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PRINCIPLES OF NON-DISCRIMINATION

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4.1. INTRODUCTION

Non-discrimination is a key concept in WTO law and policy. As already noted in Chapter 1, there are two main principles of non-discrimination in WTO law: the most-favoured-nation (MFN) treatment obligation and the national treatment obligation. In simple terms, the MFN treatment obligation prohibits a country from discriminating *between* countries; the national treatment obligation prohibits a country from discriminating *against* other countries. This Chapter examines these two principles of non-discrimination as they apply to trade in goods and trade in services.

Discrimination between, as well as against, other countries was an important characteristic of the protectionist trade policies pursued by many countries during the economic crisis of the 1930s. Historians now regard these discriminatory policies as an important contributing cause of the economic and political crises that resulted in the Second World War. Discrimination in trade matters breeds resentment among the countries, manufacturers, traders and workers discriminated against. Such resentment poisons international relations and may lead to economic and political confrontation and conflict. In addition, discrimination makes scant economic sense, generally speaking, since it distorts the market in

favour of products and services that are more expensive and/or of a lesser quality. Eventually, it is the citizens of the discriminating country that end up 'paying the bill' for the discriminatory trade policies pursued.

The importance of eliminating discrimination in the context of the WTO is highlighted in the Preamble of the *WTO Agreement* where the 'elimination of discriminatory treatment in international trade relations' is identified as one of two main means by which the objectives of the WTO may be attained.

The key provisions of the GATT 1994 dealing with non-discrimination in trade in goods are:

- Article I, on the MFN treatment obligation; and,
- Article III, on the national treatment obligation.

The key provisions on non-discrimination in the GATS are:

- Article II, on the MFN treatment obligation; and,
- Article XVII, on the national treatment obligation.

The MFN and national treatment obligations of the GATT 1994 and the GATS prohibit discrimination on the basis of 'nationality' or the 'national origin or destination' of a product, service or service supplier. It should be noted, however, that in a few situations, WTO law also prohibits discrimination based on criteria other than 'nationality' or 'national origin or destination'.

This Chapter addresses:

- the MFN treatment obligations under the GATT 1994 and the GATS; and,
- the national treatment obligations under the GATT 1994 and the GATS.

With respect to each of these fundamental non-discrimination obligations, this Chapter first examines the nature and then the constituent elements of these obligations.

4.2. MOST-FAVOURED-NATION TREATMENT UNDER THE GATT 1994

Article I of the GATT 1994, entitled *General Most-Favoured-Nation Treatment*, states in paragraph 1:

With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any [Member] to any product originating in or destined

for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other [Members].¹

4.2.1. Nature of the MFN Treatment Obligation of Article I:1 of the GATT 1994

As the Appellate Body stated in *EC – Tariff Preferences*, it is well settled that the MFN treatment obligation set out in Article I:1 is a ‘cornerstone of the GATT’ and ‘one of the pillars of the WTO trading system’.² In *US – Section 211 Appropriations Act*, the Appellate Body ruled:

For more than fifty years, the obligation to provide most-favoured-nation treatment in Article I of the GATT 1994 has been both central and essential to assuring the success of a global rules-based system for trade in goods.³

Article I:1 of the GATT 1994 prohibits discrimination *between* like products originating in, or destined for, different countries.⁴ The principal purpose of the MFN treatment obligation is to ensure *equality of opportunity* to import from, or to export to, all WTO Members. In *EC – Bananas III*, the Appellate Body stated, with respect to WTO non-discrimination obligations (such as the obligation set out in Article I:1):

... The essence of the non-discrimination obligations is that like products should be treated equally, irrespective of their origin. As no participant disputes that all bananas are like products, the non-discrimination provisions apply to *all* imports of bananas, irrespective of whether and how a Member categorizes or subdivides these imports for administrative or other reasons.⁵

Article I:1 covers not only ‘in law’, or *de jure*, discrimination but also ‘in fact’, or *de facto*, discrimination.⁶ In *Canada – Autos*, the Appellate Body rejected, as the Panel had done, Canada’s argument that Article I:1 does not apply to measures which appear, on their face, to be ‘origin-neutral’.⁷ Also measures which appear, on their face, to be ‘origin-neutral’ can give certain countries more opportunity to trade than others and can, therefore, be in violation of the non-discrimination obligation of Article I:1. The

¹ Article I:2 to 4 of the GATT 1994 deals with so-called colonial preferences and allow the continuation of such preferences albeit within certain limits. While important and controversial when the GATT 1947 was negotiated, these colonial preferences are now of very little significance anymore and will not be discussed.

² See Appellate Body Report, *EC – Tariff Preferences*, para. 101.

³ Appellate Body Report, *US – Section 211 Appropriations Act*, para. 297. See also Appellate Body Report, *Canada – Autos*, para. 69, and Appellate Body Report, *EC – Tariff Preferences*, para. 101.

⁴ See Appellate Body Report, *Canada – Autos*, para. 84.

⁵ Appellate Body Report, *EC – Bananas III*, para. 190. Note that the Appellate Body also referred to the non-discrimination obligations set out in Articles X:3(a) and XIII of GATT 1994 and Article 1.3 of the Licensing Agreement.

⁶ A measure may be said to discriminate in law or *de jure* in a case in which it is clear from reading the text of the law, regulation or policy that it discriminates. If the measure does not appear on the face of the law, regulation or policy to discriminate, it may still be determined to discriminate *de facto* if, on reviewing all the facts relating to the application of the measure, it becomes obvious that it discriminates in practice or in fact.

⁷ See Appellate Body Report, *Canada – Autos*, para. 78.

measure at issue in *Canada – Autos* was an import duty exemption accorded by Canada to imports of motor vehicles by certain manufacturers. Formally speaking there were no restrictions on the origin of the motor vehicles that were eligible for this exemption. In practice, however, the manufacturers imported only their own make of motor vehicle and those of related companies. As a result, only motor vehicles originating in a small number of countries benefited *de facto* from the exemption. Previously, the GATT Panel in *EEC – Imports of Beef* found that EC regulations making the suspension of an import levy conditional on the production of a certificate of authenticity were inconsistent with the MFN-obligation of Article I:1 after it was established that the only certifying agency authorised to produce a certificate of authenticity was an agency in the United States.⁸

4.2.2. Consistency with Article I:1 of the GATT 1994

Article I:1 of the GATT 1994 sets out a three-tier test of consistency. There are three questions which must be answered to determine whether there is a violation of the MFN treatment obligation of Article I:1, namely:

- whether the measure at issue confers a trade ‘advantage’ of the kind covered by Article I:1;
- whether the products concerned are ‘like’ products; and,
- whether the advantage at issue is granted ‘immediately and unconditionally’ to all like products concerned.

4.2.2.1. ‘Any advantage with respect to ...’

The MFN treatment obligation concerns ‘any advantage, favour, privilege or immunity’ granted by any Member to any product originating in, or destined for, any other country with respect to: (1) customs duties; (2) charges of any kind imposed *on* importation or exportation (e.g., import surcharges or consular taxes); (3) charges of any kind imposed *in connection with* importation or exportation (e.g., customs fees or quality inspection fees); (4) charges imposed on the international transfer of payments for imports or exports; (5) the method of levying such duties and charges, such as the method of assessing the base value on which the duty or charge is levied; (6) all rules and formalities in connection with importation and exportation; (7) internal taxes or other internal charges; and (8) laws, regulations and requirements affecting internal sale, offering for sale, purchase, transportation, distribution or use of any product.

In brief, the MFN treatment obligation concerns any advantage granted by any Member with respect to:

⁸ GATT Panel Report, *EEC – Imports of Beef*, paras. 4.2 and 4.3.

- customs duties, other charges on imports and exports and other customs matters;
- internal taxes; and
- internal regulation affecting the sale, distribution and use of products.

Note that the MFN treatment obligation not only concerns advantages granted to other WTO Members, but advantages granted to all other countries (including non-WTO Members). If a Member grants an advantage to a non-Member, Article I:1 obliges the Member to grant that advantage also to all WTO Members.

Generally, there has been little debate about the kind of measures covered by Article I:1. Both panels and the Appellate Body have recognised that Article I:1 clearly casts a very wide net.⁹ In *US – MFN Footwear*, also referred to as *US – Non-Rubber Footwear*, the Panel found:

... the rules and formalities applicable to countervailing duties, including those applicable to the revocation of countervailing duty orders, are rules and formalities imposed in connection with importation, within the meaning of Article I:1.¹⁰

In *Canada – Autos*, the Appellate Body usefully clarified the scope of Article I:1 by ruling:

... Article I:1 requires that “*any advantage, favour, privilege or immunity granted by any Member to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other Members.*” [Emphasis added] The words of Article I:1 refer not to *some* advantages granted “with respect to” the subjects that fall within the defined scope of the Article, but to “*any advantage*”; not to *some* products, but to “*any product*”; and not to like products from *some* other Members, but to like products originating in or destined for “*all other*” Members.¹¹

In other words, the MFN treatment obligation requires that *any* advantage granted by a Member to any product from or for another country be granted to *all* like products from or for *all other* Members.

4.2.2.2. ‘Like products’

Article I:1 concerns any product originating in or destined for any other country and requires that an advantage granted to such product shall be accorded to the ‘like product’ originating in or destined for the territories of all other Members. It is only between ‘like products’ that the MFN

⁹ Already in August 1948, the CONTRACTING PARTIES adopted a ruling by the Chairman that consular taxes would be covered by the phrase ‘charges of any kind’ in Article I:1 of the GATT 1947. See BISD II/12.

¹⁰ GATT Panel Report, *US – MFN Footwear*, para. 6.8.

¹¹ Appellate Body Report, *Canada – Autos*, para. 79.

treatment obligation applies and that discrimination is prohibited. Products that are not ‘like’ may be treated differently.

The concept of ‘like products’ is used not only in Article I:1 but also in Article II:2(a), III:2, III:4 VI:1(a), IX:1, XI:2(c), XIII:1, XVI:4 and XIX:1 of the GATT 1994. Nevertheless, the concept of ‘like products’ is not defined in the GATT 1994. As the Appellate Body considered in *EC – Asbestos* in its examination of the concept of ‘like products’ under Article III:4, the dictionary meaning of ‘like’ suggests that ‘like products’ are products that share a number of identical or similar characteristics. The reference to ‘similar’ as a synonym of ‘like’ also echoes the language of the French version of Article III:4, ‘*produits similaire*’, and the Spanish version, ‘*productos similares*’.¹² However, as the Appellate Body noted in *Canada – Aircraft*, ‘dictionary meanings leave many interpretative questions open’.¹³ With regard to the concept of ‘like products’, there are three questions of interpretation that need to be resolved:

- *first*, which characteristics or qualities are important in assessing the ‘likeness’;
- *second*, to what degree or extent must products share qualities or characteristics in order to be ‘like products’; and,
- *third*, from whose perspective should ‘likeness’ be judged.¹⁴

It is generally accepted that the concept of ‘like products’ has different meanings in the different contexts in which it is used. In *Japan – Alcoholic Beverages II*, the Appellate Body illustrated the possible differences in the scope of the concept of ‘like products’ between different provisions of the *WTO Agreement* by evoking 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.¹⁵

The meaning of the phrase ‘like products’ in Article I:1 was addressed in a number of GATT working party and panel reports.¹⁶ In *Spain –*

¹² See Appellate Body Report, *EC – Asbestos*, para. 91. Note that the French and Spanish versions of the GATT 1994 are equally authentic.

¹³ Appellate Body Report, *Canada – Aircraft*, para. 153. See also Appellate Body Report, *EC – Asbestos*, para. 92.

¹⁴ See Appellate Body Report, *EC – Asbestos*, para. 92.

¹⁵ Appellate Body Report, *Japan – Alcoholic Beverages II*, 114.

¹⁶ See, e.g., Working Party Report, *Australian Subsidy on Ammonium Sulphate*, para. 8, and GATT Panel Report, *EEC – Animal Feed Proteins*, para. 4.2. In the latter case, the Panel decided on the basis of ‘such factors as the number of products and tariff items carrying different duty rates and tariff bindings, the varying protein contents and the different vegetable, animal and synthetic origin of the protein products’ that the various protein

Unroasted Coffee, the Panel had to decide whether various types of unroasted coffee ('Colombian mild', 'other mild', 'unwashed Arabica', 'Robusta' and 'other') were 'like products' within the meaning of Article I:1. Spain did not apply customs duties on 'Colombia mild' and 'other mild', while it imposed a 7 per cent customs duty on the other three types of unroasted coffee. Brazil, which exported mainly 'unwashed Arabica', claimed that the Spanish tariff regime was inconsistent with Article I:1. In examining whether the various types of unroasted coffee were 'like products' to which the MFN treatment obligation applied, the Panel considered:

- the characteristics of the products;
- their end-use; and,
- tariff regimes of other Members.

The Panel stated as follows:

The Panel examined all arguments that had been advanced during the proceedings for the justification of a different tariff treatment for various groups and types of unroasted coffee. It noted that these arguments mainly related to organoleptic differences resulting from geographical factors, cultivation methods, the processing of the bean, and the genetic factor. The Panel did not consider that such differences were sufficient reason to allow for a different tariff treatment. It pointed out that it was not unusual in the case of agricultural products that the taste and aroma of the end-product would differ because of one or several of the above-mentioned factors.

The Panel furthermore found relevant to its examination of the matter that unroasted coffee was mainly, if not exclusively, sold in the form of blends, combining various types of coffee, and that coffee in its end-use, was universally regarded as a well-defined and single product intended for drinking.

The Panel noted that no other contracting party applied its tariff régime in respect of unroasted, non-decaffeinated coffee in such a way that different types of coffee were subject to different tariff rates.

In the light of the foregoing, the Panel concluded that unroasted, non-decaffeinated coffee beans listed in the Spanish Customs Tariff ... should be considered as "like products" within the meaning of Article I:1.¹⁷

In addition to the characteristics of the products, their end-use and tariff regimes of other Members - the criteria used by the GATT Panel in *Spain – Unroasted Coffee* - a WTO panel examining whether products are 'like' within the meaning of Article I:1 would now definitely also consider

products at issue could not be considered as 'like products' within the meaning of Articles I and III of the GATT 1947.

¹⁷ GATT Panel Report, *Spain – Unroasted Coffee*, para. 4.6 – 4.9.

consumers' tastes and habits, a criterion or factor not yet referred to in *Spain – Unroasted Coffee*.¹⁸

It is much debated whether under current WTO law, the process or production method (the 'PPM') by which a product is produced, is relevant in determining whether products are 'like' if the process or production method does not affect the physical characteristics of the products. The prevailing view is that the PPM is not relevant.¹⁹ Consequently, products produced in an environmentally-unfriendly manner cannot be treated differently than products produced in an environmentally-friendly manner on the sole basis of the difference in process or production methods.²⁰

4.2.2.3. Advantage granted 'immediately and unconditionally'

Article I:1 requires that any advantage granted by a WTO Member to imports from any country must be granted 'immediately and unconditionally' to imports from all other WTO Members.²¹ Once a WTO Member has granted an advantage to imports from a country, it cannot make the granting of that advantage to imports of other WTO Members conditional upon those other WTO Members 'giving something in return' or 'paying' for the advantage.

In a legal opinion of 1973 in the context of the accession of Hungary to the GATT, the GATT Secretariat noted:

... the prerequisite of having a co-operation contract in order to benefit from certain tariff treatment appeared to imply conditional most-favoured-nation treatment and would, therefore, not appear to be compatible with the General Agreement.²²

In *Canada – Autos*, the Appellate Body also discussed the concepts of 'immediately and unconditionally' and found:

The measure maintained by Canada accords the import duty exemption to certain motor vehicles entering Canada from certain countries. These privileged motor vehicles are imported by a limited number of designated manufacturers who are required to meet certain performance conditions. In practice, this measure does not accord the same import duty exemption immediately and unconditionally to like motor vehicles of *all* other Members, as required under Article I:1 of the

¹⁸ With respect to the criteria that can be taken used in determining 'likeness' within the meaning of Article I:1, see the discussion on the criteria used to determine whether products are 'like' within the meaning of Article III:2, first sentence and Article III:4.

¹⁹ Note, however, the discussion of the concept of 'likeness' in Article III:4 in the context of the *EC – Asbestos* dispute.

²⁰ See GATT Panel Report, *US – Tuna (Mexico)*, para. 5.15.

²¹ Note that Article I:1 also requires that any advantage granted by a WTO Member to exports to any country must be accorded 'immediately and unconditionally' to exports to all other WTO Members. This has, however, seldom been a problem.

²² Working Party Report on the 'Accession of Hungary', L/3889, adopted on 30 July 1973, BISD 20S/34, para. 12.

GATT 1994. The advantage of the import duty exemption is accorded to some motor vehicles originating in certain countries without being accorded to like motor vehicles from *all* other Members. Accordingly, we find that this measure is not consistent with Canada's obligations under Article I:1 of the GATT 1994.²³

The granting of an advantage within the meaning of Article I:1 may not be conditional on whether a Member has certain characteristics, has certain legislation or undertakes certain action. In the *Belgium – Family Allowances* case, a dispute of 1952, concerning a Belgian law providing for an exemption from a levy on products purchased from countries which had a system of family allowances similar to that of Belgium, the Panel held that the Belgian law at issue:

... introduced a discrimination between countries having a given system of family allowances and those which had a different system or no system at all, and made the granting of the exemption dependent on certain conditions.²⁴

The Panel concluded that the advantage – the exemption from a levy – was not granted 'unconditionally' and that the Belgian law was, therefore, inconsistent with the MFN treatment obligation of Article I:1.

4.3. MOST-FAVOURLED-NATION TREATMENT UNDER THE GATS

As mentioned above, the MFN treatment obligation is also one of the basic provisions of the GATS. This section examines:

- the nature of the MFN treatment obligation provided for in Article II:1 of the GATS;
- the test of consistency with Article II:1; and,
- the exemptions from the MFN treatment obligation of Article II:1 of the GATS.

4.3.1. Nature of the MFN Treatment Obligation of Article II:1 of the GATS

Article II:1 of the GATS prohibits discrimination *between* like services and service suppliers from different countries. Accordingly:

With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country.²⁵

As is the case with the MFN treatment obligation under the GATT 1994, the principal purpose of the MFN treatment obligation of Article II:1 of

²³ Appellate Body Report, *Canada – Autos*, para. 85.

²⁴ GATT Panel Report, *Belgium – Family Allowances*, para. 3.

²⁵ Article II:1 of the GATS.

the GATS is to ensure *equality of opportunity, in casu*, for services and service suppliers from *all* WTO Members.

The MFN treatment obligation of Article II:1 of the GATS applies both to *de jure* and to *de facto* discrimination. This was the ruling of the Appellate Body in *EC – Bananas III*. The Appellate Body disagreed in this case with the European Communities, which had argued that if the negotiators of the GATS wanted Article II:1 to cover also *de facto* discrimination, it would have explicitly said so.²⁶ The Appellate Body ruled, however:

The obligation imposed by Article II is unqualified. The ordinary meaning of this provision does not exclude *de facto* discrimination. Moreover, if Article II was not applicable to *de facto* discrimination, it would not be difficult -- and, indeed, it would be a good deal easier in the case of trade in services, than in the case of trade in goods -- to devise discriminatory measures aimed at circumventing the basic purpose of that Article.²⁷

In *EC – Bananas III*, various rules for the allocation of import licenses for bananas were at issue. According to the complainants, these rules, which on their face were origin neutral, discriminated against distributors of Latin American and non-traditional ACP bananas in favour of distributors of EC and traditional ACP bananas.

4.3.2. Consistency with Article II:1 of the GATS

As is the case with Article I:1 of the GATT 1994, Article II:1 of the GATS sets out a three-tier test of consistency. There are three questions which need to be answered to determine whether or not a measure violates the MFN treatment obligation of Article II:1. These three questions are whether:

- the measure is a measure covered by the GATS;
- the services or service suppliers concerned are ‘like’ services or service suppliers; and
- less favourable treatment is accorded to the services or service suppliers of a Member.

4.3.2.1 ‘Measures covered by this Agreement’

Article I:1 of the GATS states:

This Agreement applies to measures by Members affecting trade in services.

For a measure to be covered by the GATS, that measure must thus be:

- a measure by a Member; and,
- a measure affecting trade in services.

²⁶ The European Communities noted that unlike Article II:1, Article XVII of the GATS on the national treatment obligation states explicitly that it applies both to *de jure* and *de facto* discrimination .

²⁷ Appellate Body Report, *EC – Bananas III*, para. 233.

A ‘measure by a Member’ is a very broad concept. As stated in Article I:3(a) of the GATS, a ‘measure by a Member’ is not limited to measures taken by the central government or central government authorities. Measures taken by regional or local governments and authorities are also ‘a measure by a Member’ within the meaning of Article I:1 of the GATS. Measures taken by non-governmental bodies are ‘a measure by a Member’ when these measures are taken in the exercise of powers delegated by governments or authorities.²⁸ A ‘measure by a Member’ can be a law, regulation, rule, procedure, decision or administrative action, but can also take any other form.²⁹ A ‘measure by a Member’ within the meaning of Article I:1 can thus be a national parliamentary law as well as municipal decrees or rules adopted by professional bodies.³⁰

The concept of a ‘measure affecting the trade in services’ has been clarified by the Appellate Body in *Canada – Autos*. The measure at issue in that case was an import duty exemption accorded by Canada to imports of motor vehicles by certain manufacturers. The European Communities and Japan, the complainants, argued that this measure was inconsistent with Article II:1 of the GATS as it accorded ‘less favourable treatment’ to certain Members’ services and service suppliers than to those of other Members. The Panel found that the import duty exemption was indeed inconsistent with Article II:1 of the GATS. Canada appealed this finding of inconsistency and, in addition, as a threshold matter, appealed the Panel’s finding that the measure at issue fell within the scope of Article II:1 of the GATS. According to Canada the measure at issue was not a measure ‘affecting trade in services’. The Appellate Body stated that two key issues must be examined to determine whether a measure is one ‘affecting trade in services’, namely:

- whether there is ‘trade in services’ in the sense of Article I:2; and,
- whether the measure in issue ‘affects’ such trade in services within the meaning of Article I:1.³¹

²⁸ Article I:3(a) of the GATS. It follows that measures of private persons, companies or organisations, which do not exercise any delegated governmental powers, will not be considered to be a ‘measure by a Member’.

²⁹ Article XXVIII(a) of the GATS.

³⁰ Note that pursuant to Article I:3(a) of the GATS, Members have the obligation to take all reasonable measures to ensure that ‘sub-national’ levels of government and non-governmental bodies with delegated governmental powers comply with the obligations under the GATS.

³¹ See Appellate Body Report, *Canada – Autos*, para. 155. Note that the Appellate Body eventually reversed the Panel’s conclusion that the import duty exemption was inconsistent with the requirements of Article II:1 of the GATS. However, it did so, not because it came to the conclusion that Canada acted consistently with its MFN treatment obligation, but because the Panel failed to substantiate its conclusion that the import duty exemption was inconsistent with Article II:1 of the GATS. See Appellate Body Report, *Canada – Autos*, paras. 182 and 184.

With respect to the question of whether there is ‘trade in services’, note that the GATS does not define what a service is. Article I:3(b) of the GATS, however, states that the term ‘services’ includes:

... any service in any sector except services supplied in the exercise of governmental authority; ...

‘Services supplied in the exercise of governmental authority’ are defined as any service which is supplied neither on a commercial basis nor in competition with one or more service suppliers.³² Examples of such a service may be health care, police protection, penitentiary services or basic education. However, in a growing number of Members some of the services that are traditionally considered to be services supplied in the exercise of government authority, have in recent years been subject to privatisation and may now fall within the scope of the GATS.³³

While the GATS does not define ‘services’, Article I:2 thereof defines ‘*trade in services*’ as ‘the supply of a service’ within one of four defined ‘modes of supply’. Article I:2 states:

For the purpose of this Agreement, trade in services is defined as the supply of a service:

- (a) from the territory of one Member into the territory of any other Member;
- (b) in the territory of one Member to the service consumer of any other Member;
- (c) by a service supplier of one Member, through commercial presence in the territory of any other Member;
- (d) by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member.

These four modes of supply of services are commonly referred to as:

- the ‘*cross border*’ mode of supply (for example, legal advice given by a lawyer established in country A to a client in country B);
- the ‘*consumption abroad*’ mode of supply (for example, medical treatment given by a doctor established in country A to a patient from country B who comes to country A for medical treatment);
- the ‘*commercial presence*’ mode of supply (for example, financial services supplied in country B by a bank from country A through a branch office established in country B)³⁴; and,

³² Article I:3(c) of the GATS.

³³ Note also that many measures affecting services in the air transport sector do not fall within the scope of application of the GATS. See *GATS Annex on Air Transport Services*, para. 2.

³⁴ Note that pursuant to Article XXVIII(d) of the GATS, ‘commercial presence’ means any type of business or professional establishment, including through the constitution, acquisition or maintenance of a juridical person, or the creation or maintenance of a branch or a representative office, within the territory of a Member for the purpose of supplying a service.

- the ‘*presence of natural persons*’ mode of supply (for example, the services supplied in country B by a computer programmer from country A, who travels to country B to supply his services).³⁵

Clearly, the concept of ‘trade in services’ within the meaning of Article I:1 is very broad.

With respect to the question of whether the measure at issue *affects* trade in services within the meaning of Article I:1, the Appellate Body clarified in *EC – Bananas III*, the term ‘affecting’ as follows:

In our view, the use of the term “affecting” reflects the intent of the drafters to give a broad reach to the GATS. The 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”.³⁶

For a measure to affect trade in services, this measure is not required to regulate or govern the trade in, i.e., the supply of, services. A measure is covered by the GATS if it *affects* trade in services, even though the measure may regulate other matters.³⁷ A measure affects trade in services when the measure bears ‘upon the conditions of competition in supply of a service’.³⁸

Article XXVIII of the GATS gives a number of examples of ‘measures by Members affecting trade in services’. This non-exhaustive list includes measures in respect of:

- the purchase, payment or use of a service;
- the access to and use of - in connection with the supply of a service - services which are required by those Members to be offered to the public generally; and,
- the presence, including commercial presence, of persons of a Member for the supply of a service in the territory of another Member.

In brief, the concept of ‘measures by Members affecting trade in services’ is, in all respects, a concept with a broad meaning. Consequently, the scope of measures covered by the GATS, i.e., the scope of measures to which the MFN treatment obligation applies, is likewise broad.

³⁵ It is estimated that cross-border supply of services and supply through commercial presence each represent around 40 per cent of total world trade in services; consumption abroad represents around 20 per cent. Supply through presence of natural persons is, to date, insignificant. See WTO Secretariat, *Market Access: Unfinished Business*, Special Studies 6 (WTO, 2001), 105.

³⁶ Appellate Body Report, *EC – Bananas III*, para. 220.

³⁷ See Panel Reports, *EC – Bananas III*, para. 7.285.

³⁸ See *ibid.*, para. 7.281.

4.3.2.2. *'Like services or service suppliers'*

Once it has been established that the measure at issue is covered by the GATS, the second element of the three-tier test of consistency concerning Article II:1 comes into play, namely whether the services or service suppliers concerned are 'like' services or service suppliers. It is only between 'like' services or service suppliers that the MFN treatment obligation applies and that discrimination is prohibited. Services or service suppliers that are not 'like' may be treated differently.

As noted above, the term 'services' is not defined in the GATS but Article I:3(c) states that 'services' includes 'any service in any sector except services supplied in the exercise of governmental authority'. The concept of 'service supplier' is defined in the GATS. Article XXVIII(g) provides that a 'service supplier' is 'any person who supplies a service', including natural and legal persons as well as service suppliers providing their services through forms of commercial presence, such as a branch or a representative office. The concept of 'like services' and 'like service suppliers' are not defined in the GATS and, to date, there is almost no relevant case law on the meaning of these terms.³⁹ A determination of the 'likeness' of services and service suppliers should clearly be based - among other relevant factors - on:

- the characteristics of the service or the service supplier;
- the classification and description of the service in the United Nations Central Product Classification system (the 'CPC'); and,
- consumer habits and preferences regarding the service or the service supplier.

Note that two service suppliers that supply a like service are not necessarily 'like service suppliers'. Factors such as the size of the companies, their assets, their use of technology and the nature and extent of their expertise must all be taken into account.

The case law on the concept of 'like product' used in the GATT 1994 can serve as a useful source of inspiration but it is clear that the concepts of 'like services' and 'like service suppliers' raise much more difficult conceptual problems than does the concept of 'like product'.

4.3.2.3 *Treatment no less favourable*

The third and last element of the test of consistency with Article II:1 of the GATS concerns the treatment accorded to 'like services' or 'like service suppliers'. Members must accord, immediately and unconditionally, to services or service suppliers of Members 'treatment no less favourable' than the treatment they accord to 'like services' or 'like service suppliers' of any

³⁹ Note Panel Reports, *EC – Bananas III*, para. 7.322; and Panel Report, *Canada – Autos*, para. 10.248. In the latter case, the Panel stated that "to the extent that the service suppliers concerned supply the same services, they should be considered "like" for the purposes of this case".

other country. Article II of the GATS does not provide for any guidance as to the meaning of the concept of ‘treatment no less favourable’. However, as discussed below, Article XVII of the GATS on the national treatment obligation, contains guidance on the meaning of the concept of ‘treatment no less favourable’. Article XVII:3 states:

Formally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to the like services or service suppliers of any other Member.

In the context of Article XVII, a measure constitutes less favourable treatment if it *modifies the conditions of competition*. The Appellate Body ruled in *EC – Bananas III*, that in interpreting Article II:1, and, in particular, the concept of ‘treatment no less favourable’, it should *not be assumed* that the guidance of Article XVII equally applies to Article II. However, as noted above, the Appellate Body has already concluded that the concept of ‘treatment no less favourable’ in Article II:1 and Article XVII of the GATS should both be interpreted to include *de facto*, as well as *de jure*, discrimination although only Article XVII states so explicitly.⁴⁰

4.3.3. Exemptions from the MFN treatment obligation under Article II:1 of the GATS

Unlike under the GATT 1994, the GATS allows Members to schedule exemptions from the MFN treatment obligation under Article II:1. Article II:2 of the GATS provides:

A Member may maintain a measure inconsistent with paragraph 1 provided that such a measure is listed in, and meets the conditions of, the Annex on Article II Exemptions.

Members could list measures in the Annex on Article II Exemptions *until* the date of entry into force of the *WTO Agreement*, i.e., 1 January 1995.⁴¹ Around two thirds of WTO Members have listed MFN exemptions. These exemptions concern mainly the transport (especially maritime), communication (mostly audiovisual), financial and business services.⁴²

A Member’s notification of an exemption had to contain:

- a description of the sector or sectors in which the exemption applies;
- a description of the measure, indicating why it is inconsistent with Article II;

⁴⁰ See Appellate Body Report, *EC – Bananas III*, para. 234.

⁴¹ Since 1 January 1995, a Member can only exempt a measure from the application of the MFN obligation under Article II:1 by obtaining a waiver from the MFN obligation pursuant to Article IX:3 of the *WTO Agreement* (see paragraph 2 of the Annex on Article II Exemptions).

⁴² WTO Secretariat, *Market Access: Unfinished Business*, Special Studies 6 (WTO, 2001), 100.

- the country or countries to which the measure applies;
- the intended duration of the exemption; and,
- the conditions creating the need for the exemption.

In principle, exemptions *should* not exceed a period of ten years.⁴³ In January 2005, all exemptions under Article II:2 should have come to an end.⁴⁴ In the meantime, all exemptions granted for a period of more than five years are reviewed after five years by the Council for Trade in Services. In such a review, the Council examines whether the conditions that created the need for the exemption still prevail and sets a date for any further review.⁴⁵ In any case, the exemption terminates on the date provided for in the exemption.⁴⁶ It is important to note that the exemption list may not identify Members that would *not* benefit from MFN; the exemption list may only identify Members which would benefit from more market access than other Members.

Note, by way of example, that the European Communities included the following exemptions from the MFN treatment obligation in the *Annex of Article II Exemptions*:

- with respect to audiovisual services (production and distribution of television programmes and cinematographic works), measures granting the benefit for any support programmes (such as Action Plan for Advanced Television Services, MEDIA or EURIMAGES) to audiovisual works and suppliers of such works, meeting certain European origin criteria;
- with regard to publishing: foreign participation in Italian companies exceeding 49 per cent of the capital and voting rights, subject to a condition of reciprocity; or
- with regard to inland waterways transport: regulations implementing the Mannheim Convention on Rhine Shipping.⁴⁷

The lists of measures which individual Members have included in the *Annex of Article II Exemptions* can be found on the WTO website.⁴⁸

4.4. NATIONAL TREATMENT UNDER THE GATT 1994

Article III of the GATT 1994, entitled '*National Treatment on Internal Taxation and Regulation*', states in relevant part:

⁴³ Paragraph 6 of the Annex on Article II Exemptions.

⁴⁴ Many Members, however, have written down in their exemption list that particular exemptions would last for more than ten years. Note that Paragraph 6 of the Annex on Article II Exemptions states that the exemptions *should not* exceed ten years; it does not state that they *shall not* exceed ten years.

⁴⁵ Paragraphs 3 and 4 of the Annex on Article II Exemptions. If the Council would conclude that these conditions are no longer present, the Member concerned would arguably be obliged to accord MFN treatment in respect of the measure previously exempted from this obligation.

⁴⁶ Paragraph 5 of the Annex on Article II Exemptions.

⁴⁷ See European Communities and their Member States, *Final List of Article II (MFN) Exemptions*, GATS/EL/31, dated 15 April 1994.

⁴⁸ See www.wto.org/english/tratop_e/serv_e/serv_commitments_e.htm.

1. The [Members] 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 [Member] imported into the territory of any other [Member] 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 [Member] 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.*
[...]

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

The other paragraphs of Article III deal with particular measures such as internal quantitative regulations relating to the mixture, processing or use of products in specific amounts (paragraphs 5 to 7); government procurement (paragraph 8(a)); subsidies to domestic producers (paragraph 8(b)); internal maximum price control measures (paragraph 9); and internal quantitative regulations relating to cinematographic films (paragraph 10). This Chapter, does not discuss the rules relating to these specific measures in any detail. It is sufficient to mention here that pursuant to paragraph 5 local content requirements are prohibited,⁴⁹ and that pursuant to paragraphs 8(a) and 8(b) respectively, the national treatment obligation does not apply to laws, regulations or requirements governing government procurement and that the national treatment obligation does not prevent the payment of subsidies exclusively to domestic producers.⁵⁰

4.4.1. Nature of the National Treatment Obligation of Article III of the GATT 1994

4.4.1.1. The object and purpose of Article III

Article III of the GATT 1994 prohibits discrimination against imported products. Generally speaking, it prohibits Members from treating imported products less favourably than like domestic products once the

⁴⁹ Local content requirements are direct or indirect requirements that any specific amount or proportion of any product must be supplied from domestic sources.

⁵⁰ With regard to subsidies to domestic producers, it should be noted that the GATT Panel in *Italy – Agricultural Machinery* in 1958 already gave a narrow interpretation to the Article III:8(b) exemption from the MFN treatment obligation. If this provision would be interpreted broadly, any discrimination against imports could be qualified as a subsidy to domestic producers and thus render the discipline of Article III meaningless.

imported product has entered the domestic market. In 1958, in *Italy – Agricultural Machinery*, a dispute concerning an Italian law providing special conditions for the purchase on credit of Italian produced agricultural machinery, the Panel stated with regard to Article III:

... that the 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 have been cleared through customs. Otherwise indirect protection could be given.⁵¹

In *US – Section 337*, the Panel noted:

... 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” (Article III:1).⁵²

In *Japan – Alcoholic Beverages II*, the Appellate Body stated with respect to the purpose of the national treatment obligation of Article III:

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”.⁵³

In *Korea – Alcoholic Beverages*, the Appellate Body identified the objectives of Article III as ‘avoiding protectionism, requiring equality of competitive conditions and protecting expectations of equal competitive relationships’.⁵⁴

Panels and scholars have affirmed that one of the main purposes of Article III is to guarantee that internal measures of WTO Members do not undermine their commitments regarding tariffs under Article II.⁵⁵ Note,

⁵¹ GATT Panel Report, *Italian Agricultural Machinery*, para. 11.

⁵² GATT Panel Report, *US – Section 337*, para. 5.10.

⁵³ Appellate Body Report, *Japan – Alcoholic Beverages II*, 109. In a footnote, the Appellate Body refers to GATT Panel Report, *US – Section 337*, para. 5.10 (for the first quote); GATT Panel Report, *US – Superfund*, para. 5.1.9; Panel Report, *Japan – Alcoholic Beverages II*, para. 5.5(b); and GATT Panel Report, *Italy – Agricultural Machinery*, para. 11 (for the second quote). See also Appellate Body Report, *Korea – Alcoholic Beverages*, para. 119; Appellate Body Report, *Chile – Alcoholic Beverages*, para. 67; and Appellate Body Report, *EC – Asbestos*, para. 97 as well as Panel Report, *Indonesia – Autos*, para. 14.108.

⁵⁴ Appellate Body Report, *Korea – Alcoholic Beverages*, para. 120. In *Canada – Periodicals*, the Appellate Body stated: ‘The fundamental purpose of Article III of the GATT 1994 is to ensure equality of competitive conditions between imported and like domestic products’. See Appellate Body Report, *Canada – Periodicals*, 8. See also Panel Report, *Argentina – Hides and Leather*, para. 11.182.

⁵⁵ See e.g. Panel Report, *Japan – Alcoholic Beverages II*, para. 6.13.

however that the Appellate Body stressed in *Japan – Alcoholic Beverages II* that the purpose of Article III is broader. 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*. 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.⁵⁶

4.4.1.2. *Internal measures versus border measures*

Article III only applies to internal measures, not to border measures. Other GATT provisions, such as Articles II, on tariff concessions, and XI, on quantitative restrictions, apply to border measures. Since Articles III, and Articles II and XI provide for very different rules, it is important to determine whether a measure is an internal or a border measure. It is not always easy to distinguish an internal measure from a border measure when the measure is applied to imported products at the time or point of importation. The *Ad Article III Note* clarifies:

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.

It follows that if the import of a product is barred at the border because that product fails, for example, to meet a public health or consumer safety requirement that applies equally to domestic products, consistency of this import ban with the GATT is to be examined under Article III, not under Article XI.⁵⁷

In *EC – Asbestos*, the Panel examined the question as to whether Article III applies also when there is no ‘domestic product’ due to a general ban on a particular product. Canada argued that ‘as France neither produces nor mines asbestos fibres on its territory, the ban on manufacturing, processing, selling and domestic marketing is, in practical terms, equivalent to a ban on importing chrysotile asbestos fibre’, and would

⁵⁶ Appellate Body Report, *Japan – Alcoholic Beverages II*, 110.

⁵⁷ See also, GATT Panel Report, *Canada – FIRA*, para. 5.14.

therefore fall within the scope of Article XI:1. The Panel stated, however, that ‘the fact that France no longer produces asbestos or asbestos-containing products does not suffice to make the Decree [banning these products] a measure falling under Article XI:1’ since, as the Panel pointed out, ‘[t]he cessation of French production is the consequence of the Decree and not the reverse’.⁵⁸

In *India – Autos*, the Panel had occasion to illustrate the difference between measures falling within the scope of Article III:4 (internal measures) and measures falling within the scope of Article XI (border measures). The Panel ruled that India acted inconsistently with *Article III:4* by imposing an obligation on automotive manufacturers to use a certain proportion of local parts and components in the manufacture of cars and automotive vehicles and by imposing an obligation to offset the amount of their *purchases of previously imported* kits and components, already on the Indian market, by exports of equivalent value. According to the Panel, however, India also acted inconsistently with *Article XI* by imposing a further obligation on automotive manufacturers to balance their *importation* of kits and components with exports of equivalent value.⁵⁹

4.4.1.3. Articles III:1, III:2 and III:4

As stated above and as explicitly noted by the Appellate Body in *Japan – Alcoholic Beverages II*, Article III:1 articulates a general principle that internal measures should not be applied so as to afford protection to domestic production. According to the Appellate Body in *Japan – Alcoholic Beverages II*:

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.⁶⁰

The general principle that internal measures should not be applied so as to afford protection to domestic production is elaborated on in Article III:2 with regard to internal taxation and in Article III:4 with regard to internal regulation. In Article III:2, two non-discrimination obligations can be distinguished: one obligation set out in the first sentence of Article III:2 relating to internal taxation of ‘like products’ and the other obligation set out in the second sentence of Article III:2 relating to internal taxation of ‘directly competitive or substitutable products’. The sections below will discuss:

- the constituent elements of Article III:2, first sentence;

⁵⁸ Panel Report, *EC – Asbestos*, paras. 8.89 and 8.91.

⁵⁹ See Panel Report, *India – Autos*, para. 8.1.

⁶⁰ Appellate Body Report, *Japan – Alcoholic Beverages II*, 111.

- the constituent elements of Article III:2, second sentence; and,
- the constituent elements of Article III:4.

4.4.2. Test of Consistency with Article III:2, first sentence, of the GATT 1994

Article III:2, first sentence, states:

The products of the territory of any [Member] imported into the territory of any other [Member] 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.

This provision sets out a two-tier test of consistency of internal taxation. In *Canada – Periodicals*, the Appellate Body found:

[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.⁶¹

In brief, the two-tier test of consistency of internal taxation with Article III:2, first sentence, thus requires the examination of:

- whether the imported and domestic products are *like products*; and,
- whether the imported products are *taxed in excess* of the domestic products.

Recall that Article III:1 provides that internal taxation must not be applied so as to afford protection to domestic production. However, according to the Appellate Body in *Japan – Alcoholic Beverages II*, the presence of a protective application need not be established separately from the *specific* requirements of Article III:2, first sentence. The Appellate Body stated:

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

⁶¹ Appellate Body Report, *Canada – Periodicals*, 468.

sentence. To the contrary, we believe the first sentence of Article III:2 is, in effect, an application of this general principle.⁶²

The Panel in *Argentina – Hides and Leather* further clarified the relevance of Article III:1 and the general principle of ‘not affording protection to domestic production’ by stating:

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:1.⁶³

However, before applying the test under Article III:2, first sentence, it has to be determined whether the measure at issue is an ‘internal tax or other internal charge of any kind’ within the meaning of that provision.

4.4.2.1. ‘Internal tax ...’

Article III:2, first sentence concerns ‘internal taxes and other charges of any kind’ which are applied ‘directly or indirectly’ on products. Examples of such internal taxes on products are value added taxes (VAT), sales taxes and excise duties. Income taxes or import duties are not covered since they are not *internal* taxes on *products*. The words ‘applied *directly or indirectly* on products’ should be understood to mean ‘applied *on or in connection with* products’. It has been suggested that a tax applied ‘indirectly’ is a tax applied, not on a product as such, but on the processing of the product.⁶⁴

In *US – Tobacco*, the Panel examined the question of whether penalty provisions under US law, consisting of a non-refundable marketing assessment and a requirement to purchase additional quantities of domestic burley and flue-cured tobacco could be qualified as ‘internal taxes or other charges of any kind’ within the meaning of Article III:2, first sentence. The Panel stated:

It was thus the Panel’s understanding that the U.S. Government treated these [Domestic Marketing Assessment] provisions as penalty provisions for the enforcement of a domestic content requirement for tobacco, not as separate fiscal measures, and that such interpretation corresponded to the ordinary meaning of the terms used in the relevant statute and proposed rules. Further, it appeared that these penalty provisions had no separate *raison d’être* in the absence of the underlying domestic content requirement. The above factors suggested to the

⁶² Appellate Body Report, *Japan – Alcoholic Beverages II*, 111-112.

⁶³ Panel Report, *Argentina – Hides and Leather*, para. 11.137.

⁶⁴ See GATT Analytical Index, 141.

Panel that it would not be appropriate to analyze the penalty provisions separately from the underlying domestic content requirement.⁶⁵

According to the Panel in *US – Tobacco*, a penalty provision for the enforcement of a domestic law is not an ‘internal tax or charge of any kind’ within the meaning of Article III:2, first sentence.

Note that the regulatory objective pursued by the tax measure is of no relevance to the question of whether the measure is an internal tax within the meaning of Article III:2 and the consistency of that measure with the national treatment requirement. In *Japan – Alcoholic Beverages II*, the Appellate Body stated that Members may pursue, through their tax measures, any given policy objective *provided* they do so in compliance with Article III:2. In *Argentina – Hides and Leather*, the Panel rejected Argentina’s contention that the tax legislation at issue in that case was 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:2.⁶⁶

In *US – Malt Beverages*, a measure preventing imported products from being sold in a manner that would enable them to avoid taxation was considered to be a measure within the scope of Article III:2, first sentence, because it assigned a higher tax rate to the imported products.⁶⁷

4.4.2.2. ‘Like products’

Similar to the concept of ‘like products’ in Article I:1 of the GATT 1994, the concept of ‘like products’ in Article III:2, first sentence, is not defined in the GATT 1994. The GATT 1994 does not give any guidance as to the characteristics of products that must be taken into account in determining ‘likeness’ either. There are, however, a considerable number of GATT and WTO dispute settlement reports that shed light on the meaning of the concept of ‘like products’ in Article III:2, first sentence.

Under the Japanese tax system at issue in *Japan – Alcoholic Beverages II*, the internal tax imposed on domestic *shochu* was the same as that imposed on imported *shochu*; the higher tax imposed on imported vodka

⁶⁵ GATT Panel Report, *US – Tobacco*, para. 80.

⁶⁶ Panel Report, *Argentina – Hides and Leather*, para. 11.144.

⁶⁷ See GATT Panel Report, *US – Malt Beverages*, paras. 5.21 and 5.22.

was also imposed on domestic vodka. Identical products (not considering brand differences) were thus taxed identically. However, the question was whether shochu and vodka should be considered to be ‘like products’. If shochu and vodka were found to be ‘like’, vodka could not be taxed in excess of shochu. The Appellate Body in *Japan – Alcoholic Beverages II* addressed the scope of the concept of ‘like products’ within the meaning of Article III:2, first sentence. The Appellate Body first stated that this concept should be interpreted narrowly because of the existence of the concept of ‘directly competitive or substitutable products’ used in the second sentence of Article III:2. The Appellate Body ruled:

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.⁶⁸

Subsequently, the Appellate Body expressly agreed with the basic approach for determining ‘likeness’ set out in the 1970 Report of the Working Party on *Border Tax Adjustments*.⁶⁹ This Working Party found:

... 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.⁷⁰

This basic approach was followed in almost all adopted GATT panel reports after *Border Tax Adjustments* involving a GATT provision in which the concept of ‘like products’ was used.⁷¹ According to the Appellate Body in *Japan – Alcoholic Beverages II*, this approach should be helpful in identifying on a case-by-case basis the range of ‘like products’ that fall within the limits of Article III:2, first sentence of the GATT 1994. However, the Appellate Body added:

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

⁶⁸ Appellate Body Report, *Japan – Alcoholic Beverages II*, 112-113.

⁶⁹ The Working Party considered the concept of ‘like’ or ‘similar’ products as used throughout the GATT.

⁷⁰ Report of the Working Party on *Border Tax Adjustments*, BISD 18S/97, para. 18.

⁷¹ See, e.g., GATT Panel Report, *Australia – Ammonium Sulphate*; GATT Panel Report, *EEC – Animal Proteins*; GATT Panel Report, *Spain – Unroasted Coffee*; GATT Panel Report, *Japan – Alcoholic Beverages I*; and GATT Panel Report, *US – Superfund*.

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.⁷²

The criteria listed in the *Border Tax Adjustments* Report did not include the tariff classification of the products concerned. Yet tariff classification has been used as a criterion for determining ‘like products’ in several panel reports.⁷³ The Appellate Body acknowledged in *Japan – Alcoholic Beverages II* that uniform classification in tariff nomenclatures based on the Harmonised System can be of help in determining ‘likeness’ but cautioned against the use of tariff bindings since there are sometimes very broad bindings that do not necessarily indicate similarity of the products covered by those bindings. Rather, tariff bindings represent the results of trade concessions negotiated among WTO Members.⁷⁴

In *US – Malt Beverages*, the Panel held that national legislation giving special tax exemptions to products of *small* firms (whether domestic or foreign) would constitute discrimination against imports from a *larger* foreign firm and therefore infringe Article III because its products would be treated less favourably than the like products of a small domestic firm.⁷⁵ The fact that products were produced by small or large firms was irrelevant in the determination of ‘likeness’.

The same Panel also considered, however, with regard to the determination of ‘likeness’:

... the like product determination under Article III:2 also should have regard to the purpose of the Article. ... The purpose is ... not to prevent contracting parties from using their fiscal and regulatory powers for purposes other than to afford protection to domestic production. Specifically, the purpose of Article III is not to prevent contracting parties from differentiating between different product categories for policy purposes unrelated to the protection of domestic production. ... Consequently, in determining whether two products subject to different treatment are like products, it is necessary to consider whether such product differentiation is being made “so as to afford protection to domestic production”.⁷⁶

⁷² Appellate Body Report, *Japan – Alcoholic Beverages II*, 113. The Appellate Body disagreed 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’. According to the Appellate Body, it is ‘a discretionary decision that must be made in considering the various characteristics of products in individual cases.’ (Appellate Body Report, *Japan – Alcoholic Beverages II*, 114).

⁷³ Note that the tariff classification of the products concerned by other countries was a factor considered by the GATT Panel in *Spain – Unroasted Coffee*. Also the Panel in *US – Gasoline* referred to the tariff classification in its determination of ‘likeness’.

⁷⁴ See Appellate Body Report, *Japan – Alcoholic Beverages II*, 114-5.

⁷⁵ See GATT Panel Report, *US – Malt Beverages*, para. 5.19.

⁷⁶ *Ibid.*, paras. 5.24-5.25.

The Panel found domestic wine containing a particular local variety of grape ‘like’ imported wine not containing this variety of grape after considering that the purpose of differentiating between the wines was to afford protection to the local production of wine. The Panel noted that the United States did not advance any alternative policy objective for the differentiation. According to the Panel in *US – Malt Beverages*, the reason for the product differentiation was to be considered when deciding on the ‘likeness’ of products.

In a dispute concerning, *inter alia*, special tax levels for luxury vehicles, *US – Taxes on Automobiles*, the Panel elaborated on this approach of determining ‘likeness’.⁷⁷ The United States imposed a retail excise tax on cars over \$ 30,000 and the Panel had to determine whether cars with prices above and below \$ 30,000 were ‘like products’. The complainant in this dispute, the European Communities, argued before the Panel that ‘likeness’ should be determined on the basis of factors such as the end-use of the products, their physical characteristics and tariff classification. The United States, however, contended that the key factor in determining ‘likeness’ should be whether the measure was applied ‘so as to afford protection to domestic industry’. The Panel reasoned that the determination of ‘likeness’ would, in all but the most straightforward cases, have to include an examination of the *aims and effects* of the particular tax measure. According to the Panel in *US – Taxes on Automobiles*, ‘likeness’ should be examined in terms of whether the less favourable treatment was based on a regulatory distinction taken so as to afford protection to domestic production. *In casu*, the Panel decided that the luxury tax was not implemented to afford protection to the domestic production of cars and that cars above and below \$ 30,000 could not, for the purpose of the luxury tax, be considered as ‘like products’ under Article III:2, first sentence.⁷⁸

The ‘aim-and-effect’ test for determining ‘likeness’ was, however, explicitly rejected in 1996 by the Panel in *Japan – Alcoholic Beverages II*. The Panel found as follows:

The Panel noted, in this respect, that the proposed aim-and-effect test is not consistent with the wording of Article III:2, first sentence. The Panel recalled that the basis of the aim-and-effect test is found in the words “so as to afford protection” contained in Article III:1. The Panel further recalled that Article III:2, first sentence, contains no reference to those words. Moreover, the adoption of the aim-and-effect test would have important repercussions on the burden of proof imposed on the complainant. The Panel noted in this respect that the complainants, according to the aim-and-effect test, have the burden of showing not only the effect of a particular measure, which is in principle discernible, but also its aim, which sometimes can be indiscernible. The Panel also noted that very often there is a

⁷⁷ See GATT Panel Report, *US – Taxes on Automobiles*, para. 5.8 *et seq.* This Report was never adopted.

⁷⁸ Note that the GATT Panel Report in *US – Taxes on Automobiles* was never adopted by the CONTRACTING PARTIES.

multiplicity of aims that are sought through enactment of legislation and it would be a difficult exercise to determine which aim or aims should be determinative for applying the aim-and-effect test. Moreover, access to the complete legislative history, which according to the arguments of the parties defending the aim-and-effect test, is relevant to detect protective aims, could be difficult or even impossible for a complaining party to obtain. Even if the complete legislative history is available, it would be difficult to assess which kinds of legislative history (statements in legislation, in official legislative reports, by individual legislators, or in hearings by interested parties) should be primarily determinative of the aims of the legislation. The Panel recalled in this respect the argument by the United States that the aim-and-effect test should be applicable only with respect to origin-neutral measures. The Panel noted that neither the wording of Article III:2, nor that of Article III:1 support a distinction between origin-neutral and origin-specific measures.⁷⁹

In support of its rejection of the aim-and-effect test in determining ‘likeness’ in the context of Article III:2, the Panel in *Japan – Alcoholic Beverages II* further noted:

... the list of exceptions contained in Article XX of GATT 1994 could become redundant or useless because the aim-and-effect test does not contain a definitive list of grounds justifying departure from the obligations that are otherwise incorporated in Article III. The purpose of Article XX is to provide a list of exceptions, subject to the conditions that they “are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction of international trade”, that could justify deviations from the obligations imposed under GATT. Consequently, in principle, a WTO Member could, for example, invoke protection of health in the context of invoking the aim-and-effect test. The Panel noted that if this were the case, then the standard of proof established in Article XX would effectively be circumvented. WTO Members would not have to prove that a health measure is “necessary” to achieve its health objective. Moreover, proponents of the aim-and-effect test even shift the burden of proof, arguing that it would be up to the complainant to produce a *prima facie* case that a measure has both the aim and effect of affording protection to domestic production and, once the complainant has demonstrated that this is the case, only then would the defending party have to present evidence to rebut the claim. In sum, the Panel concluded that for reasons relating to the wording of Article III as well as its context, the aim-and-effect test proposed by Japan and the United States should be rejected.⁸⁰

The Appellate Body in *Japan – Alcoholic Beverages II* implicitly affirmed the Panel’s rejection of the aim-and-effect test.⁸¹

⁷⁹ Panel Report, *Japan – Alcoholic Beverages II*, para. 6.16.

⁸⁰ *Ibid.*, para. 6.17.

⁸¹ See Appellate Body Report, *Japan – Alcoholic Beverages II*, 115. The Appellate Body stated: ‘With these modifications to the legal reasoning in the Panel Report, we affirm the legal conclusions and the findings of the Panel with respect to “like products” in all other respects.’

4.4.2.3. Taxes 'in excess of'

Pursuant to Article III:2, first sentence, internal taxes on imported products should not be 'in excess of' the internal taxes applied to 'like' domestic products. In *Japan – Alcoholic Beverages II*, the Appellate Body established a strict benchmark for the 'in excess of' requirement. The Appellate Body ruled:

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.⁸²

On the absence of a 'trade effects test', the Appellate Body stated in the same case, *Japan – Alcoholic Beverages II*:

... 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.⁸³ [Emphasis added]

With respect to the absence of a *de minimis* standard, note that the Panel in *US – Superfund* had already ruled in 1987:

The rate of tax applied to the imported products is 3.5 cents per barrel higher than the rate applied to the like domestic products. ... The tax on petroleum is ... inconsistent with the United States' obligations under Article III:2, first sentence.⁸⁴

In *Argentina – Hides and Leather*, the Panel rejected Argentina's argument that the tax burden differential between imported and domestic products would only exist for a thirty-day period and therefore was *de minimis*.⁸⁵ Furthermore, the Panel ruled that the identity and circumstances of the persons involved in sales transactions could not serve as a justification for tax burden differentials.⁸⁶

In the same case, the Panel also emphasised that Article III:2, first sentence, requires a comparison of *actual* tax burdens rather than merely of *nominal* tax burdens.

While it is the *actual* tax burden on the 'like products' which must be examined, it should be noted that the Panel in *EEC – Animal Feed Proteins* ruled that an internal regulation which merely exposed imported

⁸² *Ibid.* See also Panel Report, *Argentina – Hides and Leather*, para. 11.244.

⁸³ Appellate Body Report, *Japan – Alcoholic Beverages II*, 110.

⁸⁴ GATT Panel Report, *US – Superfund*, para. 5.1.1.

⁸⁵ See Panel Report, *Argentina – Hides and Leather*, para. 11.245.

⁸⁶ See *ibid.*, para. 11.220. See also Panel Report, *US – Gasoline*, para. 6.11. As the Panel in *Argentina – Hides and Leather* noted in a footnote, the disciplines of Article III:2, first sentence, are of course subject to whatever exceptions a Member may justifiably invoke.

products to a risk of discrimination constituted, by itself, a form of discrimination and therefore less favourable treatment within the meaning of Article III.⁸⁷

A Member which applies higher taxes on imported products in some situations but ‘balances’ this by applying lower taxes on the imported products in other situations also acts inconsistently with the national treatment obligation of Article III:2, first sentence.

4.4.3. Consistency with Article III:2, second sentence of the GATT 1994

The second sentence of Article III:2 states:

Moreover, no Member 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.

As discussed above, the relevant leading principle set forth in Article III:1 is that internal taxes and other internal charges:

... should not be applied to imported or domestic products so as to afford protection to domestic production.

Furthermore, the *Ad Article III Note* provides with respect to Article III: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.

The relationship between the first and the second sentence of Article III:2 was addressed by the Appellate Body in *Canada – Periodicals*, a dispute concerning, *inter alia*, the Canadian excise tax on magazines. The Appellate Body considered:

... there are two questions which need to be answered to determine whether there is a violation of [the first sentence 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.⁸⁸

As the Appellate Body stated in *Japan – Alcoholic Beverages II* and again, in *Canada – Periodicals*, Article III:2, second sentence,

⁸⁷ See GATT Panel Report, *EEC – Animal Feed Proteins*, para. 141. See also GATT Panel Report, *US – Tobacco*, paras. 95-97.

⁸⁸ Appellate Body Report. *Canada – Periodicals*, 486.

contemplates a ‘broader category of products’ than Article III:2, first sentence.⁸⁹ Furthermore, Article III:2, second sentence sets out a different test of inconsistency. In *Japan – Alcoholic Beverages II*, the Appellate Body stated:

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
- (3) the dissimilar taxation of the directly competitive or substitutable imported and 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.⁹⁰

In brief, the test of consistency of internal taxation with Article III:2, second sentence thus requires an examination of:

- whether the imported and domestic products are *directly competitive or substitutable*;
- whether these products are *not similarly taxed*; and
- whether the dissimilar taxation is *applied so as to afford protection* to domestic production.

However, before this test of consistency of internal taxation can be applied, it must be established that the measure at issue is an ‘internal tax or other internal charge’ within the meaning of Article III:2, second sentence.

4.4.3.1. ‘Internal taxes ...’

As is the case with Article III:2, first sentence, Article III:2, second sentence is also concerned with ‘internal taxes or other internal charges’. For a discussion on the meaning and the scope of these concepts, recall the discussion above in the section dealing with Article III:2, first

⁸⁹ See *ibid.*, 470.

⁹⁰ Appellate Body Report, *Japan – Alcoholic Beverages II*, 116. This part has been later cited and endorsed by the Appellate Body, in Appellate Body Report, *Canada – Periodicals*, 470, and in Appellate Body Report, *Chile – Alcoholic Beverages*, para. 47.

sentence. With regard to this constituent element there is no difference between the first and second sentence of Article III:2.

4.4.3.2. 'Directly competitive or substitutable products'

The national treatment obligation of Article III:2, second sentence applies to 'directly competitive or substitutable products'. In *Canada – Periodicals*, the Appellate Body ruled that to be 'directly competitive or substitutable' within the meaning of Article III:2, second sentence, products do not – contrary to what Canada had argued – have to be perfectly substitutable. The Appellate Body noted:

A case of perfect substitutability would fall within Article III:2, first sentence, while we are examining the broader prohibition of the second sentence.⁹¹

With regard to the relationship between the concept of 'like products' of Article III:2, first sentence, and the concept of 'directly competitive or substitutable' products of Article III:2, second sentence, the Appellate Body stated in *Korea – Alcoholic Beverages*:

“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.⁹²

As to the meaning of the concept of 'directly competitive or substitutable products', the Appellate Body stated in *Korea – Alcoholic Beverages*:

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

⁹¹ Appellate Body Report, *Canada – Periodicals*, 473.

⁹² Appellate Body Report, *Korea – Alcoholic Beverages*, para. 118. In a footnote, the Appellate Body referred to the Appellate Body Report, *Japan - Alcoholic Beverages II* and Appellate Body Report, *Canada - Periodicals*.

moment, considered by consumers to be substitutes but which are, nonetheless, *capable* of being substituted for one another.⁹³

The Appellate Body also noted:

... 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 a degree of proximity in the competitive relationship between the domestic and the imported products. The word “direct” does not, however, prevent a panel from considering both latent and extant demand.⁹⁴

In brief, the Appellate Body considers products to be ‘directly competitive or substitutable’ when they are interchangeable, in that they offer alternative ways of satisfying a particular need or taste. The Appellate Body also considers that in examining whether products are ‘directly competitive or substitutable’, an analysis of *latent* as well as *extant* demand is required since ‘competition in the market place is a dynamic, evolving process’.

With respect to the factors to be taken into account in establishing whether products are ‘directly competitive or substitutable’, the Appellate Body, in *Japan – Alcoholic Beverages II*, agreed with the Panel in that case that these factors include, in addition to their physical characteristics, common end-use and tariff classifications, the nature of the compared products and the competitive conditions in the relevant market.⁹⁵ The Appellate Body held:

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”.⁹⁶

The Appellate Body thus considered an examination of the competitive conditions in the market, and, in particular, the cross-price elasticity of demand in that market as a means of establishing whether products are

⁹³ Appellate Body Report, *Korea – Alcoholic Beverages*, para. 114.

⁹⁴ *Ibid.*, paras. 115-116.

⁹⁵ See Appellate Body Report, *Japan – Alcoholic Beverages II*, 117.

⁹⁶ *Ibid.*

‘directly competitive or substitutable’. In *Korea – Alcoholic Beverages*, the Appellate Body further clarified:

... 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.⁹⁷

However, in that case, *Korea – Alcoholic Beverages*, the Appellate Body was careful to stress that cross-price elasticity of demand for products is not the decisive criterion in determining whether these products are ‘directly competitive or substitutable’. The Appellate Body agreed with the Panel’s emphasis on the ‘quality’ or ‘nature’ of competition rather than the ‘quantitative overlap of competition’. The Appellate Body shared the Panel’s reluctance to rely unduly on quantitative analyses of the competitive relationship. In its 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’.⁹⁸

In establishing whether products are ‘directly competitive or substitutable’, the market situation in *other* Members may be relevant and can be taken into consideration. In *Korea – Alcoholic Beverages*, the Appellate Body stated:

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.⁹⁹

The question has arisen as to whether, in examining whether products are ‘directly competitive or substitutable’, it is necessary to examine products on an item-by-item basis or whether it is permitted to group products together for the purpose of this examination. In *Korea – Alcoholic Beverages*, the Panel compared distilled and diluted *soju* (the domestic Korean liquor at issue in this case) with imported liquor products on a

⁹⁷ Appellate Body Report, *Korea – Alcoholic Beverages*, para. 121.

⁹⁸ *See ibid.*, para. 134.

⁹⁹ *Ibid.*, para. 137.

group basis, rather than on an item-by-item basis. The Appellate Body, rejecting Korea's appeal of the Panel's method of comparison, ruled: 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.¹⁰⁰

4.4.3.3. 'Not similarly taxed'

The next element or requirement of the test under Article III:2, second sentence is whether the products at issue are 'not similarly taxed'. While under Article III:2, first sentence, even the slightest tax differential leads to the conclusion that the internal tax imposed on imported products is inconsistent with the national treatment obligation, under Article III:2, second sentence, the tax differential has to be more than *de minimis* to support a conclusion that the internal tax imposed on imported products is WTO-inconsistent. In *Japan – Alcoholic Beverages II*, the Appellate Body explained:

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

¹⁰⁰ *Ibid.*, paras. 143-144.

must be heavier than on “directly competitive or substitutable” domestic products, and that burden must be more than *de minimis* in any given case.¹⁰¹

The ‘not similarly taxed’ requirement is met even if only some imported products are not taxed similarly to domestic products, while other imported products are taxed similarly. The Appellate Body stated in *Canada – Periodicals* that:

... dissimilar 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:2.¹⁰²

4.4.3.4. ‘So as to afford protection to domestic production’

The last element or requirement of the test under Article III:2, second sentence, is whether the internal taxes are applied ‘so as to afford protection to domestic production’. This requirement must be distinguished from the second requirement of ‘not similarly taxed’. In *Japan – Alcoholic Beverages II*, the Appellate Body noted:

[T]he Panel erred in blurring the distinction between [the issue of whether the products at issue were “not similarly taxed”] 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.¹⁰³

As to how to establish whether a tax measure was applied so as to afford protection to domestic production, the Appellate Body noted in *Japan – Alcoholic Beverages II*:

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. 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.

¹⁰¹ Appellate Body Report, *Japan – Alcoholic Beverages II*, 118. See on the ‘*de minimis*’ standard also Appellate Body Report, *Canada – Periodicals*, 474; Appellate Body Report, *Chile – Alcoholic Beverages*, para. 49; and Panel Report, *Indonesia – Autos*, para. 14.115.

¹⁰² Appellate Body Report, *Canada – Periodicals*, 474.

¹⁰³ Appellate Body Report, *Japan – Alcoholic Beverages II*, 119.

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.¹⁰⁴

To determine whether the application of a tax measure affords protection to domestic production, it is the application criteria, the structure and the overall application rather than the subjective intent of the legislator or regulator that must be examined. For example, if the tax measure 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, the implication is that the tax measure is applied so as to afford protection to domestic production.

As the Appellate Body acknowledged in *Japan – Alcoholic Beverages II*, the very magnitude of the tax differential may be evidence of the protective application of a tax measure. Most often, however, other factors will also be considered.

With regard to the relevance of the intent of the legislator or regulator, the Appellate Body in *Japan – Alcoholic Beverages II* noted:

[Whether a tax measure is applied so as to afford protection to domestic production] 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*.¹⁰⁵

In *Chile – Alcoholic Beverages*, Chile argued that the internal taxation on alcoholic beverages at issue in that case was aimed at, among other things, reducing the consumption of alcoholic beverages with higher alcohol content. The Appellate Body held:

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 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

¹⁰⁴ *Ibid.*, 120.

¹⁰⁵ *Ibid.*, 119.

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.¹⁰⁶

Note that in *Canada – Periodicals*, the Appellate Body did seem to give at least some importance to statements of representatives of the Canadian Government about the policy objectives of the tax measure at issue.¹⁰⁷

4.4.4. Consistency with the National Treatment Obligation of Article III:4 of the GATT 1994

The national treatment obligation of Article III of the GATT 1994 does not only concern internal taxation dealt with in Article III:2. Article III also concerns internal regulation, dealt with primarily in Article III:4.

Article III:4 states in relevant part:

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

This provision sets out a three-tier test for the consistency of internal regulation. In *Korea – Various Measures on Beef*, the Appellate Body stated:

For a violation of Article III:4 to be established, three elements must be satisfied: that the imported and domestic products at issue are “like products”; that the measure at issue is a “law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution, or use”; and that the imported products are accorded “less favourable” treatment than that accorded to like domestic products.¹⁰⁸

In other words, the three-tier test of consistency of internal regulation with Article III:4 thus requires the examination of whether:

- the measure at issue is a *law, regulation or requirement* covered by Article III:4;
- the imported and domestic products are *like products*; and,
- the imported products are accorded *less favourable treatment*.

¹⁰⁶ Appellate Body Report, *Chile – Alcoholic Beverages*, para. 71.

¹⁰⁷ See Appellate Body Report, *Canada – Periodicals*, 475-476.

¹⁰⁸ Appellate Body Report, *Korea – Various Measures on Beef*, para. 133.

In *EC – Bananas III*, the Appellate Body, in its examination of the constituent elements of Article III:4, ruled with regard to the phrase ‘so as afford protection to domestic production’ of Article III:1, as follows:

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”.¹⁰⁹

As the Appellate Body found in *EC – Asbestos*, Article III:1, nevertheless, has ‘particular contextual significance in interpreting Article III:4, as it sets forth the “general principle” pursued by that provision’.¹¹⁰

4.4.4.1. ‘Laws, regulations and requirements ...’

Article III:4 concerns ‘all laws, regulations and requirements affecting [the] internal sale, offering for sale, purchase, transportation, distribution or use [of products]’. Broadly speaking, the national treatment obligation of Article III:4 applies to regulations affecting the sale and use of products.

According to GATT case law, Article III:4 applies, *inter alia*, to:

- minimum price requirements applicable to domestic and imported beer;¹¹¹
- limitations on points of sale for imported alcoholic beverages;¹¹²
- the practice of limiting listing of imported beer to the six-pack size;¹¹³
- the requirement that imported beer and wine be sold only through in-State wholesalers or other middlemen;¹¹⁴
- a ban on all cigarette advertising;¹¹⁵
- additional marking requirements such as an obligation to add the name of the producer or the place of origin or the formula of the product;¹¹⁶
- practices concerning internal transportation of beer;¹¹⁷ and,
- trade-related investment measures.¹¹⁸

¹⁰⁹ Appellate Body Report, *EC – Bananas III*, para. 216. We note, however, that in *Canada – Periodicals*, the Panel did examine whether a measure at issue ‘afford[ed] protection to domestic production’ to determine the consistency of that measure with Article III:4. (para. 5.38).

¹¹⁰ Appellate Body Report, *EC – Asbestos*, para. 93.

¹¹¹ See GATT Panel Report, *Canada – Provincial Liquor Boards (US)*, para. 5.30.

¹¹² See GATT Panel Report, *Canada – Provincial Liquor Boards (EEC)*, para. 4.26.

¹¹³ See GATT Panel Report, *Canada – Provincial Liquor Boards (US)*, para. 5.4.

¹¹⁴ See GATT Panel Report, *US – Malt Beverages*, para. 5.32.

¹¹⁵ See GATT Panel Report, *Thailand – Cigarettes*, para. 77.

¹¹⁶ See Working Party Report, *Certificates of Origin, Marks of Origin, Consular Formalities*, para. 13.

¹¹⁷ See GATT Panel Report, *Canada – Provincial Liquor Boards (US)*, para. 5.12; and GATT Panel Report, *US – Malt Beverages*, para. 5.50.

While, to date, most cases involving Article III:4 concerned *generally applicable* ‘laws’ and ‘regulations’, Article III:4 also covers ‘requirements’ which may apply to *isolated cases only*. Article III:4 covers both measures that apply across the board and measures that apply in isolated cases only.

The question has arisen whether a ‘requirement’ within the meaning of Article III:4 necessarily needs to be a government imposed requirement, or whether an action by a private party can constitute a ‘requirement’ to which Article III:4 applies. In *Canada – Autos*, the Panel examined commitments by Canadian car manufacturers to increase the value added to cars in their Canadian plants. These commitments were communicated in letters addressed to the Canadian Government. The Panel qualified these commitments as ‘requirements’ subject to Article III:4.¹¹⁹

In brief, private action can be a ‘requirement’ within the meaning of Article III:4 if, and only if, there is such a *nexus*, i.e., a close link between that action and the action of a government, that the government must be held responsible for that private action.

4.4.4.2. ‘Like products’

As with Articles I:1 and III:2, first sentence, both discussed above, the non-discrimination obligation of Article III:4 only applies to ‘like products’. The Appellate Body considered the meaning of the concept of ‘like products’ in Article III:4 in *EC – Asbestos*. In its Report in that case, the Appellate Body first noted that the concept of ‘like products’ was also used in Article III:2, first sentence, and that in previous Reports, it had held that the scope of ‘like products’ was to be construed ‘narrowly’ in that provision.¹²⁰ The Appellate Body then examined whether this interpretation of ‘like products’ in Article III:2 could be taken to suggest a similarly narrow reading of ‘like products’ in Article III:4, since both provisions form part of the same Article. The Appellate Body reasoned as follows:

... 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

¹¹⁸ See GATT Panel Report, *Canada – FIRA*, para. 5.12 and 6.1.

¹¹⁹ The question of whether actions of private parties can qualify as ‘requirements’ within the meaning of Article III:4 was previously addressed in GATT Panel Report, *Canada – FIRA*, para. 5.4 and Panel Report, *GATT EEC – Parts and Components*, para. 5.21. The Panel in *Canada – Autos* explicitly refers to this case law and takes it further. Note that in *Canada – FIRA*, Canada argued that the purchase undertakings should be considered as private contractual obligations of particular foreign investors vis-à-vis the Canadian government. The Panel felt, however, that even if this was so, private contractual obligations entered into by investors should not adversely affect the rights which Members possess under Article III:4 of the GATT. See GATT Panel Report, *Canada – FIRA*, para. 5.6.

¹²⁰ The Appellate Body referred in a footnote to Appellate Body Report, *Japan – Alcoholic Beverages II*, 112 and 113 and Appellate Body Report, *Canada – Periodicals*, 473.

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. By contrast, Article III:4 applies only to “like products” and does not include a provision equivalent to the second sentence of Article III:2.¹²¹

The Appellate Body considered that this textual difference between Article III:2 and Article III:4 had considerable implications for the meaning of the concept of ‘like products’ in these two provisions. The Appellate Body recalled:

In *Japan – Alcoholic Beverages*, we concluded, in construing Article III:2, that the two separate obligations in the two sentences of Article III:2 must be interpreted in a harmonious manner that gives meaning to *both* sentences in that provision. We observed there that the interpretation of one of the sentences necessarily affects the interpretation of the other. Thus, the scope of the term “like products” in the first sentence of Article III:2 affects, and is affected by, the scope of the phrase “directly competitive or substitutable” products in the second sentence of that provision. We said in *Japan – Alcoholic Beverages*:

Because the second sentence of Article III:2 provides for a separate and distinctive consideration of the protective aspect of a measure in examining its application to a broader category of products that are not “like products” as contemplated by the first sentence, we agree with the Panel that the first sentence of Article III:2 must be construed narrowly so as not to condemn measures that its strict terms are not meant to condemn. Consequently, we agree with the Panel also that the definition of “like products” in Article III:2, first sentence, should be construed narrowly.¹²²

The Appellate Body, after considering the reasoning underlying its interpretation of ‘like products’ in Article III:2, first sentence, subsequently observed:

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:4.¹²³

Having distinguished the concept of ‘like products’ in Article III:4 from the concept in Article III:2, first sentence, the Appellate Body then proceeded to examine the meaning of this concept in Article III:4. It first recalled that in *Japan – Alcoholic Beverages II*, it ruled that the broad and fundamental purpose of Article III is to avoid protectionism in the

¹²¹ Appellate Body Report, *EC – Asbestos*, para. 94.

¹²² *Ibid.*, para. 95.

¹²³ *Ibid.*, para. 96.

application of internal tax and regulatory measures. As is explicitly stated in Article III:1, the purpose of Article III is to ensure that internal measures ‘not be applied to imported and domestic products so as to afford protection to domestic production’. To this end, Article III obliges Members of the WTO to provide *equality of competitive conditions for imported products in relation to domestic products*.¹²⁴ This ‘general principle’ is not explicitly invoked in Article III:4. Nevertheless, it does ‘inform’ that provision.¹²⁵

In brief, the determination of whether products are ‘like products’ under Article III:4 is, fundamentally, a determination about the nature and extent of the competitive relationship between these products. Precisely what the nature and extent of the competitive relationship needs to be for products to be ‘like’ within the meaning of Article III:4 cannot be indicated in the abstract. Nevertheless, it can be said that the concept of ‘like products’ in Article III:4 has a relatively broad scope. Its scope is broader than that of the concept of ‘like products’ in Article III:2, first sentence. However, it is no broader than the combined scope of the concepts of ‘like product’ and ‘directly competitive or substitutable products’ of Article III:2, first and second sentence respectively.

Having reached this conclusion, the Appellate Body in *EC – Asbestos* then turned to the question of how it should determine whether products are ‘like’ within the meaning of Article III:4. The Appellate Body noted:

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 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.¹²⁶

¹²⁴ See Appellate Body Report, *Japan – Alcoholic Beverages II*, 109-110.

¹²⁵ See *ibid.*, 111.

¹²⁶ *Ibid.*, para. 101. In a footnote, the Appellate Body referred to Appellate Body Report, *Japan – Alcoholic Beverages II*, 113 and 114; it also referred to the Panel Report in *US – Gasoline*, para. 6.8, where the approach set out in the *Border Tax Adjustments* Report was adopted in a dispute concerning Article III:4 of the GATT 1994. The Appellate Body noted in a footnote that the fourth criterion, tariff classification, was not mentioned by the Working Party on *Border Tax Adjustments*, but was included by subsequent panels (see, for instance, GATT

The Appellate Body in *EC – Asbestos* hastened to add, however, that while these general criteria, or groupings of potentially shared characteristics, provide a framework for analysing the ‘likeness’ of particular products, they are ‘simply tools to assist in the task of sorting and examining the relevant evidence’.¹²⁷ The Appellate Body stressed that these criteria are ‘neither a treaty-mandated nor a closed list of criteria that will determine the legal characterisation of products’.¹²⁸ In each case, *all* pertinent evidence, whether related to one of these criteria or not, must be examined and considered by panels to determine whether products are ‘like’. With regard to these general criteria, the Appellate Body in *EC – Asbestos* finally noted:

... 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.¹²⁹

In its appeal in *EC – Asbestos*, the European Communities argued that the Panel erred in its consideration of ‘likeness’, in particular, because it adopted an exclusively ‘commercial or market access approach’ to the comparison of allegedly ‘like products’; placed excessive reliance on a single criterion, namely, end-use; and failed to include consideration of the health ‘risk’ factors relating to asbestos.¹³⁰

The Appellate Body was highly critical of the manner in which the Panel examined the ‘likeness’ of *chrysotile asbestos fibres* and *PCG fibres*¹³¹ as well as the ‘likeness’ of *cement-based products containing chrysotile asbestos fibres* and *cement-based products containing PCG fibres*.¹³² The Appellate Body criticised the Panel for not examining each of the criteria set forth in *Border Tax Adjustments*¹³³ and for not examining these criteria separately.¹³⁴ The Appellate Body also disagreed with the Panel’s refusal to consider the health risks posed by asbestos in the determination of ‘likeness’, stating:

...neither the text of Article III:4 nor the practice of panels and the Appellate Body suggest that any evidence should be excluded *a priori* from a panel’s

Panel Report, *EEC – Animal Feed Proteins*, para. 4.2; and GATT Panel Report, *Japan – Alcoholic Beverages I*, para. 5.6).

¹²⁷ Appellate Body Report, *EC – Asbestos*, para. 102.

¹²⁸ *Ibid.*

¹²⁹ *Ibid.*, para. 103.

¹³⁰ The European Communities was an ‘other appellant’ pursuant to Rule 23(1) of the Working Procedures for Appellate Review.

¹³¹ PCG fibres are PVA, cellulose and glass fibres.

¹³² Appellate Body Report, *EC – Asbestos*, para. 109.

¹³³ The Panel declined to examine the third criterion (the consumers’ tastes and habits) and dismissed the fourth criterion (tariff classification) as non-decisive.

¹³⁴ In the course of the examination of the first criterion (properties, nature and quality of the products), the Panel relied on the second criterion (end-use) to come to the ‘conclusion’ that the products were like.

examination of “likeness”. Moreover, as we have said, in examining the “likeness” of products, panels must evaluate *all* of the relevant evidence. We are very much of the view that evidence relating to the health risks associated with a product may be pertinent in an examination of “likeness” under Article III:4 of the GATT 1994. We do not, however, consider that the evidence relating to the health risks associated with chrysotile asbestos fibres need be examined under a *separate* criterion, because we believe that this evidence can be evaluated under the existing criteria of physical properties, and of consumers’ tastes and habits,
¹³⁵

In the opinion of the Appellate Body, the carcinogenic or toxic nature of chrysotile asbestos fibres constitutes a defining aspect of the physical properties of those fibres and must therefore be considered when determining ‘likeness’ under Article III:4.¹³⁶ According to the Appellate Body ‘evidence relating to health risks may be relevant in assessing the *competitive relationship in the market place* between allegedly “like” products’.¹³⁷

With regard to the second and third criterion set out in *Border Tax Adjustments*, i.e., end-uses and consumers’ tastes and habits, the Appellate Body found in *EC – Asbestos*:

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.

We consider this to be especially so in cases where the evidence relating to properties establishes that the products at issue are physically quite different. In such cases, in order to overcome this indication that products are *not* “like”, a higher burden is placed on complaining Members to establish that, despite the pronounced physical differences, there is a competitive relationship between the products such that *all* of the evidence, taken together, demonstrates that the products are “like” under Article III:4 of the GATT 1994.¹³⁸

With respect to end-uses, the Appellate Body found that while it is certainly relevant that products have similar end-uses for a ‘small number of ... applications’, a panel must also consider the other, *different* end-uses for products. As the Appellate Body stated in *EC – Asbestos*:

¹³⁵ Appellate Body Report, *EC – Asbestos*, para. 113.

¹³⁶ See *ibid.*, para. 114.

¹³⁷ *Ibid.*, para. 115.

¹³⁸ *Ibid.*, paras. 117 and 118.

It is only by forming a complete picture of the various end-uses of a product that a panel can assess the significance of the fact that products share a limited number of end-uses.¹³⁹

With respect to consumers' tastes and habits, the Appellate Body was very critical of the Panel for declining to examine this criterion because, as the Panel stated, 'this criterion would not provide clear results'.¹⁴⁰ Furthermore, the Appellate Body noted that, in its opinion, consumers' tastes and habits regarding asbestos fibres or PCG 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 (as asbestos fibres are).¹⁴¹

After reversing the Panel's findings, in *EC – Asbestos*, on the 'likeness' of *chrysotile asbestos fibres* and *PCG fibres*, the Appellate Body itself examined the 'likeness' of these products and came to the conclusion that the evidence was certainly far from sufficient to satisfy the complainant's burden of proving that chrysotile asbestos fibres are 'like' PCG fibres under Article III:4. The Appellate Body considered that the evidence rather tended to suggest that these products are not 'like products'.¹⁴²

As the Appellate Body stated in *Japan – Alcoholic Beverages II*, the concept of 'like product' in WTO law is indeed like an accordion whose width varies depending on the provision under which the term is interpreted. As discussed above, the interpretation of the concept of 'like product' in Article III:4 is relatively broad. However, it is not so broad that chrysotile asbestos fibres and PCG fibres would be 'like products'.

In *US – Malt Beverages*, 1992, the Panel considered the question of whether low alcohol beer and high alcohol beer should be considered 'like products' within the meaning of Article III:4. In this regard, the Panel recalled its earlier statement on like product determinations under Article III:2, first sentence, and considered that:

... in the context of Article III, it is essential that such determinations be made not only in the light of such criteria as the products' physical characteristics, but also in the light of the purpose of Article III, which is to ensure that internal taxes and regulations "not be applied to imported or domestic products so as to afford protection to domestic production".¹⁴³

The Panel noted that on the basis of their 'physical characteristics', low and high alcohol beers were 'similar'. However, in order to determine whether low and high alcohol beers were 'like products' under Article III:4, the Panel considered that it had to examine whether the purpose of

¹³⁹ *Ibid.*, para. 119.

¹⁴⁰ Panel Report, *EC – Asbestos*, para. 8.139.

¹⁴¹ Appellate Body Report, *EC – Asbestos*, para. 122.

¹⁴² See *ibid.*, para. 141. Also with regard to the products containing asbestos and PCG fibres, the Appellate Body concluded that Canada had not satisfied the burden of proof that these products are 'like' (see Appellate Body Report, *EC – Asbestos*, para. 147).

¹⁴³ GATT Panel Report, *US – Malt Beverages*, para. 5.71.

the distinction between low and high alcohol beers was ‘to afford protection to domestic production’. The Panel noted that the United States argued that the distinction was made to encourage the consumption of low over high alcohol beer. The Panel eventually concluded that the purpose of the regulatory distinction was not to afford protection to domestic production and that low and high alcoholic beers were, therefore, not ‘like products’.¹⁴⁴

For reasons discussed above, this ‘aim-and-effect’ approach to the determination of ‘likeness’ has been discredited and abandoned by WTO panels and the Appellate Body. A first indication that WTO panels would not follow this ‘aim-and-effect’ approach was given in *US – Gasoline* in which the Panel found that chemically-identical imported and domestic gasoline were ‘like products’ because ‘chemically-identical imported and domestic gasoline by definition have exactly the same physical characteristics, end-uses, tariff classification, and are perfectly substitutable’.¹⁴⁵ The aim and effect of the regulatory distinction made was not given any consideration in determining ‘likeness’.

Finally, note that the Panel in *US – Tuna (Mexico)* found that differences in process and production methods (PPMs) of products are not relevant in determining ‘likeness’. The Panel stated:

... Article III:4 calls for a comparison of the treatment of imported tuna *as a product* with that of domestic tuna *as a product*. Regulations governing the taking of dolphins incidental to the taking of tuna could not possibly affect tuna as a product. Article III:4 therefore obliges the United States to accord treatment to Mexican tuna no less favourable than that accorded to United States tuna, whether or not the incidental taking of dolphins by Mexican vessels corresponded to that of United States vessels.¹⁴⁶

4.4.4.3. ‘Treatment no less favourable’

The fact that a measure distinguishes between ‘like products’ does not suffice to conclude that this measure is inconsistent with Article III:4. As the Appellate Body noted in *EC – Asbestos*:

... there is a second element that must be established before a measure can be held to be 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.¹⁴⁷

The Panel in *US – Section 337* explained the ‘treatment no less favourable’ element of the Article III:4 test in clear terms, noting that:

¹⁴⁴ See *ibid.*, paras. 5.25-5.26 and 5.71-5.76.

¹⁴⁵ Panel Report, *US – Gasoline*, para. 6.9.

¹⁴⁶ GATT Panel Report, *US – Tuna (Mexico)*, para. 5.15. Note that this Report was never adopted.

¹⁴⁷ Appellate Body Report, *EC – Asbestos*, para. 100.

... 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]¹⁴⁸

The Panel in *US – Section 337* thus clearly interpreted ‘treatment no less favourable’ as requiring ‘effective equality of competitive opportunities’. In later GATT and WTO reports, panels and the Appellate Body have consistently interpreted ‘treatment no less favourable’ in the same way.¹⁴⁹

In *US – Gasoline*, a dispute concerning legislation designed to prevent and control air pollution, the Panel found that the measure at issue afforded less favourable treatment to imported gasoline than to domestic gasoline because, for domestic refiners of gasoline, an individual baseline (representing the quality of gasoline produced by that refiner in 1990) was established while, for importers of gasoline, the more onerous statutory baseline applied. The Panel observed *inter alia*:

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.¹⁵⁰

Recalling the ruling of the Panel in *US – Section 337* that the words ‘treatment no less favourable’ in paragraph 4 call for effective equality of opportunities for imported products, the Panel in *US – Gasoline* thus concluded:

... since, under the baseline establishment methods, imported gasoline was effectively prevented from benefiting from as favourable sales conditions as were afforded domestic gasoline by an individual baseline tied to the producer of

¹⁴⁸ GATT Panel Report, *US – Section 337*, para. 5.11.

¹⁴⁹ See e.g. GATT Panel Report, *Canada – Provincial Liquor Boards (US)*, paras. 5.12-5.14 and 5.30-5.31; GATT Panel Report *US – Malt Beverages*, para. 5.30; Panel Report, *US – Gasoline*, para. 6.10; Panel Report, *Canada – Periodicals*, p. 75; Panel Reports, *EC – Bananas III*, paras. 7.179-7.180; and Panel Report, *Japan – Film*, para. 10.379.

¹⁵⁰ Panel Report, *US – Gasoline*, para. 6.10.

a product, imported gasoline was treated less favourably than domestic gasoline.¹⁵¹

Although in *EC – Asbestos* the Appellate Body was not called upon to examine the ‘no less favourable treatment’ finding of the Panel, the Appellate Body noted:

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.¹⁵²

In *Korea – Various Measures on Beef*, a dispute concerning a dual retail distribution system for the sale of beef under which imported beef was, *inter alia*, to be sold in specialised stores selling only imported beef or in separate sections of supermarkets, the Appellate Body stressed that the formal difference in treatment between domestic and imported products is neither necessary nor sufficient for a violation of Article III:4. Formally different treatment of imported products did not necessarily constitute less favourable treatment while the absence of formal difference in treatment did not necessarily mean that there was no less favourable treatment.¹⁵³ The Appellate Body in *Korea – Various Measures on Beef* stated:

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:4.¹⁵⁴

On the one hand, contracting parties may apply to imported products *different* formal legal requirements if doing so would accord imported products more favourable treatment. On the other hand, it also has to be recognised that there may be cases where the application of formally *identical* legal provisions would in practice accord less favourable treatment to imported products and a contracting party might thus have to apply different legal provisions to imported

¹⁵¹ *Ibid.*, para. 6.10.

¹⁵² Appellate Body Report, *EC – Asbestos*, para. 100. The Appellate Body did not examine the requirement of ‘treatment no less favourable’ any further since the Panel’s findings on this requirement had not been appealed.

¹⁵³ See also GATT Panel Report, *US – Section 337*, para. 5.11; and Panel Report, *US – Gasoline*, para. 6.25.

¹⁵⁴ Appellate Body Report, *Korea – Various Measures on Beef*, paras. 135-136.

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:4.¹⁵⁵ [Emphasis added]

From this, the Appellate Body concluded in *Korea – Various Measures on Beef* :

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.¹⁵⁶

In *US – Gasoline*, the Panel rejected the US argument that the requirements of Article III:4 were met because imported gasoline was treated similarly to domestic gasoline from *similarly situated* domestic parties.¹⁵⁷ The Panel pointed out, *inter alia*, that “[the] wording [of Article III:4] does not allow less favourable treatment dependent on the characteristics of the producer ...”.¹⁵⁸ In *US – Gasoline*, the Panel also rejected the US contention that the regulation at issue treated imported products ‘equally overall’ and was therefore not inconsistent with Article III:4.¹⁵⁹ The Panel noted that:

... 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.¹⁶⁰

Under Article III:4, as under Articles I:1 and III:2, ‘balancing’ less favourable treatment by more favourable treatment does not ‘excuse’ the less favourable treatment.¹⁶¹

GATT and WTO panels and the Appellate Body have found a wide variety of measures inconsistent with the national treatment obligation of Article III:4. In addition to the measures at issue in *US – Section 337*, *Korea – Various Measures on Beef* and *US – Gasoline*, all discussed above, measures found to be inconsistent include:

¹⁵⁵ GATT Panel Report, *US – Section 337*, para. 5.11.

¹⁵⁶ Appellate Body Report, *Korea – Various Measures on Beef*, para. 137.

¹⁵⁷ Panel Report, *US – Gasoline*, para. 6.11. The Appellate Body did not address this finding of the Panel.

¹⁵⁸ *Ibid.*

¹⁵⁹ See *Ibid.*, para. 6.14.

¹⁶⁰ *Ibid.*

¹⁶¹ See GATT Panel Report, *US – Section 337*, para. 5.14.

- minimum price requirements (*Canada – Provincial Liquor Boards (US)*);
- a general ban on all cigarette advertisement (*Thailand – Cigarettes*); and,
- regulations concerning internal transportation (*US – Malt Beverages*).

With respect to minimum price requirements, it deserves to be noted that the Panel in *Canada – Provincial Liquor Boards (US)* ruled in 1992:

... minimum prices applied equally to imported and domestic beer did not necessarily accord equal conditions of competition to imported and domestic beer. Whenever they prevented imported beer from being supplied at a price lower than that of domestic beer, they accorded in fact treatment to imported beer less favourable than that accorded to domestic beer: when they were set at the level at which domestic brewers supplied beer – as was presently the case in New Brunswick and Newfoundland – they did not change the competitive opportunities accorded to domestic beer but did affect the competitive opportunities of imported beer which could otherwise be supplied below the minimum price.¹⁶²

With respect to a general ban on all cigarette advertising, the Panel in *Thailand – Cigarettes* argued:

It might be argued that such a general ban on all cigarette advertising would create unequal competitive opportunities between the existing Thai supplier of cigarettes and new, foreign suppliers and was therefore contrary to Article III:4.¹⁶³

The Panel in *US – Malt Beverages* found:

... the requirement for imported beer and wine to be transported by common carrier, whereas domestic in-state beer and wine is not so required, may result in additional charges to transport these imported products and therefore prevent imported products from competing on an equal footing with domestic like products.¹⁶⁴

4.5. NATIONAL TREATMENT UNDER THE GATS

Article XVII of the GATS, which is entitled '*National Treatment*', states in paragraph 1:

¹⁶² GATT Panel Report, *Canada – Provincial Liquor Boards (US)*, para. 5.30.

¹⁶³ GATT Panel Report, *Thailand – Cigarettes*, para. 78. We note that such general ban on cigarette advertising was not the measure at issue in this case but a suggested alternative measure of which the Panel considered the GATT consistency. The Panel further stated: 'Even if this argument were accepted, such an inconsistency would have to be regarded as unavoidable and therefore necessary within the meaning of Article XX(b) because additional advertising rights would risk stimulating demand for cigarettes.'

¹⁶⁴ GATT Panel Report, *US – Malt Beverages*, para. 5.50.

In the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers.

This section first explores the nature of the national treatment obligation of Article XVII of the GATS and then discusses the test of consistency with this obligation.

4.5.1. Nature of the National Treatment Obligation of Article XVII of the GATS

The national treatment obligation of Article XVII of the GATS is different from the national treatment obligation of Article III of the GATT 1994. As discussed above, for trade in goods, the national treatment obligation has *general* application to all trade. On the contrary, the national treatment obligation for trade in services does not have such general application; it does not apply generally to all measures affecting trade in services. The national treatment obligation applies only to the extent that WTO Members have explicitly committed themselves to grant 'national treatment' in respect of specific service sectors.¹⁶⁵ Members set out such commitments in the national treatment column of their 'Schedule of Specific Commitments'. These specific commitments to grant national treatment are often made subject to certain conditions, qualifications and limitations, which are also set out in the Schedules. Members can, for example, grant national treatment in a specific service sector only with respect to certain modes of supply (such as cross border supply) and not others (such as commercial presence). Typical national treatment limitations included in Schedules relate to:

- nationality or residence requirements for executives;
- requirements to invest a certain amount of assets in local currency;
- restrictions on the purchase of land by foreign service suppliers;
- special subsidy or tax privileges granted to domestic suppliers; and
- differential capital requirements and special operational limits applying only to operations of foreign suppliers.¹⁶⁶

Note, by way of example, the national treatment column of the Schedule of the European Communities and its Member States with respect to higher education services, as included on the next page. It appears from this Schedule that the European Communities and its Member States have

¹⁶⁵ A list of the services sectors is contained in GATT Secretariat, *Note by the Secretariat, Services Sectoral Classification List*, MTN.GNS/W/120, dated 10 July 1991.

¹⁶⁶ See WTO Secretariat, *Market Access: Unfinished Business*, Special Studies 6, (WTO, 2001), 103.

agreed to accord national treatment to higher educational services supplied in mode 1 ('cross-border supply') (with a qualification by Italy), mode 2 ('consumption abroad') and mode 3 ('commercial presence'). However, no commitment to accord national treatment was made with regard to mode 4 ('presence of persons'), except the commitment made for all service sectors. The Schedules of Specific Commitments of Members can be found on the WTO website.¹⁶⁷

To determine the scope of the national treatment obligation of a Member, or to determine whether, in respect of a specific service, a Member must grant national treatment to services and service suppliers of other Members, it is necessary to examine the commitments, conditions, qualifications and limitations set out in the Member's Schedule very carefully.

Figure 4.1: Excerpt from the Schedule of Specific Commitments of the European Communities and their Member States¹⁶⁸

¹⁶⁷ www.wto.org, visited on 15 May 2004.

¹⁶⁸ GATS/SC/31, dated 15 April 1994.

Sector or Sub-Sector	Limitations on Market Access	Limitations on National Treatment	Additional Commitments	Notes
European Community 12				
C. Higher Education Services (CPC 923)	<p>5. PRIVATELY FUNDED EDUCATION SERVICES</p> <p>1) F: Condition of nationality. However, third country nationals can have authorization from competent authorities to establish and direct an education institution and to teach.</p> <p>2) None</p> <p>3) E, I: Needs test for opening of private universities authorised to issue recognised diplomas or degrees; procedure involves an advice of the Parliament. GR: Unbound for education institutions granting recognised State diplomas.</p> <p>4) Unbound except as indicated in the horizontal section and subject to the following specific limitations: DK: Condition of nationality for professors. F: Condition of nationality. However, third country nationals may obtain authorization from competent authorities to establish and direct an education institution and to teach. I: Condition of nationality for service providers to be authorised to issue State recognised diplomas.</p>	<p>1) I: Condition of nationality for service providers to be authorised to issue State recognised diplomas.</p> <p>2) None</p> <p>3) None</p> <p>4) Unbound except as indicated in the horizontal section</p>		

4.5.2. Consistency with Article XVII of the GATS

In the sectors inscribed in its Schedule and subject to the conditions, qualifications and limitations set out therein, a Member must accord treatment no less favourable, to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, than that it accords to its own like services and service suppliers. Article XVII of the GATS sets out a three-tier test of consistency. In brief, this three-tier test of consistency with Article XVII of the GATS requires the examination of whether:

- the measure at issue affects trade in services;
- the foreign and domestic services or service suppliers are ‘like’ services or service suppliers; and
- the foreign services or service suppliers are granted treatment no less favourable.

4.5.2.1. ‘Measures affecting trade in services’

As discussed above, in the context of the MFN treatment obligation of Article II of the GATS, the concept of a ‘measure affecting trade in services’ has been clarified by the Appellate Body in *Canada – Autos*, where it stated that two key issues must be examined to determine whether a measure is one ‘affecting trade in services’, namely:

- first, whether there is ‘trade in services’ in the sense of Article I:2; and,
- second, whether the measure at issue ‘affects’ such trade in services within the meaning of Article I:1.¹⁶⁹

Recall, with respect to the first question, the broad scope of the concept of ‘trade in services’, including all services except services supplied in the exercise of governmental authority and including services supplied in any of the four distinct modes of supply (cross-border supply, consumption abroad, commercial presence and presence of natural persons). With respect to the second question, recall that for a measure to ‘affect’ trade in services, this measure must not regulate or govern the trade in, i.e., the supply of, services. A measure affects trade in services when the measure bears ‘upon the conditions of competition in supply of a service’.

4.5.2.2. ‘Like services and service suppliers’

The second element of the three-tier test of consistency with the national treatment obligation of Article XVII of the GATS is whether the foreign and domestic services or service suppliers are ‘like’ services or service suppliers. The concept of ‘like’ services or service suppliers is discussed above in the context of the MFN treatment obligation of Article II of the GATS. As for ‘likeness’ under Article II, there is almost no relevant case law to date on the meaning of ‘likeness’ under Article XVII.¹⁷⁰ However, a determination of the ‘likeness’ of services and service suppliers should clearly be based, among other relevant factors, on:

- the characteristics of the service or the service supplier;
- the classification and description of the service in the United Nations Central Product Classification system (the ‘CPC’); and,
- consumers’ habits and preferences regarding the service or the service supplier.

As is the case in Article II, Article XVII provides that two service suppliers that supply a like service are not necessarily ‘like service suppliers’. Factors such as the size of the

¹⁶⁹ Appellate Body Report, *Canada – Autos*, para. 155.

¹⁷⁰ Note Panel Reports, *EC – Bananas III*, para. 7.322.

companies, their assets, their use of technology and the nature and extent of their expertise must all be taken into account.

4.5.2.3. *'Treatment no less favourable'*

The third and last element of the test of consistency with the national treatment obligation of Article XVII:1 of the GATS is whether the foreign services or service suppliers are granted treatment no less favourable. Paragraphs 2 and 3 of Article XVII clarify the requirement of 'treatment no less favourable' set out in paragraph 1 by stating:

2. A Member may meet the requirement of paragraph 1 by according to services and service suppliers of any other Member, either formally identical treatment or formally different treatment to that it accords to its own like services and service suppliers.

3. Formally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member.

It follows from this that a Member that gives formally identical treatment to foreign and domestic services or services suppliers may nevertheless be in breach of the national treatment obligation if that Member, by giving formally identical treatment, modifies the conditions of competition in favour of the domestic services or service suppliers. Also, a Member that gives formally different treatment to foreign and domestic services or service suppliers does not act in breach of the national treatment obligation if that Member, by giving formally different treatment, does not modify the conditions of competition in favour of the domestic services and service suppliers. The latter would obviously be the case if the different treatment would be in favour of the foreign services or service suppliers but it may also be that a formally different treatment has no impact on the conditions of competition.

With respect to inherent competitive disadvantages resulting from the fact that the service of service supplier is foreign and not domestic, footnote 10 to Article XVII states:

Specific commitments assumed under this Article shall not be construed to require any Member to compensate for any inherent competitive disadvantages which result from the foreign character of the relevant services or service suppliers.

The Panel in *Canada – Autos*, however, stressed the limited scope of this provision as follows:

Footnote 10 to Article XVII only exempts Members from having to compensate for disadvantages due to the foreign character in the application of the national treatment provision; it does not provide cover for actions which might modify the conditions of competition against services or service suppliers which are already disadvantaged due to their foreign character.¹⁷¹

¹⁷¹ Panel Report, *Canada – Autos*, para. 10.300.

4.6. SUMMARY

There are two main principles of non-discrimination in WTO law: the most-favoured-nation (MFN) treatment obligation and the national treatment obligation. In simple terms, the MFN treatment obligation prohibits a country from discriminating *between* other countries; the national treatment obligation prohibits a country from discriminating *against* other countries. These principles of non-discrimination apply – be it not in the same manner – with respect to trade in goods, as well as trade in services. The key provisions of the GATT 1994 that deal with non-discrimination in trade in goods are Article I, on the MFN treatment obligation, and Article III, on the national treatment obligation. The key provisions on non-discrimination in the GATS are Article II, on the MFN treatment obligation, and Article XVII, on the national treatment obligation.

The principal purpose of the MFN treatment obligation of Article I of the GATT 1994 is to ensure *equality of opportunity* to import from, or to export to, *all* WTO Members. There are three questions which must be answered to determine whether or not there is a violation of the MFN treatment obligation of Article I:1, namely whether:

- the measure at issue confers a trade ‘advantage’ of the kind covered by Article I:1;
- the products concerned are ‘like’ products; and,
- the advantage at issue is granted ‘immediately and unconditionally’ to all like products concerned.

As is the case with the MFN treatment obligation under the GATT 1994, the principal purpose of the MFN treatment obligation of Article II:1 of the GATS is to ensure *equality of opportunity, in casu*, for services and service suppliers of *all other WTO Members*. There are three questions which must be answered to determine whether or not a measure violates the MFN treatment obligation of Article II:1, namely, whether:

- the measure at issue affects trade in services;
- the services or service suppliers concerned are ‘like’ services or service suppliers; and,
- less favourable treatment is accorded to the services or service suppliers of a Member.

The principal purpose of the national treatment obligations of Article III of the GATT 1994 is to *avoid protectionism* in the application of internal tax and regulatory measures. As is explicitly stated in Article III:1, the purpose of Article III is to ensure that internal measures ‘not be applied to imported and domestic products so as to afford protection to domestic production’. To this end, Article III obliges Members of the WTO to provide *equality of competitive conditions* for imported products in relation to domestic products. The test of consistency of internal taxation with the national treatment obligation of Article III:2, first sentence, of the GATT 1994 requires the examination of whether:

- the measure at issue is an ‘internal tax’;
- the imported and domestic products are ‘like’ products; and,
- the imported products are not taxed in excess of the domestic products.

Article III:2, second sentence, also concerns national treatment with respect to internal taxation, but it contemplates a ‘broader category of products’ than Article III:2, first sentence. It applies not only to ‘like products’ but to ‘directly competitive or substitutable products’. Article III:2, second sentence, sets out a different test of inconsistency, which requires the examination of whether:

- the measure at issue is an ‘internal tax’;
- the imported and domestic products are directly competitive or substitutable;
- these products are not similarly taxed; and,
- the dissimilar taxation is applied so as to afford protection to domestic production.

The national treatment obligation of Article III not only concerns internal taxation, but also internal regulation. The national treatment obligation for internal regulation is set out in Article III:4. To determine whether a measure is consistent with the national treatment obligations of Article III:4, there is a three-tier test which requires the examination of whether:

- the measure at issue is a law, regulation or requirement covered by Article III:4;
- the imported and domestic products are 'like' products; and,
- the imported products are accorded less favourable treatment.

The national treatment obligation, with respect to measures affecting trade in services, is set out in Article XVII of the GATS. The national treatment obligation of Article XVII is different from the national treatment obligation of Article III of the GATT 1994. While for trade in goods, the national treatment obligation has *general* application to all trade, the national treatment obligation for trade in services applies only to the extent WTO Members have explicitly committed themselves to grant 'national treatment' in respect of specific service sectors. Often such national treatment commitments are subject to conditions and qualifications limiting the scope of the commitment. Where a Member has made a specific commitment to grant 'national treatment', it must fulfill the 'national treatment' obligations of Article XVII of the GATS. To determine whether a measure is consistent with the national treatment obligations of Article XVII, there is a three-tier test which requires the examination of whether:

- the measure at issue affects trade in services;
- the foreign and domestic services or service suppliers are 'like' services or service suppliers; and,
- the foreign services or service suppliers are granted treatment no less favourable.

The non-discrimination obligations of Articles I:1, III:2, first sentence, and III:4 of the GATT 1994 and Articles II:1 and XVII:1 of the GATS only apply to products, services or services suppliers which are 'like'. As the Appellate Body noted, the concept of 'like' products is like an accordion whose width varies depending on the provision under which the term is interpreted. However, the determination of whether products are 'like products' is, fundamentally, a determination about the nature and extent of the competitive relationship between these products. The same can be said of the determination of whether services or service suppliers are 'like'. The factors that must be considered in determining 'likeness' are, among other relevant factors:

- the characteristics of the products, services or the service suppliers;
- the classification of the products, services and service suppliers;
- consumer habits and preferences regarding the products, services or the service supplier; and,
- for products, their end use.