17 September 1985

CANADA - MEASURES AFFECTING THE SALE OF GOLD COINS

Report of the Panel
(L/5863)

I. INTRODUCTION

1. In a communication dated 25 June 1984, circulated to the contracting parties on 3 July 1984, South Africa requested bilateral consultations with Canada under Article XXIII:1 concerning the application of the retail sales tax by the provincial government of Ontario to the sale of gold coins in a manner which afforded protection to domestic production of gold coins (L/5662). Consultations held between the parties on 24 September 1984 did not lead to a mutually satisfactory solution. South Africa therefore referred the matter to the CONTRACTING PARTIES in October 1984 and requested the urgent establishment of a Panel to investigate the matter and give an appropriate ruling (L/5711). At its meeting of 6-8 and 20 November 1984, the Council agreed to establish a Panel to examine South Africa's complaint. The Chairman of the Council was authorized, in consultation with the parties concerned, to decide on appropriate terms of reference and to designate the Panel members (C/M/183).

2. The following terms of reference were announced by the Chairman of the Council on 29 January 1985 (C/M/185):

> "To examine, in the light of relevant GATT provisions, the matter referred to the CONTRACTING PARTIES by South Africa, that is, whether the action taken with effect from 11 May 1983 in respect of the levying of the retail sales tax on gold coins by the Province of Ontario accords with the provisions of Articles III and II of the General Agreement whether Canada has carried out its obligations in terms of Article XXIV:12 of the General Agreement whether any benefits accruing to South Africa under the General Agreement have been nullified or impaired; and to make such findings as will assist the CONTRACTING PARTIES in making the recommendations or giving the rulings provided for in paragraph 2 of Article XXIII".

These terms of reference were agreed to on the following understanding, as outlined by the Chairman of the Council at the same Council meeting: "It is my understanding that agreement on these terms of reference has been reached on the basis of the understanding that, in its proceedings, the Panel will hear arguments as to whether the Ontario provincial retail sales tax measure on gold coins referred to in the terms of reference accords with the provisions of Articles III and II of the General Agreement, and will provide its view thereon to the parties involved, before proceeding to hear any additional arguments related to the remaining elements outlined in the terms of reference."

3. The composition of the Panel was announced on 19 February 1985 (C/131):

Chairman:	Mr. P.-L. Girard
Members:	Mr. M. Ikeda
	Mr. M. Shaton

4. The Panel met on 16 April, 23-24 May, and 13-14 June 1985 to hear arguments from the parties to the dispute. Pursuant to the understanding on its terms of reference, the Panel first gave its view to the parties on 24 May 1985 on the question of whether the Ontario measure accorded with the provisions of Articles III and II. In accordance with its request at the Council meeting of 29 January (C/M/185), the delegation of the European Economic Community was heard by the Panel on 13 June 1985. Australia, which had also expressed an interest in the matter at the same meeting of the Council, subsequently informed the Panel that it did not wish to appear before it.

II. FACTUAL ASPECTS

5. In May 1983, as part of its Budget, the government of the Province of Ontario presented a Bill to amend the provincial Retail Sales Tax Act. The resulting Act of the provincial legislative assembly received the Royal Assent on 26 May 1983. Under this Act, Subsection 5(1) of the provincial Retail Sales Tax Act was amended to exempt from the tax "Maple Leaf Gold Coins struck by the Canadian Mint and such other gold coins as are prescribed by regulation"; under an amendment to Subsection 45(2) of the Act, the provincial authorities were empowered to prescribe gold coins to which the exemption would apply. As a result of this measure, the retail sales tax on Maple Leaf gold coins in Ontario, previously standing at 7 per cent, was eliminated with effect from 11 May 1983. No other gold coins, whether produced in Canada or abroad, were exempted from the tax.

6. Gold coins are included in a duty-free tariff concession by Canada, applying to "coin of any metal, of authorized weight and design, issued for use as currency under the authority of the government of any country; "gold coin" agreed to in the Tokyo Round (see Schedule V - Canada).

7. Provincial sales tax is applicable to all transactions in gold coins (other than Maple Leafs) between Ontario residents. These include paper transactions involving no physical movement of coin, "offshore" transactions undertaken by dealers in Ontario for Ontario residents, and transactions on the secondary market. The tax is levied on the full market value of any sales.

8. In Canada, constitutional responsibility for "direct taxation within a province in order to the raising of a revenue for provincial purposes" is vested exclusively in the legislature of each province under Section 92 of the Canadian Constitution Act, 1867 (formerly the British North America Act). Responsibility for the regulation of trade and commerce, for currency and coinage, and for legal tender, is on the other hand within the exclusive legislative authority of the Federal Parliament under Section 91 of the same Act. Laws made by either level of government which exceed their respective legislative jurisdiction, or which are found to be improperly "aimed" at the jurisdiction of the other level of government, may be struck down as being ultra vires, and hence constitutionally invalid, only by Canadian courts. While there are a number of cases where provincial legislation has been so invalidated as having encroached upon the federal government's trade and commerce powers, there are also a number of cases where provincial legislation has been upheld. There are no Supreme Court of Canada decisions exactly corresponding to the present situation concerning the differential application of provincial taxes on domestic and imported goods.

III. MAIN ARGUMENTS

(a) General

9. South Africa argued that the Ontario measure, introduced to provide an incentive for the local production of gold and gold coins, had caused the retail sales tax on gold coins in Ontario to be applied in a manner inconsistent with the provisions of Articles III and II of the General Agreement, and had therefore nullified or impaired benefits accruing to South Africa within the meaning of Article XXIII. South Africa was of the view that it was within the Federal Government's competence, acting in accordance with the relevant provisions of the Canadian constitution, to induce Ontario to remove the inconsistency with Canada's GATT commitments. The federal government of Canada had not taken the measures, reasonably at its disposal and within its power, to ensure observance of its GATT obligations by Ontario. South Africa thus asked the Panel:

(i) to find that the measure imposed by Ontario infringed Canada's GATT obligations in that it was inconsistent with the provisions of Articles II and III;

(ii) to find that benefits accruing to South Africa under the General Agreement had been nullified or impaired; and

(iii) to request the CONTRACTING PARTIES to recommend that Canada take immediate steps to terminate the discrimination against the Krugerrand.

10. Canada argued that the government of Canada had not acted in any way inconsistent with its obligations under the General Agreement. Canada's view was that its GATT obligation, taking into account Canada's specific constitutional structure and with respect to the Ontario measure, was that contained in Article XXIV:12, i.e. to take "such reasonable measures as may be available to it to ensure observance of the provisions of this Agreement by the regional and local governments within its territory." Canada pointed out that the Ontario measure in question was not taken by Canada, but by a provincial government which was not a contracting party. If it had been intended that a contracting party, which is a federal state such as Canada, was to be deemed to have automatically and directly violated a specific GATT obligation as a result of a measure taken by another level of government falling within its territory and which did not observe that provision, then the obligation contained in Article XXIV:12 would be unnecessary. It would be left empty of practical meaning. As an integral part of GATT, Canada felt that the Article XXIV:12 obligation must have practical content. Canada further stated that it had fulfilled its Article XXIV:12 obligation. Canada therefore asked the Panel to find that Canada had not acted in a manner inconsistent with its obligations under Articles III and II, that Canada's obligation in the matter being examined by the Panel was limited to that contained in Article XXIV:12, and that Canada had fully complied with its obligation under that paragraph.

11. Moreover, Canada's view was that the language of Article XXIV:12 introduces the concept of "observance" of the provisions of the General Agreement by regional or local levels of government. Canada held that "lack of observance" by another level of government in a federal State like Canada does not in itself entail a failure by the contracting party to act in a manner consistent with its GATT obligations. "Observance" represents a distinct and important GATT concept. Therefore, Canada accepted that it would be appropriate for the Panel to examine whether, in the case at hand, there had been a failure on the part of the Government of Ontario to observe certain GATT provisions.

(b) Articles III and II

12. Pursuant to the understanding on its terms of reference, the Panel first heard arguments on whether the measure taken by Ontario accorded with the provisions of Article III and Article II of the General Agreement.

13. In relation to Article III, South Africa argued firstly that, as the Ontario measure was explicitly aimed at advantaging domestically produced Maple Leaf gold coins, it was in its intent inconsistent with the provisions of Article III:1 that internal taxes "should not be applied to imported or domestic products so as to afford protection to domestic production". In this connection South Africa called attention to the statement by the Provincial Treasurer, in his 1983 budget statement, that "In the meantime, I would like to announce a modest incentive to assist our gold producers. Currently, a significant amount of the production of gold in Ontario is used in making the Canadian Maple Leaf gold coin. I propose to remove the retail sales tax from this coin to encourage its production in the face of increasing future competition." The intent and purpose of the measure, as announced by the Ontario Treasurer, was to assist Canadian gold producers by stimulating sales of the Maple Leaf coin, which was an important outlet for Canadian gold, mostly produced in Ontario. Exemption of the Maple Leaf coin only from the 7 per cent retail sales tax brought about a mandatory price differential which afforded an effective protection of 7 per cent for that coin over a directly competing imported product,

namely the Krugerrand. It was evident that the Ontario measure was not aimed at stimulating total demand for gold coins, but at switching demand to achieve an increase in Maple Leaf gold coin sales. It was thus contrary to the provisions of Article III:1.

14. Secondly, the Ontario measure conflicted directly with the provision of Article III:2 that "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 charges of any kind in excess of those applied, directly or indirectly, to like domestic products". There was no doubt that the Krugerrand and Maple Leaf coins were "like products" within the meaning of Article III:2. Both coins were produced in quantity, to the same standard based on the fine ounce of gold, and only these two coins shared the fine ounce as the standard of their gold content; both were legal tender in their countries of origin; and the two coins sold in international markets at virtually the same price. Thus the Ontario measure, by subjecting a product of South Africa imported into Canadian territory to internal taxation in excess of that applied to the like domestic product, conflicted with the provisions of Article III:2.

15. Thirdly, the Ontario measure upset the competitive relationship between the domestic and imported product and gave an unfair marketing and promotion advantage to the Maple Leaf coin. The measure thus contravened Article III:4 of the General Agreement. Serious trade losses had occurred in the Ontario market following the introduction of the measure.

16. In relation to Article II, South Africa argued that the measure led to a non-observance of, and hence an impairment of, the Canadian duty-free concession on gold coins, which had been agreed in the Tokyo Round without any qualification on the part of Canada that the Federal Government suffered any constitutional or other impediment in ensuring that the net worth of the concession would not be impaired or nullified in any way. The Ontario measure, being inconsistent with Article III:2, violated the provisions of Article II:2(a), under which "a charge equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of Article III" may be imposed on importation of any product. The discriminatory treatment introduced by the tax measure led in turn to a violation of Article II:1(a) in that Canada was not according to another contracting party "treatment no less favourable than that provided for in the appropriate Part of the appropriate Schedule". The sales tax was not legally equated with a customs duty, but the Ontario measure (although not applied at the time of importation) had the same effect as a tariff, and therefore nullified the tariff binding. The security and the predictability of market access offered by the tariff concession, which was a central obligation under GATT, had been undermined by the unilateral modification of competitive conditions in Canada, without Canada having recourse to Article XXVIII. Benefits accruing to South Africa under Article II had therefore been impaired.

17. Canada argued that the measure taken by Ontario was to be viewed in the light of Canada's obligations as a contracting party. The Government of Canada had not acted in a manner inconsistent with its obligations under Articles II and III. The relevant tariff binding was being honoured, no additional charges were applied at the border and no internal discriminatory measures were being applied by the Government of Canada. The obligation of a federal State like Canada was limited in such a case as that before the Panel to that contained in Article XXIV:12. After carefully reviewing the drafting history, Canada was of the view that the intent of the drafters of the General Agreement in this regard, as reflected in Article XXIV:12, was clear. Canada reviewed the efforts made by the drafters to attempt to come to terms with a situation in which local-level measures taken in federal States like Canada might create a failure on the part of local governments to observe provisions of the GATT. As early as the 1946 London drafting Conference, delegations engaged in the search for language which would provide for some discipline in such circumstances. In the view of Canada, if measures of local and regional governments contrary to the intention of a particular provision of the General Agreement were automatically and directly to imply a breach of that obligation by the contracting party regardless of specific constitutional circumstances then the concern of delegations was misplaced and proposals for

what eventually became Article XXIV:12 were redundant. In the context of continuing discussions on this provision, at the 1947 Geneva session, one delegate, reflecting the majority view, referred to local authorities "which are not strictly bound, so to speak, by the provisions of the Agreement, depending of course upon the constitutional procedure of the country concerned". (UN doc.E/PC/T/TAC/PV.19, pages 32-3).

18. Canada held that its view of this matter was reinforced by amendments proposed at the Havana Conference to extend the scope of what was, in effect, the Article XXIV:12 obligation as follows: "Each Member … shall be responsible for any act or omission to act contrary to the provisions of this Charter on the part of any such governments and authorities" (i.e. of a regional and local nature). The amendment was twice proposed and twice rejected by delegations. Canada stated that it believes that the close review of the drafting history clearly indicated that delegations accepted that, depending on the precise nature of specific constitutional regimes, the obligation of a contracting party with respect to measures taken by other levels of government did not necessarily include direct responsibility in terms of standard GATT obligations for such measures if they did not observe the intent of GATT provisions, but rather responsibility in terms of the Article XXIV:12 obligation. Canada reiterated that it had joined GATT as an original signatory with the provisions of Article XXIV:12 as an integral part of the General Agreement and that it was fully known and accepted, as demonstrated by the drafting history, that Article XXIV:12 applied as the obligation of federal States like Canada, depending on the specific constitutional régime in question, when measures taken by local and regional governments are examined.

19. Recalling the provincial responsibility under the Canadian constitution for "direct taxation within a province in order to the raising of a revenue for provincial purposes", Canada noted that Canadian courts have ruled that taxation may have a mixed purpose; it may be used as an instrument of economic and social policy and this may entail a forfeiture of revenue. Provinces also enjoy exclusive constitutional responsibility for "property and civil rights", the judicial interpretation of which includes business carried out within provincial boundaries.

20. Canada said that neither the Canadian federal government nor the federal legislature possesses the constitutional power to oblige a provincial government to modify a measure that the federal authorities might consider as being improperly aimed at federal constitutional jurisdiction. Only an appropriate Canadian court can make such a determination. Accordingly, in the absence of any such determination, any legislation is presumed to be constitutional. In most division of power cases in Canada, the law or measure being examined has some aspects which are clearly within the jurisdiction of the federal legislature and others which appear to be outside its jurisdiction. The Canadian Court makes an assessment in the light of all the circumstances in order to select the dominant features of the law or measure. The federal government cannot directly interfere in, nor would it expect to be regularly consulted on, the making of economic and budgetary policy by a province. Moreover, unlike the situation in almost all other federal states, the conclusion of treaties by the federal government did not confer on it the authority to implement their provisions in respect of subjects of provincial jurisdiction. The Judicial Committee of the Privy Council of the United Kingdom, acting as Canada's supreme constitutional authority at the time, ruled in 1937 that questions arising in such areas have to be dealt with by co-operation and consultation between the federal government and the provinces; this decision has never been overruled.

21. Canada went on to state that, although Canada had not acted in any way inconsistent with its Article II and III obligations and although it held that such obligations did not apply directly or automatically when provincial measures are examined, it accepted that, in order for the Panel to be in a position to examine whether Canada had acted consistently with its Article XXIV:12 obligation, the Panel would have to examine whether the Ontario action observed the intent of Articles II and III.

22. In relation to the observance of Article II by Ontario, Canada argued that this Article did not apply to internal measures imposed on imported goods after they had entered the territory of a contracting party but only to measures imposed at the time of importation. The distinction between "imported" goods and "importation" of products had been clearly established in GATT practice, in particular in the Belgian Family Allowance case (BISD 1S/59) and the case regarding EEC measures on animal feed proteins (BISD 25S/67). The Ontario retail sales tax measure was levied at the time of retail sale of goods within the province, not at the time of importation. It did not directly affect the importation of gold investment coins as such, but was an internal measure affecting their sale once within the provincial territory. Canada's view was, therefore, that the Ontario measure did not entail a lack of observance of Article II.

23. With respect to the general question of whether the measure observed the national treatment principle of Article III, Canada agreed that the Krugerrand and Maple Leaf were "like" products as investment coins within the meaning of that provision. Canada noted, however, that the measure provided for the extension of the sales tax exemption to "such other gold coins as are prescribed by regulation". Thus gold coins other than the Maple Leaf were not excluded from the legal provisions of the measure, although the exemption was currently applied only to the Maple Leaf. Moreover, Canada noted that the question of legal tender was, in its view, not relevant to the case at hand. The Krugerrand was not legal tender in Canada. The essential characteristic of gold investment coins was that of a commodity to be bought and sold as a good with commercial value well in excess of the nominal face value. Canada stated that Ontario was clearly entitled to tax the entire transaction value of any given gold coin and not only its premium over the face value. As a "commodity" or "good", the commodity value of the coin was represented by the full market price, including the portion thereof which represented the face value of such a coin.

24. In relation to South Africa's view that benefits accruing to it under Article II had been nullified or impaired, Canada recognized that, if it were shown that Canada had acted in a manner inconsistent with its obligations under GATT, the action would constitute a prima facie case of nullification or impairment, independently of any trade effects. By contrast, if it were shown that Canada had not acted inconsistently with its obligations, South Africa's complaint would be pursued under Article XXIII:1(c). Canada noted that CONTRACTING PARTIES adopted the 1979 Framework Understanding that catalogues and refines the dispute settlement procedures in the light of experience. In this regard, prima facie cases, for which inconsistency with the General Agreement is the only criterion, are contrasted with cases brought under Article XXIII:1(b) or (c) which require the complainant to provide a detailed justification. In light of the 1979 Framework Understanding, Canada stated that the concept of "non-violation" prima facie nullification or impairment was not a relevant GATT legal concept.

25. As Canada had not, in its view, acted inconsistently with its GATT obligations, Canada therefore argued that South Africa was obliged to present a detailed justification which demonstrated how the competitive relationship between the Gold Maple Leaf and the Krugerrand had, in practice, been upset. In Canada's view, a detailed justification of how benefits accruing to South Africa had been nullified or impaired should include clear evidence of adverse trade effects.

26. South Africa said that statistical evidence was not required to establish a case of nullification or impairment, where a Panel had established that a measure was not in conformity with a GATT provision. According to Paragraph 5 of the Annex to the 1979 dispute settlement understanding, a detailed justification was called for only when a complainant claimed that benefits accruing to it had been nullified and impaired by measures which did not conflict with GATT provisions. South Africa's complaint, by contrast, was based on the inconsistency of the Ontario measure with GATT provisions. With regard to Article XXIV:12, South Africa argued that those provisions in the General Agreement would become superfluous if they were, as a general rule, to be interpreted as an exoneration, in whole or in part,

of local governments from the observance of the obligations of a federal government under GATT. Article XXIV:12 contained the guarantee that a federal government was under obligation to ensure observance of GATT by provincial or local governments. If this had not been the case, provincial governments could effectively render null and void specific obligations of a federal government under GATT, leaving intact that government's rights under GATT and resulting in a serious imbalance in rights and obligations assumed under the General Agreement. Footnote 22 in the Agreement on Interpretation and Application of Articles VI, XVI and XXIII was quoted as a specific example that a contracting party, with a federal system of government, accepts that its GATT obligations extend to other levels of government within its territory. Canada did not accept South Africa's interpretation of the relevance to the case of footnote 22 in the Agreement on Interpretation and Application of Articles VI, XVI and XXIII. In Canada's view, this Subsidies Code language simply reconfirmed that domestic subsidies provided by lower levels of government may be subject to countervail action. It did not call into question the GATT consistency of such subsidies.

(c) Article XXIV:12

27. Following the delivery to the parties of its findings relating to Articles III and II, the Panel heard arguments as to whether Canada had carried out its obligations in terms of Article XXIV:12 of the General Agreement. In this connection, the Panel also considered the scope and nature of Canada's obligations under Article III, in the light of Article XXIV:12.

28. South Africa argued that Canada had failed to honour its obligations under Article XXIV:12, by not taking such reasonable measures as may be available to it to ensure observance of the provisions of this Agreement by the Government of Ontario. South Africa recognized that the Panel did not have the legal competence to judge the validity of Ontario's action under the Canadian constitution. However, it was clear that the action was improperly aimed at affecting international trade and the Federal Government's exclusive power with regard to indirect taxation (i.e. customs and excise) and hence could be considered as ultra vires Ontario. South Africa also questioned the attitude taken towards the Ontario measure by the Royal Canadian Mint, a Federal institution, a significant part of whose profits in recent years had come from the sales of Maple Leaf coins South Africa asked the Panel to request the CONTRACTING PARTIES to rule that Canada immediately take reasonable measures to persuade Ontario to terminate the discriminatory tax measure and that if Ontario should fail to act positively within one month, the Canadian federal government promptly take steps to obtain a ruling on the constitutionality of the provincial measure through a Canadian court of law as a reasonable measure.

29. South Africa maintained that Article XXIV:12, from its drafting history, was clearly intended to apply only to a situation where a federal government did not have the constitutional power to control the actions of a provincial government. The applicability of Article XXIV:12 in a particular case did not detract from the applicability of other GATT provisions. It was not a general waiver applicable to federal states; such states also had the obligation to ensure observance of GATT by provincial governments.

30. South Africa argued that the link established in Ad Article III:1 between Article III:1 and Article XXIV:12 clearly delineated the concept of "reasonable measures". As the measure in dispute resulted in a voluntary and unequivocal forfeiture of revenue by the province of Ontario, and as the removal of the retail sales tax from Krugerrand (or the re-imposition of the retail sales tax on the Maple Leaf) could be effected by administrative procedures (enabling legislation had been created - see paragraph 5 above), the abrupt termination of the measure, in accordance with Ad Article III:1, would not create "serious administrative and financial difficulties" for the Ontario authorities and would, therefore, not represent an "unreasonable measure".

31. Articles II and III, in South Africa's view, applied to all commercial exchanges of products between all contracting parties, irrespective of their form of government. There was no provision which would suggest that these obligations applied only in respect of the territory of contracting parties with non-federal constitutions. Article XXIV:12 implied that provincial governments were obliged to observe GATT provisions while federal governments had the obligation to ensure the observance of these provisions by taking all reasonable measures available to them. Moreover, the interpretative note Ad Article III:1, in distinguishing between taxes imposed by local governments which were consistent with the spirit but not the letter of Article III, and those which were inconsistent with both letter and spirit, defined "reasonable measures" as meaning that there was an obligation on a federal government to act immediately to rectify a tax measure inconsistent with the letter and spirit of Article III, unless - and only unless - abrupt action would cause serious administrative and financial hardship to the province. The immediate elimination of the discrimination would not cause administrative or financial hardship to Ontario. Canada had therefore failed to comply with its obligation under Article XXIV:12 to ensure observance of the provisions of Article III.

32. South Africa stated that the Canadian constitutional provision reserving for the provinces the exclusive right to raise direct taxation for provincial purposes did not give them the power to impose taxation in a discriminatory manner in order to protect a Canadian industry. This would encroach upon the powers of the federal government in relation to the regulation of trade and commerce and customs and excise. The point had been made in several cases tried in Canadian courts. Given this situation, it would be only reasonable to expect the federal government to test the measure in a Canadian court with the competent jurisdiction to declare it ultra vires and hence null and void. South Africa recognized that the questions of Canada's GATT obligations and its constitutional division of powers were separate issues. The Panel reference was intended to deal with questions of GATT obligations, which were South Africa's primary concern. However, the importance of the constitutional issues at stake, in particular the protection of the federal government's legislative powers to regulate international trade and commerce and the honouring of its international treaty obligations, implied that the federal government, and not private parties, should take the government of Ontario to court.

33. South Africa said that repeated representations by South Africa to Canadian federal and provincial authorities had failed to have the measure amended. South Africa had little indication that the Canadian federal authorities were pursuing the question vigorously with Ontario. Canada in fact maintained during the Article XXIII:1 consultations and during the first phase of the Article XXIII:2 proceedings that the Ontario measure did not violate Canada's GATT obligations and therefore it could be assumed that the Federal Government had no reason to urge the Ontario Government to terminate the discriminatory tax measures.

34. Canada did not accept South Africa's interpretation of the meaning and scope of the interpretative note Ad Article III:1. The examples given in this note were not exhaustive and do not purport to be so. Moreover, these examples referred to national enabling legislation, i.e. national legislation authorizing local governments to impose certain internal taxes. In the case being examined by the Panel, there was no such federal enabling legislation (the Constitution Act, 1867 was not federal legislation). Moreover, the first sentence of Ad Article III:1 clarifies that the application of this paragraph is subject to the provisions of Article XXIV:12 and not the reverse. Canada argued that this interpretative note confirmed Canada's view that its obligation in the case at hand was that contained in Article XXIV:12, not in Article III.

35. Canada stated that the federal authorities did not have the constitutional power to impose on a provincial government any view as to whether a particular measure fell within the exclusive jurisdiction of the province. The "power" of the federal government was the "power" of persuasion. The federal government could try to persuade Ontario that a measure was improperly aimed and should be removed, but the constitutionality of any particular measure could only be determined in Canadian courts. Canada

also noted that the Royal Canadian Mint was not a policy-making body, had no competence to intervene in this case and, in fact, had never suggested discriminatory taxation treatment to Ontario authorities.

36. Canada recalled that the drafting history of Article XXIV:12 clearly recognized that the obligation placed on federal states such as Canada was to take "such reasonable measures as may be available to it" to ensure observance of GATT provisions by local governments. During the 1946 London preparatory meeting, the question of local government measures was raised in the context of discussions on national treatment. The subcommittee charged with this issue suggested extending the obligation by adding a clause that read: "Each Member agrees that it will take all measures open to it to assure that the objectives of this Article are not impaired in any way by taxes, charges, laws, regulations or requirements of subsidiary governments within the territory of the member governments" (UN doc.E/PC/T/C.II/54.Add 6). But Canada noted that this proposed tightening, in the context of the discussion on national treatment, of what would subsequently become, in substantially different form, the Article XXIV:12 obligation, did not survive. During the New York conference in early 1987, a delegation suggested the obligation of taking such reasonable measures as may be available and it was this language which prevailed. Moreover, during the Havana Conference, several states had unsuccessfully proposed firmer language. In particular, an amendment to the effect that "Each Member shall take all necessary measures to assure observance of the provisions of this Charter by the regional and local governments and authorities within its territory and shall be responsible for any act or omission to act contrary to the provisions of this Charter on the part of any such government or authorities", subsequently modified to "Each Member in accordance with its constitutional system shall take measures to assure …", (UN docs. E/CONF.2/C.6/12 and Add.18 respectively) were rejected by the Conference.

37. The General Agreement had been accepted by Canada with Article XXIV:12 as an integral part of it; it was fully known and accepted that this provision applied to federal states, in a manner which varied with the specific constitutional structure of the contracting party, when measures taken by provincial or local governments were to be examined. Canada's obligations under GATT were not direct obligations under Article III, but rather obligations to take such reasonable measures as may be available to it to ensure observance of GATT by regional and local governments. Canada's view at the time of the Havana Conference - which it still held - was that there was no obligation on a contracting party to take any measure which, that contracting party considered to be unreasonable. Clearly, "reasonable" must mean something less than "all measures open" to the federal authority or "all necessary measures". Canada accepted that it must undertake in persistent fashion reasonable measures aimed at ensuring that other levels of government within Canada observe the provisions of the General Agreement in the present case, Canada's obligation was to take such measures as it judged reasonable in the circumstances to attempt to convince Ontario to modify the retail sales tax measure in question.

38. With respect to South Africa's reference to the Article XXIII:1 consultation (see paragraph 33 above), Canada sustained in those consultations that it had not acted in a manner inconsistent with its GATT obligations, but that it had been urging the Ontario Government to modify appropriately the retail sales tax measure in question through contacts at the officials' level. Since July 1983, the federal authorities had made over one hundred contacts with the appropriate Ontario officials by telephone, in writing and in person to urge forcefully that the measure be modified in the light of South Africa's complaint. Between August 1983 and July 1984, the Canadian Deputy Minister for International Trade had written three times to her Ontario counterparts, firstly reiterating South Africa's concern that the imposition of discriminatory internal taxes on imported goods was contrary to Article III of the GATT, and subsequently expressing the view that the Ontario measure, if pursued under the GATT dispute settlement procedures, would be found not to observe the national treatment principle of Article III and urging Ontario to proceed expeditiously to eliminate any discrimination in the application of the sales tax between domestic and imported gold coins. The new federal government had again taken up the question from October 1984, when, by letter and in a meeting in the provincial capital between

the federal Minister for International Trade and the Ontario Minister for Industry and Trade, the Ontario government was again urged to remove the differential treatment, if possible before the 7 November 1984 GATT Council meeting. Following that Council meeting, the federal government continued to urge Ontario, clearly and unequivocally, to modify the retail sales tax measure. Most recently, the Canadian Minister of International Trade had written to the new Ontario Minister of Industry and Trade in February 1985, reiterating that it was urgent that Ontario move quickly to remove the differential treatment on gold coins. Canada stated that it has continued to urge Ontario to modify appropriately the retail sales tax measure. Canada had thus fully complied with its Article XXIV:12 obligations.

39. Canada argued, moreover, that having regard to Canadian constitutional practice and the nature of the Canadian federation, it could not be considered a "reasonable measure" under Article XXIV:12 for the Federal authorities to take court action against Ontario in order to challenge the constitutional validity of the measure in the Canadian courts. Initiative in bringing the constitutionality of provincial legislation before the courts in Canada was, in contemporary Canadian practice, normally the responsibility of private parties directly affected by the legislation: i.e. in this case, any party, whether or not a Canadian national, with a direct commercial interest. In such ordinary litigation undertaken on private initiative, moreover, the federal government had the right to intervene on constitutional issues and had done so in the past. It was felt that this was the best way for the parties concerned to obtain a satisfactory hearing and to ensure that all the factual and legal issues were properly discussed. The vast majority of cases concerning the federal/provincial constitutional division of powers were tried in this way.

40. In Canadian practice, the only course by which the federal government might take the initiative with respect to a division of power case in the Canadian courts would be through a Reference to the Supreme Court of Canada, not to lower courts. A Reference to the Supreme Court was an exceptional request by the federal executive for a legal opinion, in cases where new constitutional principles or points of law were at issue, which was not the situation in this case. Canada pointed out that the constitutional issue that could be argued before the Courts was, in fact, a very narrow one, involving a very specific clause of a single provincial statute. Moreover, the Canadian constitutional jurisprudence for a case like that at hand was already highly developed. What was novel was limited to the application of these principles to a new factual situation and this was clearly a matter for a trial court and not for the Supreme Court at first instance. In contemporary practice, such a Reference was an extraordinary and exceptional occurrence, used very sparingly. Given the consideration just outlined, a case such as that being examined by the Panel was not the kind of case it would be appropriate for the federal government to refer to the Supreme Court. There had only been eight such References in the last twenty years, and not one Reference concerning the constitutional validity of a provincial statute, or provision thereof, since 1956. Moreover, neither South Africa nor any directly interested parties would have a formally guaranteed rôle in the Supreme Court proceedings, nor any guaranteed right to be heard. Only in ordinary trial courts could the factual background to the case be fully developed. For the above reasons, Canada considered that such a Reference could not be considered a "reasonable" measure within the meaning of Article XXIV:12.

41. In Canada's view, a court hearing on the Canadian constitutional issue could have been instigated before or in parallel to the Panel proceedings on the GATT questions involved. The two issues were separate and could be pursued simultaneously or at different times by the relevant private interested parties, on the one hand, and the South African government, on the other.

42. South Africa did not share Canada's view of the drafting history of Article XXIV:12. In essence, the drafting history reflected two basic intentions, i.e.

(a) that the central obligation of a federal government to ensure observance of GATT by local or provincial governments, was not challenged and fully recognized by the drafters of those provisions; and

(b) that federal governments were not expected to assume more severe, or lesser, obligations under GATT than other contracting parties. The retention of the words "… in accordance with its constitutional system" would have limited the scope of a federal government's obligations, whereas the phrase "… and shall be responsible for any act or omission to act contrary to the provisions of this Charter on the part of any such governments or authorities" would have prejudiced such a contracting party's rights and obligations under GATT. The deletion of both the above-quoted phrases from Article XXIV:12 enables an objective assessment by the CONTRACTING PARTIES of "reasonable measures" on a case-by-case basis. Furthermore, South Africa held the view that only the CONTRACTING PARTIES could decide on the compatibility of measures with the General Agreement, including "reasonable measures", as provided for in Article XXIV:12 and that no individual contracting party could decide on it unilaterally.

43. South Africa noted that there was an important constitutional question in this case, that of the separation of powers between federal and provincial legislatures, in relation to an action taken by one level of government, improperly aimed at or overlapping with responsibility of the other; in this case, with the federal government's responsibility for regulation of trade and commerce and indirect taxation, i.e. customs and excise, and the honouring by Canada of its international treaty obligations. South Africa had exercised its GATT rights in bringing the case before the CONTRACTING PARTIES for settlement through the Panel procedures and would expect the Panel to base its findings on considerations related to the General Agreement. In relation to the Canadian constitution, it was a domestic affair and up to the Canadian authorities to take the question to court in order to challenge the constitutionality of the measure and, in so doing, ensure observance of its GATT obligations. South Africa did not accept the Canadian explanation that it is not appropriate for the Federal Government to initiate litigation in the case at hand by way of a Reference or otherwise. If court action by the Federal Government against Ontario was not ruled out as a reasonable measure, it would improve the Federal Government's ability to persuade Ontario to terminate the discriminatory measure. It could not be expected of the South African Government or any private individual or a South African firm to initiate court proceedings against Ontario in order to enable the Canadian Federal Government to honour its GATT obligations. In addition, the Supreme Court could deliver an opinion valid throughout Canada, whereas private litigation would be initiated in provincial courts. South Africa said that Quebec had now taken similar discriminatory action. South Africa could not be expected to pursue cases in each province in turn should further actions of this type be taken.

44. Canada replied that a successful suit respecting the legislation of one province could bring results which would be applicable throughout Canada.

(d) Other arguments

45. In support of their cases, both parties supplied the Panel, with statistical information and other material relating to imports and domestic sales of gold coins in Ontario and Canada as a hole. According to South Africa, a substantial volume of Krugerrand imports were traded via the USA and in the process, country of origin data tended to be blurred. In addition, import statistics per se, the basis of Canada's arguments and conclusions in this regard, in no way reflected the substantial sale and resale of gold coins on the internal market in Canada. Retail sales data for the province of Ontario for the periods immediately before and after the measure would give the most accurate picture of the situation. Industry data showed that direct sales of Krugerrands in Ontario had fallen markedly following the introduction of the measure, while sales in the rest of Canada continued to increase. Sales of Krugerrands in Ontario

had accounted for 47 per cent of their total sales in Canada in the first five months of 1983; in 1984 Ontario represented only three per cent of the Canadian market for Krugerrands. There was a large increase in the sales of Maple Leaf coins in Ontario between 1982 and 1984, starting in the second half of 1983; South Africa contended that this dramatic rise was largely the result of the mid-1983 tax measure. Retailers' experiences supported the evidence of a severe drop in Krugerrand sales and corresponding increase in Maple Leaf purchases following the measure and confirmed that the tax differential had an important influence on buyers' decisions to purchase Maple Leafs instead of Krugerrands. South Africa stated that the investor was interested only in buying the gold embedded in the Krugerrand and the Maple Leaf and therefore he would naturally prefer to buy the coin containing the cheaper gold, i.e. Maple Leaf in Ontario with a 7 per cent price advantage. This advantage was consequently exploited to the fullest in the 1983-85 Maple Leaf advertising campaign. South Africa pointed out that there was no world-wide decline in Krugerrand sales in 1983 vs 1982 and that the sharp drop in Krugerrand sales seen in Ontario was not experienced in the other Canadian provinces or in the rest of the world.

46. Canada noted that although most imported gold coins entered Canada through Ontario, the domestic market for gold investment coins was countrywide. Country-of-origin data provided by Statistics Canada showed imports into Canada of gold coins from South Africa falling from CAN$62.7 million in 1981 to CAN$15.5 million in 1982 and increasing to CAN$28.2 million in 1983; South African imports remained strong in the second half of 1983, after the Ontario sales tax measure was introduced. In 1984, however, imports from South Africa fell to CAN$2.2 million. Toronto was the main port of entry into Canada for South African gold coins, a large proportion of which were imported indirectly through the United States. The figures for imports into Ontario paralleled those for the country as a whole. The decline in imports of Krugerrands in 1984 was so marked that it could only reflect a nationwide trend; it was partly explained by the relative strength of sales of the United States' 1984 Olympic coin. Sales of Maple Leaf coins had increased markedly throughout Canada in the period 1983-1985 first quarter, principally due to the impact of a variety of strongly increased promotional activities by the Royal Canadian Mint and a decision taken by a major Canadian distributor to cease its direct purchases of Krugerrand from the South African Chamber of Mines as well as heightened buyer uncertainty about the marketability of the Krugerrand due to an active and increasingly effective public campaign, renewed during 1983 and with an initial focus in Ontario, undertaken by Canadian church and other groups which concentrated on discouraging sales and purchases of Krugerrand because of the political situation in South Africa. Moreover, Canada considered South Africa's sales data to be misleading and contradictory in many respects. Canada noted that worldwide sales of Krugerrand declined between 1983 and 1984. Meanwhile global sales of Gold Maple Leaf remained steady in an overall declining world market. Moreover, the Maple Leaf share of the total Canadian market increased in 1984 and 1985 in all regions of Canada, not just in Ontario. Canada therefore believed that trade and sales data did not demonstrate that the Ontario retail sales tax had contributed to the decline in imports of South African gold coins into Canada or to any decline in sales of Krugerrand in the Ontario market.

47. South Africa replied that, according to trade sources, United States Olympic coins were more of the nature of medallions and thus collectable items, and not comparable with gold coins. They were sold at a substantial premium and principally in the silver edition. The vast majority of bullion dealers who were the principal gold coin traders did not handle the medallions at all. Furthermore, it was stressed by South Africa that customs and import statistics were not reliable in this case because of the nature of the gold coin market and that the statistics supplied by the relevant industry was the only available reliable source.

Statement by the EEC

48. In a statement to the Panel, the European Economic Community expressed its concern that no precedent should be established in relation to Article XXIV:12 which could affect contracting parties' confidence in obligations undertaken by federal states. It would be unacceptable if the Panel found that Article XXIV:12 could allow a local or regional authority to free itself from any GATT obligation undertaken by the central government. GATT obligations are addressed to governments. In international law, a government represented a country in its entirety. Article XXIV:12 simply recognized the fact that federal states may have difficulties in implementing their GATT obligations because of their particular administrative or legal structures. In the opinion of the Community, even if it were to be determined to the complete satisfaction of the parties to the dispute that "reasonable measures" had been taken, there would be an unacceptable gap in the implementation of the General Agreement if the Panel were to interpret Article XXIV:12 in such a way as to limit the obligations of certain contracting parties. The Note to Article III:1 furthermore confirmed that contracting parties were not allowed to maintain under Article XXIV:12 measures which are inconsistent with the letter and spirit of GATT; the only relief from the obligation to eliminate such measures was that, in case of serious administrative and financial difficulties, some time could be allowed for their elimination.

IV. FINDINGS

49. The agreement on the terms of reference for the Panel was reached on the basis of the understanding that the Panel would provide its views to the parties on the question of whether the Ontario provincial sales tax measure on gold coins accorded with the provisions of Articles III and II of the General Agreement before proceeding to hear additional arguments relating to the remaining elements outlined in the terms of reference (see para. 2 above). The Panel therefore divided its examination of the case into two stages. In the first stage the Panel limited itself to the question of whether the Ontario measure accords with the provisions of Articles III and II.

50. The Panel noted that Articles III and II of the General Agreement distinguish between charges applied to products "imported into the territory of any other contracting party" (Article III:2) and charges "imposed on or in connection with importation" (Article II:1(b)). The CONTRACTING PARTIES interpreted these provisions for the first time in the Belgian Family Allowances case in 1952. In that case, they concluded that a levy charged not at the time of importation but at the time of purchase "was to be treated as an internal charge within the meaning of paragraph 2 of Article III of the General Agreement, and not as an import charge within the meaning of Article II" (BISD 1S/60). In 1978, the CONTRACTING PARTIES adopted the same interpretation in the case of the EEC measures on Animal Feed Proteins (BISD 25S/67). The Panel noted that the Ontario retail sales tax is levied at the time of retail sale of goods within the province, not at the time of importation into Canadian territory (see para. 5 above). The Ontario measure thus affects the internal retail sale of gold coins rather than the importation of Krugerrands as such. The Panel therefore considered that the tax was an "internal tax" to be considered under Article III and not an "import charge" to be considered under Article II.

51. The Panel then examined the Ontario measure in the light of the provisions of Article III and reached the following conclusions:

(a) Both the Maple Leaf and the Krugerrand are legal tender in their respective countries of origin. However, they are normally purchased as investment goods. The Panel therefore considered that the Maple Leaf and Krugerrand gold coins were not only means of payment but also "products" within the meaning of Article III:2.

(b) The Maple Leaf and Krugerrand gold coins are produced to very similar standards, have the same weight in gold, and therefore compete directly with one another in international markets. The Panel therefore considered that the Maple Leaf and Krugerrand gold coins were "like" products within the meaning of Article III:2, first sentence.

(c) Ontario had exempted the Maple Leaf gold coin from its retail sales tax but not the Krugerrand gold coin. The internal taxes to which Krugerrand gold coins imported into Canadian territory were subject in Ontario were thus in excess of those applied to a like domestic product.

52. For these reasons, the Panel found that the Ontario retail sales tax measure did not accord with the provisions of Article III:2, first sentence, which states that "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".

53. In the second stage of its examination, the Panel first addressed the question of whether, and if so how, Article XXIV:12 affects Canada's obligations under Article III:2 in respect of the measure taken by the Province of Ontario. The Panel noted that it is a well-established principle of international law that a party to a treaty may not invoke the provisions of its internal law, including its constitutional law, as justification for the failure to perform the treaty (see Article 27 of the Vienna Convention on the Law of Treaties). According to this principle, Canada would be fully responsible for any actions, taken by any State organs, having international trade policy effects, and would have an unqualified obligation to ensure the observance of the General Agreement by regional and local governments and authorities, unless some specific provision of the General Agreement determined otherwise. The distribution of competence between the federal government and the provinces under the Canadian constitution would therefore be irrelevant. The Panel considered that the purpose of Article XXIV:12 was to qualify the basic obligation to ensure the observance of the General Agreement by regional and local government authorities in the case of contracting parties with a federal structure, by stating that such contracting parties are obliged to take "such reasonable measures as may be available" to them to ensure observance, and that this qualification applied to Canada's obligation under Article III:2 in respect of measures taken by the Province of Ontario.

54. The Panel then examined whether Article XXIV:12 applies (a) to <u>all measures</u> taken at the regional or local level or (b) <u>only to those measures which the federal government cannot control</u> because they fall outside its jurisdiction under the constitutional distribution of competence. The Panel noted that, in the preparatory meetings for an international trade organization and in the negotiations leading to the General Agreement, the following justifications and explanations were given by the delegations which suggested the inclusion of a federal State clause.

55. Australia stated in connection with a proposed rule to prevent internal fiscal and regulatory discrimination against imported goods:

> "Where the matter is one solely of action by a State, and our 'external powers' laws <u>do not give the Commonwealth authority to act</u>, we would agree to use our best efforts to secure modification or elimination of any practice regarded as discriminatory" (UN doc. E/PC/T/C.II/5, p.1).

The United States delegation stated with reference to a rule on discriminatory government procurement practices:

> "The obligation to accord fair and equitable treatment in awarding contracts applied to both central and local governments where the central government <u>was traditionally or constitutionally able to control the local government</u> (UN doc., E/PC/T/C.II/27, p.1).

A sub-committee reported that:

> "Several countries emphasized that central governments could not in many cases control subsidiary governments in this regard, but agreed that all should take such measures as might be open to them to ensure the objective" (UN doc. E/PC/T/C.II/54, p.4).

In 1947 Mexico proposed an amendment according to which federal States would have been fully responsible for actions by regional and local governments. The sub-committee which had examined the proposal reported:

> "The Mexican amendment … was withdrawn as certain delegates stated that their governments would encounter constitutional difficulties in attempting to enforce the provisions … as drafted in the Mexican amendment" (UN doc. E/CONF.2/C.6/48/Rev.1, p.4).

The United States rejected a proposal by China to change the language of Article XXIV:12 by pointing out:

> "… it is necessary to distinguish between central or federal governments, which undertake these obligations in a firm way, and local authorities, which are not strictly bound, so to speak, by the provisions of the Agreement, depending of course upon the constitutional procedure of the country concerned" (UN doc. E/PC/T/TAC/PV/19, p.33).

56. In each of these statements, there is thus a reference to the federal government's lack of authority to act, to its inability to control the local governments, to the constitutional difficulties it faces or to the constitutional procedures it has to observe. This drafting history indicates, in the view of the Panel, that Article XXIV:12 applies only to those measures taken at the regional or local level which the federal government cannot control because they fall outside its jurisdiction under the constitutional distribution of competence.

57. The Panel consequently examined whether the levying of a higher tax on imported gold coins than on like domestic gold coins fell under the jurisdiction of Ontario or under that of the Canadian federal government. The Panel carefully examined the evidence submitted by both parties on the distribution of legislative and executive powers in the fields of trade and taxation. The Panel found that the Constitution Act of 1867 reserves for the federal Parliament exclusive legislative authority for the "regulation of trade and commerce" (Section 91) and for provincial legislatures exclusive authority for "direct taxation within the province in order to the raising of a revenue for provincial purposes" (Section 92) and that in the implementation of international treaties this distribution of exclusive legislative powers must be respected. It further found that, according to Canadian jurisprudence, a provincial tax was unconstitutional if it was improperly "aimed" at the regulation of international or interprovincial trade; certain provincial tax measures which affected such trade had been found by Canadian courts to be ultra vires the provinces concerned by virtue of the nature of the taxes. The Panel, however, also found that, according to the evidence submitted to it, there was no case in the Canadian jurisprudence which matched the present case and that it was therefore not certain whether the measure fell under the jurisdiction of Ontario or under that of the Canadian federal government.

58. The Panel therefore examined whether Article XXIV:12 applied in this constitutional situation. The Panel considered that, if Article XXIV:12 is to fulfil its function of allowing federal States to accede to the General Agreement without having to change the federal distribution of competence, then it must be possible for them to invoke this provision not only when the regional or local governments' competence can be clearly established but also in those cases in which the exact distribution of competence still remains to be determined by the competent judicial or political bodies. The Panel therefore concluded that Canada had to be given the benefit of the doubt and that Article XXIV:12 had to be deemed to be applicable to the Ontario measure.

59. The Panel then turned to the question of the legal consequences of the application of Article XXIV:12 to the Ontario measure. The Panel considered that Article XXIV:12 could be interpreted either (a) as limiting the applicability of the other provisions of the General Agreement or (b) as merely limiting the obligation of federal states to secure the implementation of these provisions.

60. If Article XXIV:12 were interpreted to limit the applicability of the other provisions of the General Agreement, Canada's only obligations under the General Agreement in respect of the Ontario measure would be those contained in Article XXIV:12. The Ontario measure, by itself, could not be regarded as being inconsistent with the General Agreement and would therefore not constitute a prima facie case of nullification and impairment. The CONTRACTING PARTIES have decided that contracting parties which claim that measures not conflicting with the provisions of the General Agreement have nullified or impaired benefits accruing to them under the General Agreement are to provide a detailed justification (BISD 26S/216). So far, the CONTRACTING PARTIES have considered such claims justified only if the party bringing the complaint could show that:

(a) a tariff concession had been negotiated;

(b) a measure not conflicting with the General Agreement was subsequently introduced which upset the competitive relationship between the product for which the tariff concession was granted and another directly competitive product; and

(c) the measure could not have been reasonably anticipated at the time when the tariff concession was negotiated (BISD Vol.II/193 and 1S/58).

The right of redress of contracting parties adversely affected by the non-observance of Article III by local governments acting within their constitutional competence would thus depend on the fulfilment of these conditions. In the absence of a tariff concession and in situations in which non-observance of Article III by the local government could reasonably be anticipated, adversely affected contracting parties would have no redress under the GATT.

61. If Article XXIV:12 were interpreted as merely limiting the obligation of federal States to secure the implementation of the provisions of the General Agreement, Article III:2 would remain applicable to the Ontario measure. This measure would therefore have to be regarded as being inconsistent with Article III:2 and the principle according to which measures inconsistent with the General Agreement are presumed to have caused nullification or impairment (see para. 42) would consequently apply to it. South Africa's right to redress would arise from the non-observance of Article III:2 and it would therefore not bear the burden of proving that a tariff concession had been impaired by a measure that could not reasonably have been anticipated.

62. Article XXIV:12 would with this interpretation affect only the type of redress available to South Africa. The CONTRACTING PARTIES have in the past always ruled that measures found to be inconsistent with the General Agreement must be withdrawn; they decided that compensation should be resorted to only if the immediate withdrawal of such measures is impracticable and as a temporary measure pending their withdrawal (BISD 26S/216, para.4). Since Canada's duty to ensure the observance of Article III:2 by Ontario is limited by Article XXIV:12, South Africa would not have the normal, unqualified right to the withdrawal of the inconsistent measure. However, South Africa would retain its subsidiary right to compensation pending the success of the reasonable measures Canada is obliged to take in accordance with Article XXIV:12 to ensure observance of Article III:2 by Ontario.

63. The Panel proceeded to an evaluation of the relative merits of the two interpretations of Article XXIV:12. The Panel noted that Article XXIV:12 refers to the "observance" of the provision of the General Agreement by local governments. Only a rule that applies to local governments can

be "observed" by them. This suggests that Article XXIV:12 was not meant to regulate the scope of application of the provisions of the General Agreement but merely the measures to secure their observance by local governments. The Panel further noted that Article XXIV:12 is an exception to the general principle that a party to a treaty may not invoke its internal law as a justification for not performing its treaty obligations (see para. 42 above), that it grants a special right to federal States without giving an offsetting privilege to unitary States and that it could therefore lead to imbalances in rights and obligations between unitary and federal States if the latter encounter constitutional difficulties in carrying out their obligations under the General Agreement.

64. The Panel considered that, as an exception to a general principle of law favouring certain contracting parties, Article XXIV:12 should be interpreted in a way that meets the constitutional difficulties which federal States may have in ensuring the observance of the provisions of the General Agreement by local governments, while minimizing the danger that such difficulties lead to imbalances in the rights and obligations of contracting parties. Only an interpretation according to which Article XXIV:12 does not limit the applicability of the provisions of the General Agreement but merely limits the obligations of federal States to secure their implementation would achieve this aim.

65. For the reasons set out above, the Panel considered that the non-observance of the provisions of Article III:2 by Ontario constituted a prima facie case of nullification or impairment of benefits accruing to South Africa under the General Agreement. Canada's obligations to ensure the observance of the provisions of Article III:2 by Ontario are limited to those set out in Article XXIV:12 but, until its efforts in accordance with Article XXIV:12 have secured the withdrawal of the measure, Canada is obliged to compensate South Africa for the competitive opportunities lost as a result of the Ontario measure.

66. Having examined the consequences of Article XXIV:12 for Canada's obligations under Article III:2, the Panel proceeded to address the question of whether Canada had carried out its obligation under Article XXIV:12 to take "such reasonable measures as may be available to it to ensure observance" of Article III:2 by Ontario.

67. The Panel noted the following arguments of the parties on this point: In the view of South Africa, one reasonable measure available to Canada to ensure the observance of Article III:2 by Ontario was for the federal government to refer the matter to the Supreme Court. Canada's failure to take this measure constituted a failure to carry out the obligations of Article XXIV:12. In the opinion of Canada, Article XXIV:12 did not impose upon contracting parties the duty to take measures which they did not consider reasonable. While agreeing that a reference to the Supreme Court was a measure theoretically available, and had been used in the past, Canada contested that it would be reasonable for the federal government to take this measure, as in contemporary Canadian practice the constitutionality of provincial legislation was normally challenged in the courts by private parties directly affected by the legislation. The federal government referred jurisdictional issues to the Supreme Court only in extremely rare cases of basic national importance.

68. The Panel considered that neither the wording nor the drafting history of Article XXIV:12 supported the Canadian view that each contracting party had the right to determine itself whether a measure was "reasonable" within the meaning of Article XXIV:12. The obligation to take reasonable measures which Article XXIV:12 imposes on federal States is a counterpart to the privilege which this provision confers upon these States (see para. 42 above). If the Canadian position were accepted, the obligation under Article XXIV:12 would be void of all substance while the corresponding privilege would remain intact.

69. The Panel consequently examined what meaning should be given to the term "reasonable". The Panel noted that the only indication in the General Agreement of what was meant by "reasonable" was contained in the interpretative note to Article III:1, which defined the term "reasonable measures" for

the case of national legislation authorizing local governments to impose taxes. According to this note the question of whether the repeal of such enabling legislation would be a reasonable measure required by Article XXIV:12 should be answered by taking into account the spirit of the inconsistent local tax laws, on the one hand, and the administrative or financial difficulties to which the repeal of the enabling legislation would give rise, on the other. The basic principle embodied in this note is, in the view of the Panel, that in determining which measures to secure the observance of the provisions of the General Agreement are "reasonable" within the meaning of Article XXIV:12, the consequences of their non-observance by the local government for trade relations with other contracting parties are to be weighed against the domestic difficulties of securing observance. While recognizing that this note refers to the case of national enabling legislation, the Panel considered that the basic principle embodied therein was applicable to the present case.

70. The Panel examined the consequences of the Ontario measure for Canada's trade relations with other contracting parties. The Panel noted that the Ontario measure upset the competitive relationship between a Canadian product and a directly competing product supplied by one other contracting party, thus violating not only the principle of national treatment but also that of most-favoured-nation treatment. The grant of compensation by Canada could only re-establish the overall balance of rights and obligations between Canada and South Africa but not the competitive opportunities of South African gold coin exporters. If all provinces of Canada could levy taxes that are higher on imported goods than on like domestic goods to protect a local industry against a specific foreign supplier, Canada's ability to exchange trade concessions with other contracting parties would be impaired. The Ontario measure therefore had consequences not only for Canada's trade in gold coins but for Canada's trade relations generally.

71. The Panel then considered the domestic difficulties of Canada in securing the observance of Article III:2 by Ontario through a reference to the Supreme Court. The Panel noted that, in contemporary practice, most jurisdictional disputes between the federal government and the provinces are resolved through political procedures rather than references to the Supreme Court. The Panel found that the evidence did not permit a definite assessment of the extent of the difficulties to which a reference of the Ontario measure to the Supreme Court by the federal government would give rise, and of whether such a reference was to be considered a "reasonable measure" within the meaning of Article XXIV:12.

V. CONCLUSIONS

72. In the light of the findings set out above, the Panel recommends that the CONTRACTING PARTIES request Canada to:

(a) continue to take such reasonable measures as are available to it to secure the observance of Article III:2 by the province of Ontario in accordance with Article XXIV:12;

(b) compensate South Africa for the competitive opportunities lost as a result of the Ontario measure until its efforts in accordance with Article XXIV:12 have secured the withdrawal of the measure; and

(c) report to the CONTRACTING PARTIES on the actions taken in the light of paragraphs (a) and (b) above before the end of 1985.