ARTICLE III

Text of Article III

Article III*

National Treatment on Internal Taxation and Regulation

1. The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.*

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

3. With respect to any existing internal tax which is inconsistent with the provisions of paragraph 2, but which is specifically authorized under a trade agreement, in force on April 10, 1947, in which the import duty on the taxed product is bound against increase, the contracting party imposing the tax shall be free to postpone the application of the provisions of paragraph 2 to such tax until such time as it can obtain release from the obligations of such trade agreement in order to permit the increase of such duty to the extent necessary to compensate for the elimination of the protective element of the tax.

4. The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.

5. No contracting party shall establish or maintain any internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions which requires, directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources. Moreover, no contracting party shall otherwise apply internal quantitative regulations in a manner contrary to the principles set forth in paragraph 1.*

6. The provisions of paragraph 5 shall not apply to any internal quantitative regulation in force in the territory of any contracting party on July 1, 1939, April 10, 1947, or March 24, 1948, at the option of that contracting party; *Provided* that any such regulation which is contrary to the provisions of paragraph 5 shall not be modified to the detriment of imports and shall be treated as a customs duty for the purpose of negotiation.

7. No internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions shall be applied in such a manner as to allocate any such amount or proportion among external sources of supply.

8. (*a*) The provisions of this Article shall not apply to laws, regulations or requirements governing the procurement by governmental agencies of products purchased for governmental purposes and not with a view to commercial resale or with a view to use in the production of goods for commercial sale.

(*b*) The provisions of this Article shall not prevent the payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article and subsidies effected through governmental purchases of domestic products.

9. The contracting parties recognize that internal maximum price control measures, even though conforming to the other provisions of this Article, can have effects prejudicial to the interests of contracting parties supplying imported products. Accordingly, contracting parties applying such measures shall take account of the interests of exporting contracting parties with a view to avoiding to the fullest practicable extent such prejudicial effects.

10. The provisions of this Article shall not prevent any contracting party from establishing or maintaining internal quantitative regulations relating to exposed cinematograph films and meeting the requirements of Article IV.

Text of note *ad* Article III

Ad Article III

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

Paragraph 1

The application of paragraph 1 to internal taxes imposed by local governments and authorities with the territory of a contracting party is subject to the provisions of the final paragraph of Article XXIV. The term "reasonable measures" in the last-mentioned paragraph would not require, for example, the repeal of existing national legislation

> authorizing local governments to impose internal taxes which, although technically inconsistent with the letter of Article III, are not in fact inconsistent with its spirit, if such repeal would result in a serious financial hardship for the local governments or authorities concerned. With regard to taxation by local governments or authorities which is inconsistent with both the letter and spirit of Article III, the term "reasonable measures" would permit a contracting party to eliminate the inconsistent taxation gradually over a transition period, if abrupt action would create serious administrative and financial difficulties.

Paragraph 2

> A tax conforming to the requirements of the first sentence of paragraph 2 would be considered to be inconsistent with the provisions of the second sentence only in cases where competition was involved between, on the one hand, the taxed product and, on the other hand, a directly competitive or substitutable product which was not similarly taxed.

Paragraph 5

> Regulations consistent with the provisions of the first sentence of paragraph 5 shall not be considered to be contrary to the provisions of the second sentence in any case in which all of the products subject to the regulations are produced domestically in substantial quantities. A regulation cannot be justified as being consistent with the provisions of the second sentence on the ground that the proportion or amount allocated to each of the products which are the subject of the regulation constitutes an equitable relationship between imported and domestic products.

General

Purpose of Article III

Avoidance of protectionism in the application of internal measures

1. In examining the consistency of the Japanese taxation on liquor products with Article III, the Appellate Body in *Japan – Alcoholic Beverages II* explained the purpose of Article III in the following terms:

> "The broad and fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures. More specifically, the purpose of Article III 'is to ensure that internal measures "not be applied to imported or domestic products so as to afford protection to domestic production"'. Toward this end, Article III obliges Members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products. '[T]he intention of the drafters of the Agreement was clearly to treat the imported products in the same way as the like domestic products once they had been cleared through customs. Otherwise indirect protection could be given'."[1]

2. The Appellate Body repeatedly cited its finding referenced in paragraph 1 above.[2] Further, in *Korea – Alcoholic Beverages*, the Appellate Body added:

> "In view of the objectives of avoiding protectionism, requiring equality of competitive conditions and protecting expectations of equal competitive relationships, we decline to take a static view of the term 'directly competitive or substitutable'."[3]

3. Also, in *Canada – Periodicals*, the Appellate Body added: "[t]he fundamental purpose of Article III of the GATT 1994 is to ensure equality of competitive conditions between imported and like domestic products."[4]

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[1] Appellate Body Report, *Japan – Alcoholic Beverages II,* p. 16.

[2] Appellate Body Report, *Korea – Alcoholic Beverages*, para. 119; Appellate Body Report, *Chile – Alcoholic Beverages*, para. 67; and Appellate Body Report, *EC – Asbestos*, para. 97. See also Panel Report, *Indonesia – Autos*, para. 14.108.

[3] Appellate Body Report, *Korea – Alcoholic Beverages*, para. 120.

4. In *Argentina – Hides and Leather*, the Panel referred to the findings of the Appellate Body referenced in paragraphs 1-3 above, and stated that "Article III:2, first sentence, is not concerned with taxes or changes as such or the policy purposes Members pursue with them, but with their economic *impact* on the competitive opportunities of imported and like domestic products."[5] See also paragraph 70 below.

Protection of tariff commitments under Article III/Relevance of tariff concessions

5. In *Japan – Alcoholic Beverages II*, the Panel held that "one of the main purposes of Article III is to guarantee that WTO Members will not undermine through internal measures their commitments under Article II."[6] Although the Appellate Body agreed about the significance of Article III with respect to tariff concessions, it emphasized that the purpose of Article III was broader:

> "The broad purpose of Article III of avoiding protectionism must be remembered when considering the relationship between Article III and other provisions of the *WTO Agreement.* Although the protection of negotiated tariff concessions is certainly one purpose of Article III, the statement in Paragraph 6.13 of the Panel Report that 'one of the main purposes of Article III is to guarantee that WTO Members will not undermine through internal measures their commitments under Article II' should not be overemphasized. The sheltering scope of Article III is not limited to products that are the subject of tariff concessions under Article II. The Article III national treatment obligation is a general prohibition on the use of internal taxes and other internal regulatory measures so as to afford protection to domestic production. This obligation clearly extends also to products not bound under Article II. This is confirmed by the negotiating history of Article III."[7]

Comparison with competition law

6. In *Korea – Alcoholic Beverages*, the Panel, in a statement subsequently not addressed by the Appellate Body, considered that it is not necessary to use the same criteria for defining markets under Article III:2 as under competition law. The Panel stated:

> "While the specifics of the interaction between trade and competition law are still being developed, we concur that the market definitions need not be the same. Trade law generally, and Article III in particular, focuses on the promotion of economic opportunities for importers through the elimination of discriminatory governmental measures which impair fair international trade. Thus, trade law addresses the issue of the potentiality to compete. Antitrust law generally focuses on firms' practices or structural modifications which may prevent or restrain or eliminate competition. It is not illogical that markets be defined more broadly when implementing laws primarily designed to protect competitive opportunities than when implementing laws designed to protect the actual mechanisms of competition. In our view, it can thus be appropriate to utilize a broader concept of markets with respect to Article III:2, second sentence, than is used in antitrust law. We also take note of the developments under European Community law in this regard. For instance, under Article 95 of the Treaty of Rome, which is based on the language of Article III, distilled alcoholic beverages have been considered similar or competitive in a series of rulings by the European Court of Justice ('ECJ'). On the other hand, in examining a merger under the European Merger Regulation, the Commission of the European Communities found that whisky constituted a separate market. Similarly, in an Article 95 case, bananas were considered in competition with other fruits. However, under EC competition law, bananas constituted a distinct product market. We are mindful that the Treaty of Rome is different in scope and purpose from the General Agreement, the similarity of Article 95 and Article III, notwithstanding. Nonetheless, we observe that there is relevance in examining how the ECJ has defined markets in similar situations to assist

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[4] Appellate Body Report, *Canada – Periodicals*, p. 18.
[5] Panel Report, *Argentina – Hides and Leather*, para. 11.182. (emphasis added)
[6] Panel Report, *Japan – Alcoholic Beverages II*, para. 6.13.
[7] Appellate Body Report, *Japan – Alcoholic Beverages II*, pp. 16-17.

> in understanding the relationship between the analysis of non-discrimination provisions and competition law.[8]"[9]

Scope of application – measures imposed at the time or point of importation

7. In *Argentina – Hides and Leather*, the Panel addressed the question whether Argentine fiscal provisions concerning pre-payment of a value added tax, applied to imported goods at the time of their importation, were nevertheless to be considered "internal measures" within the meaning of Article III:2. The Panel addressed in particular Note *Ad* Article III, which sets forth that a measure applied to a product at the time of importation is nevertheless an internal measure within the meaning of Article III if this measure is also imposed on the like domestic product:

> "RG 3431 [the value-added tax measure applicable to imported goods] applies to definitive import transactions, but only if the products imported are subsequently re-sold in the internal Argentinean market. In other words, RG 3431 provides for the pre-payment of the IVA chargeable to an *internal* transaction. It should also be pointed out that the fact that RG 3431 is collected at the time and point of importation does not preclude it from qualifying as an internal tax measure."[10]

8. While the parties to the *Argentina – Hides and Leather* dispute agreed that RG 3543, another Argentine tax measure imposing a collection regime of income taxes with respect to import transactions, was an internal measure within the meaning of Article III, they disagreed with respect to the question whether the same tax regime existed for domestic goods, i.e. whether RG 2784, the income tax measure applicable with respect to domestic transactions, was the "internal analogue" of RG 3431. While RG 3543 established a *collection* regime and defined the *purchaser* as the taxable person, RG 2784 established a *withholding* regime and defined the *seller* as the taxable person. The Panel did not consider these differences significant enough for the Argentine regime to fall outside the scope the Note *Ad* Article III:

> "[I]t is clear that the fact that RG 3543 creates a collection regime and not a withholding regime does not establish, in itself, that RG 2784 is not equivalent to RG 3543. The use of a different method of taxation may be justified by objective reasons. In this regard, it seems logical to us to collect pre-payments of an income tax from the sellers of a product, as indeed RG 2784 envisages. As we understand it, RG 3543 does not do so, *inter alia*, because foreign sellers are not normally subject to income taxation in Argentina. In those circumstances, Argentina apparently saw fit to adjust for the adverse competitive effect of RG 2784 on domestic products by collecting pre-payments from importers in accordance with RG 3543.
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> …
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> For these reasons, we find that RG 3543 establishes a mechanism for the collection of the IG at the border which is equivalent in nature to the IG withholding mechanism established by RG 2784. In accordance with the Note *Ad* Article III, we therefore conclude that RG 3543 is an internal measure within the meaning of Article III:2."[11]

9. In *EC – Bananas III*, the Appellate Body found the EC import licensing system for bananas inconsistent with Article III:4. The European Communities claimed that Article III:4 was not applicable to the import licensing system because it was a border measure. The Appellate Body replied as follows:

> "At issue in this appeal is not whether *any* import licensing requirement, as such, is within the scope of Article III:4, but whether the EC procedures and requirements for the *distribution* of import licences for imported bananas among eligible operators *within* the European Communities are within the scope of this provision. The EC

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[8] *(footnote original)* In finding the relationship of the provisions to each other relevant, we do not intend to imply that we have adopted the market definitions defined in these or other ECJ cases for purposes of this decision.

[9] Panel Report, *Korea – Alcoholic Beverages*, para. 10.81.

[10] Panel Report, *Argentina – Hides and Leather*, para. 11.145.

[11] Panel Report, *Argentina – Hides and Leather*, paras. 11.150 and 11.154.

> licensing procedures and requirements include the operator category rules, under which 30 per cent of the import licences for third-country and non-traditional ACP bananas are allocated to operators that market EC or traditional ACP bananas, and the activity function rules, under which Category A and B licences are distributed among operators on the basis of their economic activities as importers, customs clearers or ripeners. These rules go far beyond the mere import licence requirements needed to administer the tariff quota for third-country and non-traditional ACP bananas or Lomé Convention requirements for the importation of bananas. These rules are intended, among other things, to cross-subsidize distributors of EC (and ACP) bananas and to ensure that EC banana ripeners obtain a share of the quota rents. As such, these rules affect 'the internal sale, offering for sale, purchase, …' within the meaning of Article III:4, and therefore fall within the scope of this provision. Therefore, we agree with the conclusion of the Panel on this point."[12]

10. In *Brazil – Taxation*, the Panel rejected Brazil's argument that measures directed at producers ("pre-market" measures), without regard to actual or potential trade effects, did not fall within the scope of application of Article III. The Panel concluded that "Article III of the GATT 1994 is not *per se* inapplicable to certain measures, in particular 'pre-market' measures directed at producers."[13] The Panel explained its reasoning:

> "In the Panel's view, the plain text of Article III of the GATT 1994 is sufficient to refute Brazil's argument. Article III:1, containing the overarching national treatment obligation that is then elaborated in the remaining paragraphs of Article III, is phrased in broad and inclusive language, referring to, and covering among other things, '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'. Article III:4 contains similar language, also referring to all laws, regulations and requirements affecting […] internal sale, offering for sale, purchase, transportation, distribution or use' of imported and domestic like products. This broad language cannot be seen as limited to measures directed at products only once they are in the market, as Brazil argues. Not only is the language not limited in that way, logically there is no reason why a measure directed at a producer rather than a product could not 'affect' the internal sale, offering for sale, purchase, etc. of domestic and imported products. Furthermore, if the formalistic approach advanced by Brazil were correct, it would be simple to entirely avoid the bedrock national treatment requirement of the multilateral trading system."[14]

11. The Appellate Body in *Brazil – Taxation* reiterated the broad scope of application of Article III:2 first sentence, since this provision is also informed by Article III:1:

> "[W]hile the focus of Article III:2, first sentence is, in particular, 'on the treatment accorded to 'products'', it does not exclude from its scope measures that are on their face directed at producers, which nevertheless subject the product concerned to taxation in excess, and thereby have an impact on the conditions of competition.[15]"[16]

State trading enterprises

12. In *Korea – Various Measures on Beef,* the Panel recognized that where a state trading enterprise has a monopoly over both importation and distribution of goods, a blurring may occur of the traditional distinction between measures affecting imported products and measures affecting importation:

> "Based on the panel findings in the *Canada – Marketing Agencies (1988)* case, the Panel considers that to the extent that LPMO fully controls both the importation and

[12] Appellate Body Report, *EC – Bananas III*, para. 211.
[13] Panel Reports, *Brazil – Taxation*, para. 7.70.
[14] Panel Reports, *Brazil – Taxation*, para. 7.63.
[15] *(footnote original)* However, whether measures directed at producers subject the product concerned to taxation in excess, and thereby have an impact on the conditions of competition, must be determined on the basis of the facts and circumstances at issue.
[16] Appellate Body Reports, *Brazil – Taxation*, para. 5.15.

> distribution of its 30 per cent share of Korean beef quota, the distinction normally made in the GATT between restrictions affecting the importation of products (i.e. border measures) and restrictions affecting imported products (i.e. internal measures) loses much of its significance."[17]

Relevance of policy purpose of internal measures / "aims-and-effects" test

13. With respect to the relevance of policy purposes of subject internal measures, in *Japan – Alcoholic Beverages II*, the Appellate Body stated as follows:

> "Members of the WTO are free to pursue their own domestic goals through internal taxation or regulation so long as they do not do so in a way that violates Article III or any of the other commitments they have made in the WTO Agreement."[18]

14. In this respect, in *Argentina – Hides and Leather*, the Panel stated that "[i]t must be stated … that the applicability of Article III:2 is not conditional upon the policy purpose of a tax measure."[19]

15. In *Japan – Alcoholic Beverages II*, the Panel explicitly rejected the so-called "aim-and-effect" test. The Panel summarized the parties' arguments for the "aim-and-effect" test as follows:

> "Japan … essentially argued that the Panel should examine the contested legislation in the light of its aim and effect in order to determine whether or not it is consistent with Article III:2. According to this view, in case the aim and effect of the contested legislation do not operate so as to afford protection to domestic production, no inconsistency with Article III:2 can be established. … [T]he United States … essentially argued that, in determining whether two products that were taxed differently under a Member's origin-neutral tax measure were nonetheless 'like products' for the purposes of Article III:2, the Panel should examine not only the similarity in physical characteristics and end-uses, consumer tastes and preferences, and tariff classifications for each product, but also whether the tax distinction in question was 'applied … so as to afford protection to domestic production': that is, whether the aim and effect of that distinction, considered as a whole, was to afford protection to domestic production. According to this view, if the tax distinction in question is not being applied so as to afford protection to domestic production, the products between which the distinction is drawn are not to be deemed 'like products' for the purpose of Article III:2."[20]

16. In upholding the Panel's rejection of the "aim-and-effect" test under Article III:2, first sentence, the Appellate Body, in *Japan – Alcoholic Beverages II*, found that the policy purpose of a tax measure (the "aim" of a measure) was not relevant for the purpose of Article III:2, first sentence:

> "Article III:2, first sentence does not refer specifically to Article III:1. There is no specific invocation in this first sentence of the general principle in Article III:1 that admonishes Members of the WTO not to apply measures 'so as to afford protection'. This omission must have some meaning. We believe the meaning is simply that the presence of a protective application need not be established separately from the specific requirements that are included in the first sentence in order to show that a tax measure is inconsistent with the general principle set out in the first sentence. However, this does not mean that the general principle of Article III:1 does not apply to this sentence. To the contrary, we believe the first sentence of Article III:2 is, in effect, an application of this general principle. … If the imported and domestic products are 'like products', and if the taxes applied to the imported products are 'in

[17] Panel Report, *Korea – Various Measures on Beef*, para. 766.
[18] Appellate Body Report, *Japan – Alcoholic Beverages II,* p. 16.
[19] Panel Report, *Argentina – Hides and Leather*, para. 11.144.
[20] Panel Report, *Japan – Alcoholic Beverages II*, para. 6.15.

> excess of' those applied to the domestic like products, then the measure is inconsistent with Article III:2, first sentence."[21]

17. The Appellate Body rejected the "aim-and-effect" test under both Article II and Article XVII of the *GATS* in *EC – Bananas III.*[22] See Section on the *GATS*.

18. In *Japan – Alcoholic Beverages II,* the Appellate Body did find that the "general principle" in Article III:1 that internal measures should not be applied so as to afford protection to domestic production "informs" the rest of Article III;[23] see below regarding the application of this principle in interpreting Article III:2, second sentence. In *EC – Asbestos*, the Appellate Body, recalling that this "general principle" "informs" Article III:4, found that "the term 'like product' in Article III:4 "must be interpreted to give proper scope and meaning to this principle."[24]

Relevance of trade effects

19. In *Japan – Alcoholic Beverages II*, the Appellate Body addressed the relevance of the trade effects of measures falling under the scope of Article III:

> "[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."[25]

20. The Appellate Body reiterated this approach in *Canada – Periodicals*:

> "It is a well-established principle that the trade effects of a difference in tax treatment between imported and domestic products do not have to be demonstrated for a measure to be found to be inconsistent with Article III."[26]

State trading monopolies

21. In *Korea – Various Measures on Beef*, the Panel addressed the relationship between Article XVII, the provision on state trading enterprises, and Article III. Finding support for its conclusions in GATT practice, the Panel held:

> "Article XVII.1(a) establishes the general obligation on state trading enterprises to undertake their activities in accordance with the GATT principles of non-discrimination. The Panel considers that this general principle of non-discrimination includes at least the provisions of Articles I and III of GATT.
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> …
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> A conclusion that the principle of non-discrimination was violated would suffice to prove a violation of Article XVII."[27]

Article III:1

Relationship between paragraph 1 and paragraphs 2, 4 and 5

22. In *US – Gasoline,* the Panel examined whether a US gasoline regulation treated imported gasoline in a manner inconsistent with Article III:1. In response to the US argument that Article III:1 "could not form the basis of a violation"[28], the Panel answered as follows:

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[21] Appellate Body Report, *Japan – Alcoholic Beverages II*, pp. 18-19.
[22] Appellate Body Report, *EC – Bananas III*, paras. 216 and 241.
[23] Appellate Body Report, *Japan – Alcoholic Beverages II,* p. 18.
[24] Appellate Body Report, *EC – Asbestos*, para. 98.
[25] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 16 (statement also endorsed in Appellate Body Report, *Korea – Alcoholic Beverages*, para. 119. See also Panel Report, *Indonesia – Autos*, para. 14.108).
[26] Appellate Body Report, *Canada – Periodicals*, p. 18.
[27] Panel Report, *Korea – Various Measures on Beef*, paras. 753 and 757.

> "The Panel examined first whether, after making a finding of inconsistency with Article III:4, it should make a finding under Article III:1. The Panel noted that the panel in the *Malt Beverages* case had examined a claim made under paragraphs 1, 2 and 4 of Article III. That panel had concluded that 'because Article III:1 is a more general provision than either Article III:2 or III:4, it would not be appropriate for the Panel to consider [the complainant's] Article III:1 allegations to the extent that the Panel were to find [the respondent's] measures to be inconsistent with the more specific provisions of Articles III:2 and III:4.' The present Panel agreed with this reasoning, and therefore did not find it necessary to examine the consistency of the Gasoline Rule with Article III:1."[29]

23. In *Japan – Alcoholic Beverages II*, the Appellate Body examined the Panel's finding of inconsistency of the Japanese Liquor Tax Law with both sentences of Article III:2. With respect to the legal status of Article III:1, the Appellate Body invoked the principle of effective treaty interpretation and found that Article III:1 constitutes part of the context for Article III:2:

> "The terms of Article III must be given their ordinary meaning – in their context and in the light of the overall object and purpose of the *WTO Agreement*. Thus, the words actually used in the Article provide the basis for an interpretation that must give meaning and effect to all its terms. The proper interpretation of the Article is, first of all, a textual interpretation. Consequently, the Panel is correct in seeing a distinction between Article III:1, which 'contains general principles', and Article III:2, which 'provides for specific obligations regarding internal taxes and internal charges'. Article III:1 articulates a general principle that internal measures should not be applied so as to afford protection to domestic production. This general principle informs the rest of Article III. The purpose of Article III:1 is to establish this general principle as a guide to understanding and interpreting the specific obligations contained in Article III:2 and in the other paragraphs of Article III, while respecting, and not diminishing in any way, the meaning of the words actually used in the texts of those other paragraphs. In short, Article III:1 constitutes part of the context of Article III:2, in the same way that it constitutes part of the context of each of the other paragraphs in Article III. Any other reading of Article III would have the effect of rendering the words of Article III:1 meaningless, thereby violating the fundamental principle of effectiveness in treaty interpretation. Consistent with this principle of effectiveness, and with the textual differences in the two sentences, we believe that Article III:1 informs the first sentence and the second sentence of Article III:2 in different ways."[30]

24. In *EC – Asbestos*, the Appellate Body referred to Article III:1 and reasoned that the "general principle" articulated therein informs the interpretation of the concept of like products in Article III:4. The Appellate Body held:

> "There must be consonance between the objective pursued by Article III, as enunciated in the 'general principle' articulated in Article III:1, and the interpretation of the specific expression of this principle in the text of Article III:4.
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> [This interpretation] must, therefore, reflect that, in endeavouring to ensure 'equality of competitive conditions', the 'general principle' in Article III seeks to prevent Members from applying internal taxes and regulations in a manner which affects the competitive relationship, in the marketplace, between the domestic and imported products involved, 'so as to afford protection to domestic production'."[31]

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[28] Panel Report, *US – Gasoline*, para. 6.17.
[29] Panel Report, *US – Gasoline*, para. 6.17.
[30] Appellate Body Report, *Japan – Alcoholic Beverages II*, pp. 17-18.
[31] Appellate Body Report, *EC – Asbestos,* para. 98. See also Panel Report, *US – Clove Cigarettes,* paras. 7.99-7.101.

25. In *Brazil – Taxation*, the Panel referred to the broad and inclusive language in Article III:1 and noted the "overarching national treatment obligation" that is embedded therein as well as its importance for the interpretation of the remaining paragraphs of Article III.[32]

26. The precise significance of Article III:1 for the interpretation of Article III:2, first sentence, was also addressed by the Panels on *Argentina – Hides and Leather*. See paragraph 36 below.[33]

Article III:2

General

General distinction between first and second sentences

27. In *Japan – Alcoholic Beverages II*, the Appellate Body described the distinction between the first and second sentences of Article III:2 as follows:

> "[T]he second sentence of Article III:2 provides for a separate and distinctive consideration of the protective aspect of a measure in examining its application to a broader category of products that are not 'like products' as contemplated by the first sentence … [.]"[34]

28. In *Canada – Periodicals*, the Appellate Body, in reviewing the Panel's finding that the Canadian excise tax on magazines was inconsistent with Article III:2, first sentence, also addressed the distinction between the first and second sentence of Article III:2:

> "[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. If the answer to one question is negative, there is a need to examine further whether the measure is consistent with Article III:2, second sentence."[35]

29. In *Canada – Periodicals*, the Appellate Body also reiterated its statement from *Japan – Alcoholic Beverages II* that Article III:2, second sentence, contemplates a "broader category of products" than Article III:2, first sentence:

> "Any measure that indirectly affects the conditions of competition between imported and like domestic products would come within the provisions of Article III:2, first sentence, or by implication, second sentence, given the broader application of the latter."[36]

30. Further, in *Canada – Periodicals*, the Appellate Body rejected Canada's argument that the imported and domestic periodicals in question were only imperfectly substitutable with each other and, therefore, did not fall under the term "directly competitive or substitutable product":

> "A case of perfect substitutability would fall within Article III:2, first sentence, while we are examining the broader prohibition of the second sentence."[37]

31. In *Korea – Alcoholic Beverages*, the Appellate Body examined the Panel's finding that Korean tax laws concerning liquor products were inconsistent with Article III:2. In rejecting Korea's appeal that "potential competition" was not enough to find that subject products were "directly competitive or substitutable products", the Appellate Body stated as follows:

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[32] Panel Reports, *Brazil – Taxation*, para. 7.63.
[33] With respect to this issue, see also Panel Report, *Japan – Film*, para. 10.371.
[34] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 19.
[35] Appellate Body Report, *Canada – Periodicals*, pp. 22-23.
[36] Appellate Body Report, *Canada – Periodicals*, p. 19.
[37] Appellate Body Report, *Canada – Periodicals*, p. 28.

> "The first sentence of Article III:2 also forms part of the context of the term. 'Like' products are a subset of directly competitive or substitutable products: all like products are, by definition, directly competitive or substitutable products, whereas not all 'directly competitive or substitutable' products are 'like'. The notion of like products must be construed narrowly[38] but the category of directly competitive or substitutable products is broader. While perfectly substitutable products fall within Article III:2, first sentence, imperfectly substitutable products can be assessed under Article III:2, second sentence."[39]

Relationship with paragraph 1

32. With respect to the relationship with paragraph 1, see paragraphs 22-26 above.

Legal status of Note Ad Article III:2

33. In *Japan – Alcoholic Beverages II*, the Appellate Body defined the legal status of Interpretative Note *Ad* Article III:2 and its relevance for the interpretation of Article III:2, as follows:

> "Article III:2, second sentence, and the accompanying *Ad* Article have equivalent legal status in that both are treaty language which was negotiated and agreed at the same time. The *Ad* Article does not replace or modify the language contained in Article III:2, second sentence, but, in fact, clarifies its meaning. Accordingly, the language of the second sentence and the *Ad* Article must be read together in order to give them their proper meaning."[40]

Article III:2, first sentence

General

Test under Article III:2, first sentence

34. In *Japan – Alcoholic Beverages II*, the Appellate Body clarified the two elements contained in the first sentence of Article III:2, "like products" and "in excess of". The Appellate Body established that these requirements constitute, in and of themselves, an application of the general principle contained in Article III:1 and that, consequently, the presence of a protective application need not be established separately from the specific criteria of Article III:2, first sentence:

> "Article III:1 informs Article III:2, first sentence, by establishing that if imported products are taxed in excess of like domestic products, then that tax measure is inconsistent with Article III. Article III:2, first sentence does not refer specifically to Article III:1. There is no specific invocation in this first sentence of the general principle in Article III:1 that admonishes Members of the WTO not to apply measures so as to afford protection'. This omission must have some meaning. We believe the meaning is simply that the presence of a protective application need not be established separately from the specific requirements that are included in the first sentence in order to show that a tax measure is inconsistent with the general principle set out in the first sentence. However, this does not mean that the general principle of Article III:1 does not apply to this sentence. To the contrary, we believe the first sentence of Article III:2 is, in effect, an application of this general principle. The ordinary meaning of the words of Article III:2, first sentence leads inevitably to this conclusion. Read in their context and in the light of the overall object and purpose of the *WTO Agreement*, the words of the first sentence require an examination of the conformity of an internal tax measure with Article III by determining, first, whether

[38] *(footnote original)* Appellate Body Reports on *Japan – Alcoholic Beverages II*, p. 20, and *Canada – Periodicals*, p. 21.
[39] Appellate Body Report, *Korea – Alcoholic Beverages*, para. 118.
[40] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 24. Two panels cited this finding and stated that "*Ad* Article III has equal stature under international law as the GATT language to which it refers, pursuant to Article XXXIV." Panel Report, *Korea – Alcoholic Beverages*, footnote 346; and Panel Report, *Chile – Alcoholic Beverages*, fn 349.

> the taxed imported and domestic products are 'like' and, second, whether the taxes applied to the imported products are 'in excess of' those applied to the like domestic products. If the imported and domestic products are 'like products', and if the taxes applied to the imported products are 'in excess of' those applied to the like domestic products, then the measure is inconsistent with Article III:2, first sentence.
>
> This approach to an examination of Article III:2, first sentence, is consistent with past practice under the GATT 1947. Moreover, it is consistent with the object and purpose of Article III:2, which the panel in the predecessor to this case dealing with an earlier version of the Liquor Tax Law, *Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages* … , rightly stated as 'promoting non-discriminatory competition among imported and like domestic products [which] could not be achieved if Article III:2 were construed in a manner allowing discriminatory and protective internal taxation of imported products in excess of like domestic products'."[41]

35. In *Canada – Periodicals*, the Appellate Body reiterated this two-tiered 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." [42]

36. In *Argentina – Hides and Leather*, Argentina, citing the finding of the Appellate Body in *Japan – Alcoholic Beverages II* referenced in paragraph 16 above, argued that the existence of a protective application must be determined together with the other specific requirements contained in Article III:2. The Panel rejected this argument:

> "We are unable to agree with Argentina's interpretation of the Appellate Body's statement. As we understand it, the presence of a protective application need be established neither separately nor together with the specific requirements contained in Article III:2, first sentence. The quoted passage from the Appellate Body report in *Japan – Alcoholic Beverages II* makes clear that Article III:2, first sentence, is, in effect, an application of the general principle stated in Article III:1. Accordingly, whenever imported products from one Member's territory are subject to taxes in excess of those applied to like domestic products in the territory of another Member, this is deemed to 'afford protection to domestic production' within the meaning of Article III:1. It follows that, in applying Article III:2, first sentence, recourse to the general principle of Article III:1 is neither necessary nor appropriate.[43] The only requirements that need to be demonstrated by the complaining party are those contained in Article III:2, first sentence, itself.[44]"[45]

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[41] Appellate Body Report, *Japan – Alcoholic Beverages II*, pp. 18-19.

[42] Appellate Body Report, *Canada – Periodicals*, pp. 22-23.

[43] *(footnote original)* We find further support for our view in the following statement made by the Appellate Body in its Report, *EC – Bananas III*, *supra*, at para. 216:

> Article III:4 does *not* specifically refer to Article III:1. Therefore, a determination of whether there has been a violation of Article III:4 does *not* require a separate consideration of whether a measure "afford[s] protection to domestic production".

While this statement relates to Article III:4 of the GATT, which is not at issue in the present case, it nevertheless provides useful clarification for purposes of analysing Argentina's argument in respect of Article III:2, first sentence. It clearly emerges from this statement that not only is there no requirement separately to establish the presence of a protective application, but that there is not even a requirement separately to consider whether there is a protective application.

[44] *(footnote original)* We note Argentina's contention that the GATT 1947 panel reports on *Japan – Alcoholic Beverages I*; *US – Section 337*, and *US – Malt Beverages*, lend support to its view that the presence of a protective application must be established for purposes of a claim under Article III:2, first sentence. See paras. 8.228 *et seq*. of this report. Since all of the aforementioned reports pre-date the Appellate Body reports on *Japan – Alcoholic Beverages II* and *EC – Bananas III* and since those Appellate Body reports directly address the issue before us, we see no need to further consider the GATT 1947 reports in this regard.

37. In *Philippines – Distilled Spirits*, the Panel recalled the two-step likeness test, established by the Appellate Body in *Japan – Alcoholic Beverages* and *Canada – Periodicals*, under the first sentence of Article III:2. The Panel emphasized that the test to determine "like products" must be construed "in a narrow manner".[46]

Burden of proof

38. In *Japan – Alcoholic Beverages II*, the Panel stated that "complainants have the burden of proof to show first that products are like and second, that foreign products are taxed in excess of domestic ones."[47]

"like domestic products"

39. The Panel in *Brazil – Taxation* rejected Brazil's argument that "intermediate products" were not subject to the disciplines of Article III:2, explaining:

> "The Panel notes that 'intermediate products' is not treaty language. Article III:2 of the GATT 1994 does not make any distinction between finished or intermediate products; it simply refers to 'products' in general. Therefore, the Panel is of the view that both categories of products (i.e. finished and intermediate goods) are subject to the disciplines of Article III:2 of the GATT 1994."[48]

40. In *EU and Certain Member States – Palm Oil (Malaysia)*, the Panel declined to make additional findings under Article III:2 as to whether palm oil as feedstock for biofuel production was like other oil-crop feedstocks for biofuel production, noting that Malaysia's arguments in this regard were the same as those presented to demonstrate that palm oil-based biofuel was like biofuel based on other feedstocks:

> "The Panel also notes that Malaysia makes the argument that palm oil as feedstock for biofuel production is like other oil-crop feedstocks for biofuel production within the meaning of Article III:2, first sentence; and that palm oil as biofuel feedstock is indirectly taxed in excess of other like oil-crop biofuel feedstocks of domestic origin. The Panel notes that Malaysia's argument with respect to palm oil as biofuel feedstock rests on the same premise of its argument that palm oil-based biofuel is indirectly taxed in excess of like domestic oil crop-based biofuels. In these circumstances, the Panel must consider the practical value that any findings with respect to palm oil as biofuel feedstock would have for implementation, in light of the findings relating to palm oil-based biofuel.
>
> The Panel sees no reason for making separate and additional findings under Article III:2, first sentence with respect to palm oil as biofuel feedstock, when such findings would rest on the same premise of the findings with respect to palm oil-based biofuel. Malaysia has not explained how additional findings with respect to palm oil as biofuel feedstock would have any practical value from the perspective of a possible appeal, implementation, or otherwise.
>
> The Panel notes that, because the alleged taxation in excess of palm oil as biofuel feedstock stems from the alleged taxation in excess of palm oil-based biofuel, it follows that any action taken to implement any findings of inconsistency with respect to taxation in excess of palm oil-based biofuel would necessarily address any taxation in excess of palm oil as biofuel feedstock. Thus, from the perspective of implementation, separate and additional findings regarding the palm oil as biofuel feedstock would appear to be entirely redundant."[49]

41. In *EU and Certain Member States – Palm Oil (Malaysia)*, the Panel found the products at issue to be like despite differences in their characteristics:

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[45] Panel Report, *Argentina – Hides and Leather*, para. 11.137.
[46] Panel Report, *Philippines – Distilled Spirits,* para. 7.33.
[47] Panel Report, *Japan – Alcoholic Beverages II*, para. 6.14.
[48] Panel Reports, *Brazil – Taxation*, para. 7.97.
[49] Panel Report, *EU and Certain Member States – Palm Oil (Malaysia)*, paras. 7.1132-7.1134.

> "The Panel considers that the evidence on the record demonstrates that, despite certain differences in product characteristics, there is a significant degree of competition between PME, RME and SBME in the French market. In the Panel's view, the competitive relationship among the products at issue in the French market is sufficient to justify a finding that, as regards FAME, even under the narrower scope of like products of Article III:2, first sentence, biofuels made from rapeseed oil and soybean oil are like palm oil-based biofuel.
>
> The Panel therefore finds that, as regards FAME, biofuels made from rapeseed oil and soybean oil are like palm oil-based biofuel within the meaning of Article III:2, first sentence."[50]

Relevant factors for the determination of "likeness"

1.1.1.1.1.1 General

42. In *Japan – Alcoholic Beverages II*, the Appellate Body was called upon to examine the Panel's finding of inconsistency of the Japanese Liquor Tax Law with Article III:2. The Appellate Body analysed what factors to take into consideration in deciding whether two products in question were "like products":

> "We agree with the practice under the GATT 1947 of determining whether imported and domestic products are 'like' on a case-by-case basis. The Report of the Working Party on *Border Tax Adjustments,* adopted by the CONTRACTING PARTIES in 1970, set out the basic approach for interpreting 'like or similar products' generally in the various provisions of the GATT 1947:
>
> > … '[T]he interpretation of the term should be examined on a case-by-case basis. This would allow a fair assessment in each case of the different elements that constitute a "similar" product. Some criteria were suggested for determining, on a case-by-case basis, whether a product is "similar": the product's end-uses in a given market; consumers' tastes and habits, which change from country to country; the product's properties, nature and quality.'[51]
>
> This approach was followed in almost all adopted panel reports after *Border Tax Adjustments.* This approach should be helpful in identifying on a case-by-case basis the range of 'like products' that fall within the narrow limits of Article III:2, first sentence in the GATT 1994."[52]

43. In *Canada – Periodicals*, the Appellate Body reiterated the aforementioned finding in *Japan – Alcoholic Beverages II*:

> "[T]he proper test is that a determination of 'like products' for the purposes of Article III:2, first sentence, must be construed narrowly, on a case-by-case basis, by examining relevant factors including:
>
> (i) the product's end-uses in a given market;
>
> (ii) consumers' tastes and habits; and
>
> (iii) the product's properties, nature and quality."[53]

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[50] Panel Report, *EU and Certain Member States – Palm Oil (Malaysia)*, paras. 7.1157-7.1158.
[51] The Appellate Body cited Report of the Working Party on *Border Tax Adjustments*, BISD 18S/97, para. 18.
[52] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 20. In *Indonesia – Autos*, the Panel followed this finding of the Appellate Body. Panel Report, *Indonesia – Autos*, para. 14.109. See also Panel Report, *Philippines – Distilled Spirits,* paras. 7.31-7.37, and 7.124-7.127.
[53] Appellate Body Report, *Canada – Periodicals*, pp. 21-22.

44. With respect to the criteria of likeness, see also the Panel Report on *Argentina – Hides and Leather*,[54] where the Panel referred to the Appellate Body's finding in *Canada – Periodicals* referenced in paragraph 43 above. Also, many other panel reports reference the same list of factors from the Working Party Report on *Border Tax Adjustments*.

45. In *Thailand – Cigarettes (Philippines),* the Panel found that it was not necessary to do a like product analysis comparing all domestic and all imported cigarettes across all price segments: domestic and imported cigarettes, within the same price segments, were "like products", based on an analysis of the physical quality and characteristics, end-uses, tariff classification, and Thai internal taxes and regulations, supported by econometric studies on cross-price elasticity of demand.[55]

46. In *Philippines – Distilled Spirits,* the Panel, recalled the Appellate Body's holding in *Mexico – Taxes on Soft Drinks* that a "likeness" analysis should focus on the physical qualities and characteristics of the final product, rather than those of raw materials. The Panel further emphasized that "the difference in raw materials would only be relevant to the extent that it results in final products that are not similar".[56]

1.1.1.1.1.2 Relevance of tariff classifications and bindings

47. In *Japan – Alcoholic Beverages II*, the Appellate Body addressed the relevance of tariff classification for establishing the "likeness" of products:

> "A uniform tariff classification of products can be relevant in determining what are 'like products'. If sufficiently detailed, tariff classification can be a helpful sign of product similarity. Tariff classification has been used as a criterion for determining 'like products' in several previous adopted panel reports.[57] For example, in the *1987 Japan – Alcohol* Panel Report, the panel examined certain wines and alcoholic beverages on a 'product-by-product basis' by applying the criteria listed in the Working Party Report on *Border Tax Adjustments*,
>
> > … as well as others recognized in previous GATT practice (see BISD 25S/49, 63), such as the Customs Cooperation Council Nomenclature (CCCN) for the classification of goods in customs tariffs which has been accepted by Japan."[58]

48. In *Japan – Alcoholic Beverages II*, in addition to tariff *classification*, the Appellate Body also examined the relevance of tariff bindings for the determination of "like products". In contrast to tariff classification, the Appellate Body expressed reservations about the reliability of tariff bindings as a criterion in establishing "likeness":

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

[54] Panel Report, *Argentina – Hides and Leather*, para. 11.167.
[55] Panel Report, *Thailand - Cigarettes (Philippines),* paras. 7.425-7.451.
[56] Panel Report, *Philippines – Distilled Spirits,* paras. 7.34-7.37.

[58] Appellate Body Report, *Japan – Alcoholic Beverages II*, pp. 21-22.

> It is true that there are numerous tariff bindings which are in fact extremely precise with regard to product description and which, therefore, can provide significant guidance as to the identification of 'like products'. Clearly enough, these determinations need to be made on a case-by-case basis. However, tariff bindings that include a wide range of products are not a reliable criterion for determining or confirming product 'likeness' under Article III:2."[59]

49. With respect to the purpose of Article III as it relates to tariff bindings, see paragraph 5 above.

1.1.1.1.1.3 Hypothetical "like products"

50. In *Canada – Periodicals*, the Panel found that the Canadian excise tax on magazines was inconsistent with Article III:2. Upon appeal, Canada argued that the Panel erred in basing its comparison upon a hypothetical example of periodicals. The Appellate Body endorsed the Panel's recourse to a hypothetical example of imported products:

> "As Article III:2, first sentence, normally requires a comparison between imported products and like domestic products, and as there were no imports of split-run editions of periodicals because of the import prohibition in Tariff Code 9958, which the Panel found (and Canada did not contest on appeal) to be inconsistent with the provisions of Article XI of the GATT 1994, hypothetical imports of split-run periodicals have to be considered. As the Panel recognized, the proper test is that a determination of 'like products' for the purposes of Article III:2, first sentence, must be construed narrowly, on a case-by-case basis, by examining relevant factors including:
>
> (i) the product's end-uses in a given market;
>
> (ii) consumers' tastes and habits; and
>
> (iii) the product's properties, nature and quality."[60]

51. In *Indonesia – Autos*, the Panel examined the consistency with Article III of measures contained in the Indonesian National Car Programme, including the luxury tax exemption given to certain domestically produced cars. On the issue of hypothetical "like products", the Panel referred to the finding of the Appellate Body in *Canada – Periodicals*, referenced in paragraph 50 above, and emphasized the significance of the fact that the Indonesian car programme distinguished between the products at issue on the grounds of nationality of the producer or the origin of the parts and components of the product:

> "In *Periodicals*, the Appellate Body recognized the possibility of using hypothetical imports to determine whether a measure violates Article III:2, although in that case the Appellate Body rejected the hypothetical example used by the Panel. But this case is different. Under the Indonesian car programmes the distinction between the products for tax purposes is based on such factors as the nationality of the producer or the origin of the parts and components contained in the product. Appropriate hypotheticals are therefore easily constructed. An imported motor vehicle alike in all aspects relevant to a likeness determination would be taxed at higher rate simply because of its origin or lack of sufficient local content. Such vehicles certainly can exist (and, as demonstrated above, do in fact exist). In our view, such an origin-based distinction in respect of internal taxes suffices in itself to violate Article III:2, without the need to demonstrate the existence of actually traded like products. This is directly in accord with the broad purposes of Article III:2, as outlined by the Appellate Body."[61]

52. In *Argentina – Hides and Leather*, referring to the finding of the Panel in *Indonesia – Autos* referenced in paragraph 51 above, the Panel reiterated this standard of varying "quantum and

[59] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 22.
[60] Appellate Body Report, *Canada – Periodicals*, pp. 20-21.
[61] Panel Report, *Indonesia – Autos*, para. 14.113.

nature of the evidence" required for a finding under Article III:2, first sentence, depending on the "structure and design" of the measure at issue:

> "In the case before us, the European Communities has neither compared specific products nor addressed the criteria relevant to determining likeness. The European Communities considers that it is not incumbent upon it to do so. We agree. In circumstances such as those confronting us in this case no comparison of specific products is required. Logically, no examination of the various criteria relevant to determining likeness is then called for either.
>
> We consider that in the specific context of a claim under Article III:2, first sentence, the quantum and nature of the evidence required for a complaining party to discharge its burden of establishing a violation is dependent, above all, on the structure and design of the measure in issue.[62] The structure and design of RG 3431 and RG 3543 and their domestic counterparts RG 3337 and RG 2784 are such that the level of tax pre-payment is not determined by the physical characteristics or end-uses of the products subject to these resolutions, but instead is determined by factors which are not relevant to the definition of likeness, such as whether a particular product is definitively imported into Argentina or sold domestically as well as the characteristics of the seller or purchaser of the product.[63] It is therefore inevitable, in our view, that like products will be subject to RG 3431 and its domestic counterpart, RG 3337. The same holds true for RG 3543 and its domestic counterpart, RG 2784. The European Communities has demonstrated this to our satisfaction, and, in our view, this is all it needs to establish in the present case as far as the 'like product' requirement contained in Article III:2, first sentence, is concerned.
>
> This view is consistent with that adopted by the panel in *Indonesia – Autos*. That panel was of the view that:
>
> > '… an origin-based distinction in respect of internal taxes suffices in itself to violate Article III:2, without the need to demonstrate the existence of actually traded like products.'"[64]

53. The Panel in *China – Auto Parts*[65] also took the hypothetical approach set out above in determining "like products" in respect of internal tax measures that discriminate solely on the basis of origin under Article III:2.

1.1.1.1.1.4 Relevance of differences among sellers of goods

54. In *Argentina – Hides and Leather*, the Panel addressed Argentina's tax collection mechanism which required the pre-payment of taxes only with respect to internal sales made by certain taxable persons, so-called *agentes de percepción*, whilst in respect of import transactions, a pre-payment obligation would arise without regard to who made them. Finding this mechanism inconsistent with Article III:2, first sentence, the Panel stated:

> "As a further consideration, we add that, in the context of an inquiry under Article III:2, first sentence, the mere fact that a domestic product is sold by a non-

[62] *(footnote original)* As the Appellate Body has stated in *US – Wool Shirts and Blouses*, p. 14: "In the context of the GATT 1994 and the *WTO Agreement*, precisely how much and precisely what kind of evidence will be required to establish such a presumption will necessarily vary from measure to measure, provision to provision, and case to case."

[63] *(footnote original)* In our view, the mere fact that a product is of non-Argentinean origin or that it is being definitively imported into Argentina does not, *per se*, distinguish it - in terms of its physical characteristics and end-uses - from a product of Argentinean origin or a product which is being sold inside Argentina. Nor does likeness turn on whether the sellers or purchasers of the products under comparison qualify as registered or non-registered taxable persons or as *agentes de percepción* under Argentinean tax law.

[64] Panel Report, *Argentina – Hides and Leather*, paras. 11.168-11.170.

[65] Panel Report, *China – Autos*, para. 7.216.

> *agente de percepción* does not, in our view, render a product which is otherwise like an imported product 'unlike' that product.[66]
>
> …
>
> The identity and circumstances of the persons involved in sales transactions cannot, in our view, serve as a justification for tax burden differentials."[67]

Relationship between "like products" and "directly competitive products" under Article III:2

55. In *Japan – Alcoholic Beverages II*, the Appellate Body analysed the scope of the first sentence of Article III:2 in relation to the second sentence of this Article. It held that the term "like products" in Article III:2, first sentence, should be construed narrowly. Subsequently, it considered the basic GATT approach for interpreting "like products" generally in the various provisions of the GATT 1947:

> "Because the second sentence of Article III:2 provides for a separate and distinctive consideration of the protective aspect of a measure in examining its application to a broader category of products that are not 'like products' as contemplated by the first sentence, we agree with the Panel that the first sentence of Article III:2 must be construed narrowly so as not to condemn measures that its strict terms are not meant to condemn. Consequently, we agree with the Panel also that the definition of 'like products' in Article III:2, first sentence, should be construed narrowly.
>
> How narrowly is a matter that should be determined separately for each tax measure in each case. We agree with the practice under the GATT 1947 of determining whether imported and domestic products are 'like' on a case-by-case basis. The Report of the Working Party on *Border Tax Adjustments*, adopted by the CONTRACTING PARTIES in 1970, set out the basic approach for interpreting 'like or similar products' generally in the various provisions of the GATT 1947:
>
> > '… the interpretation of the term should be examined on a case-by-case basis. This would allow a fair assessment in each case of the different elements that constitute a "similar" product. Some criteria were suggested for determining, on a case-by-case basis, whether a product is "similar": the product's end-uses in a given market; consumers' tastes and habits, which change from country to country; the product's properties, nature and quality'.
>
> This approach was followed in almost all adopted panel reports after *Border Tax Adjustments*. This approach should be helpful in identifying on a case-by-case basis the range of 'like products' that fall within the narrow limits of Article III:2, first sentence in the GATT 1994. Yet this approach will be most helpful if decision makers keep ever in mind how narrow the range of 'like products' in Article III:2, first sentence is meant to be as opposed to the range of 'like' products contemplated in some other provisions of the GATT 1994 and other Multilateral Trade Agreements of the *WTO Agreement.* In applying the criteria cited in *Border Tax Adjustments* to the facts of any particular case, and in considering other criteria that may also be relevant in certain cases, panels can only apply their best judgement in determining whether in fact products are 'like'. This will always involve an unavoidable element of individual, discretionary judgement. We do not agree with the Panel's observation in paragraph 6.22 of the Panel Report that distinguishing between 'like products' and 'directly competitive or substitutable products' under Article III:2 is 'an arbitrary decision'.

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[66] *(footnote original)* See also the Panel Reports on *US – Gasoline*, *supra*, para. 6.11; *United States – Alcoholic Beverages*, para. 5.19. These panels held that differential regulatory or tax treatment of imported and like domestic products cannot be maintained, consistently with Article III, on the basis that the characteristics and circumstances of the producers of those products are different. The same logic must apply, in our view, to cases where tax distinctions between like imported and domestic products are based on the characteristics and circumstances of the sellers or purchasers of those products.

[67] Panel Report, *Argentina – Hides and Leather*, paras. 11.210 and 11.220.

> Rather, we think it is a discretionary decision that must be made in considering the various characteristics of products in individual cases."[68]

56. The consequence of the determination whether two products are or are not like was stated by the Appellate Body in *Japan – Alcoholic Beverages II*:

> "If imported and domestic products are not 'like products' for the narrow purposes of Article III:2, first sentence, then they are not subject to the strictures of that sentence and there is no inconsistency with the requirements of that sentence. However, depending on their nature, and depending on the competitive conditions in the relevant market, those same products may well be among the broader category of 'directly competitive or substitutable products' that fall within the domain of Article III:2, second sentence."[69]

57. With respect to the nature of like products as a subset of the category of "directly competitive or substitutable products", see also paragraph 31 above.

Relationship with "like products" in Article III:4

58. In *EC – Asbestos*, the Appellate Body discussed the relationship between the term "like products" in Article III:4, and that in the first sentence of Article III:2. See paragraph 149 below.

59. In *Japan – Alcoholic Beverages II*, the Panel discussed whether the term "like products" can be interpreted differently between GATT provisions, with a focus on the relationship between Article III:2, first sentence and Article III:4:

> "The Panel noted that the term 'like product' appears in various GATT provisions. The Panel further noted that it did not necessarily follow that the term had to be interpreted in a uniform way. In this respect, the Panel noted the discrepancy between Article III:2, on the one hand, and Article III:4 on the other: while the former referred to Article III:1 and to like, as well as to directly competitive or substitutable products (see also Article XIX of GATT), the latter referred only to like products. If the coverage of Article III:2 is identical to that of Article III:4, a different interpretation of the term 'like product' would be called for in the two paragraphs. Otherwise, if the term 'like product' were to be interpreted in an identical way in both instances, the scope of the two paragraphs would be different. This is precisely why, in the Panel's view, its conclusions reached in this dispute are relevant only for the interpretation of the term 'like product' as it appears in Article III:2."[70]

60. In *Thailand – Cigarettes (Philippines),* the Panel found that because the scope of "like product" is broader under Article III:4 than under Article III:2, if products are "like" for purposes of Article III:2, they are automatically "like" for purposes of Article III:4:

> "[W]e also recall our finding above that *Marlboro* and *L&M* cigarettes at issue are like the domestic cigarettes within the same price segments under Article III:2, first sentence, of the GATT. The Appellate Body clarified that the scope of 'like' in Article III:4 is broader than that in the first sentence of Article III:2.[71] Accordingly, to the extent that the imported and domestic products compared are found 'like' within the meaning of the first sentence of Article III:2, they can also be deemed to meet the likeness requirement under Article III:4. Therefore, we find that *Marlboro* and *L&M* are 'like' domestic cigarettes within the meaning of Article III:4."[72]

Relationship with "like products" in other GATT provisions

61. In *Japan – Alcoholic Beverages II*, the Appellate Body explained the possible differences in the scope of "like products" depending on provisions. To illustrate that the term "like products" will

[68] Appellate Body Report, *Japan – Alcoholic Beverages II*, pp. 19-21.
[69] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 25.
[70] Panel Report, *Japan – Alcoholic Beverages II*, para. 6.20.
[71] Appellate Body Report, *EC – Asbestos*, para. 99.
[72] Panel Report, *Thailand – Cigarettes (Philippines)*, para. 7.662.

vary between different provisions of the WTO Agreement, the Appellate Body evoked the image of an accordion:

> "No one approach to exercising judgement will be appropriate for all cases. The criteria in *Border Tax Adjustments* should be examined, but there can be no one precise and absolute definition of what is 'like'. The concept of 'likeness' is a relative one that evokes the image of an accordion. The accordion of 'likeness' stretches and squeezes in different places as different provisions of the *WTO Agreement* are applied. The width of the accordion in any one of those places must be determined by the particular provision in which the term 'like' is encountered as well as by the context and the circumstances that prevail in any given case to which that provision may apply. We believe that, in Article III:2, first sentence of the GATT 1994, the accordion of 'likeness' is meant to be narrowly squeezed."[73]

"internal tax or other internal charge of any kind"

62. In *Argentina – Hides and Leather*, the Panel examined whether the measures at issue, establishing a mechanism for the collection of certain taxes, were covered by Article III:2. The Panel found that the measures provide for the imposition of charges and create a liability and, as such, fall under the scope of Article III:2:

> "We consider that RG 3431 and RG 3543 are properly viewed not as taxes in their own right, but as mechanisms for the collection of the IVA [value-added tax] and IG [income tax]. What is special, however, about RG 3431 and RG 3543 as mechanisms for the collection of the IVA and IG is that they provide for the imposition of charges. We recall that Article III:2 covers 'charges *of any kind*' (emphasis added). The term 'charge' denotes, *inter alia*, a 'pecuniary burden' and a 'liability to pay money laid on a person…'. There can be no doubt, in our view, that both RG 3431 and RG 3543 impose a pecuniary burden and create a liability to pay money. Moreover, the charges provided for in RG 3431 and RG 3543 represent advance payments of the IVA and IG. RG 3431 and RG 3543 in effect impose on importers part of their definitive IVA and IG liability. It is clear to us, therefore, that the charges in question qualify as tax measures. As such, they fall to be assessed under Article III:2.
>
> With regard to Argentina's argument that RG 3431 and RG 3543 are measures designed to achieve efficient tax administration and collection and as such do not fall under Article III:2, it should be noted that Argentina has provided no support for this argument, except to say that it is up to Members to decide how best to achieve efficient tax administration. We agree that Members are free, within the outer bounds defined by such provisions as Article III:2, to administer and collect internal taxes as they see fit. However, if, as here, such 'tax administration' measures take the form of an internal charge and are applied to products, those measures must, in our view, be in conformity with Article III:2. There is nothing in the provisions of Article III:2 to suggest a different conclusion. If it were accepted that 'tax administration' measures are categorically excluded from the ambit of Article III:2, this would create a potential for abuse and circumvention of the obligations contained in Article III:2. It must be stated, moreover, that the applicability of Article III:2 is not conditional upon the policy purpose of a tax measure. On that basis, we cannot agree with Argentina that charges intended to promote efficient tax administration or collection *a priori* fall outside the scope of Article III:2."[74]

63. In *China – Auto Parts,* the Panel found, and the Appellate Body agreed, that the charge in question was within the scope of Article III:2, because it was imposed on goods that had already been imported, and the obligation to pay it was triggered "because of an *internal* factor (e.g., because the product was *re-sold* internally or because the product was *used* internally), in the sense that such 'internal factor' occurs *after the importation* of the product of one Member into the territory of another Member."[75]

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[73] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 21.
[74] Panel Report, *Argentina – Hides and Leather*, paras. 11.143-11.144.
[75] Appellate Body Report, *China – Auto Parts*, para. 163 (citing the Panel Report, para. 7.132).

64. The Panel Report on *Thailand –Cigarettes (Philippines)* found that "value added taxes, and hence the VAT at issue imposed on cigarettes under the Thai law, are an internal tax covered by Article III:2."[76]

65. In *Brazil – Taxation*, the Panel found all challenged indirect taxes qualified as an "internal tax" within the meaning of Article III:2.[77]

66. In *EU and Certain Member States – Palm Oil (Malaysia)*, the Panel found the challenged measure to be an internal tax covered by Article III:2:

> "As explained in section 2 of this Report, the French TIRIB is an annual tax payable by entities that release fuel for consumption within the territory of France; and its applicable rate will vary depending on the incorporation of sources qualifying as renewable energy, which includes certain biofuels, into such fuel. The French TIRIB is therefore a tax that applies to products. It applies directly to fuel and indirectly to the biofuel incorporated into such fuel. The obligation to pay such tax is accrued due to the internal event of releasing the fuel for consumption in France. Thus, the French TIRIB is an internal tax applied, directly or indirectly, to products."[78]

"in excess of those applied"

General

67. In *Japan – Alcoholic Beverages II*, the Appellate Body established a strict standard for the term "in excess of" under Article III:2, first sentence:

> "The only remaining issue under Article III:2, first sentence, is whether the taxes on imported products are 'in excess of' those on like domestic products. If so, then the Member that has imposed the tax is not in compliance with Article III. Even the smallest amount of 'excess' is too much. 'The prohibition of discriminatory taxes in Article III:2, first sentence, is not conditional on a 'trade effects test' nor is it qualified by a *de minimis* standard.'"[79]

68. In *EU and Certain Member States – Palm Oil (Malaysia)*, the challenged measure was one that entailed an additional internal tax on fuel that contained palm-oil based biofuel because palm oil was excluded from the scope of biofuels that were treated as renewable energy sources.[80] The European Union, the respondent in the case, argued that the measure was origin-neutral "because it is not the incorporation of domestic *vis-à-vis* imported biofuels that triggers the reduction, but rather the type of biofuel that is incorporated regardless of its origin."[81] The Panel rejected this argument:

> "The Panel notes that Article III:2, first sentence provides for equality of competitive conditions of all products found to be like. If palm oil-based biofuel has been found to be like rapeseed oil- and soybean oil-based biofuel, the comparison to be made with respect to taxation in excess of is not between imported palm oil-based biofuel and domestic palm oil-based biofuel, but between imported palm oil-based biofuel and the like domestic products rapeseed oil and soybean oil-based biofuel.
>
> Under this comparison, it is clear that fuel containing imported palm oil-based biofuel is taxed 'in excess' of fuel containing the like domestic products rapeseed oil- and soybean oil-based biofuels. Consequently, imported palm oil-based biofuel is indirectly

[76] Panel Report, *Thailand – Cigarettes (Philippines),* para. 7.598.
[77] Panel Reports, *Brazil – Taxation*, para. 7.105.
[78] Panel Report, *EU and Certain Member States – Palm Oil (Malaysia)*, para. 7.1125.
[79] Appellate Body Report, *Japan – Alcoholic Beverages II*, p.23. This finding was followed by the Panel in *Argentina – Hides and Leather*. Panel Report, *Argentina – Hides and Leather*, para. 11.243.
[80] Panel Report, *EU and Certain Member States – Palm Oil (Malaysia)*, paras. 7.1165 and 7.1168.
[81] Panel Report, *EU and Certain Member States – Palm Oil (Malaysia)*, para. 7.1169.

> taxed 'in excess' of the like domestic products rapeseed oil- and soybean oil-based biofuels."[82]

69. Having made this finding, the Panel in *EU and Certain Member States – Palm Oil (Malaysia)* proceeded to make additional findings demonstrating that, in effect, the challenged measure subjected imported products to higher taxes compared to domestic products:

> "The European Union is the largest biodiesel producer in the world and France has been one of the major producers and consumers of biodiesel in the European Union. Rapeseed oil, palm oil and soybean oil have been the most-used feedstocks for biodiesel production in France. Thus, France produces rapeseed oil-based biofuel, soybean oil-based biofuel and palm oil-based biofuel. Rapeseed oil has been the major feedstock source for biodiesel production in the European Union and in France, so most of the oil crop-based biofuel produced in France is rapeseed oil-based biofuel. France also produces soybean oil-based biofuel and palm oil-based biofuel, but to a lesser extent. Counted together, rapeseed oil- and soybean oil-based biofuels comprise most of the biodiesel produced in France.
>
> This means that, in effect, palm oil-based biofuel imported from Malaysia, which is all the biofuel imported from such Member, is indirectly taxed 'in excess' of the like rapeseed oil and soybean oil based biofuels produced in France, which comprise most of the biofuels produced in France.
>
> The Panel therefore finds, without ruling on whether these additional findings are necessary in order for Malaysia to establish its claim under Article III:2, that the situation where, as a result of the exclusion of palm oil-based biofuel from the group of qualifying biofuels for the purposes of the French TIRIB measure, palm oil-based biofuel is indirectly taxed 'in excess' of rapeseed oil and soybean oil-based biofuels is, in effect, one where imported products are subject to taxes 'in excess' of those applied to like domestic products."[83]

Methodology of comparison – "individual import transactions" basis

70. In *Argentina – Hides and Leather*, the Panel explained the method of comparison, for the purposes of Article III:1, first sentence, of the tax burdens imposed on imports and on domestic like products. In the case before it, the Panel emphasized that Article III:2, first sentence, requires a comparison of *actual* tax burdens rather than merely of *nominal* tax burdens:

> "[I]t is necessary to recall the purpose of Article III:2, first sentence, which is to ensure 'equality of competitive conditions between imported and like domestic products'[84]. Accordingly, Article III:2, first sentence, is not concerned with taxes or charges as such or the policy purposes Members pursue with them, but with their economic impact on the competitive opportunities of imported and like domestic products. It follows, in our view, that what must be compared are the tax burdens imposed on the taxed products.
>
> We consider that Article III:2, first sentence, requires a comparison of actual tax burdens rather than merely of nominal tax burdens. Were it otherwise, Members could easily evade its disciplines. Thus, even where imported and like domestic products are subject to identical tax rates, the actual tax burden can still be heavier on imported products. This could be the case, for instance, where different methods of computing tax bases lead to a greater actual tax burden for imported products. In this regard, the GATT 1947 panel in *Japan – Alcoholic Beverages I* has stated that:
>
> > … in assessing whether there is tax discrimination, account is to be taken not only of the rate of the applicable internal tax but also of the taxation methods (e.g. different kinds of internal taxes, direct taxation of the finished product or indirect taxation by taxing the raw materials used in

[82] Panel Report, *EU and Certain Member States – Palm Oil (Malaysia)*, paras. 7.1171-7.1172.
[83] Panel Report, *EU and Certain Member States – Palm Oil (Malaysia)*, paras. 7.1174-7.1176.

> the product during the various stages of its production) and of the rules for the tax collection (e.g. basis of assessment).
>
> It may thus be stated, in more general terms, that a determination of whether an infringement of Article III:2, first sentence, exists must be made on the basis of an overall assessment of the actual tax burdens imposed on imported products, on the one hand, and like domestic products, on the other hand."[85]

71. In *Argentina – Hides and Leather*, the measure at issue was, *inter alia*, an income tax provision under which customs authorities collected a certain amount of tax when foreign goods were definitively *imported* into Argentina. The normal applicable tax rate was 3 per cent. The corresponding provision for *internal* sales provided for a withholding rate of 2 or 4 per cent, depending on whether the payment, on which the tax was being withheld, was made to a registered or non-registered taxpayer. Argentina argued that the measure applicable to imported goods was consistent with Article III:2, first sentence because, "the 3 percent rate applicable to imports is lower than the 4 percent rate applicable to like domestic products". The Panel explained:

> "Article III:2, first sentence, is applicable to each individual import transaction. It does not permit Members to balance more favourable tax treatment of imported products in some instances against less favourable tax treatment of imported products in other instances."[86]

72. In *Canada – Periodicals*, the Appellate Body also addressed the issue of "balancing more favourable treatment" in some instances against less favourable treatment in other instances under Article III:2, second sentence.[87]

73. In *Thailand – Cigarettes (Philippines)* the Panel analysed the Thai VAT system, under which VAT for domestic cigarettes was collected at the manufacturer level, while VAT for imported cigarettes was passed on through the distribution chain to the consumer. Resellers of domestic cigarettes were exempt from VAT, whereas a reseller of imported cigarettes remained potentially liable for VAT and could only deduct VAT paid on its purchases from its VAT liability if it submits required forms. In response to Thailand's argument that Article III:2 focuses on how much is collected, not when the taxes are collected, the Panel found as follows:

> "We do not … consider that the scope of scrutiny of a given measure for its consistency with Article III:2, first sentence, can simply be limited to whether the final consumer ultimately pays the same VAT for imported and domestic cigarettes. In our view, the fact that VAT is in principle a consumer tax that normally is passed on to the final consumer does not eliminate the possibility that imported cigarettes may still be exposed to potential excess taxation under a Member's specific VAT system through the manner in which resellers of imported cigarettes in the distribution chain are held liable for the VAT obligations. Further, we do not find that the VAT exemption granted only to the resale of domestic cigarettes under the Thai VAT system is a typical feature of VAT or a common practice shared by other countries.
>
> Finally, we do not agree with Thailand's view that the obligations under Article III:2, first sentence, are not concerned with the issue whether the tax is collected uniformly from different merchants at each stage of the distribution process. We agree that the issue is not whether the tax is collected uniformly from distributors at each stage of the transaction chain. However, to the extent that the manner in which the tax is collected affects the tax liability applied to imported goods, we are of the opinion that a measure falls within the scope of Article III:2, first sentence. We also find support for our view from the statement of the Appellate Body in *Canada – Periodicals* that '[a]ny measure that indirectly affects the conditions of competition between imported and like domestic products would come within the provisions of Article III:2, first

[85] Panel Report, *Argentina – Hides and Leather*, paras. 11.182-11.184.
[86] Panel Report, *Argentina – Hides and Leather*, para. 11.260.
[87] Appellate Body Report, *Canada – Periodicals*, p. 32 (quoting GATT Panel Report, *US – Section 337,* BISD 36S/345, para. 5.14).

> sentence, or by implication, second sentence, given the broader application of the latter.'"[88]

74. The Appellate Body in *Thailand – Cigarettes (Philippines)* found that "a proper conception of Thailand's measure clarifies that it is not the mere imposition of administrative requirements that creates a differential tax burden, but rather that only resellers of imported cigarettes will incur VAT liability as a consequence of failing to offset output tax. Resellers of imported cigarettes are subject to VAT liability in defined circumstances under Thai law, whereas resellers of domestic cigarettes, due to a complete exemption from VAT, are not." On this basis, the Appellate Body agreed with the Panel that Thailand subjected imported cigarettes to internal taxes in excess of those applied to like domestic cigarettes within the meaning of Article III:2, first sentence.[89]

75. In *Brazil – Taxation*, the Panel examined Brazil's tax treatment of intermediate Information and Communication Technology (ICT) products manufactured by accredited and non-accredited companies under two programmes. Companies that purchased intermediate products, manufactured by an accredited company, either did not need to pay tax or paid taxes at lower rates. In turn, these companies received no tax credit or a reduced credit, respectively, to offset debts and other liabilities. By contrast, companies that purchased imported intermediate products, which were manufactured by companies that could not be accredited under the Brazilian system, had to pay tax. As a result of the tax payment, those companies obtained a tax credit or could ask for compensation or reimbursement. To determine whether imported intermediate ICT products were subject to a higher tax burden than like domestic incentivized intermediate products, the Panel took a "thorough look into the operation of the tax holistically in order to determine the effective tax burden on the products at issue" by considering both elements of the transaction, the payment of a tax and the grant of a tax credit. The Panel first observed the tax treatment in this dispute was "similar" to that in *Argentina – Hides and Leathers*, where the panel had found the "actual tax burden" was higher on imported than domestic like products. The Panel then found that imported intermediate ICT products were subject to a higher tax burden than like domestic incentivized intermediate ICT products, reasoning:

> "First, the Panel finds that the application of the rule of credits and debits for purchases of imported (and, therefore, non-incentivized) intermediate ICT products involves the payment of a tax that is not faced by companies purchasing incentivized intermediate domestic ICT products from accredited companies, which are exempted from the tax. … The Panel is of the view that this has the effect of limiting the availability of cash flow by companies purchasing imported intermediate ICT products and results in a higher effective tax burden on these products.
>
> Second, the Panel agrees with the complaining parties that the value of the credit generated when the tax is paid diminishes over time. The real value of an amount diminishes with the passage of time, since money depreciates over time through the effect of inflation. Even if credits are generated, and those credits can be offset later in time, imported (and, therefore, non-incentivized) intermediate ICT products are subject to a higher tax burden than like incentivized domestic intermediate ICT products purchased from accredited companies, due to depreciation in the value of money over time. … Regardless, the Panel emphasizes that Article III:2 refers to tax 'in excess', which according to the Appellate Body prohibits any higher tax, even by a miniscule margin."[90]

76. The Appellate Body in *Brazil – Taxation* agreed with the Panel's reasoning and upheld the finding that imported intermediate products were taxed in excess of the like domestic incentivised intermediate products, since the purchase of the former was subject to a payment of tax upfront, whereas the latter were subject to a tax exemption or reduction.[91]

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[88] Panel Report, *Thailand – Cigarettes (Philippines)*, paras. 7.610-7.611.
[89] Appellate Body Report, *Thailand – Cigarettes (Philippines)*, para. 116.
[90] Panel Reports, *Brazil – Taxation*, paras. 7.170-7.171.
[91] Appellate Body Reports, *Brazil – Taxation,* paras. 5.41-5.42.

77. With respect to the methodology of comparison used to examine the requirement of "no less favourable treatment" under Article III:4, see paragraphs 184-188 below.[92]

Relevance of duration of tax differentials

78. In *Argentina – Hides and Leather*, the measure at issue provided for the pre-payment of taxes on import sales, while exempting certain types of internal sales from such pre-payment; thus, although a tax liability would arise for every sale, certain internal sales were not subject to the tax *pre-payment* requirement. The Panel held that the loss of interest on the part of the taxpayer due to the pre-payment requirement constituted a tax differential (even if the same nominal tax rates were imposed). The Panel then rejected Argentina's justification that the tax burden differential was limited to a 30-day period and therefore was *de minimis*:

> "The terms of Article III:2, first sentence, prohibit tax burden differentials irrespective of whether they are of limited duration. Moreover, since we have found above that even the smallest tax burden differential is in violation of Article III:2, first sentence, it would be inconsistent for us to allow tax burden differentials on the basis that their impact is limited to a 30-day period."[93]

Relevance of regulatory objectives

79. In *Japan – Alcoholic Beverages II*, the Appellate Body made a general statement on the relevance of regulatory objectives of a measure at issue, finding that Members may pursue, through their tax measures, any given policy objective, provided they do so in compliance with Article III:2. See paragraph 13 above.

80. In *Argentina – Hides and Leather*, the Panel rejected Argentina's argument that the measures in question were designed to achieve efficient tax administration and collection and as such did not fall under Article III:2. The Panel stated:

> "We agree that Members are free, within the outer bounds defined by such provisions as Article III:2, to administer and collect internal taxes as they see fit. However, if, as here, such 'tax administration' measures take the form of an internal charge and are applied to products, those measures must, in our view, be in conformity with Article III:2. There is nothing in the provisions of Article III:2 to suggest a different conclusion. If it were accepted that 'tax administration' measures are categorically excluded from the ambit of Article III:2, this would create a potential for abuse and circumvention of the obligations contained in Article III:2."[94]

81. With respect to the relevance of regulatory objectives in relation to the "aim-and-effect" test, see paragraphs 13-17 above.

82. In *Brazil – Taxation*, Brazil argued that its challenged programme of tax reductions and exemptions related to costs that companies incurred to fulfil the requirements of the programme. The Panel pointed out that the legal standard under Article III:2, first sentence, of the GATT 1994 does not consider the rationale or justification for the measure:

> "For the Panel, a tax incentive cannot be justified as offsetting a cost imposed through regulation, public policy or otherwise. The WTO-consistency of a tax is assessed on the basis of its applied level, which must be non-discriminatory, but otherwise WTO Members are free to choose the type of taxation they wish and they are free to calculate as they wish the components of such taxes – the WTO rules on taxes are limited to prohibiting their discriminatory application. Furthermore, in light of the legal standard under Article III:2, first sentence, the Panel considers that a finding on the WTO-consistency of the measure is not based on any consideration of the rationale or

[92] Further, with respect to the methodology of comparison in identifying "directly competitive and substitutable products" under the second sentence of Article III:2, see the relevant section.
[93] Panel Report, *Argentina – Hides and Leather*, para. 11.245.
[94] Panel Report, *Argentina – Hides and Leather*, para. 11.144.

> justification for the measure. The justification for a (WTO-inconsistent) tax treatment can be assessed in the context of the general exceptions of Article XX of the GATT."[95]

83. The Appellate Body in *Brazil – Taxation* agreed with the Panel's reasoning, that policy reasons and considerations can be assessed, for example, in the context of Article XX GATT in order to justify inconsistencies, and do not belong to an Article III:2 first sentence analysis.[96]

"directly or indirectly"

84. In *Canada – Periodicals*, the Appellate Body reviewed the Panel's finding that the Canadian excise tax on magazines was inconsistent with Article III:2. The Panel had found that the relevant tax provision was a measure affecting the trade in goods, as it applied to so-called split-run editions of periodicals which were distinguished from foreign non-split-run editions by virtue of their advertising content directed at the Canadian market. Canada argued that its measure regulated trade in services (advertising) "in their own right", therefore did not "indirectly" affect imported products and, as a result, was subject to GATS and *not* to GATT 1994. The Appellate Body rejected Canada's argument:

> "An examination of Part V.1 of the Excise Tax Act demonstrates that it is an excise tax which is applied on a good, a split-run edition of a periodical, on a 'per issue' basis. By its very structure and design, it is a tax on a periodical. It is the publisher, or in the absence of a publisher resident in Canada, the distributor, the printer or the wholesaler, who is liable to pay the tax, not the advertiser.
>
> Based on the above analysis of the measure, which is essentially an excise tax imposed on split-run editions of periodicals, we cannot agree with Canada's argument that this internal tax does not 'indirectly' affect imported products."[97]

85. In *Argentina – Hides and Leather*, Argentina argued that, since an income tax is not a tax on products, its measure establishing the collection regime for such a tax ("RG 3543") could not be subject to the provisions of Article III:2. Citing the finding of the Appellate Body in *Canada – Periodicals* as support[98], the Panel rejected this argument:

> "We … agree that income taxes, because they are taxes not normally directly levied on products, are generally considered not to be subject to Article III:2. It is not obvious to us, however, how the fact that the IG is an income tax outside the scope of Article III:2 logically leads to the conclusion that RG 3543 does not fall within the ambit of Article III:2, even though RG 3543 is a tax measure applied to products. Not only do we see nothing in the provisions of Article III:2 which would preclude the applicability of these provisions to RG 3543 merely because of the latter's linkage to the IG. Were we to accept Argentina's argument, it would also not be difficult for Members to introduce measures designed to circumvent the disciplines of Article III:2."[99]

86. In *Mexico – Taxes on Soft Drinks,* the Panel made findings on tax measures that were not directly imposed on sweeteners, but rather on soft drinks and syrups. The Panel nevertheless found that the imposition of a soft drink tax created a connection such that non-cane sugar sweeteners, such as beet sugar, could be regarded as being *indirectly* subject to the tax, because the tax was based solely on the nature of the sweetener used, and because the burden of the tax could be expected to fall, at least in part, on the products containing the sweetener, and thereby to fall on the sweetener:

> "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

[95] Panel Reports, *Brazil – Taxation*, para. 7.153.
[96] Appellate Body Reports, *Brazil – Taxation*, para. 5.27.
[97] Appellate Body Report, *Canada – Periodicals*, p. 18.
[98] Panel Report, *Argentina – Hides and Leather*, para. 11.160, which refers to the Appellate Body Report, *Canada – Periodicals*, p. 20.
[99] Panel Report, *Argentina – Hides and Leather*, para. 11.159.

> 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'. 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. Indeed, in a previous case the word 'indirectly' was considered to cover, *inter alia*, taxes that are imposed on inputs.
>
> 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."[100]

87. In *Mexico – Taxes on Soft Drinks* the Panel made similar findings on Mexico's distribution tax to those in paragraph 86 above. This tax was imposed on the provision of certain services when those services were provided "for the purpose of transferring" certain products, including soft drinks and syrups. The Panel held that while on its face the distribution tax was a tax *directly* applied on the provision of certain services, in the circumstances of the case, it was also a tax *indirectly* applied on non-cane sugar sweeteners when used for the production of soft drinks and syrups.[101]

Article III:2, second sentence

General

Legal status of *Ad* Article III:2

88. In *Japan – Alcoholic Beverages II*, the Appellate Body discussed the legal status of Note *Ad* Article III:2 in the interpretation of Article III:2 and held that the Note must always be read together with Article III. See paragraph 33 above.

Test under Article III:2, second sentence

89. In *Japan – Alcoholic Beverages II*, the Appellate Body explained the test to be used under Article III:2, second sentence, and distinguished this test from the test applicable under the first sentence. This distinction, in the view of the Appellate Body, is a result of the explicit reference to Article III:1 in the second sentence of Article III:2:

> "Unlike that of Article III:2, first sentence, the language of Article III:2, second sentence, specifically invokes Article III:1. The significance of this distinction lies in the fact that whereas Article III:1 acts implicitly in addressing the two issues that must be considered in applying the first sentence, it acts explicitly as an entirely separate issue that must be addressed along with two other issues that are raised in applying the second sentence. Giving full meaning to the text and to its context, three separate issues must be addressed to determine whether an internal tax measure is inconsistent with Article III:2, second sentence. These three issues are whether:
>
> (1) the imported products and the domestic products are *'directly competitive or substitutable products'* which are in competition with each other;
>
> (2) the directly competitive or substitutable imported and domestic products are *'not similarly taxed'*; and

[100] Panel Report, *Mexico – Taxes on Soft Drinks*, paras 8.44-8.45.
[101] See Panel Report, *Mexico – Taxes on Soft Drinks*, paras. 8.46-8.50.

(3) the dissimilar taxation of the directly competitive or substitutable imported domestic products *is 'applied … so as to afford protection to domestic production'.*

Again, these are three separate issues. Each must be established separately by the complainant for a panel to find that a tax measure imposed by a Member of the WTO is inconsistent with Article III:2, second sentence."[102]

Burden of proof

90. In *Japan – Alcoholic Beverages II*, the Panel, in a finding not expressly addressed by the Appellate Body, allocated the burden of proof under Article III:2, second sentence, to the complaining party:

"[T]he complainants have the burden of proof to show first, that the products concerned are directly competitive or substitutable and second, that foreign products are taxed in such a way so as to afford protection to domestic production".[103]

91. In *Korea – Alcoholic Beverages*, the Panel followed the approach to the allocation of burden of proof in the Panel Report on *Japan – Alcoholic Beverages II.* The Appellate Body rejected Korea's appeal against this allocation of the burden of proof:

"[T]he Panel properly understood and applied the rules on allocation of the burden of proof. First, the Panel insisted that it could make findings under Article III:2, second sentence, only with respect to products for which a *prima facie* case had been made out on the basis of evidence presented. Second, it declined to establish a presumption concerning all alcoholic beverages within HS 2208. Such a presumption would be inconsistent with the rules on the burden of proof because it would prematurely shift the burden of proof to the defending party. The Panel, therefore, did not consider alleged violations of Article III:2, second sentence, concerning products for which evidence was not presented. Thus, the Panel examined tequila because evidence was presented for it, but did not examine mescal and certain other alcoholic beverages included in HS 2208 for which no evidence was presented. Third, contrary to Korea's assertions, the Panel did consider the evidence presented by Korea in rebuttal, but concluded that there was 'sufficient *unrebutted* evidence' for it to make findings of inconsistency."[104]

"directly competitive or substitutable products"

92. In *EU and Certain Member States – Palm Oil (Malaysia)*, Malaysia made a claim as alternative to its claim under the first sentence of Article III:2. Despite making a finding of violation under the first claim, the Panel chose to address the alternative claim too, noting the difference between the like product definitions under the two sentences:

"The Panel notes that Malaysia has stated that its claim under Article III:2, second sentence is made in the alternative to its claim under the first sentence. The Panel has already found a violation of Article III:2, first sentence, finding that the products at issue are like within the narrow meaning of such sentence. Therefore, the Panel could stop its analysis here.

However, the Panel notes that the likeness of the products at issue under the first sentence of Article III:2 is an issue that remains disputed, and is admittedly less clear than the likeness of the products under the broader scope that applies with respect to Article 2.1 of the TBT Agreement and Articles III:4 and III:2, second sentence. Furthermore, given that the like products within the meaning of the first sentence

[102] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 24. This part has been later cited and endorsed by the Appellate Body in Appellate Body Report, *Canada – Periodicals*, pp. 24-25, and Appellate Body Report, *Chile – Alcoholic Beverages*, para. 47, as well as by the Panel in Panel Report, *Mexico – Taxes on Soft Drinks*, para. 8.66.
[103] Panel Report, *Japan – Alcoholic Beverages II*, para. 6.28.
[104] Appellate Body Report, *Korea – Alcoholic Beverages*, para. 156.

> have been considered as a subset of the 'directly competitive or substitutable products' within the meaning of the second sentence, the Panel's factual findings in the context of its assessment of the first sentence necessarily imply a view on whether the same products are directly competitive or substitutable for the purposes of the second sentence. In light of this, and for the sake of completeness, the Panel considers it appropriate to address Malaysia's claim with respect to Article III:2, second sentence."[105]

Relevance of market competition/cross-price elasticity

1.1.1.1.1.5 General

93. In interpreting the term "directly competitive or substitutable" products, the Appellate Body in *Japan – Alcoholic Beverages II* found that it was "not inappropriate" to consider the competitive conditions in the relevant market, as manifested in the cross-price elasticity in particular:

> "The GATT 1994 is a commercial agreement, and the WTO is concerned, after all, with markets. It does not seem inappropriate to look at competition in the relevant markets as one among a number of means of identifying the broader category of products that might be described as 'directly competitive or substitutable'.
>
> Nor does it seem inappropriate to examine elasticity of substitution as one means of examining those relevant markets. The Panel did not say that cross-price elasticity of demand is '*the* decisive criterion' for determining whether products are 'directly competitive or substitutable'."[106]

94. The Appellate Body developed this finding—contained in *Japan – Alcoholic Beverages II*—in the *Korea – Alcoholic Beverages* dispute:

> "We observe that studies of cross-price elasticity, which in our Report in *Japan – Alcoholic Beverages* were regarded as one means of examining a market, involve an assessment of latent demand. Such studies attempt to predict the change in demand that would result from a change in the price of a product following, *inter alia*, from a change in the relative tax burdens on domestic and imported products."[107]

95. In its approach to cross-price elasticity between domestic and imported products, the Panel in *Korea – Alcoholic Beverages* emphasized the "quality" or "nature" of competition, rather than the "quantitative overlap of competition". Upon appeal, Korea argued that through its reliance on the "nature of competition" the Panel had created a "vague and subjective element" not found in Article III:2, second sentence. The Appellate Body, however, shared the Panel's scepticism towards reliance upon the "quantitative overlap of competition":

> "In taking issue with the use of the term 'nature of competition', Korea, in effect, objects to the Panel's sceptical attitude to quantification of the competitive relationship between imported and domestic products. For the reasons set above, we share the Panel's reluctance to rely unduly on quantitative analyses of the competitive relationship. In our view, an approach that focused solely on the quantitative overlap of competition would, in essence, make cross-price elasticity *the* decisive criterion in determining whether products are 'directly competitive or substitutable'."[108]

1.1.1.1.1.6 Relevance of the market situation in other countries

96. In *Korea – Alcoholic Beverages*, the Appellate Body addressed whether the market situation in *other* Members should be taken into consideration in evaluating whether subject products are directly competitive or substitutable products. The Appellate Body held that although

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[105] Panel Report, *EU and Certain Member States – Palm Oil (Malaysia)*, paras. 7.1181-7.1182.
[106] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 25.
[107] Appellate Body Report, *Korea – Alcoholic Beverages*, para. 121.
[108] Appellate Body Report, *Korea – Alcoholic Beverages*, para. 134.

not every other market would be relevant, evidence from other markets may nevertheless be pertinent to the analysis of the market at issue:

> "It is, of course, true that the 'directly competitive or substitutable' relationship must be present in the market at issue, in this case, the Korean market. It is also true that consumer responsiveness to products may vary from country to country. This does not, however, preclude consideration of consumer behaviour in a country other than the one at issue. It seems to us that evidence from other markets may be pertinent to the examination of the market at issue, particularly when demand on that market has been influenced by regulatory barriers to trade or to competition. Clearly, not every other market will be relevant to the market at issue. But if another market displays characteristics similar to the market at issue, then evidence of consumer demand in that other market may have some relevance to the market at issue. This, however, can only be determined on a case-by-case basis, taking account of all relevant facts."[109]

"directly competitive or substitutable"

97. In *Korea – Alcoholic Beverages*, the Appellate Body considered the "object and purpose" of Article III in its interpretation of the term "directly competitive or substitutable":

> "[T]he object and purpose of Article III is the maintenance of equality of competitive conditions for imported and domestic products. It is, therefore, not only legitimate, but even necessary, to take account of this purpose in interpreting the term 'directly competitive or substitutable product'."[110]

Latent, extant and potential demand

98. In *Korea – Alcoholic Beverages*, the Appellate Body considered that competition in the market place is a dynamic, evolving process and thus the concept of "directly competitive or substitutable" implies that "the competitive relationship between products is *not* to be analyzed *exclusively* by reference to *current* consumer preferences". Following this line of argumentation, the Appellate Body concluded that the term "directly competitive or substitutable" may include the analysis of *latent* as well as *extant* demand:

> "The term 'directly competitive or substitutable' describes a particular type of relationship between two products, one imported and the other domestic. It is evident from the wording of the term that the essence of that relationship is that the products are in competition. This much is clear both from the word 'competitive' which means 'characterized by competition', and from the word 'substitutable' which means 'able to be substituted'. The context of the competitive relationship is necessarily the marketplace since this is the forum where consumers choose between different products. Competition in the market place is a dynamic, evolving process. Accordingly, the wording of the term 'directly competitive or substitutable' implies that the competitive relationship between products is *not* to be analyzed *exclusively* by reference to *current* consumer preferences. In our view, the word 'substitutable' indicates that the requisite relationship *may* exist between products that are not, at a given moment, considered by consumers to be substitutes but which are, nonetheless, *capable* of being substituted for one another.
>
> Thus, according to the ordinary meaning of the term, products are competitive or substitutable when they are interchangeable or if they offer, as the Panel noted, 'alternative ways of satisfying a particular need or taste'. Particularly in a market where there are regulatory barriers to trade or to competition, there may well be latent demand.
>
> The words 'competitive or substitutable' are qualified in the *Ad* Article by the term 'directly'. In the context of Article III:2, second sentence, the word 'directly' suggests

[109] Appellate Body Report, *Korea – Alcoholic Beverages*, para. 137.
[110] Appellate Body Report, *Korea – Alcoholic Beverages*, para. 127.

> a degree of proximity in the competitive relationship between the domestic and the imported products. The word 'directly' does not, however, prevent a panel from considering both latent and extant demand."[111]

99. In support of its proposition that the term "directly competitive or substitutable" required a dynamic interpretation of both latent and extant demand, the Appellate Body in *Korea – Alcoholic Beverages* rejected an attempt by one of the parties to read a prohibition of considering "potential competition" into the text of Note *Ad* Article III:

> "Our reading of the ordinary meaning of the term 'directly competitive or substitutable' is supported by its context as well as its object and purpose. As part of the context, we note that the *Ad* Article provides that the second sentence of Article III:2 is applicable 'only in cases where competition *was* involved'. (emphasis added) According to Korea, the use of the past indicative 'was' prevents a panel taking account of 'potential' competition. However, in our view, the use of the word 'was' does not have any necessary significance in defining the temporal scope of the analysis to be carried out. The *Ad* Article describes the circumstances in which a hypothetical tax '*would* be considered to be inconsistent with the provisions of the second sentence'. (emphasis added) The first part of the clause is cast in the conditional mood ('would') and the use of the past indicative simply follows from the use of the word 'would'. It does not place any limitations on the temporal dimension of the word 'competition'."[112]

100. The Appellate Body subsequently referred to the context of Article III:2 to support its dynamic approach to the notion of "directly competitive or substitutable":

> "The context of Article III:2, second sentence, also includes Article III:1 of the GATT 1994. As we stated in our Report in *Japan – Alcoholic Beverages*, Article III:1 informs Article III:2 through specific reference. Article III:1 sets forth the principle 'that internal taxes … should not be applied to imported or domestic products so as to afford protection to domestic production.' It is in the light of this principle, which embodies the object and purpose of the whole of Article III, that the term 'directly competitive and substitutable' must be read. As we said in *Japan – Alcoholic Beverages*:
>
> > 'The broad and fundamental purpose of Article III is to *avoid protectionism* in the application of internal tax and regulatory measures. … Toward this end, Article III obliges Members of the WTO to *provide equality of competitive conditions* for imported products in relation to domestic products. … Moreover, it is irrelevant that the "trade effects" of the tax differential between imported and domestic products, as reflected in the volumes of imports, are insignificant or even non-existent; Article III *protects expectations* not of any particular trade volume but rather of the *equal competitive relationship* between imported and domestic products.' (emphasis added)."[113]

101. The Panel in *Japan – Alcoholic Beverages II* held that "a tax system that discriminates against imports has the consequence of creating and even freezing preferences for domestic goods. In the Panel's view, this meant that consumer surveys in a country with such a tax system would likely understate the degree of potential competitiveness between substitutable products."[114] The Appellate Body in *Korea – Alcoholic Beverages* confirmed this approach and emphasized the importance of an analysis of "latent" or "potential" demand by pointing out that current consumer behaviour itself could be influenced by protectionist taxation. It concluded that if only "current instances of substitution" could be taken into account, Article III:2 would, in effect, be confirming the very protective taxation it aims to prohibit:

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[111] Appellate Body Report, *Korea – Alcoholic Beverages*, paras. 114-116.
[112] Appellate Body Report, *Korea – Alcoholic Beverages*, para. 117.
[113] Appellate Body Report, *Korea – Alcoholic Beverages*, para. 119.
[114] Panel Report, *Japan – Alcoholic Beverages II*, para. 6.28.

> "In view of the objectives of avoiding protectionism, requiring equality of competitive conditions and protecting expectations of equal competitive relationships, we decline to take a static view of the term 'directly competitive or substitutable'. The object and purpose of Article III confirms that the scope of the term 'directly competitive or substitutable' cannot be limited to situations where consumers *already* regard products as alternatives. If reliance could be placed only on current instances of substitution, the object and purpose of Article III:2 could be defeated by the protective taxation that the provision aims to prohibit. Past panels have, in fact, acknowledged that consumer behaviour might be influenced, in particular, by protectionist internal taxation. Citing the panel in *Japan – Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages* …, the panel in *Japan – Alcoholic Beverages* observed that 'a tax system that discriminates against imports has the consequence of creating and even freezing preferences for domestic goods'. The panel in *Japan – Alcoholic Beverages* also stated that 'consumer surveys in a country with … a [protective] tax system would likely understate the degree of *potential* competitiveness between substitutable products'. (emphasis added) Accordingly, in some cases, it may be highly relevant to examine latent demand."[115]

102. The Appellate Body in *Korea – Alcoholic Beverages* concluded its analysis of why "latent" demand had to be considered in the interpretation of "directly competitive or substitutable products" by emphasizing the need for such an analysis particularly in the product sector in the case before it:

> "We note, however, that actual consumer demand may be influenced by measures other than internal taxation. Thus, demand may be influenced by, *inter alia*, earlier protectionist taxation, previous import prohibitions or quantitative restrictions. Latent demand can be a particular problem in the case of 'experience goods', such as food and beverages, which consumers tend to purchase because they are familiar with them and with which consumers experiment only reluctantly.
>
> [T]he term 'directly competitive or substitutable' does not prevent a panel from taking account of evidence of latent consumer demand as one of a range of factors to be considered when assessing the competitive relationship between imported and domestic products under Article III:2, second sentence, of the GATT 1994."[116]

103. In *Canada – Periodicals*, the Appellate Body reiterated the need for the consideration of latent demand in assessing whether products are "directly competitive or substitutable". In this dispute, the Appellate Body rejected Canada's argument that the market shares of foreign and domestic magazines on the Canadian periodicals market had remained constant over an extended period of time and that this fact pointed to a lack of competition or substitutability between domestic and foreign periodicals:

> "We are not impressed either by Canada's argument that the market share of imported and domestic magazines has remained remarkably constant over the last 30-plus years, and that one would have expected some variation if competitive forces had been in play to the degree necessary to meet the standard of 'directly competitive' goods. This argument would have weight only if Canada had not protected the domestic market of Canadian periodicals through, among other measures, the import prohibition of Tariff Code 9958 and the excise tax of Part V.1 of the Excise Tax Act."[117]

104. In *Korea – Alcoholic Beverages*, the Panel elaborated on the meaning of the term "*directly* competitive or substitutable products":

> "[W]e must first decide how the term 'directly competitive or substitutable' should be interpreted …

[115] Appellate Body Report, *Korea – Alcoholic Beverages*, para. 120.
[116] Appellate Body Report, *Korea – Alcoholic Beverages*, paras. 122-124.
[117] Appellate Body Report, *Canada – Periodicals*, p. 28.

> The Appellate Body on *Japan – Taxes on Alcoholic Beverages II* stated that 'like product' should be narrowly construed for purposes of Article III:2. It then noted that directly competitive or substitutable is a broader category, saying: 'How much broader that category of 'directly competitive or substitutable products' may be in a given case is a matter for the panel to determine based on all the relevant facts in that case.' Article 32 of the Vienna Convention provides that it is appropriate to refer to the negotiating history of a treaty provision in order to confirm the meaning of the terms as interpreted pursuant to the application of Article 31. A review of the negotiating history of Article III:2, second sentence and the *Ad* Article III language confirms that the product categories should not be so narrowly construed as to defeat the purpose of the anti-discrimination language informing the interpretation of Article III. The Geneva session of the Preparatory Committee provided an explanation of the language of the second sentence by noting that apples and oranges could be directly competitive or substitutable. Other examples provided were domestic linseed oil and imported tung oil and domestic synthetic rubber and imported natural rubber. There was discussion of whether such products as tramways and busses or coal and fuel oil could be considered as categories of directly competitive or substitutable products. There was some disagreement with respect to these products.
>
> This negotiating history illustrates the key question in this regard. It is whether the products are *directly* competitive or substitutable. Tramways and busses, when they are not directly competitive, may still be indirectly competitive as transportation systems. Similarly even if most power generation systems are set up to utilize either coal or fuel oil, but not both, these two products could still compete indirectly as fuels. Thus, the focus should not be exclusively on the quantitative extent of the competitive overlap, but on the methodological basis on which a panel should assess the competitive relationship.
>
> At some level all products or services are at least indirectly competitive. Because consumers have limited amounts of disposable income, they may have to arbitrate between various needs such as giving up going on a vacation to buy a car or abstaining from eating in restaurants to buy new shoes or a television set. However, 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."[118]

Factors relevant to "directly competitive or substitutable"

105. In *Japan – Alcoholic Beverages II*, the Appellate Body agreed with the Panel's illustrative enumeration of the factors to be considered in deciding whether two subject products are "directly competitive or substitutable". For example, the nature of the compared products, and the competitive conditions in the relevant market, in addition to their physical characteristics, common end-use, and tariff classifications.[119]

106. In *Korea – Alcoholic Beverages*, the Panel evaluated whether the subject products were "directly competitive or substitutable products" by discussing the various characteristics of the products. The Panel explained its approach, implicitly endorsed by the Appellate Body[120], as follows:

> "We next will consider the various characteristics of the products to assess whether there is a competitive or substitutable relationship between the imported and domestic products and draw conclusions as to whether the nature of any such relationship is direct. We will review the physical characteristics, end-uses including evidence of advertising activities, channels of distribution, price relationships including cross-price elasticities, and any other characteristics."[121]

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[118] Panel Report, *Korea – Alcoholic Beverages*, paras. 10.37-10.40.
[119] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 25.
[120] Appellate Body Report, *Korea – Alcoholic Beverages*, para. 144.
[121] Panel Report, *Korea – Alcoholic Beverages*, para. 10.61.

107. With respect to the "grouping" methodology, see also paragraph 108 below.

Methodology of comparison – grouping of products

108. In *Korea – Alcoholic Beverages*, the Appellate Body agreed with the Panel's comparison method of domestic and imported products, where under both types of *soju* (Korean traditional liquor), i.e. distilled and diluted *soju*, were compared with imported liquor products on a group basis, rather than on an item-by-item basis. The Appellate Body rejected Korea's appeal of this methodology:

> "We consider that Korea's argument raises two distinct questions. The first question is whether the Panel erred in its 'analytical approach'. The second is whether, on the facts of this case, the Panel was entitled to group the products in the manner that it did. Since the second question involves a review of the way in which the Panel assessed the evidence, we address it in our analysis of procedural issues.
>
> The Panel describes 'grouping' as an 'analytical tool'. It appears to us, however, that whatever else the Panel may have seen in this 'analytical tool', it used this 'tool' as a practical device to minimize repetition when examining the competitive relationship between a large number of differing products. Some grouping is almost always necessary in cases arising under Article III:2, second sentence, since generic categories commonly include products with *some* variation in composition, quality, function and price, and thus commonly give rise to sub-categories. From a slightly different perspective, we note that 'grouping' of products involves at least a preliminary characterization by the treaty interpreter that certain products are sufficiently similar as to, for instance, composition, quality, function and price, to warrant treating them as a group for convenience in analysis. But, the use of such 'analytical tools' does not relieve a panel of its duty to make an objective assessment of whether the components of a group of imported products are directly competitive or substitutable with the domestic products. We share Korea's concern that, in certain circumstances, such 'grouping' of products *might* result in individual product characteristics being ignored, and that, in turn, *might* affect the outcome of a case. However, as we will see below, the Panel avoided that pitfall in this case.
>
> Whether, and to what extent, products can be grouped is a matter to be decided on a case-by-case basis. In this case, the Panel decided to group the imported products at issue on the basis that:
>
> > … on balance, all of the imported products specifically identified by the complainants have sufficient common characteristics, end-uses and channels of distribution and prices… .
>
> As the Panel explained in the footnote attached to this passage, the Panel's subsequent analysis of the physical characteristics, end-uses, channels of distribution and prices of the imported products confirmed the correctness of its decision to group the products for analytical purposes. Furthermore, where appropriate, the Panel did take account of individual product characteristics. It, therefore, seems to us that the Panel's grouping of imported products, complemented where appropriate by individual product examination, produced the same outcome that individual examination of each imported product would have produced. We, therefore, conclude that the Panel did not err in considering the imported beverages together."[122]

109. In *Argentina – Hides and Leather*, the Panel discussed the methodology of comparison to be applied with respect to the term "in excess of those applied" under the first sentence of Article III:2. See paragraphs 70-71 above. See also the Appellate Body's finding in *Canada – Periodicals* on the methodology of comparison for "dissimilar taxation". See paragraph 116 below.

[122] Appellate Body Report, *Korea – Alcoholic Beverages*, paras. 141-144.

Like products as a subset of directly competitive or substitutable products

110. In *Korea – Alcoholic Beverages*, the Appellate Body defined "like products" as a subset of "directly competitive or substitutable" products:

> "The first sentence of Article III:2 also forms part of the context of the term. 'Like' products are a subset of directly competitive or substitutable products: all like products are, by definition, directly competitive or substitutable products, whereas not all 'directly competitive or substitutable' products are 'like'. The notion of like products must be construed narrowly but the category of directly competitive or substitutable products is broader. While perfectly substitutable products fall within Article III:2, first sentence, imperfectly substitutable products can be assessed under Article III:2, second sentence." [123]

Relationship with "like products"

111. In *Japan – Alcoholic Beverages II* and *Korea – Alcoholic Beverages*, the Appellate Body compared the term "like products" with the term "directly competitive or substitutable products". See paragraphs 55-57 above.

"not similarly taxed"

General

1.1.1.1.1.7 "de minimis" standard

112. In *Japan – Alcoholic Beverages II*, the Appellate Body interpreted the term "not similarly taxed" as requiring excessive taxation more than "*de minimis*":

> "To give due meaning to the distinctions in the wording of Article III:2, first sentence, and Article III:2, second sentence, the phrase 'not similarly taxed' in the *Ad* Article to the second sentence must not be construed so as to mean the same thing as the phrase 'in excess of' in the first sentence. On its face, the phrase 'in excess of' in the first sentence means *any* amount of tax on imported products 'in excess of' the tax on domestic 'like products'. The phrase 'not similarly taxed' in the *Ad* Article to the second sentence must therefore mean something else. It requires a different standard, just as 'directly competitive or substitutable products' requires a different standard as compared to 'like products' for these same interpretive purposes."[124]

113. The Appellate Body found support for the above approach in *Japan – Alcoholic Beverages II* also in the distinction between "like products" in the first sentence and "directly competitive or substitutable products" in Note *Ad* Article III:

> "Reinforcing this conclusion is the need to give due meaning to the distinction between 'like products' in the first sentence and 'directly competitive or substitutable products' in the *Ad* Article to the second sentence. If 'in excess of' in the first sentence and 'not similarly taxed' in the *Ad* Article to the second sentence were construed to mean one and the same thing, then 'like products' in the first sentence and 'directly competitive or substitutable products' in the *Ad* Article to the second sentence would also mean one and the same thing. This would eviscerate the distinctive meaning that must be respected in the words of the text.
>
> To interpret 'in excess of' and 'not similarly taxed' identically would deny any distinction between the first and second sentences of Article III:2. Thus, in any given case, there may be some amount of taxation on imported products that may well be 'in excess of' the tax on domestic 'like products' but may not be so much as to compel a conclusion that 'directly competitive or substitutable' imported and domestic products are 'not similarly taxed' for the purposes of the *Ad* Article to Article III:2,

[123] Appellate Body Report, *Korea – Alcoholic Beverages*, para. 118.
[124] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 26.

> second sentence. In other words, there may be an amount of excess taxation that may well be more of a burden on imported products than on domestic 'directly competitive or substitutable products' but may nevertheless not be enough to justify a conclusion that such products are 'not similarly taxed' for the purposes of Article III:2, second sentence. We agree with the Panel that this amount of differential taxation must be more than *de minimis* to be deemed 'not similarly taxed' in any given case. And, like the Panel, we believe that whether any particular differential amount of taxation is *de minimis* or is not *de minimis* must, here too, be determined on a case-by-case basis. Thus, to be 'not similarly taxed', the tax burden on imported products must be heavier than on 'directly competitive or substitutable' domestic products, and that burden must be more than *de minimis* in any given case."[125]

114. In *EU and Certain Member States – Palm Oil (Malaysia)*, the Panel found dissimilar taxation between fuel containing palm oil-based biofuel on the one hand and rapeseed oil and soybean oil-based biofuels on the other. On this basis, the Panel found that the measure violated the second sentence of Article III:2:

> "The Panel considers that the mere possibility of achieving a tax rate of EUR zero per hectolitre by fully satisfying the incorporation target is sufficient to have a significant impact on the market, incentivizing the use of qualifying biofuels for the purposes of the French TIRIB measure, including rapeseed oil- and soybean oil-based biofuels, allowing such biofuels to compete for a share of the fuel market, and excluding palm oil-based biofuel from competing for such share of the fuel market.
>
> This impact on the market can be illustrated by the fact that, before announcing a decrease in the use of palm oil as biofuel feedstock, Total had unsuccessfully challenged the exclusion of oil palm-crop based biofuel from the group of qualifying biofuels for the purposes of the French TIRIB measure. In addition, this is further reinforced by the EU's characterization of the tax as being 'about increasing the cost of using fuels which do not contain a sufficient quantity of renewable energy, thereby creating an incentive for the use of those that contain such quantity.'
>
> In light of the above, in the Panel's view, the tax burden on imported palm oil-based biofuel resulting from the difference in taxation is heavier than on directly competitive or substitutable domestic products, and more than *de minimis*. Consequently, the difference in taxation amounts to dissimilar taxation within the meaning of Article III:2, second sentence."[126]

1.1.1.1.1.8 Distinction from "so as to afford protection"

115. With respect to the distinction between "not similarly taxed" and "so as to afford protection" by the Appellate Body in *Japan – Alcoholic Beverages II*, see paragraphs 120-128 below.

Methodology of comparison – treatment of dissimilar taxation of some imported products

116. In *Canada – Periodicals*, referring to its Report on *Japan – Alcoholic Beverages II*[127], the Appellate Body stated:

> "[D]issimilar taxation of even some imported products as compared to directly competitive or substitutable domestic products is inconsistent with the provisions of the second sentence of Article III:2. In *United States - Section 337*, the panel found:
>
> > …that the 'no less favourable' treatment requirement of Article III:4 has to be understood as applicable to each individual case of imported

[125] Appellate Body Report, *Japan – Alcoholic Beverages II*, pp. 26-27. This "*de minimis*" standard was endorsed by the Appellate Body in *Canada – Periodicals* (Appellate Body Report, *Canada – Periodicals*, p. 29); in *Chile – Alcoholic Beverages* (Appellate Body Report, *Chile – Alcoholic Beverages*, para. 49).
[126] Panel Report, *EU and Certain Member States – Palm Oil (Malaysia)*, paras. 7.1207-7.1209.
[127] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 27.

> products. The Panel rejected any notion of balancing more favourable treatment of some imported products against less favourable treatment of other imported products."[128]

117. The issue of balancing more favourable treatment of some imported products against less favourable treatment of other imported products was also addressed by the Panel in *Argentina – Hides and Leather* with respect to Article III:2, first sentence (see paragraphs 70-71 above) and by the Panel in *US – Gasoline* (see paragraph 199 below).[129]

"so as to afford protection to domestic production"

General

118. In *EU and Certain Member States – Palm Oil (Malaysia)*, the Panel found that the dissimilar taxation between fuel containing palm oil-based biofuel on the one hand and rapeseed oil and soybean oil-based biofuels on the other, had the effect of affording protection to domestic production:

> "As already explained, as a consequence of the exclusion of palm oil-based products from being considered as renewable energy sources for the purposes of the French TIRIB, or more specifically, as a result of the exclusion of palm oil-based biofuel from the group of qualifying biofuels for the purposes of the French TIRIB measure, if palm oil-based biofuel is incorporated into diesel to satisfy any portion of the incorporation target, replacing renewable energy sources, the tax burden on such diesel will increase in proportion to the amount of palm oil-based biofuel incorporated. In contrast, if rapeseed oil- and/or soybean oil-based biofuels are incorporated into diesel to satisfy any portion of the incorporation target, the tax burden on such diesel will decrease in proportion to the amount of rapeseed oil- and/or soybean oil-based biofuels incorporated, with the possibility of achieving a tax rate of EUR zero per hectolitre if the incorporation target is fully satisfied. The Panel has already found that the mere possibility of achieving a tax rate of EUR zero per hectolitre by fully satisfying the incorporation target is sufficient to incentivize the use of qualifying biofuels for the purposes of the French TIRIB measure, including rapeseed oil- and soybean oil-based biofuels, allowing such biofuels to compete for a share of the fuel market, and excluding palm oil-based biofuel from competing for such share of the fuel market.
>
> The Panel also recalls that Malaysia is one of the two world's largest producers of palm oil, which produces and exports palm oil as feedstock for biofuel production and palm oil-based biofuel, including to the European Union. In turn, France has been one of the major producers and consumers of biodiesel in the European Union, producing rapeseed oil-based biofuel, soybean oil-based biofuel and palm oil-based biofuel. While most of the oil crop-based biofuel produced in France is rapeseed oil-based biofuel, France also produces soybean oil-based biofuel and palm oil-based biofuel, but to a lesser extent. Counted together, rapeseed oil- and soybean oil-based biofuels comprise most of the biodiesel produced in France.
>
> This means that the exclusion of palm oil-based biofuels from the group of qualifying biofuels for the purposes of the French TIRIB measure has the effect of incentivizing the use of rapeseed oil-based biofuel, which is the oil crop-based biofuel that France produces the most, and soybean oil-based biofuels, which is also produced in France but to a smaller extent, to the advantage of the French domestic producers of such biofuels, and to the detriment of imports of palm oil-based biofuels from Malaysia. Therefore, by excluding palm oil-based biofuels from the group of qualifying biofuels,

[128] Appellate Body Report, *Canada – Periodicals*, p. 29.
[129] Further, with respect to the methodology of comparison in identifying "directly competitive and substitutable products" under the second sentence of Article III:2, see the relevant section. Also, with respect to this issue under Article III:4, see the relevant section.

> the French TIRIB measure has the effect of affording protection to French producers of rapeseed oil- and soybean oil-based biofuels."[130]

119. The Panel in *EU and Certain Member States – Palm Oil (Malaysia)*, after making the above finding, declined to assess the views expressed by individual French legislators with regard to the objective of the measure:

> "The European Union contends that the statements by Members of the French legislature in parliamentary debates demonstrate that the French TIRIB measure is driven primarily by environmental concerns. The European Union submits that the fact that the other oil crops biofuels do not fall within the same exclusion from the French TIRIB measure is objectively explained both by the EU analysis with regard to high ILUC-risk crop and their share of expansion in land with high-carbon stock, as well as by information elaborated by the French authorities, which concluded, for instance, that the large increase in rapeseed production in France between 2005 and 2008 had a limited effect on deforestation. For the European Union, it is coherent with the climate change and environmental objective of the French TIRIB that this type of biofuel is not treated the same way as palm oil-based biofuel for the purpose of the French TIRIB measure, and the fact that the incorporation of imported biofuel in the fuel released for consumption in France contributes to the French TIRIB measure confirms that the structure, design and application of the measure is not to afford protection to domestic products.
>
> The Panel has focused its analysis on the structure and application of the measure itself, and has found, on that basis, that the French TIRIB measure has the effect of affording protection to French producers of rapeseed oil- and soybean oil-based biofuels. Under these circumstances, the Panel considers it unnecessary, for the purposes of the evaluation of the claim under Article III:2, second sentence, to delve further into objectives expressed by individual legislators or the public policy concerns that may lay behind the measure."[131]

1.1.1.1.1.9 Relationship with Ad Article – distinction from "not similarly taxed"

120. In *Japan – Alcoholic Beverages II*, the Appellate Body drew a distinction between the term "not similarly taxed" and the term "so as to afford protection to domestic production" as follows:

> "[T]he Panel erred in blurring the distinction between that issue and the entirely separate issue of whether the tax measure in question was applied 'so as to afford protection'. Again, these are separate issues that must be addressed individually. If 'directly competitive or substitutable products' are *not* 'not similarly taxed', then there is neither need nor justification under Article III:2, second sentence, for inquiring further as to whether the tax has been applied 'so as to afford protection'. But if such products are 'not similarly taxed', a further inquiry must necessarily be made."[132]

Relevant factors

1.1.1.1.1.10 General

121. In *Japan – Alcoholic Beverages II*, the Appellate Body indicated as follows:

> "As in [GATT Panel Report on *Japan – Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83], we believe that an examination in any case of whether dissimilar taxation has been applied so as to afford protection requires a comprehensive and objective analysis of the structure and application of the measure in question on domestic as compared to imported products.

[130] Panel Report, *EU and Certain Member States – Palm Oil (Malaysia)*, paras. 7.1219-7.1221.
[131] Panel Report, *EU and Certain Member States – Palm Oil (Malaysia)*, paras. 7.1223-7.1224.
[132] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 27.

> 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."[133]

1.1.1.1.1.11 Relevance of tax differentials

122. In *Japan – Alcoholic Beverages II*, the Appellate Body held that the very magnitude of the tax differentials may be evidence of the protective application of a national fiscal measure:

> "The very magnitude of the dissimilar taxation in a particular case may be evidence of such a protective application, as the Panel rightly concluded in this case. Most often, there will be other factors to be considered as well. In conducting this inquiry, panels should give full consideration to all the relevant facts and all the relevant circumstances in any given case.
>
> …
>
> The dissimilar taxation must be more than *de minimis.* It may be so much more that it will be clear from that very differential that the dissimilar taxation was applied 'so as to afford protection'. In some cases, that may be enough to show a violation. In this case, the Panel concluded that it was enough. Yet in other cases, there may be other factors that will be just as relevant or more relevant to demonstrating that the dissimilar taxation at issue was applied 'so as to afford protection'. In any case, the three issues that must be addressed in determining whether there is such a violation must be addressed clearly and separately in each case and on a case-by-case basis. And, in every case, a careful, objective analysis, must be done of each and all relevant facts and all the relevant circumstances in order to determine 'the existence of protective taxation'."[134]

123. The Appellate Body in *Japan – Alcoholic Beverages II* supported its interpretation of the various elements of Article III:2, second sentence, by emphasizing the consistency of its analysis with the customary rules of interpretation of public international law:

> "Our interpretation of Article III is faithful to the 'customary rules of interpretation of public international law'. WTO rules are reliable, comprehensible and enforceable. WTO rules are not so rigid or so inflexible as not to leave room for reasoned judgements in confronting the endless and ever-changing ebb and flow of real facts in real cases in the real world. They will serve the multilateral trading system best if they are interpreted with that in mind. In that way, we will achieve the 'security and predictability' sought for the multilateral trading system by the Members of the WTO through the establishment of the dispute settlement system'."[135]

1.1.1.1.1.12 Relevance of tariffs on subject products

124. The Panel's approach in *Japan – Alcoholic Beverages II* reveals the possible roles of tariffs in a finding that a national measure has been applied "so as to afford protection to domestic production". The Appellate Body agreed[136] with the following finding of the Panel:

> "The Panel took note, in this context, of the statement by Japan that the 1987 Panel Report erred when it concluded that shochu is essentially a Japanese product. The Panel accepted the evidence submitted by Japan according to which a shochu-like product is produced in various countries outside Japan, including the Republic of

[133] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 29.
[134] Appellate Body Report, *Japan – Alcoholic Beverages II*, pp. 29-30.
[135] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 31.
[136] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 31.

> Korea, the People's Republic of China and Singapore. The Panel noted, however, that Japanese import duties on shochu are set at 17.9 per cent. At any rate what is at stake, in the Panel's view, is the market share of the domestic shochu market in Japan that was occupied by Japanese-made shochu. The high import duties on foreign-produced shochu resulted in a significant share of the Japanese shochu market held by Japanese shochu producers. Consequently, in the Panel's view, the combination of customs duties and internal taxation in Japan has the following impact: on the one hand, it makes it difficult for foreign-produced shochu to penetrate the Japanese market and, on the other, it does not guarantee equality of competitive conditions between shochu and the rest of 'white' and 'brown' spirits. Thus, through a combination of high import duties and differentiated internal taxes, Japan manages to 'isolate' domestically produced shochu from foreign competition, be it foreign produced shochu or any other of the mentioned white and brown spirits."[137]

1.1.1.1.1.13 Relevance of the intent of legislators/regulators

125. In *Japan – Alcoholic Beverages II*, the Appellate Body considered that the subjective intent of legislators and regulators in the drafting and the enactment of a particular measure is irrelevant for ascertaining whether a measure is applied "so as to afford protection to domestic production":

> "This third inquiry under Article III:2, second sentence ['so as to afford protection'], must determine whether 'directly competitive or substitutable products' are 'not similarly taxed' in a way that affords protection. This is not an issue of intent. It is not necessary for a panel to sort through the many reasons legislators and regulators often have for what they do and weigh the relative significance of those reasons to establish legislative or regulatory intent. If the measure is applied to imported or domestic products so as to afford protection to domestic production, then it does not matter that there may not have been any desire to engage in protectionism in the minds of the legislators or the regulators who imposed the measure. It is irrelevant that protectionism was not an intended objective if the particular tax measure in question is nevertheless, to echo Article III:*1, 'applied* to imported or domestic products so as to afford protection to domestic production'. This is an issue of how the measure in question is *applied*."[138]

126. In contrast to its statements in *Japan – Alcoholic Beverages II*, the Appellate Body in *Canada – Periodicals* did ascribe some significance to the statements of representatives of the Canadian executive about the policy objectives of the part of the Excise Tax Act at issue. The Appellate Body did so after finding that "the magnitude of the dissimilar taxation between imported split-run periodicals and domestic non-split-run periodicals is beyond excessive, indeed, it is prohibitive" and that "[t]here is also ample evidence that the very design and structure of the measure is such as to afford protection to domestic periodicals":

> "The Canadian policy which led to the enactment of Part V.1 of the Excise Tax Act had its origins in the *Task Force Report*. It is clear from reading the *Task Force Report* that the design and structure of Part V.1 of the Excise Tax Act are to prevent the establishment of split-run periodicals in Canada, thereby ensuring that Canadian advertising revenues flow to Canadian magazines. Madame Monique Landry, Minister Designate of Canadian Heritage at the time the *Task Force Report* was released, issued the following statement summarizing the Government of Canada's policy objectives for the Canadian periodical industry:
>
> > 'The Government reaffirms its commitment to protect the economic foundations of the Canadian periodical industry, which is a vital element of Canadian cultural expression. To achieve this objective, the Government will continue to use policy instruments that encourage the flow of advertising revenues to Canadian magazines and discourage the establishment of split-run or 'Canadian' regional editions with advertising aimed at the Canadian market. We are committed to ensuring that Canadians have access to Canadian ideas and information through

[137] Panel Report, *Japan – Alcoholic Beverages II*, para. 6.35.
[138] Appellate Body Report, *Japan – Alcoholic Beverages II*, pp. 27-28.

> genuinely Canadian magazines, while not restricting the sale of foreign magazines in Canada.'

Furthermore, the Government of Canada issued the following response to the *Task Force Report*:

> 'The Government reaffirms its commitment to the long-standing policy of protecting the economic foundations of the Canadian periodical industry. To achieve this objective, the Government uses policy instruments that encourage the flow of advertising revenues to Canadian periodicals, since a viable Canadian periodical industry must have a secure financial base.'

During the debate of Bill C-103, An Act to Amend the Excise Tax Act and the Income Tax Act, the Minister of Canadian Heritage, the Honourable Michel Dupuy, stated the following:

> '[T]he reality of the situation is that we must protect ourselves against split-runs coming from foreign countries and, in particular, from the United States.'

Canada also admitted that the objective and structure of the tax is to insulate Canadian magazines from competition in the advertising sector, thus leaving significant Canadian advertising revenues for the production of editorial material created for the Canadian market. With respect to the actual application of the tax to date, it has resulted in one split-run magazine, Sports Illustrated, to move its production for the Canadian market out of Canada and back to the United States. Also, Harrowsmith Country Life, a Canadian-owned split-run periodical, has ceased production of its United States' edition as a consequence of the imposition of the tax."[139]

127. In *Korea – Alcoholic Beverages*, Korea appealed the Panel's finding that the Korea tax measures were inconsistent with Article III:2, second sentence, on the ground that the Panel ignored the explanation provided by Korea of the structure of the subject Korean taxation on liquor products. The Appellate Body rejected Korea's argument and expressed its agreement with the Panel's approach:

> "Although [the Panel] considered that the magnitude of the tax differences was sufficiently large to support a finding that the contested measures afforded protection to domestic production, the Panel also considered the structure and design of the measures. In addition, the Panel found that, in practice, '[t]here is virtually no imported soju so the beneficiaries of this structure are almost exclusively domestic producers'. In other words, the tax operates in such a way that the lower tax brackets cover almost exclusively domestic production, whereas the higher tax brackets embrace almost exclusively imported products. In such circumstances, the reasons given by Korea as to *why* the tax is structured in a particular way do not call into question the conclusion that the measures are applied 'so as to afford protection to domestic production'. Likewise, the reason why there is very little imported soju in Korea does not change the pattern of application of the contested measures."[140]

128. In *Chile – Alcoholic Beverages*, the Appellate Body examined Chile's claim that the subject taxation on alcoholic beverages was aimed at, among others, reducing the consumption of alcoholic beverages with higher alcohol content. The Appellate Body again refused to accept explanations of policy objectives which were not ascertainable from the objective design, architecture and structure of the measure and supported the Panel's attempts to "relate the observable structural features of the measure with its declared purposes":

> "We recall once more that, in *Japan – Alcoholic Beverages*, we declined to adopt an approach to the issue of 'so as to afford protection' that attempts to examine 'the

[139] Appellate Body Report, *Canada – Periodicals*, pp. 30-32.
[140] Appellate Body Report, *Korea – Alcoholic Beverages*, para. 150.

> many reasons legislators and regulators often have for what they do'. We called for examination of the design, architecture and structure of a tax measure precisely to permit identification of a measure's objectives or purposes as revealed or objectified in the measure itself. Thus, we consider that a measure's purposes, objectively manifested in the design, architecture and structure of the measure, *are* intensely pertinent to the task of evaluating whether or not that measure is applied so as to afford protection to domestic production. In the present appeal, Chile's explanations concerning the structure of the New Chilean System – including, in particular, the truncated nature of the line of progression of tax rates, which effectively consists of two levels (27 per cent *ad valorem* and 47 per cent *ad valorem*) separated by only 4 degrees of alcohol content – might have been helpful in understanding what *prima facie* appear to be anomalies in the progression of tax rates. The conclusion of protective application reached by the Panel becomes very difficult to resist, in the absence of countervailing explanations by Chile. The mere statement of the four objectives pursued by Chile does not constitute effective rebuttal on the part of Chile.
>
> At the same time, we agree with Chile that it would be inappropriate, under Article III:2, second sentence, of the GATT 1994, to examine whether the tax measure is *necessary* for achieving its stated objectives or purposes. The Panel did use the word 'necessary' in this part of its reasoning. Nevertheless, we do not read the Panel Report as showing that the Panel did, in fact, conduct an examination of whether the measure is necessary to achieve its stated objectives. It appears to us that the Panel did no more than 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."[141]

129. The Panel in *Mexico – Taxes on Soft Drinks,* after finding that the disputed tax measures did afford protection to the Mexican production of cane sugar, went on to consider the intent of the Mexican legislators in the drafting of the tax measures and the evidentiary weight that should be ascribed to such intent:

> "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. 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."[142]

Article III:4

General

Test under paragraph 4

130. In *Korea – Various Measures on Beef*, the Appellate Body explained the three elements of a violation of Article III:4:

> "For a violation of Article III:4 to be established, three elements must be satisfied: that the imported and domestic products at issue are 'like products'; that the measure at issue is a 'law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution, or use'; and that the

[141] Appellate Body Report, *Chile – Alcoholic Beverages*, paras. 71-72.
[142] Panel Report, *Mexico – Taxes on Soft Drinks*, para. 8.91 (see also paras. 8.92-8.94).

> imported products are accorded 'less favourable' treatment than that accorded to like domestic products."[143]

131. In *EC – Bananas III*, the Appellate Body reviewed the Panel's finding that the EC's allocation method of tariff quota for bananas was inconsistent with Article III:4. The Appellate Body considered that an independent consideration of the phrase "so as [to] afford protection to domestic production" is not necessary under Article III:4:

> "Article III:4 does *not* specifically refer to Article III:1. Therefore, a determination of whether there has been a violation of Article III:4 does *not* require a separate consideration of whether a measure 'afford[s] protection to domestic production'."[144]

132. In *Turkey – Rice,* Türkiye's measure required importers of rice to buy a certain amount of rice from domestic sources as a condition for importation at reduced tariff levels. The Panel noted the measure altered the competitive relationship between domestic and imported rice:

> "The measure under consideration, the domestic purchase requirement, created a distinction between different categories of rice, based solely on the criterion of their respective origin. Under the rules contained in Decree 2005/9315 of 10 August 2005 on the *Application of Tariff Quota for the Importation of Some Species of Paddy Rice and Rice*, the purchase of paddy rice from domestic producers and the purchase of domestic paddy rice or milled rice from the TMO granted the purchaser the benefit of access to the importation of rice at reduced tariff levels. In contrast, the purchase of imported rice did not grant the same benefit. Turkey has not disputed this fact.
>
> …
>
> The Panel believes that, if the domestic purchase requirement had the effect of altering the competitive relationship between imported and domestic rice, even for the purpose of partially compensating for the benefits granted through the TRQs, it is difficult to see how this requirement did not affect the internal sale, offering for sale, purchase, and use of imported rice. The domestic purchase requirement certainly 'had an effect on' the competitive relationship between imported and domestic rice, and thus affected the decisions of operators on the purchase of imported and domestic rice.
>
> There is no disagreement between the parties that, pursuant to Decree 2005/9315 of 10 August 2005 on the *Application of Tariff Quota for the Importation of Some Species of Paddy Rice and Rice552*, which was in force at the time of establishment of this Panel, only importers who purchased domestic paddy rice from local producers or who purchased domestic paddy rice or milled rice from the TMO were eligible to benefit from the tariff quotas for the importation of rice. In other words, compliance with the domestic purchase requirement was a necessary condition to benefit from access to the TRQ. Purchase of like imported rice did not grant the same benefit."[145]

133. The Panel in *Turkey – Rice* therefore found that "[t]he purchase of domestic rice accorded an advantage that the purchase of the like imported product did not, i.e., the option to buy imported rice at reduced tariff rates."[146]

Burden of proof

134. In *Japan – Film*, the Panel allocated the burden of proof under Article III:4 according to the general principle that it is for the party asserting a fact or claim to bear the burden of proving this fact or claim:

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[143] Appellate Body Report, *Korea – Various Measures on Beef*, para. 133. See also Panel Report, *EU – Energy Package,* para. 7.519.

[144] Appellate Body Report, *EC – Bananas III*, para. 216. In this regard, see Panel Report, *Canada – Periodicals*, para. 5.38, where the Panel examined whether a measure at issue "afford[ed] protection to domestic production."

[145] Panel Report, *Turkey – Rice*, paras. 7.215, 7.225 and 7.233.

[146] Panel Report, *Turkey – Rice*, para. 7.234.

> "As for the burden of proof … we note that it is for the party asserting a fact, claim or defence to bear the burden of providing proof thereof. Once that party has put forward sufficient evidence to raise a presumption that what is claimed is true, the burden of producing evidence shifts to the other party to rebut the presumption. Thus, in this case, including the claims under Articles III … , it is for the United States to bear the burden of proving its claims. Once it has raised a presumption that what it claims is true, it is for Japan to adduce sufficient evidence to rebut any such presumption."[147]

135. The Appellate Body confirmed this approach by the Panel in *Japan – Film* to the allocation of the burden of proof in its report in *EC – Asbestos.* In so doing, the Appellate Body referred to its finding on *US – Wool Shirts and Blouses*[148]:

> "Applying these rules, it is our opinion that Canada, as the complaining party, should normally provide sufficient evidence to establish a presumption that there are grounds for each of its claims. If it does so, it will then be up to the EC to adduce sufficient evidence to rebut the presumption. When the EC puts forward a particular method of defence in the affirmative, it is up to them to furnish sufficient evidence, just as Canada must do for its own claims. If both parties furnish evidence that meets these requirements, it is the responsibility of the Panel to assess these elements as a whole. Where the evidence concerning a claim or a particular form of defence is, in general, equally balanced, a finding has to be made against the party on which the burden of proof relating to this claim or this form of defence is incumbent."[149]

"like products"

Relevant factors

General

136. In *EC – Asbestos*, the Appellate Body reviewed the Panel's approach to its "likeness" analysis, and criticised the Panel for not taking into account *all* of the relevant criteria:

> "It is our view that, having adopted an approach based on the four criteria set forth in *Border Tax Adjustments*, the Panel should have examined the evidence relating to *each* of those four criteria and, then, weighed *all* of that evidence, along with any other relevant evidence, in making an *overall* determination of whether the products at issue could be characterized as 'like'. Yet, the Panel expressed a 'conclusion' that the products were 'like' after examining only the *first* of the four criteria. The Panel then repeated that conclusion under the second criterion – without further analysis – before dismissing altogether the relevance of the third criterion and also before rejecting the differing tariff classifications under the fourth criterion. In our view, it was inappropriate for the Panel to express a 'conclusion' after examining only one of the four criteria. By reaching a 'conclusion' without examining all of the criteria it had decided to examine, the Panel, in reality, expressed a conclusion after examining only some of the evidence. Yet, a determination on the 'likeness' of products cannot be made on the basis of a partial analysis of the evidence, after examination of just one of the criteria the Panel said it would examine. For this reason, we doubt whether the Panel's overall approach has allowed the Panel to make a proper characterization of the 'likeness' of the fibres at issue."[150]

137. In *EC – Asbestos*, the Appellate Body also disagreed with the Panel's findings with respect to the examination of the first criteria of likeness – product properties. More specifically, the Appellate Body held that toxicity was a physical difference to be taken into account in the determination of "likeness" and linked this criterion to the criterion of competitive relationship between the products at issue:

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[147] Panel Report, *Japan – Film,* para. 10.372.
[148] Panel Report, *EC – Asbestos*, para. 8.78.
[149] Panel Report, *EC – Asbestos*, para. 8.79.
[150] Appellate Body Report, *EC – Asbestos*, para. 109. See also Panel Report, *EU – Energy Package,* para. 7.534.

> "Panels must examine fully the physical properties of products. In particular, panels must examine those physical properties of products that are likely to influence the competitive relationship between products in the marketplace. … [T]he Panel made the following statements regarding chrysotile asbestos fibres:
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> …
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> This carcinogenicity, or toxicity, constitutes, as we see it, a defining aspect of the physical properties of chrysotile asbestos fibres. The evidence indicates that PCG fibres, in contrast, do not share these properties, at least to the same extent. We do not see how this highly significant physical difference *cannot* be a consideration in examining the physical properties of a product as part of a determination of 'likeness' under Article III:4 of the GATT 1994."[151]

138. Also, in *EC – Asbestos*, with respect to the criteria of end-use and consumer tastes and habits, the Appellate Body again established an explicit link to the criterion of a competitive relationship between products:

> "Before examining the Panel's findings under the second and third criteria, we note that these two criteria involve certain of the key elements relating to the competitive relationship between products: first, the extent to which products are capable of performing the same, or similar, functions (end-uses), and, second, the extent to which consumers are willing to use the products to perform these functions (consumers' tastes and habits). Evidence of this type is of particular importance under Article III of the GATT 1994, precisely because that provision is concerned with competitive relationships in the marketplace. If there is – or could be – *no* competitive relationship between products, a Member cannot intervene, through internal taxation or regulation, to protect domestic production. Thus, evidence about the extent to which products can serve the same end-uses, and the extent to which consumers are – or would be – willing to choose one product instead of another to perform those end-uses, is highly relevant evidence in assessing the 'likeness' of those products under Article III:4 of the GATT 1994."[152]

139. After having found that the (degree of) toxicity of a product was a physical characteristic to be taken into account for the determination of likeness under Article III:4, the Appellate Body emphasized the significance of the toxicity of a subject product also in relation to consumers' behaviour:

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

[151] Appellate Body Report, *EC – Asbestos*, para. 114. With respect to the minority's opinion on this point, see Appellate Body Report, *EC – Asbestos*, paras. 151-154.
[152] Appellate Body Report, *EC – Asbestos*, para. 117.

> the additional costs associated with safety procedures required to use such products in the manufacturing process."[153]

140. In *EC – Asbestos*, the Appellate Body rejected Canada's argument that consumers' tastes and habits were irrelevant in this dispute because "the existence of the measure has disturbed normal conditions of competition between the products":[154]

> "In our Report in *Korea – Alcoholic Beverages*, we observed that, '[p]articularly in a market where there are regulatory barriers to trade or to competition, there may well be latent demand' for a product. We noted that, in such situations, 'it may be highly relevant to examine latent demand' that is suppressed by regulatory barriers. In addition, we said that 'evidence from other markets may be pertinent to the examination of the market at issue, particularly when demand on that market has been influenced by regulatory barriers to trade or to competition.' We, therefore, do not accept Canada's contention that, in markets where normal conditions of competition have been disturbed by regulatory or fiscal barriers, consumers' tastes and habits cease to be relevant. In such situations, a Member may submit evidence of latent, or suppressed, consumer demand in that market, or it may submit evidence of substitutability from some relevant third market. In making this point, we do not wish to be taken to suggest that there *is* latent demand for chrysotile asbestos fibres. Our point is simply that the existence of the measure does not render consumers' tastes and habits irrelevant, as Canada contends."[155]

141. Further, in *EC – Asbestos*, the Appellate Body acknowledged that an analysis of the various criteria for establishing "likeness" can produce "conflicting indications"; however, it emphasized that the fact that the analysis of a particular criterion may produce an unclear result does not relieve a panel of its duty to inquire into the relevant evidence:

> "In many cases, the evidence will give conflicting indications, possibly within each of the four criteria. For instance, there may be some evidence of similar physical properties and some evidence of differing physical properties. Or the physical properties may differ completely, yet there may be strong evidence of similar end-uses and a high degree of substitutability of the products from the perspective of the consumer. A panel cannot decline to inquire into relevant evidence simply because it suspects that evidence may not be 'clear' or, for that matter, because the parties agree that certain evidence is not relevant. In any event, we have difficulty seeing how the Panel could conclude that an examination of consumers' tastes and habits 'would not provide clear results', given that the Panel did not examine *any* evidence relating to this criterion."[156]

"the situation of the parties dealing in [subject products]"

142. In *US – Gasoline*, the Panel addressed the respondent's argument that with respect to the treatment of the imported and domestic products, the situation of the parties dealing in gasoline must be taken into consideration:

> "The Panel observed first that the United States did not argue that imported gasoline and domestic gasoline were not like *per se.* It had argued rather that with respect to the treatment of the imported and domestic products, the situation of the parties dealing in the gasoline must be taken into consideration. The Panel, recalling its previous discussion of the factors to be taken into account in the determination of like product, noted that chemically-identical imported and domestic gasoline by definition have exactly the same physical characteristics, end-uses, tariff classification, and are perfectly substitutable. The Panel found therefore that chemically-identical imported and domestic gasoline are like products under Article III:4."[157]

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[153] Appellate Body Report, *EC – Asbestos*, para. 122.
[154] Appellate Body Report, *EC – Asbestos*, para. 123.
[155] Appellate Body Report, *EC – Asbestos*, para. 123.
[156] Appellate Body Report, *EC – Asbestos*, para. 120.
[157] Panel Report, *US – Gasoline*, para. 6.9.

"Hypothetical" like products when origin is the sole distinctive criterion

143. In *India – Autos*, the Panel declared that, when origin is the sole distinguishing criterion, it is correct to treat products as "alike" within the meaning of Article III:4:

> "The Panel notes that the only factor of distinction under the 'indigenization' condition between products which contribute to fulfilment of the condition and products which do not, is the origin of the product as either imported or domestic. India has not disputed the likeness of the relevant automotive parts and components of domestic or foreign origin for the purposes of Article III:4 of the GATT 1994. Origin being the sole criterion distinguishing the products, it is correct to treat such products as like products within the meaning of Article III:4."[158]

144. The Panel in *Canada – Wheat Exports and Grain Imports* confirmed this approach relying also on the Panel report in *Argentina – Hides and Leather*:

> "In *Argentina – Hides and Leather*, in dealing with a claim under Article III:2 of the GATT 1994, the panel found that where a Member draws an origin-based distinction in respect of internal taxes, a comparison of specific products is not required and, consequently, it is not necessary to examine the various likeness criteria. … While this finding is pertained to Article III:2, we consider that the same reasoning is applicable in this case *mutatis mutandi*."[159]

145. The Panel Reports on *Canada –Autos*[160], *Turkey – Rice*[161], *China – Auto Parts*[162], *China – Publications and Audiovisual Products*[163], and *Thailand – Cigarettes (Philippines)*[164], also followed this "hypothetical" analysis, finding that products are "like" for the purposes of Article III:4 when the only distinction drawn is their origin.

146. In *Brazil – Taxation,* the Appellate Body upheld the Panel's finding of likeness based on the hypothetical approach with regard to tax measures that distinguished relevant imported and domestic products solely on the basis of origin under Article III:2.[165]

147. See also the cases involving "hypothetical" analysis under Article III:2, at paragraphs 50-53 above.

"regulatory concerns"

148. In *US – Clove Cigarettes*, the Appellate Body ruled that regulatory concerns underlying a measure may be relevant to a "likeness" analysis under Article III:4 of the GATT 1994 as under a "likeness" analysis under Article 2.1 of the TBT Agreement:

> "Similarly, we consider that the regulatory concerns underlying a measure, such as the health risks associated with a given product, may be relevant to an analysis of the 'likeness' criteria under Article III:4 of the GATT 1994, as well as under Article 2.1 of the TBT Agreement, to the extent they have an impact on the competitive relationship between and among the products concerned."[166]

Relationship with "like products" under Article III:2, first sentence

149. In *EC – Asbestos*, the Appellate Body interpreted the term "like" in Article III:4 by comparing the same term as used in Article III:2. The Appellate Body emphasized the need for consistency between the general principle of Article III, contained in paragraph 1, and the

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[158] Panel Report, *India - Autos*, para. 7.174.
[159] Panel Report, *Canada – Wheat Exports and Grain Imports*, fn. 246 to para. 6.164.
[160] Panel Report, *Canada – Autos*, para. 10.74.
[161] Panel Report, *Turkey – Rice*, para. 7.216.
[162] Panel Report, *China – Auto Parts*, para. 7.235.
[163] Panel Report, *China – Publications and Audiovisual Products*, paras. 7.1444-7.1447 and 7.1506.
[164] Panel Report, *Thailand – Cigarettes (Philippines)*, paras. 7.661-7.662.
[165] Panel Reports, *Brazil – Taxation*, para. 7.139; Appellate Body Reports, *Brazil – Taxation*, para. 5.23.
[166] Appellate Body Report, *US – Clove Cigarettes*, para. 119.

interpretation of Article III:4. The Appellate Body then interpreted the term "like products" to refer to products which are in a competitive relationship:

> "[T]here must be consonance between the objective pursued by Article III, as enunciated in the 'general principle' articulated in Article III:1, and the interpretation of the specific expression of this principle in the text of Article III:4. This interpretation must, therefore, reflect that, in endeavouring to ensure 'equality of competitive conditions', the 'general principle' in Article III seeks to prevent Members from applying internal taxes and regulations in a manner which affects the competitive relationship, in the marketplace, *between the domestic and imported products involved*, 'so as to afford protection to domestic production.'
>
> As products that are in a competitive relationship in the marketplace could be affected through treatment of *imports* 'less favourable' than the treatment accorded to *domestic* products, it follows that the word 'like' in Article III:4 is to be interpreted to apply to products that are in such a competitive relationship. Thus, a determination of 'likeness' under Article III:4 is, fundamentally, a determination about the nature and extent of a competitive relationship between and among products. In saying this, we are mindful that there is a spectrum of degrees of 'competitiveness' or 'substitutability' of products in the marketplace, and that it is difficult, if not impossible, in the abstract, to indicate precisely where on this spectrum the word 'like' in Article III:4 of the GATT 1994 falls. We are not saying that *all* products which are in *some* competitive relationship are 'like products' under Article III:4. In ruling on the measure at issue, we also do not attempt to define the precise scope of the word 'like' in Article III:4. Nor do we wish to decide if the scope of 'like products' in Article III:4 is co-extensive with the combined scope of 'like' and 'directly competitive or substitutable' products in Article III:2. However, we recognize that the relationship between these two provisions is important, because there is no sharp distinction between fiscal regulation, covered by Article III:2, and non-fiscal regulation, covered by Article III:4. Both forms of regulation can often be used to achieve the same ends. It would be incongruous if, due to a significant difference in the product scope of these two provisions, Members were prevented from using one form of regulation – for instance, fiscal – to protect domestic production of certain products, but were able to use another form of regulation – for instance, non-fiscal – to achieve those ends. This would frustrate a consistent application of the 'general principle' in Article III:1. For these reasons, we conclude that the scope of 'like' in Article III:4 is broader than the scope of 'like' in Article III:2, first sentence. Nonetheless, we note, once more, that Article III:2 extends not only to 'like products', but also to products which are 'directly competitive or substitutable', and that Article III:4 extends only to 'like products'. In view of this different language, and although we need not rule, and do not rule, on the precise product scope of Article III:4, we do conclude that the product scope of Article III:4, although broader than the *first* sentence of Article III:2, is certainly *not* broader than the *combined* product scope of the *two* sentences of Article III:2 of the GATT 1994."[167]

150. Further, in *EC – Asbestos*, the Appellate Body also referred to the Report of the Working Party on *Border Tax Adjustments*. It confirmed that the criteria listed in this Report provide a framework for analysing the "likeness" of products on a case-by-case basis. However, the Appellate Body emphasized that these criteria were not treaty language nor did they constitute a "closed list" and that "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":

> "We turn to consideration of how a treaty interpreter should proceed in determining whether products are 'like' under Article III:4. As in Article III:2, in this determination, '[n]o one approach … will be appropriate for all cases.' Rather, an assessment utilizing 'an unavoidable element of individual, discretionary judgement' has to be made on a case-by-case basis. The Report of the Working Party on *Border Tax Adjustments* outlined an approach for analyzing 'likeness' that has been followed and developed since by several panels and the Appellate Body. This approach has, in the main, consisted of employing four general criteria in analyzing 'likeness': (i) the

[167] Appellate Body Report, *EC – Asbestos*, paras. 98-99.

> properties, nature and quality of the products; (ii) the end-uses of the products; (iii) consumers' tastes and habits – more comprehensively termed consumers' perceptions and behaviour – in respect of the products; and (iv) the tariff classification of the products. We note that these four criteria comprise four categories of 'characteristics' that the products involved might share: (i) the physical properties of the products; (ii) the extent to which the products are capable of serving the same or similar end-uses; (iii) the extent to which consumers perceive and treat the products as alternative means of performing particular functions in order to satisfy a particular want or demand; and (iv) the international classification of the products for tariff purposes.
>
> These general criteria, or groupings of potentially shared characteristics, provide a framework for analyzing the 'likeness' of particular products on a case-by-case basis. 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 characterization 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. In addition, although each criterion addresses, in principle, a different aspect of the products involved, which should be examined separately, the different criteria are interrelated. For instance, the physical properties of a product shape and limit the end-uses to which the products can be devoted. Consumer perceptions may similarly influence – modify or even render obsolete – traditional uses of the products. Tariff classification clearly reflects the physical properties of a product.
>
> The kind of evidence to be examined in assessing the 'likeness' of products will, necessarily, depend upon the particular products and the legal provision at issue. When all the relevant evidence has been examined, panels must determine whether that evidence, as a whole, indicates that the products in question are 'like' in terms of the legal provision at issue. We have noted that, under Article III:4 of the GATT 1994, the term 'like products' is concerned with competitive relationships between and among products. Accordingly, whether the *Border Tax Adjustments* framework is adopted or not, it is important under Article III:4 to take account of evidence which indicates whether, and to what extent, the products involved are – or could be – in a competitive relationship in the marketplace."[168]

151. In *Japan – Alcoholic Beverages II*, the Appellate Body found that the term "like product" evoked the image of an accordion whose width would vary depending on the provision under which the term was being interpreted. See paragraph 61 above.

152. In *US – Clove Cigarettes*, the Appellate Body ruled that its previous finding with respect to Article III:2 that actual competition does not need to take place in the whole market, but may be limited to a segment of the market when examining whether products are "directly competitive or substitutable" equally applies when assessing "likeness" under Article III:4:

> "In *Philippines – Distilled Spirits*, the Appellate Body considered that the standard of 'directly competitive or substitutable' relating to Article III:2, second sentence, of the GATT 1994 is satisfied even if competition does not take place in the whole market but is limited to a segment of the market. The Appellate Body found that 'it was reasonable for the [p]anel to draw, from the Philippines' argument that imported distilled spirits are only available to a 'narrow segment' of its population, the inference that there is actual competition between imported and domestic distilled spirits at least in the segment of the market that the Philippines admitted has access to both imported and domestic distilled spirits'. In that same dispute, the Appellate Body found that Article III:2, second sentence, does not require that competition be assessed in relation to the market segment that is most representative of the 'market as a whole', and that Article III of the GATT 1994 'does not protect just some instances or most instances, but rather, it protects all instances of direct competition'. Although the Appellate Body's finding in *Philippines – Distilled Spirits* concerned the second sentence of Article III:2 of the GATT 1994, we consider this

[168] Appellate Body Report, *EC – Asbestos*, paras. 101-103.

> interpretation of 'directly competitive or substitutable products' to be relevant to the concept of 'likeness' in Article III:4 of the GATT 1994 … , since likeness under th[is] provision is determined on the basis of the competitive relationship between and among the products. In our view, the notion that actual competition does not need to take place in the whole market, but may be limited to a segment of the market, is separate from the question of the degree of competition that is required to satisfy the standards of 'directly competitive or substitutable products' and 'like products'."[169]

1.6.2.2.1 Less favourable treatment

153. The Appellate Body in *EC - Asbestos* acknowledged that its interpretation resulted in giving Article III:4 "a relatively broad product scope". Nevertheless the Appellate Body pointed out that mere "likeness" of products and distinctions between "like products" in and of themselves would not lead to inconsistency with Article III:4; rather, "less favourable treatment" would also have to be established in order to find a violation of Article III:4:

> "We recognize that, by interpreting the term 'like products' in Article III:4 in this way, we give that provision a relatively broad product scope – although no broader than the product scope of Article III:2. In so doing, we observe that there is a second element that must be established before a measure can be held to be inconsistent with Article III:4. Thus, even if two products are 'like', that does not mean that a measure is inconsistent with Article III:4. A complaining Member must still establish that the measure accords to the group of 'like' *imported* products 'less favourable treatment' than it accords to the group of 'like' *domestic* products. The term 'less favourable treatment' expresses the general principle, in Article III:1, that internal regulations 'should not be applied … so as to afford protection to domestic production'. If there is 'less favourable treatment' of the group of 'like' imported products, there is, conversely, 'protection' of the group of 'like' domestic products. However, a Member may draw distinctions between products which have been found to be 'like', without, for this reason alone, according to the group of 'like' *imported* products 'less favourable treatment' than that accorded to the group of 'like' *domestic* products. In this case, we do not examine further the interpretation of the term 'treatment no less favourable' in Article III:4, as the Panel's findings on this issue have not been appealed or, indeed, argued before us."[170]

154. The Panel in *EC – Approval and Marketing of Biotech Products* considered Argentina's claim that the European Communities acted inconsistently with Article III:4 of the GATT 1994 in respect of the product-specific measures at issue. Specifically, Argentina argued that the European Communities failed to consider for final approval various applications concerning certain specified biotech products for which the European Communities had already begun approval procedures Argentina argued that this failure was inconsistent with Article III:4 because it less favourable treatment to biotech products than to non-biotech products. Argentina argued, *inter alia*, that "the inconsistencies resulted from the fact that biotech and non-biotech products are "like products".

155. The Panel in *EC – Approval and Marketing of Biotech Products* considered Argentina's claim that the European Communities acted inconsistently with Article III:4 of the GATT 1994 by providing less favourable treatment to biotech products that were the subject of eight applications submitted for approval to the EC authorities; and that the European Communities had failed to consider or had suspended consideration of these applications. The Panel first focused on the "no less favourable treatment" element of Article III:4. The Panel noted that Argentina had not alleged origin-based discrimination, and concluded that Argentina had not established that the alleged less favourable treatment of imported biotech products was explained by the products' foreign origin rather than other factors:

> "In considering Argentina's contention, the first thing to be observed is that Argentina has not provided specific factual information about the treatment accorded by the European Communities to the non-biotech products which Argentina considers to be like the biotech products at issue. It appears to be Argentina's contention, however,

[169] Appellate Body Report, *US – Clove Cigarettes*, paras. 142-143.
[170] Appellate Body Report, *EC – Asbestos*, para. 100.

> that these non-biotech products may be marketed in the European Communities, whereas the relevant biotech products may not be marketed.
>
> At any rate, even if it were the case that, as a result of the measures challenged by Argentina, the relevant imported biotech products cannot be marketed, while corresponding domestic non-biotech products can be marketed, in accordance with the aforementioned statements by the Appellate Body this would not be sufficient, in and of itself, to raise a presumption that the European Communities accorded less favourable treatment to the group of like *imported* products than to the group of like *domestic* products. We note that Argentina does not assert that domestic biotech products have not been less favourably treated in the same way as imported biotech products, or that the like domestic non-biotech varieties have been more favourably treated than the like imported non-biotech varieties. In other words, Argentina is not alleging that the treatment of products has differed depending on their origin. In these circumstances, it is not self-evident that the alleged less favourable treatment of imported biotech products is explained by the foreign origin of these products rather than, for instance, a perceived difference between biotech products and non-biotech products in terms of their safety, etc. In our view, Argentina has not adduced argument and evidence sufficient to raise a presumption that the alleged less favourable treatment is explained by the foreign origin of the relevant biotech products."[171]

156. The Panel in *EC – Approval and Marketing of Biotech Products* therefore found that Argentina did not demonstrate a violation of Article III:4:

> "In the light of the above, we find that Argentina has not established that, as a result of the alleged suspension of consideration of, or the failure to consider, the relevant eight applications, the European Communities has accorded 'less favourable treatment' to imported products than to domestic products.
>
> Since we have found that Argentina has not demonstrated to our satisfaction that imported products have been treated 'less favourably' than domestic products, there is no need to go on to determine whether the challenged measures in fact constitute 'requirements' within the meaning of Article III:4, and whether the imported products which Argentina alleges have been treated less favourably are 'like' the domestic products which Argentina alleges have been treated more favourably. Our finding on the 'no less favourable treatment' obligation necessarily implies that Argentina has failed to establish its claim under Article III:4 with regard to the eight product-specific measures in question."[172]

Relationship with "like products" in other GATT provisions

157. With respect to the interpretation of "like products" under GATT Article I, see Section on "like products" in Article I of the GATT 1994.

"laws, regulations or requirements"

Differences from "measures" under Article XXIII:1(b)

158. In *Japan – Film*, the Panel examined the relationship between the term "laws, regulations or requirements" under Article III:4 and the term "measures" under Article XXIII:1(b). The Panel opined that the concept of "measure" for the purposes of Article XXIII:1(b) is "equally applicable to the definitional scope of 'all laws, regulations and requirements' in Article III:4:

> "A literal reading of the words *all laws, regulations and requirements* in Article III:4 could suggest that they may have a narrower scope than the word *measure* in Article XXIII:1(b). However, whether or not these words should be given as broad a construction as the word *measure*, in view of the broad interpretation assigned to

[171] Panel Report, *EC – Approval and Marketing of Biotech Products*, paras. 7.2513-7.2514.
[172] Panel Report, *EC – Approval and Marketing of Biotech Products*, paras. 7.2515-7.2516.

> them in the cases cited above, we shall assume for the purposes of our present analysis that they should be interpreted as encompassing a similarly broad range of government action and action by private parties that may be assimilated to government action. In this connection, we consider that our previous discussion of GATT cases on administrative guidance in relation to what may constitute a 'measure' under Article XXIII:1(b), specifically the panel reports on *Japan – Semi-conductors* and *Japan – Agricultural Products*, is equally applicable to the definitional scope of 'all laws, regulations and requirements' in Article III:4."[173]

Non-mandatory measures

159. In *Canada – Autos*, the Panel, in a finding not addressed by the Appellate Body, held that a measure can be subject to Article III:4 even if its compliance is not mandatory, and noted as follows:

> "We note that it has not been contested in this dispute that, as stated by previous GATT and WTO panel and appellate body reports, Article III:4 applies not only to mandatory measures but also to conditions that an enterprise accepts in order to receive an advantage, including in cases where the advantage is in the form of a benefit with respect to the conditions of importation of a product. The fact that compliance with the CVA requirements is not mandatory but a condition which must be met in order to obtain an advantage consisting of the right to import certain products duty-free therefore does not preclude application of Article III:4."[174]

160. In *Canada – Wheat Exports and Grain Imports,* Canada argued that the measure at issue could only be found inconsistent if it mandated or required less favourable treatment. Making reference to the Appellate Body Report in *US – Corrosion-Resistant Steel Sunset Review*[175]*,* the Panel made the following finding which was not challenged on appeal:

> "Canada is of the view that since the United States in this case is challenging Section 57(c), as such, Section 57(c) would, under GATT/WTO practice, be inconsistent with Article III:4 only if it mandated, or required, less favourable treatment of foreign grain. Canada is referring here to the so-called 'mandatory/discretionary' distinction which has been applied by numerous GATT and WTO panels. The United States did not specifically address this point. We note that the Appellate Body has not, as yet, expressed a view on whether the mandatory/discretionary distinction is a legally appropriate analytical tool for panels to use. In this case, our ultimate conclusion with respect to the United States' challenge to Section 57(c) does not depend on whether or not the mandatory/discretionary distinction is valid. This said, we will continue on the assumption that Section 57(c) is inconsistent with Article III:4 only if it mandates, or requires, less favourable treatment of imported grain."[176]

161. Examining the term "requirement" in the context of Article III:4 of the GATT 1994, the Panel in *India – Autos* found that this term encompasses two distinct situations, (1) obligations which an enterprise is legally bound to carry out; and (2) those which an enterprise voluntarily accepts in order to obtain an advantage from the government.[177]

162. In considering the term "requirement", the Panel in *US – Renewable Energy* examined the two distinct situations identified by the Panel in *India – Autos* and found that handbooks that develop and clarify certain rules and procedures set out in related legislative instruments qualified as requirements since they "set out the conditions and procedures that need to be followed to

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[173] Panel Report, *Japan – Film*, para. 10.376.
[174] Panel Report, *Canada – Autos*, para. 10.73.
[175] In *US – Corrosion-Resistant Steel Sunset Review*, the Appellate Body, in the context of an anti-dumping dispute, had expressly abstained from pronouncing generally on the continuing relevance or significance of the mandatory/discretionary distinction. Appellate Body Report, *US – Corrosion-Resistant Steel Sunset Review*, para. 93.
[176] Panel Report, *Canada – Wheat Exports and Grain Imports*, para 6.184.
[177] Panel Report, *India – Autos*, paras. 7.189-7.191.

benefit from the relevant advantages, and they are issued by public authorities responsible for administering these programs".[178]

163. In *China – Auto Parts*, the Panel examined measures imposing various administrative procedures on any automobile manufacturers who intend to use imported auto parts. Although the measures were voluntary, in the sense that a manufacturer could avoid them by not using imported parts at all, the Panel concluded that these measures were "laws and regulations" as they were mandatory for all manufacturers using imported parts.[179]

164. In *EU – Energy Package*, the Panel disagreed with the EU's view that the EU Directive could not be challenged as it gave discretion to member states and that the member states' implementing measures transposing the Directive were the relevant measures to be challenged. The Panel noted that such an approach would contradict the Appellate Body's finding in *US – Corrosion-Resistant Steel Sunset Review* that there was no reason for holding that, non-mandatory measures could not be challenged "as such". The Panel stated that the element of discretion was only relevant in the context of the substantive assessment under Article II:1 of the GATS and Articles I:1 and III:4 of the GATT 1994, and particularly if the less favorable treatment is attributable to the unbundling measure in the Directive considering the discretion under it:

> "We have difficulties accepting this position. In our view, the approach suggested by the European Union would be tantamount to automatically excluding the unbundling measure in the Directive from review under Article II:1 of the GATS and Articles I:1 and III:4 of the GATT 1994 by virtue of the fact that this measure involves an element of discretion. As indicated by the European Union, complaining parties would thus be confined to challenging the 'national measure[s] transposing the Directive' and the treatment accorded by such measures in the territory of the individual EU member States. This would, in our view, contradict the Appellate Body's finding in *US – Corrosion-Resistant Steel Sunset Review* that there is 'no reason for concluding that, in principle, non-mandatory measures cannot be challenged 'as such'' and that the discretionary or mandatory nature of a challenged measure 'is relevant, if at all, only as part of the panel's assessment of whether the measure is, as such, inconsistent with particular obligations.'
>
> …
>
> Following the approach by the Appellate Body in *US – Corrosion-Resistant Steel Sunset Review*, we will consider the element of discretion under the Directive's unbundling measure only if relevant in the context of our substantive assessments under Article II:1 of the GATS and Articles I:1 and III:4 of the GATT 1994. More particularly, should we find that Russia has demonstrated that its pipeline transport services and service suppliers or its imported natural gas are accorded less favourable treatment, we will consider whether such potential less favourable treatment is attributable to the unbundling measure in the Directive, taking into account the element of discretion allowed under it."[180]

Action of private parties

165. In *Canada – Autos*, the Panel examined the GATT-consistency of commitments undertaken by Canadian motor vehicle manufacturers in their letters addressed to the Canadian Government to increase Canadian value added in the production of motor vehicles. Referring to the GATT Panel Reports on *Canada – FIRA* and *EEC – Parts and Components*[181], the Panel analysed whether the action of private parties is subject to Article III:4. The Panel found that "[n]either legal enforceability [n]or the existence of a link between a private action and an advantage conferred by a government is a necessary condition in order for an action by a private party to constitute a 'requirement'":

[178] Panel Report, *US – Renewable Energy*, para. 7.153.
[179] Panel Report, *China – Auto Parts,* paras. 7.240-7.243.
[180] Panel Report, *EU – Energy Package*, paras. 7.393 and 7.395.
[181] GATT Panel Reports, *Canada – FIRA*, para. 5.4; *EEC – Parts and Components*, para. 5.21.

> "It is evident from the reasoning of the Panel Reports in *Canada – FIRA* and in *EEC – Parts and Components* that these Reports do not attempt to state general criteria for determining whether a commitment by a private party to a particular course of action constitutes a 'requirement' for purposes of Article III:4. While these cases are instructive in that they confirm that both legally enforceable undertakings and undertakings accepted by a firm to obtain an advantage granted by a government can constitute 'requirements' within the meaning of Article III:4, we do not believe that they provide support for the proposition that either legal enforceability or the existence of a link between a private action and an advantage conferred by a government is a necessary condition in order for an action by a private party to constitute a 'requirement.' To qualify a private action as a 'requirement' within the meaning of Article III:4 means that in relation to that action a Member is bound by an international obligation, namely to provide no less favourable treatment to imported products than to domestic products.
>
> A determination of whether private action amounts to a 'requirement' under Article III:4 must therefore necessarily rest on a finding that there is a nexus between that action and the action of a government such that the government must be held responsible for that action. We do not believe that such a nexus can exist only if a government makes undertakings of private parties legally enforceable, as in the situation considered by the Panel on *Canada – FIRA*, or if a government conditions the grant of an advantage on undertakings made by private parties, as in the situation considered by the Panel on *EEC – Parts and Components*. We note in this respect that the word 'requirement' has been defined to mean '1. The action of requiring something; a request. 2. A thing required or needed, a want, a need. Also the action or an instance of needing or wanting something. 3 Something called for or demanded; a condition which must be complied with.' The word 'requirements' in its ordinary meaning and in light of its context in Article III:4 clearly implies government action involving a demand, request or the imposition of a condition but in our view this term does not carry a particular connotation with respect to the legal form in which such government action is taken. In this respect, we consider that, in applying the concept of 'requirements' in Article III:4 to situations involving actions by private parties, it is necessary to take into account that there is a broad variety of forms of government of action that can be effective in influencing the conduct of private parties."[182]

The terms "laws" and "regulations"

166. In *India – Solar Cells*, the Panel defined the terms "laws" and "regulations" first by having recourse to their dictionary definition and second by referring to meanings attributed to the terms in previous cases in the context of Articles XX(d) and X:1 of the GATT 1994. On the basis of its analysis, the Panel concluded that "the terms 'laws or regulations' refer to legally enforceable rules of conduct under the domestic legal system of the WTO Member concerned, and do not include general objectives"[183]:

> "We commence our examination of the phrase 'laws or regulations' by noting that 'law' is defined in the *Shorter Oxford English Dictionary* as a 'rule of conduct imposed by secular authority', while 'regulation' is defined as a 'rule prescribed for controlling some matter, or for the regulating of conduct'. We observe that these definitions have been applied by prior panels interpreting the words 'laws or regulations' in the context of Article XX(d) and Article X:1 of the GATT 1994.
>
> As a starting point, these dictionary definitions make clear that 'laws' and 'regulations' refer to 'rules'. We note that in *Mexico – Taxes on Soft Drinks*, the Appellate Body concluded that 'the terms 'laws or regulations' refer to rules that form part of the domestic legal system of a WTO Member'. … We further note that the dictionary definition of 'law' includes a 'rule of conduct', and that the definition of 'regulation' likewise refers to a 'rule prescribed for controlling some matter, or for the regulating of conduct'. We consider that interpreting 'laws or regulations' to mean rules governing conduct is consistent with the immediate context in which these terms

[182] Panel Report, *Canada – Autos*, paras. 10.106-10.107.
[183] Panel Report, *India – Solar Cells*, para. 7.310.

> appear. By its terms, Article XX(d) refers to 'laws or regulations' in respect of which 'compliance' can be secured. We consider that, by necessary implication, the 'laws or regulations' referred to in Article XX(d) must therefore be rules in respect of which conduct would, or would not, be in 'compliance'."[184]

"requirement"

167. In *India – Autos*, the Panel analysed the notion of "requirement" within Article III:4:

> "An ordinary meaning of the term 'requirement', as articulated in the New Shorter Oxford Dictionary, is 'Something called for or demanded; a condition which must be complied with'. The *Canada – FIRA* panel further suggested that there must be a distinction between 'regulations' and 'requirements' and that requirements could not be assumed to mean the same, i.e. 'mandatory rules applying across the board'."[185]

168. In *India – Autos*, the Panel recalled that GATT jurisprudence "suggests two distinct situations which would satisfy the term 'requirement' in Article III:4: (i) obligations which an enterprise is 'legally bound to carry out'; [and (ii)] those which an enterprise voluntarily accepts in order to obtain an advantage from the government." The Panel therefore stated that:

> "A binding enforceable condition seems to fall squarely within the ordinary meaning of the word 'requirement', in particular as 'a condition which must be complied with'. The enforceability of the measure in itself, independently of the means actually used or not to enforce it, is a sufficient basis for a measure to constitute a requirement under Article III:4."[186]

169. In *Argentina – Import measures*, the Panel considered as a "requirement" within the meaning of Article III:4 the Argentine Government's policy regarding local content, which in the Panel's view was reflected in the oral statements by the president of Argentina as well as in news items posted on government websites:

> "In the Panel's view, the evidence makes clear that the achievement of a certain level of local content is required by the Argentine Government in order for economic operators to import and for them to obtain certain advantages. This constitutes a 'requirement' within the meaning of Article III:4 of the GATT 1994."[187]

170. The Panel in *Turkey – Pharmaceutical Products (EU)* rejected Türkiye's argument that the discretion given to Turkish authorities prevents the challenged measure from being a "requirement":

> "In the light of the Panel's understanding of the prioritization measure as challenged by the European Union, the Panel does not accept Turkey's argument that the 'discretion' left to Turkish authorities prevents this measure from qualifying it as a 'requirement'. As the Panel understands this measure, it is only domestically manufactured pharmaceutical products that can benefit from priority assessment (e.g. listing and review by the DRC and/or MEEC for inclusion in the Annex 4/A list) and criteria (e.g. the 'local production' coefficient) attaching to a product's status as locally produced. Therefore, in the context of both the Annex 4/A list and GMP and marketing authorization procedures, the advantage attaches to a domestic production criterion."[188]

[184] Panel Report, *India – Solar Cells*, paras. 7.307-7.308.
[185] Panel Report, *India - Autos*, para. 7.174.
[186] Panel Report, *India – Autos*, paras. 7.190-7.191.
[187] Panel Report, *Argentina – Import Measures*, para. 6.280.
[188] Panel Report, *Turkey – Pharmaceutical Products (EU)*, para. 7.330.

"affecting the internal sale, offering for sale, purchase"

Scope of "affecting"

171. In *EC – Bananas III*, the Appellate Body upheld the Panel's finding that the EC import licensing requirements concerning import quotas for bananas were inconsistent with Article III:4. The Panel had found that in answering the question whether Article III:4 was applicable to the EC import licensing requirements, it was important to distinguish between, on the one hand, the mere requirement to present a licence upon importation of a product as such and, on the other hand, the procedures applied by the European Communities in the context of the licence allocation. The latter procedures, in the view of the Panel, were internal laws, regulations and requirements affecting the internal sale of imported products.[189] In this context, the Panel opined that the scope of application of Articles I and III was not necessarily mutually exclusive.[190] The Appellate Body, in examining whether the measure at issue was subject to Article III:4, attached significance to the fact that the measure at issue went beyond "mere import licence requirements" and that the "intention" of the measure was to "cross-subsidize distributors of [certain] bananas":

> "At issue in this appeal is not whether *any* import licensing requirement, as such, is within the scope of Article III:4, but whether the EC procedures and requirements for the *distribution* of import licences for imported bananas among eligible operators *within* the European Communities are within the scope of this provision. … These rules go far beyond the mere import licence requirements needed to administer the tariff quota for third-country and non-traditional ACP bananas or Lomé Convention requirements for the importation of bananas. These rules are intended, among other things, to cross-subsidize distributors of EC (and ACP) bananas and to ensure that EC banana ripeners obtain a share of the quota rents. As such, these rules affect 'the internal sale, offering for sale, purchase, …' within the meaning of Article III:4, and therefore fall within the scope of this provision."[191]

172. In *Canada – Autos*, the Panel, in a finding not addressed by the Appellate Body, interpreted the term "affecting" as having a broad scope of application and as referring to measures which have an effect on imported goods:

> "With respect to whether the CVA requirements affect the 'internal sale, … or use' of products, we note that, as stated by the Appellate Body, the ordinary meaning of the word 'affecting' implies a measure that has 'an effect on' and thus indicates a broad scope of application. The word 'affecting' in Article III:4 of the GATT has been interpreted to cover not only laws and regulations which directly govern the conditions of sale or purchase but also any laws or regulations which might adversely modify the conditions of competition between domestic and imported products.
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> …
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> The idea that a measure which distinguishes between imported and domestic products can be considered to affect the internal sale or use of imported products only if such a measure is shown to have an impact under current circumstances on decisions of private firms with respect to the sourcing of products is difficult to reconcile with the concept of the 'no less favourable treatment' obligation in Article III:4 as an obligation addressed to governments to ensure effective equality of competitive opportunities between domestic and imported products, and with the principle that a showing of trade effects is not necessary to establish a violation of this obligation. In this respect, it should be emphasized that, contrary to what has been argued by Canada, the present case does not involve 'the possibility of a future change in circumstances creating the potential for discrimination' or 'discrimination that might exist after a change in circumstances that could occur at some unspecified time in the future.' Rather, the present case clearly involves formally different treatment of imported and domestic products albeit that the actual trade effects of this different treatment may be minimal under current circumstances. We therefore disagree with Canada's

[189] Panel Report, *EC – Bananas III*, para. 7.181.
[190] Panel Report, *EC – Bananas III*, para. 7.176.
[191] Appellate Body Report, *EC – Bananas III*, para. 211.

> assertion that the CVA requirements do not entail a 'current potential for discrimination under present circumstances.' As a consequence, whether or not in practice motor vehicle manufacturers can easily meet the CVA requirements of the MVTO 1998 and the SROs on the basis of labour costs alone does not alter our finding that the CVA requirements affect the internal sale or use of products. We therefore do not consider it necessary to examine the factual issues raised by the parties in support of their different views on this matter.
>
> In light of the foregoing considerations, we find that the CVA requirements affect the internal sale or use in Canada of imported parts, materials and non-permanent equipment for use in the production of motor vehicles. We further consider that the CVA requirements accord less favourable treatment within the meaning of Article III:4 to imported parts, materials and non-permanent equipment than to like domestic products because, by conferring an advantage upon the use of domestic products but not upon the use of imported products, they adversely affect the equality of competitive opportunities of imported products in relation to like domestic products."[192]

173. In *India – Autos*, the Panel considered that, in order to rule on whether certain "indigenization" requirements were inconsistent with Article III:4 of GATT 1994, it had to determine, *inter alia*, whether the measures "affected" the "internal sale, purchase, transportation, distribution or use" of the products concerned. In that regard, the Panel recalled that the ordinary meaning of the term "affecting" has been understood to imply "a measure that has an effect on". It went on to state that:

> "[T]he fact that the measure applies only to imported products need not [be], in itself, an obstacle to its falling within the purview of Article III.[193] For example, an internal tax, or a product standard conditioning the sale of the imported but not of the like domestic product, could nonetheless 'affect' the conditions of the imported product on the market and could be a source of less favorable treatment. Similarly, the fact that a requirement is imposed as a condition on importation is not necessarily in itself an obstacle to its falling within the scope of Article III:4.[194]" [195]

174. In *US – FSC (Article 21.5 – EC)*, the Appellate Body shared the view that the word "affecting" in Article III:4 of the GATT 1994 has a "broad scope of application":

> "We observe that the clause in which the word 'affecting' appears – 'in respect of all laws, regulations and requirements *affecting* their internal sale, offering for sale, purchase, transportation, distribution or use' – serves to define the scope of application of Article III:4. (emphasis added) Within this phrase, the word 'affecting' operates as a link between identified types of government action ('laws, regulations and requirements') and specific transactions, activities and uses relating to products in the marketplace ('internal sale, offering for sale, purchase, transportation, distribution or use'). It is, therefore, not *any* 'laws, regulations and requirements' which are covered by Article III:4, but only those which '*affect*' the specific transactions, activities and uses mentioned in that provision. Thus, the word 'affecting' assists in

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[192] Panel Report, *Canada – Autos*, paras. 10.80 and 10.84-10.85. See also Panel Reports, *Brazil – Taxation*, paras. 7.65-7.66.

[193] *(footnote original)* Article III:1 refers to the application of measures "to imported *or* domestic products", which suggests that application to both is not necessary.

[194] *(footnote original)* Thus, the "advantage" to be obtained could consist in a right to import a product. See for instance, the Report of the second GATT panel on *EC – Bananas II* as cited and endorsed in *EC – Bananas III*, WT/DS27/R/USA, adopted on 25 September 1997, as modified by the Appellate Body Report, para. 4.385 (DSR 1997:II, 943)

> "The Panel further noted that previous panels had found consistently that this obligation applies to any requirement imposed by a contracting party, including requirements 'which an enterprise voluntarily accepts to obtain an advantage from the government.' In the view of the Panel, a requirement to purchase a domestic product in order to obtain the right to import a product at a lower rate of duty under a tariff quota is therefore a requirement affecting the purchase of a product within the meaning of Article III:4."

[195] Panel Report, *India – Autos*, para. 7.306.

> defining the types of measure that must conform to the obligation not to accord 'less favourable treatment' to like imported products, which is set out in Article III:4.
>
> The word 'affecting' serves a similar function in Article I:1 of the *General Agreement on Trade in Services* (the 'GATS'), where it also defines the types of measure that are subject to the disciplines set forth elsewhere in the GATS but does not, in itself, impose any obligation. In *EC – Bananas III*, we considered the meaning of the word 'affecting' in that provision of GATS. We stated:
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> > [t]he ordinary meaning of the word 'affecting' implies a measure that has 'an effect on', which indicates a *broad scope of application*. This interpretation is further reinforced by the conclusions of previous panels that the term 'affecting' in the context of Article III of the GATT is wider in scope than such terms as 'regulating' or 'governing'. (emphasis added, footnote omitted)."[196]

175. The Panel Report on *China – Publications and Audiovisual Products* summed up the jurisprudence regarding the scope of the word "affecting":

> "The word 'affecting' covers not only measures which directly regulate or govern the sale of domestic and imported like products, but also measures which create incentives or disincentives with respect to the sale, offering for sale, purchase, and use of an imported product 'affect' those activities."[197]

Application of "affecting"

176. In the *Canada – Autos* case, the Panel found that the Canadian value added requirements, which stipulated that the amount of Canadian value added in the manufacturer's local production of motor vehicles must be equal to or greater than the amount of Canadian value added in the production of motor vehicles, by the same manufacturer, during an earlier reference period, were in violation of Article III:4 of GATT 1994. The Panel also addressed another aspect of the Canadian measures, the so-called "ratio requirements". Under these measures, the ratio of the net sales value of the vehicles *produced* in Canada to the net sales value of the vehicles *sold* for consumption in Canada during the relevant period had to be at least equal to the ratio in a reference year. The Panel found that the "ratio requirements" did not affect the sale of imported products:

> "For purposes of Article III, the manner in which the ratio requirements affect the treatment accorded to motor vehicles with respect to the conditions of their importation is irrelevant. That there is a limitation on the net sales value of vehicles which can be imported duty-free therefore cannot constitute a grounds for finding a violation of Article III:4. The fact that internal sales of domestic vehicles are not subject to a 'similar' limitation is also without relevance. By definition, a violation of Article III cannot be established on the basis of a comparison between the conditions of internal sale of domestic products with the conditions of importation of imported products."[198]

177. The Panel in *Mexico – Taxes on Soft Drinks* having already concluded that two of the measures challenged by the United States under Article III:4 (the soft drink tax and the distribution tax) were imposed on imported sweeteners in a manner inconsistent with Article III:2, considered that the facts that were analysed by the Panel and led it to consider that the two taxes "apply" to imported sweeteners, also supported the conclusion that these taxes "affected" imported sweeteners.[199]

178. In *Mexico – Taxes on Soft Drinks*, the Panel considered that Mexican bookkeeping requirements imposed a burden on producers of soft drinks and syrups in addition to the payment of the soft drink tax and the distribution tax. However, the Panel considered that this burden did

[196] Appellate Body Report, *US – FSC (Article 21.5 – EC)*, paras. 208-209.
[197] Panel Report, *China – Publications and Audiovisual Products*, para. 7.1450.
[198] Panel Report, *Canada – Autos*, para. 10.149.
[199] Panel Report, *Mexico – Taxes on Soft Drinks*, para. 8.109.

not extend to producers who used cane sugar rather than beet sugar or HFCS as a sweetener. The Panel found that in the light of this and other considerations, "as well as the broad scope of the expression 'affect the internal sale, offering for sale, purchase, transportation, distribution, or use of imported products', that these bookkeeping requirements did affect the 'use' of imported beet sugar and HFCS by the soft drinks industry."[200]

179. The Panel in *US – Renewable Energy*, when considering whether a challenged measure affects the "sale, purchase, transportation, distribution or use of goods in a market", found that a panel should consider "whether such measure has an impact on the conditions of competition between domestic and imported like products, but need not examine whether or the extent to which the measure has, under current circumstances, influenced purchasing decisions on the market". The Panel further considered that a showing of "only minimal impact on the purchasing decisions of private firms" would be insufficient to "rebut a *prima facie* showing that a measure affects the competitive relationship between imported and domestic products".[201]

180. In *China – Publications and Audiovisual Products,* in a finding not reviewed by the Appellate Body, the Panel analysed claims regarding distribution of imported reading materials and sound recordings. The Panel considered that "the term 'distribution' in Article III:4 can be understood as meaning a process or series of transactions necessary to market and supply goods, either directly or through intermediaries, from the producer to the consumer"[202] and that "for the purposes of Article III:4 of the *GATT 1994* internal 'distribution' is the portion of that process or series of transactions from the point of importation (i.e., the time when the goods enter the customs territory of the importing Member) until the good is received by the consumer."[203]

"treatment no less favourable"

General

Equality of competitive opportunities

181. In *US – Gasoline*, the Panel, in a finding not addressed by the Appellate Body, found that the measure in question afforded to imported products less favourable treatment than that afforded to domestic products because sellers of domestic gasoline were authorized to use an individual baseline, while sellers of imported gasoline had to use the more onerous statutory baseline:

> "The Panel observed that domestic gasoline benefited in general from the fact that the seller who is a refiner used an individual baseline, while imported gasoline did not. This resulted in less favourable treatment to the imported product, as illustrated by the case of a batch of imported gasoline which was chemically-identical to a batch of domestic gasoline that met its refiner's individual baseline, but not the statutory baseline levels. In this case, sale of the imported batch of gasoline on the first day of an annual period would require the importer over the rest of the period to sell on the whole cleaner gasoline in order to remain in conformity with the Gasoline Rule. On the other hand, sale of the chemically-identical batch of domestic gasoline on the first day of an annual period would not require a domestic refiner to sell on the whole cleaner gasoline over the period in order to remain in conformity with the Gasoline Rule. The Panel also noted that this less favourable treatment of imported gasoline induced the gasoline importer, in the case of a batch of imported gasoline not meeting the statutory baseline, to import that batch at a lower price. This reflected the fact that the importer would have to make cost and price allowances because of its need to import other gasoline with which the batch could be averaged so as to meet the statutory baseline. Moreover, the Panel recalled an earlier panel report which stated that 'the words 'treatment no less favourable' in paragraph 4 call for effective equality of opportunities for imported products in respect of laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products.' The Panel found therefore that since, under the

[200] Panel Report, *Mexico – Taxes on Soft Drinks*, para. 8.112.
[201] Panel Report, *US – Renewable Energy*, para. 7.161.
[202] Panel Report, *China – Publications and Audiovisual Products*, para. 7.1459.
[203] Panel Report, *China – Publications and Audiovisual Products*, para. 7.1465.

> baseline establishment methods, imported gasoline was effectively prevented from benefitting from as favourable sales conditions as were afforded domestic gasoline by an individual baseline tied to the producer of a product, imported gasoline was treated less favourably than domestic gasoline."[204]

182. In *Japan – Film*, the Panel reiterated the standard of equality of competitive conditions as a benchmark for establishing "no less favourable treatment":

> "Recalling the statement of the Appellate Body in *Japan - Alcoholic Beverages* that 'Article III obliges Members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products', we consider that this standard of effective equality of competitive conditions on the internal market is the standard of national treatment that is required, not only with regard to Article III generally, but also more particularly with regard to the "no less favourable treatment" standard in Article III:4. We note in this regard that the interpretation of equal treatment in terms of effective equality of competitive opportunities, first clearly enunciated by the panel on *US – Section 337*, has been followed consistently in subsequent GATT and WTO panel reports. The panel report on *US - Section 337* explains the test in very clear terms, noting that
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> > 'the 'no less favourable' treatment requirement set out in Article III:4, is unqualified. These words are to be found throughout the General Agreement and later Agreements negotiated in the GATT framework as *an expression of the underlying principle of equality of treatment* of imported products as compared to the treatment given either to other foreign products, under the most favoured nation standard, or to domestic products, under the national treatment standard of Article III. The words "treatment no less favourable" in paragraph 4 call for *effective equality of opportunities* for imported products in respect of the application of laws, regulations and requirements affecting the internal sale, offering for sale, purchase transportation, distribution or use of products. This clearly sets a minimum permissible standard as a basis' (emphasis added)."[205]

183. In *Korea – Various Measures on Beef*, the measure at issue established a dual retail distribution system for the sale of beef. *Inter alia*, imported beef was to be sold either in specialized stores selling only imported beef or, in the case of larger department stores, in separate sales. The Appellate Body first held that such different treatment of imported products did not necessarily lead to less favourable treatment:

> "We observe … that Article III:4 requires only that a measure accord treatment to imported products that is 'no less favourable' than that accorded to like domestic products. A measure that provides treatment to imported products that is *different* from that accorded to like domestic products is not necessarily inconsistent with Article III:4, as long as the treatment provided by the measure is 'no less favourable'. According 'treatment no less favourable' means, as we have previously said, according *conditions of competition* no less favourable to the imported product than to the like domestic product. …
>
> This interpretation, which focuses on the *conditions of competition* between imported and domestic like products, implies that a measure according formally *different* treatment to imported products does not *per se*, that is, necessarily, violate Article III:4. In *United States – Section 337*, this point was persuasively made. In that case, the panel had to determine whether United States patent enforcement procedures, which were formally different for imported and for domestic products, violated Article III:4. That panel said:
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> > 'On the one hand, contracting parties may apply to imported products *different* formal legal requirements if doing so would accord imported products more favourable treatment. On the other hand, it also has to be

[204] Panel Report, *US – Gasoline*, para. 6.10.
[205] Panel Report, *Japan – Film*, para. 10.379.

> recognised that there may be cases where the application of formally *identical* legal provisions would in practice accord less favourable treatment to imported products and a contracting party might thus have to apply different legal provisions to imported products to ensure that the treatment accorded them is in fact no less favourable. For these reasons, the mere fact that imported products are subject under Section 337 to legal provisions that are different from those applying to products of national origin is in itself not conclusive in establishing inconsistency with Article III:4.' (emphasis added)
>
> A formal difference in treatment between imported and like domestic products is thus neither necessary, nor sufficient, to show a violation of Article III:4. Whether or not imported products are treated 'less favourably' than like domestic products should be assessed instead by examining whether a measure modifies the *conditions of competition* in the relevant market to the detriment of imported products."[206]

184. In *EC – Asbestos*, the Appellate Body interpreted the term "no less favourable treatment" as requiring that the *group* of imported products not be accorded less favourable treatment than that accorded to the *group* of domestic like products:

> "A complaining Member must still establish that the measure accords to the group of 'like' *imported* products 'less favourable treatment' than it accords to the group of 'like' *domestic* products. The term 'less favourable treatment' expresses the general principle, in Article III:1, that internal regulations 'should not be applied … so as to afford protection to domestic production'. If there is 'less favourable treatment' of the group of 'like' imported products, there is, conversely, 'protection' of the group of 'like' domestic products. However, a Member may draw distinctions between products which have been found to be 'like', without, for this reason alone, according to the group of 'like' *imported* products 'less favourable treatment' than that accorded to the group of 'like' *domestic* products. In this case, we do not examine further the interpretation of the term 'treatment no less favourable' in Article III:4, as the Panel's findings on this issue have not been appealed or, indeed, argued before us."[207]

185. In *China - Publications and Audiovisual Products*, the Panel rejected the view that "a lack of 'significant' alteration in the conditions of competition would mean that [a respondent] has fulfilled its obligation to treat the imported products no less favourably than the like domestic products".[208] In the Panel's view, "[t]he phrase 'treatment no less favourable' is not qualified by a *de minimis* standard."[209]

186. In considering less favourable treatment, the Panel in *US – Renewable Energy* found that "that evidence showing that the measure may have had minimal or no market effects in recent years" would not be sufficient to rebut a *prima facie* case showing that non-local products, including imported products, are treated less favourably than like local products.[210]

187. The Appellate Body in *Brazil – Taxation* upheld the Panel's finding that the existing incentives amounting to lower administrative burdens modified the conditions of competition:

> "The ICT programmes are designed in a manner that creates incentives for the market participants, that is, purchasers of intermediate ICT products, to behave in a manner that has the 'direct practical effect' of treating imported intermediate ICT products less favourably than like domestic intermediate ICT products. In this case, by creating an incentive to purchase incentivized domestic intermediate ICT products in order to be relieved from and/or to face reduced administrative burdens. Accordingly, we agree with the Panel that, 'when faced with a decision to choose', a purchaser, 'under normal circumstances, will

[206] Appellate Body Report, *Korea – Various Measures on Beef*, paras. 135-137. See also Panel Report, *EU – Energy Package,* para. 7.539.
[207] Appellate Body Report, *EC – Asbestos*, para. 100.
[208] Panel Report, *China – Publications and Audiovisual Products*, para. 7.1537.
[209] Panel Report, *China – Publications and Audiovisual Products*, para. 7.1537. See also Panel Report, *India – Solar Cells*, para. 7.97.
[210] Panel Report, *US – Renewable Energy*, para. 7.265.

> prefer to avoid the administrative burden that comes with the payment of the tax' and thus prefer to purchase incentivized domestic intermediate ICT products."[211]

188. The Panel in *US – Renewable Energy* found that an assertion by India that a tax incentive for the use of domestic ingredients was not sufficient, without more details as to how the "tax incentive modifies the conditions of competition with respect to the final product, is not sufficient to establish the existence of less favourable treatment", to establish the existence of less favourable treatment.[212]

The detrimental impact stems exclusively from a legitimate regulatory distinction

189. In *EC – Seal Products*, the Appellate Body clarified that the analysis of whether a measure causes a detrimental impact on competitive opportunities for like imported products under Article III:4 "does not involve an assessment of whether such detrimental impact stems exclusively from a legitimate regulatory distinction"[213] as in the case of Article 2.1 of the TBT Agreement. To support its view, the Appellate Body noted the right of WTO Members to regulate as enshrined in Article XX, and stated:

> "In our view, the fact that, under the GATT 1994, a Member's right to regulate is accommodated under Article XX, weighs heavily against an interpretation of Articles I:1 and III:4 that requires an examination of whether the detrimental impact of a measure on competitive opportunities for like imported products stems exclusively from a legitimate regulatory distinction."[214]

The detrimental impact is unrelated to foreign origin

190. In *US – COOL (Article 21.5 – Canada and Mexico)*, the Appellate Body rejected the proposition that Article III:4 of the GATT 1994 includes consideration of whether the detrimental impact on imports is unrelated to the foreign origin of the product.[215]

Formally equal treatment

191. In *Dominican Republic – Import and Sale of Cigarettes* the Panel considered the requirement that a tax stamp must be affixed on cigarette packets in the territory of the Dominican Republic and under the supervision of Dominican Republic tax authorities. This requirement applied to both domestic and imported cigarettes and therefore was a formally identical requirement. However, the Panel agreed with the complaining party, that this formal equality itself resulted in less favourable treatment being accorded to imported cigarettes as compared to domestic cigarettes, since tax stamps could be affixed on packets of domestic cigarettes as part of the production process, while in the case of imported cigarettes an additional process had to be undertaken, which entailed added costs. The Panel noted that the relevant test for whether a measure is consistent with Article III:4 of the GATT is not whether the measure accords a treatment which is formally the same for both imported and like domestic products, but rather whether it accords a treatment for imported products which is no less favourable than that granted to like domestic products:

> "[A]s noted by a previous [GATT] panel, there are cases in which formally equal rules may accord a treatment for imported products which is less favourable than the one granted to like domestic products:
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> > '[T]here may be cases where the application of formally identical legal provisions would in practice accord less favourable treatment to imported products and a contracting party might thus have to apply different legal

[211] Appellate Body Reports, *Brazil – Taxation*, para. 5.60.
[212] Panel Report, *US – Renewable Energy*, para. 7.271.
[213] Appellate Body Report, *EC – Seal Products*, para. 5.117.
[214] Appellate Body Report, *EC – Seal Products*, para. 5.125.
[215] Appellate Body Report, *US – COOL (Article 21.5 – Canada and Mexico)*, para. 5.358. See also Appellate Body Report, *US – Clove Cigarettes*, fn. 372 to para. 179.

> provisions to imported products to ensure that the treatment accorded to them is in fact no less favourable[.]'"[216]

Relationship with "upsetting the competitive relationship" under Article XXIII:1(b)

192. In *Japan – Film*, the Panel equated the standards of "upsetting effective equality of competitive opportunities" under Article III:4 and "upsetting the competitive relationship" under Article XXIII:1(b).

Methodology of comparison

193. The Appellate Body, in *Thailand – Cigarettes (Philippines)* commented generally on analysis of "less favourable treatment":

> "The analysis of whether imported products are accorded less favourable treatment requires a careful examination 'grounded in close scrutiny of the 'fundamental thrust and effect of the measure itself'', including of the implications of the measure for the conditions of competition between imported and like domestic products. This analysis need not be based on empirical evidence as to the actual effects of the measure at issue in the internal market of the Member concerned. Of course, nothing precludes a panel from taking such evidence of actual effects into account.
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> …
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> In our view … an analysis of less favourable treatment should not be anchored in an assessment of the degree of likelihood that an adverse impact on competitive conditions will materialize. Rather, an analysis under Article III:4 must begin with careful scrutiny of the measure, including consideration of the design, structure, and expected operation of the measure at issue. Such scrutiny may well involve – but does not require – an assessment of the contested measure in the light of evidence regarding the actual effects of that measure in the market. In any event, there must be in every case a genuine relationship between the measure at issue and its adverse impact on competitive opportunities for imported versus like domestic products to support a finding that imported products are treated less favourably."[217]

Relevance of formal differences between imported and domestic products in legal requirements

194. In *Korea – Various Measures on Beef*, the Appellate Body addressed the relevance of formal regulatory differences between domestic and imported products and held that formally different treatment of imported and domestic goods did not, in and of itself, necessarily lead to less favourable treatment. See paragraph 183 above.

195. The Panel in *US – Gasoline* examined the consistency with Article III:4 of a United States environmental regulation on gasoline and its potential to result in formally different regulation for imported and domestic products. The Panel stated as follows:

> "Although such a scheme could result in formally different regulation for imported and domestic products, the Panel noted that previous panels had accepted that this could be consistent with Article III:4. The requirement under Article III:4 to treat an imported product no less favourably than the like domestic product is met by granting formally different treatment to the imported product, if that treatment results in maintaining conditions of competition for the imported product no less favourable than those of the like domestic product."[218]

196. In *EC – Bananas III*, the Appellate Body agreed with the Panel's finding that the EC allocation method of tariff quota for bananas was inconsistent with Article III:4. The Appellate

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[216] Panel Report, *Dominican Republic – Import and Sale of Cigarettes,* para. 7.182.
[217] Appellate Body Report, *Thailand – Cigarettes (Philippines)*, paras. 129 and 134.
[218] Panel Report, *US – Gasoline*, para. 6.25.

Body addressed, among other things, so-called hurricane licences, which authorize operators who include or represent European Communities' and African, Caribbean and Pacific (ACP) producers, or producer organizations "to import in compensation third-country bananas and non-traditional ACP bananas for the benefit of the operators who directly suffered damage as a result of the impossibility of the supplying the Community market with bananas originating in affected producer regions"[219] because of the impact of tropical storms:

> "Although [the] issuance [of subject import licences] results in increased exports from those countries, we note that hurricane licences are issued exclusively to EC producers and producer organizations, or to operators including or directly representing them. We also note that, as a result of the EC practice relating to hurricane licences, these producers, producer organizations or operators can expect, in the event of a hurricane, to be compensated for their losses in the form of 'quota rents' generated by hurricane licences. Thus, the practice of issuing hurricane licences constitutes an incentive for operators to market EC bananas to the exclusion of third-country and non-traditional ACP bananas. This practice therefore affects the competitive conditions in the market in favour of EC bananas. We do not dispute the right of WTO Members to mitigate or remedy the consequences of natural disasters. However, Members should do so in a manner consistent with their obligations under the GATT 1994 and the other covered agreements."[220]

197. In *US – FSC (Article 21.5 – EC)*, the Appellate Body declared that the examination of whether a measure involves "less favourable treatment" of imported products within the meaning of Article III:4 cannot rest on simple assertion, but must be founded on a careful analysis of the contested measure and of its implications in the marketplace:

> "The examination of whether a measure involves 'less favourable treatment' of imported products within the meaning of Article III:4 of the GATT 1994 must be grounded in close scrutiny of the 'fundamental thrust and effect of the measure itself'. This examination cannot rest on simple assertion, but must be founded on a careful analysis of the contested measure and of its implications in the marketplace. At the same time, however, the examination need not be based on the *actual effects* of the contested measure in the marketplace.
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> …
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> In our view, the above conclusion is not nullified by the fact that the fair market value rule will not give rise to less favourable treatment for like imported products in each and every case… Even so, the fact remains that in an indefinite number of other cases, the fair market value rule operates, by its terms, as a significant constraint upon the use of imported input products. We are not entitled to disregard that fact."[221]

Relevance of "treatment accorded to similarly situated domestic parties"

198. In *US – Gasoline*, the Panel "rejected the US argument that the requirements of Article III:4 are met because imported gasoline is treated similarly to domestic gasoline from *similarly situated* domestic parties".[222] In addition to pointing out that "[the] wording [of Article III:4] does not allow less favourable treatment dependent on the characteristics of the producer and the nature of the data held by it"[223], the Panel held that even if the approach of the United States were followed, there would be great uncertainty and indeterminacy of the basis of treatment:

> "Apart from being contrary to the ordinary meaning of the terms of Article III:4, any interpretation of Article III:4 in this manner would mean that the treatment of imported and domestic goods concerned could no longer be assured on the objective

[219] Panel Report, *EC – Bananas III*, para. 7.243.
[220] Appellate Body Report, *EC – Bananas III*, para. 213.
[221] Appellate Body Report, *US – FSC (Article 21.5 – EC),* paras. 215 and 221.
[222] Panel Report, *US – Gasoline*, para. 6.11.
[223] Panel Report, *US – Gasoline,* para. 6.11.

> basis of their likeness as products. Rather, imported goods would be exposed to a highly subjective and variable treatment according to extraneous factors. This would thereby create great instability and uncertainty in the conditions of competition as between domestic and imported goods in a manner fundamentally inconsistent with the object and purpose of Article III.
>
> [E]ven if the US approach were to be followed, under any approach based on similarly situated parties' the comparison could just as readily focus on whether imported gasoline from an identifiable *foreign* refiner was treated more or less favourably than gasoline from an identifiable US refiner. There were … many key respects in which these refineries could be deemed to be the relevant similarly situated parties, and the Panel could find no inherently objective criteria by means of which to distinguish which of the many factors were relevant in making a determination that any particular parties were 'similarly situated'. Thus, although these refineries were similarly situated, the Gasoline Rule treated the products of these refineries differently by allowing only gasoline produced by the domestic entity to benefit from the advantages of an individual baseline. This consequential uncertainty and indeterminacy of the basis of treatment underlined … the rationale of remaining within the terms of the clear language, object and purpose of Article III:4 as outlined above".[224]

Relevance of "more favourable treatment of some imported products"

199. In *US – Gasoline*, the Panel rejected the US argument that the subject regulation treated imported products "equally overall"[225], stating as follows:

> "The Panel noted that, in these circumstances, the argument that on average the treatment provided was equivalent amounted to arguing that less favourable treatment in one instance could be offset provided that there was correspondingly more favourable treatment in another. This amounted to claiming that less favourable treatment of particular imported products in some instances would be balanced by more favourable treatment of particular products in others."[226]

Relationship with other methodologies of comparison

200. With respect to the methodology of comparison for "in excess of those applied" under the first sentence of Article III:2, see paragraphs 67-81 above. With respect to the methodology of comparison in identifying "directly competitive or substitutable products" under the second sentence of Article III:2, see paragraphs 108 above. With respect to the methodology of comparison in examining the "dissimilar taxation" under the second sentence of Article III:2, see paragraphs 116-117 above.

Relationship of Article III:4 with other paragraphs of Article III

Article III:1

201. With respect to the relationship between Paragraphs 1 and 4 of Article III, see paragraphs 22-26 above. Also, in *EC – Bananas III*, the Appellate Body touched on this issue in discussing whether the independent consideration of "so as to afford protection to domestic production" is necessary under Article III:4. See paragraph 131 above. Further, this issue was touched upon by the Appellate Body in *EC – Asbestos* in relation to the interpretation of the term "like products" under paragraph 4. See paragraphs 202-203 below.

Article III:2

202. In *EC – Asbestos*, the Appellate Body considered that Article III:2 constitutes part of the context of Article III:4, and examined the relationship between these paragraphs. However, the

[224] Panel Report, *US – Gasoline*, paras. 6.12-6.13.
[225] Panel Report, *US – Gasoline*, para. 6.14.
[226] Panel Report, *US – Gasoline*, para. 6.14. In support of its proposition, the Panel cited GATT Panel Report, *US – Section 337*, BISD 36S/345, para. 5.14.

Appellate Body concluded that Article III:1, rather than Article III:2, had "particular contextual significance" for the interpretation of Article III:4:

> "To begin to resolve these [interpretative] issues, we turn to the relevant context of Article III:4 of the GATT 1994. In that respect, we observe that Article III:2 of the GATT 1994, which deals with the internal tax treatment of imported and domestic products, prevents Members, through its first sentence, from imposing internal taxes on imported products 'in excess of those applied … to *like* domestic products.' (emphasis added) In previous Reports, we have held that the scope of 'like' products in this sentence is to be construed 'narrowly'. This reading of 'like' in Article III:2 might be taken to suggest a similarly narrow reading of 'like' in Article III:4, since both provisions form part of the same Article. However, both of these paragraphs of Article III constitute specific expressions of the overarching, 'general principle', set forth in Article III:1 of the GATT 1994. As we have previously said, the 'general principle' set forth in Article III:1 'informs' the rest of Article III and acts 'as a guide to understanding and interpreting the specific obligations contained' in the other paragraphs of Article III, including paragraph 4. Thus, in our view, Article III:1 has particular contextual significance in interpreting Article III:4, as it sets forth the 'general principle' pursued by that provision. Accordingly, in interpreting the term 'like products' in Article III:4, we must turn, first, to the 'general principle' in Article III:1, rather than to the term 'like products' in Article III:2."[227]

203. After emphasizing the significance of Article III:1 for the interpretation of Article III:4, the Appellate Body in *EC – Asbestos* considered the different respective structures of Articles III:2 and III:4:

> "In addition, we observe that, although the obligations in Articles III:2 and III:4 both apply to 'like products', the text of Article III:2 differs in one important respect from the text of Article III:4. Article III:2 contains *two separate* sentences, each imposing *distinct* obligations: the first lays down obligations in respect of 'like products', while the second lays down obligations in respect of 'directly competitive or substitutable' products.[228] By contrast, Article III:4 applies only to 'like products' and does not include a provision equivalent to the second sentence of Article III:2. We note that, in this dispute, the Panel did not examine, at all, the significance of this textual difference between paragraphs 2 and 4 of Article III."[229]

204. The Appellate Body in *EC – Asbestos* also recalled its report in *Japan – Alcoholic Beverages II*, where it had emphasized the need to interpret the two sentences of Article III:2 and the separate obligations contained therein in the light of the structure of Article III:2:

> "For us, this textual difference between paragraphs 2 and 4 of Article III has considerable implications for the meaning of the term 'like products' in these two provisions. In *Japan – Alcoholic Beverages,* we concluded, in construing Article III:2, that the two separate obligations in the two sentences of Article III:2 must be interpreted in a harmonious manner that gives meaning to *both* sentences in that provision. We observed there that the interpretation of one of the sentences necessarily affects the interpretation of the other. Thus, the scope of the term 'like products' in the first sentence of Article III:2 affects, and is affected by, the scope of the phrase 'directly competitive or substitutable' products in the second sentence of that provision. We said in *Japan – Alcoholic Beverages*:
>
> > 'Because the second sentence of Article III:2 provides for a separate and distinctive consideration of the protective aspect of a measure in examining its application to a broader category of products that are not 'like products' as contemplated by the first sentence, we agree with the Panel that the first sentence of Article III:2 must be construed narrowly

[227] Appellate Body Report, *EC – Asbestos*, para. 94.
[228] *(footnote original)* The meaning of the second sentence of Article III:2 is elaborated upon in the Interpretative Note to that provision. This note indicates that the second sentence of Article III:2 applies to "directly competitive or substitutable product[s]".
[229] Appellate Body Report, *EC – Asbestos*, para. 94.

> so as not to condemn measures that its strict terms are not meant to condemn. Consequently, we agree with the Panel also that the definition of 'like products' in Article III:2, first sentence, should be construed narrowly.'
>
> In construing Article III:4, the same interpretive considerations do not arise, because the 'general principle' articulated in Article III:1 is expressed in Article III:4, not through two distinct obligations, as in the two sentences in Article III:2, but instead through a single obligation that applies solely to 'like products'. Therefore, the harmony that we have attributed to the two sentences of Article III:2 need not and, indeed, cannot be replicated in interpreting Article III:4. Thus, we conclude that, given the textual difference between Articles III:2 and III:4, the 'accordion' of 'likeness' stretches in a different way in Article III:4."[230]

205. In *Brazil – Taxation*, the Panel clarified the difference in the scope of application of paragraphs 2 and 4 of Article III:

> "While Article III:2 prohibits tax discrimination between imported and domestic like products, Article III:4 … deal[s] with discrimination introduced through regulations. Specifically, Article III:4 prohibits regulatory discrimination between imported and like domestic products."[231]

206. In *Brazil – Taxation*, the Panel further noted that a measure can be subject to the disciplines both of Article III:2 and Article III:4: "It is well established that a single measure can be inconsistent with two or more provisions of Article III at the same time. This is because multiple features of a single measure may operate simultaneously. In such a situation, different aspects of the same measure could be considered to be covered by the disciplines of either or both Article III:2 and III:4."[232] The Appellate Body upheld this finding.[233]

Article III:8

207. See paragraphs I.A.1(a)(i)218-I.A.1(a)(i)219, I.A.1(a)(i)237, and I.A.1(a)(i)241-I.A.1(a)(i)244 below.

Relationship of Article III:4 with other GATT provisions

Article I:1

208. In *EC – Seal Products*, the Appellate Body made some general observations about the similarities and differences between Articles I:1 and III:4 of the GATT 1994. First, the Appellate Body acknowledged that "the most favoured nation (MFN) and national treatment obligations under Articles I:1 and III:4 are both fundamental non-discrimination obligations under the GATT 1994."[234] However, "the MFN obligation under Article I:1 proscribes, discriminatory treatment between and among like products of different origins" while "the national treatment obligation under Article III:4 proscribes, discriminatory treatment of imported products vis-à-vis like domestic products."[235] Second, the Appellate Body noted that "there is overlap in the scope of application of Articles I:1 and III:4, insofar as 'internal matters may be within the purview of the MFN obligation'."[236] Third, there is a textual difference regarding the obligations that they impose on the Members. According to the Appellate Body, "the national treatment obligation under Article III:4 of the GATT 1994 is … expressed through a 'treatment no less favourable' standard" while "the legal standard under Article I:1 of the GATT 1994 is expressed through an obligation to extend any 'advantage' granted by a Member to any product originating in or destined for any other country 'immediately and unconditionally' to the

[230] Appellate Body Report, *EC – Asbestos*, paras. 95-96.
[231] Panel Reports, *Brazil – Taxation*, para. 7.33.
[232] Panel Reports, *Brazil – Taxation*, para. 7.34.
[233] Appellate Body Reports, *Brazil – Taxation,* para. 5.53.
[234] Appellate Body Report, *EC – Seal Products*, para. 5.80.
[235] Appellate Body Report, *EC – Seal Products*, para. 5.80.
[236] Appellate Body Report, *EC – Seal Products*, para. 5.81.

'like product' originating in or destined for all other Members."[237] Finally ,the Appellate Body concluded that "neither Article I:1 nor Article III:4 require a demonstration of the actual trade effects of a specific measure."[238] Since, "each provision is concerned, fundamentally, with prohibiting discriminatory measures by requiring, , in the context of Article I:1, equality of competitive opportunities for like imported products from all Members, and, in the context of Article III:4, equality of competitive opportunities for imported products and like domestic products."[239]

Article XI

209. The Panel in *Argentina – Import Measures* did not consider that the relationship between Articles XI:1 and III:4 of the GATT imposed any specific order of analysis as regards the claims at issue.

Article XX

210. In *US – Gasoline*, the Appellate Body discussed the relationship between Article III:4 and Article XX in interpreting Article XX(g). The Appellate Body stated:

> "Article XX(g) and its phrase, 'relating to the conservation of exhaustible natural resources,' need to be read in context and in such a manner as to give effect to the purposes and objects of the *General Agreement*. The context of Article XX(g) includes the provisions of the rest of the *General Agreement*, including in particular Articles I, III and XI; conversely, the context of Articles I and III and XI includes Article XX. Accordingly, the phrase 'relating to the conservation of exhaustible natural resources' may not be read so expansively as seriously to subvert the purpose and object of Article III:4. Nor may Article III:4 be given so broad a reach as effectively to emasculate Article XX(g) and the policies and interests it embodies. The relationship between the affirmative commitments set out in, *e.g.*, Articles I, III and XI, and the policies and interests embodied in the 'General Exceptions' listed in Article XX, can be given meaning within the framework of the *General Agreement* and its object and purpose by a treaty interpreter only on a case-to-case basis, by careful scrutiny of the factual and legal context in a given dispute, without disregarding the words actually used by the WTO Members themselves to express their intent and purpose."[240]

211. In *EC – Asbestos*, the Appellate Body found that "carcinogenicity, or toxicity, constitutes … a defining aspect of the physical properties of [the subject products]".[241] The Appellate Body disagreed with the Panel's finding that considering the health risks associated with a product under Article III:4 would negate the effect of Article XX(b):

> "We do not agree with the Panel that considering evidence relating to the health risks associated with a product, under Article III:4, nullifies the effect of Article XX(b) of the GATT 1994. Article XX(b) allows a Member to 'adopt and enforce' a measure, *inter alia*, necessary to protect human life or health, even though that measure is inconsistent with another provision of the GATT 1994. Article III:4 and Article XX(b) are distinct and independent provisions of the GATT 1994 each to be interpreted on its own. The scope and meaning of Article III:4 should not be broadened or restricted beyond what is required by the normal customary international law rules of treaty interpretation, simply because Article XX(b) exists and may be available to justify measures inconsistent with Article III:4. The fact that an interpretation of Article III:4, under those rules, implies a less frequent recourse to Article XX(b) does not deprive the exception in Article XX(b) of *effet utile*. Article XX(b) would only be deprived of *effet utile* if that provision could *not* serve to allow a Member to 'adopt and enforce' measures 'necessary to protect human … life or health'. Evaluating evidence relating to the health risks arising from the physical properties of a product does not prevent a measure which is inconsistent with Article III:4 from being justified under

[237] Appellate Body Report, *EC – Seal Products*, para. 5.82.
[238] Appellate Body Report, *EC – Seal Products*, para. 5.83.
[239] Appellate Body Report, *EC – Seal Products*, para. 5.83.
[240] Appellate Body Report, *US – Gasoline*, p. 18.
[241] Appellate Body Report, *EC – Asbestos*, para. 114.

> Article XX(b). We note, in this regard, that, different inquiries occur under these two very different Articles. Under Article III:4, evidence relating to health risks may be relevant in assessing the *competitive relationship in the marketplace* between allegedly 'like' products. The same, or similar, evidence serves a different purpose under Article XX(b), namely, that of assessing whether a *Member* has a sufficient basis for 'adopting or enforcing' a WTO-inconsistent measure on the grounds of human health."[242]

212. In *Thailand – Cigarettes (Philippines),* the Appellate Body summed up the proper approach when Article XX(d) is invoked to justify an inconsistency with Article III:4:

> "[W]hen Article XX(d) is invoked to justify an inconsistency with Article III:4, what must be shown to be 'necessary' is the treatment giving rise to the finding of less favourable treatment. Thus, when less favourable treatment is found based on differences in the regulation of imports and of like domestic products, the analysis of an Article XX(d) defence should focus on whether those regulatory differences are 'necessary' to secure compliance with 'laws or regulations' that are not GATT-inconsistent."[243]

Article XXIII:1(b)

213. In *Japan – Film*, the Panel did not find a significant distinction between the standard it had set out for Article XXIII:1(b) and the standard of "upsetting effective equality of competitive opportunities" under Article III:4:

> "We recall our earlier findings that none of the eight distribution 'measures' cited by the United States had been shown to discriminate against imported products, either in terms of a *de jure* discrimination (a measure that discriminates *on its face* as to the origin of products) or in terms of a *de facto* discrimination (a measure that in its application upsets the relative competitive position between domestic and imported products, as it existed at the time when a relevant tariff concession was granted). In this connection, it could be argued that the standard we enunciated and applied under Article XXIII:1(b) – that of 'upsetting the competitive relationship' – may be different from the standard of 'upsetting effective equality of competitive opportunities' applicable to Article III:4. However, we do not see any significant distinction between the two standards apart from the fact that this Article III:4 standard calls for no less favourable treatment for imported products in general, whereas the Article XXIII:1(b) standard calls for a comparison of the competitive relationship between foreign and domestic products at two specific points in time, i.e., when the concession was granted and currently."[244]

Article III:5

General

214. In *Brazil – Taxation*, the complainants challenged certain features of Brazil's "ICT programs" under Articles III:4 and III:5 of the GATT 1994. Under the programmes, manufacturers received tax incentives if they complied with requirements to use domestic inputs in the production of incentivized products. The Panel first examined the measures under Article III:4, finding they accorded less favourable treatment to imported products (i.e. inputs for the production of incentivized goods) than that accorded to domestic like products. The Panel next assessed whether, after finding an inconsistency with Article III:4, it would be appropriate to apply the principle of judicial economy *vis-à-vis* the claims under Article III:5:

> "The Panel is fully aware of its task of securing a positive solution to this dispute. However, the Panel sees no reason why it would need to assess two claims under two different provisions of Article III of the GATT of 1994, covering the same features of the ICT programmes, in order to secure a positive solution to the dispute. This is

[242] Appellate Body Report, *EC – Asbestos*, para. 115.
[243] Appellate Body Report, *Thailand – Cigarettes (Philippines)*, para. 177.
[244] Panel Report, *Japan – Film*, para. 10.380.

> because the same aspects that lead to the finding of inconsistency with Article III:4 of the GATT 1994 (specifically the finding of discrimination against imported inputs through the imposition of local content requirements), are the same aspects that the complaining parties allege to be inconsistent with Article III:5 of the GATT 1994.
>
> …
>
> The Panel therefore considers that, in the specific context of this dispute, if Brazil brings its measures into conformity with Article III:4 of the GATT of 1994, it will also bring its measures into conformity with Article III:5 of the GATT of 1994. In particular, the reasons for the alleged inconsistency in respect of Article III:5 are, in the Panel's view, fully resolved by the Panel's findings in respect of Article III:4."

Article III:8

General

215. In *Brazil – Taxation*, the Panel addressed the difference in scope between subparagraphs (a) and (b) of Article III:8:

> "Article III:8(a) states that the provisions of Article III 'shall not apply to' government procurement whereas, by contrast, Article III:8(b) states that the provisions of Article III 'shall not prevent the payment of subsidies exclusively to domestic producers'. This difference in wording suggests a different scope of application for Article III:8(b) compared to Article III:8(a). Thus, while discrimination resulting from government procurement is completely exempted from the application of Article III by virtue of Article III:8(a), Article III:8(b) stands for the more limited proposition that the national treatment obligation in Article III does not extend to, or prohibit, the act of limiting subsidization only to domestic (to the exclusion of foreign) producers."[245]

Item (a)

General

216. In *Canada – Renewable Energy / Canada – Feed in Tariff Program*, the Panel characterized Article III:8(a) as a "scope provision" rather than as an exception:

> "We agree with the European Union's characterization of Article III:8(a) of the GATT 1994 as a 'scope' provision rather than an exception. … We recall that the Appellate Body in *China – Raw Materials* considered the different nature of Articles XI:2 and XX of the GATT 1994, and stated that:
>
> > Members can resort to Article XX of the GATT 1994 as an exception to justify measures that would otherwise be inconsistent with their GATT obligations. By contrast, Article XI:2 provides that the general elimination of quantitative restrictions shall not extend to the items listed under subparagraphs (a) and (c) of that provision. This language seems to indicate that the scope of the obligation not to impose quantitative restrictions itself is limited by Article XI:2(a). Accordingly, where the requirements of Article XI:2(a) are met, there would be no scope for the application of Article XX, because no obligations exists. (Appellate Body Report, *China – Raw Materials*, para. 334).
>
> We note that, pursuant to Article III:8(a), the provisions of Article III shall not apply to laws, regulations or requirements governing certain type of procurement. Thus, consistent with the Appellate Body's view relating to the relationship between Articles XI:2 and XX of the GATT 1994, the language in Article III:8(a) seems to indicate that the scope of the national treatment obligation under Article III is limited by

[245] Panel Reports, *Brazil – Taxation*, para. 7.84.

> Article III:8(a). In other words, if a measure is covered by Article III:8(a), it will not fall within the scope of Article III of the GATT 1994."[246]

217. The proceedings in *Canada – Renewable Energy / Canada – Feed-in Tariff Program* called on the Panel to interpret and apply Article III:8(a) for the first time. The Panel identified three issues that determined the provision's application:

> "These proceedings are the first where a panel has been asked to interpret and apply Article III:8(a) of the GATT 1994. A plain reading of this provision, which we have already set out above, suggests that it can be broken up into a number of cumulative elements. The parties' arguments appear to raise issues with respect to the following three questions:
>
> > (i) whether the challenged measures can be characterized as 'laws, regulations or requirements *governing* procurement';
> >
> > (ii) whether the challenged measures involve '*procurement* by governmental agencies'; and
> >
> > (iii) whether any 'procurement' that exists is undertaken 'for *governmental purposes* and not with a view to *commercial resale* or with a view to use in the production of goods for commercial sale'."[247]

218. The Appellate Body in *Canada – Renewable Energy / Canada – Feed-in Tariffs* examined Article III:8(a), concluding that through the negative use of the term "apply" in the provision "preclude[s] the application of the other provisions of Article III to measures that meet the requirements of that paragraph." The Appellate Body stated:

> "Article III:8(a) … establishes a derogation from the national treatment obligation of Article III for government procurement activities falling within its scope. Measures satisfying the requirements of Article III:8(a) are not subject to the national treatment obligations set out in other paragraphs of Article III. Article III:8(a) is a derogation limiting the scope of the national treatment obligation and it is not a justification for measures that would otherwise be inconsistent with that obligation."[248]

219. Further, the Appellate Body in *Canada – Renewable Energy / Canada – Feed-in Tariffs* stated that Article III:8(a) "should be interpreted holistically", with "consideration of the linkages between the different terms used in the provision and the contextual connections to other parts of Article III, as well as to other provisions of the GATT 1994." In this respect, the Appellate Body explained:

> "Article III:8(a) contains several elements describing the types and the content of measures falling within the ambit of the provision. Some of the terms qualify other terms used in the same provision, or provide guidance for the interpretation of those terms. Indeed, the participants have emphasized the relationships between the various terms in Article III:8(a), although they do not agree on the interpretation of all of them. We consider that Article III:8(a) should be interpreted holistically. This requires consideration of the linkages between the different terms used in the provision and the contextual connections to other parts of Article III, as well as to other provisions of the GATT 1994. At the same time, the principle of effective treaty interpretation requires us to give meaning to every term of the provision.
>
> Article III:8(a) describes the types of measures falling within its ambit as 'laws, regulations or requirements governing the procurement by governmental agencies of products purchased'. We note that the word 'governing' links the words 'laws, regulations or requirements' to the word 'procurement' and the remainder of the paragraph. In the context of Article III:8(a), the word 'governing', along with the word 'procurement' and the other parts of the paragraph, define the subject matter of the

[246] Panel Reports, *Canada – Renewable Energy / Canada – Feed-in Tariff Program*, fn 263.
[247] Appellate Body Reports, *Canada – Renewable Energy / Canada – Feed-in Tariff Program*, paras. 7.24-7.25.
[248] Appellate Body Reports, *Canada – Renewable Energy / Canada – Feed-in Tariff Program*, para. 5.56.

> 'laws, regulations or requirements'. The word 'governing' is defined as 'constitut[ing] a law or rule for'. Article III:8(a) thus requires an articulated connection between the laws, regulations, or requirements and the procurement, in the sense that the act of procurement is undertaken within a binding structure of laws, regulations, or requirements."[249]

Test

220. The Appellate Body in *Canada – Renewable Energy / Canada – Feed-in Tariffs* identified the types of measures covered by the Article:

> "Article III:8(a) describes the types of measures falling within its ambit as 'laws, regulations or requirements governing the procurement by governmental agencies of products purchased'. We note that the word 'governing' links the words 'laws, regulations or requirements' to the word 'procurement' and the remainder of the paragraph. In the context of Article III:8(a), the word 'governing', along with the word 'procurement' and the other parts of the paragraph, define the subject matter of the 'laws, regulations or requirements'. The word 'governing' is defined as 'constitut[ing] a law or rule for'. Article III:8(a) thus requires an articulated connection between the laws, regulations, or requirements and the procurement, in the sense that the act of procurement is undertaken within a binding structure of laws, regulations, or requirements." [250]

221. In addition, the Appellate Body in *Canada – Renewable Energy / Canada – Feed-in Tariffs* clarified the textual elements of Article III:8(a) relevant to a determination of whether a measure is exempted from the national treatment obligation of Article III of the GATT 1994:

> "In our view, the term 'governmental agencies' refers to those entities acting for or on behalf of government in the public realm within the competences that have been conferred on them to discharge governmental functions.
>
> …
>
> [W]e are of the view that the phrase 'products purchased for governmental purposes' in Article III:8(a) refers to what is consumed by government or what is provided by government to recipients in the discharge of its public functions. The scope of these functions is to be determined on a case by case basis. Finally, we recall that Article III:8(a) refers to purchases 'for governmental purposes'. The word 'for' relates the term 'products purchased' to 'governmental purposes', and thus indicates that the products purchased must be intended to be directed at the government or be used for governmental purposes. Thus, Article III:8(a) requires that there be a rational relationship between the product and the governmental function being discharged."[251]

222. The Appellate Body in *Canada – Renewable Energy / Canada – Feed-in Tariffs* underlined that measures falling within the ambit of Article III:8(a) of the GATT 1994 must not be "with a view to commercial resale or with a view to use in the production of goods for commercial sale":

> "Turning then to the meaning of the words 'commercial resale', we note that the term 'resale' is defined as the 'sale of something previously bought'. In the context of Article III:8(a), the word 'resale' refers to the term 'products purchased'. Accordingly, the product not to be 'resold' on a commercial basis is the product 'purchased for governmental purposes'. As we see it, 'commercial resale' is a resale of a product at arm's length between a willing seller and a willing buyer. …
>
> [W]hether a transaction constitutes a 'commercial resale" must be assessed having regard to the entire transaction. In doing so, the assessment must look at the transaction from the seller's perspective and at whether the transaction is oriented at

[249] Appellate Body Reports, *Canada – Renewable Energy / Canada – Feed-in Tariff Program*, para. 5.57.
[250] Appellate Body Reports, *Canada – Renewable Energy / Canada – Feed-in Tariff Program*, para. 5.58.
[251] Appellate Body Reports, *Canada – Renewable Energy / Canada – Feed-in Tariff Program*, paras. 5.61 and 5.68.

> generating a profit for the seller. We see profit-orientation generally as an indication that a resale is at arm's length. Profit-orientation indicates that the seller is acting in a self-interested manner. Yet, as the Panel noted, there are circumstances where a seller enters into a transaction out of his or her own interest without making a profit. There are different circumstances in which a seller may offer a product at a price that does not allow him or her to make a profit, or sometimes even fully to recoup cost. In such circumstances, it may be useful to look at the seller's long-term strategy. This is because loss-making sales could not be sustained indefinitely and a rational seller would be expected to be profit-oriented in the long term, though we accept that strategies can vary widely and thus do not see this as applying axiomatically. The transaction must also be assessed from the perspective of the buyer. A commercial resale would be one in which the buyer seeks to maximize his or her own interest. It is an assessment of the relationship between the seller and the buyer in the transaction in question that allows a judgement to be made whether a transaction is made at arm's length."[252]

"products purchased"

223. At issue in *Turkey – Pharmaceutical Products (EU)* was the localisation requirement adopted by Türkiye, which the Panel described as follows:

> "The localisation requirement relates to Turkey's policy objective of achieving the gradual transition from imports to domestic manufacturing of pharmaceuticals.[253] To achieve this policy objective, Turkey requires foreign producers to commit to localise in Turkey their production of certain pharmaceutical products.[254] If a foreign producer does not make a commitment for a pharmaceutical product subject to localisation, if the Turkish authorities reject the commitment, or if the commitment made is not fulfilled, the pharmaceutical product concerned is no longer reimbursed by the [Social Security Institution]."[255]

224. The Panel started its assessment as to whether the localisation requirement fell within the scope of Article III:8(a) "by focusing on the 'products purchased' (if any) through the challenged measure, and more specifically with the question whether the localisation requirement involves the 'purchase' of pharmaceutical products included in the Annex 4/A list by governmental agencies".[256]

225. The Panel noted the difficulty in deciding the applicability of Article III:8(a) in situations where a product is paid for by the government but consumed by third parties:

> "In those situations where a government pays for products that are ultimately used and consumed by non-governmental third parties, rather than by the government itself, the applicability of Article III:8(a) may become less straightforward. Among other things, it may become more difficult in such situations to differentiate a payment constituting a 'purchase' of products, which in principle falls within the scope of the derogation in Article III:8(a), from other forms of payments which might be labelled as financing, reimbursement or funding, which in principle are not covered by Article III:8(a). The difficulty of conceptualizing what is meant by a 'product purchased', and how to differentiate a purchase from other types of transactions, may be compounded where the end result of different types of arrangements is identical –

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[252] Appellate Body Report, *Canada – Renewable Energy / Canada – Feed-in Tariff Program*, paras. 5.70-5.71.

[253] (*footnote original*) The objective is to meet 60% (by value) of domestic pharmaceutical demand through domestic production. (Republic of Turkey, Ministry of Development, Tenth Development Plan 2014-2018 (2014), approved by Decision No. 1041 of the Grand National Assembly of Turkey of 2 July 2013 (Tenth Development Plan 2014-2018) (Exhibit EU-12), point 1.16.) This 60% figure relates to the share of locally produced medicines in terms of sales value of the total domestic demand for medicines. (Turkey's responses to the second set of questions, para. 72.)

[254] (*footnote original*) Turkey explains that this does not mean that the entire production process needs to take place in Turkey, but rather that "the bulk production, i.e. the establishment of a finished pharmaceutical form (granular, tablet, solution) from raw materials (active substances) and excipients (inactive substances), takes place in Turkey." (Turkey's first written submission, para. 137.)

[255] Panel Report, *Turkey – Pharmaceutical Products (EU)*, para. 2.20.

[256] Panel Report, *Turkey – Pharmaceutical Products (EU)*, para. 7.63.

> i.e. the government pays for products that are ultimately used or consumed by third parties. In such situations, it becomes necessary to ensure that the application of Article III:8(a) is grounded in an objective legal standard and sound interpretation of the definition of the term 'product purchased'."[257]

226. The Panel concluded that in the context of Article III:8(a) purchase of a product by the government requires acquisition of the product's ownership by the government:

> "The foregoing analysis leads the Panel to conclude that, in the context of the phrase 'procurement by governmental agencies of products purchased for governmental purposes' in Article III:8(a), a product is 'purchased' by a government only if the government acquires ownership of that product through some kind of payment. The fact that SSI pays for the products is not sufficient: for a purchase to occur by the SSI, it would have to be established that the SSI acquires ownership of the products. As elaborated in the next subsection, the Panel agrees with Turkey that the range of transactions through which a government may acquire ownership of products may vary, and the specific features of what constitutes ownership may vary depending on factors such as the nature of the good. However, the Panel considers that in all cases, if there is no acquisition of ownership of products by the government, then there is no 'purchase' of products by the government and the measure at issue will not fall within the scope of the government procurement derogation in Article III:8(a). Thus, the Panel does not agree with Turkey's argument that the SSI 'pays for the pharmaceutical products and thus is the ultimate buyer (or the purchaser)'."[258]

227. Having reached this conclusion, the Panel distinguished the notion of "acquisition" of a good from having "physical possession" of the good, and noted that ownership of a product may be acquired through various types of transactions:

> "Second, insofar as Turkey's argument is that treating the acquisition of ownership over a good as a constitutive element of the concept of a 'purchase' of that good is overly formalistic, then the Panel disagrees. The Panel does not consider it formalistic to interpret Article III:8(a) as being, in principle, applicable to situations in which a governmental agency (e.g. state-owned pharmacy and/or hospital) purchases pharmaceutical products and then provides them directly to patients, and as being, in principle, not applicable to other situations where the government pays for the cost of the pharmaceutical products consumed by patients without ever acquiring ownership over these products.
>
> …
>
> The Panel accepts that the range of transactions through which a government may acquire ownership of products may vary, and that the specific features of what constitutes ownership may vary depending on factors such as the nature of the good."[259]

228. Turning to the facts of the case, the Panel in *Turkey – Pharmaceutical Products (EU)* found that the Social Security Institution (SSI) of Türkiye did not acquire ownership of the pharmaceutical products at issue:

> "Thus, in assessing whether the SSI acquires ownership of pharmaceutical products included in the Annex 4/A list, the Panel has sought to determine whether the SSI acquires any legal rights over the products of the type typically associated with ownership of goods. The Panel has also taken into account the kinds of legal rights over pharmaceutical products that are acquired by other entities that undisputedly acquire ownership over those products in the context of the Turkish system. These other entities include private pharmacies that acquire ownership of pharmaceutical products when they purchase them from wholesalers, and the final consumers (i.e. outpatients) that acquire ownership of pharmaceutical products when they obtain

[257] Panel Report, *Turkey – Pharmaceutical Products (EU)*, para. 7.68.
[258] Panel Report, *Turkey – Pharmaceutical Products (EU)*, para. 7.74.
[259] Panel Report, *Turkey – Pharmaceutical Products (EU)*, paras. 7.79 and 7.83.

> them from pharmacies. The Panel observes that it is undisputed between the parties that pharmacies acquire ownership of medicines when obtaining them from wholesalers, and that the final consumers (i.e. outpatients) subsequently acquire ownership of pharmaceutical products when obtaining them from retail pharmacies.[260]
>
> The Panel is unable to discern any basis upon which it could conclude that the SSI acquires any legal rights over the pharmaceutical products it pays for, let alone that it acquires the types of legal rights that are typically associated with ownership of goods. Generally, there is nothing in the parties' description of Turkey's pharmaceutical reimbursement system to suggest that the SSI acquires any right of possession, any right of control, any right of exclusion, any right to derive income, or any right to freely dispose of the pharmaceutical products that it acquires."[261]

229. In finding that the SSI did not acquire ownership of the goods at issue, the Panel in *Turkey – Pharmaceutical Products (EU)* noted that the SSI did not even have the right to take physical possession of such goods:

> "As an example of the kinds of legal rights typically associated with ownership of goods that the SSI does not acquire, the Panel notes that it is undisputed that SSI does not ever acquire the right to take physical possession of the pharmaceutical products that it pays for. For reasons already given, the Panel does not consider taking physical possession of goods to be a constitutive element of a 'purchase'. However, while a purchaser need not necessarily exercise the right to take physical possession of the purchased goods for the transaction to be considered a purchase, the absence of any such right to take physical possession of the goods is a strong indicator that the entity paying for these goods has not acquired any right of ownership over them. This is especially so when the goods in question are in the nature of goods that can freely be transported and stored, such as pharmaceutical products.[262] The absence of any right for the SSI to take physical possession of the products it pays for stands in marked contrast to the rights of ownership acquired by retail pharmacies when purchasing pharmaceutical products from warehouses, and the rights of ownership acquired by outpatients when receiving those products from the retail pharmacies. In both cases, these purchasing entities acquire, and exercise, the right to take physical possession of the products in question.
>
> In addition, the Panel finds no basis to support Turkey's assertion that the SSI obtains the right to dispose of the pharmaceutical products that it pays for according to its own choices. Based on the parties' description of the process, it seems undisputed that, following approval in the Medula system, the pharmaceutical product in question must be provided to the individual consumer (i.e. outpatient) named in the prescription. According to the parties' description of the process, all relevant decisions

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[260] (*footnote original*) The point of disagreement between the parties is whether the SSI acquires intervening ownership of the product. The European Union argues that the pharmacy retains ownership and control of their stock, once purchased from wholesalers, until they are sold to patients, and that when sold to patients, there is "no doubt that patients obtain those products (including property over them)". (European Union's second written submission, paras. 106-107.) Turkey argues that the pharmacy retains ownership and control of their stock, once purchased from wholesalers, and that the SSI acquires the title to medicines listed in Annex 4/A and prescribed to patients at the moment the provision of such medicines is registered and approved in the Medula system and that, at that moment, the SSI acquires the right to dispose of those medicines by dispensing them, through the retail pharmacies, to patients, and "the title to those medicines is then immediately transferred to patients because the patients have the legal right to those medicines." (Turkey's closing statement, para. 23.)

[261] Panel Report, *Turkey – Pharmaceutical Products (EU)*, paras. 7.84-7.85.

[262] (*footnote original*) The Panel considers that pharmaceutical products are in the nature of goods that can freely be transported and stored in the sense that there are no physical, logistical or practical limitations on their transportation and storage of the type that may be encountered in the case of certain other types of goods – for instance, electricity. Of course, pharmaceutical products cannot be freely transported and stored in the sense of being unregulated products that can be freely bought and sold by anyone, and there are a range of legal and regulatory limitations on how they are transported and stored. As Turkey observes "[t]heir production and placing on the market are strictly regulated and their consumption is subject to the prescription by medical doctors. Their provision requires specific conditions and must be carried out by trained professionals, i.e. pharmacists. Medicines cannot be freely bought by consumers and cannot be treated as such." (Turkey's second written submission, para. 5.)

> and choices associated with the disposition of pharmaceutical products are made by the prescribing doctor, the pharmacy, and the ultimate consumer (i.e. the outpatient). The Panel is unable to discern any SSI involvement in choosing who receives and consumes any of the pharmaceutical products that the SSI pays for. Put differently, all of the pharmaceutical products paid for by the SSI would be disposed of in exactly the same manner in a counterfactual scenario in which the SSI did not pay for all or part of the cost of those products. Neither the SSI nor any other governmental agency plays any role in directing, or redirecting, pharmaceutical products to recipients of their choosing."[263]

230. The Panel in *Turkey – Pharmaceutical Products (EU)* stated that Article III:8(a) covers situations where a governmental agency purchases products through an intermediary, but underlined that such purchases should lead to the acquisition of ownership by the government:

> "The Panel agrees with Turkey that the terms of Article III:8(a) do not necessarily preclude a governmental agency from purchasing products through an 'intermediary'. However, the Panel considers that, to fall within the scope of Article III:8(a), a governmental purchase effected through an intermediary, and/or through the combined actions of several entities, must be conducted in a way that leads to the government acquiring ownership of the product purchased. In a situation in which a purchasing entity is an organ of the State (whether legislative, executive, or judicial), its acquisition of ownership over products entails that the government has acquired ownership over those products. Likewise, in the case of purchases made by a publicly owned and controlled entity, the government's ownership of the purchasing entity may entail the government also acquiring ownership over any products purchased by that publicly owned and controlled entity. A government may also enter into transactions through a private, arms-length third party entity that involve purchasing products and, insofar as the relevant transactions are structured and organized in a manner that results in the government acquiring ownership, that entity may well qualify as a 'governmental agency' for purposes of Article III:8(a). What is relevant in each of these cases is that the entity's purchases entail, or result in, government ownership over the products in question.
>
> To find otherwise would lead to the conclusion that Article III:8(a) would apply to purchases made by non-governmental, private entities despite the government never acquiring ownership over the products."[264]

231. The Panel did not consider Türkiye's arguments regarding SSI's control over the actions of retail pharmacies sufficient to demonstrate acquisition of ownership of the relevant pharmaceutical products by the SSI:

> "In the Panel's view, these disputed issues do not relate to the question whether the pharmacies' purchases from wholesalers entail or result in the SSI acquiring ownership over those products, and therefore are not directly relevant. Even if the Panel were to accept Turkey's assertion that the SSI controls all the elements concerning the acquisition of pharmaceutical products included in the Annex 4/A list, to such an extent that it could be said that the SSI instructs and directs pharmacies what to do, this would not make pharmacies 'governmental agencies' for the purposes of Article III:8(a), or transform their purchases into purchases by the government, so long as the pharmacies acquire ownership over pharmaceutical products independently of the government.
>
> To find otherwise would imply that if private parties are instructed or directed by a government to purchase certain products, the act of instruction or direction would make those private parties 'governmental agencies' with the result that their purchases would then be covered by Article III:8(a). If that were correct, then it would follow that all domestic content requirements imposed by governments on private entities would fall within the scope of Article III:8(a) because the measure imposing the requirement – be it a general law, regulation or requirement, or an

[263] Panel Report, *Turkey – Pharmaceutical Products (EU)*, paras. 7.86-7.87.
[264] Panel Report, *Turkey – Pharmaceutical Products (EU)*, paras. 7.96-7.97.

> individual contractual arrangement – would have the effect of turning those entities into 'governmental agencies' for purposes of Article III:8(a)."[265]

232. The Panel also pointed to the absurdity of the view that a private entity should be deemed a governmental agency each time it is directed by the government to purchase certain products:

> "Indeed, if it were correct to reason that a private entity should be deemed to be a 'governmental agency' whenever it is instructed or directed by the government to purchase certain products, then it would follow, by way of illustrative example, that private electricity generators subjected to certain domestic content requirements on generation equipment were themselves 'governmental agencies' acting on behalf of the government. This would, of course, stand in direct contradiction to what the panels and Appellate Body found in previous cases under Article III:8(a)."[266]

233. In the *ad hoc* appeal arbitration under Article 25 of the DSU in *Turkey – Pharmaceutical Products (EU)*, the Arbitrator stated that Article III:8(a) does not necessarily exclude situations where the relevant products are purchased by an entity other than the government provided that the procurement is by a governmental agency:

> "Importantly, nothing in the text of Article III:8(a) explicitly specifies which entity purchases products for the purposes of government procurement. When a provision omits to further qualify an action, this can serve as an indication that no limitation is intended to be imposed on the manner or circumstances in which such action may be taken. If we were to read into Article III:8(a) a requirement that a purchase necessarily needs to be made by a governmental agency, we would be adding to the text of Article III:8(a) or moving the preposition 'by governmental agencies' to relate to the words 'products purchased' in this provision. The text and structure of the phrase 'procurement by governmental agencies of products purchased' together with the contextual elements discussed above suggest to us that while a typical government procurement scenario under Article III:8(a) would involve a purchase by governmental agencies of the products being procured, there is no such requirement in Article III:8(a). We cannot exclude that another entity may purchase the relevant products, so long as there is procurement by a governmental agency and procurement of products purchased for governmental purposes."[267]

234. The Arbitrator noted, however, that this view does not extend the scope of the derogation found in Article III:8(a):

> "We emphasize that, for the derogation in Article III:8(a) to apply, different requirements need to be met. In particular, Article III:8(a) requires a *procurement by governmental agencies* of products purchased *for governmental purposes*. Our interpretation set out above does not extend the scope of the derogation contained in Article III:8(a) beyond what is set by the provision itself. In other words, Article III:8(a) would not extend to an open-ended range of protectionist measures and allow Members to circumvent their national treatment obligations, simply because the possibility is not excluded that, in certain circumstances, the relevant purchase transaction might be entered into by a non-governmental agency. Our understanding takes into account the fundamental purpose of Article III to avoid protectionism in the application of internal tax and regulatory measures and reflects the carefully drafted balance between the national treatment obligation under Article III and the derogation contained in Article III:8(a)."[268]

235. On this basis, the Arbitrator found that the Panel had erred by basing its interpretation on the notion that Article III:8(a) requires a purchase by governmental agencies:

> "For the reasons set out above, we consider that the 'procurement by governmental agencies of products purchased for governmental purposes' would typically involve the

[265] Panel Report, *Turkey – Pharmaceutical Products (EU)*, paras. 7.100-7.101.
[266] Panel Report, *Turkey – Pharmaceutical Products (EU)*, para. 7.102.
[267] Award of the Arbitrators, *Turkey – Pharmaceutical Products (EU)*, para. 6.46.
[268] Award of the Arbitrators, *Turkey – Pharmaceutical Products (EU)*, para. 6.47.

> procurement of products through a *purchase by* a governmental agency. However, Article III:8(a) does not contain an unequivocal requirement to that effect. We do not foreclose the possibility that, in certain circumstances, the relevant purchase transaction may be entered into by a non-governmental entity so long as the products are *procured by* a governmental agency and procurement is of products purchased for governmental purposes. We therefore find that the Panel erred in considering, as a starting point for its analysis in paragraph 7.65 of the Panel Report, that Article III:8(a) required a *purchase by* governmental agencies."[269]

236. The Arbitrator came to the same conclusion as the Panel, albeit on different legal reasoning.[270] In response to Türkiye's argument that the SSI controlled the process of obtaining and dispensing the medicines at issue, the Arbitrator stated that procurement by a government can be made through an intermediary. However, the Arbitrator noted that Türkiye had not pointed to evidence showing SSI's alleged control:

> "Türkiye points to the level of control of the SSI over the retail pharmacies. Türkiye argues that 'the SSI controls the entire process of obtaining and dispensing medicines included in Annex 4/A to patients.' While we do not exclude that procurement by a governmental agency may occur through an intermediary, it remains that, for the purposes of the derogation under Article III:8(a), there needs to be a process whereby governmental agencies acquire or obtain products purchased for governmental purposes. Türkiye did not explain how, through any such alleged control, the SSI would acquire or obtain medicines through a purchase of medicines. Türkiye has not pointed to elements showing a sufficient level of control by the SSI over the pharmaceutical products included in the Annex 4/A list when they are purchased by the retail pharmacies or otherwise. … We also recall the Panel's factual finding that all relevant decisions and choices associated with the disposition of pharmaceutical products are made by the prescribing doctor, the pharmacy, and the ultimate consumer, without SSI involvement: '[A]ll of the pharmaceutical products paid for by the SSI would be disposed of in exactly the same manner in a counterfactual scenario in which the SSI did not pay for all or part of the cost of those products.'
>
> In our view, the various elements set out above, taken together, indicate that there is no procurement by the SSI of products purchased for governmental purposes, whether at the moment when retail pharmacies purchase products from wholesalers or otherwise."[271]

Competitive relationship

237. The Appellate Body in *Canada – Renewable Energy / Canada – Feed-in Tariff Program* observed that Article III:8(a) "becomes relevant only if there is discriminatory treatment of foreign products that are covered by the obligations in Article III". The Appellate Body added that the scope of Article III:8(a) extends to products purchased that are "like" products under Article III:2 and Article III:4 or to products that are "directly competitive" or "substitutable" in accordance with the *Ad* Note to Article III:2:

> "Because Article III:8(a) is a derogation from the obligations contained in other paragraphs of Article III, we consider that the same discriminatory treatment must be considered both with respect to the obligations of Article III and with respect to the derogation of Article III:8(a). Accordingly, the scope of the terms 'products purchased' in Article III:8(a) is informed by the scope of 'products' referred to in the obligations set out in other paragraphs of Article III. Article III:8(a) thus concerns, in the first instance, the product that is subject to the discrimination. The coverage of Article III:8 extends not only to products that are identical to the product that is purchased, but also to 'like' products. In accordance with the *Ad* Note to Article III:2, it also extends to products that are directly competitive to or substitutable with the product purchased under the challenged measure. For convenience, this range of

[269] Award of the Arbitrators, *Turkey – Pharmaceutical Products (EU)*, para. 6.49.
[270] Award of the Arbitrators, *Turkey – Pharmaceutical Products (EU)*, para. 6.69.
[271] Award of the Arbitrators, *Turkey – Pharmaceutical Products (EU)*, paras. 6.67-6.68.

> products can be described as products that are in a competitive relationship. What constitutes a competitive relationship between products may require consideration of inputs and processes of production used to produce the product."[272]

238. In *India – Solar Cells*, the Appellate Body clarified that the use of the term "competitive relationship" is "shorthand for delineating the scope of 'like'[] or 'directly competitive of substitutable'" products:

> "In other words, since 'the derogation of Article III:8(a) must be understood in relation to the obligations stipulated in Article III', the product of foreign origin must be either 'like', or 'directly competitive' with or 'substitutable' for – i.e. in a 'competitive relationship' with – 'the product purchased'. We do not consider that the scope of a derogation can extend beyond the scope of the obligation from which derogation is sought."[273]

239. In *India – Solar Cells*, India argued that Article III:8(a) does not require an assessment of the "competitive relationship" between the product procured and the one discriminated against in all cases. India asserted that the Appellate Body in *Canada – Renewable Energy / Canada Feed-in Tariff* left open the possibility of an alternative standard to a situation involving discrimination against "inputs and processes of production". Because the measures at issue – a requirement to use domestically sourced generation equipment to achieve the necessary level of domestic content – were not "distinguishable in any relevant respect from those examined by the Appellate Body" in the earlier dispute, the Panel did not find it necessary to further address India's argument. However, on appeal, India reasserted its original argument and contended the Panel had erred insofar as the competitive relationship test "is not a single inflexible rule to be applied in all circumstances for consideration under Article III".[274] The Appellate Body recalled its findings in *Canada – Renewable Energy / Canada – Feed-in Tariff* and disagreed with India's interpretation of its findings:

> "On appeal in this dispute, India argues that the Appellate Body in *Canada – Renewable Energy / Canada – Feed-in Tariff Program* suggested that the scope of Article III:8(a) may extend, in some cases, to 'inputs' and 'processes of production', regardless of whether the product subject to discrimination is in a competitive relationship with the product purchased. We disagree with India's reading of the Appellate Body report in *Canada – Renewable Energy / [Canada –] Feed-in Tariff Program*. The Appellate Body explicitly stated that it was not deciding whether 'the cover of Article III:8(a) may also extend to discrimination relating to inputs and processes of production used in respect of products purchased by way of procurement.' This question arises only after the product subject to discrimination has been found to be like, directly competitive with, or substitutable for – in other words, in a competitive relationship with – the product purchased. In respect of the latter issue, although a consideration of inputs and processes of production may inform the question of whether the product purchased is in a competitive relationship with the product being discriminated against, it does not displace the competitive relationship standard. Under Article III:8(a) of the GATT 1994, the foreign product discriminated against must necessarily be in a competitive relationship with the product purchased by way of procurement.
>
> … We have rejected India's reading of Article III:8(a) above and have found that a competitive relationship between the product discriminated against and the product purchased must be established in all cases."[275]

[272] Appellate Body Report, *Canada – Renewable Energy / Canada – Feed-in Tariff Program*, para. 5.63.
[273] Appellate Body Report, *India – Solar Cells*, para. 5.22. See also Appellate Body Reports, *Canada – Renewable Energy / Canada – Feed-in Tariff Program*, para. 5.74.
[274] Appellate Body Report, *India – Solar Cells*, para. 5.19.
[275] Appellate Body Report, *India – Solar Cells*, paras. 5.24-5.25.

Item (b)

General

240. The Panel in *EC and certain member States – Large Civil Aircraft* characterized Article III:8(b) as follows:

> "In effect, Article III:8(b) of the GATT 1994 confirms that, without more, the mere payment of subsidies to firms so long as they engage in domestic production activities should not be interpreted as imparting to such subsidies a discriminatory element as among domestic and foreign goods in a manner that Article III may discipline. Indeed, if this were not the case, then it appears that the only way for a WTO Member to avoid a payment of subsidies being prohibited under WTO law would be to offer the subsidy payments to firms worldwide. We recall that Article III:4 of the GATT 1994 – like Article 3.1(b) of the SCM Agreement – prohibits subsidies that are contingent on the use of domestic over imported goods, notwithstanding the presence of Article III:8(b) of the GATT 1994. This suggests that the act of granting subsidies to firms so long as they engage in domestic production activities, without more, should not be equated to making those subsidies contingent on the use of domestic over imported goods and hence prohibited.[276]"[277]

"the payment of subsidies exclusively to domestic producers"

241. In the *Canada – Periodicals* dispute, one of the measures at issue related to postal rates charged by the Canadian Post Corporation, a Crown Corporation controlled by the Canadian Government. Canada Post applied reduced postal rates to Canadian-owned and Canadian-controlled periodicals meeting certain requirements. These lower postal rates were funded by the Department of Canadian Heritage, which provided funds to Canada Post so that this agency could in turn offer the reduced postal rates to eligible Canadian periodicals. Canada argued that the reduced postal rate was exempted from the strictures of Article III:4 by virtue of Article III:8(b), because the reduced postal rate represented "payment of subsidies exclusively to domestic producers". The Panel agreed with Canada and found that the funds provided by the Department of Canadian Heritage passed through Canada Post directly to the eligible Canadian publishers and that therefore, Canada's funded rate scheme on periodicals qualified under Article III:8 (b). The Appellate Body reversed the Panel's finding and found that Article III:8(b) applied only to the payment of subsidies which involve the expenditure of revenue by a government:

> "In examining the text of Article III:8(b), we believe that the phrase, 'including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article and subsidies effected through governmental purchases of domestic products' helps to elucidate the types of subsidies covered by Article III:8(b) of the GATT 1994. It is not an exhaustive list of the kinds of programmes that would qualify as 'the payment of subsidies exclusively to domestic producers', but those words exemplify the kinds of programmes which are exempted from the obligations of Articles III:2 and III:4 of the GATT 1994.
>
> Our textual interpretation is supported by the context of Article III:8(b) examined in relation to Articles III:2 and III:4 of the GATT 1994. Furthermore, the object and purpose of Article III:8(b) is confirmed by the drafting history of Article III. In this context, we refer to the following discussion in the Reports of the Committees and Principal Sub-Committees of the Interim Commission for the International Trade Organization concerning the provision of the Havana Charter for an International Trade Organization that corresponds to Article III:8(b) of the GATT 1994:

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[276] *(footnote original)* To be clear, in noting this suggestion, we need not address, let alone resolve, the question of whether Article III:8(b) is an exemption, which clarifies that Article III is inherently inapplicable to subsidies paid exclusively to domestic producers, or an exception, which removes from the scope of Article III:4 measures that would otherwise be covered by that provision.

[277] Panel Report, *EC and certain member States – Large Civil Aircraft*, para. 6.785. See also Panel Report, *US – Tax Incentives*, para. 7.357; Appellate Body Report, *US – Tax Incentives*, para. 5.16.

> 'This sub-paragraph was redrafted in order to make it clear that nothing in Article 18 could be construed to sanction the exemption of domestic products from internal taxes imposed on like imported products or the remission of such taxes. At the same time the Sub-Committee recorded its view that nothing in this sub-paragraph or elsewhere in Article 18 would override the provisions of Section C of Chapter IV.'
>
> We do not see a reason to distinguish a reduction of tax rates on a product from a reduction in transportation or postal rates. Indeed, an examination of the text, context, and object and purpose of Article III:8(b) suggests that it was intended to exempt from the obligations of Article III only the payment of subsidies which involves the expenditure of revenue by a government."[278]

242. In *Indonesia – Autos*, the Panel examined the consistency of certain tax exemption to domestically produced automobiles. The Panel rejected Indonesia's argument that tax exemptions are excluded from the scope of Article III by virtue of Article III:8(b), stating:

> "Indonesia maintains the view that 'the payment of subsidies' in Article III:8(b) of GATT must refer to all subsidies identified in Article 1 of the SCM Agreement, not merely to the subset of 'direct' subsidies. Under this approach, any measure which constitutes a subsidy within the meaning of the SCM Agreement would not be subject to Article III of GATT. In Indonesia's view, only this interpretation avoids rendering the SCM Agreement meaningless.
>
> …
>
> We consider that the purpose of Article III:8(b) is to confirm that subsidies to producers do not violate Article III, so long as they do not have any component that introduces discrimination between imported and domestic products. In our view the wording 'payment of subsidies exclusively to domestic producers' exists so as to ensure that only subsidies provided to producers, and not tax or other forms of discrimination on products, be considered subsidies for the purpose of Article III:8(b) of GATT. This is in line with previous GATT panels and WTO Appellate Body reports."[279]

243. In coming to this conclusion, the Panel in *Indonesia – Autos* found support in the negotiating history of Article III:8(b):

> "We recall also that the type of interpretation sought by Indonesia was explicitly excluded by the drafters of Article III:8(b) when they rejected a proposal by Cuba at the Havana Conference to amend the Article so as to read:
>
> > 'The provisions of this Article shall not preclude the exemption of domestic products from internal taxes as a means of indirect subsidization in the cases covered under Article [XVI]'.
>
> The arguments submitted by Indonesia that its measures are only governed by the SCM Agreement clearly do not find any support in the wording of Article III:8(b) of GATT. On the contrary, Article III:8(b) confirms that the obligations of Article III and those of Article XVI (and the SCM Agreement) are different and complementary: subsidies to producers are subject to the national treatment provisions of Article III when they discriminate between imported and domestic products."[280]

244. In *EC – Commercial Vessels*, Korea alleged that the disputed EC regulations (the TDM Regulation and related measures) were in breach of the national treatment requirement of Article III:4, Korea submitted that the state aid provided for by the TDM Regulation fell within the scope of this provision as a measure "affecting the internal sale" of imported products and that it

[278] Appellate Body Report, *Canada – Periodicals*, pp. 33-34.
[279] Panel Report, *Indonesia – Autos*, paras. 14.41 and 14.43.
[280] Panel Report, *Indonesia – Autos*, paras. 14.44-14.45.

amounted to less favourable treatment within the meaning of Article III:4 because it clearly reduced the competitive opportunities of Korean products, as compared with domestic products. Korea also argued that Article III:8(b) only applies to domestic subsidy programmes of a general nature and does not apply to the kind of targeted aid scheme at issue in this case.

245. The Panel in *EC – Commercial Vessels* found that the subsidies authorized under the TDM Regulation were covered by the notion of "the payment of subsidies exclusively to domestic producers" in Article III:8(b), and thus were not "prevented" by Article III. The Panel considered in this respect that there was no support in the text and context of Article III:8(b) for the position of Korea that the targeted nature of these subsidies made Article III:8(b) inapplicable:

> "Korea also argues that the TDM Regulation is not covered by Article III:8(b) because the subsidies it provides for are not general in nature. The Panel, however, can see no basis in the text of Article III:8(b) for the proposition that its applicability depends not only upon whether a measure constitutes 'the payment of subsidies exclusively to domestic producers', but also upon whether that measure serves 'the general public purposes of economic development'. The Panel also notes that Korea has failed to explain how this argument is supported by the text, context or object and purpose of Article III:8(b)."[281]

246. The Panel in *EC – Commercial Vessels* also rejected Korea's distinction between the formal recipient and ultimate beneficiary of a subsidy in assessing its consistency with Article III:3(b), and found the challenged measure to be consistent with that provision:

> "The Panel notes that Korea argues, although not specifically in connection with Article III:8(b), that the formal recipient of the subsidies provided for under the TDM Regulation is irrelevant because the ultimate beneficiary of the subsidy is the ship-owner. The Panel can find no textual support in Article III:8(b) for the view that a distinction must be made, for purposes of application of that provision, between the 'formal recipient' and the 'ultimate beneficiary' of a subsidy solely on the grounds that the subsidy allows the producer to sell a product at a lower price. Indeed, were such a price effect a sufficient basis to conclude that a subsidy is not a 'payment of subsidies exclusively to domestic producers', Article III:8(b) would be deprived of its effectiveness as production subsidies can have such an effect in many instances.
>
> In short, while the Panel realizes that the state aid provided for by the TDM Regulation may adversely affect the conditions of competition between domestic and Korean products, that effect is not relevant to whether Article III:8(b) applies to the aid.
>
> The Panel concludes that the state aid provided for by the TDM Regulation is covered by Article III:8(b) of the GATT 1994 and that, as a consequence, the TDM Regulation is not inconsistent with Article III:4 of the GATT 1994."[282]

247. The Appellate Body in *Brazil – Taxation,* in analysing the legal standard under Article III:8(b), held that, in contrast with Article III:8(a) which amounts to a derogation, "Article III:8(b) provides a *justification* for measures that would otherwise be inconsistent with the national treatment obligation in Article III".[283] The Appellate Body then turned to interpret the term "payment of subsidies" as used in this provision:

> "An examination of the text and context of Article III:8(b), as supported by its negotiating history, therefore suggests that the term 'payment of subsidies' in Article III:8(b) does not include within its scope the exemption or reduction of internal taxes applied, directly or indirectly, on domestic products. Instead, as the Appellate Body has observed, Article III:8(b) 'was intended to exempt from the obligations of Article III only the payment of subsidies which involves the expenditure of revenue by a government'."[284]

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[281] Panel on *EC – Commercial Vessels*, para. 7.72.
[282] Panel Report, *EC – Commercial Vessels*, paras. 7.73-7.75.
[283] Appellate Body Reports, *Brazil – Taxation*, para. 5.84.
[284] Appellate Body Reports, *Brazil – Taxation*, para. 5.92.

248. In *Brazil – Taxation*, one Appellate Body Member expressed a separate opinion with respect to the interpretation of the term "payment of subsidies" under Article III:8(b). In contrast with the majority view that found "payment of subsidies" to include only instances of expenditure of revenue by the government, this Member expressed the view that this term entails all of subsidies granted by a government, through either monetary or non-monetary transfers. In this Member's view, only the latter interpretation respects the balance of rights and obligations under the SCM Agreement, which, together with the GATT 1994, forms part of the WTO Agreement:

> "An interpretation of 'payment of subsidies' in Article III:8(b) as excluding revenue foregone would undermine, inconsistently with Article 3.2 of the DSU as well as the fundamental principle of effectiveness in treaty interpretation, the careful balance of rights and obligations under the SCM Agreement with respect to an entire category of measures that are expressly included within the definition of a subsidy in Article 1.1, namely, the foregoing of government revenue that is otherwise due. In other words, the majority's interpretation of the term 'payment of subsidies' in Article III:8(b) would fundamentally alter the carefully constructed balance of rights and obligations under the SCM Agreement and the GATT 1994 with respect to subsidies and would risk rendering redundant the actionable subsidies disciplines of the SCM Agreement insofar as subsidies in the form of the foregoing of revenue are concerned.
>
> For the above reasons, I am of the view that the term 'payment of subsidies' in Article III:8(b) refers to the provision by a WTO Member, whether through monetary or non-monetary transfers having an equivalent effect, of a subsidy, as defined in Article 1.1 of the SCM Agreement. In my view, this is the only interpretation that, consistently with the customary rules of treaty interpretation, gives meaning and effect to the precise terms of Article III:8(b), while at the same time respecting the carefully negotiated balance of rights and obligations under the SCM Agreement, which forms part of the single package under the WTO Agreement. Insofar as they constitute the 'payment of subsidies exclusively to domestic producers'[285], the measures at issue in this dispute, as well as any conditions for eligibility for the payment of subsidies that define the class of eligible 'domestic producers' by reference to their activities in the subsidized products' markets, would, in my view, be justified under Article III:8(b)."[286]

249. In examining the immediate context for the term "payment of subsidies", the Appellate Body in *Brazil – Taxation* clarified that it is not the payment of subsidies that must be consistent with the obligations under Article III, rather the internal taxes from which the payment of subsidies is derived:

> "The text of the first example, namely, 'payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of [Article III]', makes it clear that it is not the payment of subsidies that must be consistent with the obligations under Article III of the GATT. Instead, it is the internal taxes applied to products, the proceeds of which are used for the payment of subsidies, which must be consistent with the obligations under Article III.[287] When these internal taxes are applied in a manner consistent with Article III, the proceeds derived from such taxes may be used for payments of subsidies exclusively to domestic producers, and such payments of subsidies, as well as any resulting discrimination against like imported products, will be justified under Article III:8(b). However, when the internal taxes are higher on imported products than on like domestic products, or otherwise accord less favourable treatment to imported products, and are thus inconsistent with Article III, the payment of subsidies derived from the proceeds of such GATT-inconsistent taxes would not be justified under Article III:8(b). In other words, the text of the first example suggests that subsidies that are paid through the proceeds of discriminatory internal taxes applied, directly or indirectly, on products continue

[285] *(footnote original)* As correctly noted by the majority, in addition to the scope of "payment of subsidies", the focus of inquiry under Article III:8(b) is also on whether the domestic entity at issue is a *producer* of the product with respect to which a violation of the national treatment obligation arising from the "payment of subsidies" is alleged.

[286] Appellate Body Reports, *Brazil – Taxation*, paras. 5.137-5.138.

[287] *(footnote original)* We note that subsidies to domestic producers can be paid in product markets other than those from which the tax proceeds are derived.

> to be subject to the obligations in Article III.[288] We note in this regard that the Appellate Body in *Canada – Periodicals* agreed with the GATT panel in *US – Malt Beverages* that, '[e]ven if the proceeds from non-discriminatory product taxes may be used for subsequent subsidies, the domestic producer, like his foreign competitors, must pay the product taxes due.'"[289]

250. The Appellate Body then turned to analyse the phrase "exclusively to domestic suppliers". According to the Appellate Body, "the use of the term 'exclusively' therefore indicates that Article III:8(b) exempts from the disciplines of Article III those 'payments of subsidies' that are made solely to domestic producers, to the exclusion of foreign producers."[290] The Appellate Body went on to add that:

> "[T]o the extent that the payment of subsidies exclusively to domestic producers of a given product affects the conditions of competition between such a product and the like imported product, resulting in an inconsistency with the national treatment obligation in Article III, such a payment would be justified under the exception contained in Article III:8(b), provided that the conditions thereunder are met."[291]

251. However, the Appellate Body made a distinction between subsidies falling within the scope of Article III:8(b) and those requiring the use of domestic over imported goods:

> "Moreover, besides the effect of the payment of subsidies exclusively to domestic producers on the conditions of competition in the relevant product market(s), there will often be conditions for eligibility that attach to such payments. For instance, insofar as Article III:8(b) justifies the payment by WTO Members of subsidies exclusively to domestic producers, conditions for eligibility that define the class of eligible 'domestic producers' by reference to their activities in the subsidized products' markets would be justified under Article III:8(b). By contrast, a requirement to use domestic over imported goods in order to have access to the subsidy may, however, not be covered by the exception in Article III:8(b) and would therefore continue to be subject to the national treatment obligation in Article III. This is because, while the payment of subsidies and certain eligibility criteria may affect the conditions of competition between the product produced by the producer receiving the subsidy and the like imported products, a requirement to use domestic products in order to have access to the subsidy would impact the conditions of competition between a *different set of domestic and like imported products*, namely, the domestic product whose use is mandated and the like imported product."[292]

252. The Appellate Body in *Brazil – Taxation* emphasised that for Article III:8(b) to serve as justification, the entities receiving the subsidy have to be "producers":

> "Turning to the term 'domestic producers', as used in Article III:8(b), we note that the dictionary meaning of 'producer' is '[a] person who … produces (in various senses)'. The scope of Article III:8(b) suggests that the focus of inquiry under that provision ought to be on whether the domestic entity at issue is a *producer* of the product with respect to which a violation of the national treatment obligation arising from the 'payment of subsidies' is alleged. This is because Article III:8(b) serves as a justification only for discrimination resulting from the effects of the payment of a subsidy on the conditions of competition in the relevant product market(s). Therefore, whether a domestic entity is a 'domestic producer' within the meaning of Article III:8(b) is a question that must be answered in light of the

[288] *(footnote original)* Giving due importance to the examples means that one cannot accept that the opposite of the situation reflected in the first example, namely the payment of subsidies derived from proceeds of taxes applied *inconsistently* with Article III, would also be covered by Article III:8(b). One cannot but understand the inclusion in the scope of Article III:8(b) of payments of subsidies derived from proceeds of taxes *consistent* with Article III as the exclusion from the scope of Article III:8(b) of payments of subsidies derived from proceeds of taxes *inconsistent* with Article III.

[289] Appellate Body Reports, *Brazil – Taxation*, para. 5.89.

[290] Appellate Body Reports, *Brazil – Taxation,* para. 5.93.

[291] Appellate Body Reports, *Brazil – Taxation,* para. 5.94.

[292] Appellate Body Reports, *Brazil – Taxation,* para. 5.95.

> specific facts and circumstances of a given case, including the nature of discrimination that is alleged."[293]

253. The Appellate Body in *Brazil – Taxation* agreed with the Panel's preliminary view that the "exclusive provision of subsidies (or any eventual effects therefrom in the domestic market) does not by itself constitute discriminatory treatment in respect of imported products of the type prohibited by Article III".[294] However, the Appellate Body found certain findings by the Panel too broad, and reversed them:

> "Although the Panel did, at an early stage of its analysis, acknowledge that the payment of subsidies exclusively to domestic producers (and the resulting market effects) does not by itself constitute discriminatory treatment with respect to imported products of the type prohibited by Article III, the Panel's interpretation of Article III:8(b) and its application to the measures at issue obfuscate the distinction between the effects of the payment of a subsidy to a domestic producer on the conditions of competition in the relevant product market(s) and the conditions for eligibility attaching thereto, on the one hand, and any other effects arising from requirements to use domestic over imported inputs in the production process, on the other hand. Moreover, at no stage did the Panel undertake an assessment of whether the measures at issue constitute the 'payment of subsidies exclusively to domestic producers' within the meaning of Article III:8(b). Because of these shortcomings in the Panel's reasoning, we reverse the Panel's overly broad and unqualified findings that 'subsidies that are provided exclusively to domestic producers pursuant to Article III:8(b) of the GATT 1994 are not *per se* exempted from the disciplines of Article III of the GATT 1994' and that 'aspects of a subsidy resulting in product discrimination (including requirements to use domestic goods, as prohibited by Article 3.1 of the SCM Agreement) are not exempted from the disciplines of Article III pursuant to Article III:8(b).'
>
> Under a proper interpretation of Article III:8(b), none of the measures at issue in this dispute is capable of being justified under that provision because they all involve the exemption or reduction of internal taxes affecting the conditions of competition between like products and therefore cannot constitute the 'payment of subsidies' within the meaning of Article III:8(b)."[295]

Relationship of Article III with other GATT provisions

Article I

254. See the Section on Article I.

255. The Panel in *US – Gasoline* did not examine a claim under Article I of the GATT 1994, considering that it was unnecessary in view of the findings it had reached on the violation of Article III:4 for the subject measure.[296]

256. The Panel in *EC – Commercial Vessels* considered the effect of Article III:8(b) on the phrase "matter referred to in paragraphs 2 and 4 of Article III", which is to be found in Article I.

Article II

257. See the Section on Article II of the GATT 1994.

258. In *EC – Bananas III*, the Appellate Body found the EC import licensing system for bananas inconsistent with Article III:4. The European Communities claimed that Article III:4 was not applicable to the import licensing system because it was a border measure. The Appellate Body noted the existence of the "operator category rules" and the "activity function rules", which both affected the allocation of licences. The Appellate Body held that "these rules go far beyond the

[293] Appellate Body Reports, *Brazil – Taxation,* para. 5.96.
[294] Appellate Body Reports, *Brazil – Taxation,* para. 5.108.
[295] Appellate Body Reports, *Brazil – Taxation,* paras. 5.123-5.124.
[296] Panel Report, *US – Gasoline*, para. 6.19.

mere import licence requirements needed to administer the tariff quota … and therefore fall within the scope of [Article III:4]".[297]

259. Exercising judicial economy, the Panel in *Korea – Various Measures on Beef* did not examine claims regarding a certain practice of the Korean state trading agency for beef under Articles III:4 and XVII after having found a violation of Articles XI and II:1(a) for that practice.[298]

Article VI

260. In *US – 1916 Act (EC)*, exercising judicial economy, the Panel found that the US statute was inconsistent with Article VI and did not examine the EC claim that it was also inconsistent with Article III. The Appellate Body did not address the issue upon appeal. The Panel first stated that Article VI was, with respect to the 1916 Act, the more specific provision, such that it had to be addressed first:

> "It is a general principle of international law that, when applying a body of norms to a given factual situation, one should consider that factual situation under the norm which most specifically addresses it. As a result, one way to reply to the question above is to determine which article more specifically addresses the 1916 Act. We agree that this will require us to touch upon the substance of the case, but we recall that this test is used here for purely procedural reasons, that is to determine the order of our review. Such a *prima facie* analysis is, of course, without prejudice to the final findings on the issue of the applicability of Articles III:4 and VI, to be reached after a more detailed review of the scope of each provision, as necessary.
>
> As mentioned above, our understanding is that Article III:4 and Article VI are based on two different premises. The applicability of Article III:4 seems to depend primarily on whether the measure applied pursuant to the law at issue is an internal measure or not. In contrast, the applicability of Article VI seems to be based on the nature of the trade practice which is addressed. Under Article VI, the type of sanction eventually applied does not seem to be relevant for a measure to be considered as an anti-dumping measure, or not. We note in this respect that, for the EC, the fact that the 1916 Act imposes other sanctions than duties is insufficient to make that law fall outside the scope of Article VI and, for the United States, under Article VI, dumping does not have to be counteracted exclusively with duties. Consequently, it seems to us that the fact that a law imposes measures that can be qualified as 'internal measures', such as fines, damages or imprisonment, does not appear to be sufficient to conclude that Article VI is not applicable to that law.
>
> We also note that the parties agree that the 1916 Act deals with transnational price discrimination. Furthermore, the United States argues that it does not merely address dumping, and that other requirements under the 1916 Act make that law fall outside the scope of Article VI. We note that Article III:4 states that imported products
>
> > 'shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.'"[299]

261. The Panel held that damages, fines or imprisonment could theoretically accord less favourable treatment to imported products, but opined that the terms of Article III:4 were less specific than Article VI with respect to the case before it:

> "Determining that damages, fines or imprisonment, which are imposed on persons, may accord less favourable treatment to imported products with respect to their internal sale, offering for sale, purchase, transportation, distribution or use, is not *a priori* impossible and has actually been done by previous panels. However, a

[297] Appellate Body Report, *EC – Bananas III*, para. 211.
[298] Panel Report, *Korea – Various Measures on Beef*, para. 7.80.
[299] Panel Report, *US – 1916 Act (EC)*, paras. 6.76-6.78; Panel Report, *US – 1916 Act (Japan)*, paras. 6.75-6.76.

> preliminary examination of the scope of application of Article III:4 (i.e. internal sale, offering for sale, purchase, transportation, distribution or use) would tend to show that the terms of Article III:4 are less specific than those of Article VI when it comes to the notion of transnational price discrimination.
>
> In application of the principle recalled by the Appellate Body *in European Communities – Bananas* and by the Permanent Court of International Justice in the *Serbian Loans* case, there would be reasons to reach the preliminary conclusion that we should review the applicability of Article VI to the 1916 Act in priority, as that article apparently applies to the facts at issue more specifically. This preliminary conclusion is based on our understanding of the arguments of the parties and on a preliminary review of the terms of Articles III:4 and VI. Since the fact that the 1916 Act provides for the imposition of internal measures does not seem to be sufficient as such to differentiate the scope of application of Article III:4 and that of Article VI, we had to consider the other terms of these articles."[300]

262. The Panel in *US – 1916 Act (EC)* then held, after finding that the 1916 Act fell under the scope, and was in violation of, Article VI, that it was no longer necessary to consider whether some elements of the 1916 Act could also be subject to Article III:4:

> "We recall that we decided to proceed first with a review of whether Article VI applied to the 1916 Act because Article VI seemed to address more specifically the terms of the 1916 Act. We found that the 1916 Act, because it targets 'dumping' within the meaning of Article VI of the GATT 1994, was fully subject to the provisions of Article VI of the GATT 1994 and the Anti-Dumping Agreement and could not evade the disciplines of Article VI by the mere fact that it had anti-trust objectives or included requirements of an anti-trust nature. We therefore find it unnecessary to determine whether some elements of the 1916 Act could be subject to Article III:4.
>
> We also found that the 1916 Act violates the provisions of Article VI and certain provisions of the Anti-Dumping Agreement. We consider these findings sufficiently complete to enable the DSB to make sufficiently precise recommendations and rulings so as to allow for prompt compliance 'in order to ensure effective resolution of disputes to the benefit of all Members.' Therefore, we are entitled to exercise judicial economy in accordance with WTO panel and Appellate Body practice and decide not to review the EC claims under Article III:4."[301]

263. The Panel in *US – 1916 Act (Japan)* further elaborated on the precise relationship between Article VI and Article III:

> "When we considered the relationship between Article VI and Article III:4 of the GATT 1994, we noted that Article VI seemed to address the basic feature of the 1916 Act (i.e. transnational price discrimination) more directly than Article III:4. In our findings, we concluded that Article VI applies to a measure whenever that measure objectively addresses a situation of transnational price discrimination, as defined in Article VI:1. Thus, we found that the 1916 Act was *fully* subject to the provisions of Article VI of the GATT 1994 and the Anti-Dumping Agreement and could not escape the disciplines of Article VI by the mere fact that it had anti-trust objectives, did not address *injurious dumping* as such, included additional requirements of an anti-trust nature or led to the imposition of measures other than anti-dumping duties that were not border adjustment measures.
>
> However, even though we considered that Article VI deals specifically with the type of price discrimination at issue, we did not address the question whether Article VI applied to the 1916 Act *to the exclusion* of Article III:4. In this regard, we recall that, in its report on *European Communities – Bananas*, the Appellate Body noted that:

[300] Panel Report, *US – 1916 Act (EC)*, paras. 6.78-6.79; Panel Report, *US – 1916 Act (Japan)*, paras. 6.76-6.77.
[301] Panel Report, *US – 1916 Act (EC)*, paras. 6.219-6.220.

> 'Although Article X:3(a) of the GATT 1994 and Article 1.3 of the *Licensing Agreement* both apply, the Panel, in our view, should have applied the *Licensing Agreement* first, since this agreement deals specifically, and in detail, with the administration of import licensing procedures. If the Panel had done so, then there would have been no need for it to address the alleged inconsistency with Article X:3(a) of the GATT 1994.'"[302]

264. After recalling the findings of the Appellate Body in *EC – Bananas III*, the Panel in *US – 1916 Act* went on to distinguish the subject-matter at issue in that case from the case before it. The Appellate Body did not address the finding of the Panel that it was entitled to exercise judicial economy with respect to the claims under Article III:4:

> "We are mindful of the fact that Article X:3(a) of the GATT 1994 deals with the way domestic trade laws in general should be applied, whereas Article 1.3 of the Agreement on Import Licensing Procedures deals with the way rules should be applied in the specific sector of import licensing. In contrast, it may be said that Articles III:4 and VI do not share the same purpose. However, we view the Appellate Body statement as applying the general principle of international law *lex specialis derogat legi generali.* This is particularly clear from its remark that the *Agreement* on Import Licensing Procedures 'deals specifically, and in detail, with the administration of import licensing procedures'. In our opinion, Article VI and the Anti-Dumping Agreement 'deals specifically, and in detail, with the administration of' anti-dumping. In the present case, the question of the applicability of Article III:4 was essentially raised by the type of measures imposed under the 1916 Act. On the basis of the reasoning of the Appellate Body, we conclude that, even assuming that Article III:4 is applicable, in light of our findings under Article VI and the Anti-Dumping Agreement, we do not need to make findings under Article III:4 of the GATT 1994.
>
> We nevertheless recall that, as stated by the Appellate Body in its report on *Australia – Measures Affecting Importation of Salmon*, our findings must be complete enough to enable the DSB to make sufficiently precise recommendations and rulings so as to allow for prompt compliance 'in order to ensure effective resolution of disputes to the benefit of all Members.'
>
> Having regard to our findings under Article VI and the Anti-Dumping Agreement, and keeping in mind that, in our view, Article VI and the Anti-Dumping Agreement deal specifically and in detail with laws addressing dumping as such, we do not consider that making *additional* findings under Article III:4 is necessary in order to enable the DSB to make sufficiently precise recommendations and rulings so as to allow prompt compliance by the United States in order to ensure an effective resolution of this dispute.
>
> Therefore, we find that we are entitled to exercise judicial economy and decide not to review the claims of Japan under Article III:4 of the GATT 1994."[303]

Article XI

265. Exercising judicial economy, the Panel in *Korea – Various Measures on Beef* did not examine claims regarding a practice of the Korean state trading agency for beef under Articles III:4 and XVII after having found a violation of Articles XI and II:1(a) for that practice.[304]

266. The Panel in *EC – Asbestos* examined the WTO-consistency of a French ban on the manufacture, import and export, and domestic sales and transfer of certain asbestos and asbestos-containing products. In findings that were not appealed, the Panel examined whether the French measure fell under the scope of Article III or Article XI. Canada argued that the interpretative Note *Ad* Article III did not apply because asbestos was not produced in France; thus

[302] Panel Report, *US – 1916 Act (Japan)*, paras. 6.268-6.269; Panel Report, *US – 1916 Act (EC)*, para. 6.219.
[303] Panel Report, *US – 1916 Act (Japan)*, paras. 6.269-6.272.
[304] Panel Report, *Korea – Various Measures on Beef*, para. 7.80.

the French ban was equivalent in practical terms to a ban on importing chrysotile asbestos fibres. The Panel first found that the Note *Ad* Article III did apply to this case, stating:

> "[T]he word 'comme' in the French text of Note *Ad* Article III ['and' in the English text] implies in the first place that the measure applies to the imported product and to the like domestic product. [T]he fact that France no longer produces asbestos or asbestos-containing products does not suffice to make the Decree a measure falling under Article XI:1. It is in fact because the Decree prohibits the manufacture and processing of asbestos fibres that there is no longer any French production. The cessation of French production is the consequence of the Decree and not the reverse. Consequently, the Decree is a measure which 'applies to an imported product and to the like domestic product' within the meaning of Note *Ad* Article III.
>
> Secondly, the Panel notes that the words 'any law, regulation or requirement …which applies to an imported product and ['comme' in the French text] to the like domestic product' in the Note *Ad* Article III could also mean that the same regime must apply to the imported product and the domestic product. In this case, under the Decree, the domestic product may not be sold, placed on the domestic market or transferred under any title, possessed for sale, offered or exported. If we follow Canada's reasoning, products from third countries are subject to a different regime because, as they cannot be imported, they cannot be sold, placed on the domestic market, transferred under any title, possessed for sale or offered. Firstly, the regulations applicable to domestic products and foreign products lead to the same result: the halting of the spread of asbestos and asbestos-containing products on French territory. In practice, in one case (domestic products), they cannot be placed on the domestic market because they cannot be transferred under any title. In the other (imported products), the import ban also prevents their marketing."[305]

267. The Panel also rejected Canada's argument that an *identical* measure must be applied to the domestic product and the like imported product if the measure applicable to the imported product is to fall under Article III:

> "We note that the relevant part of the English text of Note *Ad* Article III reads as follows: 'Any […] law, regulation or requirement […] which applies to an imported product *and* to the like domestic product'. The word 'and' does not have the same meaning as 'in the same way as', which can be another meaning for the word 'comme' in the French text. We therefore consider that the word 'comme' cannot be interpreted as requiring an identical measure to be applied to imported products and domestic products if Article III is to apply.
>
> We note that our interpretation is confirmed by practice under the GATT 1947. In *United States – Section 337 of the Tariff Act of 1930,* the Panel had to examine measures specifically applicable to imported products suspected of violating an American patent right. In this case, referring to Note *Ad* Article III, the Panel considered that the provisions of Article III:4 did apply to the special procedures prescribed for imported products suspected of violating a patent protected in the United States because these procedures were considered to be 'laws, regulations and requirements' affecting the internal sale of the imported products, within the meaning of Article III of the GATT. It should be noted that in this case the procedures examined were not the same as the equivalent procedures applicable to domestic products."[306]

268. In *India – Autos*, the Panel recalled the Panel Report on *Canada – FIRA* when it stated that Articles III and XI of GATT 1994 have distinct scopes of application. It quoted from that Panel that "the General Agreement distinguishes between measures affecting the 'importation' of products, which are regulated in Article XI:1, and those affecting 'imported products', which are dealt with in

[305] Panel Report, *EC – Asbestos*, paras. 8.91-8.92.
[306] Panel Report, *EC – Asbestos*, paras. 8.94-8.95.

Article III. If Article XI:1 were interpreted broadly to cover also internal requirements, Article III would be partly superfluous."[307]

269. In *India – Autos,* the Panel did, however, consider that under certain circumstances, specific measures may have an impact upon both the importation of products (Article XI) and the competitive conditions of imported products on the internal market (Article III):

> "[I]t therefore cannot be excluded *a priori* that different aspects of a measure may affect the competitive opportunities of imports in different ways, making them fall within the scope either of Article III (where competitive opportunities on the domestic market are affected) or of Article XI (where the opportunities for importation itself, i.e. entering the market, are affected), or even that there may be, in perhaps exceptional circumstances, a potential for overlap between the two provisions, as was suggested in the case of state trading.
>
> …
>
> [T]here may be circumstances in which specific measures may have a range of effects. In appropriate circumstances they may have an impact both in relation to the conditions of importation of a product and in respect of the competitive conditions of imported products on the internal market within the meaning of Article III:4.[308] This is also in keeping with the well established notion that different aspects of the same measure may be covered by different provisions of the covered Agreements."[309]

Article XVII

270. The Panel in *Korea – Various Measures on Beef* discussed the relationship between GATT Articles III and XVII.[310]

Relationship of Article III with other WTO Agreements

General

271. In *Japan – Alcoholic Beverages II*, in discussing the purpose of Article III, the Appellate Body stated:

> "The broad purpose of Article III of avoiding protectionism must be remembered when considering the relationship between Article III and other provisions of the *WTO Agreement.*"[311]

272. The Appellate Body in *Canada – Renewable Energy / Canada – Feed-in Tariff Program* noted the overlaps between Article III:4 of the GATT 1994, Article 2 of the TRIMs Agreement and Article 3.1(b) of the SCM Agreement:

> "Both the national treatment obligations in Article III:4 of the GATT 1994 and the TRIMs Agreement, and the disciplines in Article 3.1(b) of the SCM Agreement, are cumulative obligations. Article III:4 of the GATT 1994 and the TRIMs Agreement, as well as Article 3.1(b) of the SCM Agreement, prohibit the use of local content

[307] Panel Report, *India – Autos,* para. 7.220.
[308] *(footnote original)* The Panel notes that the TRIMS Agreement Illustrative List envisages measures relating to export requirements both in the context of Article XI:1, as noted above in the context of our analysis under Article XI:1, and in the context of Article III:4 of the GATT 1994, by listing as inconsistent with that provision measures which require "that an enterprise's purchases or use of imported products be limited to an amount related to the volume or value of local products that it exports" TRIMS Illustrative List, Item 1 (b).
[309] Panel Report, *India - Autos*, paras. 7.224 and 7.296.
[310] Panel Report, *Korea – Various Measures on Beef*, paras. 753 and 757, and 7.80.
[311] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 16.

> requirements in certain circumstances. These provisions address discriminatory conduct."[312]

SPS Agreement

273. In *EC – Hormones (US)*, the Panel examined the consistency of certain sanitary measures of the European Communities with Articles I and III of the GATT 1994 and certain provisions of the SPS Agreement. With respect to the relationship between Article III of the GATT 1994 and SPS Agreement, the Panel stated as follows:

> "Since we have found that the EC measures in dispute are inconsistent with the requirements of the SPS Agreement, we see no need to further examine whether the EC measures in dispute are also inconsistent with Article I or III of GATT.
>
> As noted above in paragraph 8.42, if we were to find an inconsistency with Article I or III of GATT, we would then need to examine whether this inconsistency could be justified, as argued by the European Communities, under Article XX(b) of GATT and would thus necessarily need to revert to the SPS Agreement under which we have already found inconsistencies. Since the European Communities has not invoked any defence under GATT other than Article XX(b), an inconsistency with Article I or III of GATT would, therefore, in any event, not be justifiable."[313]

274. In *EC – Approval and Marketing of Biotech Products*, one of the complainants, Argentina, alleged that a number of the product-specific measures at issue were inconsistent with Annex C(1)(a) of the SPS Agreement. In considering this claim, the Panel noted that provision lays down a national treatment obligation and thus considered this claim in the light of the jurisprudence on Article III:4 (see also paragraph 154 above):

> "In these circumstances, it is not self-evident that the alleged less favourable manner of processing applications concerning the relevant imported biotech products (*e.g.*, imported biotech maize) is explained by the foreign origin of these products rather than, for instance, a perceived difference between biotech products and novel non-biotech products in terms of the required care in their safety assessment, risk for the consumer, etc. Argentina has not adduced argument and evidence sufficient to raise a presumption that the alleged less favourable treatment is explained by the foreign origin of the relevant biotech products."[314]

275. The Panel in *US – Section 211 Appropriations Act*, in a finding with which the Appellate Body agreed, considered the appropriate standard of examination under Article 3.1 of the TRIPS Agreement and quoted with approval the findings of the GATT Panel in *US – Section 337* on the "no less favourable" treatment standard under Article III:4 of GATT 1947. See the material on TRIPS Article 3 in the Section on the TRIPS Agreement.

276. The Panel in *EC – Trademarks and Geographical Indications* also referred to the above passage and applied the same standard of examination in the context of Article 3.1 of the TRIPS Agreement. The same Panel also referred to the Appellate Body's interpretation of the "no less favourable" treatment standard under Article III:4 of GATT 1994 in *US – FSC (Article 21.5 – EC)* and applied it in the context of Article 3.1 of the TRIPS Agreement. See the Section on Article 3 of the TRIPS Agreement.

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[312] Appellate Body Reports, *Canada – Renewable Energy / Canada – Feed-in Tariff Program*, para. 5.5. See also Panel Reports, *Brazil – Taxation*, para. 7.48.

[313] Panel Report, *EC – Hormones (US)*, paras. 8.272-8.273; Panel Report, *EC – Hormones (Canada)*, paras. 8.275-8.276.

[314] Panel on *EC – Approval and Marketing of Biotech Products,* para. 7.2411 (see also para. 7.2415 for a very similar finding related to the claim by Argentina that, after 1998, the European Communities applied its approval procedures in a less favourable manner for the biotech products which were the subject of the product-specific measures challenged by Argentina than for like biotech products before 1998 (1998 being the year which, according to Argentina, the European Communities began applying its general *de facto* moratorium on approvals of biotech products)).

TBT Agreement

277. In *EC – Sardines*, the Panel considered that, in this case, the analysis of the claims under the *TBT Agreement* would precede any examination of the claims under Article III:4 of GATT 1994. In doing so, the Panel recalled the Appellate Body's statement in *EC — Bananas III* which declared "that the panel 'should' have applied the Licensing Agreement first because this agreement deals 'specifically, and in detail' with the administration of import licensing procedures". In the Panel's view, the Appellate Body is suggesting that where two agreements apply simultaneously, a panel should normally consider the more specific agreement before the more general agreement."[315] Using that same rationale, the Panel concluded that since "[a]rguably, the TBT Agreement deals 'specifically, and in detail' with technical regulations", and considering the parties claims, "then the analysis under the TBT Agreement would precede any examination under [Article III:4 of] the GATT 1994."[316]

278. In *US – Clove Cigarettes*, the Panel considered whether the jurisprudence under Article III:4 of the GATT 1994 would be directly transposable to the interpretation of "likeness" in the context of Article 2.1 of the TBT Agreement. The Panel observed that both provisions regulate different kinds of measures and, while recognizing the similarity of the language of both national treatment provisions, this difference should be accorded significance:

> "In our view, it is far from clear that it is always appropriate to transpose automatically the competition-oriented approach to likeness under Article III:4 of the GATT 1994 to Article 2.1 of the TBT Agreement because that approach was developed by the Appellate Body in *EC – Asbestos* on the basis of the general principle in Article III:1 of the GATT 1994, which does not have an equivalent in the TBT Agreement.
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> …
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> In our view, the absence in the TBT Agreement of language such as that in Article III:1 of the GATT 1994 has meaning for our interpretive exercise. Even if the GATT 1994 were considered to serve as a context for Article 2.1 of the TBT Agreement, it would not be the immediate context of that provision. … [W]e consider that an interpreter should first assess the immediate context of the provision subject to interpretation before reaching for an interpretative aid that is further removed."[317]

279. In *US – Clove Cigarettes*, the Appellate Body noted the very similar formulation of Article III:4 of the GATT 1994 and Article 2.1 of the TBT Agreement and pointed to the overlap in the scope and application of both provisions in respect of technical regulations:

> "We further note that technical regulations are in principle subject not only to Article 2.1 of the TBT Agreement, but also to the national treatment obligation of Article III:4 of the GATT 1994, as 'laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use' of products."[318]

SCM Agreement

280. In *Indonesia – Autos*, the Panel examined the consistency with Article III of measures contained in the Indonesian National Car Programme, including luxury tax exemption given to certain domestically produced cars. Indonesia argued that the challenged measures were subsidies, which were exclusively governed by Article XVI of GATT and the SCM Agreement. The Panel disagreed with Indonesia's view, underlining that Article III of the GATT 1994 and the SCM Agreement generally deal with different matters:

> "[W]e think that Article III of GATT 1994 and the WTO rules on subsidies remain focused on different problems. Article III continues to prohibit discrimination between domestic and imported products in respect of internal taxes and other domestic

[315] Panel Report, *EC – Sardines*, para. 7.15.
[316] Panel Report, *EC – Sardines*, para. 7.16.
[317] Panel Report, *US – Clove Cigarettes,* paras. 7.99 and 7.104. See also Panel Report, *EU and Certain Member States – Palm Oil (Malaysia)*, para. 7.988.
[318] Appellate Body Report, *US – Clove Cigarettes*, para. 100.

> regulations, including local content requirements. It does not 'proscribe' nor does it 'prohibit' the provision of any subsidy *per se*. By contrast, the SCM Agreement prohibits subsidies which are conditional on export performance and on meeting local content requirements, provides remedies with respect to certain subsidies where they cause adverse effects to the interests of another Member and exempts certain subsidies from actionability under the SCM Agreement. In short, Article III prohibits discrimination between domestic and imported products while the SCM Agreement regulates the provision of subsidies to enterprises.
>
> Contrary to what Indonesia claims, the fact that a government gives a subsidy to a firm does not imply that the subsidy itself will necessarily discriminate between imported and domestic products in contravention of Article III of GATT. Article III:8(b) of GATT makes clear that a government may use the proceeds of taxes collected equally on all imported and domestic products in order to provide a subsidy to domestic producers (to the exclusion of producers abroad)."[319]

281. The Panel in *Indonesia – Autos* then noted that overlap between the GATT 1994 and an agreement signed in the Uruguay Round was not unique to the SCM Agreement:

> "Finally, the fact that, as a result of the Uruguay Round, the SCM Agreement to some extent covers subject matters that were already covered by other GATT disciplines is not unique. This situation is similar to the relationship between GATT 1994 and GATS. In *Periodicals* and in *Bananas III*, the defending parties argued that since a set of rules on services exists now in GATS, the provisions of Article III:4 of GATT on distribution and transportation have ceased to apply. Twice the Appellate Body has ruled that the scope of Article III:4 was not reduced by the fact that rules on trade in services are found in GATS: '[t]he entry into force of the GATS, as Annex 1B of the WTO Agreement, does not diminish the scope of application of the GATT 1994.'"[320]

282. On this basis, the Panel in *Indonesia – Autos* concluded that there is no general conflict between Article III and the SCM Agreement:

> "Accordingly, we consider that Article III and the SCM Agreement have, generally, different coverage and do not impose the same type of obligations.[321] Thus there is no general conflict between these two sets of provisions."[322]

283. The Panel in *Indonesia – Autos*, in the context of discussing the relationship between Article III and the SCM Agreement, considered in which manner "direct" taxes (taxes on individuals and economic entities) and "indirect" taxes (taxes on products) are covered by Article III of GATT 1994:

> "When subsidies to producers result from exemptions or reductions of indirect taxes on products, Article III:2 of GATT is relevant. In contrast, subsidies granted in respect of direct taxes are generally not covered by Article III:2, but may infringe Article III:4 to the extent that they are linked to other conditions which favour the use, purchase, etc. of domestic products."[323]

284. The Panel in *Indonesia – Autos* also rejected Indonesia's argument that if Article III applied to the subject measures, the SCM Agreement would be reduced to "inutility":

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[319] Panel Report, *Indonesia – Autos*, paras. 14.33-14.34.
[320] Panel Report, *Indonesia – Autos*, para. 14.35.
[321] *(footnote original)* This conclusion is confirmed, amongst other provisions, by the footnote to Article 32.1 of the SCM Agreement which recognizes that actions against subsidies remain possible under GATT 1994. Article 32.1 of the SCM Agreement reads as follows: "No specific action against a subsidy of another Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement". The footnote 56 to this Article reads as follows: "This paragraph is not intended to preclude action under other relevant provisions of GATT 1994, where appropriate".
[322] Panel Report, *Indonesia – Autos*, para. 14.36.
[323] Panel Report, *Indonesia – Autos*, para. 14.38.

> "This is to say that the only subsidies that would be affected by the provisions of Article III are those that would involve discrimination between domestic and imported products. While Article III of GATT and the SCM Agreement may appear to overlap in respect of certain measures, the two sets of provisions have different purposes and different coverage. Indeed, they also offer different remedies, different dispute settlement time limits and different implementation requirements. Thus, we reject Indonesia's argument that the application of Article III to subsidies would reduce the SCM Agreement to 'inutility'.
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> We note further that Indonesia's argument would imply that every time a measure involves tax discrimination in respect of products, that measure should be considered a subsidy governed exclusively by the SCM Agreement to the exclusion of Article III:2. It appears to us that this line of argument would reduce Article III:2 to 'inutility', since the very explicit (and arguably only) purpose of Article III:2 is to deal with tax discrimination in respect of products."[324]

285. In *Brazil – Taxation*, the Panel concluded that a subsidy contingent on the use of domestic over imported products would be inconsistent with both Article 3.1(b) of the SCM Agreement and Article III:4 of the GATT 1994:

> "[T]here are reasons to believe that Article 3.1(b) codifies in the SCM Agreement the principle of non-discrimination already contained in Article III of the GATT 1994. This is demonstrated both by the GATT dispute *Italy – Agricultural Machinery* of 1958, and by the records of the SCM negotiations of the Uruguay Round.
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> …
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> A harmonious reading of Article 3.1(b) of the SCM Agreement (which prohibits subsidies contingent upon of the use of domestic over imported products) and Article III:4 of the GATT 1994 (which prohibits laws, regulations and requirements that discriminate against imported products, including local content requirements), read in light of paragraph 1(a) of the Annex to the TRIMs Agreement, indicates that a subsidy contingent on the use of domestic over imported products would be inconsistent with both Article 3.1(b) of the SCM Agreement and Article III:4 of the GATT 1994."[325]

286. In *Brazil – Taxation*, although the Panel acknowledged the overlaps between Article III:4 of the GATT 1994 and Article 3.1 (b) of the SCM Agreement, it also noted the difference in their scope of application:

> "In particular, the scope of Article III:4 of the GATT 1994 is broader than that …of Article 3.1(b) of the SCM Agreement, since it refers generally to 'laws, regulations and requirements'. … [A] measure is only covered by Article 3.1(b) of the SCM Agreement if it is a subsidy within the meaning of that agreement."[326]

287. In *EC and certain member States – Large Civil Aircraft (Article 21.5 – US)*, the complainant argued that the European Union and some of its member States made subsidies to the airplane manufacturer Airbus contingent on the "production" of domestic components, thus constituting a prohibited subsidy under Article 3.1(b) of the SCM Agreement. The European Union argued that the Panel must interpret Article 3.1(b) of the SCM Agreement in harmony with Article III:8(b) of the GATT 1994, which exempts the practice of providing subsidies exclusively to domestic producers from the national treatment disciplines of Article III. In light of these provisions, the European Union argued that production subsidies given exclusively to domestic producers cannot violate Article 3.1(b) of the SCM Agreement. The Panel agreed with this interpretive approach, which "appears well established".[327] Further, the Panel noted that "the Appellate Body has more specifically indicated that because Article III of the GATT 1994 and Article 3.1(b) of the SCM Agreement both discipline subsidies that are contingent on the use of domestic over imported

[324] Panel Report, *Indonesia – Autos*, paras. 14.39-14.40.
[325] Panel Reports, *Brazil – Taxation*, para. 7.42 and 7.45.
[326] Panel Reports, *Brazil – Taxation*, para. 7.47.
[327] Panel Report, *EC and certain member States – Large Civil Aircraft (Article 21.5 – US)*, para. 6.783.

goods a degree of consistency is required in their interpretation."[328] After examining Article III:8(b), the Panel rejected the complainant's argument that the measures at issue were contingent on the use of domestic over imported goods because the measures conditioned subsidy receipt on the production of components:

> "In effect, Article III:8(b) of the GATT 1994 confirms that, without more, the mere payment of subsidies to firms so long as they engage in domestic production activities should not be interpreted as imparting to such subsidies a discriminatory element as among domestic and foreign goods in a manner that Article III may discipline. Indeed, if this were not the case, then it appears that the only way for a WTO Member to avoid a payment of subsidies being prohibited under WTO law would be to offer the subsidy payments to firms worldwide. We recall that Article III:4 of the GATT 1994 – like Article 3.1(b) of the SCM Agreement – prohibits subsidies that are contingent on the use of domestic over imported goods, notwithstanding the presence of Article III:8(b) of the GATT 1994. This suggests that the act of granting subsidies to firms so long as they engage in domestic production activities, without more, should not be equated to making those subsidies contingent on the use of domestic over imported goods and hence prohibited.[329]"[330]

TRIMs Agreement

Order of analysis

288. The Panel in *Indonesia – Autos* addressed claims that certain Indonesian local content requirements for import duty exemptions to automobiles and their parts and components were inconsistent with the TRIMs Agreement and Article III:4 of the GATT 1994:

> "The complainants have claimed that the local content requirements under examination, and which we find are inconsistent with the TRIMs Agreement, also violate the provisions of Article III:4 of GATT. Under the principle of judicial economy, a panel only has to address the claims that must be addressed to resolve a dispute or which may help a losing party in bringing its measures into conformity with the WTO Agreement. The local content requirement aspects of the measures at issue have been addressed pursuant to the claims of the complainants under the TRIMs Agreement. We consider therefore that action to remedy the inconsistencies that we have found with Indonesia's obligations under the TRIMs Agreement would necessarily remedy any inconsistency that we might find with the provisions of Article III:4 of GATT. We recall our conclusion that non applicability of Article III would not affect as such the application of the TRIMs Agreement. We consider therefore that we do not have to address the claims under Article III:4, nor any claim of conflict between Article III:4 of GATT and the provisions of the SCM Agreement."[331]

289. In *Canada – Autos*, following the finding of a violation of Article III:4, the Panel opined that a finding under the *TRIMs Agreement* was not necessary:

> "[W]e do not consider it necessary to make a specific ruling on whether the CVA requirements provided for in the MVTO 1998 and the SROs are inconsistent with Article 2.1 of the TRIMs Agreement. We believe that the Panel's reasoning in *EC Bananas III* as to why it did not make a finding under the TRIMs Agreement after it had found that certain aspects of the EC' licensing procedures were inconsistent with Article III:4 of the GATT also applies to the present case. Thus, on the one hand, a finding in the present case that the CVA requirements are not trade-related investment measures for the purposes of the TRIMs Agreement would not affect our finding in respect of the inconsistency of these requirements with Article III:4 of the

[328] Panel Report, *EC and certain member States – Large Civil Aircraft (Article 21.5 – US)*, para. 6.783.
[329] *(footnote original)* To be clear, in noting this suggestion, we need not address, let alone resolve, the question of whether Article III:8(b) is an exemption, which clarifies that Article III is inherently inapplicable to subsidies paid exclusively to domestic producers, or an exception, which removes from the scope of Article III:4 measures that would otherwise be covered by that provision.
[330] Panel Report, *EC and certain Member States – Large Civil Aircraft (Article 21.5 – US)*, para. 6.785.
[331] Panel Report, *Indonesia – Autos*, para. 14.93.

> GATT since the scope of that provision is not limited to trade-related investment measures. On the other hand, steps taken by Canada to bring these measures into conformity with Article III:4 would also eliminate the alleged inconsistency with obligations under the TRIMs Agreement."[332]

290. In *India – Autos*, the Panel dealt with separate claims under both the GATT 1994 and the TRIMs Agreement. It noted that previous panels confronted with concurrent claims concerning these two agreements had taken differing approaches to the choice of order of analysis of such claims. The Panel recognized that, in some circumstances, there may be a practical significance in determining a particular order for the examination of claims based on the TRIMS and GATT 1994, for example if a party claimed as a defence that a measure had been notified under the TRIMs Agreement. Since that was not the case in this dispute, the Panel did not find any particular reason to start its examination on any particular order, nor did it consider that the end result would be affected by either determination of order of analysis. In fact, the Panel was not persuaded that, as a general matter, the TRIMs Agreement could inherently be characterized as more specific than the relevant GATT provisions, and stated:

> "As a general matter, even if there was some guiding principle to the effect that a specific covered Agreement might appropriately be examined before a general one where both may apply to the same measure, it might be difficult to characterize the TRIMs Agreement as necessarily more 'specific' than the relevant GATT provisions. Although the TRIMS Agreement 'has an autonomous legal existence', independent from the relevant GATT provisions, as noted by the *Indonesia – Autos* panel, the substance of its obligations refers directly to Articles III and XI of the GATT, and clarifies their meaning, *inter alia*, through an Illustrative list. On one view, it simply provides additional guidance as to the identification of certain measures considered to be inconsistent with Articles III:4 and XI:1 of the GATT 1994. On the other hand, the TRIMs Agreement also introduces rights and obligations that are specific to it, through its notification mechanism and related provisions. An interpretative question also arises in relation to the TRIMs Agreement as to whether a complainant must separately prove that the measure in issue is a 'trade-related investment measure'. For either of these reasons, the TRIMs Agreement might be arguably more specific in that it provides additional rules concerning the specific measures it covers. [333] The Panel is therefore not convinced that, as a general matter, the TRIMs Agreement could inherently be characterized as more specific than the relevant GATT provisions."[334]

291. The Panel in *India – Autos* ultimately decided to examine the GATT claims first, since both complainants had addressed their claims under GATT 1994 prior to their claims under the TRIMS Agreement, and the order selected for examination of the claims could have an impact on the potential to apply judicial economy. In effect, the Panel stated:

> "It seems that an examination of the GATT provisions in this case would be likely to make it unnecessary to address the TRIMs claims, but not vice-versa. If a violation of the GATT claims was found, it would be justifiable to refrain from examining the TRIMs claims under the principle of judicial economy. Even if no violation was found under the GATT claims, that also seems an efficient starting point since it would be difficult to imagine that if no violation has been found of Articles III or XI, a violation could be found of Article 2 of the TRIMs Agreement, which refers to the same provisions. Conversely, if no violation of the TRIMs Agreement were found, this would not necessarily preclude the existence of a violation of GATT Articles III:4 or XI:1 because the scope of the GATT provisions is arguably broader if India's argument was

[332] Panel Report, *Canada – Autos*, para. 10.91.

[333] *(footnote original)* To say, for instance, that the TRIMs Agreement is more specific because it contains a specific criterion of the presence or absence of a trade-related investment measure depends upon whether that is a distinct criterion and whether the lack of such a criterion in Articles III and XI of GATT 1994 makes these provisions more general as opposed to merely having a broader range of coverage on the same criteria. The only practical difference and potential advantage in looking at the TRIMs agreement first in this instance seems to be the possible utilization of the Illustrative List, to the extent that it would be relevant to the claims at issue and may facilitate the identification of a violation of Articles III:4 or XI:1 of GATT 1994.

[334] Panel Report, *India - Autos*, para. 7.157.

> accepted that there is a need to prove that a measure is an investment measure and its assertion that this is not the case with the measures before this Panel."[335]

292. In *Canada – Renewable Energy / Canada Feed-in Tariff Program*, the Panel dealt with claims under the SCM Agreement, the GATT 1994, and the TRIMs Agreement. The complainants argued the Panel should first address the claims under the SCM Agreement, while Canada urged examination under Article III:4 of the GATT first. The Panel noted that the complainants asserted, and Canada did not contest, that the measures at issue were related to "trade-related investment measures affecting the imports of renewable energy generation equipment and components". Of the three Agreements, the Panel noted the TRIMs Agreement deals "most directly, specifically and in detail" with these measures. However, the Panel noted that Article 2.1 of the TRIMs Agreement requires evaluation of the consistency of the challenged measures with Article III:4 of the GATT 1994. Accordingly, the Panel decided to "simultaneously evaluate the merits of … the complainants' claims under Article 2.1 of the TRIMs Agreement and Article III:4 of the GATT 1994". The Appellate Body affirmed the Panel's order of analysis, seeing "practical value in following the same sequence as the Panel".[336]

Substantive relationship

293. The Appellate Body in *Canada – Renewable Energy / Canada – Feed-in Tariff Program* agreed with the Panel's analysis on the relationship between Article III of the GATT and Article 2.1 of the TRIMs Agreement:

> "Article 2.1 of the TRIMs Agreement prohibits Members from applying a TRIM – that is, an investment measure related to trade in goods – 'that is inconsistent with the provisions of Article III or Article XI of GATT 1994'. The cross-reference in the latter part of Article 2.1 to Article III of the GATT 1994 is unqualified. We understand this to be a reference to Article III of the GATT 1994 in its entirety, including Article III:4. Thus, as the Panel explained, a measure that is inconsistent with Article III:4 of the GATT 1994 would also be a TRIM that is incompatible with Article 2.1 of the TRIMs Agreement. Importantly, the cross-reference to Article III also includes paragraph 8(a) of that provision. As we discuss in more detail in section 5.3 of these Reports, a measure that falls within the scope of paragraph 8(a) cannot violate Article III of the GATT 1994. This, in turn, means that a Member applying such a measure would not violate Article 2.1 of the TRIMs Agreement."[337]

294. The Appellate Body in *Canada – Renewable Energy / Canada Feed-in Tariff Program* also examined the applicability of Article III:8(a) to measures falling within the scope of Article 2.2 of the TRIMs Agreement and the illustrative list annexed thereto. It agreed with the Panel's conclusion that the application of Article III:8(a) is not precluded when a challenged measure also falls under the scope of Article 2.2 of the TRIMS Agreement:

> "In our view, Article 2.2 provides further specification as to the type of measures that are inconsistent with Article 2.1. The operative part of Article 2.2 is the reference to the Illustrative List, which provides examples of measures that are inconsistent with the national treatment obligation. While Article 2.2 and the Illustrative List focus on the specific provisions where such obligation is reflected – that is, Article III:4 of the GATT 1994 – we do not believe it responds to the question of whether such measures are inconsistent with Article III of the GATT 1994 in its entirety. Where a measure falls within the scope of Article III:8(a), the measure is not inconsistent with Article III overall. Thus, we agree with the Panel that Article 2.2 and the Illustrative List must be understood as clarifying to which TRIMs the general obligation in Article 2.1 applies. Furthermore, we understand the absence of a reference to Article III:8(a) of the GATT 1994 in Article 2.2 of the TRIMs Agreement and in the Illustrative List as indicating that these provisions are neutral as to the applicability of the former provision. This

[335] Panel Report, *India - Autos*, para. 7.161.
[336] Panel Reports, *Canada Renewable Energy / Canada – Feed-in Tariff Program*, para. 7.70.
[337] Appellate Body Reports, *Canada Renewable Energy / Canada – Feed-in Tariff Program*, para. 5.20.

> results in a harmonious interpretation of Articles 2.1 and 2.2 of the TRIMs Agreement and Articles III:4 and III:8(a) of the GATT 1994."[338]

295. In *Canada – Renewable Energy/Feed-In Tariff Program*, the Appellate Body endorsed the Panel's finding that measures falling under paragraph 1(a) of the TRIMs Illustrative List are necessarily inconsistent with Article III:4. Particularly, the Appellate Body ruled that "by its terms, a measure that falls within the coverage of paragraph 1(a) of the Illustrative List is 'inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994'."[339] To this end, the Appellate Body concluded that this assessment obviates the need for separate and additional examination of the legal elements of Article III:4:

> "[It] is not obvious what a stand-alone finding of violation of Article III:4 of the GATT 1994 would add to a finding of violation of Article III:4 that is consequential to an assessment under the Illustrative List of the TRIMs Agreement."[340]

296. In *Brazil – Taxation*, the Panel considered that where a TRIM measure contains a local content requirement, such a requirement is necessarily inconsistent with both Article III:4 and Article 2.1 of the TRIMs Agreement:

> "The TRIMs Agreement also lists, in the Illustrative List annexed to the agreement, examples of TRIMs that are specifically inconsistent with Article III:4 of the GATT 1994. Paragraph 1(a) of the Annex to the TRIMs Agreement explains that 'TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 include those … compliance with which is necessary to obtain an advantage, and which require … the purchase or use by an enterprise of products of domestic origin or from any domestic source'. This provision therefore refers to so-called 'local content requirements'. Thus, if a Panel finds that a particular measure is a TRIM, and that such a measure contains a so-called local content requirement, then that local content requirement is necessarily inconsistent with both Article III:4 of the GATT 1994 and Article 2.1 of the TRIMs Agreement."[341]

297. In *Brazil – Taxation*, although the Panel acknowledged the overlaps between Article III:4 and Article 2 of the TRIMs Agreement, it also noted the difference in their scope of application:

> "In particular, the scope of Article III:4 of the GATT 1994 is broader than that of Article 2.1 of the TRIMs Agreement … , since it refers generally to 'laws, regulations and requirements'. A measure is only covered by Article 2.1 of the TRIMs Agreement if it is a TRIM within the meaning of that agreement."[342]

GATS

298. In *Canada – Periodicals*, the Appellate Body examined the Panel's finding that Canada was in violation of Article III:2 in imposing an excise tax on split-run editions of periodicals, i.e. those editions which "contain…an advertisement that is primarily directed to a market in Canada and that does not appear in identical form in all editions of that issue of the periodical[s] that were distributed in the periodical[s'] country of origin."[343] Canada claimed that the excise tax was subject to the *GATS*, and thus, not subject to Article III:2 of the GATT 1994.[344] Rejecting this argument, the Appellate Body stated:

> "The entry into force of the GATS, as Annex 1B of the *WTO Agreement*, does not diminish the scope of application of the GATT 1994. …

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[338] Appellate Body Reports, *Canada Renewable Energy / Canada – Feed-in Tariff Program*, para. 5.26.
[339] Appellate Body Report, *Canada – Renewable Energy/Feed-In Tariff Program*, para. 5.24. See also Panel Report, *India – Solar Cells*, paras. 7.47-7.49.
[340] Appellate Body Reports, *Canada – Renewable Energy/Feed-In Tariff Program*, para. 5.94.
[341] Panel Reports, *Brazil – Taxation*, para. 7.41. See also Appellate Body Reports, *Canada – Renewable Energy/Feed-In Tariff Program*, para. 5.103; Panel Report, *India – Solar Cells*, paras. 7.47-7.49.
[342] Panel Reports, *Brazil – Taxation*, para. 7.47.
[343] Panel Report, *Canada – Periodicals*, para. 2.2.
[344] Appellate Body Report, *Canada – Periodicals*, p. 17.

We agree with the Panel's statement:

> 'The ordinary meaning of the texts of GATT 1994 and GATS as well as Article II:2 of the WTO Agreement, taken together, indicates that obligations under GATT 1994 and GATS can co-exist and that one does not override the other.'"[345]

299. In *EC – Bananas III*, the Appellate Body also addressed the question of "whether the GATS and the GATT 1994 are mutually exclusive agreements", as follows:

> "The GATS was not intended to deal with the same subject matter as the GATT 1994. The GATS was intended to deal with a subject matter not covered by the GATT 1994, that is, with trade in services. Thus, the GATS applies to the supply of services. It provides, *inter alia*, for both MFN treatment and national treatment for services and service suppliers. Given the respective scope of application of the two agreements, they may or may not overlap, depending on the nature of the measures at issue. Certain measures could be found to fall exclusively within the scope of the GATT 1994, when they affect trade in goods as goods. Certain measures could be found to fall exclusively within the scope of the GATS, when they affect the supply of services as services. There is yet a third category of measures that could be found to fall within the scope of both the GATT 1994 and the GATS. These are measures that involve a service relating to a particular good or a service supplied in conjunction with a particular good. In all such cases in this third category, the measure in question could be scrutinized under both the GATT 1994 and the GATS. However, while the same measure could be scrutinized under both agreements, the specific aspects of that measure examined under each agreement could be different. Under the GATT 1994, the focus is on how the measure affects the goods involved. Under the GATS, the focus is on how the measure affects the supply of the service or the service suppliers involved. Whether a certain measure affecting the supply of a service related to a particular good is scrutinized under the GATT 1994 or the GATS, or both, is a matter that can only be determined on a case-by-case basis. This was also our conclusion in the Appellate Body Report in *Canada – Periodicals*."[346]

300. The finding that the scope of application of GATT and GATS, respectively, may or may not overlap, was reiterated by the Appellate Body in *Canada – Autos*.[347]

301. In *Argentina – Financial Services*, the Appellate Body acknowledged that the "presumption of likeness" in the context of trade in goods equally applies to trade in services. However, the Appellate Body cautioned that "compared to trade in goods, the scope for such a presumption [in the services context] would be more limited and complex":

> "In our view, where a measure provides for a distinction based exclusively on origin, there will or can be services and service suppliers that are the same in all respects except for origin and, accordingly, 'likeness' can be presumed and the complainant is not required to establish 'likeness' on the basis of the relevant criteria set out above. Accordingly, we consider that, under Articles II:1 and XVII:1 of the GATS, a complainant is not required in all cases to establish 'likeness' of services and service suppliers on the basis of the relevant criteria for establishing 'likeness'. Rather, in principle, a complainant may establish 'likeness' by demonstrating that the measure at issue makes a distinction between services and service suppliers based exclusively on origin. However, we consider that, compared to trade in goods, the scope for such a presumption under the GATS would be more limited, and establishing 'likeness' based on the presumption may often involve greater complexity in trade in services, due to the following reasons.
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> First, we have found above that the determination of 'likeness' under Articles II:1 and XVII:1 involves consideration of both the service and the service supplier. Accordingly, depending on the circumstances of the particular case, an origin-based distinction in

[345] Appellate Body Report, *Canada – Periodicals*, p. 19.
[346] Appellate Body Report, *EC – Bananas III*, para. 221.
[347] Appellate Body Report, *Canada – Autos*, para. 159.

the measure at issue would have to be assessed not only with respect to the services at issue, but also with regard to the service suppliers involved. Such consideration of both the services and the service suppliers may render more complex the analysis of whether or not a distinction is based exclusively on origin, in particular, due to the role that domestic regulation may play in shaping, for example, the characteristics of services and service suppliers and consumers' preferences.

In addition, we note the principles for determining origin set out in Article XXVIII of the GATS. The definitions of the various terms set out in Article XXVIII(f), (g), and (k) through (n) of the GATS provide an indication of the possible complexities of determining origin and whether a distinction is based exclusively on origin in the context of trade in services. An additional layer of complexity stems from the existence of different modes of supply and their implications for the determination of the origin of services and service suppliers."[348]

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Current as of: December 2024

[348] Appellate Body Report, *Argentina – Financial Services*, paras. 6.38-6.40.