the word "secure" in its responses to questions posed by the Panel in the opening session. Mexico repeatedly referred to the tax as aimed at "inducing" United States compliance with its alleged NAFTA obligations. This suggests to the United States that Mexico also implicitly admits that its tax cannot in fact secure United States compliance with alleged NAFTA obligations; the most that it can hope is that its tax encourages United States compliance with those obligations by punishing the United States with a breach of the obligations Mexico owes the United States under the GATT.

4.216 In this connection, the United States also notes Mexico's candid response to the question posed by the United States as to whether Mexico's tax applies to imports of HFCS from just the United States or from other WTO Members as well. In that response, Mexico confirmed that the tax applies to HFCS imports from any WTO Member. The United States finds it difficult that Mexico's tax could be necessary to secure United States compliance with the NAFTA when the tax penalizes not just HFCS of United States origin, but HFCS from all other WTO Members.

4.217 Much more could be said about Mexico's incorrect claims with respect to its Article XX(d) defence as well as its request for the Panel to decline jurisdiction. However, in the interest of brevity, the United States will defer those points to its second submission.

4.218 Before closing, however, the United States would like to comment more broadly on the sweetener dispute with respect to the provisions of the NAFTA. The United States has made clear its view that that other matter is not relevant to this current proceeding. It is the United States' firm view that it has been acting in full conformity with its obligations regarding sugar under the NAFTA. It has a dispute with Mexico over the precise terms of those NAFTA obligations. Mexico has described its efforts to resolve that other matter and its frustration over the fact that, that issue has not been resolved to date. The Panel should understand that the United States is equally dedicated to resolving that other matter and shares Mexico's disappointment that it has not been able to reach a mutually satisfactory resolution. As Mexico noted in its opening statement, dialogue and negotiations on the NAFTA issue have continued, most recently among sweetener producers in both countries. The United States is before the WTO to resolve a WTO dispute over HFCS, but it has no less interest in resolving the NAFTA sugar issue in the appropriate forum.

4.219 Mexico has presented the Panel with a narrative that describes some of the complexities in the sugar case. There are many more that could be presented and that would uphold the United States view of the matter. The point is that this is not the place where that issue can be resolved. This dispute is about Mexico's commitments to WTO Members under the covered agreements, and Mexico has pointed to nothing in the text of those covered agreements that bars the United States from recourse under WTO dispute settlement.

G. CLOSING STATEMENT OF MEXICO AT THE FIRST MEETING OF THE PANEL

4.220 Mexico would like to confine itself to the following subjects:

4.221 Firstly, on the subject of judicial economy, Mexico referred in detail in its opening statement to the basis for its request that the Panel decline to exercise its jurisdiction, and explained why the Panel is entitled to do so. Unfortunately, the third parties presented their arguments during their session with the Panel without having had the benefit of Mexico's arguments in that respect. Mexico would therefore simply like to repeat that it is not asking the Panel to decline its jurisdiction for reasons of judicial economy. This is merely an example of the implied or incidental jurisdiction that the Panel has. Mexico would like to refer the Panel to the arguments on the subject presented in Mexico's opening statement.

4.222 Secondly, Mexico would like to refer to the issue of whether or not Article XX(d) of the GATT 1994 excludes international treaties. In this connection, Mexico would like to refer the Panel to the argument made by the Government of Guatemala in the third party session concerning the importance of regional trade agreements in the context of the multilateral trading system, and the fundamental role played by the dispute settlement mechanisms provided for under those agreements, especially as regards the legal certainty that they bring to the multilateral trading system.

4.223 The United States confirmed that there was a disagreement between the two parties, Mexico and the United States, regarding trade in sugar in the framework of the North American Free Trade Agreement (NAFTA). The United States confirmed the validity of Mexico's request for the establishment of a NAFTA Chapter XX Arbitral Panel, and confirmed that the dispute was still pending – in spite of the fact that the United States Government, more specifically the Office of the United States Trade Representative, removed it from its official website, oddly enough just before bringing this dispute before the WTO. The United States also stated that it was unfortunate that to date, more than four years after Mexico requested the establishment of an arbitral panel and more than six years after the NAFTA Chapter XX Dispute Settlement Mechanism was activated, it had not been

possible to settle the dispute either through consultations and negotiations or through the dispute settlement mechanism. This is because the United States has thus far blocked Mexico's request to establish an arbitral panel. To date, the NAFTA arbitral panel has not been composed because the United States has not appointed panellists, nor has it agreed on the appointment of a chairperson.

4.224 The United States contends that the Government acted in full conformity with the NAFTA provisions. Mexico would simply like to point out that this is no more than an affirmation by the legal representative of the United States, but that the only evidence pertaining to this issue in the record is the evidence that Mexico supplied. The only evidence of the ineffectiveness of the NAFTA dispute settlement mechanism, due to the United States' intransigence in refusing to appoint panellists, is the evidence provided by Mexico. Indeed, not only did the United States fail to supply evidence to refute Mexico's arguments in this respect, but it did not even deny the evidence during the meeting. Mexico responded to the United States' statement (in reply to a question from the Panel) that a NAFTA Chapter XX arbitral panel had been established, and to its attempt to convince the Panel that the proceeding was under way. Mexico rejects the United States' assertion, pointing to a technical difference between establishing an arbitral panel and composing that panel. It is an unquestionable fact that today, more than four years after Mexico's request, the United States has not appointed panellists and that there is no arbitral panel that can settle Mexico's grievances.

4.225 Mexico has met the burden of proof which, in the circumstances, satisfies all of the requirements of Article XX(d) of the GATT 1994. It has supplied both the legal elements and the evidence relating to the United States' measures.

H. SECOND WRITTEN SUBMISSION OF THE UNITED STATES

1. Introduction

4.226 In its first submission, the United States established a prima facie case that Mexico's tax measures on HFCS and soft drinks and syrups sweetened with HFCS are inconsistent with Articles III:2 and III:4 of the GATT 1994. Mexico has not rebutted that case and instead has attempted to change the subject by asserting that the United States is in breach of its obligations under the NAFTA and that this alleged breach justifies a request for the Panel to refuse to address the Article III claims or, in the alternative, that this alleged breach justifies Mexico's tax measure under Article XX(d) of the GATT 1994. The Panel has already rejected Mexico's request for it to decline to address the United States Article III claims and the United States respectfully requests it to reject likewise Mexico's Article XX(d) defence.

4.227 Mexico cannot, and does not, rely on the text of the GATT to support its Article XX(d) defence. All Mexico is able to offer in support of its contentions that Article XX(d) covers another Member's obligations under an international agreement is that neither a panel nor the Appellate Body has ever rejected these specific contentions and that unspecified "principles of international law" exist which override the ordinary meaning of the text of the WTO Agreement. There is no basis for this argument, which is wholly contrary to the customary principles of treaty interpretation applicable under Article 3.2 of the DSU.

4.228 United States obligations under the NAFTA are simply not an issue this Panel need ever reach to resolve the matter before it; there is no basis for the Panel to conclude that "laws or regulations" encompass another Member's obligations under an international agreement. This conclusion can, and should, be reached without ever considering the meaning of various NAFTA provisions or the obligations allegedly owed Mexico by the United States under the NAFTA.

4.229 Mexico's approach to this dispute has had the effect of narrowing the issues before the Panel to (1) confirming that the United States has established a prima facie case that Mexico's tax measures

are inconsistent with Articles III:2 and III:4 of the GATT 1994 and (2) examining the merits of Mexico's contention that its tax measures are justified under Article XX(d) of the GATT 1994.

2. Mexico's tax measures are inconsistent with Article III of the GATT 1994

(a) Burden of proof

4.230 Mexico has indicated that the Panel should construe its non-response to the United States claims to mean that, once the Panel has satisfied itself that the United States has met its burden to establish a prima facie case under Article III, Mexico does not object to the Panel proceeding on the presumption that its tax measures are incompatible with Article III. The United States does not disagree with this approach.

4.231 Confirmation that the United States has established a prima facie case of inconsistency in this dispute should not be an arduous task. The United States evidence is uncontested and in some instances is confirmed by Mexico.

4.232 The Panel may find it useful to draw upon the panels' approach in *US – Shrimp* and *Turkey – Textiles*, where the panels undertook a brief analysis confirming that the complaining party had made its prima facie case and then proceeded to examine the defending party's affirmative defence. Proceeding on the same basis in this dispute, the Panel should find the United States has met its burden of proof and that Mexico's tax measures are in breach of its obligations under Articles III:2 and III:4 of the GATT 1994.

(b) Mexico's tax measures are inconsistent with Article III of the GATT 1994

4.233 As reviewed in the United States first submission, Mexico applies a 20 per cent tax on the internal transfer and importation of soft drinks and syrups ("HFCS soft drink tax") and a 20 per cent tax on the representation, brokerage, agency, consignment and distribution of soft drinks and syrups ("distribution tax"). Mexico further subjects the internal transfer of soft drinks and syrups to certain bookkeeping and reporting requirements ("reporting requirements"). Mexico exempts from these taxes and reporting requirements transfers of soft drinks and syrups sweetened exclusively with cane sugar. Thus, Mexico applies a 20 per cent tax on the importation of soft drinks and syrups (regardless of sweetener) and a 20 per cent tax on the internal transfer, as well as on the representation, brokerage, agency, consignment and distribution, of soft drinks and syrups sweetened with any sweetener other than cane sugar. Internal transfers of soft drinks and syrups sweetened with any sweetener other than cane sugar are further subject to the reporting requirements.

4.234 For the reasons outlined at greater length in previous submissions, Mexico's tax measures are inconsistent with Article III of the GATT 1994. First, Mexico's HFCS soft drink and distribution taxes are inconsistent with Article III:2 as a discriminatory tax on imported, non cane sugar sweeteners for use in soft drinks and syrups. These non cane sugar sweeteners include HFCS, as highlighted in the United States first submission, as well as beet sugar as addressed in more detail below. The HFCS soft drink and distribution taxes are inconsistent with both the first and second sentences of Article III:2. That said, the United States has focused its arguments under Article III:2 with respect to HFCS on the second sentence. As detailed below, the United States has focused its arguments regarding beet sugar on the first sentence of Article III:2.

4.235 Second, Mexico's HFCS soft drink and distribution taxes are inconsistent with Article III:2 of the GATT 1994 as discriminatory taxes on imported soft drinks and syrups. When collected "at the time or point of importation," Mexico's HFCS soft drink tax discriminates on its face against imports, as only domestic transfers of soft drinks and syrups are subject to the cane sugar-only exemption. When collected on subsequent internal transfers of imported soft drinks and syrups, Mexico's HFCS

soft drink and distribution taxes discriminate *de facto* against imported soft drinks and syrups made with non-cane sugar sweeteners including HFCS and beet sugar.

4.236 Third, Mexico's HFCS soft drink and distribution taxes are inconsistent with Article III:4 of the GATT 1994 as a law affecting the internal sale and use of non cane sugar sweeteners including HFCS and beet sugar. As discussed in the United States responses to questions, to the extent a measure that discriminates against imported product takes the form of dissimilar taxation affecting the internal sale, offering for sale, purchase, transportation, distribution or use of the imported product, that measure may breach both Articles III:2 and III:4 of the GATT 1994. This is the case with the HFCS soft drink and distribution taxes as applied to non-cane sugar sweeteners.

4.237 Fourth, Mexico's reporting requirements are inconsistent with Article III:4 of the GATT 1994 as requirements affecting the internal sale and use of non cane sugar sweeteners including HFCS and beet sugar.

(i) Mexico's tax measures on non-cane sugar sweeteners are inconsistent with Article III:2 of the GATT 1994

The United States has established a prima facie case that the HFCS soft drink and distribution taxes are inconsistent with Article III:2, second sentence

4.238 The United States has met its prima facie burden of establishing that Mexico's HFCS soft drink tax is inconsistent with the second sentence of Article III:2. Mexico's distribution tax is also inconsistent with the second sentence of Article III:2 of the GATT 1994. The distribution tax discriminates against HFCS for use in soft drinks and syrups in the same manner as the HFCS soft drink tax.

4.239 Mexico has confirmed that HFCS and cane sugar compete and are substitutes as sweeteners for soft drinks and syrups. Mexico has also confirmed that it imposed the taxes to stop the displacement of Mexican cane sugar by imported HFCS as a sweetener for soft drinks and syrups. With respect to this latter admission and despite Mexico's claim to the contrary, it is not possible to reach any other conclusion than a measure designed to stop the displacement of domestic production by imported products is a measure to protect domestic production. Because Mexico has not rebutted the United States prima facie case, the United States respectfully requests that the Panel find that the HFCS soft drink and distribution taxes as applied to HFCS for use in soft drinks and syrups are inconsistent with Mexico's obligations under the second sentence of Article III:2 of the GATT 1994.

The HFCS soft drink and distribution taxes are inconsistent with Article III:2, first sentence, with respect to beet sugar

4.240 Although the focus of United States argumentation in this dispute has been the discrimination Mexico's tax measures impose on HFCS, and this remains the principal concern of the United States, Mexico's HFCS soft drink and distribution taxes discriminate against all non-cane sugar sweeteners as sweeteners for soft drinks and syrups. These non-cane sugar sweeteners include not only HFCS but also beet sugar.

4.241 Beet and cane sugar are "like" products. In its first submission, the United States explained that in their refined form (the form required to produce soft drinks and syrups) beet sugar is "chemically and functionally identical" to cane sugar. Beet and cane sugar are both "a form of sucrose" with the same molecular structure. In fact, cane and beet sugar are equally 99.95 per cent sucrose with the remaining 0.05 per cent consisting of trace minerals and proteins. Cane and beet sugar may be used for identical purposes, including as a sweetener for soft drinks and syrups. Because they are virtually identical with respect to physical properties and end-uses, they are

distributed in the same manner and consumers (in this case, soft drink and syrup producers) use them interchangeably. For example, as the EC mentioned in its third party statement to the Panel, European soft drink producers sweeten their products with beet sugar. Beet and cane sugar are equally classified under HS heading 1701. Although "like" products need not be identical products, cane and beet sugar are nearly that. Beet sugar is, thus, "like" cane sugar within the meaning of the first sentence of Article III:2.

4.242 As was demonstrated for HFCS in the United States first submission, the incidence of the tax on beet sugar used as a sweetener for soft drinks and syrups is much greater than the nominal 20 per cent tax on non-cane sugar sweetened soft drinks and syrups. With respect to beet sugar, the HFCS soft drink and distributions taxes amount to nearly a 400 per cent tax on the use of beet sugar. A nearly 400 per cent tax that is not applied to the like domestic product is clearly a tax in "excess of" within the meaning of GATT Article III:2, first sentence.

4.243 The application of the HFCS soft drink and distribution taxes to beet sugar – a nearly identical product – highlights the truly protectionist purpose of Mexico's tax measures. In providing a tax exemption for soft drinks and syrups sweetened only with cane sugar, which is almost exclusively a domestic product in Mexico, but not for soft drinks and syrups sweetened with the nearly identical sweetener, beet sugar, which is exclusively an imported product, Mexico designed its tax measures to protect domestic production.

4.244 Because beet and cane sugar are "like" products but only beet sugar when used as a sweetener for soft drinks and syrups is subject to taxation, the HFCS soft drink and distribution taxes are inconsistent with the first sentence of Article III:2 of the GATT 1994 as taxes applied on imports in excess of those applied to like domestic products. Accordingly, the United States respectfully requests that the Panel find the HFCS soft drink and distribution taxes inconsistent with Article III:2.

(ii) Mexico's tax measures on soft drinks and syrups are inconsistent with Article III:2 of the GATT 1994

The United States has established a prima facie case that the HFCS soft drink and distribution taxes with respect to soft drinks and syrups are inconsistent with Article III:2, first sentence

4.245 The United States has also established a prima facie case that Mexico's HFCS soft drink and distribution taxes are inconsistent with the first sentence, or in the alternative, the second sentence of Article III:2 of the GATT 1994 with respect to soft drinks and syrups sweetened with HFCS. The United States has demonstrated that soft drinks and syrups sweetened with HFCS are "like" (or, with respect to the second sentence claim, "directly competitive or substitutable" with) soft drinks and syrups sweetened with Mexican cane sugar. The United States has also demonstrated that by providing an exemption from the HFCS soft drink and distribution taxes only for the internal transfer of soft drinks and syrups sweetened exclusively with cane sugar, Mexico applies a tax to imported soft drinks and syrups – which are nearly all sweetened with non-cane sugar sweeteners – in "excess of" that applied to the like domestic product. Based on these demonstrations, the United States has established a prima facie case that Mexico's HFCS soft drink and distribution taxes are inconsistent with the first sentence of Article III:2.

4.246 The United States has further demonstrated that Mexico's taxation of soft drinks and syrups made with non-cane sugar sweeteners is applied so as to afford protection to Mexican production of soft drinks and syrups, which even before imposition of Mexico's tax measures were largely sweetened with cane sugar. Therefore, the United States has also established a prima facie case of inconsistency with the second sentence of Article III:2 with respect to imported soft drinks and syrups. Mexico has not rebutted this case nor the case with respect to soft drinks and syrups under the first sentence of Article III:2. Accordingly, on the basis of the United States prima facie case, the

United States respectfully requests that the Panel find the HFCS soft drink and distribution taxes with respect to soft drinks and syrups are inconsistent with the first sentence, or in the alternative, the second sentence, of Article III:2 of the GATT 1994.

> The HFCS soft drink and distribution taxes are inconsistent with Article III:2, first sentence, with respect to soft drinks and syrups sweetened with beet sugar

4.247 Mexico's soft drink and distribution taxes discriminate against all non-cane sugar-sweetened soft drinks and syrups. These non-cane sugar-sweetened soft drinks and syrups include not only soft drinks and syrups sweetened with HFCS, but also those sweetened with beet sugar.

4.248 The discrimination against soft drinks and syrups sweetened with beet sugar, coupled with the fact that these soft drinks and syrups are "like" those sweetened with cane sugar, renders the HFCS soft drink and distribution taxes inconsistent with the first sentence of Article III:2 of the GATT 1994 with respect to beet sugar-sweetened soft drinks and syrups, just as it does for soft drinks and syrups sweetened with HFCS.

4.249 As noted above, the United States explained in its first submission that beet and cane sugar are "chemically and functionally identical" and may be used interchangeably as a sweetener for soft drinks and syrups. As beet and cane sugar are virtually identical, it follows that soft drinks and syrups sweetened with them are as well and, therefore, that soft drinks and syrups sweetened with beet sugar are "like" those sweetened with cane sugar.

4.250 In addition, soft drinks and syrups sweetened with beet sugar are "like" soft drinks and syrups sweetened with cane sugar because they share the same physical properties, end-uses, consumer preferences and tariff classification. Specifically, each of the physical characteristics described in the United States first submission with respect to HFCS- and cane sugar-sweetened soft drinks and syrups equally apply with respect to soft drinks and syrups sweetened with beet sugar. With respect to chemical composition, as stated above, cane and beet sugar are 99.95 per cent the same chemical compound. The identity of the chemical make-up of soft drinks and syrups sweetened with cane versus beet sugar is, therefore, even greater. To be exact, that would make beet sugar- and cane sugar-sweetened soft drinks 99.99 per cent identical. Moreover, as noted in the United States first submission, the ingredient label on a can of soda reads the same (both in Mexico and the United States, as well as in Europe) regardless of whether it is sweetened with HFCS, beet sugar or cane sugar.

4.251 Furthermore, although in the United States most regular soft drinks and syrups are sweetened with HFCS and in Mexico with cane sugar, in the EC (as the EC mentioned in its third party submission and statement to the Panel) soft drinks and syrups are sweetened with beet sugar. There is no indication that consumers in Europe use soft drinks and syrups sweetened with beet sugar for end-uses that in any way differ from the end-uses for soft drinks and syrups in the United States or Mexico. As discussed in the United States first submission, Coca-Cola, the world largest soft drink producer attests that "[b]ecause there is no noticeable taste difference, bottlers have the option of using either high fructose corn syrup (HFCS), beet sugar or cane sugar, depending on availability and cost." Also as discussed in the United States first submission, United States soft drink and syrup producers generically refer to the sweetener component as "sugar", not cane or beet sugar or HFCS. With respect to tariff classification, there is no separate classification for soft drinks and syrups based on the type of sweetener used, as Mexico confirmed in its responses to the Panel's questions.

4.252 Although soft drinks and syrups sweetened with beet sugar are "like" soft drinks and syrups sweetened with cane sugar, only the former is subject to a 20 per cent tax on its importation and internal transfer (the HFCS soft drink tax) as well as on its distribution, representation, brokerage, agency, and consignment (the distribution tax). As explained in the United States first submission, as

well as above, in Mexico soft drinks and syrups are largely sweetened with cane sugar. This was true even before imposition of Mexico's discriminatory taxes. Soft drinks and syrups produced in the United States and elsewhere, however, are sweetened largely with non-cane sugar sweeteners. A 20 per cent tax applied to beet sugar-sweetened soft drinks and syrups that is not applied to "like" cane sugar-sweetened soft drinks is, therefore, a tax applied on imports from the United States and elsewhere "in excess of" that applied to the like domestic product.

4.253 Because beet- and cane sugar-sweetened soft drinks and syrups are "like" products, but only beet sugar-sweetened soft drinks and syrups are subject to taxation, the HFCS soft drink and distribution taxes are also inconsistent with the first sentence of Article III:2 of the GATT 1994 as taxes applied on imported beet sugar-sweetened soft drinks and syrups in excess of those applied to like domestic soft drinks and syrups sweetened with cane sugar.

4.254 The United States notes that, in its responses to the Panel's questions, Mexico raised for the first time that, due to an amendment made to the IEPS during the Panel proceedings effective January 1, 2005, the HFCS soft drink tax allows the same tax exemption for importations of cane sugar-only soft drinks and syrups as it does for their internal transfer. This fact, however, should not change the Panel's analysis in this dispute. The 1 January 2005 amendment to the HFCS soft drink tax is outside the Panel's terms of reference. The Panel should, therefore, not take into account the 1 January 2005 amendment to the IEPS in evaluating the United States claims that Mexico's tax measures as described in its request for a panel are inconsistent with Mexico's obligations under Article III of the GATT 1994.

4.255 In any event, the amendment does not change the *de facto* discrimination that exists with respect to the internal transfer and distribution of imported soft drinks and syrups sweetened with non-cane sugar sweeteners. The 1 January 2005 amendment only affects importations of soft drinks and syrups and, therefore, does not change the *de facto* discrimination that exists with respect to the internal transfer and distribution of imported soft drinks and syrups sweetened with non-cane sugar sweeteners.

> The United States has established a prima facie case that Mexico's tax measures affecting the use of HFCS are inconsistent with Article III:4 of the GATT 1994

4.256 In addition to being inconsistent with Article III:2, first and second sentences, of the GATT 1994, the United States has also established a prima facie case that Mexico's tax measures (HFCS soft drink tax, distribution tax and reporting requirements) are inconsistent with Article III:4 as measures affecting the use of HFCS as a sweetener for soft drinks and syrups. Mexico has not rebutted this case. Therefore, on the basis of the United States prima facie case, the United States respectfully requests the Panel to find the HFCS soft drink and distribution taxes and reporting requirements on HFCS for soft drink and syrup use to be inconsistent with Article III:4 of the GATT 1994.

4.257 Mexico's HFCS soft drink and distribution taxes and reporting requirements are also inconsistent with Article III:4 of the GATT 1994 as applied to beet sugar. As stated above, cane and beet sugar are "like" products within the meaning of the first sentence of Article III:2. Indeed, beet and cane sugar are nearly identical products. Further, the discrimination imposed on beet sugar by Mexico's tax measures discriminate against beet sugar just as they do HFCS by offering an advantage on the use of cane sugar (which is almost exclusively a domestic product) that it does not equally offer on beet sugar (which is exclusively an imported product). Specifically, Mexico's tax measures provide a complete tax exemption for use of the domestic product, cane sugar, while denying that same exception to like imported products, whether HFCS or beet sugar. Mexico's HFCS soft drink and distribution taxes and reporting requirements are, therefore, also inconsistent with Article III:4 as applied to beet sugar.

3. Mexico's tax measures are not justified under Article XX(d) of the GATT 1994

4.258 Mexico asserts that, even if its tax measures are inconsistent with Article III, they are nevertheless justified as "necessary to secure compliance" with United States obligations under the NAFTA. Mexico contends that Article XX(d) of the GATT 1994 provides an exception for such measures. Mexico is incorrect. Article XX(d) provides an exception for measures necessary to secure compliance with "laws or regulations." It does not provide an exception for measures to secure compliance with obligations under an international agreement. In arguing to the contrary, Mexico attempts to construct an entirely new Article XX exception. This new exception would offer WTO Members a free pass from their WTO obligations any time a Member believes obligations owed it under the WTO Agreement or any other international agreement have not been fulfilled. Such an exception would fundamentally undermine the dispute settlement system established in the WTO Agreement and should be rejected.

4.259 The party who invokes Article XX(d) as an affirmative defence bears the burden of proof with respect to each element of that defence. Thus, in this dispute Mexico must establish and prove that it has met each of the elements required for invocation of an Article XX(d) defence.

4.260 The elements required to invoke Article XX(d) are that the measure at issue must: (1) concern compliance with "laws or regulations" which are not inconsistent with the GATT; (2) be designed to "secure compliance" with such laws or regulations; and (3) be "necessary" to secure such compliance. If these elements are met, the measure will be provisionally justified under paragraph (d). However, for an Article XX defence to be successful, the application of the measure in question must also comply with the chapeau to Article XX. Whether the measure is provisionally justified under paragraph (d) should be examined prior to considering whether the application of the measure is consistent with the chapeau.

4.261 Mexico's tax measures do not qualify for an Article XX(d) defence. They are not provisionally justified under paragraph (d) nor are they consistent with the requirements of the chapeau. The failure of Mexico's Article XX(d) defence begins with the first step of the analysis as its tax measures do not concern compliance with "laws or regulations." The Panel may reject Mexico's Article XX(d) defence on this basis alone and, for this reason, it need not examine further whether Mexico's tax measures are "necessary to secure compliance" or in keeping with the chapeau. That said, for the sake of completeness, the United States has provided an analysis of each of the elements required to justify a measure under Article XX(d), including the elements of the chapeau.

(a) United States' obligations under the NAFTA are not "laws or regulations"

4.262 Mexico's argument that Article XX(d) provides a legal justification for the HFCS tax depends on reading the phrase "laws or regulations" in Article XX(d) to include obligations under international agreements. Such a reading would be contrary to the text of Article XX(d), read in its context and in light of the object and purpose of the GATT 1994.

4.263 As explained in the United States responses to the Panel's questions, the ordinary meaning of "laws or regulations" is the domestic laws or regulations of a government. The phrase "laws or regulations" is not defined as including obligations under an international agreement, which have a different meaning.

4.264 This interpretation of the ordinary meaning of "laws or regulations" is supported by the context in which the phrase "laws or regulations" appears – namely, Article XX of the GATT and more broadly the GATT and the WTO Agreement as a whole. In particular, Article XX itself distinguishes between "laws" and "regulations" on the one hand and "obligations" under an international agreement on the other. Thus, while Article XX(d) provides a defence for measures

necessary to secure compliance with "laws or regulations," Article XX(h) provides a defence for measures "undertaken in pursuance of obligations under any intergovernmental commodity agreement." There would be no reason for the different phrasing had the drafters intended "law or regulations" to mean the same thing as "obligations under" an international agreement. Indeed, reading "laws or regulations" to include obligations under "international agreements" would render Article XX(h) redundant.

4.265 Other provisions of the GATT further support the distinction between "laws" and "regulations" on the one hand and "agreements" and "obligations" on the other hand. The United States cited several examples in its responses to the Panel's questions. The United States emphasizes that none of those examples supports Mexico's contention that the phrase "laws or regulations" in Article XX(d) includes obligations under an international agreement. To the contrary, the cited examples reinforce that "laws or regulations" in the context of Article XX(d) mean the domestic laws and regulations of a government.

4.266 Further, variations on the phrase "laws or [and] regulations" appear many times in a number of the WTO agreements, each time referring to *domestic* laws and regulations, not treaties. For instance, Article XVI:4 of the Marrakesh Agreement Establishing the WTO provides that "[e]ach Member shall ensure the conformity of its laws, regulations and administrative procedures with its obligations as provided in the annexed Agreements."

4.267 Moreover, Article 23 of the DSU provides "[w]hen Members seek the redress of a violation of obligations... under the covered agreements ... they shall have recourse to, and abide by, the rules and procedures of this Understanding." Since the WTO Agreement is an international agreement, Mexico's reading of Article XX(d) would authorize unilateral action by any Member to secure compliance with another Member's obligations under the WTO Agreement. Such a result, however, would be in clear conflict with Article 23, not to mention render it meaningless. Mexico's reading of Article XX(d) would also render redundant Article 22 of the DSU, which prescribes rules for the suspension of concessions, including seeking authorization to do so from the DSB. Mexico's interpretation of Article XX(d), however, would permit suspension of concessions without DSB authorization and without any requirement to adhere to the rules established in Article 22 of the DSU.

4.268 Mexico's reading of "laws or regulations" is not only incompatible with the ordinary meaning of the term based on the customary rules of treaty interpretation, but has other far-reaching consequences as well. The threat presented by Mexico's concept of Article XX(d) can best be understood by exploring where such a use of Article XX(d) would lead. If "laws or regulations" are read to include international agreements, then any Member can invoke Article XX(d) as justification for actions depriving others of their rights under the GATT to the extent needed to "secure compliance" with any other international agreement. For example, Mexico's reading would also authorize trade measures by any Member to coerce compliance by another Member with treaty-based boundary claims or other international agreements.

4.269 Against the above, Mexico has offered little in support of its proposition that "laws or regulations" may include obligations owed it under the NAFTA or any other international agreement. Mexico's point that "there are no GATT or WTO precedents that reject Mexico's interpretation" only highlights the fact that not a single WTO Member or GATT 1947 contracting party has advocated such a position before a dispute settlement panel. In fact, every GATT or WTO dispute settlement proceeding in which Article XX(d) has been invoked, other than Mexico's in this dispute, has involved a domestic law enforcing another domestic regime. In *US – Shrimp*, on which Mexico repeatedly relies (including for its contention that Article XX(d) encompasses obligations under an international agreement), the United States did not argue that its import ban was necessary to secure enforcement of the Inter-American Convention on the Protection and Conservation of Sea Turtles. Instead, it raised its Article XX defence under the exception "relating to the conservation of

exhaustible natural resources," citing the Inter-American Convention as evidence that sea turtles constituted an exhaustible natural resource and that its import ban was not arbitrary or unjustifiable discrimination.

4.270 Moreover, Mexico appears to argue, on the one hand, that Article XX(d) must be "interpreted in accordance with the customary rules of international law" but, on the other hand, must be interpreted "with a view to the change[] in the international legal milieu that have occurred since Article XX was drafted in 1947." The customary rules of interpretation applicable in WTO dispute settlement provide that the terms of a treaty are to be interpreted based on their ordinary meaning in their context and in light of the treaty's object and purpose. Mexico makes no effort to interpret Article XX(d) by reference to this fundamental rule, and does not explain how or why its vague and unsupported references to "changes in the international milieu" should affect the analysis under this rule. Indeed, there is no basis for concluding that they should.

4.271 Mexico also offers that "laws or regulations" encompass obligations under an international agreement because the Statute of the International Court of Justice "defines" "international law" to include "international conventions." Mexico's reasoning is circular. Mexico has not established that phrase "laws or regulations" as used in Article XX(d) means or includes "international law." As explained above, "laws or regulations" mean the domestic laws or regulations of a government. It is, therefore, irrelevant whether international conventions are included in the "definition" of "international law." Moreover, there is a clear textual difference between "laws or regulations" and "international law." For starters, one uses the singular "law" while the other uses the plural "laws." While one may speak of international "law" in the same sense as one speaks about "common law" or the "law of the sea," international law is not ordinarily used in the plural. For example, Article 3.2 of the DSU provides that the dispute settlement system serves to clarify the provisions of the covered agreements "in accordance with the customary rules of interpretation of public international law." The difference in usage of "laws" versus "law" in the Spanish and French texts is even more striking.

4.272 Moreover, the fact that the United States may refer to arguments raised in the context of NAFTA proceedings as "legal" arguments does not make United States obligations under the NAFTA "laws or regulations" under Article XX(d). Mexico's argument merely assumes the conclusion that "laws or regulations" include international agreements, simply because international agreements provide international legal obligations. The argument does not address the point, however, of whether obligations – legal or otherwise – under an international agreement are included "laws or regulations" within the meaning of Article XX(d).

4.273 Finally, the United States is compelled to point out that, contrary to Mexico's suggestion in response to question No. 25 of the Panel, the United States has not conceded that NAFTA is a law. Rather, as explained in the United States opening statement, while a Member may adopt domestic laws in order to implement the terms of an international agreement, such as the NAFTA, obligations owed that Member by another Member under the terms of that agreement do not constitute "laws or regulations" within the meaning of Article XX(d).

(b) Mexico's tax measures are not designed to "secure compliance"

4.274 Even if one could read "laws or regulations" to mean obligations owed another Member under an international agreement, Mexico's tax measures are not designed to "secure compliance" within the meaning of Article XX(d) of the GATT 1994.

4.275 Although Mexico claims to have imposed its tax measures to secure or induce United States compliance with the NAFTA, Mexico's position presupposes that the United States is not in compliance with its NAFTA obligations. This position, however, is Mexico's own determination. To be clear, it is the firm view of the United States that it is in full compliance with its NAFTA

obligations on market access for Mexican cane sugar. That Mexico disagrees on this point does not convert its *allegation* that the United States has not complied with its NAFTA obligations into a breach of that agreement. Mexico's tax measures cannot be designed to secure "compliance" with obligations the United States does not have or with obligations it has already fulfilled.

4.276 Furthermore, as Mexico itself has confirmed, its tax measures apply to soft drinks and syrups and non-cane sugar sweeteners imported from *any* WTO Member, not just those from the United States. At no point, however, has Mexico explained how taxing soft drinks and syrups in this manner in any way contributes to United States compliance with the NAFTA. Rather, regardless of the source of the soft drinks and syrups or non-cane sugar sweeteners, a tax on their transfer or use protects Mexico's own cane sugar industry.

(c) Mexico's tax measures are not "necessary"

4.277 Even assuming *arguendo* that Mexico's tax measures somehow contributed to NAFTA compliance, they are not "necessary" to secure such compliance as required by Article XX(d).

4.278 In determining the necessity of a measure, the Appellate Body has characterized Article XX(d) as involving a "process of weighing and balancing a series of factors which prominently include [1] the contribution made by the compliance measure to the enforcement of the law or regulation at issue, [2] the importance of the common interests or values protected by that law or regulation, and [3] the accompanying impact of the law or regulation on imports or exports." Mexico's tax measures come up considerably short in this balance.

4.279 First, as reviewed above, Mexico's tax measures do not contribute to enforcement of the NAFTA and have done nothing to contribute to the resolution of the dispute the United States and Mexico have over their obligations under NAFTA. Second, with respect to the "common interests or values" that Mexico's tax measures are designed to protect, these are nothing more than the interests of Mexican sugar producers to be protected from competition from imported HFCS and other non-cane sugar sweeteners. The protection of a domestic industry from imports cannot be an "important" interest in the context of Article XX.

4.280 Third, Mexico's tax measures have had a devastating effect on imports. The first United States submission explained, for example, that Mexico's tax measures have so severely penalized the use of imported HFCS, that since their enactment, Mexican imports of HFCS have fallen to less than 6 per cent of their pre-tax level and use of imported HFCS as a sweetener soft drinks and syrups has ceased. It is difficult to understand how this harm imposed on HFCS and soft drinks and syrups sweetened with HFCS is designed to "secure compliance" with unrelated provisions under the NAFTA on market access for sugar.

4.281 In analysing the extent to which a measure is "necessary," prior panels have also considered whether an alternative measure that is not inconsistent with the GATT is reasonably available. Mexico had any number of alternative measures reasonably available to it – short of breaching its national treatment obligations – to assist its domestic cane sugar industry and/or resolve its disagreement with the United States over the exact terms of the NAFTA. As the party invoking Article XX(d), Mexico bears the burden of demonstrating that this was not in fact the case. Mexico has not done so. For example, Mexico has yet to explain why it is necessary to breach its national treatment obligations owed to all WTO Members to resolve a bilateral trade dispute with the United States.

4.282 Mexico's suggestion that no alternative measures were available to it because the "United States has refused to submit to dispute settlement" under the NAFTA and "has preferred to drag on bilateral discussions" is misplaced on several levels. In the first instance, the United States has not

"refused" to submit to dispute settlement under the NAFTA. In fact, the United States has engaged in and completed two of the NAFTA's three "stages" of dispute settlement. The United States is currently engaged in the third stage. Mexico's suggestion that the United States is somehow "blocking" the process in breach of its obligations under the NAFTA is, again, based on Mexico's own interpretation of the NAFTA and its own determination as to whether the United States is acting in accordance those obligations. For the record, the United States does not view any of its actions as being inconsistent with the provisions of the NAFTA's dispute settlement mechanism.

4.283 For this reason and the others stated above, Mexico has failed to demonstrate that its tax measures are provisionally justified under Article XX(d) as measures "necessary to secure compliance with laws or regulations." The United States respectfully requests that the Panel find to this effect, in which case it would not be necessary to further consider Mexico's arguments with respect to the chapeau of Article XX. If a measure does not meet the requirements of one of the paragraphs of Article XX(d), it is not relevant whether it meets the elements of the chapeau.

(d) Mexico's tax measures are incompatible with the chapeau to Article XX

4.284 Should the Panel, nonetheless, continue its analysis, it should also find that Mexico has failed to demonstrate that its tax measures meet the requirements of the chapeau to Article XX because Mexico's application of its tax measures amounts to a disguised restriction on international trade.

4.285 The chapeau generally works to prevent the abuse of the exceptions of Article XX by providing that measures falling within one of its paragraphs must not be applied in a manner that constitutes "a means of arbitrary or unjustifiable discrimination between countries" or a "disguised restriction on trade." "[D]isguised restrictions" embrace "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." Because Mexico's tax measures do not meet the elements of paragraph (d), Mexico cannot possibly demonstrate that application of its tax measures are "formally within the terms of an exception listed in Article XX" and applied in a manner that does not constitute arbitrary or unjustifiable discrimination or a disguised restriction on trade.

4.286 Further, Mexico has openly stated that its tax measures are designed to protect its cane sugar industry. Yet, in asserting its Article XX(d) exception, Mexico contends that its tax measures are designed to secure United States compliance with the NAFTA. In other words, Mexico claims its tax measures are, for purposes of asserting its Article XX(d) defence, measures to secure United States compliance with NAFTA. But this asserted purpose of its tax measures does not match with the repeated statements by the Mexican Government and Supreme Court, as documented in the United States first submission, that its tax measures are designed to protect Mexican production of cane sugar. Accordingly, Mexico's tax measures are not in fact a legitimate Article XX(d) measure, but rather are nothing more than disguised restrictions on trade – namely, measures to protect its domestic cane sugar industry from imported HFCS.

4.287 Mexico's references to *US – Shrimp* in this respect are essentially irrelevant. Mexico has referred to *US – Shrimp* to argue that an attempt to negotiate an agreement is sufficient to authorize a WTO Member to breach its WTO obligations. Mexico's argument does not reflect a correct reading of the report in that dispute. In *US – Shrimp*, the measure at issue had already been found to be provisionally justified under Article XX(g) as a measure relating to the conservation of a natural resource. As stated above, Mexico cannot provisionally justify its tax measures under Article XX(d). Moreover, *US – Shrimp* does not stand for the proposition that once a Member attempts to negotiate a solution to a "dispute," it is then free to breach its WTO obligations.

4.288 In sum, Mexico's tax measures are not provisionally justified under Article XX(d), nor are they applied in a manner consistent with its chapeau. There is no Article XX exception for measures

designed to secure a Member's compliance with obligations owed another Member under an international agreement – whether that agreement is the WTO Agreement, the NAFTA or any other international agreement. The Panel should reject Mexico's Article XX(d) defence accordingly.

4.289 Mexico makes other general assertions about "international law" and its importance. Leaving aside the fact that Mexico has not identified what principles of "international law" these may be, the rights and obligations of WTO Members are found in the text of the WTO Agreement, and with respect to whether Mexico is entitled to an exception for its tax measures under Article XX(d), in the text of Article XX(d).

4. Conclusion

4.290 For the reasons set out above, the United States respectfully requests the Panel to find that Mexico's tax measures are:

With respect to sweeteners:

(1) inconsistent with GATT Article III:2, second sentence, as a tax applied on imported HFCS which is "directly competitive or substitutable" with Mexican cane sugar which is "not similarly taxed" (HFCS soft drink tax);

(2) inconsistent with GATT Article III:2, second sentence, as a tax applied on the agency, representation, brokerage, consignment and distribution of HFCS which is "directly competitive or substitutable" with Mexican cane sugar which is "not similarly taxed" (distribution tax);

(3) inconsistent with GATT Article III:2, first sentence, as a tax applied on imported beet sugar which is "like" Mexican cane sugar and is taxed "in excess of" Mexican cane sugar (HFCS soft drink tax);

(4) inconsistent with GATT Article III:2, first sentence, as a tax applied on the agency, representation, brokerage, consignment and distribution of beet sugar "in excess of those applied to like domestic products" (distribution tax);

(5) inconsistent with GATT Article III:4 as a law that affects the internal use of imported HFCS and imported beet sugar and accords HFCS and beet sugar "treatment ... less favourable than that accorded to like products of national origin" by:

(a) taxing soft drinks and syrups that use HFCS or beet sugar as a sweetener (HFCS soft drink tax),

(b) taxing the agency, representation, brokerage, consignment and distribution of soft drinks and syrups sweetened with HFCS or beet sugar (distribution tax), and

(c) subjecting soft drinks and syrups sweetened with HFCS or beet sugar to various bookkeeping and reporting requirements (reporting requirements);

With respect to soft drinks and syrups:

(6) inconsistent with GATT Article III:2, first sentence, as a tax applied on imported soft drinks and syrups sweetened inter alia with HFCS and beet sugar," in excess of those applied to like domestic products" (HFCS soft drink tax);

(7) inconsistent with GATT Article III:2, first sentence, as a tax applied on the agency, representation, brokerage, consignment and distribution of soft drinks and syrups sweetened inter alia with HFCS and beet sugar, "in excess of those applied to like domestic products" (distribution tax);

(8) inconsistent with GATT Article III:2, second sentence, as a tax applied on imported soft drinks and syrups sweetened with HFCS, which are directly competitive or substitutable with domestic soft drinks and syrups which are "not similarly taxed" (HFCS soft drink tax); and

(9) inconsistent with GATT Article III:2, second sentence, as a tax applied on the agency, representation, brokerage, consignment and distribution of soft drinks and syrups sweetened with HFCS, which are directly competitive or substitutable with domestic soft drinks and syrups which are "not similarly taxed" (distribution tax).

I. SECOND WRITTEN SUBMISSION OF MEXICO

1. Introduction

4.291 Mexico received the Panel's decision to refuse to decline its jurisdiction with disappointment, particularly since, as the Panel will see, the second round of written submissions allows Mexico to elaborate upon its earlier submissions in light of certain admissions made by the United States.

4.292 The key facts have been established, particularly in light of certain admissions made by the United States. They raise legal issues of fundamental importance in terms of the GATT's interaction with the institutions and rules of a regional free trade agreement authorized by its Article XXIV.

4.293 The question presented for this Panel, is how should it respond to this dispute which has arisen under a free trade agreement authorized by GATT Article XXIV. The parties are agreed that this Panel does not have jurisdiction over the NAFTA or disputes arising thereunder.

4.294 The Panel should find that it would be both artificial and highly prejudicial to Mexico to treat the United States' complaint as anything other than an attempt to present to its advantage a narrow slice of a larger dispute that plainly falls outside of the WTO's jurisdiction. Equity is in Mexico's favour:

– Treating the dispute as purely a WTO dispute rewards the United States for engaging in forum shopping while it continues to block Mexico's good faith attempts to resolve its long-standing grievance.

– It is entirely possible – indeed likely – that if this Panel were to make the rulings requested by the United States, its findings would directly contradict those made by a NAFTA Panel presented with the same facts.

– A side effect of the United States' complaint that would cause additional harm is the possibility of collateral findings of fact being made by this Panel which could be used by the NAFTA Chapter Eleven claims against Mexico. This Panel is being asked to determine legal issues in a narrower legal context (the GATT 1994) that may prejudge the resolution of the same and additional issues under a different, broader set of treaty rules (the NAFTA).

4.295 In short, accepting the United States' arguments will not "secure a positive solution" to the dispute, which is the very aim of the WTO dispute settlement mechanism. It is likely to exacerbate the dispute.

2. Review of the facts

4.296 The United States has tried to characterize some of the facts in a way that reflects less poorly on its intransigence; but, other than to deny a NAFTA breach[57], it has not contradicted any Mexican factual assertion as to its conduct in the events giving rise to this dispute or as to the serious consequences of the limited access to the United States' market for the Mexican sugar industry and the millions of people who depend upon it.[58]

3. The United States' response

(a) The United States' characterization of the NAFTA dispute

4.297 The United States accuses Mexico of failing to obtain a panel finding of breach of the NAFTA when it has entirely blocked Mexico's efforts to establish the Panel. The United States goes further to argue that the Panel must not take the United States' own conduct in creating this impasse into account.

(b) General comment on the United States' position

4.298 International law, of which WTO law is a part, does not support the United States' claim. As the Permanent Court of International Justice observed in the *Chorzów Factory* (Merits) Case:

> "[O]ne party cannot avail himself of the fact that the other has not fulfilled some obligation, or has not had recourse to some means of redress, if the former party has, by some illegal act, prevented the latter from fulfilling the obligation in question, or from having recourse to the tribunal which would have been open to him."[59]

4.299 This is a recognized general principle of international law.[60] The United States' conduct is highly relevant to the Panel's consideration of whether, through the measure at issue, Mexico is justifiably seeking to secure the United States' compliance with the NAFTA.

4.300 The United States appears to contend that, pursuant to its terms of reference, the Panel cannot examine rules of international law other than those set out in the WTO "covered agreements".

4.301 WTO jurisprudence confirms that WTO panels and the Appellate Body can fall back on, and even apply, principles of customary international law in WTO disputes.

4.302 WTO panels are also to interpret the WTO agreements in accordance with the customary rules of interpretation in international law. The Vienna Convention on the Law of Treaties, which has repeatedly been held to codify such rules, provides in Article 31(3) that, in interpreting a treaty, account shall be taken not only of the treaty itself (i.e., GATT 1994), but also of "any relevant rules of international law applicable in the relations between the parties".

---

[57] Closing statement of the United States, first meeting of the Panel, para. 9.

[58] For example, it has not denied that it instructed the United States' Section of the NAFTA Secretariat not to appoint panelists after it was requested to do so by Mexico.

[59] PCIJ. Ser. A, No. 17, p. 29.

[60] Brownlie refers to this as an example of the International Court employing a general principle of law. See Brownlie, Principles of Public International Law, (Oxford University Press, 6th ed.) p. 17. Exhibit MEX-35.

(c) The United States cannot specify what other avenues were open to Mexico

4.303 Although it says that Mexico should have taken other action to protect its interests, the United States does not specify what such action should have been. The United States ignores the fact that Mexico exhausted all diplomatic and other efforts before adopting the measure. In the meantime, its industry faced a severe financial crisis that threatened to become a social one.

4.304 Moreover, the United States has implicitly conceded that it continues to adhere to its view that a State has the right to take unilateral action to protect its interests, as a perfectly justified response, given the failure of bilateral efforts to resolve the problem, due to the intransigence of another State in blocking resort to and the operation of a non-WTO treaty dispute settlement mechanism. Thus, the United States has not ruled out taking the same sort of action as Mexico did.

(d) The United States' practice under the NAFTA

4.305 Since NAFTA's entry into force, the United States has also taken rebalancing action.

4.306 After NAFTA's entry into force, Canada raised its tariffs on certain agricultural products on an MFN basis when implementing the Uruguay Round results. Canada applied its new agricultural tariffs on imports of United States-originating agricultural products. The United States argued this was contrary to NAFTA's Article 302, which prohibits a Party from increasing any existing customs duty on an originating good.

4.307 In addition to initiating NAFTA's Chapter Twenty dispute settlement proceedings (to which Canada submitted), the United States took the same action as the Canadian action of which it complained; that is, it rebalanced the situation in view of Canada's action.

4.308 This United States action is inconsistent with the position now taken in the United States' response to Panel question No. 30, but consistent with United States' practice in other contexts: for example, in response to a measure taken by France under a bilateral civil aviation agreement which severely limited United States' carriers from changing the gauge of aircraft for flights into Paris, the United States imposed substantial restrictions on Air France's ability to fly into the United States in order to induce France to submit the dispute to arbitration under the treaty. The arbitral tribunal later upheld the United States' measures as a lawful and generally proportionate measure intended to induce France to submit to dispute settlement.[61]

(e) The United States' statements before the WTO on taking unilateral action outside of the WTO

4.309 The Panel will be aware of the European Communities' complaint in *US – Section 301 Trade Act*.[62] The European Communities challenged the WTO-consistency of a United States statute that conferred certain retaliatory powers on the Executive Branch, contending that the statute mandated action inconsistent with United States' obligations under the WTO Agreements, specifically the DSU.

4.310 Paragraphs 4.133-4.136 of the Panel Report record the United States' explanation that it distinguished between retaliating against a WTO trading partner for matters governed by the WTO (in which case it would invoke DSU procedures before imposing retaliatory measures) and imposing measures on a WTO trading partner for matters falling within a non-WTO agreement (in which case,

[61] United States response to Panel questions, para. 71. For an example of the United States taking measures in advance of a dispute panel ruling, see the *Air Services Agreement of 27 March 1946 Arbitration (United States v. France)*, RIAA XVIII, p. 146 (1979). Exhibit MEX-37.

[62] Report of the Panel on *US – Section 301 Trade Act*.

it considered itself free to impose sanctions where another State blocked the operation of a dispute settlement mechanism).

4.311 The United States plainly reserved its right to take unilateral action against another WTO Member in relation to non-WTO covered agreements such as NAFTA.

4.312 The Panel concluded that, having regard to the statutory scheme and to representations made to it by the United States during the course of the proceeding, section 304 could be applied consistently with United States' WTO obligations. However, it is plain from the structure of the United States law, the Statement of Administrative Action, the United States' statements to the Panel, and from the Panel Report itself[63], that these all related solely to the situation where the United States considered that another WTO Member had violated a WTO covered agreement. The United States did not repudiate its legal right to take action where, for example, a State blocked the operation of a non-WTO trade agreement's dispute settlement mechanism.

4. Legal submissions

(a) This Panel's powers under the applicable "covered agreements" are broader and more flexible than the United States contends

4.313 The United States has contended that the Panel "*cannot* resolve the matter in dispute" (emphasis added) – i.e., the United States claims that Mexico's tax measures are inconsistent with Article III of the GATT – unless it issues findings of breach.[64] This argument attempts to constrain the Panel more tightly than the actual text of GATT 1994 or the DSU either provides or requires.

4.314 It warrants noting that, having directed the Panel to Articles 11 and 7 of the DSU, the United States does not take the crucial next step of turning to what the applicable covered agreement, GATT 1994, actually requires a panel to do. Since the DSU refers to the GATT 1947 in this regard, Mexico will focus on that agreement.[65]

4.315 Article XXII did not require a panel to make a ruling of breach; rather, it mandated the Contracting Parties "to consult with any contracting party *or parties* in respect of any matter for which it has not been possible to find a satisfactory solution through consultation under paragraph 1." (emphasis added) The article's reference to parties in the plural indicates that its purpose was to assist disputing parties in finding satisfactory solutions to their differences, precisely what Mexico is asking this Panel to do.

4.316 Similarly, Article XXIII:2 provided for the referral of a matter (including an alleged failure of a Contracting Party to carry out its obligations under the GATT or a Contracting Party's application of a measure which conflicts with the provisions of the GATT) to the CONTRACTING PARTIES.

4.317 Three points warrant noting: First, Articles XXII and XXIII conferred discretion upon the CONTRACTING PARTIES (and panels acting at their behest). Second, neither set limits on a panel's power to shape its recommendations or make a "ruling in the matter" in response to the facts peculiar

[63] The Panel noted at para 7.13, that it was not its "task to examine any aspects of Sections 301-310 outside the EC claims. We are, in particular, not called upon to examine the WTO compatibility of US actions taken in individual cases in which Sections 301-310 have been applied. Likewise, we have not been asked to address the WTO consistency of those provisions in Section 301-310 relating to determinations and actions taken by the USTR that do not concern the enforcement of US rights under the WTO Agreement, including the provisions authorizing the USTR to make a determination as to whether or not a matter falls outside the scope of the WTO Agreements." (emphasis added)

[64] United States response to Panel questions, para. 3.r

[65] See Article 3(1) of the DSU.

to a particular case. To the contrary, they are to determine what is *appropriate* in the circumstances. Finally, these remedies were available to the CONTRACTING PARTIES in situations where a breach of the GATT was alleged.

4.318 GATT's dispute settlement procedures evolved, but when it came to creating the WTO's dispute settlement system in the early 1990s, the drafters did not amend GATT Articles XXII and XXIII when GATT 1947 became GATT 1994.

4.319 This affirmation of the flexibility expressly reserved by and to the CONTRACTING PARTIES some 47 years after GATT 1947's entry into force shows that the WTO Members sought to retain a measure of flexibility in dispute settlement proceedings involving GATT 1994.

4.320 The flexibility that GATT's drafters established is preserved in the DSU: "In the absence of a mutually agreed solution, the first objective of the dispute settlement mechanism is *usually* to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements … " (emphasis added)

4.321 Article 11 of the DSU contemplates other possibilities that the United States has chosen to ignore. Thus, it would be within the Panel's discretion, based on an objective assessment of the matter before it, to recommend what steps the parties should take to "secure a positive solution to the dispute".

(b) Mexico's measures can be justified under Article XX(d)

(i) The United States' position on Article XX(d) is internally inconsistent

4.322 The United States' suggestion that an international treaty cannot be a "law" within the meaning of Article XX(d) is contradicted by paragraph 54 of the United States' response to the Panel's questions, where it is stated:

> "Article XX(d) of the GATT does not justify measures adopted by one Member to secure compliance by another Member with international obligations *arising from a treaty which is not part of the WTO 'covered agreements*.'"(emphasis added)

4.323 This contemplates that Article XX(d) justifies GATT-inconsistent measures adopted by one WTO Member to secure another Member's compliance with obligations under a WTO covered agreement. Nothing in the GATT suggests that the term "laws" encompasses only the WTO "covered agreements", but not other international treaties that are not only not inconsistent with the provisions of GATT 1994 but are expressly authorized by Article XXIV.

4.324 The United States reviews the wording of various GATT 1994 provisions to point out that different words (laws, regulations, obligations, etc.) are used in different places.

4.325 On the United States' reading of the GATT, it has obligations under the NAFTA, but those obligations are not to be confused with "law". Therefore, it says that Article XX(d) is not available to Mexico to justify a measure designed to secure United States' compliance with its admitted obligations that exist only by virtue of an international legal instrument enforceable (theoretically, at least[66]) by law.

[66] The NAFTA Parties intended and considered them to be enforceable until the United States refused to participate in NAFTA dispute settlement.

4.326 Mexico observed that international law is no less law than domestic law. In fact, the United States concedes that it entered into international legal obligations *vis-à-vis* Mexico. The definition of "international agreement" cited by the United States supports this view: "treaties and other agreements of a contractual character between different countries … creating legal rights and obligations".[67]

4.327 The United States argues that the drafters of Article XX(d) precluded the justification offered by Mexico because, rather than using "obligations", they used the word "laws". Yet this ignores the fact that laws by definition encompass obligations. In other words, the term "laws" includes obligations under international treaties.[68] Accordingly, the relevant question regarding the meaning of "laws or regulations" in these proceedings is whether these terms include international law.

4.328 In short, if, as the United States contends, measures taken to enforce the WTO covered agreements can be justified under Article XX(d) as "necessary to secure compliance with laws … which are not inconsistent with the provisions of this Agreement", the text can equally support other laws such as Article XXIV free trade agreements which, as Mexico pointed out, are "not inconsistent with the provisions of" GATT 1994.

(ii) Article XX(d) of the GATT 1994 can justify measures necessary to secure compliance with laws or regulations applicable outside the territorial jurisdiction of the Member taking the measure

4.329 As discussed in Mexico's response to question No. 25 from the Panel, GATT and WTO jurisprudence interpreting Article XX of the GATT confirms that other paragraphs of the GATT General Exceptions clause are capable of being interpreted to encompass otherwise GATT inconsistent measures relating to measures of other States or to activities occurring outside of the territory of the State invoking Article XX. For example, in paragraphs 5.15 and 5.16 of its Report, the GATT Panel *US – Tuna (EEC)* stated as follows:

> "The Panel noted that two previous panels have considered Article XX(g) to be applicable to policies related to migratory species of fish, and had made no distinction between fish caught within or outside the territorial jurisdiction of the contracting party that had invoked this provision."
>
> The Panel then observed that measures providing different treatment to products of different origins could in principle be taken under other paragraphs of Article XX and other Articles of the General Agreement with respect to things located, or actions occurring, outside the territorial jurisdiction of the party taking the measure. An example was the provision in Article XX(e) relating to products of prison labour. *It could not therefore be said that the General Agreement proscribed in an absolute manner measures that related to things or actions outside the territorial jurisdiction of the party taking the measure*."[69] (emphasis added)

4.330 In its second submission to the WTO panel in *US – Shrimp*, the United States argued strenuously that the *US – Tuna (EEC)* panel had rejected Thailand's argument that Article XX implicitly contained a territorial jurisdiction limitation.[70]

---

[67] United States response to Panel's questions, para. 71.
[68] Article 38 of the Statute of the International Court of Justice.
[69] GATT Panel Report on *US – Tuna (EEC)* (unadopted), paras. 5.15-5.16.
[70] *US – Shrimp*, second submission of the United States, July 28, 1997, paras. 74-76. Exhibit MEX-41.

4.331 The Appellate Body found that there was no valid reason for supporting the conclusion that either Article XX(b) or (g) apply only to policies in respect of things located or actions occurring within the territorial jurisdiction of the Member taking the measure. Against this background, a territorial jurisdiction limitation equally need not be read into Article XX(d). In Mexico's view, paragraph (d) of Article XX can encompass measures necessary to secure compliance with laws that bind the two (or more) States concerned.

(iii) The United States' distinction is not borne out in NAFTA itself

4.332 The United States' very strict dualist separation between international and domestic law is overstated when United States treaty practice is taken into account.[71]

4.333 The United States has viewed the NAFTA as creating obligations that redound to the benefit of private parties and while it does not confer a right of action upon private parties, its domestic law provides a mechanism for interested persons to secure another Party's compliance with NAFTA by petitioning the United States government to take action against that Party. Mexico understands that, under United States law, the Office of the United States Trade Representative is legally obliged to fully investigate such a complaint and to take action against the other Party if it concludes that the other Party may be in breach of the Treaty.

(c) The nature of the Mexican measures

4.334 In its response to questions, the United States makes much of its effort to protect the multilateral system.[72] It is true that Mexico's measures do not distinguish between HFCS imports from the United States and other WTO Members. Indeed, they do not distinguish between imported fructose and domestically produced fructose. This is because of the nature of the trade.

[71] In Article 2021 of the NAFTA, the Parties found it necessary to prohibit any of them from creating a domestic cause of action that would allow private parties to sue in the domestic courts of a Party in order to secure another NAFTA Party's compliance with its NAFTA obligations. Article 2021 provides that: "No Party may provide for a right of action under its domestic law against any other Party on the ground that a measure of another Party is inconsistent with this Agreement." Canada provided in its North American Free Trade Agreement Implementation Act: 6(1) *No person has any cause of action and no proceedings in any kind shall be taken, without the consent of the Attorney General of Canada, to enforce or determine any right or obligation is claimed or rises solely under or by virtue of Part 1 [Implementation of Agreement Generally] or any other order or regulation made under Part 1.* See exhibit MEX-42. The United States provided likewise in Section 102(c) of the North American Free Trade Agreement Implementation Act: "*No person other than the United States … shall have any cause of action or defence under … the [NAFTA] or by virtue of Congressional approval thereof …..*" It was unnecessary for Mexico to enact a similar provision because the NAFTA has direct effect under Mexican constitutional law and therefore Article 2021, like the rest of NAFTA, had immediate effect without further implementing action. It would have been unnecessary to prohibit a domestic cause of action if the NAFTA could never have the effect of a law in the internal legal order of a Party. Removing the possibility of a private right of action did not constrain any of the Parties themselves from taking action to secure another Party's compliance with the NAFTA through executive or legislative measures. Indeed, the United States retained a domestic right of petition in section 301 of its Trade Act of 1974, which permitted a private party to petition the USTR to secure compliance with the NAFTA by another NAFTA Party. See Exhibit MEX-43.

[72] "[T]he United States has difficulty understanding how a breach of Mexico's WTO obligations contributes to these goals" [para. 78], "*the United States finds it difficult to understand how, in seeking to enforce the alleged obligations of the United States under the NAFTA, it is necessary to breach the national treatment obligations Mexico has undertaken with respect to every other WTO Member*" [para. 79], and "*no matter what Mexico's complaint might be, Mexico could have sought NAFTA compliance through any number of means - diplomatic or otherwise – short of breaching its WTO obligations*" [para. 80].

4.335 The measures related virtually exclusively to the United States, not to other WTO Members. Mexico appreciates that other Members have a systemic interest in the matter, but the fact is that the trade was overwhelmingly one that arose under the NAFTA and was supplied by the United States. The measures are a response to its persistent refusal to respond to Mexico's repeated efforts to resolve the dispute.[73]

(d) The measures at issue meet the necessity test under Article XX(d) of the GATT 1994

4.336 The United States argues that Mexico's tax measures cannot be necessary to secure compliance with the NAFTA.[74] It maintains its position that none of the Mexican or United States concerns about the dispute over bilateral trade in sweeteners has been resolved. In short, the United States suggests that because the measures at issue have so far not succeeded in securing United States compliance with the NAFTA, they cannot be necessary within the meaning of Article XX.

4.337 Mexico has three responses to this argument:

– First, in *Korea – Various Measures on Beef*, the Appellate Body did not rule that only measures that actually secure compliance with the law or regulation at issue can be deemed "necessary" within the meaning of Article XX(d). Rather, it stated that "[t]he greater the contribution [to the realization of the end pursued], the more easily a measure might be considered to be 'necessary'".[75] Measures that make a lesser contribution to securing compliance with a law or regulation may also be "necessary".

– Second, from Mexico's perspective, the measures at issue actually greatly contribute to the end pursued by Mexico, that is, the securing of United States compliance with the NAFTA. The record evidence reveals that the adoption of the tax initially created the desired dynamic to secure the United States' compliance or otherwise arrive at a mutually satisfactory resolution. This interest dissipated when the United States launched this WTO proceeding, but the proceeding itself is further evidence that the Mexican measures had their intended effect of attracting United States attention with a view to resolving the dispute over its compliance with NAFTA. Mexico believes that if this Panel upholds Mexico's position, the measures will induce the United States to finally resolve the entire dispute.

– Third, conversely, if the Panel accedes to the United States' arguments, it will damage Mexico's prospects for securing United States' compliance with the NAFTA. The Panel will have assisted the United States in continuing to block any resolution of Mexico's grievance. This would be plainly unfair.

[73] As the International Law Commission noted in its commentary on counter-measures, "*[a] second essential element of countermeasures is that they 'must be directed against' a State which has committed an internationally wrongful act…*" "*This does not mean that countermeasures may not incidentally affect the position of third States or indeed other third parties. ... Similarly if, as a consequence of suspension of a trade agreement, trade with the responsible State is affected and one or more companies lose business or even go bankrupt. Such indirect or collateral effects cannot be entirely avoided.*" See James Crawford, "*The International Law Commission's Articles on State Responsibility: Introduction, Text and Commentaries*", (Cambridge University Press 2002) p. 285.

[74] United States response to Panel questions, paras. 75-80.

[75] Appellate Body Report on *Korea – Various Measures on Beef*, para. 163.

5. The United States has not responded to Mexico's arguments that the measures meet the requirements of the chapeau of Article XX of the GATT 1994

4.338 In its previous submission, Mexico established prima facie that the measures at issue meet the requirements of the chapeau of Article XX of the GATT 1994. In this regard, Mexico notes that the United States has not responded to the substance of its arguments. Accordingly, should the Panel determine that the measures are provisionally justified under paragraph (d), it should also find that the measures are not applied in a manner that creates arbitrary or unjustifiable discrimination between countries where the same conditions prevail or a disguised restriction on international trade.

4.339 Mexico's good faith efforts to resolve this long-standing dispute clearly meet the requirements set out by the Appellate Body in *US – Shrimp*.

6. Conclusion

4.340 Mexico reiterates its request that this Panel take particular care in formulating its findings and recommendations so as not to suggest that it is definitively interpreting the parties' respective rights and obligations under the NAFTA. Mexico nevertheless requests that in applying Article XX of the GATT 1994 and in deciding as to the scope and content of any recommendations that it may issue, the Panel consider the undisputed facts of the United States' admission of the existence of a NAFTA dispute and its failure to rebut Mexico's allegations that it has refused to submit to the NAFTA dispute settlement procedure.

4.341 For the foregoing reasons and those set out in Mexico's prior submissions, Mexico reiterates its request that the United States' complaint be rejected.

J. OPENING STATEMENT OF THE UNITED STATES AT THE SECOND MEETING OF THE PANEL

1. Introduction

4.342 This statement will briefly review the status of this dispute, and will principally focus on responding to the arguments presented by Mexico concerning Article XX(d) in its second submission.

2. Status of this dispute

4.343 This dispute, as the Panel is well aware, and despite Mexico's repeated attempts to argue otherwise, concerns Mexico's obligations under the WTO Agreement and certain tax measures that Mexico imposes on non-cane sugar sweeteners and soft drinks and syrups. Mexico readily admits that it imposed these tax measures to stop the displacement of Mexican cane sugar by imports of HFCS from the United States.

4.344 The United States first and second submissions and responses to Panel questions have presented all of the facts and argument necessary to establish a prima facie case that Mexico's tax measures on soft drinks and syrups – contained in the IEPS – are in breach of its obligations under Articles III:2 and III:4 of the GATT 1994. Mexico has not contested any of those facts or arguments. Accordingly, the United States will focus here on Mexico's alleged defence under Article XX(d) of the GATT 1994.

3. Article XX(d) – "laws or regulations"

4.345 Under this defence, Mexico contends that its tax measures are necessary to secure United States compliance with the NAFTA and, therefore, justified as an exception to WTO rules under

Article XX(d). As the party asserting it, Mexico bears the burden of proof on this defence. Mexico has not met that burden and, therefore, cannot justify its tax measures under Article XX(d).

4.346 The fundamental flaw in Mexico's defence is that Article XX(d) pertains to "laws or regulations," not obligations owed Mexico under the NAFTA or any other international agreement. Thus, the energy Mexico has expended attempting to convince the Panel that its tax measures are "necessary" or "justifiable," because Mexico has "exhausted" efforts to find a solution to the NAFTA sugar dispute, are simply efforts to distract attention from the fact that Mexico is unable to sustain its assertion that "laws or regulations" means or includes obligations under an international agreement.

4.347 As the United States explained in its second submission and in response to the Panel's questions, the phrase "laws or regulations" means rules promulgated by a government such as statutes or administrative rules – in other words, the domestic laws or regulations of the Member applying the measure at issue. This is the interpretation of the phrase "laws or regulations" derived from application of the Vienna Convention rules of treaty interpretation. These rules direct the treaty interpreter to the ordinary meaning of the terms of the treaty in their context and in light of the treaty's object and purpose.[76] As demonstrated in the United States responses to questions and second submission, the ordinary meaning of "laws or regulations" is the domestic laws or regulations of the Member claiming the Article XX(d) exception. This meaning is supported by (1) the dictionary definition of the words "laws" and "regulations"; (2) the use of the words "laws" and "regulations" as opposed to the words "obligations" or "agreements" used in Article XX and elsewhere in the GATT 1994 and the WTO Agreement[77]; and (3) the effect on the WTO Agreement of reading the phrase "laws or regulations" to include obligations under international agreements.[78] The United States has already detailed each of these points in previous submissions. The United States emphasizes here that acceptance of Mexico's interpretation of "laws or regulations" to include obligations owed Mexico under the NAFTA would open the door for any Member to claim that a breach of the WTO Agreement, or some other treaty, by another Member meant that the Member was free to breach any of its WTO obligations. Such a reading of Article XX(d) would nullify Article 23 of the DSU, render Article 22 of the DSU meaningless, and significantly undermine the effective functioning of the WTO dispute settlement system.

4.348 Such a reading would also mean that WTO panels and the Appellate Body would be called upon to examine any treaty that was the subject of such a claim of breach to determine if the trade measures adopted were "necessary to secure compliance" with that treaty. To do so would require WTO panels or the Appellate Body to determine if there was, in fact, a breach of the underlying agreement. In other words, WTO dispute settlement would become a forum of general dispute resolution for all international agreements, and all such agreements would be in effect incorporated into, and enforced by, the WTO Agreement by virtue of Article XX(d). This cannot possibly be what Mexico, let alone other WTO Members, intends. Ironically, it would also mean that with each additional international agreement a Member enters into, the more it diminishes the benefits secured under the WTO Agreement: the Member's WTO rights would be subject to being infringement by any party with whom it had entered into an international agreement so long as the party claimed the WTO breach was to secure compliance with the non-WTO Agreement.

4.349 Despite the serious, even astounding, implications of what Mexico argues, it is surprising how little Mexico has provided in support of its contention that United States obligations under the NAFTA constitute "laws or regulations" within the meaning of Article XX(d). Other than the mere

[76] Vienna Convention on the Law of Treaties, Art. 31(1).
[77] United States responses to Panel questions, paras. 72-74; United States' second written submission, paras. 44-46.
[78] United States second submission, paras. 47-48.

assertion that "laws" as used in Article XX(d) includes international agreements[79], the only support Mexico offers is that Article 38 of the International Court of Justice (ICJ) Statute includes "international conventions" as a source of "international law"[80], that "treaties" like "laws" create legal obligations[81], and that paragraphs (b) and (g) of Article XX are not limited to measures relating to "policies in respect of things located or actions occurring within the territorial jurisdiction of the Member taking the measure."[82] The latter of these arguments is essentially irrelevant. The question is not whether the measure at issue relates to actions occurring outside the territorial jurisdiction of the Member taking the measure. In the disputes cited by Mexico[83], the measure at issue was a domestic law applied within the jurisdiction of the Member taking the measure, and none of these disputes, of course, was interpreting "laws or regulations" under Article XX(d). Rather, the question is whether Article XX(d) applies to obligations owed by another Member under an international agreement. It does not. The reference to the ICJ Statute likewise misses the point and for the same reason. Mexico has yet to demonstrate that the phrase "laws or regulations" means or includes "international law" or that the creation of "legal obligations" is synonymous with the word "laws."

4.350 In particular, whatever is included in the scope of "international law," there is a textual difference between the words "international law" and the word "laws" which, of course, is the actual word used in Article XX(d). In Article XX(d) and throughout the WTO Agreement, the word "laws" is used to refer to domestic laws.[84] By contrast, in the two instances where the WTO Agreement references the words "international law" – in Article 3.2 of the DSU and Article 17.6 of the Antidumping Agreement – the word "law" appears in the singular and is proceeded by the word "international." As noted in the United States second submission, the Spanish and French texts of the Agreement use entirely different words to refer to "international law" as contained in Articles 3.2 and 17.6, than they do to refer to "laws" as contained in Article XX(d).[85] To borrow a quote from Mexico's second submission and Mexico's opening statement at this meeting: "[A] treaty interpreter is not entitled to assume that the use of different words in a treaty was merely inadvertent or 'accidental.'"[86]

4.351 Moreover, "laws" as it appears in Article XX(d) is used in conjunction with the word "regulations." As the United States has explained, "regulations" are defined as instruments "issued by various governmental departments to carry out the intent of the law."[87] Thus, a reading of the phrase "laws or regulations" to mean the domestic laws or regulations of the Member applying the measure at issue attributes the same scope to the word "laws" as it does to the word "regulations." Mexico's reading, on the other hand, creates an asymmetry between the scope of the word "laws" and the word

---

[79] Mexico's first written submission, para. 118; Mexico's second written submission, para. 71.

[80] Mexico's responses to Panel questions, p. 13 (WTO translation); *see also* Mexico's second written submission, para. 71 (citing Article 38 of the ICJ Statute).

[81] Mexico's second written submission, paras. 69-72, 77-78; Mexico's responses to Panel questions, p. 13 (WTO translation).

[82] Mexico's second written submission, paras. 74-76; Mexico responses to Panel questions, p. 13-14 (WTO translation).

[83] Mexico's second written submission, paras. 74-76 (citing *US – Shrimp*); Mexico's responses to Panel questions, p. 13-14 (WTO translation) (citing *US – Shrimp*).

[84] *See, e.g.*, Marrakesh Agreement Establishing the WTO, Art. XVI:4*;* GATT Arts. VII:1, VIII:3 and X:1; General Agreement on Trade in Services (GATS) Arts. V:3, VI:3, XXVIII(k) and Annex on Telecommunications, para. 3(d); Agreement on Import Licensing Procedures, Art. 8.2; Agreement on the Implementation of Article VII of the General Agreement on Tariffs and Trade 1994, Art. 3.2; AD Agreement, Art. 18.5; Agreement on Rules of Origin, passim; Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), preamble, Arts. 3.2, 8.1, 40.2, 63.1,63.2, and 65.3; Agreement on Preshipment Inspection, passim.

[85] United States' second written submission, note 72.

[86] Mexico's second written submission, para. 50 (citing the Appellate Body in *EC – Hormones*).

[87] United States responses to Panel questions, para. 71.

"regulations" as used in Article XX(d). Under Mexico's reading, only the former captures instruments that are not solely domestic in scope.

4.352 Mexico's argument that international agreements create "legal obligations" is likewise without merit.[88] The mere fact that international agreements create "obligations" between States, that are referred to as "legal," does not address the question of whether obligations under an international agreement – whether legal or otherwise – fall within the scope of the phrase "laws or regulations" in Article XX(d). Mexico has not demonstrated that "legal obligations" assumed by the United States under the NAFTA constitute "laws" within the meaning of Article XX(d). In this regard, the United States points out that in the United States, international trade agreements, such as the NAFTA and the WTO Agreement, are not laws and are not enforceable in United States courts.[89] That interested parties in the United States may ask the United States Trade Representative to seek our trading partners' compliance with those agreements, contrary to Mexico's suggestion[90], does not make those agreements "laws."

4.353 Rather than demonstrate that the phrase "laws or regulations" means or includes "international law" or international agreements, Mexico, instead, argues that the United States "must explain why the term 'laws' as used in Article XX(d) cannot include international law."[91] Mexico forgets its burden of proof. It is Mexico's burden, as the party asserting the defence, to establish that its tax measures qualify as measures "necessary to secure compliance with laws or regulations" within the meaning of Article XX(d). Throughout these proceedings, however, Mexico has been unable to demonstrate that obligations owed Mexico under an international agreement constitute "laws or regulations." Without such a demonstration, Mexico cannot justify its tax measures by way of Article XX(d).

4. Article XX(d) – "necessary to secure compliance"

4.354 Despite being unable to demonstrate that "laws or regulations" actually means or includes international agreements, Mexico makes much of its allegedly exhaustive efforts to resolve the dispute it has with the United States over market access for cane sugar under the NAFTA. On the basis of these efforts, Mexico insists that its tax measures are "necessary to secure compliance" and in keeping with the chapeau to Article XX. As the United States explained in its second submission and responses to questions, these efforts do not render Mexico's tax measures "necessary" or designed to "secure compliance" within the meaning of paragraph (d); they also do not mean that Mexico's tax measures are applied in a manner that is consistent with the chapeau to Article XX. Rather than repeat what was said in our earlier submissions, the United States will focus on two points regarding Mexico's second submission.

4.355 The first relates to Mexico's insistence that its tax measures "relate[] virtually exclusively to the United States" and are "directed against the United States."[92] To support this assertion, Mexico explains that most imports of HFCS and soft drinks come from the United States and "arose under the NAFTA."[93] Mexico then concludes that its tax measures are, therefore, a response to the United States "refusal" to resolve the NAFTA sugar dispute. The United States presumes Mexico included this point in response to the United States point that breaching obligations owed WTO Members other than the United States cannot be necessary to secure United States compliance with the NAFTA.[94]

---

[88] Mexico's second written submission, paras. 69-72, 77-78.
[89] *Corus Staal BV v. United States*, CAFC Slip Op. No.04-1107 (Jan. 21, 2005) at 9.
[90] Mexico's second written submission, para. 78.
[91] Mexico's second written submission, paras. 71, 73.
[92] Mexico's second written submission, paras. 3, 81.
[93] Mexico's second written submission, para. 81.
[94] *See* United States' second written submission, paras. 59, 65.

Mexico's response, however, incorrectly assumes that a measure may avoid a breach of Article III simply because it affects only a small amount of trade. To quote the Appellate Body:

> "Article III obliges Members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products. ... [I]t 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."[95]

Regardless of the share of Mexican HFCS imports formerly accounted for by products of Members other than the United States, Mexico's tax measures would still treat the products of those other Members less favourably than the products of Mexico, in violation of Article III of the GATT. Therefore, Mexico still has not answered the question why such less favourable treatment of *other Members' products* is necessary to secure United States compliance with the NAFTA.

4.356 In pointing out that its tax measures are targeted "virtually exclusively" at the United States, Mexico appears to state that its tax measures also discriminate *de facto* against imports from the United States *vis-à-vis* imports from other countries. Apparently Mexico is conceding a breach of Article I of the GATT 1994, as well as Article III in this dispute, although Article I is not within this Panel's terms of reference.[96]

4.357 The second point is that Mexico continues to be unable to explain why the discrimination imposed on imported HFCS as a result of Mexico's tax measures is necessary to secure United States compliance with the NAFTA. This owes to the fact that Mexico cannot explain why stopping the displacement of Mexican cane sugar by imported HFCS is anything more than a means to protect its cane sugar industry. In other words, while Mexico attributes much harm to its cane sugar industry because of the displacement of cane sugar by imported HFCS, Mexico has yet to explain how stopping this displacement through its discriminatory tax measures would result in United States compliance with alleged NAFTA obligations. Even greater opportunities to export "displaced" Mexican cane sugar are merely another means to aid Mexico's cane sugar industry; they are not means to secure United States compliance with alleged NAFTA obligations. In short, Mexico has explained why it believes helping its cane sugar industry is necessary. It has also explained how measures which stop or counteract the displacement of cane sugar may contribute to this. Yet, neither explanation addresses why Mexico's tax measures constitute measures to secure compliance with the NAFTA, much less necessary ones.

4.358 The closest Mexico comes to stating why it believes its tax measures are "necessary to secure compliance" with the NAFTA, is its contention that, by hurting United States exports of HFCS through its discriminatory tax measures, Mexico will "induce" sweetener producers to come to the "negotiating table."[97] Even if Mexico's contention were correct, *inducing* sweetener *producers* to engage in negotiations is not the same thing as securing United States compliance with the NAFTA.

4.359 Moreover, the United States points out that Mexico's tax measures could not have even been "necessary" to stop the displacement of Mexican cane sugar by imported HFCS as a result of "preferential access" for HFCS under the NAFTA.[98] This is because Mexico did not provide such preferential access at the time it imposed its tax measures. Rather, from 1997 through May of 2002, Mexico imposed WTO- and NAFTA-inconsistent anti-dumping duties on HFCS from the United

[95] Appellate Body Report on *Japan – Alcoholic Beverages II*, p. 16, DSR 1996:1, 97, at 109.
[96] GATT Art. I:1.
[97] Mexico's second written submission, para. 83.
[98] Mexico's first written submission, paras. 5-6, 124.

States.[99] In other words, Mexico has already adversely altered the balance of rights and obligations under the NAFTA, which was negotiated as a set of mutual concessions. Now Mexico is withdrawing concessions under the WTO, concessions which were never negotiated on the basis of other concessions granted under the NAFTA.

5. Issues relating to Mexico's "preliminary ruling" request

4.360 Aside from its Article XX(d) defence, Mexico raises a number of other issues in the course of these proceedings that are simply not relevant to resolution of this dispute. In its second submission, for example, Mexico continues to argue points only relevant – if at all – to its already-rejected request for a preliminary ruling. These points include Mexico's assertions that "this is a NAFTA dispute[100]," that a finding of WTO-inconsistency will prejudice on-going or future NAFTA proceedings[101], that the Panel need not issue findings on the consistency of Mexico's tax measures with Mexico's WTO obligations[102], and that the United States does not have the right, or does not deserve, to bring this dispute before the WTO.[103] The Panel has already considered these issues in rejecting Mexico's request for a preliminary ruling and in concluding that the Panel "does not have the discretion, as argued by Mexico, to decide not to exercise its jurisdiction in a case that has been properly brought before it."[104] These issues also do not bear on whether Mexico's tax measures are consistent with Article III or justified under Article XX(d). They are, therefore, not issues that this Panel needs to consider further.

6. "General principles of international law"

4.361 Mexico has also attempted to justify its tax measures under "general principles of international law." The matter in dispute, however, concerns the consistency of Mexico's tax measures with Mexico's obligations under the WTO Agreement – namely, whether Mexico's tax measures are consistent with Article III and, if not, whether they are justified under Article XX(d). Issues Mexico raises concerning justifications for its tax measures under "general principles of international law" are, therefore, not issues this Panel need, or should, resolve.

4.362 That said, Mexico's suggestion that its tax measures are somehow justified as a matter of "general principles of international law" – although still irrelevant to the consistency of Mexico's tax measures with Mexico's WTO obligations – does raise some concerns which merit a couple of brief remarks.

4.363 First, the WTO dispute settlement system exists to resolve WTO disputes, that is, disputes over Members' rights and obligations under the covered agreements.[105] Accordingly, when a WTO panel is established, it is established to examine the relevant provisions of the covered agreements and "to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in *those agreements*."[106] A WTO panel's mandate simply does not extend to determining the rights and obligations of countries under general principles of international law. Thus, in this dispute, the Panel's mandate is limited to determining the consistency of Mexico's tax measures with Mexico's obligations under the covered agreements. Just as the Panel's mandate does not extend to

[99] *See* United States first written submission para. 14-18.
[100] *See, e.g.,* Mexico's second written submission, paras. 4, 7.
[101] *See, e.g.,* Mexico's second written submission, paras. 6, 8.
[102] Mexico's second written submission, paras. 48-57.
[103] *See, e.g.,* Mexico's second written submission, paras. 8.
[104] Letter from the Chairman of the Panel to Representatives of the Parties (18 January 2005) at 2.
[105] DSU Arts. 1.1, 3.2 and 3.4.
[106] DSU Art. 7.1(emphasis added); *see also* DSU Art. 11.

examining United States obligations under the NAFTA[107], it does not extend to examining Mexico's rights under general principles of international law.

4.364 Second, exceptions to WTO rules are expressly stated in the text of the WTO Agreement. Yet, nothing in the text of the WTO Agreement provides that a measure that is otherwise WTO-inconsistent might be justified under the WTO Agreement so long as it comports with some (unspecified) general principles of international law. Moreover, there is no basis for a panel to graft general principles of international law onto the rights and obligations agreed upon by WTO Members and expressed in the text of the WTO Agreement. In fact, the Appellate Body has already rejected the notion that a principle of international law – whether recognized or not – might be used as grounds for justifying measures that are otherwise inconsistent with a Member's obligations under the WTO Agreement.[108]

4.365 Mexico's reliance on the Appellate Body reports in *EC – Bananas III*, *US – Wool Shirts and Blouses*, *India – Patents (US)* and *Canada – Aircraft* in this regard are inapposite. Although the Appellate Body did refer in those reports to non-WTO tribunals' practice regarding certain procedural issues, it did not rely on that practice as the basis for its findings. Instead, in each of the reports cited by Mexico[109], the Appellate Body concluded that the text of the DSU and other provisions of the WTO Agreement supported the panel's findings with respect to the relevant procedural issue, noting, in addition, that non-WTO tribunals had similarly viewed the issue.[110] These reports do not support Mexico's contention that its tax measures – which are inconsistent with Article III and not excepted under Article XX – are nevertheless justified under the WTO Agreement due to a "recognized general principle of international law."

4.366 Mexico's contention likewise does not find support in its out-of-context citations to statements made by the United States in connection with the Air Services Agreement of 1946[111], the GATT 1947[112], the NAFTA[113], or another WTO dispute settlement proceeding.[114] Whatever statements the United States may or may not have made in these contexts – over half of which pre-date United States obligations under the WTO Agreement – such statements cannot be used as grounds to create new exceptions to WTO rules.

4.367 In addition to its defence under Article XX(d) and assertion of a "right to take unilateral action" under general principles of international law, Mexico contends – in what appears to be an argument recycled from its failed request for a preliminary ruling – that the Panel need not limit its recommendations in this dispute to a request that Mexico bring its WTO-inconsistent tax measures

---

[107] United States responses to Panel questions, para. 12.

[108] Appellate Body Report on *EC – Hormones*, paras. 120-125.

[109] Mexico's second written submission, para. 17.

[110] Appellate Body Report on *EC – Bananas III*, paras. 10, 132-138 (considering representation by private counsel and standing and referring to DSU Article 3.7 and GATT Article XXIII); Appellate Body Report on *US – Wool Shirts and Blouses*, pp. 14-17, DSR 1997:I, 323, at 335, (considering the burden of proof and referring to DSU Article 3.8 and GATT Article XXIII); Appellate Body Report on *India – Patents (US)*, paras. 64-71 (considering the ability to review municipal law and referring to the panel's "task in determining whether India's [measures] were in conformity with India's obligations under Article 70.8(a) of the TRIPS Agreement"); Appellate Body Report on *Canada – Aircraft*, paras. 197-206 (considering adverse inferences and referring to the panel's mandate, DSU Article 11 and SCM Agreement Article 4).

[111] Mexico's second written submission, para. 32 (regarding a 1978 dispute over the right to operate a West Coast to Paris flight via London).

[112] Mexico's second written submission, para. 23, 37-38 (regarding a 1989 statement in connection with a dispute over hormone-treated beef).

[113] Mexico's second written submission, para. 33-35 (regarding a 1994 memorandum of understanding); *id.* paras. 28-30 (regarding a 1996 dispute over agricultural products).

[114] Mexico's second written submission, paras. 40-45 (regarding *US – Section 301 Trade Act*).

into compliance.[115] Mexico is incorrect.[116] Panel recommendations are limited to recommendations that WTO-inconsistent measures be brought into conformity with the covered agreements.[117] This limitation is explicitly provided for in Article 19.1 of the DSU which provides: "Where a panel ... concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement."

7. Conclusion

4.368 Therefore, in this dispute, for the reasons already stated and in its prior submissions, the United States respectfully requests the Panel to find that Mexico's tax measures are inconsistent with Articles III:2 and III:4 of the GATT 1994 and not justified under Article XX(d), and recommend that Mexico bring its WTO-inconsistent tax measures into conformity with its obligations under the GATT 1994.

K. OPENING STATEMENT OF MEXICO AT THE SECOND MEETING OF THE PANEL

1. Introduction

4.369 Mexico will focus on the essence of the dispute as it has developed through the parties' written and oral submissions and their responses to the questions posed by the Panel. At the heart of this case lies the following question:

> "What can a WTO Member that seeks to secure compliance with a free trade agreement do when another Party blocks dispute settlement under the said agreement even while it acknowledges the existence of a legitimate dispute?"

4.370 Mexico's response is that in such extraordinary circumstances, international law, including the WTO Agreement, does not preclude a WTO Member from taking measures to secure the other Member's compliance with its treaty obligations and to rebalance the situation under the free trade agreement.

4.371 The United States' position in this case has been ambiguous. *When it is the complainant*, its position is clear: it claims a legal right not only to take counter-measures, but to do so prior to submitting the matter to dispute settlement.

4.372 In this case, however, the United States finds itself in the position of being the obstructing respondent and does not wish to admit that its long-standing view as to the rights of the obstructed complainant State must apply equally when it is the recalcitrant party. Yet it is obvious that, if the United States has this right as the obstructed complainant, it cannot logically contend that it does not accrue to another State that is obstructed by the United States.

4.373 This is why the United States avoided answering the question that Mexico put to it at the end of the first substantive meeting with the Panel. The obvious conclusion is that the United States agrees with Mexico's view that a NAFTA party has the legal right to take action to protect its interests when another Party has obstructed NAFTA's dispute settlement process. But the United States does not want to admit to that in writing.

4.374 Nevertheless, as Mexico showed in its second written submission, there is evidence from the NAFTA that confirms that this is the United States position. Mexico reviewed that evidence at

---

[115] Mexico's second written submission, paras. 62-64.
[116] *See also* United States opening statement at the first meeting of the Panel, para. 12.
[117] DSU Art. 19.1.

paragraphs 27 to 36 of its second submission. Mexico directs the Panel both to the United States tariffs imposed in response to Canada's tariffs in the NAFTA dispute on *Tariffs Applied by Canada to Certain US-Origin Agricultural Products* and to the Memorandum of Understanding signed by two United States cabinet secretaries who undertook not to "take countermeasures inconsistent with the NAFTA or the GATT" during a 12-month period. That evidence is fully consistent with the United States statement to the GATT Council to which Mexico referred in its first written submission (paragraph 126).

4.375 The measure at issue resulted from Mexico's complaint in the context of NAFTA that:

– the United States failed to comply with its NAFTA market access commitments for sugar from Mexico;

– the United States' refusal to admit Mexican sugar into its market caused a serious sugar surplus in the Mexican market that led to severe financial stress in the Mexican sugar industry;

– US-originating HFCS made substantial inroads into the Mexican sweeteners market, displacing sugar from important sectors and further contributing to increasing the sugar surplus;

– Mexico was forced to take other measures at considerable public expense to alleviate the impact of the surplus in its market;

– throughout this time, Mexico pressed for a resolution of the dispute concerning its NAFTA rights by all means, including recourse to the specific dispute settlement mechanism and to negotiations and bilateral consultations;

– the United States steadfastly refused to permit the NAFTA dispute settlement system to discharge its function of assisting the disputing parties in achieving a mutually satisfactory solution to the dispute.

4.376 After exhausting all alternative means, the Mexican Congress adopted the measure challenged by the United States in this proceeding.

4.377 The United States has been forced to admit that there is a genuine dispute between the parties that has not been resolved, but insists that this is not relevant to the issues before the Panel. In the face of all of the evidence and the fact that it has been almost five years since Mexico requested the establishment of an arbitral panel under NAFTA Chapter Twenty – which request is still pending – the United States now claims that it has not impeded the operation of this dispute settlement mechanism. It contends that Mexico has simply "attempted to change the subject" by informing the Panel of the existence and relevance of the larger dispute within the NAFTA (United States second written submission, paragraph 1).

4.378 These contentions are not borne out by the record. Mexico submits that the NAFTA dispute is highly relevant to the issues before this Panel.

4.379 Indeed, the United States goes even further. In its most recent written submission, the United States affirms that there is no link between its HFCS case and Mexico's claim with regard to the market access commitments for Mexican sugar. For example, in paragraph 64 of its second written submission, the United States notes:

> "It is difficult to understand how this harm imposed on HFCS and soft drinks and syrups sweetened with HFCS is designed to 'secure compliance' with unrelated provisions under the NAFTA on market access for sugar."

4.380 With all due respect, this is an absurd statement. As Mexico showed in its first written submission, the United States Trade Representative himself, Michael Kantor, established the link between HFCS and sugar in 1993, when he proposed negotiating the exchange of letters. Paragraphs 37 to 51 of Mexico's first written submission refer to that and Mexico submitted the letter in which that link is established in this proceeding:

> " ...
>
> I propose that we exchange side letters to clarify that, in determining a party's 'net production surplus' status, sugar will be considered to include raw or refined sugar derived directly or indirectly from sugar cane or sugar beets, liquid refined sugar, and high fructose corn sweetener … ".[118]

4.381 Moreover, the United States claim is based entirely in the full substitutability of HFCS for sugar in certain industrial uses. The United States Department of Agriculture's market studies corroborate this:

> " ...
>
> The Mexican sugar industry wants the US sugar quota to be higher, in agreement with the higher Mexican sugar production. Basically, the Mexican sugar industry is not against US HFCS imports into Mexico; what they want is to gain access for more than the 25,000 MT of sugar currently allowed under the TRQ for Mexico. With the high levels of imported HFCS and higher levels of sugar production, the sugar industry claims there is danger of a closing of 15 to 20 mills, resulting in layoff of about 100,000 workers."[119]

4.382 In Mexico's opinion, it is an affront to this Panel to deny the link between HFCS and sugar, when the United States was the first to establish it.

4.383 In this submission, Mexico will elaborate upon these issues. It will also respond to the main arguments that are invoked by the United States in its rebuttal submission against Mexico's defence under Article XX(d) of the GATT 1994.

2. The relevance and status of the NAFTA dispute

4.384 Mexico proposes to start by making a few points about the approach taken by the United States in this case, with particular reference to its rebuttal submission.

4.385 First, the United States continues to wrongly argue that the adoption of the measures by Mexico was to protect the domestic production of cane sugar.[120] Mexico insists, and it should now be perfectly clear, that the intent behind Mexico's measures was to secure the United States' compliance with its NAFTA obligations while it rebalanced its market. But for the United States' refusal to resolve the dispute through the NAFTA mechanism, the Mexican measures would never have been necessary.

---

[118] Mexico's first written submission, para. 41.
[119] Mexico's first written submission, para. 61.
[120] United States second written submission, para. 16.

4.386 The Panel should be aware that this was not in a situation where, with no treaty-based expectation of being able to export sugar surpluses to the United States market, Mexico generated a surplus. Quite the contrary: the bilateral trade regime negotiated in the NAFTA foresaw the Mexican sugar industry's modernization (after the privatization that was taking place while the NAFTA was being negotiated) and expressly contemplated that any surpluses generated could be exported to the United States market. Both parties were fully conscious of the competition between sugar and HFCS, and that HFCS access to the Mexican market would contribute to generating surpluses. The regime established in NAFTA Annex 703.2 regarding trade in sugar and syrups deals exclusively with the sugar surplus exports during the transition period.

4.387 The United States subsequently refused to allow the agreed access to Mexican sugar, in order to protect its own sugar industry from competing with Mexican sugar, yet nevertheless sought to ensure that HFCS, either US-originating or locally produced from United States corn, had free access to the Mexican market, without regard to the consequences for the Mexican sugar industry.

4.388 Mexico submitted the matter to the NAFTA dispute settlement mechanism, but the United States obstructed its operation by refusing to appoint panellists and even forbade the United States Section of the NAFTA Secretariat – in charge of administering the proceedings – to do so when Mexico requested the appointment of panellists. The United States now seeks to convince this Panel that it has not obstructed the operation of dispute settlement proceedings and that it is seemingly normal that some five years later the proceedings are still in the panellist appointment stage. Under such circumstances the best answer it can offer to this Panel is that all of this is simply irrelevant to the claim it has submitted under the DSU.

4.389 The Panel should be aware of the fact that during the years before the Mexican Congress adopted this tax over 3 million tons of HFCS were sold into the Mexican market, thereby exacerbating the effect of the NAFTA-induced surplus on the Mexican industry and cane sugar sector. What segment of the Mexican market has HFCS taken? The soft drinks segment.

4.390 The IEPS tax on soft drinks sweetened with sweeteners other than cane sugar constitutes a temporary response to the United States action aimed at a rebalancing of the situation pending a resolution of the bilateral sweeteners trade dispute. When the facts surrounding the measures' enactment are taken into account, it cannot reasonably be maintained that the purpose of the IEPS tax is simply to protect the Mexican sugar producers from import competition.

4.391 The United States did not bring this factual context to the Panel's attention. Mexico urges the Panel to re-read the United States' first written submission and see just how much now undisputed factual context was omitted when it brought this case forward.

4.392 Once it was confronted with all the facts, the United States simply made superficial assertions about the rightness of its position under the NAFTA while simultaneously urging the Panel not to look at the underlying wider dispute.

4.393 Mexico requests the Panel to take note of the extensive documentary evidence that it has adduced in this proceeding. Mexico's first written submission contains 29 annexes which include contemporaneous letters regarding the establishment of the NAFTA arbitral panel. Mexico meticulously sought to demonstrate through contemporaneous documents how the dispute arose, what steps Mexico took to resolve the dispute in accordance with the procedures set out in the NAFTA, how the United States blocked Mexico's efforts through its acts and omissions, and the serious consequences of the United States' obstructionism for the Mexican productive sectors.

4.394 None of that documentary evidence was contested, still less rejected, by the United States.

4.395 Mexico's first written submission set out Mexico's efforts to resolve the underlying dispute in great detail and in a carefully documented fashion. Mexico does not have to rehearse them here.

4.396 When it was finally cornered on its steadfast refusal to subject itself to the NAFTA dispute settlement mechanism, the United States weakly claimed that the NAFTA parties are presently "engaged in the third stage" of the dispute settlement process, namely, the panellist selection stage.[121] This is simply not true. After having forbidden its NAFTA Secretariat Section to appoint panellists, the United States took no further action. Yet now the United States cannot bring itself to admit that it has obstructed a dispute settlement mechanism in precisely the manner for which it has criticized so many other States.

4.397 Mexico has been placed in an extraordinarily difficult situation by the United States manipulation of the dispute settlement mechanisms of the NAFTA and WTO. But the Panel must recognize that Mexico submitted to its jurisdiction, and has presented its legal arguments in good faith. Further, Mexico has been scrupulous in presenting the underlying facts to the Panel. The United States has not disputed those underlying facts, and has not submitted any evidence to refute Mexico's evidence.

4.398 So Mexico is greatly troubled when during the first substantive meeting and in its second written submission the United States makes statements such as "The United States is currently engaged in the third stage" of the NAFTA dispute settlement procedure. The uncontradicted evidence is that it has been almost five years since Mexico requested the formation of an arbitral panel under NAFTA Chapter Twenty and that the United States refused to cooperate in naming arbitrators. The United States even gave instructions to its NAFTA Secretariat Section to abstain from appointing them. For the United States now to argue that the dispute settlement proceeding is still ongoing, and that it has complied with its NAFTA dispute settlement obligations, is not only false but demeaning to the integrity of this arbitration proceeding.

4.399 The Panel should reject the United States' attempt to argue that it is, in good faith, actually trying to allow the NAFTA panel to discharge its duty. The Panel should also reject the United States' arguments that its own conduct is irrelevant to asserting its legal rights in this forum. It should reject its request to ignore the circumstances of the wider dispute arising under the NAFTA and its own actions in this regard. It should also reject the suggestion that there is no link between sugar and HFCS and that the measure at issue did not have the purpose of securing United States' compliance with the NAFTA. Lastly, the United States' hope that this Panel will dignify and indeed reward its intransigence and obstructive conduct in the context of international cooperation should be rejected.

4.400 Mexico agrees that this Panel has no jurisdiction to decide whether the United States has failed to comply with its market access commitments or indeed whether Mexico's rebalancing measures are justified under the NAFTA. Mexico has not asked this Panel to decide the NAFTA dispute. The point is simple: it is one thing to say that a WTO panel cannot decide a dispute under a treaty different from the "covered agreements" and is quite another thing to say that a WTO panel cannot consider the facts of a dispute arising under another treaty that has also given rise to the dispute before it. Mexico submits that the Panel can and must consider the totality of the facts relating to the measure that is the subject of this dispute. These facts explain the history of the dispute between the two parties, Mexico's good faith efforts to resolve it, and the failure of those efforts owing to the United States' acts and omissions. The United States has not and cannot take issue with the facts as a whole. The Panel to take these facts into consideration for a variety of reasons:

– to explain the intent of the measures;

[121] United States second written submission, para. 66.

– to explain the serious prejudice that Mexico is suffering as a result of United States forum shopping while continuing to obstruct the resolution of Mexico's grievance in the NAFTA forum;

– to explain that Mexico has a bona fide position that the measures can be justified under the NAFTA and that the entire dispute could be resolved there;

– to support Mexico's position that the measures can be justified under GATT 1994 Article XX(d); and

– because all the facts should be taken into consideration by the Panel when it formulates recommendations for the resolution of this portion of the dispute.

4.401 As Mexico has stated, the United States' conduct is highly relevant to the Panel's consideration of whether, through the measures at issue, Mexico is justifiably seeking to secure the United States' compliance with the NAFTA. In evaluating that issue, the Panel can consider the rules of customary international law and general principles of law even if they are not expressly set out in the WTO "covered agreements".

4.402 Pursuant to Article 31(3) of the Vienna Convention on the Law of Treaties, in interpreting the WTO "covered agreements" (including the GATT 1994), this Panel must take into account "any relevant rules of international law applicable in the relations between the parties". Clearly, the NAFTA sets out such rules for the relations between Mexico and the United States which are relevant to the present dispute. Consequently, the Panel is entitled to take notice of evidence supporting Mexico's arguments.

4.403 For the reasons set out above, Mexico requests the Panel to make the following determinations of fact – which it will address further below – whatever its resolution on the merits of this dispute may be:

– Mexico and the United States negotiated the sweeteners bilateral preferential trade regime which includes HFCS and sugar, products that compete in certain market segments;

– a legitimate broader dispute exists between Mexico and the United States regarding access of Mexican sugar to the United States market;

– Mexico has exhausted all efforts to resolve that dispute through diplomatic channels, bilateral consultations and negotiations, and through NAFTA's Chapter Twenty dispute settlement mechanism;

– notwithstanding the fact that Mexico requested the establishment of a NAFTA arbitral panel in 2000, to date the United States has not appointed panellists and has thus frustrated Mexico's attempt to resolve its grievances under the NAFTA;

– the tax measure at issue is a response to the United States' refusal to submit to NAFTA dispute settlement, one which seeks to induce the United States to do so as well as to rebalance Mexico's market which has been affected by the sugar production surplus resulting in part from United States HFCS imports and HFCS production from corn imported from the United States; and

– the United States has stated that under international law it can validly adopt counter-measures when another State refuses to submit to dispute settlement mechanisms.

4.404 Lastly, in considering the applicability of the provisions of the GATT 1994 in this dispute pursuant to Article 11 of the DSU, Mexico urges the Panel to bear in mind the following general principle of international law enunciated by the Permanent Court of International Justice:

> "[O]ne party cannot avail himself of the fact that the other has not fulfilled some obligation, or has not had recourse to some means of redress, if the former party has, by some illegal act, prevented the latter from fulfilling the obligation in question, or from having recourse to the tribunal which would have been open to him."[122]

4.405 The United States has violated its commitment to submit to NAFTA dispute settlement and thereby prevented Mexico from having its sugar market access rights clarified. It has then criticized Mexico for unilaterally determining that the United States has violated the NAFTA without having first obtained a panel report in its favour.

4.406 The United States has also attempted to draw a line between this slice of the dispute and the larger NAFTA dispute. It says that whatever has occurred under the NAFTA is entirely separate from the matter before this Panel. It suggests that consequently this Panel has no right even to take those facts into consideration here. The United States' position is plainly wrong.

4.407 Mexico would ask the Panel to refer to the opening paragraph of NAFTA Article 2005 which permits a complainant to settle "disputes regarding any matter arising under both this Agreement", i.e., NAFTA, "and the *General Agreement on Tariffs and Trade* … in either forum". Thus, the text of the NAFTA makes it clear that disputes like this one arise under both agreements, not one or the other. The dispute is not separable from the NAFTA. Nor is it one which arises exclusively under the WTO.

4.408 Mexico has already pointed out that the only WTO provision at issue in this case, Article III of the GATT 1994, is expressly incorporated into the NAFTA by Article 301. In that sense, Mexico is thus speaking of precisely the same obligation incorporated in two agreements, the GATT 1994 and a free trade agreement signed pursuant to Article XXIV thereof.

4.409 Mexico recognizes that this Panel cannot resolve the NAFTA dispute, but insists that the Panel can take notice of it. Ignoring these facts would reward the United States for persistently obstructing the operation of the NAFTA dispute settlement mechanism by frustrating the attempt to resolve a legitimate dispute which it acknowledges to exist between the parties, by forum shopping, and it will not contribute to achieving the main objective of the DSU's dispute settlement mechanism – that of finding a positive solution to the dispute – but rather will preserve the inequity of the United States conduct and the obvious prejudice suffered by Mexico.

3. The Panel has greater flexibility to formulate recommendations than the United States admits

4.410 In its second written submission, Mexico pointed out that under the DSU the Panel has greater flexibility to formulate recommendations than the United States is prepared to recognize. The United States simply asks the Panel to ignore its own actions, to find that there was a breach of the GATT, and to recommend that Mexico bring the measure into compliance with the GATT 1994.

4.411 The United States devotes much time and attention to Article 11 of the DSU and the Panel's terms of reference, but does not address what the GATT 1994 – the applicable covered agreement –

[122] *Chorzów Factory (Merits) Case*, PCIJ. Ser. A, No. 17, p. 29. (Emphasis added).

actually requires a panel to do. As Mexico noted, Articles XXII and XXIII of the GATT 1947 do not support the conclusion asserted by the United States.

4.412 Article XXII did not require a panel to make a ruling of breach as claimed by the United States; rather, it mandated the Contracting Parties "to consult with any contracting party *or parties* in respect of any matter for which it has not been possible to find a satisfactory solution through consultation under paragraph 1". (Emphasis added).

4.413 Similarly, Article XXIII:2 provided for the referral of a matter (including an alleged failure of a Contracting Party to carry out its obligations under the GATT or a Contracting Party's application of a measure which conflicts with the provisions of the GATT) to the CONTRACTING PARTIES. Upon such referral, the CONTRACTING PARTIES:[123]

> "[S]hall promptly investigate any matter so referred to them and shall make appropriate recommendations to the contracting parties which they consider to be concerned, or give a ruling on the matter, as appropriate." (emphasis added)

4.414 The GATT's drafters thus contemplated *either* the making of "appropriate recommendations to the contracting parties … concerned" *or* a "ruling on the matter", again, "as appropriate". Thus: (i) one remedy available to the CONTRACTING PARTIES was recommendatory; and (ii) the other, the possibility of a ruling, was itself made conditional upon its appropriateness.

4.415 Three points warrant noting: First, Articles XXII and XXIII conferred discretion upon the CONTRACTING PARTIES (and panels acting at their behest). Second, neither Article sets limits on the CONTRACTING PARTIES (or a panel's) power to shape its recommendations or make a "ruling in the matter" in response to the facts peculiar to a particular case. To the contrary, they (or a panel) are to determine what is appropriate in the circumstances. Third, these remedies were available to the CONTRACTING PARTIES in situations where breach of the GATT was alleged.

4.416 The flexibility that the GATT's drafters established is preserved in the DSU: "In the absence of a mutually agreed solution, the first objective of the dispute settlement mechanism is *usually* to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements" (Emphasis added.) The inclusion of the qualifying word "usually" was intentional. The DSU's drafters could have used the mandatory "*shall be* to secure the withdrawal …" or have amended GATT Articles XXII and XXIII when the GATT 1947 became the GATT 1994, but chose not to.

4.417 In short, it is not correct to maintain that the only "rulings" provided for in the GATT are findings of breach followed by a recommendation to withdraw the measures at issue. It is open to panels to make other findings in order to secure a positive solution to a dispute.

4.418 This is confirmed by the terms of reference that established this Panel:

> "To examine, in the light of the relevant provisions of the covered agreements cited by the United States in document WT/DS308/4, the matter referred to the DSB by the United States in that document, and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements." (emphasis added)

[123] As practice evolved, this function was exercised by panels established by the CONTRACTING PARTIES.

4.419 Article 11 of the DSU contemplates possibilities that the United States has chosen to ignore. Thus, it would be within the Panel's discretion, based on an objective assessment of the matter, to recommend what steps the parties should take to "secure a positive solution to [the] dispute". Since the United States claims that it shares Mexico's disappointment at the parties' inability to resolve the larger dispute, it should welcome the recommendation that Mexico is requesting from the Panel.

4. The two Article III obligations at issue

4.420 Mexico wishes to comment briefly on the United States argument that the same measures may breach both Article III:2 and Article III:4 of the GATT 1994.[124] As a matter of WTO law, Mexico doubts that this is possible. Indeed, the excerpt of the Appellate Body Report in *EC – Asbestos* quoted by the United States does not support the proposition that there is an overlap in the scope of coverage of these two distinct paragraphs of Article III. On the contrary, it suggests that fiscal regulation is covered by a specific provision, namely, Article III:2, while non-fiscal regulation is covered by another provision, namely Article III:4. To be sure, in the paragraph quoted by the United States, the Appellate Body was not even discussing the question of whether the same measure could be examined under both Article III:2 and Article III:4. It was examining a totally different legal issue, that is, the meaning of the term "like" in both provisions.

4.421 In its responses to the questions of the Panel, Mexico also noted that WTO jurisprudence actually suggests that measures taking the form of "internal taxes or other charges" should be examined under Article III:2.[125] The Panel should note that the brief comment on this legal point does not qualify Mexico's intention as regards addressing the United States' arguments under Article III of the GATT 1994, but is made simply because, like all other WTO Members, Mexico has a systemic interest in the correct interpretation of that provision.

5. Mexico's defence under Article XX(d) of the GATT 1994

4.422 As previously explained, irrespective of whether the measures at issue are inconsistent with Article III of the GATT 1994, Mexico believes that they are justified under Article XX(d). The allegations made by the United States against Mexico's defence warrant a response.

4.423 At paragraph 39 of the United States' second written submission, it is contended that "Mexico must establish and prove that it has met each of the elements required for invocation of an Article XX(d) defence". Mexico acknowledges that as the party who has invoked an affirmative defence, it has the initial burden of proof on this issue. However, the United States is mischaracterizing the applicable rules on the allocation of the burden of proof by suggesting that the burden of proving that its measures are saved by Article XX(d) rests solely on Mexico's shoulders.

4.424 Simply put, pursuant to the well-known rules governing the allocation of the burden of proof, the onus is on Mexico to raise a presumption that what it claims is true. In other words, Mexico's burden is to make out a prima facie case that its measures are justified under Article XX(d) of the GATT 1994. Once it has done so, the burden then shifts to the United States to rebut that prima facie case.

4.425 Mexico has put forward sufficient evidence and legal arguments to establish a prima facie case that its measures are justified under Article XX(d), and maintains that the United States has failed to rebut its arguments and evidence.

---

[124] United States second written submission, para. 12.
[125] Mexico's responses to Panel questions, p. 8.

4.426 The United States' primary argument is that Mexico attempts to construct a new Article XX exception by claiming that the NAFTA constitutes "laws or regulations" within the meaning of paragraph (d) of that provision, and that such an exception would "fundamentally undermine the dispute settlement system established in the WTO Agreement".[126] This doomsday scenario does not withstand scrutiny.

4.427 It is wrong to say that Mexico's interpretation would offer WTO Members *carte blanche* to breach from their WTO obligations whenever a Member claims that obligations owed to it under any international agreement have not been fulfilled. This is not Mexico's position nor is it in accordance with the facts of this case.

4.428 Mexico does not contend that the mere claim of a WTO Member that another Member has breached an international treaty is enough to justify the adoption of measures that could be inconsistent with WTO provisions. The Panel should be aware that there is a legitimate dispute between the parties, as recognized by the United States, regarding its NAFTA market access commitments and that Mexico considers that the United States has breached those NAFTA market access obligations. Nevertheless, the measure adopted by the Mexican Congress is not simply a response to this claim raised by Mexico.

4.429 Nor does Mexico request that this Panel issue a finding that the United States has breached its NAFTA market access commitments in order to conclude that the measure is justified under GATT 1994 Article XX(d).

4.430 The United States trivializes Mexico's position.

4.431 There should be no doubt for this Panel that the United States has impeded Mexico's access to the NAFTA dispute settlement mechanism and, therefore, that it has made it impossible for Mexico to obtain a resolution of its grievance with regard to the market access conditions under that Treaty. There should be no doubt that Mexico has also exhausted diplomatic channels, bilateral negotiations, and international cooperation without success. Nor should this Panel have any doubt as to the prejudice that the Mexican industry has suffered.

4.432 The measure adopted by the Mexican Congress occurred only after all other efforts had failed. It is not about a mere claim that the United States has breached its market access obligations. Mexico has plainly demonstrated that the United States has prevented it from gaining access to the dispute settlement mechanism. This is not a mere allegation and, naturally, it is not a question that can be resolved by a NAFTA arbitral panel. This is a question of fact that this Panel can clearly decide based on the evidence filed in this proceeding.

4.433 Mexico's position is that, in such circumstances, the tax measure at issue is justified under Article XX(d) of GATT 1994.

4.434 The United States' argument further trivializes the application of Article XX(d), because such application is subject to a number of requirements. In the first place, as in all matters affecting the WTO, a Member's invocation of an exception is subject to the dispute settlement mechanism. Second, contrary to the United States' assertion, Article XX(d), by its own terms, is restricted to measures necessary to secure compliance with those laws or regulations which are not inconsistent with the provisions of the GATT 1994.

4.435 The mere confirmation that the terms "laws and regulations" in Article XX(d) include international law would not mean that all measures related to the enforcement of international law

[126] United States second written submission, para. 37.

would *ipso facto* be justified under that provision. Demonstrating that the measures for which the exception is claimed are related to "laws and regulations" which are not inconsistent with the GATT is only the first element that needs to be established.

4.436 In addition, as the Appellate Body clarified in *Korea – Various Measures on Beef*, (1) the measures must be designed to "secure compliance" with such "laws or regulations"; (2) they must be "necessary" to secure such compliance; and (3) they must also comply with the requirements of the chapeau to Article XX. In short, for an Article XX(d) defence to be successful, it does not suffice to allege that the measures at issue are related to the enforcement of "laws or regulations". Article XX is structured and has always been interpreted so as to avoid any abuse by WTO Members.

4.437 Were any other WTO Member to seek to justify a measure related to the enforcement of an international treaty under Article XX, it would be subject to the same strict process of justification and review.

4.438 Moreover, Mexico is not arguing that Article XX(d) would be available to justify measures aimed at securing Members' compliance with obligations owed under the WTO Agreement. Nor does Mexico's reading of Article XX(d) mean that unilateral action to counter a breach of the provisions of the WTO Agreement would be authorized.[127] This is yet another example of a non-existent systemic concern that the United States incorrectly believes would arise should Mexico's interpretation be upheld by this Panel. Mexico recognizes that Article 23 of the DSU prevents a WTO Member from seeking redress of a violation of WTO obligations other than by having recourse to the rules and procedures of the DSU. But Article 23 of the DSU says nothing about measures aimed at securing compliance with other international agreements that are not inconsistent with the GATT. At most, Article 23 can only exclude measures aimed at securing compliance with obligations under the WTO Agreement from the scope of measures potentially authorized by Article XX(d) of the GATT 1994.

4.439 For these reasons, Mexico's interpretation could not render Article 23 meaningless. Mexico's measures are not about securing United States compliance with the WTO "covered agreements", but with <u>other</u> international agreements which are not inconsistent with the GATT 1994, in this case an agreement authorized by Article XXIV. Mexico maintains that Article XX(d) of the GATT and Article 23 of the DSU can still be read harmoniously and there is no conflict between those two provisions. A WTO Member may very well implement measures to secure compliance with obligations under an international agreement without breaching its obligations under Article 23 of the DSU.

4.440 The United States also argues that reading "laws and regulations" to include international treaties would render Article XX(h) of the GATT 1994 redundant.[128] Again, this is incorrect.

4.441 Article XX(h) provides a specific exception for measures "undertaken in pursuance of any intergovernmental commodity agreement". In order to invoke Article XX(h), a WTO Member does not have to establish that the agreement in question is not inconsistent with the provisions of the GATT 1994, nor does it have to demonstrate that the measure is "necessary". It has only to show that a measure was "undertaken in pursuance" of obligations under an intergovernmental commodity agreement. Article XX(h) sets out a distinct right, applicable to a special subset of "laws or regulations" or international agreements: the "intergovernmental commodity agreement[s]". Arguably, it is easier to justify a measure under Article XX(h), but the wording of that provision does not imply that "intergovernmental commodity agreement[s]" or obligations under other international agreements cannot also be "laws or regulations" within the meaning of Article XX(d).

[127] United States second written submission, para. 47.
[128] *Id.*, para. 44.

4.442 Turning to the United States argument that the terms "laws and regulations" exclude international treaties, Mexico reiterates that nothing in the text, the context, or the object and purpose of Article XX(d) compels the restrictive interpretation that the United States urges. For the reasons set out at paragraphs 70 to 73 of Mexico's second written submission, the terms "laws and regulations" do not exclude them.

4.443 Mexico also notes that the United States keeps reading the word "domestic" into the text of Article XX(d). As Mexico noted before, when the GATT drafters wanted to limit the application of GATT provisions to domestic measures, they did so in an explicit manner. The applicable principles of treaty interpretation "neither require nor condone the imputation into a treaty of words that are not there … "[129]

4.444 The United States also refers to Article XVI:4 of the Marrakesh Agreement Establishing the WTO to support its view that the phrase "laws and regulations" means "domestic laws and regulations". However, a careful review of this provision actually supports Mexico's interpretation that the scope of Article XX(d) is not limited to a Member's domestic laws. In fact, Article XVI:4 of the WTO Agreement reads: "[e]ach Member shall ensure the conformity of its laws, regulations and administrative procedures with its obligations … ". In comparison, Article XX(d) does not read "measures … necessary to secure compliance with its laws and regulations which are not incompatible with the provision of this Agreement". Again, Mexico notes that when the GATT or WTO drafters wanted to limit the scope of certain provisions, they expressly did so.

4.445 Mexico would like to briefly address the United States' arguments that Mexico's measures are not "necessary" within the meaning of Article XX(d) of the GATT 1994. The United States' second written submission repeats the bald assertion that "Mexico had any number of alternative measures reasonably available to it… to assist its domestic cane sugar industry and/or resolve its disagreement with the United States over the exact terms of the NAFTA".[130] Mexico insists that there should be no doubt for this Panel that Mexico exhausted all measures reasonably available to it, including:

- Diplomatic and international cooperation efforts, including bilateral consultations and negotiations;

- resorting to the NAFTA's dispute settlement mechanism and exhausting all efforts to establish an arbitral panel, but the United States not only refused to appoint panellists, but when Mexico requested the United States NAFTA Secretariat to do so, ordered it to abstain from appointing them;

- sponsoring negotiations between industries of both countries;

- providing relief, at considerable public expense, to its sugar industry which faced a severe financial crisis.

4.446 In summary, Mexico at all times has sought to resolve the dispute in good faith. Of course, the United States is unable to identify a single alternative measure which would have been reasonably available to Mexico to achieve its legitimate objectives.

4.447 It was only when all of these attempts had failed that Mexico took the measures now complained of. This Panel should reject the United States argument without hesitation.

[129] Report of the Appellate Body on *India – Patents*, para. 46.
[130] United States second written submission, para. 65.

4.448 Mexico would remind the Panel that virtually all the facts submitted by Mexico have been corroborated by contemporaneous reports of the United States Department of Agriculture. Mexico did not submit self-serving evidence. Our first written submission cited those USDA reports.

6. Conclusions

4.449 For the reasons set out in Mexico's prior submissions and elaborated upon in this opening statement, Mexico requests that the Panel find that Mexico's measures are justified under Article XX(d) of the GATT 1994. Accordingly, the United States' complaint must be rejected in its entirety.

L. CLOSING STATEMENT OF MEXICO AT THE SECOND MEETING OF THE PANEL

1. Response to the United States' oral arguments

(a) Paragraphs 6 and 7[131]

4.450 At paragraph 6 of its opening oral statement, the United States stated that "acceptance of Mexico's interpretation of 'laws or regulations' to include obligations owed to Mexico under the NAFTA would open the door for any Member to claim that a breach of the WTO Agreement, or some other treaty, by another Member meant that the Member was to be free to breach any of its WTO obligations". At paragraph 7, it further states that in such a case "WTO dispute settlement would become a forum of general dispute resolution for all international agreements, and all such agreements would be in effect incorporated into, and enforced by, the WTO Agreement by virtue of Article XX(d)". Mexico addressed those issues in the opening session in detail, at paragraphs 59 to 72 of its oral statement,[132] but would like to add that this is an incorrect but highly – albeit unintentionally – revealing statement in that it assumes that all WTO Members that are parties to other international treaties will ordinarily refuse to submit to dispute settlement under those treaties, just as the United States has done in this case.

4.451 In its opening statement, Mexico pointed out clearly that a Member must do more than merely claim that a treaty has been breached in order to satisfy the necessity test; in addition, it must comply with all the requirements established under Article XX(d), and its action is further subject to review by means of the DSU. If a State sought to secure another Member's compliance with another treaty through Article XX(d) without first invoking that treaty's dispute settlement mechanism, the obvious answer of a WTO Panel would be that Article XX(d) cannot be used as a means of forum shopping. The Member in question would have to use the proper forum, that is, the one established by the other treaty.

4.452 Moreover, the Panel should note the theoretical dimension of the United States' argument. Frankly, the situation it poses is purely hypothetical. It would arise only if WTO Members were sued pursuant to other international treaties owing to presumed breaches under such treaties, and refused to submit to dispute settlement mechanisms under such treaties. The first question that arises is: why would WTO Members invoke a GATT 1994 exception when the treaties with which they seek to secure compliance have mechanisms to resolve disputes arising thereunder? If both States submit to the stipulated mechanism to settle their dispute, that will be the end of the matter.

4.453 There should not be any doubt: Mexico does not consider that the US attitude with regard to this case is the regular conduct of the community of States. Mexico does not suppose that States ordinarily commit acts giving rise to international complaints by other States and then refuse to

[131] See paras. 4.347 and 4.348 of this report, above.
[132] See paras. 4.426 to 4.439 of this report, above.

submit such acts to review under established dispute settlement mechanisms. International practice shows that States regularly comply with agreements to submit to dispute settlement procedures. Mexico's participation in this and other proceedings corroborates this fact. In its first written submission, Mexico showed how on the three other occasions where a NAFTA panel was requested, the respondent agreed to appoint panellists. The United States was the respondent party in two of the three cases and its measures were challenged successfully.

4.454 Mexico has made it clear that this case presents extraordinary circumstances in which a dispute exists regarding compliance by a State – the United States – with its international obligations, and that State has refused to submit to a dispute settlement mechanism expressly established by exploiting a deficiency in the procedure for the appointment of panellists.

4.455 Mexico maintains that in these extraordinary circumstances, the GATT 1994 allows the affected State to adopt measures to secure the obstructionist State's compliance, and to protect its legitimate interests by rebalancing the situation and re-establishing the *status quo ante*. The only reason why Mexico has invoked Article XX(d) in this case is that it cannot have access to the NAFTA dispute settlement mechanism, which has been blocked by the United States.

(b) Paragraph 11[133]

4.456 In paragraph 11 of its opening statement, the United States claimed that "international trade agreements, such as the NAFTA and the WTO Agreement, are not laws and are not enforceable in US courts". This is a mischaracterization of US law and of the NAFTA itself.

4.457 The starting point is the US Constitution. Article VI, Clause 2 states that international treaties, as well as the Constitution itself and the laws of the United States, "shall be the Supreme Law of the Land". With regard to treaties subscribed by the US that are international trade agreements, such as the WTO and NAFTA, for purposes of its domestic law the United States has chosen to ratify those agreements as if they were domestic legislation, and the US Congress has provided that in such circumstances those agreements are not self-executing at the domestic level.

4.458 Nevertheless, the simple reason why the NAFTA is not a law which is enforceable by private parties in the US courts is that the NAFTA Parties expressly agreed in Article 2021 that they would not provide for a right of action under their domestic law to secure another Party's compliance with its NAFTA obligations. In the NAFTA the Parties expressly agreed not to provide for a domestic cause of action that would allow private parties to sue in the domestic courts of a Party in order to secure another NAFTA Party's compliance with its NAFTA obligations. In other words, it would have been unnecessary to prohibit such a domestic cause of action if the NAFTA could never have the effect of a law in the internal legal order of the United States. In its second written submission, Mexico quotes NAFTA Article 2012 at footnote 59 and notes the implementing action taken by Canada and the United States. In the absence of such a NAFTA provision, any NAFTA Party could have made NAFTA enforceable by private right of action before its domestic courts.

4.459 However, barring a private cause of action in the courts of each NAFTA Party does not mean that NAFTA has no domestic legal effect in each Party.

4.460 Interestingly, Section 102(c) of the NAFTA Implementation Act states that "No person *other than the United States* … *shall have any cause of action or defence under …[the NAFTA] or by virtue of Congressional approval thereof…*". Thus, US law expressly provides that international trade agreements are directly enforceable in judicial actions brought by the federal government. For the WTO, this is implemented in 19 USC 3512(b)(2)(A), which provides:

[133] See para. 4.352 of this report, above.

> "*No State law, or the application of such a State law, may be declared invalid as to any person or circumstance on the ground that the provision or application is inconsistent with any of the Uruguay Round Agreements, except in an action brought by the United States for the purpose of declaring such law or application invalid*."

4.461 Further, the United States actually retained a type of domestic right of petition in Section 301 of its Trade Act of 1974, which permits private parties to petition the United States Trade Representative to secure compliance with the NAFTA by another NAFTA Party. Clearly, international treaties, including trade agreements, are treated as "laws" in the United States.

4.462 The recent court decision in the *Corus Staal* case, cited by the United States in its opening statement does not support its proposition that trade agreements are not laws. Rather, that decision found that a private party could not rely on the WTO Anti-Dumping Agreement or WTO panel decisions as a basis for overturning the US Commerce Department's interpretation of US anti-dumping law. That is a much narrower point.

4.463 Accordingly, the position of the United States that there is an absolute separation between laws and regulations, as internal obligations, and international treaties, as international obligations, and that in no circumstances can international agreements be law, is incorrect. It is clear that the three NAFTA Parties, like many other countries, consider international treaties to be laws. This contradicts the United States position on the ordinary meaning of the terms "laws and regulations".

4.464 The Panel should appreciate as well that, as Mexico pointed out, when the drafters wished to limit the meaning of the terms, they did do expressly. As the United States pointed out in its opening statement, when they wished to refer to international law as excluding domestic law, they did so clearly through the use of the term "international law". Equally, when they wanted to refer to the domestic law as excluding international law they used formulas such as "laws and regulations of a Member", "its laws and regulations", "the laws and internal regulations", etc. Article XX(d) is not the only case in the WTO Agreements in which the formula "laws and regulations" is used without qualification and, accordingly, it cannot be presumed that it excludes international treaties.

(c) Paragraphs 16 and 17[134]

4.465 At paragraphs 16 and 17 of its opening statement, the US alleges that Mexico has not made it clear why it believes that its measures are necessary to secure compliance with NAFTA. Mexico thinks that it has made this point perfectly clear, but for the assistance of the United States, it will set out its reasoning in summary form as follows:

- The NAFTA contains agreements on the bilateral sweeteners trade, pursuant to which Mexico would export sugar to the US and the US would export HFCS to Mexico.
- Mexico believed that the US breached its obligations with regard to the Mexican sweeteners trade, and had recourse to the dispute settlement mechanism.
- The US was fully aware of Mexico's grievance. The USDA reported on the hardship caused in Mexico by the breakdown of the bilateral sweeteners trade agreement.
- Although the first two stages – bilateral consultations and consultations through the Free Trade Commission – took place, the US impeded the establishment of an arbitral panel.

[134] See paras. 4.357 and 4.358 of this report, above.

– Meanwhile, United States HFCS and HFCS locally produced from US corn continued to gain access to the Mexican market, almost entirely displacing Mexican sugar in the soft drinks segment.

– As the US refused to settle the dispute through the mechanism established under NAFTA's Chapter Twenty, after attempts to resolve it through this and other means had failed, the Mexican Congress adopted a tax in order to rebalance its market and re-establish the *status quo ante,* as a temporary measure until a solution is reached.

– In these circumstances, Mexico believes that its measures fall within the scope of Article XX(d).

– The Mexican Congress measure is a response to the concern to rebalance the Mexican market affected by the HFCS imports and its local production, until Mexican sugar is granted the agreed access under the NAFTA or a solution is reached to the dispute in another form. The affected commodity was HFCS, the directly related commodity. The measure is intended to secure US compliance with its NAFTA commitments. It provides a strong incentive for the US to cooperate in the dispute settlement procedure or otherwise reach a mutually satisfactory solution.

(d) Paragraph 17[135]

4.466 In paragraph 17 of its opening statement, the US points out that Mexico contends that "by hurting US exports of HFCS through its discriminatory tax, Mexico will 'induce' sweetener producers to come to the 'negotiating table'". This is not what Mexico submitted. Mexico's rebuttal argument is clearly expressed at paragraphs 82 and 83 of its second written submission. The concrete point is that, even though the measures adopted by Mexico have not yet resolved the dispute, they have had an effect aimed at resolution, even if this has been a minor one. As an example, Mexico referred to a news report that quotes the President of the National Chamber of the Sugar and Alcohol Industries, who points out that the tax motivated the US producers to sit down again at the negotiating table, whereas previously they had not had any communication with the Mexican industry. Admittedly, having the United States comply with its international obligations is not the same as having the producers of both countries establish contact; however, the fact that the US maintains a position of complete intransigence does not make the measure any less necessary. Mexico would regret it if the US chose to maintain that position of absolute intransigence, as seems to have been suggested.

(e) Paragraph 18[136]

4.467 In paragraph 18 of its opening statement, the United States offers a new argument. It suggests that the anti-dumping measures adopted by Mexico with respect to HFCS imports altered the balance of rights and obligations under the NAFTA. This is incorrect. Mexico conducted an anti-dumping investigation pursuant to the request of the domestic industry. It concluded that dumping was occurring and that there was injury to the domestic industry, and it imposed anti-dumping measures. The measures were challenged through the WTO dispute settlement procedures and NAFTA's Chapter Nineteen. Mexico submitted to both proceedings. When the panellists concluded that Mexico had not satisfied the requirements needed to impose the measures, Mexico revoked the corresponding administrative resolution, cancelled the bond posted, and the anti-dumping duties were refunded. Mexico did not alter the balance of rights and obligations of the NAFTA. It considered that it had a right and it exercised it. After it was challenged successfully, Mexico revoked the measures and cancelled their effects. Moreover, the Mexican measures did not inhibit HFCS imports.

[135] See para. 4.358 of this report, above.
[136] See para. 4.359 of this report, above.

It must not be forgotten that during that period approximately 3 million tons of HFCS entered the Mexican market.

(f) Paragraph 20[137]

4.468 The argument that the United States attributes to Mexico at paragraph 20 of its opening statement is also incorrect. In its second written submission, as well as in its opening statement, Mexico alluded to the general law principle stated by the Permanent Court of International Justice in the *Chorzów Factory* case pursuant to which a party cannot argue in its favour that another party has not complied with an obligation or that it has not had recourse to some means of redress when, by way of an illegal act, that party has prevented the other party from complying with its obligation or from having recourse to a tribunal that would have been otherwise available. Mexico has also alluded to other rules of international law. It considers that WTO panels and the Appellate Body can consider and apply them. Mexico refers the Panel to paragraphs 110 of Mexico's first written submission and 14 to 18 of its second written submission.

4.469 Mexico considers that the measures at issue in this dispute are justified pursuant to the principles and rules of international law, including the NAFTA and the rules of customary international law. Mexico submits that the Panel can consider such rules, but it has not requested the Panel to rule that, in the scope of the WTO, the measures are justified based on rules of international law. Mexico relies on its defence in the application of Article XX(d) of the GATT 1994.

(g) Paragraph 22[138]

4.470 At paragraph 22 of its opening statement, the United States refers to Articles 7 and 11 of the DSU and argues that WTO panels "are established to examine the relevant provisions of the covered agreements and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements". Mexico agrees with this general statement, but reminds the Panel that the United States has made erroneous submissions on crucial points regarding the meaning of these provisions.

(a) "Making the recommendations" or "giving the rulings" provided for "in those agreements", including the GATT 1994, does not mean that panel recommendations are limited to recommendations that WTO-inconsistent measures be brought into conformity with the covered agreements. Mexico discussed at length GATT Articles XXII and XXIII. The United States has ignored them despite the fact that the GATT is the specific covered agreement at issue. Those articles confer more flexibility on WTO Panels than the US concedes. See paragraphs 43 to 52 of Mexico's opening statement at this second meeting.

(b) GATT Articles XXII and XXIII have not been amended by the DSU.

(c) Pursuant to those GATT provisions, a WTO Panel has the flexibility to issue any rulings or recommendations that it deems appropriate in the circumstances of a dispute.

(d) While it is true that, when a panel concludes that the measures in dispute are inconsistent with the covered agreements, Article 19.1 of the DSU mandates it to recommend that the Member concerned bring the measure into conformity, Article 19.1 does not prevent a panel from issuing <u>other</u> rulings or recommendations

[137] See para. 4.361 of this report, above.
[138] See para. 4.363 of this report, above.

in accordance with GATT Articles XXII and XXIII. Contrary to the United States' argument at paragraph 26 of its opening statement, Article 19 of the DSU only clarifies that one recommendation is warranted when findings of inconsistency are issued. It does not rule out the possibility that other recommendations or rulings be issued based on GATT 1994 Articles XXII and XXIII.

(e) Thus, it is entirely within the Panel's discretion to recommend, in the extraordinary circumstances of this dispute, that the parties take steps to resolve the broader NAFTA dispute.

2. Conclusions

4.471 Throughout this proceeding, Mexico has urged the Panel to recognize the substantial prejudice resulting from the United States' refusal to cooperate in good faith in the international arena to resolve a legitimate dispute regarding the bilateral sweeteners trade, in addition to an abuse of the proceedings. The Panel is a jurisdictional body that operates under international law rules, and it should not condone the US conduct.

4.472 Mexico has meticulously documented the origins of the bilateral dispute, the efforts it has made to resolve it legally through all means, the United States' persistent refusal to submit to the NAFTA's dispute settlement mechanism, and the serious prejudice that resulted and still can result for Mexico.

4.473 There is not the least doubt that the United States has abused the proceedings, even this Panel's proceeding. It has refused to submit to the established mechanism to settle disputes, a mechanism that it negotiated and subscribed to in an international treaty, has engaged in forum shopping and has not only presented to the Panel an incomplete overview of the pertinent facts, but has also made false statements.

4.474 In deliberating on this case, consider the detailed account of the facts that Mexico has offered, including the repeated efforts to establish an arbitral panel under the NAFTA and to find a solution to the dispute, an account plainly established, in many instances in official documents drawn up by the United States itself.

- Contrast that with the case that the US brought before the Panel, in which it chose to omit all reference to the underlying broader dispute that in fact is the source of the dispute that the Panel now has before it.

- Contrast that also with the lukewarm response of the United States when confronted with the undisputed facts: on the one hand, seeking to ignore it, stating that it is completely irrelevant; but also suggesting erroneously, for example, that both countries are presently involved in the establishment of the arbitral panel requested by Mexico.

- Consider further the US response to a Panel question where, notwithstanding having admitted that no NAFTA panel has been established almost five years after Mexico requested it, the US complained that Mexico unilaterally made a determination that the US had breached its market access obligations, without having obtained a panel ruling.

- Consider the United States' evasive response to Mexico's question about its current views on the legitimacy of counter-measures when one State blocks another's access to a treaty's dispute settlement mechanism.

Mexico's respectful view is that this Panel deserved a sincere and complete response from the United States.

4.475 The US has provoked an unfair interaction between the NAFTA and the WTO Agreement, resulting from the automatic operation of the WTO's DSU and Chapter Eleven of the NAFTA, and the corresponding lack of automaticity in the operation of NAFTA's Chapter Twenty, due to the US refusal to appoint panellists in a proceeding that presently requires the good faith and cooperation of both disputing Parties. On the one hand, Mexico has given its consent *ex ante* to submit to WTO dispute settlement proceedings and to NAFTA's Chapter Eleven. The United States, however, has exploited the fault in the panellist appointment process under NAFTA's Chapter Twenty and has for many years been able to avoid submitting to the dispute settlement system.

4.476 There is more than a little irony in this case:

– Mexico's grievance long pre-dates this US grievance before the Panel. However, owing to US intransigence, in spite of Mexico's having satisfied all the requirements for panel appointment in Chapter Twenty, no panel was established and all other efforts to resolve the crisis failed. Mexico took action to protect its own legitimate interests and to rebalance its market, as well as to seek to secure US compliance with its international obligations. The US insists that that it is not in breach of its obligations but it refuses to allow an independent panel to examine that claim.

– Mexico emphasizes that it would never have imposed the measures in the first place if it had not been for the US refusal to submit to dispute settlement. The Mexican measures were immediately submitted to this Panel following the US claim, in accordance with the DSU, and now Mexico faces three separate NAFTA Chapter Eleven claims in addition to the one that it has already successfully defended (the *GAMI Investments* case) which arose out of the September 2001 expropriation of 29 failing mills, mills that were failing because of the sugar surplus crisis.

– However, the United States, whose refusal led to the measures now complained of in both forums, has successfully managed to avoid any legal scrutiny of its conduct.

4.477 Mexico urges the Panel to reflect deeply on the inequity of this situation. It is fundamentally unfair to reward the obstructing respondent, who now comes here asking the Panel to consider only a small part of the dispute between the parties. With all due respect, it would bring international dispute settlement mechanisms into disrepute to reward a State that has avoided international cooperation.

4.478 The equities are in Mexico's favour and the prejudice that Mexico is suffering cannot be understated:

– Treating the dispute as purely a WTO dispute would reward the United States for engaging in forum shopping while it simultaneously continues to block Mexico's good faith attempts to resolve its longstanding grievance. This would be to perpetuate an injustice that has persisted for more than six years and is prejudicial in and of itself.

– The prejudice is compounded:

On the one hand, there is the economic prejudice to the Mexican sugar industry and the sugar producers segment, whose characteristics and economic, political and social sensitivities already explained. The Panel should not forget that, as pointed out at paragraph 77 of our first written submission, it is in the interests of the United States

to prolong the NAFTA dispute. At the origin of the broader dispute that arises under the NAFTA there is a protectionist interest of the United States, an interest in isolating its sugar industry from competing with Mexican sugar that has motivated the trade restrictions on Mexican access to that market. The longer the economic disruption of the Mexican sugar sector lasts, the more its sugar production capacity weakens. If this capacity diminishes, there is a smaller likelihood of sugar surplus being generated that can be exported to the US market.

If this Panel were to make the findings requested by the United States, it is likely that they could directly contradict those that might be made by a NAFTA Panel presented with the same facts. Mexico has directed the Panel to examples of counter-measures taken in the NAFTA context as well as to other instances where the United States has reserved the right to take action of the type that Mexico took. This evidence is being put before the Panel, not because the Panel can pass on the legality of countermeasures under NAFTA, but to demonstrate that Mexico would have a perfectly legitimate defence against any US claim in this forum. Given the United States' conduct to date, the prospect of a NAFTA Panel being in a position to make such rulings appears remote. However, there is substantial evidence that a NAFTA Panel would find Mexico's measures to be justified under applicable rules of international law – if the United States agreed to submit to the jurisdiction of a panel competent to examine all the facts and legal matters – and this Panel should take note of that evidence.

There is, of course, the additional prejudice resulting from the inability to resolve a grievance with regard to the bilateral trade in sweeteners.

– Mexico faces a prejudice of being sued in different forums. There is a potential prejudice that could result from the NAFTA Chapter Eleven cases, in which substantive monetary damages are claimed, and a collateral effect of the United States' complaint is the possibility that this Panel could make certain findings on the facts that could be used in the NAFTA Chapter Eleven claims against Mexico. This Panel is being asked to determine legal issues in a narrow legal context (the GATT 1994) that may prejudge the resolution of the same or related issues under a broader set of legal rules (including the NAFTA rules). Yet this Panel cannot determine Mexico's right to take countermeasures under the NAFTA; only a body that has that jurisdiction can do so.

M. CLOSING STATEMENT OF THE UNITED STATES AT THE SECOND MEETING OF THE PANEL

4.479 The United States would like to emphasize what this dispute is about. This dispute is about Mexico's obligations under Article III of the GATT 1994 and the consistency of Mexico's tax measures with those obligations. Throughout these proceedings, and again in its opening statement, however, Mexico has done its utmost to avoid any discussion of this issue. Instead, Mexico has chosen to focus its response in these proceedings on an unprecedented reading of Article XX(d) and a recasting of this dispute as one about United States obligations under the NAFTA. As the United States has maintained throughout these proceedings, and continues to maintain, both Mexico's Article XX(d) defence and its efforts to recast this dispute as one under NAFTA are unsustainable. To avoid repetition on these points, the United States would like to refer the Panel to its prior submissions for the many reasons why Mexico's XX(d) defence must fail and why its discussions of NAFTA in these proceedings are simply not relevant to task before this Panel. Instead, the United States will use its closing statement to respond to some specific points raised in the various sections of Mexico's opening statement.

1. Introduction and the relevance and the status of the NAFTA dispute

4.480 Turning to the first two sections of Mexico's statement (its introduction and discussion of the relevance of the NAFTA dispute), Mexico makes three assertions there and one omission that merit some remarks.

4.481 First, Mexico continues to fault the United States in these proceedings for not discussing Mexico's grievances under the NAFTA. Yet, even Mexico admits that Mexico's grievances under the NAFTA are outside the Panel's terms of reference and, therefore, not issues which this Panel may issue findings on in this dispute. Accordingly, rather than engage on issues that are clearly outside this Panel's terms of reference, the United States has chosen to remain focused on the issues that actually are within the Panel's terms of reference – namely the consistency of Mexico's tax measures with Mexico's WTO obligations.

4.482 Second, Mexico asserts that the United States does not see any "link" between HFCS and cane sugar. This, of course, is not the United States view. The United States agrees with Mexico, for example, that HFCS and cane sugar are directly competitive and substitutable products. What the United States claims are not linked, however, are Mexico's obligations under the WTO Agreement and United States obligations under the NAFTA. That is, nothing in the WTO Agreement makes the obligations Mexico owes the United States under Article III of the GATT 1994 contingent on Mexico's view of whether the United States has complied with obligations under the NAFTA.

4.483 Third, Mexico asserts that Article 31(3) of the Vienna Convention requires panels to consider any relevant standards or norms applicable to the relations of the parties to a treaty. And, therefore, Mexico asserts that the Panel must consider the NAFTA in this dispute. Article 31(3) of the Vienna Convention, however, pertains to the interpretation of the terms of a treaty, and provides that "relevant rules of international law applicable in the relations between the parties" shall be taken into account along with the context of the treaty's terms. Mexico has not identified any terms of the WTO Agreement for which it might be using the NAFTA or "general principles of international law" as relevant context for interpretation of the meaning of the WTO Agreement's terms. Mexico reference to Article 31(3) does not change the fact that interpretation and application of the NAFTA are outside the Panel's terms of reference.

4.484 Fourth, as to Mexico's omission, Mexico fails to explain how the Panel could consider whether Mexico's tax measures are necessary to secure United States compliance with the NAFTA, if the Panel does not first examine what the terms of the NAFTA are and whether United States actions are consistent with those terms. Yet, these issues as to the interpretation and application of the NAFTA are the precise issues Mexico has already conceded are outside this Panel's terms of reference. Thus, the very determination that Mexico's Article XX(d) defence calls upon the Panel to make – namely, United States compliance with the NAFTA – is the very determination Mexico asserts is not within the Panel's authority to make.

4.485 Mexico's suggestion that the Panel might consider the "facts" of the NAFTA, and take as "background" that a dispute under the NAFTA prompted Mexico's tax measures and gave rise to the present WTO dispute, does not save its Article XX(d) defence. The fact that the NAFTA exists or that a dispute exists thereunder, does not answer the question of whether Mexico's tax measures constitute measures to secure compliance with alleged United States obligations to provide market access for Mexican sugar under the NAFTA (that is, assuming for the moment the NAFTA obligations fall within the scope of "laws or regulations"). With respect to supposed factual issues such as those in paragraph 36 of Mexico's opening statements, the United States would like to come back to those later in writing.

2. Recommendations

4.486 Turning to the next section of Mexico's statement as to the recommendations a WTO panel is permitted to make, Mexico contends that per Article XXIII of the GATT, the recommendations a WTO panel might make in a given dispute are more flexible than suggested by the United States. This is simply not true. DSU Article 19.1 definitively answers the question of what types of recommendations WTO panels are permitted to make – that is, if a panel finds a Member in breach of its WTO obligations, it "shall recommend that the Member concerned bring the measure into conformity" with the relevant covered agreement.

3. Article III

4.487 With respect to Mexico's points on Article III:2 and III:4, the United States has already addressed the issues Mexico raises in the United States second submission and responses to questions. The United States will not repeat those responses now, other than to make three brief points. One, as the United States has said before, a measure may constitute both a breach of Article III:2 and III:4. Two, Mexico has not rebutted the evidence and arguments presented by the United States that Mexico's tax measures constitute a form of dissimilar taxation within the meaning of Article III:2 or a law affecting the internal sale and use of imported products within the meaning of Article III:4. Three, it is Mexico that has chosen to alter the conditions of competition by applying tax measures that discriminate against soft drinks and syrups as well as against sweeteners. Specifically, Mexico's tax measures constitute an excise tax on soft drinks and syrups containing HFCS. The United States has demonstrated how that tax translates linearly into a conditional tax on HFCS and, in fact, as a prohibitive excise tax on HFCS. It, therefore, falls under Article III:2. Mexico's tax measures are also measures "affecting" the use of imported HFCS. The measures punish bottlers for using imported HFCS. Mexico's tax measures, therefore, fall under Article III:4. If there is overlap with respect to Articles III:2 and III:4 in this dispute, it is because the particular tax measures Mexico has chosen to apply are discriminatory excise taxes on one product that also punishes the bottler for using imported inputs to make that product.

4. Article XX(d)

4.488 Turning to Article XX(d) and the specific points Mexico raises there. The first point is that, despite Mexico's assertions otherwise, Mexico most clearly has not met its burden of proof with respect to its Article XX(d) defence. Under that burden, Mexico must put forth facts and arguments sufficient to establish that its tax measures are, first, justified under paragraph (d) as measures "necessary to secure compliance with laws or regulations" and, second, applied in manner that is in keeping with the chapeau to Article XX. As late as this second meeting of the Panel, however, Mexico has yet to marshal any legal argument under the relevant rules of treaty interpretation to support its assertion that the phrase "laws or regulations" encompasses United States obligations under the NAFTA or to provide any factual support for its contention that its tax measures secure, or even contribute, to United States compliance with alleged NAFTA obligations, much less that its tax measures are necessary to such compliance.

4.489 Mexico's comments in paragraphs 9 and following of its closing statement on the status of the NAFTA under United States law, to the extent the United States has been able to understand them, do not appear accurate or complete. However, unfortunately the United States is not in a position to comment in more detail on those paragraphs on such short notice.

4.490 More generally, the United States fails to see how Mexico's more general point assists its position. Mexico seems to say that different countries treat the relationship between their international obligations and their internal laws in different ways. The United States fails to see why that would be an argument in favour of interpreting the words "laws or regulations" in Article XX(d)

of the GATT as applying to international agreements. If anything, Mexico's point highlights the difference between international obligations, and internal laws and regulations.

4.491 Further to this point, the phrase "laws or regulations" within Article XX(d) means the "laws or regulations" of the Member claiming the Article XX(d) exception; not the laws or regulations of the Member against whom it has invoked its Article XX(d) exception. Therefore, by way of example, Mexico might invoke Article XX(d) as justification for a measure to secure compliance with its own laws or regulations, but not the laws or regulations of other Members. Said another way, Mexico cannot assert an Article XX(d) defence for measures to enforce United States domestic law.

4.492 The United States' second point is that in its opening statement – and perhaps this is a reflection of Mexico's recognition of where acceptance of its Article XX(d) defence may lead – Mexico suggests that its reading of Article XX(d) is not as broad as it might first appear. That is, Mexico suggests that its reading of Article XX(d) only applies in situations where (i) a genuine dispute exists under an international agreement; (ii) dispute settlement under that international agreement has not resolved the dispute; (iii) diplomatic efforts have also not resolved that dispute; (iv) the domestic industry of the Member invoking Article XX(d) has suffered some type of harm as a result of the dispute under the international agreement; and (v) the relevant international agreement is not a WTO agreement. This new reading of Article XX(d), however, does not get us past the fact that Article XX(d) does not apply to obligations under an international agreement. Nor does it get us past the fact that, under Mexico's reading of Article XX(d), any Member, who believes that another Member has breached obligations owed under an international agreement, would be free to breach its WTO obligations, provided the Member claimed to have exhausted other avenues to resolve the dispute and to have a domestic industry in need of assistance. Despite Mexico's claims, this would be an extremely broad exception to WTO rules.

4.493 Finally, no less than two pages from the end of its opening statement, Mexico tries to refute some of the points the United States offers, based on application of the rules of treaty interpretation, as to why the phrase "laws or regulations" means the domestic laws or regulations of the Member claiming the Article XX(d) exception. Mexico's arguments here, however, do not save its Article XX(d) defence. For example, the fact that Article XVI:4 of the Marrakesh Agreement includes the word "its" before "laws, regulations and administrative procedures" only re-emphasizes the United States point that "laws or regulations" as used in the WTO Agreement is understood to mean the domestic laws or regulations of WTO Members, not obligations under international agreements or under general principles of international law. In the numerous instances where the WTO Agreement references "laws" or "regulations" some are proceeded by the word "its" or the word "their" (referring to a Member's, or Members' in the plural, laws and regulations); others are simply preceded by "the" or no article at all, as in Article XX(d). What is clear, however, is that when the WTO drafters meant to refer to international law, they did so expressly, as in Articles 3.2 of the DSU and 17.6 of the Anti-Dumping Agreement.

4.494 Moreover, contrary to Mexico's assertion, the United States is not reading "national" or "domestic" into the text of Article XX(d). Rather, the ordinary meaning of the phrase "laws or regulations" interpreted in its context and in light of the WTO Agreement's object and purpose leads to the conclusion that phrase "laws or regulations" with no qualifying adjective proceeding it, means the domestic laws or regulations of the Member claiming the Article XX(d) exception.

V. ARGUMENTS OF THE THIRD PARTIES

5.1 The arguments presented by Canada, China, the European Communities, Guatemala and Japan in their written submissions and oral statements are reflected in the summaries below.[139]

A. CANADA

1. Introduction

5.2 The Panel has invited the parties and third parties to comment on Mexico's request for a preliminary ruling on whether the Panel should decline to exercise its jurisdiction in this dispute.

5.3 Canada's statement will therefore address the two following questions:

– first, whether the Panel should decide this request by means of a preliminary ruling; and

– second, whether the Panel should in this case decline to exercise its jurisdiction.

5.4 For reasons that Canada will briefly elaborate, the answer to the first question is, yes, the Panel should make a preliminary ruling. The answer to the second question is, no, the panel should not – and cannot – decline to exercise its jurisdiction.

2. Mexico's request for a preliminary ruling

5.5 Mexico asserts that this Panel (i) has the competence to decline to exercise its jurisdiction in its entirety; and (ii) should do so in this case. Because a finding in favour of Mexico on these two points would render moot any consideration of the United States' claims on their merits, this issue should be dealt with at the earliest stages of the proceedings.

5.6 The WTO jurisprudence is clear on the need to raise and consider jurisdictional objections in a timely manner. The Appellate Body in *US – 1916 Act* stressed that an objection to jurisdiction should be raised as early as possible in the panel process because "the vesting of jurisdiction in a panel is a fundamental prerequisite for lawful panel proceedings".[140]

5.7 The Appellate Body further emphasised this point in *Mexico – Corn Syrup* where it stated that panels must address and dispose of certain issues of a fundamental nature such as jurisdiction in order to satisfy themselves that they have authority to proceed in a particular matter.[141]

5.8 Mexico's request that the Panel decline to exercise its jurisdiction, is not, as such, a challenge or objection to the Panel's jurisdiction. Canada does not understand Mexico to be suggesting that the Panel does not have authority to proceed. On the contrary, Mexico has recognised in its first submission that this Panel has prima facie jurisdiction to hear this case.[142] However, whether the question raised is a panel's authority to proceed to hear the claims on their merits, as in the case of a jurisdictional objection, or, as in this case, the Panel's discretion to proceed, the issues in both situations are of a fundamental nature. From a practical standpoint, were the Panel to find that it could and should accede to Mexico's request, the consequences would be the same as if the Panel

[139] The summaries of the third parties' arguments are based on the executive summaries submitted by the third parties to the Panel, in the case of China, the European Communities and Japan; and on the oral statements submitted by Canada and Guatemala.

[140] Appellate Body Report on *US – 1916 Act*, para 54.

[141] Appellate Body Report on *Mexico –Corn Syrup (Article 21.5 – US)*, para 36.

[142] Translation of the first written submission of Mexico, at para 93.

were to find that it did not have jurisdiction: it would obviate the need to consider the complainant's claims or to make further recommendations to the Dispute Settlement Body.

5.9 In the light of the Appellate Body's guidance in the case of jurisdictional objections and given that Mexico's request was duly formulated within the terms of paragraph 13 of the Panel's Working Procedures, it would be appropriate, and indeed preferable, for the Panel to deal with this issue on a preliminary basis.

5.10 Canada is therefore of the view that the Panel should decide this issue by means of a preliminary ruling rather than deal with the matter in its final report.

3. The Panel's authority to decline jurisdiction

5.11 Mexico relies on the principle of "judicial economy" to argue that the Panel may decline to exercise its jurisdiction when one of the parties refuses to take the matter in dispute before what Mexico asserts is the appropriate forum.[143]

5.12 Canada does not agree with Mexico that the Panel has the authority to decline to exercise its jurisdiction in this case.

5.13 Article 3.2 of the Dispute Settlement Understanding expressly recognises that the dispute settlement system serves to preserve the rights and obligations of WTO Members under the covered agreements. Accordingly, as set out in Article 11 of the DSU, a panel has a responsibility to make an objective assessment of the matter before it, including an assessment of the conformity with the relevant covered agreements of the measure at issue.

5.14 This Panel was established with the standard terms of reference set out Article 7.1 of the DSU. According to these terms of reference the Panel is charged with examining the matter before it in the light of the relevant covered agreements and making such findings as necessary to assist the Dispute Settlement Body in making recommendations or rulings. Article 3.4 of the DSU provides that these recommendations or rulings are to be aimed at achieving a satisfactory settlement of the matter in accordance with the rights and obligations of the parties under the relevant covered agreements.[144]

5.15 The United States, in this case, claims that Mexico's tax measures are inconsistent with Mexico's obligations under Article III of the GATT 1994. The GATT 1994 is a covered agreement in Appendix 1 of the DSU. Nevertheless, Mexico suggests, that based on the principle of "judicial economy" the Panel could in this case simply decline to exercise its undisputed jurisdiction. The Panel simply cannot do this.

5.16 "Judicial economy" is nothing more than a principle by which a tribunal may choose to limit its findings to those necessary to resolve the dispute. It cannot override the express provisions of the DSU, nor the rights and obligations, of parties and of panels, that flow from those provisions. In particular, "judicial economy" cannot be applied to relieve a panel of its duty to make the findings that are necessary to resolve a dispute. Thus, in *Australia - Salmon*, the Appellate Body emphasized that the principle of "judicial economy" must be applied keeping in mind the aim of the dispute settlement system, which is to resolve the matter at issue and "to secure a positive solution to a dispute".[145]

[143] *Ibid.* at para 97.
[144] Articles 7.1 and 3.4 of the DSU.
[145] Report of the Appellate Body on *Australia – Salmon*, para. 223.

5.17 For the Panel to do as Mexico asks and abstain entirely from making findings in this case would be a gross misapplication of the principle of "judicial economy". To do so would be contrary to the Panel's duty under Article 11 of the DSU, contrary to the Panel's terms of reference, and contrary to the aims of resolving the matter at issue and securing a positive solution to the dispute. In short, the Panel cannot accede to Mexico's request without disregarding critical provisions of the DSU and undermining the effective functioning of the WTO dispute settlement process.

5.18 For these reasons, Canada respectfully submits that the Panel must deny Mexico's request to decline to exercise its jurisdiction in this case.

B. CHINA

1. Introduction

5.19 China notices that this dispute raises some important issues in the interpretation and application of GATT 1994 Article III. In this submission, China will focus on two issues:

(i) Whether the HFCS can be deemed to be taxed in the meaning of GATT 1994 Article III:2, second sentence, based only on the fact that soft drinks and beverages sweetened with HFCS have been taxed in the meaning of GATT Article III:2, second sentence; and

(ii) Whether cane sugar can be established as the "like product" of HFCS under GATT Article III:4 conclusively with the analysis on "directly competitive and substitutable" products in the meaning of GATT Article III:2, second sentence.

2. Whether the HFCS can be deemed to be taxed in the meaning of GATT 1994 Article III:2, second sentence, based only on the fact that soft drinks and beverages sweetened with HFCS have been taxed in the meaning of GATT Article III:2 second sentence

5.20 In the opinion of the United States, HFCS and cane sugar have been dissimilarly taxed by the "HFCS soft drink tax" in the meaning of GATT Article III:2, second sentence. This raises an issue with regard to the interpretation and application of GATT Article III:2, second sentence: that is whether a product (HFCS in this case), can be deemed to be taxed simply because it is a component of another product, soft drinks taxed by IEPS measure in the meaning of GATT Article III:2, second sentence.

5.21 Taking into account Mexico's HFCS soft drink tax measure itself and paragraph 2 of Article III of GATT 1994, China understands that products subject to the HFCS soft drink tax are soft drinks and syrups sweetened with HFCS, not the HFCS itself when used as a component in making the products, soft drinks and syrups. As such China cannot concur with the United States' interpretation of the applicability of the HFCS soft drink tax on HFCS used as sweetener in soft drinks and syrups, other than the soft drinks and syrups using HFCS as sweetener.

5.22 Moreover, in the context of GATT Article III:2, second sentence, the word "apply" when used in defining the scope of a statute, shall be read as application of a tax to the objects explicitly referred to in the language of the statutes, and not any others that have not been explicitly defined as applicable in the statute. This is supported by the dictionary explanation of "apply" both in the legal and ordinary sense of the word.

5.23 From the above, China believes that "apply" leads to an explicit referring of object. In other words, from the point of view of the measure at issue, the word "apply" in Article III:2 of GATT

1994, as well as the word "taxed product" in paragraph 2 of *Ad* Article III shall be construed narrowly and the application of principles in Article III:2 of GATT 1994 shall not be extended to an item not explicitly defined within the scope of the HFCS soft drink tax.

3. Whether cane sugar can be established as the "like product" of HFCS under GATT Article III:4 conclusively with the analysis on "directly competitive and substitutable products" within the meaning of Article III:2, second sentence of GATT1994

5.24 On this issue, the United States claims that HFCS and cane sugar are "like products" within the meaning of Article III:4 of GATT 1994. The United States also believes that HFCS imported from United States competed successfully whereas Mexican bottlers were rapidly and increasingly substituting HFCS for sugar, and that led the Mexican Congress to impose the HFCS Soft Drink Tax and Distribution Tax.[146]

5.25 In proving the likeness of HFCS and cane sugar within the meaning of Article III:4, United States mentions four elements relevant to the like product inquiry that the Appellate Body examined more extensively in *EC – Asbestos.*[147] It seems that the United States' assertion of likeness of cane sugar of Mexican origin with the US-imported HFCS is built first on its belief of a competitive relationship between cane sugar and HFCS, which is, as the United States citing the Appellate Body in *EC – Asbestos*[148], "fundamentally" of like products under Article III:4 of the GATT.[149]

5.26 It is noteworthy that based on its understanding of some of the precedent panel and/or Appellate Body reports, the United States tends to equate the two distinct concepts, the "like products" within the meaning of Article III:4 of GATT 1994 and "directly competitive and substitutable products" within the meaning of Article III:2 of GATT 1994, second sentence. However, this approach calls for further analysis.

5.27 Recognizing the relevancy of competitiveness and substitutability to product likeness under Article III:4 of GATT 1994, China notes that the Appellate Body in *EC – Asbestos* had further pointed out that "We are not saying that all products which are in some competitive relationship are 'like products' under Article III:4." Furthermore, the Appellate Body concluded that the scope of "like" in GATT Article III:4 is broader than the scope of "like" in GATT Article III:2 first sentence, but not broader than the combined product scope of two sentences of Article III:2, i.e. both "like product" and the "directly competitive and substitutable" products.[150]

5.28 In addition, while acknowledging the four elements criteria as "a framework for analysing the 'likeness' of products on a case-by-case basis", the Appellate Body has emphasized that:

> "These criteria are, it is well to bear in mind, simply tools to assist in the task of sorting and examining the relevant evidence. They are neither a treaty-mandated nor a closed list of criteria that will determine the legal characteristics of products. More important, the adoption of a particular framework to aid in the examination of evidence does not dissolve the duty or the need to examine, in each case, all of the pertinent evidence."[151]

---

[146] *Id.*
[147] Appellate Body Report on *EC – Asbestos*, para.101.
[148] Appellate Body Report on *EC – Asbestos*, para.98-99.
[149] United States first written submission, para.157.
[150] Appellate Body Report on *EC – Asbestos*, para. 99.
[151] Appellate Body Report on *EC – Asbestos*, paras.102.

5.29 In view of the different language of GATT Articles III:2 and GATT Article III:4, and the reluctance of the Appellate Body to equate the product scope of GATT Article III:4 with that of GATT Article III:2, second sentence, China believes that the scope of "like products" in the meaning of Article III:4 should not be taken as identical to "direct competitive and substitutable" within the meaning GATT Article III:2, second sentence. Otherwise, the drafters of GATT1994 and/or the Appellate Body would have specified in that regard, and therefore it deserves a separate and full-length analysis in an assertion of likeness of products.

5.30 Subject to further analysis of application of the four elements criteria by the United States in this case, China expects that the panel will evaluate all factors pertinent to this case in determining the likeness of products under Article III:4 in this case.

C. THE EUROPEAN COMMUNITIES

1. The preliminary ruling requested by Mexico that the panel should decline to exercise its jurisdiction

5.31 In its defence, Mexico has stated that it considers that the dispute before the Panel has its roots in a wider dispute with the United States in the context of NAFTA. For this reason, Mexico has requested the Panel to issue a preliminary ruling by which the Panel should decline to exercise its jurisdiction.

5.32 In its defence, Mexico has recognised that the Panel does have prima facie jurisdiction to hear the case brought by the United States. However, Mexico also submits that the Panel has competence to decline to exercise its jurisdiction. In support of this view, Mexico refers in particular to the possibility for WTO panels to exercise "judicial economy". Mexico further submits that the United States case is part of a larger dispute under NAFTA, and that addressing the United States claims under the GATT would therefore not secure a positive solution to the dispute.

5.33 Article 11 of the DSU describes the function of panels as requiring the Panel to make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and to make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements. This function is also reflected in the standard terms of reference provided for in Article 7 (1) of the DSU.

5.34 In the present case, the United States claims are based on Article III of the GATT 1994, i.e. a provision of a covered agreement. There is no doubt, and Mexico does not contest, that the Panel therefore has jurisdiction to examine the United States claims under this provision, and to make findings to assist the DSB in making appropriate recommendations.

5.35 The EC does not agree, however, that the Panel could decline to exercise this jurisdiction on the basis of the notion of "judicial economy". In accordance with the jurisprudence of the Appellate Body, the notion of judicial economy enables a Panel to omit making a finding on a specific claim, when such a finding is not necessary for resolving the dispute under the covered agreements, for instance because the measure has already been found to be in violation of another provision of the covered agreements. In contrast, the notion of judicial economy does not entitle a panel to abstain completely from making findings in a dispute properly before it.

5.36 In support of its view, Mexico has referred to the GATT Panel Report in *US – Nicaraguan Trade*. However, in this case, which predates the entry into force of the WTO Agreement, the Panel's terms of reference specifically excluded consideration of the United States' defence under

Article XXI(b)(iii) of the GATT 1994. Accordingly, this report cannot serve as precedent for the present Panel, which has standard terms of reference in accordance with Article 7 (1) of the DSU.

5.37 The European Communities would like to add that it is not unusual that the same dispute might arise, fully or partially, under the WTO and under international agreements outside the WTO. This should not necessarily prevent a WTO panel from resolving a dispute properly brought before it. A recent example in point would be *Argentina – Poultry Anti-Dumping Duties*, in which the Panel considered the dispute despite the fact that the same measures had previously been the subject of dispute settlement under Mercosur.

5.38 The EC takes note that Mexico has also complained that the United States has not agreed to submit the broader dispute to dispute settlement under NAFTA. The EC is not in a position to comment on the dispute settlement procedures under NAFTA. However, the absence of recourse to dispute settlement under NAFTA cannot justify an exercise of "judicial economy" on the part of a WTO panel. Whether the attitude of the United States might be legally relevant in other regards under the WTO agreements, for instance from the point of view of good faith or estoppel, need not be further examined here, since Mexico has not so far raised this question.

2. The relationship of the WTO agreements and other international agreements

5.39 The EC is not in a position to comment on Mexico's dispute with the United States under NAFTA. However, since Mexico has evoked the NAFTA context in the present dispute, the EC considers it appropriate to offer some preliminary remarks regarding the relationship between the WTO Agreements and other international agreements.

5.40 In accordance with Articles 7(1) and 11 of the DSU, the function of the Panel is to make findings in the light of the provisions of the covered agreements. However, this does not mean that the Panel cannot take into account other provisions of international law, when such provisions are relevant to the dispute before it. In fact, the Appellate Body has confirmed that the WTO Agreements are not to be read in "clinical isolation" from public international law. In the view of the EC, it is therefore not excluded that applicable rules of international law may also include bilateral or multilateral agreements between the parties, when such rules are relevant for the decision of a dispute before a panel.

5.41 In the present case, Mexico has so far not invoked any specific provision of NAFTA or general rules of public international law in its defence against the claims of the United States. The Panel may therefore not need to address the complex question of the relationship between the WTO agreements and other bilateral or multilateral agreements. However, should this issue arise, the EC submits that the Panel should approach it bearing in mind the fundamental importance of this question and taking into account the considerations set out above.

3. The claims raised by the United States under Article III:2 of the GATT 1994

5.42 As regards the United States claim under the first sentence of Article III:2 GATT, the United States has explained in considerable detail that beverages sweetened with HFCS and beverages sweetened with cane sugar are like products. The EC shares this analysis of the United States. The EC would like to add, however, that this applies not only in the comparison of beverages sweetened with HFCS and cane sugar. For instance, it is clear that beverages sweetened with other types of sugar, and notably with beet sugar as the main type of sugar produced in the EC, would equally have to be considered to be "like" beverages sweetened with cane sugar.

5.43 As regards the question whether the Mexican measure involves taxation of imported beverages in excess of domestic beverages, the United States analysis appears to be based on a

comparison between beverages sweetened with HFCS and beverages sweetened with cane sugar. The understanding therefore seems to be that all beverages sweetened with cane sugar, whether domestic or imported, are exempted from the Mexican tax measure. However, in the factual part of the United States submission, the United States has interpreted the Mexican measure to impose the tax on imported beverages sweetened with any sweetener, including beverages sweetened with cane sugar. If this interpretation, on which Mexico has not so far commented, were correct, then at least as far as beverages sweetened with cane sugar are concerned, the Mexican measure would clearly constitute taxation of imported beverages in excess of domestic beverages, i.e. *de jure* discrimination against imports.

5.44 In contrast, the situation may be somewhat different in so far as the United States challenges the Mexican taxation of imports of HFCS-sweetened beverages. The United States submits that whereas virtually all beverages produced in the United States are sweetened with HFCS, all beverages regular soft drinks and syrups produced in Mexico are sweetened with cane sugar. Whereas this may be true at present, this statement was not true at the time the Mexican measure was adopted. In fact, the United States itself submits that before the imposition of the Mexican tax measure, Mexican soft drink producers had begun to switch over to use of HFCS, and that accordingly a sizeable proportion of soft drinks produced in Mexico was sweetened with HFCS.

5.45 It still appears that at the time the Mexican measure was adopted, a significant proportion of beverages produced in Mexico were sweetened with cane sugar, whereas virtually all beverages produced in the United States were sweetened with HFCS. To this extent, it may be justified to consider that the Mexican measure overall involved taxation of imported products in excess of domestic products. Moreover, it can be argued that by maintaining the tax measure in a situation where virtually all beverages produced in Mexico are sweetened with cane sugar, whereas imported beverages are sweetened with other sweeteners, Mexico effectively also taxes imported products in excess of domestic products.

5.46 In response to the United States claim under the second sentence of Article III:2 of the GATT 1994, given in particular the introductory language of the Ad note to Article III:2 of the GATT 1994, it might be questioned whether a measure which is incompatible with the first sentence of Article III:2 of the GATT 1994 can also be incompatible with the second sentence thereof. In any event, should the Panel find that the Mexican treatment of imported beverages is incompatible with the first sentence of Article III:2 GATT, it may no longer need to address the United States claim under the second sentence.

5.47 As regards discriminatory taxation of HFCS and other sweeteners, the second sentence of Article III:2 of the GATT 1994 provides that 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. The Ad note to Article III:2 provides further that 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".

5.48 In its submission, the United States has discussed whether HFCS and cane sugar can be regarded as directly competitive or substitutable products. In this respect, the EC would remark that there are certain differences between HFCS and cane sugar as regards end-uses and consumer preferences. In particular, HFCS is exclusively used in industrial production of beverages and possibly other products. In contrast, cane sugar is also used in households for a variety of purposes, which is not the case for HFCS. This notwithstanding, the EC would agree that there is a considerable overlap in end-uses and preferences between HFCS and cane sugar. For this reason, the EC can agree

with the United States submission that HFCS and cane sugar are directly competitive or substitutable products at least to the extent that use for the sweetening of beverages is concerned.

5.49 Furthermore, it follows from the United States submission that HFCS is largely imported from the United States, whereas cane sugar is largely a domestic and not an imported product in Mexico. Accordingly, it can be considered that the Mexican measure involves taxation of imported products in excess of domestic products.

4. The defence presented by Mexico under Article XX(d) of the GATT 1994

5.50 The EC cannot comment on Mexico's claim against the United States under NAFTA. However, the EC considers that Mexico's defence under Article XX(d) of the GATT 1994 in the present case raises serious systemic issues and therefore warrants several remarks.

5.51 First, Article XX(d) justifies only measures necessary to secure compliance with "laws or regulations". Such laws or regulations must be laws or regulations applicable in the internal legal order of the WTO Member in question. At a general level, the European Communities would not exclude that an international agreement concluded by a WTO Member might also constitute a "law or regulation" within the meaning of Article XX(d) of the GATT 1994, provided that the agreement is directly applicable in the internal legal order of such member, and is therefore capable of being directly enforced on individuals. However, Mexico has not provided any information on the status of NAFTA in its internal legal order. More importantly still, it appears that the provisions invoked by Mexico impose obligations primarily on the United States, and are therefore not capable of being enforced in the legal order of Mexico.

5.52 Secondly, the measure must be necessary to "secure compliance" with the law or regulation. As just set out, this compliance must be secured within the legal order of the Member in question. The object and purpose of measures under Article XX(d) of the GATT 1994 is not to secure compliance with the obligations incumbent on other WTO Members under public international law. This is also apparent from the examples listed in Article XX(d) of the GATT 1994, which include customs enforcement, the protection of patents, trade marks and copyrights, and the prevention of deceptive practices.

5.53 Third, the EC notes that the Mexican measure does not only apply to beverages sweetened with HFCS imported from the United States, but would also apply to, for instance, beverages sweetened with beet sugar imported from any other WTO Member, including the EC. It is clear, that this could not be justified as securing compliance with obligations under NAFTA.

5.54 At a systemic level, Mexico's interpretation would transform Article XX(d) of the GATT 1994 into an authorisation of counter-measures within the meaning of public international law. It must be assumed, however, that if the contracting parties had intended such an interpretation, they would have expressed this in a clearer way. Moreover, under customary international law, as codified in the International Law Commission's Articles on Responsibility of States for Internationally Wrongful Acts, counter-measures are subject to strict substantive and procedural conditions, which are not contained in Article XX(d) of the GATT 1994.

5.55 The EC notes that Mexico has not so far justified its measure as a counter-measure under customary international law. Such a justification would already meet the objection that the Mexican measure does not only apply to products from the United States, but from anywhere. In any event, should Mexico still attempt such a justification, then this would also raise the difficult question of whether the concept of counter-measures is available to justify the violation of WTO obligations. In accordance with Article 50 of the International Law Commission's Articles on Responsibility of States for Internationally Wrongful Acts, this would not be the case if the WTO agreements are to be

considered as a *lex specialis* precluding the taking of counter-measures. This complex question has been addressed in the report of the International Law Commission at its fifty-third session.

D. GUATEMALA

5.56 Guatemala is grateful for the opportunity to participate in this meeting and to express its views. It is participating in this dispute because it has a *trade interest* and a *systemic interest* in matter at issue.

5.57 Guatemala's *trade interest* in this dispute is as outlined below.

5.58 In spite of the various distortions and problems connected with access to international markets, Guatemala has an efficient and productive sugar sector. Indeed, Guatemala ranks seventh among the world's leading sugar exporters; its production costs are among the lowest, and its output per hectare among the highest.

5.59 Sugar production in Guatemala is not only an important source of subsistence in the rural areas, but it provides benefits and elementary social assistance[152] to the population of Guatemala, including education and health programmes developed and promoted by sugar producers.

5.60 Thus, given the characteristics of the Mexican sugar industry[153], Guatemala understands the decisive role played by that industry in Mexico's development.

5.61 In view of the above, Guatemala thinks that the Panel should heed Mexico's call[154] to consider, in the course of its deliberations, the importance of the sugar industry in Mexico, and the implications for the country of reforms to that sector.

5.62 As regards Guatemala's *systemic interest* in this dispute, there are two specific elements to be mentioned.

5.63 The first is to ensure that the WTO agreements, in particular the Dispute Settlement Understanding and Articles III and XX of the GATT, are properly interpreted.

5.64 It is in this context that Guatemala would like to express its views regarding the Government of Mexico's request that the Panel decline to exercise its jurisdiction.[155]

5.65 Guatemala considers that the dispute settlement system serves to preserve the rights and obligations of Members under the covered agreements.[156]

5.66 In this dispute, the United States considered Mexico's tax measures to be inconsistent with its obligations under Article III of the GATT 1994, and therefore requested the Dispute Settlement Body to establish a panel pursuant to Article 6 of the DSU to examine the matter, with the standard terms of reference as set out in Article 7.1 of the DSU.[157]

---

[152] The unique initiatives that make Guatemala the world leader in social activities promoted by the sugar industry have contributed, in particular, to the eradication of childhood blindness and the significant decline in the infant mortality rate.

[153] Section II A of the first written submission of Mexico, 1 November 2004.

[154] Section III C of the first written submission of Mexico, 1 November 2004.

[155] Section III B of the first written submission of Mexico, 1 November 2004.

[156] Article 3.2 of the DSU.

[157] Document WT7DS308/4 of 11 June 2004.

5.67 In Guatemala's view, the Panel's task is to examine the complaint brought by the United States with respect to the violation of a covered agreement in order to preserve the rights of that Member under that agreement.

5.68 Moreover, according to Article 7 of the DSU, the terms of reference and jurisdiction of a panel are determined by the complaint brought by the complaining party, which must satisfy the requirements laid down in Article 6 of the DSU.

5.69 On that basis, Guatemala considers that the Panel has the jurisdiction to examine the matter at issue. However, as confirmed by the Appellate Body[158] and pursuant to Article 6.1 of the DSU, the establishment of a panel by the DSB is practically automatic, and as the DSB does not scrutinize requests for the establishment of a panel in detail, it is incumbent upon the Panel to examine the request carefully to ensure its compliance with both the letter and the spirit of Article 6.2 of the DSU.

5.70 The second element of systemic interest to Guatemala is the importance of regional trade agreements for the multilateral trading system.

5.71 The North American Free Trade Agreement (NAFTA) between the United States, Canada, and Mexico has been the main source of inspiration or the model for other WTO Members in negotiating free trade agreements.

5.72 NAFTA is a framework of model regulations for the expansion of free and fair trade among its members. This fact should be stressed in order to remind the parties to the present dispute of the importance of NAFTA in the context of international trade.

5.73 Furthermore, NAFTA also comprises various mechanisms for settling trade disputes between its members.

5.74 In its first written submission, Mexico sets forth a number of circumstances relating to NAFTA obligations. Guatemala is not in a position to pass judgement in that respect, nor will it take a stance as to whether or not there has been any kind of violation of NAFTA rules. However, Guatemala would like to mention two basic points that are of its interest.

5.75 Firstly, Guatemala considers the WTO dispute settlement mechanism to be a system that brings legal certainty to trade relations between Members, and hence, there is nothing to prevent a party from resorting to the system in relation to matters covered by the WTO agreements. However, it is preferable for members of an agreement to seek practical solutions that help to strengthen free trade within the dispute settlement mechanism provided for under that agreement.

5.76 Secondly, free trade agreements like NAFTA must be seen as milestones in the process of liberalizing multilateral trade. Free trade agreements are not at variance with the multilateral trading system – on the contrary, they are complementary.

5.77 Thus, it is impermissible to impede the exercise rights or to try to evade obligations under one of these forums by resorting to the other. Moreover, a violation of a rule under a free trade agreement cannot in itself be "isolated" or "exempt" from repercussions in the multilateral trading system; consequently, it is equally impermissible for Members to adopt unilateral measures to try to correct the situation. Such measures are a threat to the multilateral trading system.

5.78 Finally, Guatemala considers that, to the extent that these free trade agreements fit together to form the "multilateral system", Members should try to ensure that the commitments assumed

[158] Appellate Body Report on *EC – Bananas III*, paragraph 142.

thereunder are not merely rhetorical and that any conflicts or disputes arising from those agreements are settled by consensus.

E. JAPAN

1. Analysis of IEPS's conformity with the first sentence of Article III:2 of the GATT 1994

5.79 The United States claims that provisions which tax imported soft drinks and other beverages (hereinafter collectively "soft drinks") as well as imported syrups, concentrates, powders, essences and extracts that can be diluted to produce such beverages (hereinafter collectively "syrups") and the agency, representation, brokerage, consignment and distribution (hereinafter collectively "distribution") of soft drinks and syrups sweetened with HFCS pursuant to IEPS, are inconsistent with Article III:2, first sentence.

5.80 As confirmed by the Appellate Body in *Japan – Alcoholic Beverages II*, a tax measure is inconsistent with the first sentence of Article III:2 when: (i) the taxed imported and domestic products are "like," and (ii) the taxes applied to the imported products are "in excess of" those applied to like domestic products.[159] As regards the "in excess of" requirement, past panels have established that "[e]ven the smallest amount of 'excess' is too much"[160] and the prohibition thereof is "not conditional on a 'trade effects test' nor is it qualified by a *de minimis* standard."[161] In the present case, it is relatively straightforward that the second requirement of "in excess of" will be met, since imported soft drinks and syrups as well as the distribution of soft drinks and syrups using HFCS are taxed an additional 20 per cent as opposed to products using cane sugar or the distribution thereof. Accordingly, the determination of "like products" becomes crucial in finding whether there is a violation of the first sentence of Article III:2 in the present case.

5.81 Japan would like to address one preliminary point before going into the issue of determining what "like products" under the first sentence of Article III:2 are. In its first written submission, the United States compares soft drinks and syrups sweetened with HFCS and those sweetened with cane sugar to be "like products".[162] However, the IEPS on its face does not discriminate against imports of soft drinks and syrups sweetened with HFCS, as those produced domestically are also subject to the same taxation as imports, and an issue of whether such comparison is appropriate arises. The first sentence of Article III:2 settles this issue by stipulating that such an origin neutral measure can also be challenged under Article III:2. The first sentence of Article III:2 clearly stipulates that the comparison to be made is between internal taxes on 'imported products and … those applied to like domestic products.'"[163] In other words, the point of contention in a case regarding the first sentence of Article III:2 is whether imported products are similar enough to be considered "like" domestic products that are accorded more favourable treatment. If this is established, it is irrelevant whether an imported product and an identical domestic product of the particular import are treated equally under the tax measure.[164] Therefore, the point of contention the United States has raised is appropriate.

5.82 As to the interpretation of "like products" under the first sentence of Article III:2, there is no treaty-mandated definition of how this shall be determined or a closed list of criteria.[165] The

---

[159] Appellate Body Report on *Japan – Alcoholic Beverages II*, Section H.1, pp.18-19, DSR 1996:I, 97, at 111.

[160] *Id.*, Section H.1.(b), p.23, DSR 1996:I, 97, at 115.

[161] *Id.*, Section H.1.(b), p.23, DSR 1996:I, 97, at 115; GATT Panel Report, *US – Malt Beverages* para. 5.6. *See also, Brazil – Internal Taxes*, para.16; *US – Superfund*, para. 5.1.9; *Japan – Alcoholic Beverages I* para.5.8.

[162] United States first written submission, Section V.B.1, para. 76.

[163] Panel Report on *Japan Alcoholic Beverages I*, para. 5.5(a).

[164] *See* GATT Panel Report on *Japan – Alcoholic Beverages I*, para.5.5.

[165] Appellate Body Report on *EC – Asbestos*, para.102.

Appellate Body in *Japan – Alcoholic Beverages II* confirmed the "practice under the GATT 1947 of determining whether imported and domestic products are 'like' on a case-by-case basis," following the approach the Working Party Report on Border Tax Adjustments had taken to set out a case-by-case interpretation of what "like products" shall mean within different provisions of the GATT 1947.[166] [167]

5.83 In interpreting the scope of "like products" under the first sentence of Article III:2 in a case-by-case manner, previous panel and appellate body reports have employed a list of criteria, of which commonly employed criteria are: (i) the product's properties, nature and quality, (ii) product's end-uses in a given market, (iii) consumer's tastes and habits and (iv) tariff classification.[168]

5.84 As a corollary of the fact that the products compared in likeness in each individual case are different and therefore necessitate a case-by-case analysis, it is also apparent that when applying a set of criteria to determine "likeness," the weight put on each criterion should be adjusted to accommodate the characteristics of the products concerned in individual cases. In other words, one criterion may be more decisive than others in a particular case, and the decisive criterion may differ from case to case.[169]

5.85 The analysis of the correct application of the above criteria is mainly factual. Therefore, Japan, at this juncture, will confine its comments on the following points.

5.86 Firstly, in light of the fact that the products concerned in the case at hand are soft drinks and syrups, which are articles of taste to be provided to consumers, and the similarity between such products with alcoholic beverages contemplated in *Japan – Alcoholic Beverages II* in the sense that both are beverages (or extracts which can be diluted into beverages) for mass consumption, Japan is of the view that the four criteria above are helpful in determining whether the products concerned are "like products." Therefore it is appropriate to apply these criteria as the United States has pointed out in its submission.

5.87 Furthermore, due to the similarities between such products concerned in *Japan – Alcoholic Beverages II* and those in the case at hand, it should be of reference that in *Japan – Alcoholic Beverages II*, the likeness between shochu and vodka was determined based on the similarities in physical characteristics and end-uses of products, stating that both are "white/clean spirits, made of similar raw materials, and the end-uses were virtually identical." The Panel on *Japan – Alcoholic Beverages II* also noted that shochu and vodka were classified in the same heading under Japan's tax classification at the time, and were covered by the same Japanese tariff binding at the time of its negotiation.[170]

5.88 Secondly, with regard to the criterion of consumer's tastes and habits, in the present case, the consumers of soft drinks and syrups are individuals in Mexico. Accordingly, the relevant evidence would be results of consumer surveys conducted on consumers in Mexico. However, the current consumer perception may not be available due to the imposition of the tax measure, which has the effects of restricting the production and importation of soft drinks and syrups sweetened by HFCS. In this respect, the statement made by the Panel in *Japan – Alcoholic Beverages II* should be recalled:

---

[166] The Report of the Working Party on Border Tax Adjustments, BISD 18S/97, para. 18 states that such interpretation "would allow a fair assessment in each case of the different elements that constitute a 'similar' product." *See also* Panel Report, *Japan – Alcoholic Beverages II*, , para. 6.21.

[167] Appellate Body Report on *Japan – Alcoholic Beverages II* , Section. H.1.(a), p.20, DSR 1996:I, 97, at 113.

[168] *Id.*,Section. H.1.(a), pp.20-22, DSR 1996:I, 97, at 113-114.

[169] *See* Appellate Body Report on *EC – Asbestos*, para.146.

[170] Panel Report on *Japan – Alcoholic Beverages II*, para. 6.23.

> "[A] tax system that discriminates against imports had the consequence of creating and even freezing preferences for domestic goods."[171]

5.89 Thirdly, the United States, in its submission, has referred to the Mexican tariff schedule.[172] It should be noted that in order to apply the criterion of tariff classification, consideration should be given on whether the particular tariff classification is not too broad to be used for such comparison.[173]

2. Analysis of IEPS's conformity with the second sentence of Article III:2 of the GATT 1994

5.90 The United States alleges that taxes pursuant to IEPS is inconsistent with the second sentence of Article III:2 of the GATT as taxes applied on imported HFCS, imported soft drinks and syrups, and the agency, representation, brokerage, consignment and distribution of soft drinks and syrups sweetened with HFCS.

5.91 As provided in the second sentence of Article III:2 and confirmed by the Appellate Body report in *Japan – Alcoholic Beverages II*[174], whether a tax measure is inconsistent with the second sentence of Article III:2 is determined by three separate elements: (i) whether the products concerned are directly competitive or substitutable, (ii) whether the directly competitive products are "not similarly taxed"; and (iii) whether the dissimilar taxation is applied "so as to afford protection to domestic production."

5.92 With regard to the first element above, Japan agrees with the United States that, in assessing the competitive relationship between products, the criteria should be determined on a "case-by-case" basis in light of the relevant facts in the case.[175] Examples of specific criteria employed to determine whether products are "directly competitive or substitutable" are: physical characteristics, the channels of distribution, the end-uses of the products, price relationship (including cross-price elasticities) among other relevant characteristics[176], which should be considered in view of the relevant "market place."[177]

5.93 The United States, in its submission, refers to the results of the SECOFI anti-dumping investigation of HFCS published on 23 January 1998 as Mexico's determination that cane sugar and HFCS share the same essential physical characteristics.[178] Japan is concerned, however, whether the likeness issue in an anti-dumping case could be equated with the issue of direct competitiveness under Article III:2.[179]

---

[171] *Id*., Panel Report, para.6.28.

[172] United States first written submission, Section V.B.1(d), paras.3-4.

[173] Appellate Body Report on *Japan – Alcoholic Beverages II* , Section H.1.(a), p.22, DSR 1996:I, 97, at 115.

[174] *Id*., Section H.2., p.24, , DSR 1996:I, 97, at 116.

[175] United States first written submission, Section V.C.1(a), para. 15 (however, the relevant page number of the AB Report referred to in the US submission should be 25, not 20). *See also* Panel Report on *Japan – Alcoholic Beverages II*, para. 6.22.

[176] Appellate Body Report on *Japan – Alcoholic Beverages II* , Section H.2(a), p.25; GATT Panel Report on *Japan – Alcoholic Beverages I*, para. 6.22; Panel Report on *Chile – Alcoholic Beverages*, para. 7.30.

[177] GATT Panel Report on *Japan – Alcoholic Beverages I*, para. 6.22, Appellate Body Report, *Japan – Alcoholic Beverages II*, Section H.2(a), p.25, , DSR 1996:I, 97, at 117.

[178] United States first written submission, V.C.1(i), para.23.

[179] GATT Panel Report on *Japan – Alcoholic Beverages I*, para. 5.6 stated that: "The Panel was aware of the more specific definition of the term 'like product' in Article 2:2 of the 1979 Antidumping Agreement (BISD 26S/172) but did not consider this very narrow definition for the purpose of antidumping proceedings to be suitable for the different purpose of GATT Article III:2."

5.94 With regard to the second element, "the amount of differential taxation must be more than *de minimis* to be deemed 'not similarly taxed' in any given case".[180] Although "whether any particular differential amount of taxation is *de minimis* or is not … must … be determined on a case-by-case basis[181]," in the present case, it appears relatively clear that an additional tax of 20 per cent in question is beyond *de minimis*.

5.95 With regard to the third element, whether a tax measure is applied "so as to afford protection" to domestic products is determined through the "design, architecture and structure" of the measure, and is not an issue of intent[182], as the United States has rightly claimed. Thus, an examination of the stated objectives of the particular tax measure is irrelevant in determining any inconsistency with the second sentence of Article III:2 as a general rule. However, neither the complainant nor the panel is prevented from examining the relevancy between the features of a measure revealed by the "design, architecture and structure" and the stated objective of such a measure. In *Chile - Alcoholic Beverages*, the Appellate Body confirmed that a panel can "try to relate the observable structural features of the measure with its declared purposes, a task that is unavoidable in appraising the application of the measure as protective or not of domestic production."[183] To this extent, the United States' reference to the Mexican objectives of the tax measure could be relevant.[184]

VI. INTERIM REVIEW

6.1 The Panel issued its interim report to the parties on 27 June 2005. On 11 July 2005, the United States and Mexico submitted written comments and requested the Panel to review precise aspects of the interim report. On 25 July 2005, the United States and Mexico submitted written comments on each other's comments and requests for interim review.

6.2 The Panel has modified its report, where appropriate, in light of the parties' comments and requests, as explained below. The Panel has also made certain revisions and technical corrections for the purposes of clarity and accuracy. References to paragraph numbers and footnotes in Section VI of this report refer to those in the interim report, except as otherwise noted.

A. CLERICAL AND EDITORIAL CHANGES

6.3 The United States suggests certain changes to correct clerical errors contained in the different sections of the interim report, and to further clarify the report. The Panel has taken account of the United States' suggestions and modified most of the indicated paragraphs. The Panel has also made some additional clerical and editorial changes throughout the report. It has also corrected the numbers of paragraphs from the English and Spanish versions of the interim report issued to the parties.

---

[180] Appellate Body Report on *Japan – Alcoholic Beverages II* , Section H.2.(b), p. 27, DSR 1996:I, 97, at 119; Panel Report on *Japan – Alcoholic Beverages II* , para.6.33.

[181] *Id.*

[182] The Appellate Body in *Japan – Alcoholic Beverages II* set out as follows:

> "It is not necessary for a panel to sort through the many reasons legislators and regulators 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" (Appellate Body Report, *Japan – Alcoholic Beverages II* , Section H.2.(c), pp. 27-28, DSR 1996:I, 97, at 119.)

[183] Appellate Body Report on *Chile – Alcoholic Beverages*, para. 72.

[184] United States first written submission, V.C.1(c), para. 36.

6.4 Mexico notes that its comments on the United States' responses to questions posed by the Panel after the second substantive meeting had not been included in Annex C of the interim report. The Panel has amended this omission for the final report.

B. FACTUAL ASPECTS

6.5 The Unites States requests the Panel to modify the interim report's language in certain paragraphs in order to better reflect the facts demonstrated by evidence submitted by the parties. The United States also suggests that some cross-references and citation of evidence be added to the text of the Report. The Panel has modified the language of the report and added the references as requested, as well as other references not indicated by the United States.

C. ARGUMENTS OF THE PARTIES

6.6 The United States suggests modifications in certain paragraphs of the interim report, relating to Mexico's arguments. The Panel has decided to keep the relevant text as it had been originally presented by Mexico.

D. PRELIMINARY RULING

6.7 Mexico requests the Panel to amend paragraph 7.15 of the interim report, in order to clarify that the Panel's findings, conclusions and recommendations in the report only relate to Mexico's rights and obligations under the WTO Agreements, and not to Mexico's rights and obligations under other international agreements or other obligations under international law. Mexico also requests the Panel to delete paragraph 7.16, since in its opinion its measures would be justified under the NAFTA if the dispute were to be submitted in its entirety to dispute settlement under the mechanism established by this agreement.

6.8 The Panel has modified paragraph 7.15 of the interim report, as requested by Mexico, and modified paragraph 7.16 in order to clarify its meaning. The Panel has also made other minor changes.

E. COMMENTS ON PANEL'S FINDINGS

6.9 The parties request a number of modifications and minor corrections in the text of the report. Such requests have been duly considered and adopted, where appropriate, by the Panel. Some suggestions, however, have not been accepted as they would have improperly altered the substance of the findings, as noted below.

6.10 The United States requests the deletion of paragraphs 8.54, 8.115 and 8.153 of the interim report, since in its opinion they did not adequately reflect the United States arguments on the different treatment received by domestic and imported products as a result of the application of the soft drink tax, the distribution tax and the bookkeeping requirements. The Panel rejects the request to delete the paragraphs. However, in the light of the United States request, the Panel clarified their language. The Panel's reasoning is in fact based on the United States argument, supported by factual evidence, that *most* imports are being discriminated against.

6.11 Mexico disagrees with the description made by the Panel in paragraph 8.162, *in fine*, of the interim report.[185] Mexico considers that the paragraph wrongfully suggested that Mexico's position was that certain rules of international law were irrelevant for the purpose of interpreting Article XX of

[185] The interim report in Spanish, as issued to the parties, erroneously identified this paragraph as 8.180.

the GATT 1994. Mexico states that the Panel could resort to rules of international law other than the WTO Agreements to evaluate whether its measures were justified as measures necessary to secure compliance by the United States with the NAFTA. Mexico further states that its position throughout the dispute was that such measures were justified under international law. Mexico wishes to note these points for the record, but requests no specific action from the Panel.

6.12 The United States requests the revision of paragraphs 8.184 and 8.185 of the interim report. In its opinion, the Panel's analysis should focus on whether Mexico has met the burden of proof of its affirmative defence (which it has not, in the view of the United States) and not on what it means to enforce or to secure compliance. The United States suggests that the Panel consider the contribution that the measures at issue have made to securing compliance on the part of the United States, rather than focus on whether the outcome of such measures is "certain" or "uncertain". Mexico expressed its strong objection to the United States' request, and asked the Panel to reject it. Although it expresses its disagreement with the Panel's conclusions, Mexico is of the view that paragraphs 8.184 to 8.187 of the interim report need to be maintained, being germane to the Panel's finding that Mexico failed to demonstrate that the impugned measures were intended to secure compliance with laws or regulations that are not inconsistent with the GATT 1994. The Panel has retained the concerned paragraphs, although it has introduced changes in order to clarify their meaning. The Panel notes that its reasoning does not focus on whether the achievement of Mexico's objective through the measures at issue is certain or uncertain. Rather, the Panel considers that international countermeasures (as the ones allegedly imposed by Mexico) are intrinsically unable to *secure* compliance of laws and regulations. In contrast, national measures are, beyond particular factual considerations, usually in a position to achieve to achieve that objective, through the use of coercion, if necessary.

6.13 The United States raises an additional argument in support of the Panel's finding in paragraphs 8.184 and 8.185 of the interim report that Mexico's tax measures do not qualify under Article XX(d) of the GATT 1994, namely that the parties to the NAFTA (including Mexico) agreed on the mechanism necessary to resolve any dispute concerning compliance with that agreement. The argument has not been raised in the course of the dispute, until the interim review stage. Moreover, the United States has not requested consideration of such an argument in the final report.

6.14 The United States questions the use of the Appellate Body Report on *US – Gambling* in support of the Panel's conclusion that "the uncertain outcome of international countermeasures is a reason for disqualifying them as measures eligible for consideration under Art. XX(d)" in paragraphs 8.186 and 8.187 of the interim report. The United States argues that the referred case was not considering the necessity of a measure "to secure compliance with a law or regulation", but rather for the protection of public morals or the maintenance of public order. The United States adds that the Appellate Body did not say that a measure with uncertain results could never qualify as a reasonably available alternative, but rather it concluded, on the basis of the facts presented in that case, that a process of negotiation about regulation of a service was not an alternative "capable of comparison" to a measure restricting the service. The Panel agrees with the United States on the different context of the *US – Gambling* findings and those of the present case, but it considers that the reference is worthy of being kept as confirmation of the view that the uncertain outcome of international countermeasures is a reason for disqualifying them as measures eligible for consideration under Article XX(d).

6.15 With relation to paragraph 8.192 of the interim report, the United States requests the Panel to consider some of its arguments related to the meaning of the word "law", such as a definition of the term "laws" previously recalled in its submissions, the importance of the use of the word "laws" in plural in Article XX(d) of the GATT 1994 and the different translation into French and Spanish of the word "law", as used in Article XX(d) and in Article 3.2 of the DSU. Mexico did not oppose this request. The Panel has included the appropriate references to the definition presented by the United States and its other arguments related to the ordinary meaning of the word "law", which were considered in the course of the proceedings.

6.16 Finally, the United States requests the deletion of paragraph 8.234 of the interim report, which referred to Mexico's allegations that questioned whether the United States had acted in good faith in the course of the proceedings. Mexico expressly states that it does not object to deleting such paragraph. The Panel has accepted the request.

VII. PRELIMINARY RULING

A. INTRODUCTION

7.1 On 18 January 2005, the Panel issued a preliminary ruling, rejecting Mexico's request for the Panel to decline to exercise its jurisdiction in the case in favour of an Arbitral Panel under Chapter Twenty of the North American Free Trade Agreement (NAFTA).[186] The Panel concluded that, under the DSU, it had no discretion to decide whether or not to exercise its jurisdiction in a case properly before it. Furthermore, even if it had such discretion, the Panel did not consider that there were facts on record that would justify the Panel declining to exercise its jurisdiction in the present case. The Panel informed the parties that it would provide them with a detailed reasoning for that ruling in its final report.

7.2 In order to issue its preliminary ruling, the Panel considered Mexico's request as well as the arguments presented by the United States, the complaining party in the case, and by the third parties. Nothing in the DSU, or in the Panel's working procedures, required the Panel to address Mexico's request in a preliminary ruling. Instead, the Panel could have waited to rule on the request until its final report. It was the Panel's opinion, however, that both the parties and the panel proceeding were better served by an early ruling on the request. Had it been appropriate for the Panel to decline to exercise its jurisdiction, an early decision to this effect would have saved time and resources. On the other hand, if the Panel – as in the event it did – rejected Mexico's request, an early decision would allow the parties to concentrate on the other aspects of the dispute.

7.3 In view of the above, the Panel issued a preliminary ruling rejecting Mexico's request that it decline to exercise its jurisdiction in the case.

B. THE PANEL'S JURISDICTION TO HEAR THE PRESENT CASE

7.4 Both parties agreed that the Panel had jurisdiction to hear the United States' claims in the present case.[187] The Panel's jurisdiction in this case was thus not challenged by either of the parties. In light of the above, the Panel was satisfied that it had proper jurisdiction in this case and therefore the authority to consider and make rulings and recommendations on the matters raised by the parties.

C. MEXICO'S REQUEST

7.5 In considering Mexico's request, the Panel first addressed whether it had the discretion to decline to exercise its jurisdiction to hear and decide a case properly brought before it.

7.6 The Panel recalled that Article 11 of the DSU states that:

> "The function of panels is to assist the DSB in discharging its responsibilities under this Understanding and the covered agreements. Accordingly, a panel should make an objective assessment of the matter before it, including an objective assessment of

[186] See Annex B to this Report.

[187] Mexico's first written submission, para. 93. Mexico's response to Panel question No. 35. United States' written version of oral statements during the first substantive meeting of the parties with the Panel, para. 13. United States' response to Panel question No. 2, para. 10.

> the facts of the case and the applicability of and conformity with the relevant covered agreements, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements..."

7.7 In the context of Mexico's request, the term "discretion" would imply that the Panel has the power to decide whether or not to act. Indeed, discretion may be said to exist only if a legal body has the freedom to choose among several options, all of them equally permissible in law. It seems that such freedom for a panel would exist within the framework of the DSU only if a complainant did not have a legal right to have a panel decide a case properly before it.

7.8 As the Appellate Body has stated, the aim of the WTO dispute settlement system is to resolve the matter at issue in particular cases and to secure a positive solution to disputes.[188] A panel has thus to address the claims on which a finding is necessary to enable the DSB to make sufficiently precise recommendations or rulings to the parties. A panel would seem therefore not to be in a position to choose freely whether or not to exercise its jurisdiction. Were a panel to choose not to exercise its jurisdiction in a particular case, it would be failing to perform its duties. More specifically, the panel would be failing to perform its duty to make "an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and to make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements...".

7.9 Moreover, the Panel recalled that, under Articles 3.2 and 19.2 of the DSU, a panel may not add to or diminish the rights and obligations of WTO Members provided in the covered agreements. If a WTO panel were to decide not to exercise its jurisdiction in a particular case, it would diminish the rights of the complaining Member under the DSU and other WTO covered agreements. In this regard, the Panel also recalled Article 23 of the DSU, which provides that Members of the WTO "shall" have recourse to, and abide by, the rules and procedures of the DSU when they seek the redress of a violation of obligations or other nullification or impairment of benefits under the WTO covered agreements. In the Panel's view, the terms of Article 23 of the DSU make it clear that a WTO Member that considers that any of its WTO benefits have been nullified or impaired as a result of a measure adopted by another Member has the right to bring the case before the WTO dispute settlement system.

7.10 That being said, the Panel would point out that it makes no findings about whether there may be other cases where a panel's jurisdiction might be legally constrained, notwithstanding its approved terms of reference. In any event, such a situation would be distinguishable from the case before this Panel, where Mexico argued that the Panel legally had the discretion not to exercise its jurisdiction and requested the Panel to apply such discretion.

7.11 Mexico has argued that the United States' claims are linked to a broader dispute between the two countries related to trade in sweeteners under a regional treaty, the NAFTA.[189] In Mexico's opinion, under those circumstances, it would not be appropriate for the Panel to issue findings on the merits of the United States' claims.[190] In this regard, Mexico emphasized that its request to the Panel was not so much that the Panel decline to exercise its jurisdiction, but rather that it decline to exercise it "in favour of a NAFTA Chapter Twenty Arbitral Panel". In Mexico's opinion, only such a panel under the NAFTA would be in a position to "address the dispute as a whole".[191]

---

[188] Appellate Body Report on *Australia – Salmon*, para. 223.
[189] Mexico's first written submission, paras. 88-92.
[190] Ibid., paras. 102-103.
[191] Ibid., para. 13.

7.12 According to the information supplied by Mexico, there is a differing interpretation between Mexico and the United States regarding the conditions provided under the NAFTA for access of Mexican sugar to the United States' market.[192] The United States has acknowledged that there is such a difference which has resulted in a dispute under the NAFTA that "is presently in the panelist selection stage".[193]

7.13 However, Mexico did not argue, nor is there any evidence on record to indicate, that there are legal obligations under the NAFTA or any other international agreement to which Mexico and the United States are both parties, which might raise legal impediments to the Panel hearing this case or to the United States bringing its complaint to the WTO. Indeed, when specifically questioned on this point by the Panel, Mexico responded that there was nothing in the NAFTA that would prevent the United States from bringing the present case to the WTO dispute settlement system.[194] Mexico further added that it did not challenge the United States' right to bring its complaint to the WTO dispute settlement system nor to request the establishment of the Panel.[195]

7.14 Moreover, neither the subject matter nor the respective positions of the parties are identical in the dispute under the NAFTA which has been mentioned by Mexico and the dispute before us. In the present case, the complaining party is the United States and the measures in dispute are allegedly imposed by Mexico. In the NAFTA case, the situation appears to be the reverse: the complaining party is Mexico and the measures in dispute are allegedly imposed by the United States. As for the subject matter of the claims, in the present case the United States is alleging discriminatory treatment against its products resulting from internal taxes and other internal measures imposed by Mexico. In the NAFTA case, instead, Mexico is arguing that the United States is violating its market access commitments under the NAFTA.

7.15 The Panel was mindful that, under Article 3.10 of the DSU, Members should not link "complaints and counter-complaints in regard to distinct matters". In other words, even conceding that there seems to be an unresolved dispute between Mexico and the United States under the NAFTA, the resolution of the present WTO case cannot be linked to the NAFTA dispute. In turn, any findings made by this Panel, as well as its conclusions and recommendations in the present case, only relate to Mexico's rights and obligations under the WTO covered agreements, and not to its rights and obligations under other international agreements, such as the NAFTA, or other rules of international law.

7.16 The Panel additionally noted that Mexico has not argued that its challenged tax measures have been mandated or authorized under the rules of the NAFTA.[196]

7.17 Even assuming, for the sake of argument, that a panel might be entitled in some circumstances to find that a dispute would more appropriately be pursued before another tribunal, this Panel believes that the factors to be taken into account should be those that relate to the particular dispute. We understand Mexico's argument to be that the United States' claims in the present case should be pursued under the NAFTA, not because that would lead to a better treatment of this particular claim, but because it would allow Mexico to pursue another, albeit related, claim against the United States. The Panel fears that if such a matter were to be considered then there would be no

[192] Ibid., paras. 5, 27-77.
[193] United States' response to Panel question No. 7, para. 20.
[194] Mexico's response to Panel question No. 4.
[195] Mexico's response to Panel question No. 34.
[196] However, Mexico has argued that under the NAFTA the examination of the challenged tax measures could be linked to its complaint regarding the United States' market access commitments for Mexican sugar. See, Mexico's second written submission, para. 6. See also, Mexico's response to Panel question No. 58. But see, United States' response to Panel question No. 58, paras. 22-24.

practical limit to the factors which could legitimately be taken into account, and the decision to exercise jurisdiction would become political rather than legal in nature.

D. RULING BY THE PANEL

7.18 For the reasons indicated above, the Panel decided to reject Mexico's request for the Panel to decline to exercise its jurisdiction in the case in favour of an Arbitral Panel under Chapter Twenty of the North American Free Trade Agreement (NAFTA). The Panel concluded that, under the DSU, it has no discretion to decide whether or not to exercise its jurisdiction in a case properly before it. Furthermore, even if it had such discretion, the Panel did not consider that there were facts on the record that would justify the Panel declining to exercise its jurisdiction in the present case.

VIII. FINDINGS

A. CLAIMS AND ORDER OF ANALYSIS

1. Claims regarding soft drinks and claims regarding sweeteners

8.1 The United States' claims concern three measures adopted by Mexico, namely: a "soft drink tax", a "distribution tax" and a number of "bookkeeping requirements". The "soft drink tax" is a 20 per cent *ad valorem* tax on the transfer or, as applicable, the importation of certain soft drinks and syrups. The "distribution tax" is a 20 per cent tax on the provision of specific services (commission, mediation, agency, representation, brokerage, consignment and distribution), when these services are provided for transferring certain soft drinks and syrups. Finally, the "bookkeeping requirements" are a number of requirements imposed on taxpayers subject to the "soft drink tax" and to the "distribution tax".

8.2 The United States has submitted claims regarding the treatment that Mexico accords both to imports of soft drinks and syrups and to imports of non-cane sugar sweeteners, such as beet sugar and HFCS. The United States emphasizes that although the measures at issue are imposed by Mexico on soft drinks and syrups, this is a dispute which fundamentally concerns the treatment accorded to sweeteners.[197]

8.3 Mexico does not contest that this is mainly a dispute about the treatment of sweeteners, rather than about the treatment of soft drinks and syrups. Mexico agrees with the United States that, although the measures at issue are taxes that apply to soft drinks and syrups, these measures were imposed to "stop the displacement of domestic cane sugar by imported HFCS and soft drinks and syrups sweetened with HFCS". Mexico contends, however, that the dispute concerns, not just the treatment of imported sweeteners in Mexico, but is part of a broader dispute with the United States concerning the bilateral trade in sweeteners under a regional trade agreement, the NAFTA.[198]

8.4 Accordingly, the Panel will first examine the United States' claims regarding the treatment of imported non-cane sugar sweeteners in Mexico and will then turn to its claims regarding the treatment of imported soft drinks and syrups.

[197] United States' first written submission, para. 1.

[198] Mexico's first written submission, paras. 1-14 and 111. Written version of Mexico's oral statement during second substantive meeting of the Panel with the parties, para. 36.

2. Claims under Articles III:2 and III:4 of the GATT 1994, regarding the treatment of sweeteners

8.5 With respect to the sweeteners, the United States claims that that the soft drink tax and the distribution tax are inconsistent with both Articles III:2 and III:4 of the GATT 1994, whereas the bookkeeping requirements are inconsistent with Article III:4 of the GATT 1994.[199]

(a) Claims under Article III:2 of the GATT 1994

8.6 The United States argues that both the soft drink tax and the distribution tax, as they are applied to beet sugar and to HFCS, are inconsistent with the first sentence and with the second sentence of Article III:2 of the GATT 1994, respectively.[200]

8.7 The United States contends that beet sugar and cane sugar are "like" products, but that only beet sugar when used as a sweetener for soft drinks and syrups is subject to the soft drink tax and the distribution tax. According to the United States, this results in imported beet sugar being subject to taxes in excess of those applied to like domestic products, and that the taxes are therefore inconsistent with the first sentence of Article III:2 of the GATT 1994.[201]

8.8 The United States also contends that HFCS and cane sugar are directly competitive or substitutable products and that the soft drink tax and the distribution tax result in imported HFCS being taxed dissimilarly compared to domestic cane sugar in a manner so as to afford protection to Mexican domestic production. According to the United States, the soft drink tax and the distribution tax are therefore inconsistent with the second sentence of Article III:2 of the GATT 1994.[202]

(b) Claims under Article III:4 of the GATT 1994

8.9 The United States further argues that the soft drink tax, the distribution tax and the bookkeeping requirements, as they are applied on HFCS and beet sugar, are inconsistent with Article III:4 of the GATT 1994.

8.10 The United States says that, as sweeteners for soft drinks and syrups, beet sugar, HFCS and cane sugar are "like products" within the meaning of Article III:4 of the GATT 1994. It adds that the Special Tax on Production and Services (*Impuesto Especial sobre Producción y Servicios*, or IEPS)[203] affects the use of beet sugar and HFCS, by conditioning access to an advantage (the exemption from the tax) on use of a domestic sweetener (cane sugar). Producers of soft drinks and syrups who use imported beet sugar or HFCS to sweeten their products do not enjoy the same advantage. The IEPS thus accords less favourable treatment to imports than to like Mexican domestic products. The United States concludes that the soft drink tax, the distribution tax and the bookkeeping requirements are inconsistent with Article III:4 of the GATT 1994.[204]

---

[199] United States' second written submission, paras. 10-13

[200] United States' second written submission, paras. 14, 15 and 18.

[201] United States' second written submission. paras. 18-22.

[202] United States' first written submission, paras. 93, 94 and 131-140.

[203] For the remainder of this Section, we will refer to the Mexican Special Tax on Production and Services as IEPS and to the Law that regulates such tax (the Law on the Special Tax on Production and Services, *Ley del Impuesto Especial sobre Producción y Servicios*) as LIEPS.

[204] United States' first written submission, paras. 22, 153-162. United States' second written submission, paras. 12, 13 and 34-36.

(c) Simultaneous claims under Articles III:2 and III:4 of the GATT 1994

8.11 As noted above, the United States presents claims in relation to sweeteners under both Articles III:2 and III:4 of the GATT 1994. These claims have not been presented as alternatives. Rather, the United States argues that the IEPS as a tax on non-cane sugar sweeteners may be examined under both paragraphs. In its view, the IEPS is both an "internal tax" on non-cane sugar sweeteners for use in soft drinks and syrups within the meaning of Article III:2 and a "law ... affecting the internal ... use" of non-cane sugar sweeteners within the meaning of Article III:4.[205] The United States argues that Article III:2 prohibits dissimilar taxation of imported and domestic products, while Article III:4 prohibits less favourable treatment of imported products as compared to domestic products with respect to laws affecting their internal sale, use, etc. Thus, to the extent the less favourable treatment of the imported product takes the form of dissimilar taxation that affects its internal sale and use, the measure at issue may constitute a breach of both Articles III:2 and III:4 of the GATT 1994.[206]

8.12 The United States argues that, if there is overlap with respect to Articles III:2 and III:4 in this dispute, it is only "because of the particular tax measures Mexico has chosen to employ to discriminate against [non-cane sugar sweeteners]". In its opinion, "a discriminatory excise tax on a product, which also punishes users of that product for using imported inputs, would fit under both provisions".[207]

8.13 Mexico responds that, under previous WTO jurisprudence, when a measure, such as in this case, is an internal tax or other internal charge, it should be assessed under Article III:2 of the GATT 1994, and not under Article III:4. Non-fiscal regulations, on the other hand, would be covered by Article III:4.[208]

(d) Panel's analysis of the simultaneous claims

8.14 The Panel asked the parties whether a particular order should be followed when dealing with the United States' claims under Articles III:2 and III:4 of the GATT. As noted, in Mexico's opinion, WTO jurisprudence suggests that, if the challenged measure constitutes a tax measure, it should be assessed under Article III:2 of the GATT 1994, whereas a non-fiscal regulation would be covered by Article III:4 of the GATT 1994.[209] In turn, the United States does not express any strong preference on the order in which to analyse the claims. However, it suggests that the Panel could employ the same order used by the United States in its submissions, i.e., first Article III:2 and then Article III:4.[210]

8.15 Accordingly, the Panel will begin its analysis regarding the treatment accorded to sweeteners by Mexico under the challenged measures, by examining whether the soft drink tax and the distribution tax are internal taxes within the meaning of Article III:2. If the measures are internal taxes under Article III:2, the Panel will then continue its analysis on whether the measures are consistent with the requirements of Article III:2.

---

[205] United States response to Panel question No. 11, para. 26.
[206] United States response to Panel question No. 21, para. 43.
[207] United States response to Panel question No. 55, para. 16.
[208] Mexico's response to Panel questions Nos. 11 and 55. Written version of Mexico's oral statement during second substantive meeting of the Panel with the parties, paras. 53-54.
[209] Mexico's response to Panel questions Nos. 11 and 55.
[210] United States response to Panel question No. 55, para 17.

B. BURDEN OF PROOF

1. General rule on burden of proof

8.16 The general rule is that the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence.[211] Following this principle, the Appellate Body has explained that the complaining party in any given case should establish a prima facie case of inconsistency of a measure with a provision of the WTO covered agreements, before the burden of showing consistency with a provision or defending it under an exceptional provision is taken on by the defending party.[212] According to the Appellate Body, a prima facie case is "one which, in the absence of effective refutation by the defending party, requires a panel, as a matter of law, to rule in favour of the complaining party presenting the prima facie case."[213] To establish a prima facie case, the party asserting a particular claim must adduce evidence sufficient to raise a presumption that what is claimed is true. In this regard, precisely how much and precisely what kind of evidence will be required to establish a presumption that a claim is valid will necessarily vary from case to case.[214]

8.17 In this case, the initial burden of proof rests upon the United States, as a complainant, to establish its prima facie case that the measures at issue are inconsistent with certain provisions of the WTO covered agreements. The burden will then be on Mexico to rebut such a claim.

2. Burden of proof applied to the present case

8.18 In assessing the parties' claims and arguments in this case, the Panel notes that, other than to argue that the measure is not applied "so as to afford protection", Mexico does not respond to the United States' claims on the alleged violations of Article III of the GATT 1994. However, Mexico does not concede to the United States' claims on the alleged violations of Article III, nor does it agree that its tax measures are in violation of Article III. Mexico submits that its decision not to respond to the United States claims does not release the United States from its obligation as a complainant to establish a prima facie case, and that the Panel should make findings only after an examination of whether the conditions required by the different provisions of Article III have been met.[215]

8.19 In this regard, the United States argues that it should not be an arduous task for the Panel to confirm that it has established a prima facie case of inconsistency in this dispute. According to the United States, it has put forward more than ample evidence and legal arguments in its two submissions, its oral statements and responses to the Panel's questions, and all the uncontested facts that have been presented by the United States should be accepted for purposes of the Panel's factual and legal findings in this dispute. The United States also draws the Panel's attention to the approach in *US – Shrimp* and *Turkey – Textiles*, where the panels undertook a brief analysis, based on the evidence before them, confirming that the complaining parties had made their prima facie case and then proceeded to examine the respondents' affirmative defence under Articles XX and XXIV of the GATT 1994, respectively when, as in this case, the respondents did not make any rebuttals to the complainants' claims.[216]

---

[211] Appellate Body Report on *US – Shirts and Blouses*, p. 14, DSR 1997:I, p. 323 at p. 335. Panel Report on *US – Shrimp*, para. 7.14.

[212] Appellate Body Report on *EC – Hormones*, para. 104.

[213] Ibid.

[214] Appellate Body Report on *US – Shirts and Blouses*, p. 14, DSR 1997:I, p. 323 at p. 335.

[215] Mexico's response to Panel questions Nos. 9, 18 and 41.

[216] United States response to Panel question No. 9, paras. 22-23; and question No. 12, para. 27. United States second written submission, para. 6. Written version of United States oral statement during second substantive meeting of the Panel with the parties, para. 3.

8.20 The assessment of the consistency of the measures at issue with Article III entails an examination of factors such as like products, excessive or dissimilar taxation between imported and domestic products, protection of domestic industry, and less favourable treatment afforded to imported products. Therefore, to determine whether the United States has established its Article III claims, the Panel will need to examine the claims, arguments and evidence submitted by the parties for each legal requirement under the relevant provision of Article III while, at the same time, being mindful of the relatively succinct analytical approach adopted by the panels in *US – Shrimp* and *Turkey – Textiles* in the absence of any counter-arguments by the respondent.

C. THE UNITED STATES' CLAIMS REGARDING SWEETENERS UNDER THE FIRST SENTENCE OF ARTICLE III:2 OF GATT 1994

1. The United States' claims

8.21 The United States claims that two of the challenged tax measures, specifically the soft drink tax and the distribution tax, are inconsistent with the first sentence of Article III:2, because they are internal taxes imposed on imported beet sugar in excess of the taxes applied to a like domestic product, in this instance, cane sugar.

8.22 The United States argues that beet sugar and cane sugar are "like" products and that the incidence of the challenged taxes on the non-cane sugar sweeteners (in this case, beet sugar) for the production of soft drinks and syrups is much greater than the nominal 20 per cent tax on the final soft drinks and syrups. Such taxes, which are not applied to the like domestic product, would be inconsistent with the first sentence of Article III:2 of the GATT 1994.[217]

2. Mexico's response

8.23 Mexico does not respond to the United States' claims in this regard.[218]

3. Article III:2, first sentence, of the GATT 1994

8.24 Under the first sentence of Article III:2 of the GATT 1994:

> "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."

8.25 As articulated by the Appellate Body in its report in *Canada – Periodicals*, the analysis of whether a measure is inconsistent with the first sentence of Article III:2 of the GATT 1994 involves a two-step test:

> "[T]here are two questions which need to be answered to determine whether there is a violation of Article III:2 of the GATT 1994: (a) whether imported and domestic products are like products; and (b) whether the imported products are taxed in excess of the domestic products. If the answers to both questions are affirmative, there is a violation of Article III:2, first sentence."[219]

---

[217] United States' second written submission, paras. 18-22.
[218] Mexico's first written submission, para. 114. Mexico's response to Panel question No. 9.
[219] Appellate Body Report on *Canada – Periodicals*, pp. 22-23, DSR 1997:I, p. 449, at p. 465-66.

4. Panel's analysis

8.26 In order to examine this claim, and taking into account the fact that Mexico has chosen not to respond to the claims that the measures are inconsistent with Article III, the Panel will consider the United States' legal arguments, as well as all the available evidence.

(a) Likeness of products

8.27 The United States argues that beet sugar and cane sugar are "like products" within the meaning of the first sentence of Article III:2 of the GATT 1994. Indeed, the United States asserts that, although Article III:2 does not require that products be identical to be considered alike, cane and beet sugar are virtually identical with respect to their physical properties and end-uses, are distributed in the same manner to consumers (in this case, producers of soft drinks and syrups) that use them interchangeably and are both classified under heading 1701 of the Harmonized System.[220]

8.28 The consistent interpretation of dispute settlement bodies under the GATT 1947 and the WTO has been that the determination that products are "like" under Article III:2, first sentence, must be done "on a case-by-case basis, by examining relevant factors".[221] These factors include "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."[222] Another relevant factor identified by the Appellate Body is tariff classification, which, if sufficiently detailed, "can be a helpful sign of product similarity", and has been used for this purpose in several adopted panel reports.[223] The Appellate Body has added that the definition of "like products" in Article III:2, first sentence, must be construed narrowly.[224]

8.29 In order to address the likeness requirement of the first sentence of Article III:2, the Panel will therefore consider, on the basis of the evidence presented by the parties, the products' properties, nature and quality; their end-uses in a given market; consumers' tastes and habits; and the tariff classification of the products based on the Harmonized System. It will construe the test of likeness in a narrow manner, as has been consistently done under the first sentence of Article III:2 of the GATT 1994.[225]

(i) Products' properties, nature and quality

8.30 Physically and chemically, beet sugar and cane sugar are forms of sucrose (a combination of glucose and fructose bonded together) with an identical molecular structure. The main difference between these two forms of sugar is the source from which they are derived, sugar beets and sugar cane respectively.[226]

8.31 Both beet sugar and cane sugar are sweeteners and, more precisely, nutritive sweeteners or sweeteners with a caloric content (as opposed to non-nutritive or non-caloric sweeteners, such as

[220] United States' second written submission, para. 19.
[221] Appellate Body Report on *Canada – Periodicals*, p. 21, DSR 1997:I, p. 449, at p. 466. See also, Appellate Body Report on *Japan – Alcoholic Beverages II*, p. 20, DSR 1996:I, p. 97, at p. 113.
[222] GATT Report of the Working Party on *Border Tax Adjustments*, BISD 18S/97, para. 18, as quoted in Appellate Body Report on *Japan – Alcoholic Beverages II*, p. 20, DSR 1996:I, p. 97, at p. 113.
[223] Appellate Body Report on *Japan – Alcoholic Beverages II*, pp. 21-22, DSR 1996:1, p. 97, at p. 114.
[224] Ibid., pp. 19-21, DSR 1996:1, p. 97, at 112-114.
[225] Appellate Body Report on *Canada – Periodicals*, p. 21, DSR 1997:I, p. 449, at p. 468. See also, Appellate Body Report on *Japan – Alcoholic Beverages II*, pp. 19-21, DSR 1996:1, p. 97, at pp. 112-114.
[226] United States' first written submission, para. 22. United States' second written submission, para. 19.

saccharine). As such, both may be used as a sweetener in the industrial production of various products, including the soft drinks and syrups that are involved in the present dispute.[227]

(ii) Products' end-uses

8.32 For the particular end-use that is relevant in this case, the production of soft drinks and syrups, there is no difference between beet sugar and cane sugar. Producers can use beet sugar or cane sugar, or any combination of the two, when preparing soft drinks and syrups.[228]

8.33 Being virtually identical in their physical properties and end-uses, beet sugar and cane sugar can be distributed in the same manner, and industrial consumers (in this case, the producers of soft drinks and syrups) can use them interchangeably. In so far as a choice is made between them it will be based on availability and price.[229]

(iii) Consumers' tastes and habits

8.34 With regard to consumers' perceptions and behaviour in respect of the products, the Panel notices that both beet sugar and cane sugar are almost identical "sugars". There does not seem to be a conspicuous difference in taste between the two products.[230] Furthermore, for the particular end-use that is relevant in this case, i.e. the production of soft drinks and syrups, any difference in taste between beet sugar and cane sugar is even less noticeable. Consumers of soft drinks and syrups would not be aware that one type of sugar has been used, rather than the other, since the use of one or the other does not alter the taste of the product, nor is it normally indicated on the labelling of the soft drink or syrup. The United States has quoted a major soft drink producer who states that "[b]ecause there is no noticeable taste difference, bottlers have the option of using either high fructose corn syrup (HFCS), beet sugar or cane sugar, depending on availability and cost."[231]

(iv) Tariff classification of the products

8.35 Beet sugar and cane sugar are both classified under Harmonized System heading 1701.[232]

(v) Conclusion

8.36 Having considered the above factors, the Panel concludes that beet sugar and cane sugar are "like products" within the meaning of the first sentence of Article III:2, as sweeteners in the production of soft drinks and syrups.

---

[227] United States' first written submission, paras. 8 and 29. United States' second written submission, para. 19.

[228] United States' first written submission, para. 77. United States' second written submission, paras. 19, 27-29. See also United States' responses to Panel question No. 74, para 68. Exhibit US-40 (a), paras. 412, 415, 416, and 425 (original in Spanish).

[229] United States' first written submission, para. 109. United States' second written submission, paras. 19, 27-29. European Communities' third party written submission, para. 25. Exhibit US-40 (a), paras. 367 and 407 (original in Spanish).

[230] Exhibit US-40 (a), paras. 355 and 391 (original in Spanish).

[231] United States' first written submission, para. 77. United States' second written submission, paras. 19, 27-29. See also United States' response to Panel question No. 74, para 68.

[232] United States' second written submission, para. 19. See also United States' response to Panel question No. 74, para. 68.

(b) Taxed in excess

8.37 Having determined that beet sugar and cane sugar are "like products" within the meaning of the first sentence of Article III:2 of the GATT 1994, the Panel will now examine whether, through the soft drink tax and the distribution tax, Mexico is subjecting, directly or indirectly, imported products to internal taxes in excess of those applied, directly or indirectly, to like domestic products.

8.38 The United States argues that, by imposing a tax on soft drinks and syrups because they are sweetened with sweeteners other than cane sugar, Mexico has also imposed a tax on the sweeteners themselves. It further argues that, while the tax rate on the soft drinks and syrups is 20 per cent *ad valorem*, the effective rate of the tax, when calculated on the value of the sweeteners in the soft drinks and syrups, far exceeds that figure. This is because the value of the sweeteners is only a fraction of that of the soft drinks or syrups of which they form part. According to the United States, the soft drink tax and the distribution tax result in an effective tax rate of nearly 400 per cent on beet sugar, which is clearly a tax "in excess" of that applied to the like domestic product for the purposes of the first sentence of Article III:2.[233]

8.39 The Panel will focus its analysis on two questions: (i) whether beet sugar contained in soft drinks and syrups is "subject, directly or indirectly," to the soft drink tax and the distribution tax; and, (ii) whether the soft drink tax and the distribution tax subject imported beet sugar to internal taxes "in excess of" those applied to domestic cane sugar.

(i) Is beet sugar subject, directly or indirectly, to the soft drink tax and the distribution tax?

8.40 Article III:2 of the GATT 1994 does not cover all internal taxes and internal charges, but only those internal taxes or internal charges that are "applied" by Members, directly or indirectly, to products. The Article also refers in its first sentence to products that are "subject, directly or indirectly, to internal taxes or other internal charges". In the context of the present case, the two expressions (that "a tax be applied on a product" and that "a product be subject to a tax") can be taken to have a common meaning that involves the existence of a link between the relevant tax and the taxed product.

8.41 Although they are contained in the same legislative instrument (the LIEPS), the soft drink tax and the distribution tax are distinct measures that operate in different ways. The United States has asked the Panel to make findings on the consistency of each of these measures (as well as of the bookkeeping requirements) with Mexico's obligations under the GATT 1994.[234] Accordingly, the Panel will consider separately whether beet sugar is subject to internal taxes in the form of the soft drink tax or the distribution tax, or both.

Soft drink tax

8.42 The first sentence of Article III:2 refers to internal taxes or other internal charges that are applied "directly or indirectly" to products. It also refers to products that are subject "directly or indirectly" to internal taxes or other internal charges of any kind. The provision thus requires some connection, even if indirect, between the respective internal taxes or other internal charges, on the one hand, and the taxed product, on the other. The qualifying expression "directly or indirectly" does not eliminate the requirement for such a connection.

[233] United States' second written submission, para. 20. United States response to Panel question No. 15, para. 33, and question No. 74, paras. 71-73.

[234] United States response to Panel question No. 22, para. 48.

8.43 The soft drink tax is regulated by the Law on the Special Tax on Production and Services (*Ley del Impuesto Especial sobre Producción y Servicios*, or LIEPS)[235] and its implementing legislation. The tax is triggered by the importation or the internal transfer of soft drinks and syrups containing sweeteners other than cane sugar and it is charged on the importer or the purchaser as a percentage of the value of the soft drinks or syrups.[236] Because the tax is not proportional to the value of non-cane sweeteners in the drink or syrup, it might be argued that beet sugar is not subject *directly* to the tax. However, because, as explained in the following paragraph, beet sugar is subject at least *indirectly* to the tax, the point need not be decided here.

8.44 In regard to the question of the *indirect* imposition of the soft drink tax on sweeteners, it is significant that: (a) it is the presence of non-cane sugar sweeteners that provides the trigger for the imposition of the tax; and, (b) the burden of the tax can be expected to fall, at least in part, on the products containing the sweetener, and thereby to fall on the sweetener. The Appellate Body has said that "Article III protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products".[237] Taxes *directly* imposed on finished products can *indirectly* affect the conditions of competition between imported and like domestic inputs and therefore come within the scope of Article III:2, first sentence.[238] Indeed, in a previous case the word "indirectly" was considered to cover, *inter alia*, taxes that are imposed on inputs.[239]

8.45 Given the facts just stated, the Panel concludes that the operation of the soft drink tax in regard to sweeteners is a factor influencing such competitive relationship and that such non-cane sugar sweeteners are therefore "subject … to" the tax, albeit that the relationship is indirect. Consequently, non-cane sugar sweeteners are *indirectly* subject to the soft drink tax when they are used for the production of soft drinks and syrups.

Distribution tax

8.46 The distribution tax is also regulated by the LIEPS and its implementing legislation.[240] However, the degree of connection between the tax and the relevant products is more remote in the case of the distribution tax than in the case of the soft drink tax.

8.47 The "distribution tax" is a tax on the provision of certain services when those services are provided "for the purpose of transferring" certain products, including soft drinks and syrups.[241] In general, it is not evident that the distribution tax is a tax imposed on products, even *indirectly*. According to some of the criteria used in a previous WTO case, there may be reasons to consider the distribution tax as a tax on services rather than on products.[242] It is not triggered by the sales of the relevant products, but rather by the provision of services related to those products[243]; it is imposed at *ad valorem* rates, not on the price of the relevant products, but rather on the value of the related

[235] As noted, for the remainder of this Section, we will refer to the Mexican Law on the Special Tax on Production and Services as LIEPS and to the tax itself (Special Tax on Production and Services, *Impuesto Especial sobre Producción y Servicios*) as IEPS.

[236] Mexico's response to Panel question No. 48.

[237] Appellate Body Report on *Japan – Alcoholic Beverages II*, p. 16, DSR 1996:1, p. 97, at p. 110.

[238] Cf., Appellate Body Report on *Canada – Periodicals*, p. 19, DSR 1997:I, p. 449, at pp. 464-465.

[239] GATT Panel Report on *Japan – Alcoholic Beverages I*, para. 5.8. See also, Panel Report on *Canada – Periodicals*, paras. 3.49 and 5.29.

[240] Mexico's response to Panel questions Nos. 81-82.

[241] LIEPS, article 2 (II.A). Although the tax is also imposed on the provision of services related to other products, such as alcoholic beverages, cigarettes and other tobacco products.

[242] Appellate Body Report on *Canada –Periodicals*, pp. 17-18, DSR 1997:1, p. 449, at pp. 463-464. See also, Panel Report on *Canada –Periodicals*, paras. 5.28-5.29.

[243] LIEPS, article 2 (II.A).

services provided[244]; a special section of the LIEPS[245], separate from the section governing taxes on products, is only applicable to this tax; and, the person legally liable for the payment of the tax is the supplier of the service and not the producer of the relevant products (although the producers are obliged by law to retain the tax[246]).

8.48 Until January 2002, the LIEPS imposed payment of the distribution tax on the provision of services related to all soft drinks and syrups, regardless of the sweetener used. Since January 2002, and as a result of amendments introduced in the LIEPS, payment of the distribution tax has been exempted for the provision of services related to soft drinks sweetened with cane sugar. Pursuant to this amendment, the distribution tax is now imposed on certain services related to one group of soft drinks and syrups, while the same services related to another group of soft drinks and syrups are exempted from the tax, based only on whether those soft drinks and syrups are sweetened with cane sugar or with non-cane sugar sweeteners.

8.49 In the case of the soft drink tax, it was noted that the imposition of the tax creates a connection such that non-cane sugar sweeteners, such as beet sugar, can also be regarded to be *indirectly* subject to such tax, because the tax is based solely on the nature of the sweetener used, and because the burden of the tax can be expected to fall, at least in part, on the products containing the sweetener, and thereby to fall on the sweetener.[247] The imposition of the distribution tax creates a similar connection, considering again that it is based solely on the nature of the sweetener used, and that the burden of the tax can be expected to fall, at least in part, on the products containing the sweetener, and thereby to fall on the sweetener. Thus, while on its face the distribution tax is a tax *directly* applied on the provision of certain services, in the circumstances of this case, it is also an tax *indirectly* applied on non-cane sugar sweeteners when they are used for the production of soft drinks and syrups.

8.50 In conclusion, the distribution tax is a tax *indirectly* imposed on non-cane sugar sweeteners, such as beet sugar.

(ii) Do the soft drink tax and the distribution tax subject imported sweeteners to internal taxes in excess of those applied to like domestic sweeteners?

8.51 If the soft drink tax and the distribution tax are regarded as taxes *indirectly* imposed on non-cane sugar sweeteners[248], the evidence supports the conclusion that they subject beet sugar to internal taxes in excess of those applied to cane sugar. Indeed, the soft drink tax subjects the importation or the internal transfer of a certain group of soft drinks, those sweetened with non-cane sugar sweeteners, to the payment of a 20 per cent *ad valorem* tax.[249] As for the distribution tax, assuming that the services provided have some value, the 20 per cent *ad valorem* tax on those services will result in an additional tax on non-cane sugar sweeteners.

8.52 The Appellate Body has said that even the smallest amount of excess of the tax that imported products are subject to over the tax applied to like domestic products will satisfy the "in excess" criterion in Article III:2, first sentence. It has also made clear that the prohibition of discriminatory taxes in this provision is not conditional on a "trade effects test", nor qualified by a *de minimis* standard.[250]

---

[244] Ibid., Articles 17 and 3(XII).
[245] Ibid., Chapter IV of the Law.
[246] Ibid., Article 5-A.
[247] See para. 8.44 above.
[248] See paras. 8.45 and 8.50 above.
[249] United States response to Panel question No. 74, paras. 72-75.
[250] Appellate Body Report on *Japan – Alcoholic Beverages II*, p.23, DSR 1996:1, p. 97, at p. 115.

8.53 The United States contends that under the soft drink tax and the distribution tax the effective tax rate to which non-cane sugar sweeteners in soft drinks and syrups are subject is as high as 400 per cent.[251] Mexico does not dispute this figure. In any event, it is clear that, in *ad valorem* terms, the indirect tax burden on beet sugar as an input resulting from the 20 per cent tax on the value of the finished soft drinks or syrups and that resulting from the 20 per cent tax on the value of services associated with the soft drinks or syrups, based solely on the use of that non-cane sugar sweetener, would have to be compared with the corresponding burden on cane sugar, the like domestic product, which is zero per cent. In each case, there can be no doubt that the one is "in excess" of the other.

8.54 The United States contends that almost all imported products are being taxed in excess of like domestic products as a result of the application of the soft drink tax and the distribution tax, and that the only sweetener exempted from the measures (cane sugar) is almost exclusively a domestic product. As the following paragraphs explain, the Panel finds that the facts of the case support this contention. However, the Panel refrains from ruling on whether such a finding is necessary in order for the United States to establish its claim under Article III:2, first sentence, of the GATT 1994.

8.55 As described above, the IEPS establishes a different regime for two groups of soft drinks and syrups. One group of soft drinks and syrups is subject, *inter alia*, to the payment of a soft drink tax and a distribution tax, while the other group is exempted from these taxes. The criterion established by the Mexican legislation for the division of soft drinks and syrups into these two groups is whether the soft drinks and syrups are sweetened with cane sugar or with non-cane sugar sweeteners, such as beet sugar.

8.56 Mexico produces cane sugar for the use of the soft drink and syrup industry. Most sugar consumed in Mexico is locally produced.[252] In the five years from 1997 to 2001, cane sugar represented less than 1 per cent each year of total Mexican imports of sweeteners.[253] Unlike the United States, Mexico does not produce beet sugar. Consequently, any soft drinks containing beet sugar would contain an imported sweetener.

8.57 Although there is no record of imports of beet sugar into Mexico, not even incorporated in imported soft drinks, the soft drink tax and the distribution tax alter the conditions of competition to the detriment of beet sugar, making it less likely that there would be imports of beet sugar. As the European Communities indicates in its third party submission, in some WTO Members beet sugar may be the sweetener of choice for the production of soft drinks and syrups.[254]

8.58 The Panel therefore concludes that the situation where beet sugar is liable to higher taxes than those applied to cane sugar is *in effect* one where imported products are subject to taxes in excess of those applied to the like domestic products.

5. Conclusion

8.59 For the reasons stated above, the Panel concludes that the soft drink tax and the distribution tax indirectly subject beet sugar imported into Mexico to internal taxes in excess of those indirectly applied to like domestic products, and are in this respect inconsistent with Article III:2, first sentence, of the GATT 1994.

---

[251] United States' second written submission, para. 20.

[252] Exhibit US-15.

[253] United States' first written submission, paras. 19, 20, 23-26 and 56. See also United States' response to Panel question No. 74, paras. 70 and 75. Exhibit US-42.

[254] European Communities' third party written submission, para. 25.

D. THE UNITED STATES' CLAIMS REGARDING SWEETENERS UNDER THE SECOND SENTENCE OF ARTICLE III:2 OF GATT 1994

1. The United States' claims

8.60 The United States also requests the Panel to find that two of the challenged tax measures, the soft drink tax and the distribution tax, are inconsistent with the second sentence of Article III:2, because directly competitive or substitutable products – HFCS and cane sugar – are not taxed similarly and protection is thereby afforded to domestic production.

8.61 The United States argues that HFCS and cane sugar are "directly competitive or substitutable" products when used as sweeteners for soft drinks and syrups. The United States further contends that, as a result of the soft drink tax and the distribution tax, HFCS and cane sugar are not being similarly taxed in Mexico. According to the United States, the incidence of the taxes on HFCS for the production of soft drinks and syrups is much greater than the 20 per cent tax that is imposed on the final soft drinks and syrups. The United States claims that this dissimilar taxation is being applied by Mexico so as to afford protection to domestic production, inconsistently with the second sentence of GATT Article III:2.[255]

2. Mexico's response

8.62 Mexico's only response to the United States' claim under the second sentence of Article III:2, regarding the treatment of HFCS, is that its measures are not intended to afford protection to its domestic production within the meaning of Article III of the GATT.[256]

3. Article III:2, second sentence, of GATT 1994

8.63 The second sentence of Article III:2 of the GATT 1994 says:

> "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 [of Article III]."

8.64 In turn, paragraph 1 of Article III of the GATT states:

> "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.*" (Emphasis added).

8.65 Finally, the *Ad* Note to Article III:2 of the GATT provides:

> "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

---

[255] United States' first written submission, paras. 93-140. United States' second written submission, paras. 14-16.

[256] Mexico's first written submission, section III.D. Mexico's response to Panel question No. 83. Written version of Mexico's oral statement during second substantive meeting of the Panel with the parties, para. 18.

the other hand, a *directly competitive or substitutable product which was not similarly taxed.*" (Emphasis added).

4. Panel's analysis

8.66 There are three elements to be considered to determine whether a measure is inconsistent with Article III:2, second sentence: first, whether the imported products and the domestic products are "directly competitive or substitutable products" which are in competition with each other; second, whether the directly competitive or substitutable imported and domestic products are "not similarly taxed;" and third, whether the dissimilar taxation of the directly competitive or substitutable imported and domestic products is "applied ... so as to afford protection to domestic production."[257]

(a) Directly competitive or substitutable products

8.67 *Ad* Note to paragraph 2 of Article III makes it clear that to fall within the scope of paragraph 2, second sentence, it is sufficient that the relevant products be "directly competitive or substitutable".

8.68 The Appellate Body has said that products are "directly competitive or substitutable" if they are interchangeable or if they offer "alternative ways of satisfying a particular need or taste".[258] The phrase connotes a relationship between imported and domestic products at issue that can be essentially described as "in competition" in the marketplace.[259] In order to make this assessment, GATT and WTO bodies have examined the following factors: the competitive conditions between the products in the relevant market, in the light of the nature of both products, their physical characteristics, their common end-uses, consumers' perceptions and behaviour in respect of the products, and the products' tariff classifications.[260] The Panel will examine these factors in respect of HFCS and cane sugar.

(i) Products' properties, nature and quality

8.69 Both HFCS and cane sugar are sweeteners and, more precisely, nutritive sweeteners or sweeteners with a caloric content (as opposed to non-nutritive or non-caloric sweeteners, such as saccharine).[261] As such, both may be used, during an industrial process, for the purpose of sweetening products such as the soft drinks and syrups that are involved in the present dispute.

8.70 Physically, although not identical, HFCS and cane sugar have similar characteristics. They are both combinations of glucose and fructose, albeit in different proportions. In the case of HFCS, the precise proportions of glucose and fructose depend on the grade of the HFCS. The United States has provided evidence regarding the existence of three types of HFCS: HFCS-42, HFCS-55 and HFCS-90. The number stands for the percentage of fructose in the product. HFCS-42 and HFCS-55 are the grades most commonly used in the production of soft drinks and syrups. In these two formulations, the proportions of glucose and fructose in HFCS are similar to those in cane sugar. This similarity is deliberate, since HFCS is designed to mimic sugar as far as possible, so that it can be used as an alternative industrial sweetener. HFCS-90 may also be used as a sweetener for soft drinks and syrups if it is blended with HFCS-42 to produce HFCS-55. While HFCS is always liquid, sugar can also be consumed in liquid form, particularly for industrial uses such as the production of soft

[257] Appellate Body Report on *Japan – Alcoholic Beverages II*, p.24, DSR 1996:1, p. 97, at p. 116.
[258] Appellate Body Report on *Korea – Alcoholic Beverages*, para. 115.
[259] Ibid., para. 114.
[260] See, for example, Appellate Body Report on *Japan – Alcoholic Beverages II*, p. 25, DSR 1996:1, p. 97, at p. 117.
[261] United States' first written submission, para. 29.

drinks and syrups. Indeed, as part of the process of producing soft drinks and syrups, cane sugar is mixed with water to produce a sugar syrup, which is then added to other ingredients to produce the soft drink or syrup.[262]

(ii) Products' end-uses

8.71 Cane sugar and HFCS may serve the same end-use, i.e., to be sweeteners in the production of soft drinks and syrups. Indeed, the evidence suggests that HFCS was developed mainly as a cost-effective alternative to sugar for the production of soft drinks. Producers of soft drinks and syrups will decide whether to use cane sugar or HFCS – or, indeed, beet sugar – or any combination of those sweeteners, very largely on the basis of their relative prices.[263] Some producers may even use blends of sugar and HFCS.[264]

(iii) Consumers' perceptions and behaviour

8.72 Concerning consumers' perceptions, the Panel has already noted that the sweeteners in the present case are an input used in the production of a final product, i.e., soft drinks and syrups. The immediate consumers of the sweeteners are the industrial producers of soft drinks and syrups. The evidence suggests that these producers consider HFCS and cane sugar to be completely interchangeable and will substitute HFCS for cane sugar, if that reduces costs. According to the United States Department of Agriculture, "HFCS deliveries have shown strong growth from the period when first introduced in the 1970s up to the late 1990s. In the period up to 1986, HFCS growth came at the expense of corresponding reductions in sugar deliveries. After 1986, strong demand for carbonated soft drinks helped promote strong demand for HFCS. Since 1999, soft drink consumption growth has fallen and with it, the demand for HFCS."[265]

8.73 In the particular case of Mexico, the evidence indicates that, as HFCS became available, and before the tax measures were imposed, Mexican producers of soft drinks and syrups started substituting it for cane sugar. The United States Department of Agriculture estimated that "prior to the imposition of the tax in January 2002, Mexico's soft drink industry was using 450,000-480,000 mt of HFCS, or between 75 and 80 percent of total HFCS consumption of 600,000 mt, dry basis".[266] When the Mexican Government imposed measures on HFCS (such as anti-dumping duties and the tax measures challenged under the present case), the producers switched back to cane sugar. The United States has also pointed to the fact that industrial producers of fruit and vegetable juices, which are not subject to the IEPS, have continued using HFCS. All this evidence indicates that industrial consumers of sweeteners regard cane sugar and HFCS as interchangeable products for producing soft drinks and syrups.[267]

8.74 As for final consumers, the evidence indicates that the consumers of soft drinks and syrups do not differentiate between products sweetened with cane sugar and those sweetened with HFCS. HFCS and cane sugar are similar in terms of smell and colour: both are odourless and, when presented as liquids, colourless. The taste, colour and other physical characteristics of soft drinks and syrups sweetened with HFCS and cane sugar are indistinguishable.[268] Furthermore, Mexican labelling

[262] United States' first written submission, paras. 96-102 and 107. United States response to Panel question No. 72, paras. 56-60. Exhibits US-22 and US-40 (a), paras. 339 to 426 (especially paras. 350 to 355, original in Spanish).

[263] Exhibit US-40 (a), para. 355 (original in Spanish).

[264] United States' first written submission, paras. 106-113. Exhibit US-27.

[265] United States Department of Agriculture, "Sugar and Sweeteners Outlook" (May 27, 2004), Exhibit US-21, p. 19.

[266] Ibid., p. 23.

[267] United States' first written submission, paras. 14, 34, and 106-113. Exhibits US-26 and US-27.

[268] Exhibit US-22.

regulations do not make a distinction between the different sweeteners, so a bottler can switch between different mixtures of HFCS and cane sugar without changing the labelling, and the consumer will not be aware which of them is being used.[269] The Panel may therefore conclude that, as between HFCS and cane sugar, the specific caloric sweetener used is not a factor that Mexican consumers take into account when choosing a soft drink or syrup.[270]

(iv) Tariff classification of the products

8.75 Both cane sugar and HFCS are described as "sugars" in the Harmonized System. Cane sugar occupies heading 1701 of the Harmonized System, while HFCS is classified within heading 1702, together with liquid sugar and invert sugar, as part of the group "other sugars". Both products are therefore part of Harmonized System Chapter 17, "Sugars and sugar confectionery".[271]

(v) Determination by other authorities

8.76 The determination that HFCS and cane sugar may be regarded as "directly competitive or substitutable products" for producing soft drinks and syrups is supported by a similar conclusion reached by other bodies. In a press bulletin issued in 2003, the Mexican Ministry of Economics announced, in response to requests from industrial consumers of sugar in Mexico, the approval of an import quota of refined sugar as a "preventive measure", in case domestic production was insufficient to satisfy domestic demand. The bulletin goes on to state that the concerns of the industrial consumers of sugar were "mainly the consequence of the entry into force of the Special Tax on Production and Services (IEPS) for soft drinks elaborated with fructose, which generated a replacement of fructose with sugar in the sweeteners market of approximately 500 thousand tonnes..." (*Dichas preocupaciones son consecuencia fundamentalmente de la entrada en vigor del Impuesto Especial sobre Producción y Servicios (IEPS) para refrescos elaborados con fructuosa y que generó una sustitución de fructuosa por azúcar en el Mercado de edulcorantes de aproximadamente 500 mil toneladas*).[272]

8.77 A decision by the Mexican Federal Competition Commission in June 1999 similarly concluded that "Refined sugar is used mainly in the production of bottled refreshments, while standard sugar is used in various branches of the food industry. High fructose corn syrup (HFCS) is a substitute mainly for refined sugar" (*El azúcar refinada se utiliza principalmente en la producción de refrescos embotellados, mientras que el azúcar estándar es empleada en diversas ramas de la industria alimentaria. El jarabe de maíz de alta fructuosa (jmaf) es sustituto principalmente del azúcar refinada.*). [273] An earlier report of the same Mexican Federal Competition Commission had defined HFCS as a "close substitute for refined sugar in processing soft drinks" (*un sustituto cercano del azúcar refinada en la elaboración de bebidas gaseosas*).[274]

(vi) Conclusion

8.78 For the reasons indicated above, the Panel concludes that HFCS and cane sugar are "directly competitive or substitutable products" for producing soft drinks and syrups, within the meaning of Article III:2, second sentence.

---

[269] Exhibit US-37 (a), table 1 (original in Spanish).
[270] United States' first written submission, paras. 99, 100 and 111. Exhibit US-40 (a), para. 391 (original in Spanish).
[271] United States' first written submission, para. 117.
[272] Exhibit US-53 (original in Spanish).
[273] Exhibit US-56 (original in Spanish).
[274] Exhibit US-55 (original in Spanish).

(b) Not similarly taxed

8.79 For the Panel to conclude that an imported product is being "not similarly taxed" when compared to a directly competitive or substitutable domestic product, within the meaning of the second sentence of Article III:2 of the GATT 1994, it must determine that the tax burden on the imported product is heavier than on the domestic product, and that this difference is more than *de minimis*.[275]

8.80 The Panel has already determined that the soft drink tax and the distribution tax are indirectly applied to non-cane sugar sweeteners.[276]

8.81 The evidence indicates that, as a result of the application of the soft drink tax and the distribution tax, HFCS is being taxed dissimilarly compared to cane sugar. Indeed, as has been noted, the soft drink tax subjects the importation and the internal transfer of a certain group of soft drinks, those sweetened with non-cane sugar sweeteners, to the payment of a 20 per cent *ad valorem* tax. As for the distribution tax, assuming that the services provided have some value, the 20 per cent *ad valorem* tax on those services will result in an additional tax *indirectly* imposed on non-cane sugar sweeteners. When considered as a tax on the input, in *ad valorem* terms the actual tax burden that the soft drink tax and the distribution tax impose on non-cane sugar sweeteners (in particular, on HFCS), is higher than the rate of 20 per cent tax imposed on the finished product. Indeed, the actual tax burden on the input would be relative to the proportion that the value of the input represents of the price of the finished product and the value of the services provided.

8.82 The United States contends that under the soft drink tax and the distribution tax the effective tax rate to which non-cane sugar sweeteners in soft drinks and syrups are subject is as high as 400 per cent.[277] Mexico does not dispute this figure. In any event, it is clear that the burden on sweeteners resulting from the 20 per cent tax on the value of the finished soft drinks or syrups and that resulting from the 20 per cent tax on the value of services associated with the soft drinks or syrups, based solely on the use of non-cane sugar sweeteners, would have to be compared with the corresponding burden on cane sugar, the like domestic product, which is zero per cent. The term "not similarly taxed" is taken to mean a difference in tax that is more than *de minimis*.[278] The Panel is in no doubt that in each case the difference in taxation between soft drinks or syrups sweetened with HFCS and those sweetened with cane sugar is more than *de minimis*. Consequently, a product (HFCS) which is being taxed at considerably more than 20 per cent is not being "similarly taxed" to one (cane sugar) which is subject to no tax.

8.83 For these reasons, the Panel concludes that the difference in taxation between imported HFCS and domestic cane sugar, resulting from the application of the soft drink tax and the distribution tax, is more than *de minimis* and the two products are therefore "not similarly taxed".

(c) So as to afford protection to domestic production

8.84 The last issue to be considered by the Panel in regard to Article III:2, second sentence, is whether the soft drink tax and the distribution tax are being applied "so as to afford protection" to Mexican domestic production. The United States argues that, with respect to HFCS, the soft drink tax and the distribution tax afford protection to Mexican domestic production of cane sugar.[279]

---

[275] Appellate Body Report on *Japan – Alcoholic Beverages II*, p. 27, DSR 1996:1, p. 97, at p. 119.
[276] See paras. 8.45 and 8.50 above.
[277] United States' second written submission, para. 20.
[278] Appellate Body Report on *Japan – Alcoholic Beverages II*, p. 27, DSR 1996:1, p. 97, at p. 119.
[279] United States response to Panel question No. 29, para. 68.

8.85 For a violation of Article III:2, second sentence, it is not enough that imports and directly competitive or substitutable domestic products be dissimilarly taxed, the relevant tax must also be applied "so as to afford protection" to domestic production. In that regard, as explained by the Appellate Body:

> "[W]e 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."[280]

8.86 The design and operation of the soft drink tax and the distribution tax indicate that they afford protection to Mexican production of cane sugar. These taxes apply to the importation and internal transfers of all soft drinks and syrups, except for internal transfers of soft drinks and syrups sweetened with cane sugar. As the Panel has already determined, this means that the challenged measures mostly affect imported sweeteners as opposed to domestic like products.[281] Mexican production of sweeteners for soft drinks and syrups is concentrated on cane sugar, whereas imports of sweeteners were overwhelmingly concentrated on HFCS (until this trade ceased, coinciding with the imposition of the taxes).

8.87 The magnitude of the tax differential between imported and domestic products, resulting from the application of the soft drink tax and the distribution tax, is additional evidence of the protective effect of the measure on Mexican domestic production of sugar. As has been already noted, the 20 per cent tax rate on the finished soft drinks and syrups constitutes a tax on HFCS as an input that is considerably more than 20 per cent.[282]

8.88 The finding that the tax measures have a protective effect is in line with the general character of the measures taken by Mexico in recent years in the sugar sector.[283] Mexico has been able to maintain a relatively protected market for sugar.[284] This has allowed Mexico to maintain relatively high domestic prices for sugar, compared to international prices. According to the available data, most sugar consumed in Mexico is domestically produced, since Mexico imports very small quantities of sugar. Indeed, annual Mexican imports of sugar in the period 1995-2003, never exceeded 2.65 per cent of its domestic consumption and, in seven out of the nine years that comprise this period, they were below 1 per cent of domestic consumption.[285]

8.89 Mexico does not deny the importance it attributes to the protection of its cane sugar industry. Although Mexico states that its tax measures were "not intended to afford protection to domestic production within the meaning of Article III of the GATT 1994"[286], it acknowledges that the IEPS

---

[280] Appellate Body Report on *Japan – Alcoholic Beverages II*, p. 29, DSR 1996:I, p. 97, at p. 120.

[281] See para.8.56, above.

[282] See para. 8.82 above.

[283] See, for example, Mexico's first written submission, para. 52. See also, United States' first written submission, footnote 30. United States' comments to Mexico's response to Panel question No. 90, para. 48. Exhibits US-59, US-61, US-62, US-63, US-64 and US-65.

[284] Cf. Appellate Body Report on *Japan – Alcoholic Beverages II*, p. 31, DSR 1996:I, p. 97, at p. 122. See also, Panel Report on *Japan – Alcoholic Beverages II*, para. 6.35.

[285] United States' first written submission, para. 20. Exhibit US-42.

[286] Mexico's first written submission, section III.D. Written version of Mexico's oral statement during second substantive meeting of the Panel with the parties, para. 18.

was one of a number of measures adopted by the Mexican authorities to alleviate the adverse economic situation experienced by its domestic sugar industry. Indeed, it has expressed its agreement with the United States' observation that the challenged measures were imposed to "stop the displacement of domestic cane sugar by imported HFCS and soft drinks and syrups sweetened with HFCS".[287] Mexico claims, however, that its tax measures are not intended to afford protection to domestic production within the meaning of Article III of the GATT 1994, but were rather adopted as a response to the impairment of Mexico's rights under the NAFTA regarding market access opportunities for its sugar exports to the United States' market.[288]

8.90 In its various submissions in this case, Mexico describes at length the economic and social importance of its sugar sector. For example, it says that "in Mexico the cultivation of sugarcane is widespread and crucial to the rural economy. It is a vital cash crop for many relatively poor farmers in 15 of Mexico's 32 states. There are some 155,000 cane growers in Mexico and it is estimated that nearly 3 million people in rural Mexico depend on the sugarcane crop."[289] Mexico adds that: "Sugarcane is the leading and most important crop in Mexico. The cultivated field area is twice that of tomatoes, corn, carrots, and potatoes."[290] According to its figures, 1.5 per cent of the Mexican workforce depends directly on its sugar industry.[291] Sugar cane generates higher returns to the farmers than any other crop, in terms of production value per harvested hectare.[292]

8.91 The protective effect of the measure on Mexican domestic production of sugar does not seem to be an unintended effect, but rather an intentional objective. The Appellate Body has cautioned against ascribing too much importance to the subjective legislative intent of legislators and regulators in the drafting of a particular measure, to determine whether the measure is applied so as to afford protection to domestic production, particularly when that declared intent is that protectionism was not an objective.[293] However, the declared intention of legislators and regulators of the Member adopting the measure should not be totally disregarded, particularly when the explicit objective of the measure is that of affording protection to domestic production. Indeed, the Appellate Body has confirmed that statements made by government representatives of a Member, admitting to the protective intent of a measure, may be relevant as part of a number of considerations in reaching the conclusion that a measure is applied so as to afford protection to domestic production.[294]

8.92 In this respect, the United States has presented a copy of the written record of the debate that took place in December 2001 in the Mexican Congress on the bill that proposed the amendments to the LIEPS that would put in place the measures at issue. During that debate, a member of the Mexican Congress presented the bill on behalf of the committee that had drafted it (the Committee of Treasury and Public Credit of the Chamber of Deputies (*Comisión de Hacienda y Crédito Público*). During his presentation, the representative of the committee declared, after explaining to the chamber the taxes that would be imposed on soft drinks and syrups, "[w]e legislators, however, have the commitment to protect the national sugar industry, because a great number of Mexicans' subsistence depends on it. To that effect, it is proposed that the tax on soft drinks be applied only to those [soft drinks] that for their production utilize fructose instead of cane sugar".[295]

8.93 In March 2002, the Mexican Executive exempted, *inter alia*, all imports and transfers of soft drinks and syrups (and not only those of soft drinks and syrups sweetened with cane sugar) from

[287] Mexico's first written submission, para. 111. United States' first written submission, para. 3.
[288] Mexico's response to Panel question No. 83.
[289] Mexico's first written submission, para. 4.
[290] Ibid., para. 16.
[291] Ibid., para. 17.
[292] Ibid., para. 20.
[293] Appellate Body Report on *Japan – Alcoholic Beverages II*, pp. 27-28, DSR 1996:I, p. 97, at pp. 119.
[294] Appellate Body Report on *Canada – Periodicals*, pp. 30-32, DSR 1997:1, p. 449, at pp. 475-476.
[295] Exhibit US-28, US-29 (original in Spanish) and US-34(a), page 90 (original in Spanish).

payment of the soft drink tax. The Mexican Supreme Court of Justice was asked by the Chamber of Deputies of the Mexican Congress to annul that exemption on the grounds that the exemption was unconstitutional. When considering the case, the Supreme Court of Justice stated that:

> "[i]n order to resolve the alleged unconstitutionality of the challenged decree, that is, whether the law approved by the Congress of the Union is being duly executed, it is necessary to turn to the motives that prompted the ordinary legislator to reform the Law on the Tax on Production and Services, in order to extend the scope of subjects to that tax to those who use sweeteners different than cane sugar."[296]

8.94 The Mexican Supreme Court of Justice looked at the report of the Committee of Treasury and Public Credit of the Mexican Chamber of Deputies and at the statement made to the chamber by the representative of that committee to which we have referred. From those documents, the Court concluded that "the legislator's intent when extending the aforementioned tax to gasified waters, soft drinks, hydrating drinks and other taxed goods and activities, when they use fructose in their production rather than cane sugar, was that of protecting the sugar industry". The Court concluded that the Executive had violated, not only the fiscal objective of the measure, but "also its extra-fiscal objective that was expressed in the legislative procedure, that is the protection of the domestic sugar industry".[297] The exemption granted by the Mexican Executive was thus annulled.

8.95 Having considered all these factors, the Panel concludes that the soft drink tax and the distribution tax are being applied so as to afford protection to Mexican domestic production of cane sugar.

5. Conclusion

8.96 For the reasons given above, the Panel concludes that the dissimilar taxation imposed on directly competitive or substitutable imports (HFCS) and domestic products (cane sugar) is applied in a way that affords protection to domestic production, and that the tax measures are therefore inconsistent with Article III:2, second sentence, of the GATT 1994.

E. THE UNITED STATES' CLAIMS REGARDING SWEETENERS UNDER ARTICLE III:4 OF GATT 1994

1. The United States' claims

8.97 The United States requests the Panel to find that the challenged tax measures (the soft drink tax, the distribution tax and the bookkeeping requirements) are inconsistent with Article III:4 of the GATT 1994, because they are internal measures that affect the internal use and sale of imported non-cane sugar sweeteners and accord those non-cane sugar sweeteners treatment that is less favourable than that accorded to like products of national origin, i.e. cane sugar.

8.98 The United States claims that beet sugar, HFCS and cane sugar, as sweeteners for soft drinks and syrups, are "like products"; that the three challenged tax measures (the soft drink tax, the distribution tax and the bookkeeping requirements) affect the use of beet sugar and HFCS, by conditioning access to an advantage (the exemption from the tax) on use of a domestic sweetener (cane sugar); that producers of soft drinks and syrups who use imported beet sugar or HFCS to sweeten their products do not enjoy the same advantage; and that the three measures therefore accord less favourable treatment to imports than to like Mexican domestic products. The United States

[296] Exhibit US-31 (original in Spanish).
[297] Ibid.

concludes that the soft drink tax, the distribution tax and the bookkeeping requirements are therefore inconsistent with Article III:4 of the GATT 1994.[298]

2. Mexico's response

8.99 Mexico does not respond to the United States' claims in this regard.[299]

3. Article III:4 of GATT 1994

8.100 Under Article III:4 of the GATT 1994:

> "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."

8.101 The Appellate Body has said that "[f]or 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".[300]

4. Panel's analysis

8.102 The Panel has already determined that the soft drink tax and the distribution tax, as applied on beet sugar and HFCS, are internal taxes inconsistent with Article III:2 of the GATT 1994. Consequently, the Panel need not proceed any further in respect of these two measures. Nevertheless, the Panel will analyse the United States' claims against the soft drink tax and the distribution tax under Article III:4, in the event that either or both of the two measures should be considered more properly as measures affecting the internal use of sweeteners, rather than as internal taxes on sweeteners.

(a) Likeness of products

8.103 The United States argues that, as sweeteners for the production of soft drinks and syrups, beet sugar, HFCS and cane sugar are "like products" within the meaning of Article III:4. In its opinion, cane and beet sugar are not only "like", but are almost identical. HFCS and cane sugar, on the other hand, are near perfect substitutes as sweeteners in soft drinks and syrups.[301]

---

[298] United States' first written submission, paras. 155-162. United States' second written submission, paras. 34-36.

[299] Mexico's first written submission, para. 114. Mexico's response to Panel question No. 9.

[300] Appellate Body Report on *Korea – Various Measures on Beef*, para. 133.

[301] United States' first written submission, paras. 155-162. United States' second written submission, paras. 34 and 36.

8.104 The analysis of the likeness between imported and domestic products for the purpose of Article III:4 covers the characteristics of the relevant products and the extent of the competitive relationship between them. The Appellate Body has said that:

> "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."[302]

8.105 Beet sugar and cane sugar have already been found to be like products within the meaning of the first sentence of Article III:2 of the GATT 1994, as sweeteners in the production of soft drinks and syrups.[303] Since the Appellate Body has clarified that "that the scope of 'like' in Article III:4 is broader than the scope of 'like' in Article III:2, first sentence"[304], it follows that beet sugar and cane sugar are like products within the meaning of Article III:4.

8.106 As regards the likeness of cane sugar and HFCS, the factors to be taken into account – the products' properties, nature and quality; their end-uses in a given market; consumers' tastes and habits; and the tariff classification of the products – are the same as those examined by the panel when considering whether the two products were "directly competitive or substitutable" under Article III:2, second sentence.[305] It is not necessary for the Panel to repeat its factual conclusions regarding those factors. All that is necessary is that the Panel should consider, in the light of those factual conclusions, whether, and to what extent, the products involved are, or could be, in a competitive relationship in the marketplace and satisfy the "like products" criterion in Article III:4. The Panel is satisfied that the facts amply demonstrate that, as sweeteners for soft drinks and syrups, cane sugar and HFCS are in a close competitive relationship and that they undoubtedly can be considered as "like products" under Article III:4.

(b) Measures affecting the internal use of sweeteners

8.107 The United States claims that the LIEPS "affects" the use of beet sugar and HFCS, because they grant producers of soft drinks and syrups an advantage (an exemption from the three challenged tax measures: the soft drink tax, the distribution tax and the bookkeeping requirements) that is conditional on the use of a domestic sweetener, cane sugar. The added burdens imposed on the use of beet sugar and HFCS would influence the producers' choice of sweeteners. In the United States' opinion, the best evidence of this effect is the fact that, after imposition of the tax measures, all Mexican bottlers of soft drinks and syrups that were using HFCS, reverted to use of cane sugar. The United States thus concludes that the LIEPS is a law "affecting" the "internal use" of beet sugar and HFCS.[306]

8.108 The term "affecting" in the expression "laws, regulations and requirements affecting [the] internal sale, offering for sale, purchase, transportation, distribution or use" in Article III:4 of the GATT 1994 has a broad scope. As articulated in WTO and GATT jurisprudence, it "cover[s] not only laws and regulations which directly govern the conditions of sale or purchase but also any laws or

---

[302] Appellate Body Report on *EC – Asbestos*, para. 99.

[303] See para. 8.36 above.

[304] Appellate Body Report on *EC – Asbestos*, para. 99. Cf. Appellate Body Report on *Japan – Alcoholic Beverages II*, p. 19-21, DSR 1996:I, p. 97, at pp. 112-114.

[305] See paras. 8.69 to 8.77 above.

[306] United States' first written submission, para. 160. United States' second written submission, para. 34. United States response to Panel question No. 11, para. 26; question No. 21, para. 44; and question No. 55, para. 14.

regulations which might adversely modify the conditions of competition between domestic and imported products[307]."[308]

8.109 The Panel has already concluded that two of the measures challenged by the United States under Article III:4 of the GATT 1994 (the soft drink tax and the distribution tax) are imposed on imported sweeteners in a manner inconsistent with Article III:2.[309] The facts that were analysed by the Panel and led it to consider that the two taxes "apply" to imported sweeteners,[310] also support the conclusion that these taxes "affect" imported sweeteners.

8.110 The LIEPS exempts producers of soft drinks and syrups from payment of the soft drink tax, contingent on the use of cane sugar as a sweetener. On the other hand, producers of soft drinks and syrups that use any other sweetener to sweeten their products, including beet sugar or HFCS, do not enjoy the same exemption. Similarly, the LIEPS imposes a distribution tax on the provision of certain services, when these services are provided for the purpose of transferring soft drinks and syrups sweetened with non-cane sugar sweeteners. Providers of the same services, when the soft drinks and syrups are sweetened with cane sugar, are exempted from the distribution tax.[311]

8.111 The LIEPS also imposes a number of requirements (referred to in this case as the "bookkeeping requirements") on taxpayers who are subject to the soft drink tax and the distribution tax.[312] The bookkeeping requirements include the following obligations:

(a) Provide the tax authorities, in March of each year, in respect of the goods produced, transferred or imported in the immediately preceding year, with information regarding consumption of the goods by state and the corresponding tax, and the services provided by establishment in each state[313];

(b) Provide the Tax Administration Service with quarterly information, in the months of April, July, October and January of the relevant year, on their 50 main customers and suppliers in the quarter immediately preceding that in which they filed their statement, in respect of such goods[314];

(c) Maintain physical volumetric controls of the goods manufactured, produced or bottled, as appropriate, and report quarterly, in the months of April, July, October and January of the relevant year, on the monthly readings registered by each of the devices used for such controls, in the quarter immediately preceding that in which they filed their statement[315];

(d) In the case of importers or exporters of soft drinks or syrups, register in the sectoral register of importers and exporters, as appropriate, kept by the Ministry of Finance and Public Credit[316]; and,

---

[307] *(footnote original)* Panel Report on *Italy – Agricultural Machinery*, para. 12.
[308] See, for example, Panel Report on *Canada – Autos*, para. 10.80.
[309] See paras. 8.59 and 8.96 above.
[310] See paras. 8.42 to 8.45 and 8.46 to 8.50 above. See also, para. 8.80 above.
[311] United States' first written submission, paras. 159-160. United States' second written submission, paras. 34-36. United States response to Panel question No. 74, paras. 72-75.
[312] Mexico's response to Panel questions Nos. 22 and 50. United States response to Panel question No. 74, para. 76.
[313] LIEPS, article 19(VI).
[314] LIEPS, article 19(VIII).
[315] LIEPS, article 19(X).
[316] LIEPS, article 19(XI).

(e) Provide the Tax Administration Service with quarterly information, in the months of April, July, October and January of the relevant year, on the price, value and volume of each product transferred in the immediately preceding quarter.[317]

8.112 These bookkeeping requirements impose a burden on producers of soft drinks and syrups in addition to the payment of the soft drink tax and the distribution tax. However, this burden does not extend to producers who use cane sugar rather than beet sugar or HFCS as a sweetener. In light of the previous considerations and the broad scope of the expression "affect the internal sale, offering for sale, purchase, transportation, distribution, or use of imported products", the Panel considers that these bookkeeping requirements affect the "use" of imported beet sugar and HFCS by the soft drinks industry.

8.113 For the reasons indicated above, the Panel concludes that the soft drink tax, the distribution tax and the bookkeeping requirements may be considered as measures that affect the internal use in Mexico of non-cane sugar sweeteners, such as beet sugar and HFCS, within the meaning of Article III:4 of the GATT 1994.

(c) Less favourable treatment

8.114 The United States argues that the IEPS accords less favourable treatment to imports than that accorded to like products of national origin. In the United States' opinion, this is because in relation to their use in the production of soft drinks and syrups, the challenged measures bestow a substantive advantage on cane sugar that is not extended to non-cane sugar sweeteners, such as beet sugar or HFCS. The United States does not contend that the challenged measures overtly discriminate between imported and domestic products, but that they result in the latter being treated less favourably *in practice*. Since in Mexico cane sugar is almost exclusively a domestically produced sweetener, while HFCS is mostly an imported product and beet sugar is exclusively an imported product, this advantage in fact implies that the measures afford imported HFCS and beet sugar less favourable treatment than that accorded to the like product of national origin, cane sugar.[318]

8.115 The United States contends that almost all imported products are being accorded less favourable treatment as a result of the application of the challenged measures, since almost all imported products are comprised of non-cane sugar sweeteners and the only sweetener exempted from the measures (cane sugar) is almost exclusively a domestic product. As the following paragraphs explain, the Panel finds that the facts of the case support this contention. However, the Panel refrains from ruling on whether such a finding is necessary in order for the United States to establish its claim under Article III:4 of the GATT 1994.

8.116 The LIEPS establishes a different regime for two groups of soft drinks and syrups. One group of soft drinks and syrups is subject to the payment of a soft drink tax and a distribution tax and to the fulfilment of certain bookkeeping requirements, while the other group is exempted from these taxes and requirements. The criterion established by the Mexican legislation for the division of soft drinks and syrups into these two groups is whether the soft drinks and syrups are sweetened with cane sugar or with non-cane sugar sweeteners, such as beet sugar or HFCS. These measures have the effect of penalizing the consumption of non-cane sugar sweeteners by industrial producers of soft drinks and syrups. Producers who opt for the use of non-cane sugar sweeteners, such as beet sugar or HFCS, in the preparation of their soft drinks and syrups are subject to the payment of taxes and to the completion of requirements that are not demanded of those producers who use cane sugar instead.

[317] LIEPS, article 19(XIII).

[318] United States' first written submission, paras. 161-162. United States' second written submission, paras. 34 and 36.

8.117 The challenged measures create an economic incentive for producers to use cane sugar as a sweetener in the production of soft drinks and syrups, instead of other non-cane sugar sweeteners such as beet sugar or HFCS. This incentive is created by conferring an advantage (the exemption from the soft drink tax, the distribution tax and the bookkeeping requirements) on those producers that use cane sugar instead of non-cane sugar sweeteners, such as beet sugar or HFCS. These measures do not legally impede producers from using non-cane sugar sweeteners, such as beet sugar or HFCS. However, they significantly modify the conditions of competition between cane sugar, on the one hand, and non-cane sugar sweeteners, such as beet sugar or HFCS, on the other. Indeed, there is evidence that the imposition of these measures reverted the trend that was seemingly under way in the Mexican market towards the replacement of cane sugar as an industrial sweetener in the production of soft drinks and syrups, for non-cane sugar sweeteners, such as HFCS.[319]

8.118 The description of the soft drink tax, the distribution tax, and the bookkeeping requirements, and the fact that they are imposed only on soft drinks and syrups that contain non-cane sugar sweeteners, leaves no doubt that the soft drinks and syrups sweetened with beet sugar and HFCS are less favourably treated. The measures therefore alter the conditions of competition in the Mexican market in favour of cane sugar and to the detriment of non-cane sugar sweeteners, such as beet sugar or HFCS, according a less favourable treatment to the latter than that accorded to cane sugar.

8.119 The evidence demonstrates that, although on their face the challenged measures do not distinguish between imported and domestic sweeteners, the distinction they make between the use of cane sugar and non-cane sugar sweeteners is, in fact, one that distinguishes between imported and domestic sweeteners. Domestically produced sweeteners in Mexico consist overwhelmingly of cane sugar. In the years prior to the imposition of the challenged measures, production of HFCS started to develop in Mexico, mainly to satisfy the demand for sweeteners by the domestic soft drinks and syrups industry. However, even in 2001, when HFCS reached its highest share of the Mexican sweetener market, it still represented less than 10 per cent, with cane sugar accounting for almost all the rest. Coinciding with the imposition of the challenged measures, Mexican production of HFCS started to decline.[320]

8.120 In turn, before the challenged measures were instituted, as a group imported sweeteners in Mexico were overwhelmingly constituted by non-cane sugar sweeteners. In the five years from 1997 to 2001, non-cane sugar sweeteners, consisting almost entirely of HFCS, represented almost 100 per cent of total Mexican imports of sweeteners. Imports of cane sugar during that period represented less than 1 per cent of total Mexican imports of sweeteners in each year.[321]

8.121 In conclusion, it is evident that in practice the challenged measures detrimentally affect the competitive situation of the imported sweeteners that the producers of soft drinks and syrups could have chosen (mostly HFCS), when compared to that of the most widely available domestic sweetener (i.e., cane sugar).

8.122 Consequently, the Panel finds that the challenged measures accord less favourable treatment to imported non-cane sugar sweeteners, such as beet sugar and HFCS, than that accorded to like products of national origin.

---

[319] United States' first written submission, paras. 25-26. United States response to Panel question No. 72, para. 59.

[320] United States' first written submission, paras. 16 and 23-25. See also, Exhibits US-11(b), US-11(c), US-11(d) and US-11(e).

[321] United States' first written submission, para. 25. See also Exhibit US-42.

5. Conclusions

8.123 For the reasons indicated (and subject to the qualification made above[322], regarding the Panel's findings that the soft drink tax and the distribution tax are inconsistent with Article III:2 as regards imported beet sugar and imported HFCS), the Panel concludes that, through the soft drink tax, the distribution tax and the bookkeeping requirements, Mexico accords less favourable treatment to imported non-cane sugar sweeteners, such as beet sugar and HFCS, than that accorded to like products of national origin, i.e., cane sugar. These measures are therefore inconsistent with Article III:4 of the GATT 1994.

F. THE UNITED STATES' CLAIMS REGARDING SOFT DRINKS AND SYRUPS UNDER THE FIRST SENTENCE OF ARTICLE III:2 OF GATT 1994

1. The United States' claims

8.124 The United States requests the Panel to find that two of the challenged tax measures, specifically the soft drink tax and the distribution tax, are inconsistent with the first sentence of Article III:2, because they are internal taxes imposed on imported soft drinks and syrups sweetened with HFCS and beet sugar in excess of the taxes applied to the like domestic product, i.e., soft drinks and syrups sweetened with cane sugar.[323]

8.125 With regard to the soft drink tax, the United States argues that the measure is imposed at the time of importation into Mexico of all soft drinks and syrups, regardless of the type of sweetener used.[324] The tax is also imposed on internal transfers of soft drinks and syrups, except for those exclusively sweetened with cane sugar (and with the exception of public sales). The distribution tax is imposed on the provision of certain services (agency, representation, brokerage, consignment and distribution) for soft drinks and syrups, except for those exclusively sweetened with cane sugar.[325]

8.126 The United States observes that the vast majority of soft drinks and syrups produced in Mexico are sweetened with cane sugar, while in the United States the sweetener of choice for soft drink and syrup production is HFCS.[326] Since soft drinks and syrups sweetened with non-cane sugar sweeteners, such as HFCS and beet sugar, and Mexican domestic soft drinks and syrups sweetened with cane sugar are "like" products, the United States submits that the imposition of the soft drink tax and the distribution tax subjects imported products to taxes higher than those applied to the like domestic product, in a manner inconsistent with the first sentence of Article III:2 of the GATT 1994.

2. Mexico's response

8.127 Mexico does not respond to these United States' claims.[327]

3. Panel's analysis

8.128 As was done with respect to the treatment accorded to beet sugar, the Panel will analyse the consistency of the challenged measures with Article III:2, first sentence, by considering two

---

[322] See para. 8.102 above.

[323] United States' first written submission, paras. 57 and 62-90. United States' second written submission, paras. 23 and 25-31.

[324] United States response to Panel question No. 13, para. 29 and question No. 14, paras. 30-32.

[325] United States' first written submission, paras. 59, 60, 85 and 89. United States' second written submission, para. 9.

[326] United States' first written submission, para. 56.

[327] Mexico's first written submission, para. 114. Mexico's response to Panel question No. 9.

questions. First, whether the imported and domestic products are like products. Second, whether the imported products are subject to taxes in excess of those applied to the like domestic products.[328]

(a) Likeness of products

8.129 The United States contends that imported soft drinks and syrups and domestic soft drinks and syrups are alike, because soft drinks and syrups sweetened with non-cane sugar sweeteners including HFCS and beet sugar (which are mostly imported), are like those sweetened with cane sugar (which are mostly domestic).[329] According to the United States, soft drinks sweetened with non-cane sugar sweeteners, in particular, with HFCS and beet sugar, and those sweetened with cane sugar, have "virtually identical" characteristics in terms of physical properties, end-uses, consumer tastes and habits, and tariff classification.[330]

8.130 Under the principles established by previous GATT and WTO dispute settlement bodies, the Panel will determine the "likeness" of the products by examining the products' properties, nature and quality; their end-uses in the given market; consumers' perceptions and behaviour; and the products' tariff classification.[331]

(i) Products' properties, nature and quality

8.131 Regarding the physical characteristics of the soft drinks, both types of products (soft drinks and syrups sweetened with non-cane sugar sweeteners and soft drinks and syrups sweetened with cane sugar) are virtually identical. They have identical physical appearances. They are virtually indistinguishable by the human body, since they contain similar amounts of calories and are digested and absorbed in the same manner. Since caloric non-cane sugar sweeteners (HFCS and beet sugar) and cane sugar have a very similar chemical composition, it follows that soft drinks and syrups sweetened with non-cane sugar sweeteners and soft drinks and syrups sweetened with cane sugar have nearly the same chemical composition. In countries such as Mexico and the United States, both types of soft drinks and syrups are usually indistinguishable on the basis of their ingredient labels, since both generally bear the same ingredient inscription on the label.[332]

(ii) Products' end-uses

8.132 As the United States has contended, it is evident that soft drinks and syrups, regardless of the caloric sweetener used, share identical end-uses. Both types of products may be drunk for quenching thirst, providing energy or nourishment, or for socialization; they may be drunk straight or mixed with other beverages; they may be consumed before, after or during meals; and they may be consumed at home or in public places alike, regardless of whether they are sweetened with HFCS or beet sugar or with cane sugar.[333]

8.133 The evidence also indicates that, regardless of the caloric sweetener used, soft drinks and syrups use similar distribution channels. The United States has quoted major producers of soft drinks (*Coca-Cola* and the *Pepsi Bottling Group*) to the effect that there are no differences in the distribution channels used for these products. Retail seems to be the primary distribution channel in both Mexico

[328] Appellate Body Report on *Canada – Periodicals*, p. 24, DSR 1997:I, p. 449, at p. 465-466.

[329] United States second written submission, para. 23.

[330] United States first written submission, paras. 66-83. United States second written submission, paras. 23 and 26-29. United States responses to Panel question No.. 18, para. 39, and question No. 74, paras. 68 and 69.

[331] Appellate Body Report on *Canada – Periodicals*, p. 21, DSR 1997:I, p. 449, at p. 466. See also, Appellate Body Report on *Japan – Alcoholic Beverages II*, pp. 21-22, DSR 1996:I, p. 97, at p. 113.

[332] Exhibits US-22 and US-37(a), table 1 (original in Spanish).

[333] United States first written submission, para. 72 and footnote 117. Exhibit US-38.

(where most soft drinks are sweetened with cane sugar) and the United States (where most soft drinks are sweetened with HFCS). Considering the evidence, there is no indication that channels of distribution for major producers of soft drinks in Mexico changed during the 1990s through 2001, even though the producers switched from cane sugar to a blend of HFCS and sugar, and then again to cane sugar during this period.[334]

(iii) Consumers' perceptions and behaviour

8.134 Regarding consumer tastes and preferences, the United States has indicated that surveys and taste tests conducted by soft drinks bottlers demonstrate that consumers do not show any consistent pattern of preference for soft drinks sweetened with sugar versus soft drinks sweetened with HFCS, nor do they detect any significant difference in taste and sweetness.[335] There is also evidence that in Mexico, under labelling regulations, labels will generally identify "all monosaccharides and disaccharides that are present in a non-alcoholic food or beverage" as "sugars" (*azúcares*), so that consumers may not even be aware of the specific type of caloric sweetener used.[336] Also, marketing strategies in Mexico seem not to have changed when the largest local bottler of soft drinks switched to a blend of sugar and HFCS, instead of pure cane sugar, from 1996 through 2003.[337] All these facts support the conclusion that there is no perceived consumer preference for any of the considered products based exclusively on the type of caloric sweetener that is used. Indeed, the difficulty for consumers to distinguish between soft drinks and syrups sweetened with HFCS and those sweetened with cane sugar is not a matter of chance. HFCS was designed to mimic sugar as much as possible, in order to be an alternative industrial sweetener.[338]

(iv) Tariff classification of the products

8.135 With respect to their tariff classification, Mexico does not draw any distinction between soft drinks and syrups on the basis of the type of sweetener used (cane sugar, beet sugar or HFCS). Its tariff schedule classifies soft drinks and syrups as follows:

(a) soft drinks, hydrating and rehydrating beverages: 2202.10 and 2202.90

(b) syrups (including concentrates, powders, essences and extracts): 2101.11, 2101.12, 2101.20, 2101.30, 2106.90.05, 2106.90.06 and 2106.90.07.[339]

(v) Conclusion

8.136 In view of these considerations, the Panel concludes that soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are "like products" for the purposes of Article III:2, first sentence of the GATT 1994. HFCS and cane sugar have a slight difference in the exact ratio of their components (i.e. fructose to glucose) [340], but the difference between both products is not enough to make soft drinks sweetened with one or the other not "like". Likewise, the Panel finds that soft drinks and syrups sweetened with beet sugar and soft drinks and syrups sweetened with cane sugar are "like products" for the purposes of this provision. In fact, the two are virtually identical.

---

[334] United States first written submission, paras. 73-76. Exhibits US-16, US-18, US-19, US-20, US-24 and US-39.

[335] United States first written submission, paras. 77, 78 and 99.

[336] United States first written submission, paras. 68-71 and 111. Exhibits US-36 and US-37.

[337] United States first written submission, para. 81.

[338] United States first written submission, para. 107.

[339] United States first written submission, paras. 27 and 82. Exhibit US-43. Mexico's response to Panel question No. 44.

[340] *See* footnote 115 of the United States first written submission.

(b) Taxed in excess

8.137 Having determined that soft drinks and syrups sweetened with beet sugar and HFCS may be regarded as "like products" when compared with soft drinks and syrups sweetened with cane sugar, the Panel will now turn to the issue of whether, through the soft drink tax and the distribution tax, Mexico is subjecting, directly or indirectly, imported products to internal taxes *in excess* of those applied, directly or indirectly, to like domestic products, in a manner inconsistent with the first sentence of Article III:2 of the GATT.

8.138 The challenged tax measures (soft drink tax and the distribution tax) are applied at different points in time. First, at the time of importation, the soft drink tax is applied to all imported soft drinks and syrups, regardless of the sweetener used. Second, once imported soft drinks and syrups clear customs and enter into the Mexican market, the soft drink tax is applied to soft drinks sweetened with non-cane sugar sweeteners upon each internal transfer (with the exception of public sales). Third, the distribution tax is applied to soft drinks and syrups sweetened with non-cane sugar sweeteners on the provision of certain services within Mexico. The Panel will examine the challenged tax measures considering these three points in time to determine whether they are imposed on imported soft drinks and syrups in excess of the taxes imposed on like domestic soft drinks and syrups.[341]

(i) Soft drink tax at the time of importation

8.139 At the time when the DSB established this Panel and approved its terms of reference, Mexico was imposing a 20 per cent tax (the soft drink tax) on "all imported soft drinks and syrups" at the point of importation, regardless of the sweetener used.[342] The United States argues that this tax discriminated on its face against imports, since it was not applied to domestic products.[343]

Amendments to the LIEPS

8.140 In November 2004, the Mexican Congress amended the LIEPS with the effect that, from January 2005, imported soft drinks and syrups qualify for the exemption from payment of the soft drink tax, as long as they are sweetened exclusively with cane sugar.[344]

8.141 The United States argues that the Panel should not take such amendment into consideration, because it is outside the Panel's terms of reference. It submits that the measures before the Panel are Mexico's tax measures as they stood when this Panel was established, which were embodied in the text of the LIEPS published on 1 January 2002 and its subsequent amendments published on 30 December 2002 and 31 December 2003.[345] Mexico responds that the Panel has the power to consider the amendments to the LIEPS in the context of this dispute. In its opinion, the obligation contained in Article 11 of the DSU, under which a Panel must assist the DSB in discharging its responsibilities under the DSU by making an objective assessment of the matter before it, require panels to take into account events which occurred during the proceedings, including amendments to the measures at issue.[346]

[341] United States first written submission, paras. 38-44.
[342] Mexico's response to Panel question No. 45.
[343] United States second written submission, para. 11.
[344] Mexico's response to Panel questions Nos. 45, 50 and 52. Exhibit MEX-46.
[345] United States second written submission, para. 32. United States response to Panel question No. 52, paras. 1-6.
[346] Mexico's response to Panel question No. 52.

8.142 In respect of these arguments, the Panel first notes that the entry into force of the amendments to the LIEPS occurred after the date of establishment of the Panel (6 July 2004).[347] The parties do not claim that the amendments are within the Panel's terms of reference. In its request for the establishment of a panel in this case, the United States identified the measures at issue as the "Law on the Special Tax on Production and Services (*Ley del Impuesto Especial sobre Producción y Servicios* or "IEPS") published on 1 January 2002 and its subsequent amendments published on 30 December 2002 and 31 December 2003".[348] The specific reference made by the United States to "subsequent amendments published on 30 December 2002 and 31 December 2003" is not broad enough to include further amendments that came after the establishment of the Panel[349], and consideration of such amendments does not seem necessary to secure a positive solution to the present dispute for the reasons explained below.

8.143 Several previous panels have refrained from making findings on measures terminated before their establishment.[350] In *Argentina – Textiles and Apparel*, the panel declined to rule on a measure that was "revoked before the Panel was established and its term of reference set, i.e. before the Panel started its adjudication process"[351], even though the measure had been included in its terms of reference. The panel cited in its support the statement of the Appellate Body that the aim of dispute settlement is not:

> "[T]o encourage either panels or the Appellate Body to 'make law' by clarifying existing provisions of the *WTO Agreement* outside the context of resolving a particular dispute. A panel need only address those claims which must be addressed in order to resolve the matter in issue in the dispute."[352]

8.144 In the present case, however, the amendments to the LIEPS entered into force on 1 January 2005, which was six months after the establishment of the Panel. Furthermore, the effects of the new amendments seem to be limited to only part of the claims against the challenged measures, i.e. the imposition of the soft drink tax to all imported soft drinks and syrups at the point of importation, regardless of the sweetener used. The Panel recalls that the Appellate Body has said that "the demands of due process are such that a complaining party should not have to adjust its pleadings throughout dispute settlement proceedings in order to deal with a disputed measure as a 'moving target'."[353] Given its terms of reference[354], in the light of the obligations contained in Article 11 of the Dispute Settlement Understanding, and without an agreement between the parties to terminate the proceedings as regards this aspect of the contested measures, the Panel considers there is no basis for it to abstain from ruling on the complaint made by the United States. Indeed, several panels have

---

[347] "Mexico – Tax Measures on Soft Drinks and other Beverages. Constitution of the Panel Established at the Request of the United States. Note by the Secretariat". Doc. WT/DS308/5/Rev.1 of 25 August 2004.

[348] See, "Mexico – Tax Measures on Soft Drinks and other Beverages. Request for the Establishment of a Panel by the United States". Doc. WT/DS308/4 of 11 June 2004.

[349] See, Appellate Body Report on *Chile – Price Band System*, para. 144.

[350] See, for example, Panel report on *US – Gasoline*, and Panel Report on *Argentina – Textiles and Apparel*.

[351] Panel report on *Argentina – Textiles and Apparel*, para. 6.13.

[352] Appellate Body Report on *US – Wool Shirts and Blouses*, p. 19, DSR 1997:I, p. 323 at p. 340.

[353] Appellate Body Report on *Chile – Price Band System*, para. 144.

[354] See, "Mexico – Tax Measures on Soft Drinks and other Beverages. Constitution of the Panel Established at the Request of the United States. Note by the Secretariat". Doc. WT/DS308/5 of 20 August 2004. See also, "Mexico – Tax Measures on Soft Drinks and other Beverages. Request for the Establishment of a Panel by the United States". Doc. WT/DS308/4 of 11 June 2004.

reached the same conclusion, when examining measures terminated before or during the panel process.[355]

Soft drink tax at the time of importation

8.145 The Panel will therefore examine the soft drink tax as it stood on 6 July 2004, in respect of its application at the point of importation.[356] There is no question that the imported soft drinks and syrups were directly subject to the soft drink tax. The same tax is also directly applied on internal transfers of the product domestically, as long as the soft drinks or syrups are not sweetened with cane sugar.[357] According to *Ad* Article III of the GATT 1994:

> "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."

8.146 The Panel has already discussed the meaning of the term "in excess of".[358] This term has been interpreted very strictly, and encompasses even the slightest difference in the level of taxes. The Appellate Body has said that "[e]ven 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.'"[359] There can be no doubt that a tax difference of 20 per cent can be regarded as "in excess".

Conclusion

8.147 Since at the point of importation all imported soft drinks and syrups, whether sweetened with cane or beet sugar or with HFCS, were subject to a tax in excess of the tax applied to the like domestic products (soft drinks and syrups sweetened with cane sugar), the soft drink tax is in this respect inconsistent with Article III:2, first sentence, of the GATT 1994.

(ii) Soft drink tax on internal transfers

8.148 Mexico also imposes a 20 per cent soft drink tax on internal transfers of soft drinks and syrups sweetened with non-cane sugar sweeteners, including HFCS and beet sugar. An exemption from this tax is available only for those soft drinks and syrups that are sweetened with cane sugar.[360]

---

[355] See, for example, Panel Report on *US – Certain EC Products*; Panel Report on *US – Wool Shirts and Blouses*; Panel Report on *Indonesia – Autos*; Panel Report on *Chile – Price Band System*; and, Panel Report on *Canada – Wheat Exports and Grain Imports*.

[356] LIEPS, article 1 (I). United States first written submission, paras. 85-86. United States second written submission, paras. 11, 23, 30-31. United States response to Panel question No. 14, para. 30; question No. 27, paras. 59-60; and question No. 74, para. 73.

[357] Domestic soft drinks and syrups sweetened with cane sugar are exempted from the soft drink tax on their internal transfers under Article 8 of the LIEPS.

[358] See para. 8.52 above.

[359] Appellate Body Report on *Japan – Alcoholic Beverages*, p. 23, DSR 1996:I, p. 97, at p. 115.

[360] United States response to Panel questions Nos. 14, 27 and 74.

The United States claims that this aspect of the tax constitutes *de facto* discrimination and is inconsistent with Article III:2, first sentence, of the GATT 1994.[361]

8.149 The Panel has already concluded that, in regard to internal transfers, as a result of the soft drink tax, beet sugar used as a sweetener in soft drinks and syrups is subject, directly or indirectly, to a tax in excess of that applied to the like domestic product, because of the non-application of that tax when the sweetener used is cane sugar and considering that the burden of the tax can be expected to fall, at least in part, on the products containing the sweetener.[362] By the same logic, the Panel finds that the soft drinks and syrups sweetened with beet sugar or HFCS are subject, directly or indirectly, to the soft drink tax. Furthermore, as concluded above[363], a difference of 20 per cent tax undoubtedly meets the "in excess of" criterion. Finally, the Panel notes that soft drinks and syrups imported into Mexico are sweetened primarily with non-cane sugar sweeteners (HFCS or beet sugar), whereas Mexican domestic soft drinks and syrups are sweetened primarily with cane sugar.[364] Since the latter are the main beneficiaries of the exemption from the tax, and using the logic that it applied to the discrimination regarding sweeteners[365], the Panel concludes that, although the soft drink tax does not on its face distinguish between imported and domestic products, it has this result in practice.

(iii) Distribution tax

8.150 The United States also claims that the distribution tax of 20 per cent, which is charged on representation, brokerage, agency, consignment and distribution provided in relation with soft drinks or syrups sweetened with non-cane sugar sweeteners, is inconsistent with Article III:2, first sentence. This is because no such tax is applied to such services when provided in relation to soft drinks or syrups sweetened with cane sugar. In this instance also the United States argues that the discrimination is *de facto*.[366]

8.151 The distribution tax is imposed on certain services provided for the purpose of transferring one group of soft drinks and syrups, while the same services related to another group of soft drinks and syrups are exempted from the tax, based only on the consideration of whether those soft drinks and syrups are sweetened with cane sugar or with non-cane sugar sweeteners.

8.152 The Panel has already concluded that the imposition of the distribution tax, based solely on the nature of the sweetener used, and considering that the burden of the tax can be expected to fall, at least in part, on the products containing the sweetener, creates a connection such that the tax can also be regarded as a tax *indirectly* imposed on non-cane sugar sweeteners.[367] By the same logic, the Panel finds that, while on its face the distribution tax is a tax on the provision of certain services, in the circumstances of this case, it is also a tax applied *indirectly* on soft drinks and syrups. Furthermore, as concluded above[368], assuming that the services provided have some value, the 20 per cent *ad valorem* tax on those services will result in an additional tax on soft drinks and syrups sweetened with non-cane sugar sweeteners. That figure would have to be compared with the tax rate applied to

[361] United States first written submission, para. 87. United States second written submission, paras. 11, 23, 30-31 and 33. United States response to Panel question No. 14, paras. 30-31; question No. 27, paras. 59 and 61; and question No. 74, paras. 71-74.

[362] See para. 8.59 above.

[363] See para. 8.146 above.

[364] United States first written submission, paras. 30, 32 and 35. Exhibits US-8, US-10, US-13 and US-57.

[365] See paras. 8.55 to 8.58 above.

[366] United States first written submission, paras. 89-90. United States second written submission, paras. 11, 23, 30-31. United States response to Panel question No. 14, para. 32; question No. 27, paras. 59 and 61; question No. 74, paras. 71-74.

[367] See para. 8.48 above.

[368] See para. 8.51 above.

the provision of services related to soft drinks and syrups sweetened with cane sugar, the like domestic product, which is zero per cent. There can be no doubt that the former is "in excess" of the latter. Finally, using the same logic that it applied to the discrimination regarding the soft drink tax[369], the Panel concludes that, although the distribution tax does not on its face distinguish between imported and domestic products, it has this result in practice.

(iv) Taxes imposed in excess

8.153 Considering the respective groups of products that are subject to the soft drink tax and the distribution tax, domestic soft drinks and syrups are the main beneficiaries of the tax exemption under the LIEPS. Indeed, most domestic soft drinks and syrups in Mexico are sweetened with cane sugar, while most imported soft drinks and syrups are sweetened with non-cane sugar sweeteners, such as HFCS.

8.154 In light of the above, a soft drink tax and a distribution tax imposed only on soft drinks and syrups with non-cane sugar sweeteners, most of which are imported, and not applied to soft drinks and syrups sweetened with cane sugar, most of which are domestic, may be regarded as a tax imposed on imports "in excess of" that imposed on like domestic products.

4. Conclusion

8.155 For the reasons given above, the Panel concludes that, at the time of establishment of this Panel, the soft drink tax, as applied by Mexico at the point of importation, subjected soft drinks and syrups imported into Mexico to internal taxes in excess of those directly applied to like domestic products, in a manner inconsistent with Article III:2, first sentence, of the GATT 1994.

8.156 The Panel also finds that the soft drink tax, as applied on internal transfers in Mexico, subjects imported soft drinks and syrups to internal taxes in excess of those directly applied to like domestic products, in a manner inconsistent with Article III:2, first sentence, of the GATT 1994.

8.157 Finally, the Panel finds that the distribution tax, as applied on the provision of certain services, when those services are provided for the purpose of transferring soft drinks and syrups sweetened with non-cane sugar sweeteners, subjects imported soft drinks and syrups to internal taxes in excess of those indirectly applied to like domestic products, in a manner inconsistent with Article III:2, first sentence, of the GATT 1994.

G. THE UNITED STATES' CLAIMS REGARDING SOFT DRINKS AND SYRUPS UNDER THE SECOND SENTENCE OF ARTICLE III:2 OF GATT 1994

1. The United States' claims

8.158 The United States also argues that two of the challenged tax measures, specifically the soft drink tax and the distribution tax, are inconsistent with the second sentence of Article III:2 of GATT 1994, because soft drinks and syrups sweetened with HFCS and beet sugar and the directly competitive or substitutable products, i.e., soft drinks and syrups sweetened with cane sugar, are dissimilarly taxed, so as to afford protection to domestic production.[370]

8.159 The United States presents this claim only as an alternative should the Panel not consider that soft drinks and syrups sweetened with HFCS and those sweetened with cane sugar are like products,

[369] See para. 8.149 above.
[370] United States first written submission, paras. 141-152.

and that the soft drink tax and the distribution tax are in this respect inconsistent with Article III:2, first sentence, of the GATT 1994.[371]

2. Mexico's response

8.160 Mexico's only response to this claim is that its measures are not intended to afford protection to its domestic production within the meaning of Article III of the GATT.[372]

3. Panel's analysis

8.161 The panel has already determined that the soft drink tax and the distribution tax, as applied by Mexico on soft drinks and syrups, are inconsistent with Article III:2, first sentence, of the GATT 1994.[373] Since the condition set by the United States has therefore not been fulfilled, the Panel will not address this claim.

H. MEXICO'S DEFENCE UNDER PARAGRAPH (D) OF ARTICLE XX OF GATT 1994

1. Mexico's defence

8.162 As described above, for the most part Mexico has not presented rebuttal arguments regarding the United States' claims under Article III of GATT 1994. Mexico argues, however, that if the IEPS taxes are found by the Panel to violate Article III, the measures are nevertheless justifiable under Article XX(d) of GATT 1994.[374] In its opinion, the measures are "necessary to secure compliance" by the United States with the United States' obligations under the NAFTA, an international agreement that is a law not inconsistent with the provisions of the GATT 1994.[375] Mexico does not claim any justification for its measures other than that provided through Article XX(d). Furthermore, although Mexico has characterized its actions as an exercise of countermeasures, as recognized under international law[376], it does not seem to be suggesting that the international law rules governing such actions should affect the interpretation of Article XX(d).

2. The United States' response

8.163 The United States responds that, although Article XX(d) of GATT 1994 permits a WTO Member to maintain measures that are "necessary to secure compliance with laws or regulations which are not inconsistent" with the provisions of the GATT 1994, the NAFTA is not a "law or regulation," and Mexico's taxes are not "necessary to secure compliance." In its opinion, nothing in Article XX(d) supports the contention that a WTO Member may violate its WTO obligations in order to punish another Member because the former thinks that the latter has not complied with its

---

[371] United States responses to Panel questions, question No. 18, para. 39. United States second written submission, paras. 23-24.

[372] Mexico's first written submission, section III.D. Mexico's responses to Panel questions, question No. 83. Written version of Mexico's oral statement during second substantive meeting of the Panel with the parties, para. 18.

[373] See paras. 8.155 to 8.157 above.

[374] Mexico's first written submission, paras. 115-138.

[375] Mexico's first written submission, paras. 117-118 and 125.

[376] See, for example, written version of Mexico's oral statement during second substantive meeting of the Panel with the parties, para. 3.

obligations under another international agreement.[377] The United States adds that Mexico's measures are also incompatible with the requirements of the *chapeau* to Article XX.[378]

3. Article XX(d) of GATT 1994

8.164 According to the *chapeau* and paragraph (d) of Article XX of the GATT:

> "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: [...]
>
> > (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;"

4. Panel's analysis

(a) Order of analysis

8.165 The Panel will follow the well-established two-tiered process of analysis elaborated by the Appellate Body in *US – Gasoline*:

> "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."[379]

8.166 The burden lies on Mexico, as the party invoking the affirmative defence provided by Article XX(d), to demonstrate that the measures which the Panel has found to be inconsistent with Article III, satisfy the requirements of the invoked defence.[380]

8.167 Regarding the first stage in the application of Article XX, the Panel will follow the order of analysis set out by the Appellate Body:

> "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

[377] Written version of United States' oral statement during first substantive meeting of the Panel with the parties, paras. 7-8. United States second written submission, paras. 41-67.

[378] United States second written submission, paras. 68-73.

[379] Appellate Body Report on *US – Gasoline*, p. 22, DSR 1996:I, p. 3, at p. 20.

[380] Appellate Body Report on *Korea – Various Measures on Beef*, para. 157. See also, Appellate Body Report on *US – Gambling*, para. 309.

Article XX(d) as a justification has the burden of demonstrating that these two requirements are met.[381],[382]

(b) Designed to secure compliance with laws or regulations

8.168 Mexico argues that the challenged tax measures are "designed to secure compliance" by the United States with the NAFTA, a law that is not inconsistent with the provisions of the GATT 1994.[383]

8.169 In order to determine whether a measure may be considered to be "designed to secure compliance", the Panel will look at the meaning of the expression "to secure compliance". It will then examine the issue of the design of the measures. Finally, it will address the issue of whether the NAFTA may be considered to be part of the laws and regulations covered by paragraph (d).

(i) To secure compliance

8.170 Mexico argues that the tax measures at issue are justifiable under Article XX(d) as "necessary to secure compliance" by the United States with the United States' obligations under the NAFTA. In Mexico's opinion, this provision allows WTO Members to adopt measures that are necessary to secure compliance by another Member with the latter's international obligations arising from a treaty that is not one of the WTO "covered agreements". Mexico refers to its IEPS taxes on soft drinks and syrups as "temporary and proportionate measures" intended to induce the United States to comply with what Mexico says are its NAFTA obligations regarding market access conditions for Mexican sugar or to submit to dispute settlement procedures under the NAFTA regarding these obligations.[384] Mexico also speaks of the measures as intended to rebalancing its market so that Mexican surplus sugar that could have been exported to the United States can be sold locally.[385] While acknowledging that there are no WTO or GATT precedents to support an interpretation that Article XX(d) would justify such measures, Mexico argues that there are none that deny it.[386]

8.171 The United States responds that Article XX(d) does not provide an exception for measures to secure compliance with obligations of a WTO Member under another international agreement. In the first place, the United States argues that obligations under an international agreement are not covered by the expression "laws or regulations".[387] According to the United States, the ordinary meaning of the terms "laws or regulations" encompasses only the domestic laws or regulations of a government; it does not include obligations under an international agreement, which have a different meaning.[388] The United States submits that such interpretation of the ordinary meaning of "laws or regulations" is supported by the context in which the terms appear – namely, Article XX of the GATT and more

[381] *(footnote original)* 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.

[382] Appellate Body Report on *Korea – Various Measures on Beef*, para. 157. See also, Appellate Body Report on *US – Gambling*, para. 295.

[383] Mexico's first written submission, para. 118.

[384] Written version of Mexico's oral statement during first substantive meeting of the Panel with the parties, para. 45. Written version of Mexico's oral statement during second substantive meeting of the Panel with the parties, para. 36. Mexico's response to Panel question No. 87.

[385] Mexico's first written submission, para. 84.

[386] Mexico's response to Panel question No. 25.

[387] United States second written submission, paras. 2 and 37.

[388] United States second written submission, para. 43. United States response to Panel question No. 30, para. 71.

broadly the GATT and the WTO Agreement as a whole.[389] In its opinion, Mexico's interpretation would allow any WTO Member to invoke Article XX(d) as a justification for actions depriving other Members of their rights under the GATT to the extent needed to "secure compliance" with any other international agreement.[390]

8.172 The United States further argues that, even if "laws or regulations" could be read to include obligations owed by one WTO Member to another under an international agreement, Mexico's tax measures are not designed to "secure compliance" within the meaning of Article XX(d) of the GATT 1994. In this regard, Mexico's position presupposes that the United States is not in compliance with its NAFTA obligations, a matter that has not been proved by Mexico, that is currently being disputed in the NAFTA forum and that would anyhow be outside the Panel's terms of reference. The United States adds that Mexico has not explained how its tax measures are designed to secure compliance by the United States, considering that the measures apply to soft drinks and syrups and non-cane sugar sweeteners imported from *any* WTO Member, and not just those from the United States. Rather, in its opinion, those taxes protect Mexico's own cane sugar industry.[391]

8.173 The Panel commences its analysis of the issue by recalling that, in order to be justified by Article XX(d), a measure must be "necessary to secure compliance with laws or regulations that are not inconsistent with the provisions of the GATT 1994".[392]

8.174 The word "compliance" may be defined as "the action of complying with a request, command, etc.", while in that sense to "comply" with is to "act in accordance with".[393] In turn, to "secure" may be defined as to "make (something) certain or dependable. Now [especially] ensure (a situation, outcome, result, etc.)".[394]

8.175 The context in which the expression is used makes clear that "to secure compliance" is to be read as meaning to enforce compliance. Firstly, the provision is addressing compliance with "laws or regulations", and these characteristically concern obligations rather than requests, and compliance is secured by enforcement through the use of force by the authorities, if necessary. Secondly, the examples of measures that are given in the latter part of paragraph (d) all concern that concept (the terms used in these examples are "enforcement" (twice), "protection", and "prevention").[395]

8.176 This interpretation is confirmed by consideration of the *travaux préparatoires* of GATT 1947. The strong language used in the phrase "to secure compliance" differs from that contained in early drafts of the Charter for an International Trade Organization (ITO), a weaker "to induce compliance".[396] There is also evidence that negotiators were aware of the issue of countermeasures. During the negotiations on the ITO Charter, India proposed the inclusion (in the provision that would be the basis for Article XX of the GATT) of a paragraph that would allow a country "temporarily to

---

[389] United States second written submission, paras. 44-46. United States response to Panel question No. 30, paras. 72-74.

[390] United States second written submission, para. 48.

[391] United States second written submission, paras. 56-59.

[392] See, for example, GATT Panel Report on *EEC – Parts and Components*, para. 5.14.

[393] *The New Shorter Oxford English Dictionary* (Clarendon Press, 1993), Vol. I, p. 461.

[394] Ibid., Vol. II, p. 2754.

[395] Paragraph (d) illustrates the measures that may be covered by the provision by citing measures such as 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".

[396] "Preparatory Committee of the International Conference on Trade and Employment, Committee II, Report of the Technical Sub-Committee", Doc. E/PC/T/C.II/54/rev.1 (28 November 1946), p. 37. See also, Panel Report on *EEC – Parts and Components*, para. 5.16. *Suggested Charter for an International Trade Organization of the United Nations* (United States Department of State, September 1946), Article 32, p. 24.

discriminate against the trade of another Member when this is the only effective measure open to it to retaliate against discrimination practised by that Member in matters outside the purview of the [International Trade] Organization, pending a settlement of the issue through the United Nations".[397] The proposal was not accepted.[398]

8.177 The interpretation is also confirmed by the Appellate Body's use of the expression "enforcement instrument" when referring to measures covered by paragraph (d).[399] Indeed, Mexico has also referred to measures "designed as an enforcement instrument", when referring to the measures that would be covered by paragraph (d).[400]

8.178 The identification of the phrase "to secure compliance" with the notion of enforcement has important implications for the arguments presented by Mexico. The context of Mexico's action is essentially international. Countermeasures have an intrinsic inter-state character, and there is no concept of private action against a state being justifiable on this basis. On the other hand, the notion of enforcement contains a concept of action within a hierarchical structure that is associated with the relation between the state and its subjects, and which is almost entirely absent from international law (action under Chapter VII of the United Nations Charter is arguably an exception, but it has no relevance in the present dispute[401]). The possibility for states to take countermeasures, that is to try by their own actions to persuade other states to respect their obligations, is itself an acknowledgement of the absence of any international body with enforcement powers. In contrast to this, the capacity to enforce laws and regulations through the use of coercion, if necessary, is perhaps the most important of the features that distinguish states from other kinds of bodies.

8.179 The examples provided in Article XX(d) serve to reinforce the conclusion that this provision is concerned with action at a domestic rather than international level. Customs, monopolies, patents, trade marks and copyrights, and deceptive practices are in essence matters that are regulated under domestic law. It can be argued that the topics covered by these examples are all capable of being the subjects of international agreements.[402] However, the same point could be made of almost any aspect of national law, and the argument does not detract from the basic point that these examples essentially concern aspects of domestic law which make use of systems of enforcement. Thus, there could be domestic customs laws without international agreements, but international agreements on customs without domestic law would be meaningless. Of course, these topics are listed in Article XX(d) merely as examples, so they cannot of themselves be taken as providing conclusive support for the Panel's conclusions. Nevertheless, they provide a significant indicator of the intended interpretation.

8.180 The Panel will return to the notion of enforcement in its discussion of "laws or regulations"[403], but before leaving the current topic it is worth noting that the Draft Articles on *Responsibility of States for internationally wrongful acts* adopted by the International Law Commission[404] do not speak of enforcement when addressing the use of countermeasures. Rather, paragraph 1 of Article 49 states that "[a]n injured State may only take countermeasures against a State which is responsible for an

---

[397] Doc. E/PC/T/180 (19 August 1947), p. 97.

[398] See, "Havana Charter for an International Trade Organization", United Nations Conference on Trade and Employment, Final Act and Related Documents (Lake Success, New York, April 1948), pp. 33-34.

[399] Appellate Body Report on *Korea – Various Measures on Beef*, paras. 162-163. See also, Panel Report on *US – Gasoline*, para. 6.33. See also, GATT Panel Report on *EEC – Parts and Components*, paras. 5.17-5.18.

[400] Mexico's response to Panel question No. 24.

[401] A special exception for action of this kind is created by Article XXI(c) of GATT 1994.

[402] Written version of Mexico's oral statement during first substantive meeting of the Panel with the parties, para. 42. See also, Mexico's response to Panel question No. 67.

[403] See para. 8.199 below.

[404] "Draft Articles on Responsibility of States for internationally wrongful acts" adopted by the International Law Commission at its fifty-third session (2001).

internationally wrongful act in order to induce that State to comply with its obligations under Part Two." Nor is the notion of enforcement used in the Commentary on the articles, except in regard to procedures within the European Union, which because of its unique structures and procedures is obviously a special case.[405]

8.181 For these reasons the Panel concludes that the phrase "to secure compliance" in Article XX(d) does not apply to measures taken by a Member in order to induce another Member to comply with obligations owed to it under a non-WTO treaty.

(ii) Whether Mexico's tax measures are designed to secure compliance

8.182 In *Korea – Various Measures on Beef*, the Appellate Body said that:

> "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."[406]

8.183 In that case, the Appellate Body was confirming the decision of the panel which said 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.* First, the system was established at the time when, as stated by Korea and not refuted by the Complaining parties, acts of misrepresentation were widespread in the beef sector. Second, it must be conceded that the dual retail system does appear to reduce the opportunities and thus the temptations for butchers to misrepresent foreign beef for domestic beef, when compared with the situation where all domestic and imported beef could officially be supplied to the same shop."[407]

8.184 The question of whether the measure identified by Mexico is *designed* to secure compliance is therefore one that must be addressed by the Panel. The considerations that influenced the Panel in reaching a conclusion regarding the phrase "to secure compliance"[408] are also relevant to answering this question.

8.185 The panel additionally notes that, when enforcement action is taken within a Member's legal system there will normally be no doubt, provided the action is pointed at the right target, that it will achieve that target. At least, there is no systemic problem in arriving at that conclusion, because the State by its very nature is usually in a position to achieve that enforcement, through the use of coercion, if necessary. However, the situation is quite different when one considers international relations. Mexico argues that its tax measures are designed to secure compliance by the United States with obligations Mexico considers the United States to have under the NAFTA. Regardless of the issue of Mexico's actual intentions regarding its measures, the effectiveness of those measures in achieving their stated goal – that of bringing about a change in the behaviour of the United States – seems to the Panel to be inescapably uncertain.

---

[405] "Commentaries to the draft Articles on Responsibility of States for internationally wrongful acts" adopted by the International Law Commission at its fifty-third session (2001), p. 337.

[406] Appellate Body Report on *Korea – Various Measures on Beef*, para. 157. See also, Appellate Body Report on *Dominican Republic – Import and Sales of Cigarettes*, para. 65.

[407] Panel Report on *Korea – Various Measures on Beef*, para. 658.

[408] See para. 8.175 above.

8.186 In this regard, Mexico has not explained how its measures will make any significant contribution to securing compliance on the part of the United States, and much less how they will perforce bring about such a change of conduct. Mexico has claimed only that the measures have had the effect of "attracting the attention" of the United States.[409] Attracting the attention of a Member is not equivalent to securing compliance of that Member with a law or regulation. Even conceding that the measures may have "attracted the attention of the United States", at most this would imply the beginning of a process between the parties with uncertain results. The Panel mentions these considerations principally in order to reinforce its conclusion that the outcome of international countermeasures, such as those adopted by Mexico, is inherently unpredictable, and that they are therefore not eligible to be considered as measures "to secure compliance" within the meaning of Article XX(d). However, even if the assumption were to be made in the abstract that international countermeasures are potentially capable of qualifying as measures designed to secure compliance, the Panel's conclusion would be that Mexico has not established that its measures contribute to securing compliance in the circumstances of this case.

8.187 Confirmation of the view that the uncertain outcome of international countermeasures is a reason for disqualifying them as measures eligible for consideration under Article XX(d) is to be found in the Appellate Body Report in the *US – Gambling* case. When considering whether a measure could be considered to be "necessary", the Appellate Body dismissed the idea that consultations between the Members concerned could constitute a reasonably available alternative:

> "Engaging in consultations with Antigua, with a view to arriving at a negotiated settlement that achieves the same objectives as the challenged United States' measures, was not an appropriate alternative for the Panel to consider because consultations are by definition a process, the results of which are uncertain and therefore not capable of comparison with the measures at issue in this case."[410]

8.188 As indicated by the Appellate Body, measures that are of uncertain outcome do not qualify as reasonably available alternatives when considering whether a measure is necessary to secure compliance with a law or regulation. Following a similar rationale, in order to qualify as a measure "to secure compliance", it would seem that there should be a degree of certainty in the results that may be achieved through the measure. Such certainty is inherently absent in the case of international countermeasures.

8.189 Finally, it should be noted that, as regards the design of the measures, the Panel has already determined that, by their design and operation, the challenged tax measures afford protection to Mexican domestic production.[411] The measures apply to imported soft drinks and syrups, and particularly to those produced with non-cane sugar sweeteners, from all origins. Even Mexico acknowledges that its measures are intended to rebalance its sugar market, so that surplus sugar that could otherwise have been exported to the United States could be sold in the Mexican domestic market.[412] These considerations serve to further undermine Mexico's claim that, in the circumstances of this case, its measures are designed to secure compliance with laws or regulations.

8.190 For these reasons, the Panel is not convinced by Mexico's argument that the challenged tax measures are *designed* to secure compliance by the United States with laws or regulations.

---

[409] Mexico's second written submission, para. 83.
[410] Appellate Body Report on *US – Gambling*, para. 317.
[411] See para. 8.86 above.
[412] Mexico's first written submission, para. 84.

(iii) Laws and regulations covered by paragraph (d) of Article XX

8.191 As noted above, the United States argues that the phrase "laws or regulations" in paragraph (d) covers only internal or domestic laws and regulations, and does not extend to international obligations owed to Mexico by other countries under the NAFTA, and other international agreements. It contends that both the ordinary meaning of the terms "laws or regulations", as well as the context in which the terms appear – namely, Article XX of the GATT and more broadly the GATT and the WTO Agreements – support its interpretation that they are limited to domestic laws or regulations.[413] In the view of the United States, Mexico has not established that the phrase "laws or regulations" as used in Article XX(d) means or includes "international law" or obligations owed to Mexico under an international agreement such as the NAFTA.[414]

8.192 Mexico responds that international agreements that are incorporated into domestic law, and the legal obligations arising from those agreements, would be covered by the phrase "laws or regulations". It argues that "international law is no less law than domestic law". In its opinion, "[t]he mere characterization of a rule as an obligation under an international agreement does not mean that such a rule is not also a 'law' within the meaning of Article XX(d)."[415]

8.193 The Panel commences its examination of the phrase "laws or regulations" by noting that "law" can be defined as a "rule of conduct imposed by secular authority" or as "[a]ny of the body of individual rules in force in a State or community"[416], while "regulation" can be defined as a "rule prescribed for controlling some matter, or for the regulating of conduct".[417] However, these definitions are too general to resolve the question of the meaning of these terms in Article XX(d),[418] and in particular whether, as argued by Mexico, they include the rules of international agreements, such as those of the NAFTA. Nor does the Panel find guidance in this regard from the use of the plural form of the word "laws" in paragraph (d); nor from the different use of the word in the Spanish and French text of the GATT 1994 and the DSU.[419] For the answer to this question it is necessary to look at the context in which the words occur. This context includes the other terms of paragraph (d) as well as the other provisions of GATT 1994, and indeed of the WTO covered agreements.

8.194 The phrase "laws or regulations" is most closely linked with the opening words of the paragraph: "to secure compliance with". Furthermore, in looking for the meaning of these words, the

---

[413] Written version of United States' oral statement during first substantive meeting of the Panel with the parties, para. 9. United States second written submission, paras. 37 and 41-55. United States response to Panel question No. 30, paras. 72-78.

[414] United States second written submission, paras. 42-55. Written version of United States' oral statement during second substantive meeting of the Panel with the parties, paras. 4-12.

[415] Mexico's first written submission, para.118. Written version of Mexico's oral statement during first substantive meeting of the Panel with the parties, paras. 41-44. Mexico's second written submission, paras. 66-73.

[416] *The New Shorter Oxford English Dictionary* (Clarendon Press, 1993), Vol. I, pp. 1544-1545.

[417] Ibid., Vol. II, p. 2530.

[418] See also United States response to Panel question No. 30, para. 71.

[419] The United States argues that there is a textual difference between "laws or regulations" and "international law". In support for its argument, it refers to the fact that one expression uses the singular "law" while the other uses the plural "laws". In its view, while it is possible to speak of international "law" in the same sense as to speak about "common law" or the "law of the sea", international law is not ordinarily used in the plural. It also argues that the word "law", as used in the expressions "public international law" (in Article 3.2 of the DSU) and "laws or regulations" (in Article XX(d) of the GATT 1994) has been translated differently in the Spanish and French texts of the agreements. See, United States second written submission, para. 51 and footnote 72. Written version of United States' oral statement during second substantive meeting of the Panel with the parties, para. 9. The Panel notes that the singular form of the word "law" can also be used in reference to any particular body of rules in force in a community, such as "criminal law", "commercial law" or "administrative law", without regard to whether it is domestic or international.

Panel found it necessary to look at the whole expression "to secure compliance with laws or regulations". It therefore follows logically that the conclusions reached in that analysis must also apply in the present context. Consequently, the conclusion that these words refer to enforcement action within a particular domestic legal system, and that they do not extend to international action of the type taken by Mexico, necessarily applies to both parts of this expression.

8.195 Both parties have sought to invoke the use of the terms "laws" and "regulations" elsewhere in the GATT 1994 and in other WTO agreements in support of their respective suggested interpretations.[420] The use of these terms in the text of the GATT 1994[421] and the WTO Agreement[422] suggests that such terms relate principally to domestic rules issued by the authorities of Members (or of GATT contracting parties) and not to obligations under international agreements. At the same time, it should be noted that in a limited number of instances, the WTO Agreement refers to "regulations" adopted by the WTO Ministerial Conference[423], and to "financial regulations" adopted by the General Council[424], suggesting that the term "regulation" may also be associated to acts adopted by international bodies. The Panel does not find that this last consideration gives any decisive indication of the meaning of "laws or regulations" in Article XX(d), and in particular does not detract from the conclusion it has reached by considering the immediate context of the phrase.

8.196 The Panel does not see that the issue of the possible direct effect of an international agreement in domestic law is relevant in the present context. Whether or not an agreement has that effect, it retains its *international* character, and it is that character and the international character of the obligations that arise from it which lead to the possible use of countermeasures to encourage respect for those obligations. Thus, even if some of the rules of the agreement become part of national law as a result of a doctrine of direct effect, it remains the case that it is the international dimension of the agreement's rules that needs to be considered when interpreting the phrase "laws or regulations".

8.197 Finally, the Panel observes that, even if it were to assume that the expression "laws or regulations" in Article XX(d) could include international agreements such as the NAFTA, it would in any event conclude that, on the facts of the case, because of the uncertainty of their consequences, the challenged measures are not designed "to secure compliance with laws or regulations which are not inconsistent with the provisions" of GATT 1994.

---

[420] United States response to Panel question No. 30, paras. 72-74. United States second written submission, paras. 37 and 44-46. Written version of United States' oral statement during second substantive meeting of the Panel with the parties, paras. 6 and 9. Written version of Mexico's oral statement during second substantive meeting of the Panel with the parties, para. 77. Mexico's response to Panel question No. 84.

[421] See, for example, Article II:5 ("tariff laws of such contracting party"); Article III:1 ("internal taxes and other internal charges, and laws, regulations and requirements"); Articles III:4 and III:8 ("laws, regulations and requirements"); Article V:3 ("applicable customs laws and regulations"); Article VII:1 (contracting party's "laws or regulations relating to value for customs purposes"); Article VIII:2 (contracting party's "laws and regulations"); Article IX:2 ("laws and regulations relating to marks of origin"); Article IX:4 ("laws and regulations of contracting parties relating to the marking of imported products"); Article X:1 ("Laws, regulations, judicial decisions and administrative rulings of general application, made effective by any contracting party "); and Article X:3(a) (contracting party's "laws, regulations, decisions and rulings").

[422] See Article XVI:4 of the WTO Agreement (Member's "laws, regulations and administrative procedures").

[423] See, for example, Articles VI:2 and VI:3 of the WTO Agreement.

[424] Ibid., Articles VII:2, VII:3 and VII:4.

(iv) Conclusion

8.198 For the reasons indicated above, the Panel concludes that Mexico has not demonstrated that the challenged measures are designed "to secure compliance with laws or regulations", within the meaning of Article XX(d) of the GATT 1994.

(c) Necessary to secure compliance with laws or regulations

8.199 Mexico argues that the challenged tax measures are "necessary" to secure compliance by the United States with its own obligations under the NAFTA, a law that is not inconsistent with the provisions of the GATT 1994.[425]

8.200 Mexico argues that the measures at issue have "to a large extent" contributed to the end pursued, that is, securing the United States' compliance with the NAFTA. In its opinion, the evidence reveals that the adoption of the IEPS tax created a "desired dynamic to secure the United States' compliance or otherwise arrive at a mutually satisfactory resolution of the dispute". Mexico adds that the measures have had the effect of "attracting the attention" of the United States.[426] As evidence to support its assertion, Mexico has presented a newspaper article on the effect of the IEPS tax in the bilateral sweeteners dispute between Mexico and the United States under the NAFTA. In the article, the president of the Mexican National Chamber of the Sugar and Alcohol Industries is quoted as saying: "Thanks to the tax, they [American sugar and corn growers, sugar refiners, and HFCS producers] are sitting at the negotiating table…Without the tax, they would not even answer the telephone."[427]

8.201 The United States responds that, even assuming *arguendo* that Mexico's tax measures contributed to NAFTA compliance, they are not "necessary" to secure such compliance as required by Article XX(d).[428]

8.202 Having found that Mexico, as the responding party invoking the affirmative defence, has not established that the challenged measures are designed to secure compliance with laws or regulations, under the terms of Article XX(d) of the GATT 1994, the Panel concludes that it does not need to determine whether such measures are "necessary" to secure such compliance by the United States. In some disputes, where a party fails to establish one of the elements of its case, the panel, with a view to assisting the Appellate Body may nevertheless proceed to rule on the remaining elements. However, such an approach is not possible in the present case because the question of whether a measure is "necessary" cannot be examined without taking into account the particular nature of that measure, especially the way in which it secures compliance with laws or regulations. In other words, the elements that Mexico must establish are so closely related that the Panel, having found that the measures do not meet the criterion that they are *designed* "to secure compliance", cannot meaningfully provide any additional analysis about whether the measures are *necessary* "to secure compliance".

(d) *Chapeau* of Article XX

8.203 As Mexico has failed to justify provisionally the challenged measures, it is not necessary for the Panel to consider whether the measures are consistent with the *chapeau* of Article XX.

---

[425] Mexico's first written submission, paras. 117 and 123-126.
[426] Mexico's second written submission, para. 83.
[427] Mexico's second written submission, para. 83. Exhibit MEX-8.
[428] United States second written submission, paras. 60-67.

5. Conclusion

8.204 For the reasons given above, the Panel concludes that Mexico has not established that the challenged measures are justified under Article XX of the GATT 1994.

I. ADDITIONAL REQUESTS BY MEXICO

1. Mexico's additional requests

8.205 Mexico requests that, if the Panel exercises its jurisdiction, it should refrain from making certain findings that could jeopardize Mexico's ability to mount a proper defence in international proceedings that are taking place in other *fora*. More specifically, Mexico requests that the Panel recommend that the parties (Mexico and the United States) take steps to resolve their sweeteners trade dispute within the NAFTA framework. Mexico also asks the Panel to employ particular care in terms of how it formulates its findings and recommendations, making clear that its findings apply solely to the parties' respective rights and obligations under the WTO agreements and cannot be taken to pre-judge legal rights under other rules of international law.[429] In response to questions from the Panel, Mexico has clarified that the international proceedings that it is referring to, are three investor – State disputes under Chapter Eleven of the NAFTA, in which claims for monetary damages have been presented against Mexico.[430]

8.206 After being informed of the Panel's preliminary ruling regarding its decision to exercise jurisdiction, Mexico has reiterated its view that the present dispute is one more properly dealt with under the NAFTA and has repeated its argument that the Panel has broad powers of discretion under the GATT and the DSU to decide whether or not to issue findings in a matter that has been brought before it. In Mexico's opinion, this Panel does not have a legal obligation to issue findings on the claims raised by the United States. The relevant provisions in GATT and the DSU do not say that a panel must issue findings of breach on the merits of a claim.[431]

8.207 Mexico states that neither Article XXII nor Article XXIII of GATT establish an obligation for panels to issue findings. In particular, Article XXIII:2 only provides that a matter (including an alleged failure of a Member to carry out its obligations or a Member's application of a measure which conflicts with the agreements) may be referred to the CONTRACTING PARTIES. Upon such referral, the CONTRACTING PARTIES shall promptly investigate the matter and shall make appropriate recommendations to the contracting parties which they consider to be concerned, or give a ruling on the matter, as appropriate. When dealing with a dispute, CONTRACTING PARTIES would thus have two options, "as appropriate": (*i*) to make recommendations to the contracting parties concerned; or, (*ii*) to issue a ruling in the matter. Articles XXII and XXIII of the GATT would confer this discretion upon the CONTRACTING PARTIES (and upon panels acting at their behest). Panels would have the power to determine what is appropriate in the circumstances of each particular case, even in situations where a breach of the agreements was alleged.

8.208 Mexico argues further that, when the WTO was created, this flexibility was preserved. The drafters of the WTO's dispute settlement system did not amend GATT Articles XXII and XXIII when GATT 1947 became GATT 1994. Moreover, in Article 3 of the DSU, the Members stated that they affirmed their adherence to the principles for the management of disputes heretofore applied under Articles XXII and XXIII of GATT 1947, and the rules and procedures as further elaborated and modified herein. This flexibility is further illustrated by Article 3.7 of the DSU: "... The aim of the

[429] Mexico's first written submission, paras. 14, 104 and 110.
[430] Mexico's response to Panel question No. 36.
[431] Mexico's second written submission, paras. 48-64. Written version of Mexico's oral statement during second substantive meeting of the Panel with the parties, paras. 43-52.

dispute settlement mechanism is to secure a positive solution to a dispute. A solution mutually acceptable to the parties to a dispute and consistent with the covered agreements is clearly to be preferred". The flexibility is further preserved in the same paragraph: "In the absence of a mutually agreed solution, the first objective of the dispute settlement mechanism is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements…" The inclusion of the qualifying word "usually" was intentional, in case of unusual circumstances in which the withdrawal of the measures concerned would not result in a positive solution to a dispute. It is thus open to panels to make other findings in order to secure a positive solution to a dispute. Article 11 of the DSU clarifies that it is within the Panel's discretion, based on an objective assessment of the matter before it, to recommend what steps the parties should take to "secure a positive solution to the dispute". This flexibility is confirmed by the terms of reference of this Panel: "To examine, in the light of the relevant provisions of the covered agreements cited by the United States in document WT/DS308/4, the matter referred to the DSB by the United States in that document, and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements".

8.209 Mexico argues that, in this case, issuing findings would not secure a positive solution to the dispute. Findings would not lead to a mutually acceptable solution to the parties if Mexico continues to be blocked in having its grievance under the NAFTA resolved. The Panel should aim to treat both parties fairly.

8.210 Mexico requests that the Panel take particular care in formulating its findings and recommendations so as not to suggest that it is interpreting the two parties' rights and obligations under the NAFTA.[432]

8.211 Mexico additionally requests the Panel to make the following determinations of fact, whatever its resolution on the merits of this dispute may be. First, that Mexico and the United States have negotiated a bilateral preferential trade regime for sweeteners, which includes HFCS and sugar, products that compete in certain market segments. Second, that a legitimate broader dispute exists between Mexico and the United States regarding access of Mexican sugar to the US market. Third, that Mexico has exhausted all efforts to resolve that dispute through diplomatic channels, bilateral consultations and negotiations, and through NAFTA's Chapter Twenty dispute settlement mechanism. Fourth, that, notwithstanding the fact that Mexico requested the establishment of a NAFTA arbitral panel in 2000, to date the United States has not appointed panellists and has thus frustrated Mexico's attempt to resolve its grievances under the NAFTA. Fifth, that the tax measures at issue are a response to the United States' refusal to submit to NAFTA's dispute settlement; a response that seeks to induce the United States to do so, as well as to rebalance Mexico's market which has been affected by the sugar production surplus resulting in part from United States' HFCS imports and HFCS production from corn imported from the United States. Sixth, that the United States has stated that under international law it can validly adopt counter-measures when another State refuses to submit to dispute settlement mechanisms.[433]

8.212 Finally, Mexico requests the Panel, in the course of its deliberations, to give the fullest weight to Mexico's status as a developing country and to the fact that agrarian reform entails a lengthy process of adjustment.[434]

[432] Mexico's second written submission, para. 86.
[433] Written version of Mexico's oral statement during second substantive meeting of the Panel with the parties, para. 36.
[434] Mexico's first written submission, paras. 105-109, 137 and 139.

2. The United States response

8.213 The United States responds to Mexico's arguments in this regard, by stating that they are not relevant to the resolution of this dispute. In the United States' opinion, Mexico's assertions that this is a NAFTA dispute and that a finding of WTO-inconsistency could prejudice Mexico's interests in on-going or future NAFTA proceedings, do not bear on whether Mexico's tax measures are consistent with Article III of the GATT 1994 or justified under Article XX(d). They are, therefore, not issues that this Panel needs to consider further. The United States adds that Mexico is incorrect in arguing that the Panel need not limit its recommendations in this dispute to a request that Mexico bring its WTO-inconsistent tax measures into compliance. Panel recommendations are limited to recommendations that WTO-inconsistent measures be brought into conformity with the covered agreements. This limitation is explicitly provided for in Article 19.1 of the DSU.[435]

8.214 Regarding Mexico's request that the Panel make certain determinations of fact, the United States responds that most of the facts identified by Mexico involve determinations of contested legal issues. The United States also disputes many of the facts identified by Mexico. It additionally argues that these determinations do not concern facts that this Panel needs to determine in order to fulfil its mandate in this dispute, which concerns the consistency of Mexico's tax measures with Mexico's WTO obligations and not the United States' actions under the NAFTA. The United States concludes that the Panel should not agree to make the determinations of fact requested by Mexico.[436]

3. Panel's analysis

(a) The Panel's "discretion"

8.215 Mexico has made a variety of requests regarding the findings and recommendations that the Panel might make. Most of these requests rest on the premise that the Panel has discretion as to what it may do in this regard, in support of which Mexico has made a number of arguments. The Panel will commence its analysis by examining these. In essence, Mexico argues that the Panel has discretion to depart from the procedure stated in Article 19.1 of the DSU:

> "Where a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement. In addition to its recommendations, the panel or Appellate Body may suggest ways in which the Member concerned could implement the recommendations." (Footnotes omitted.)

8.216 In support of its arguments, Mexico has referred to Article 3.1 of the DSU[437], which states that:

> "Members affirm their adherence to the principles for the management of disputes heretofore applied under Articles XXII and XXIII of GATT 1947, and the rules and procedures as further elaborated and modified herein."

8.217 Mexico seems to invoke Article 3.1 of the DSU merely in order to address the text of Articles XXII and XXIII of the GATT. Since the latter provisions are explicitly included in WTO law as part of the GATT 1994, there is no need to invoke Article 3.1 of the DSU for this purpose. Mexico has not referred to any other matters that would require the invocation of Article 3.1.

---

[435] Written version of United States oral statement during second substantive meeting of the Panel with the parties, paras. 19 and 26.

[436] United States response to Panel question No. 73, paras. 61-67.

[437] Mexico's second written submission, para. 59.

8.218 Despite Mexico's argument[438], the Panel does not find anything in Article XXII of the GATT which suggests that panels have the discretion not to issue rulings and recommendations in disputes where they have found measures to be inconsistent with WTO obligations.

8.219 As to Article XXIII of the GATT, Mexico points to several features in Article XXIII:2 in support of its contentions. This paragraph states in its relevant parts that:

> "If no satisfactory adjustment is effected between the contracting parties concerned within a reasonable time, or if the difficulty is of the type described in paragraph 1 (*c*) of this Article, the matter may be referred to the CONTRACTING PARTIES. The CONTRACTING PARTIES shall promptly investigate any matter so referred to them and shall make appropriate recommendations to the contracting parties which they consider to be concerned, or give a ruling on the matter, as appropriate..."[439]

8.220 Mexico claims that the use of the phrase "as appropriate" gives discretion to panels whether or not to issue rulings. In the first place, it is clear that, even if such discretion exists, it is given to CONTRACTING PARTIES (and their equivalent under the WTO, the DSB), and not to panels. More generally, it must be borne in mind that the use of panels in dispute settlement was not specifically envisaged in the text of the GATT adopted in 1947, but was developed in the following years. The topic was the subject of a number of decisions of the CONTRACTING PARTIES during this period.[440] Many of the elements of these decisions have now been absorbed into the DSU. Terms in Article XXIII:2 should therefore not be read in isolation. In particular, the Panel regards it as significant that none of the DSU provisions touching on the powers of panels in regard to making recommendations qualifies those powers with the phrase "as appropriate". The relevant DSU provisions are considered below.

8.221 Mexico also claims support for its arguments from the use of the word "or" that connects the two options open to the CONTRACTING PARTIES: to make recommendations, and to give a ruling.[441] The Panel is not aware of any authoritative interpretation of the term "ruling". However, it does not find that in this context the word "or" indicates that the two options are mutually exclusive. The term most likely includes a panel's conclusion that the respondent Member's measures are inconsistent with particular WTO obligations. Such a conclusion would invariably be accompanied by a recommendation. Consequently, whether in relation to the Panel in making proposals to the DSB, or to the DSB itself, this use of the word merely serves to present a list of the actions that may be taken. It does not indicate that the Panel has the flexibility that is claimed by Mexico.

8.222 Apart from these specific points, Mexico argues that Articles XXII and XXIII of the GATT confer "discretion upon the Contracting Parties (and panels acting at their behest)".[442] The Panel does not see how these provisions can in general be read as giving discretion to either the CONTRACTING PARTIES or panels.

8.223 Mexico seeks support for its position from several provisions of the DSU. The Panel will examine these in turn in order to determine the present legal situation.

---

[438] Mexico's second written submission, para. 55.

[439] Under the system of the GATT 1947, the expression "CONTRACTING PARTIES" in capital letters, meant the Contracting Parties "acting jointly". GATT, Article XXV:1.

[440] See, for example, Understanding Regarding Notification, Consultation, Dispute Settlement and Surveillance (1979), BISD 26S/210. Doc. L/4907. See also, Decision on Improvements to the GATT Dispute Settlement Rules and Procedures (1989), Doc. L/6489.

[441] Mexico's second written submission, para. 57.

[442] Mexico's second written submission, para. 58. Written version of Mexico's oral statement during second substantive meeting of the Panel with the parties, para. 48.

8.224 Mexico claims that Article 3.7 of the DSU confirms the flexibility accorded to panels.[443] This provision states that:

> "Before bringing a case, a Member shall exercise its judgement as to whether action under these procedures would be fruitful. The aim of the dispute settlement mechanism is to secure a positive solution to a dispute. A solution mutually acceptable to the parties to a dispute and consistent with the covered agreements is clearly to be preferred. In the absence of a mutually agreed solution, the first objective of the dispute settlement mechanism is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements. The provision of compensation should be resorted to only if the immediate withdrawal of the measure is impracticable and as a temporary measure pending the withdrawal of the measure which is inconsistent with a covered agreement. The last resort which this Understanding provides to the Member invoking the dispute settlement procedures is the possibility of suspending the application of concessions or other obligations under the covered agreements on a discriminatory basis vis-à-vis the other Member, subject to authorization by the DSB of such measures...."

8.225 Mexico refers in particular to the second and fourth sentences. Regarding the former, the Panel's view is that the statement that "[t]he aim of the dispute settlement mechanism is to secure a positive solution to the dispute" is too general to be set against the precise rules that define the role of panels. Regarding the fourth sentence ("[i]n the absence of a mutually agreed solution, the first objective of the dispute settlement mechanism is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements"), the Panel notes that it simply describes the desired outcome of dispute settlement proceedings, when a finding of inconsistency has already been made by the DSB and no other mutually acceptable solution has been reached between the parties. The word "usually" in the phrase "is usually to secure the withdrawal of the measures concerned" does not have the implications given to it by Mexico. This phrase must be read in conjunction with the remainder of the paragraph, which addresses the fall-back solutions to be adopted when immediate withdrawal of the measure is not achieved. These in effect state what should happen in other-than-usual cases. Consequently, Article 3.7 of the DSU does not confer a general discretion on panels to make any kind of recommendations they might think appropriate in a particular case.

8.226 Mexico has also invoked Article 11 of the DSU in support of its contentions.[444] That provision reads:

> "The function of panels is to assist the DSB in discharging its responsibilities under this Understanding and the covered agreements. Accordingly, a panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements. Panels should consult regularly with the parties to the dispute and give them adequate opportunity to develop a mutually satisfactory solution."

8.227 Mexico points to the use of the word "should" rather than "shall" as an indication that panels have a discretion in these matters.[445] It acknowledges that "should" can mean "shall"[446], but says that

---

[443] Mexico's second written submission, para. 60.
[444] Mexico's second written submission, para. 50.
[445] Ibid.

this interpretation cannot be assumed. In fact, the obligatory nature of the panels' duties under Article 11 has been repeatedly emphasized by the Appellate Body.[447] Indeed, the importance of the topics covered by this provision would not allow for any other interpretation.

8.228 Mexico has also argued that the terms of reference of this Panel confirm the notion that the Panel has flexibility to decide whether to issue findings on the claims. Mexico has recalled the terms of reference of this Panel: "[t]o examine... the matter referred to the DSB by the United States... and to make such findings as will assist the DSB in making the recommendations *or* in giving the rulings provided for in those agreements" (emphasis added by Mexico).[448] The Panel notes that this formulation follows the standard terms of reference stated in Article 7.1 of the DSU, and that in its mention of recommendations and rulings it directly reflects the terms of Article XXIII:2 of the GATT, which also refers to the making of recommendations "or" the giving of a ruling.[449] Consequently, the explanation that the Panel gave above in order to show that Article XXIII:2 provides no basis for Mexico's argument is also applicable in regard to the terms of reference.

8.229 Finally, the Panel returns to Article 19.1 of the DSU:

> "Where a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned[450] bring the measure into conformity with that agreement.[451] In addition to its recommendations, the panel or Appellate Body may suggest ways in which the Member concerned could implement the recommendations."

8.230 While Article 19.1 allows panels (and the Appellate Body) to suggest ways in which the Member concerned can implement the appropriate recommendations, this provision also confirms the Panel's earlier conclusion[452] that it is a legal obligation for panels (and for the Appellate Body), once they have concluded that a measure is inconsistent with a covered agreement, to recommend that the Member concerned bring the measure into conformity with that agreement. Since the Panel has concluded that it does not have discretion to depart from the procedure stated in Article 19.1, there is no occasion for it to consider the various ways in which Mexico requested that such discretion should be exercised. Mexico does not request the Panel to make suggestions of the kind described in the second sentence of Article 19.1. In any event, since Mexico's interest lies in having the Panel issue recommendations directed at what the United States should do, such a step would serve no purpose.

(b) Determinations of fact requested by Mexico

8.231 As for the factual determinations requested by Mexico, the Panel notes that some of the facts included in its request have been taken into account and noted in the findings, to the extent that those facts are relevant for the resolution of the matter put before this Panel.

---

[446] Mexico cites in its support the Appellate Body Report on *Canada – Aircraft*, para. 187. See Mexico's second written submission, para. 50.

[447] See, for example, Appellate Body Report on *EC – Hormones*, para. 133. See also, Appellate Body Report on *Korea – Dairy*, para. 137.

[448] Mexico's second written submission, para. 63.

[449] See paras. 8.219 to 8.222 above.

[450] (f*ootnote original*) The "Member concerned" is the party to the dispute to which the panel or Appellate Body recommendations are directed.

[451] (f*ootnote original*) With respect to recommendations in cases not involving a violation of GATT 1994 or any other covered agreement, see Article 26.

[452] See para. 8.225 above.

8.232 Both parties acknowledge that there is a dispute between them concerning the United States' commitments under the NAFTA regarding the access of Mexican sugar to the United States market.[453] However, that is a separate dispute from the one that has been brought before this Panel. First, it is a dispute regarding obligations under a different international agreement, the NAFTA. Second, the DSU and the terms of reference approved by the DSB define the limits of the matter that is before of this Panel. Article 3.10 of the DSU states that WTO Members understand that "complaints and counter-complaints in regard to distinct matters should not be linked". Consequently, even if, *arguendo*, the dispute between Mexico and the United States regarding access of Mexican sugar in the United States market were a matter under the WTO covered agreements, a Panel could not link the complaints and counter-complaints related to distinct matters in one single case.

(c) Mexico's status as a developing country

8.233 Mexico requests the Panel, in the course of its deliberations, to give the fullest weight to Mexico's status as a developing country and to the fact that agrarian reform entails a lengthy process of adjustment.[454]

8.234 The Panel is aware of the crucial importance of the provisions on special and differential treatment in the WTO agreements in general, and of Article 12.11 of the DSU in particular. During the Panel proceedings, the Panel has taken into account Mexico's status as a developing country, *inter alia*, when establishing the timetable for the panel process, and has accorded flexibility within that timetable for the receipt of Mexico's submissions and responses. In the course of these proceedings, however, Mexico has raised no specific provisions on differential and more-favourable treatment for developing country Members that require additional consideration.[455]

4. Conclusion

8.235 In light of the above considerations, the Panel will follow Article 19.1 of the DSU as regards the recommendations that it makes.

IX. CONCLUSIONS AND RECOMMENDATION

9.1 For the reasons indicated in this report, the Panel has determined that, under the DSU, it has no discretion to decline to exercise its jurisdiction in the case that has been brought before it.

9.2 With respect to the United States' claims, the Panel concludes as follows:

(a) With respect to Mexico's soft drink tax and distribution tax:

(i) As imposed on sweeteners, imported beet sugar is subject to internal taxes in excess of those applied to like domestic sweeteners, in a manner inconsistent with Article III:2, first sentence, of the GATT 1994;

(ii) As imposed on sweeteners, imported HFCS is being taxed dissimilarly compared with the directly competitive or substitutable products, so as to afford protection to the Mexican domestic production of cane sugar, in a manner inconsistent with Article III:2, second sentence, of the GATT 1994;

---

[453] Mexico's first written submission, paras. 1-8, 12, and 27-77. United States' response to Panel question No. 73, paras. 62-64.

[454] Mexico's first written submission, paras. 105-109, 137 and 139. Mexico's response to Panel question No. 24.

[455] Mexico's response to Panel question No. 39.

(iii) As imposed on sweeteners, imported beet sugar and HFCS are accorded less favourable treatment than that accorded to like products of national origin, in a manner inconsistent with Article III:4 of the GATT 1994;

(iv) As imposed on soft drinks and syrups, imported soft drinks and syrups sweetened with non-cane sugar sweeteners (including HFCS and beet sugar) are subject to internal taxes in excess of those applied to like domestic products, in a manner inconsistent with Article III:2, first sentence, of the GATT 1994.

(b) With respect to Mexico's bookkeeping requirements: As imposed on sweeteners, imported beet sugar and HFCS are accorded less favourable treatment than that accorded to like products of national origin, in a manner inconsistent with Article III:4 of the GATT 1994.

9.3 With respect to Mexico's invocation of Article XX(d) of the GATT 1994, the Panel concludes that the challenged tax measures are not justified as measures that are necessary to secure compliance by the United States with laws or regulations which are not inconsistent with the provisions of the GATT 1994.

9.4 Under Article 3.8 of the DSU, 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. The Panel concludes that, to the extent that the measures listed above are inconsistent with the GATT 1994, they have nullified or impaired benefits accruing to the United States under that agreement.

9.5 Having concluded that it has no discretion to depart from the procedure stated in Article 19.1 of the DSU, the Panel recommends that the Dispute Settlement Body request Mexico to bring the inconsistent measures as listed above into conformity with its obligations under the GATT 1994.

ANNEX A

REQUEST FOR THE ESTABLISHMENT OF A PANEL

WORLD TRADE ORGANIZATION

WT/DS308/4
11 June 2004

(04-2542)

Original: English

MEXICO – TAX MEASURES ON SOFT DRINKS AND OTHER BEVERAGES

Request for the Establishment of a Panel by the United States

The following communication, dated 10 June 2004, from the delegation of the United States to the Chairperson of the Dispute Settlement Body, is circulated pursuant to Article 6.2 of the DSU.

The United States considers that certain tax measures of the Government of Mexico on soft drinks and other beverages as well as on syrups, concentrates, powders, essences or extracts that can be diluted to produce such products (hereinafter "beverages and syrups") that use any sweetener other than cane sugar are inconsistent with Mexico's commitments and obligations under the *General Agreement on Tariffs and Trade 1994* ("GATT 1994"). Those measures include:

(1) Law on the Special Tax on Production and Services (*Ley del Impuesto Especial sobre Producción y Servicios* or "IEPS") published on 1 January 2002 and its subsequent amendments published on 30 December 2002 and 31 December 2003[456]; and

(2) any related or implementing measures, including the *Reglamento de la Ley del Impesto Especial sobre Producción y Servicios* published on 15 May 1990, the *Resolucion Miscelanea Fiscal Para 2004* (Title 6) published on 30 April 2004, and the *Resolucion Miscelanea Fiscal Para 2003* (Title 6) published on 31 March 2003 which identify, *inter alia*, details on the scope, calculation, payment and bookkeeping and recording requirements of the IEPS.

Mexico's tax measures impose a 20 per cent tax on beverages and syrups that use sweeteners other than cane sugar. Mexico's tax measures also impose a 20 per cent tax on services related to the

[456] *Ley del Impuesto Especial sobre Producción y Servicios* (1 Jan. 2002); *Se Reforman Y Adicionan Diversas Diposiciones de la Ley del Impuesto Especial sobre Producción y Servicios*, (30 Dec. 2002); *Se Reforman, Adicionan y Derogan Diversas Disposiciones de la Ley Del Impuesto Al Valor Agregado, de la Ley Del Impuesto Sobre La Renta, de la Ley Del Impuesto Especial Sobre Producciónyy Servicios, de la Ley Del Impuesto Sobre Tenencia o Uso De Vehículos, de la Ley Federal Del Impuesto Sobre Automóviles Nuevos y de la Ley Federal De Derechos* (31 Dec. 2003); *Ley del Impuesto Especial sobre Producción y Servicios* (31 Dec. 2003).

transfer of beverages and syrups, including the commissioning, mediation, agency, representation, brokerage, consignment and distribution of such products. Beverages and syrups sweetened only with cane sugar, and services related to their transfer, are not subject to these measures.

Mexico's tax measures also impose several bookkeeping and reporting requirements on beverages and syrups, and services related to the transfer of such products, that are not similarly imposed on beverages and syrups sweetened only with cane sugar, or on services related to the transfer of beverages and syrups sweetened only with cane sugar.

The United States considers that Mexico's tax measures discriminate against imported sweeteners other than cane sugar (including high-fructose corn syrup ("HFCS")), and imported beverages and syrups made with such sweeteners, because Mexico's tax measures do not apply to cane sugar, or beverages and syrups made solely with cane sugar. The United States considers imported sweeteners other than cane sugar, and imported beverages and syrups made with such sweeteners, including HFCS and beverages and syrups made with HFCS, to be like and directly competitive or substitutable with Mexican cane sugar and beverages and syrups made with Mexican cane sugar.

The United States considers that Mexico's tax measures are inconsistent with Mexico's obligations under Article III of the GATT 1994. In particular, Mexico's tax measures appear to be inconsistent with Article III:2, first and second sentences, and Article III:4 of the GATT 1994.

On 16 March 2004, the United States requested consultations with the Government of Mexico pursuant to Articles 1 and 4 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") and Article XXII:1 of the GATT 1994 concerning Mexico's tax measures on beverages and syrups, and services related to the transfer of such products. The United States held consultations with Mexico on these measures in Geneva on 13 May 2004. Unfortunately, these consultations did not resolve the dispute.

Accordingly, the United States respectfully requests the Dispute Settlement Body to establish a panel pursuant to Article 6 of the DSU to examine this matter with standard terms of reference as set out in Article 7.1 of the DSU.

ANNEX B

FAX DATED 18 JANUARY 2005 FROM THE CHAIRMAN OF THE PANEL TO THE PARTIES AND THIRD PARTIES CONCERNING MEXICO'S REQUEST FOR A PRELIMINARY RULING

As you know, Mexico, as the responding party in these proceedings, has asked the Panel to decline to exercise its jurisdiction in the case in favour of an Arbitral Panel under Chapter Twenty of the North American Free Trade Agreement (NAFTA). Mexico asked that the Panel make this decision through a preliminary ruling.

The Panel has had the opportunity to consider Mexico's request, as well as the arguments on the matter presented by the United States - the complaining party in these proceedings -, and by third parties, including the arguments presented in the responses to questions formulated by the Panel.

After careful consideration of the matter, the Panel has decided to reject Mexico's request. The Panel considers that, under the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), it does not have the discretion, as argued by Mexico, to decide not to exercise its jurisdiction in a case that has been properly brought before it. In any event, even if it had such discretion, the Panel does not consider that the circumstances of this case would justify it declining to exercise its jurisdiction in the present dispute.

The Panel will provide the parties with a fully detailed reasoning for this decision in its report. The decision in no way affects the merits of the substantive claims brought by the United States in the present case, nor the defences to these claims raised by Mexico.