

“Like” is a Four-Letter Word—GATT Article III’s “Like Product” Conundrum

By
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INTRODUCTION

The General Agreement on Tariffs and Trade of 1947 (General Agreement)¹ seeks to limit the ability of each individual government to insulate its constituent industries from outside competition.² One of the central principles of the General Agreement is that of national treatment, a principle of nondiscrimination embodied in Article III.³ In theory, Article III prohibits internal taxes and other regulations that enhance the competitive position of domestic producers relative to that of foreign producers.

Central to the application of Article III, particularly the second paragraph which addresses the use of internal taxes and other charges to differentiate between imports and domestically produced goods, is the concept of “like product,” which arises out of the language of the statute.⁴ Of the limited number of dispute resolution panel rulings issued by GATT,⁵ three have considered in de-

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1. General Agreement on Tariffs and Trade, October 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 188 [hereinafter General Agreement]. In keeping with normal usage, this article will refer to the document as the General Agreement and to the quasi-institution that evolved to administer that document as the GATT.

2. The long-term goal of the General Agreement is trade liberalization so that all barriers to trade other than tariffs are eliminated, and the use of tariffs is restricted as they are “bound” and eventually negotiated down. This goal is, of course, a general objective and is subject to numerous exceptions. Philip M. Nichols, *GATT Doctrine*, 36 VA. J. INT’L L. 379, 386-87 (1996).

3. See John H. Jackson, *National Treatment Obligation and Non-Tariff Barriers*, 10 MICH. J. INT’L L. 207, 208 (1989) [hereinafter Jackson, *National Treatment*].

4. Specifically, the provision states: “[t]he products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products.” General Agreement, *supra* note 1, article III:2 (emphasis added).

5. Only 196 cases were handled by the GATT over nearly half a century. Francis Williams, *News: World Trade: Antagonists Queue for WTO Judgement: Frances [sic] Williams on a Vote of Confidence in the Trade Body’s Capacity to Settle Disputes*, FIN. TIMES, Aug. 8, 1996, at 6. Of those, 115 complaints were filed during the 1980s, yielding 47 decisions by panels, which is more than the three previous decades combined. Nichols, *supra* note 2, at 398. See also ROBERT E. HUDEC, ENFORCING INTERNATIONAL TRADE LAW: THE EVOLUTION OF THE MODERN GATT LEGAL SYSTEM 13-14 (1993). This small number of rendered decisions means that the body of GATT law

tail the question of "like product" as it arises in Article III.⁶ The result has been the emergence of two different approaches for applying the provision—one stresses a flexible reading of Article III to achieve the purpose of the provision; the other stresses a literal reading of the article to give each word of the provision its full effect. As a result, the role of the term "like product" in the first approach differs completely from that of the second.

Then came the World Trade Organization (WTO),⁷ and along with it a recent panel ruling, *Japan—Alcoholic Beverages*, which was subsequently submitted to appellate scrutiny under the regime of the new WTO *Dispute Settlement Understanding*.⁸ Unfortunately, the panel report was pedestrian in its reasoning and thoroughly muddled the "like product" issue by its strict adherence to formalism. The appellate ruling, in attempting to mitigate the damage done to the national treatment obligation without a wholesale rejection of the panel's approach, intensified the confusion over the application of the term. Consequently, there currently exists a national treatment obligation that is certainly unclear, likely too harsh, and which ultimately will do violence to the General Agreement's integrity and make the WTO unnecessarily intrusive on national government policy making.

The meaning of the term "like," as in "similar," is ambiguous. It produces all manners of metaphysical and epistemological questions. The *Alcoholic Beverages* panel and appellate body ignore these difficulties. Nevertheless, the appellate body rendered a meaningless, but apt, metaphor in its final report:

there can be no precise and absolute definition of what is "like." The concept of "likeness" is a relative one and evokes the image of an accordion. The accordion of "likeness" stretches and squeezes in different places as different provisions of the WTO Agreement are applied. The width of the accordion in any one of those places must be determined by the particular provision in which the term "like" is encountered as well as by the context and the circumstances that prevail in any given case to which that provision may apply.⁹

The metaphor of an accordion, despite its awkward phrasing and ultimate unhelpfulness in defining any useful "like product" standard in applying Article III, is amusingly accurate. This is so because the term "like product" has changed shape quite regularly in prior panel interpretations, not as a result of its inherent flexibility, but rather due to its inherent ambiguity.¹⁰ While accurate when applied to the notion that the term "like product" cannot be defined to fit all provisions in the General Agreement, the appellate body's statement also can

is limited. Cf. 74 cases have been filed with the WTO in the two years since its inception. See Williams, *supra* note 5 at 6.

6. See discussion *infra* text accompanying notes 16-49.

7. Marrakesh Agreement Establishing the World Trade Organization, LEGAL INSTRUMENTS—RESULTS OF THE URUGUAY ROUND (1994) [hereinafter WTO Agreement].

8. See WTO Dispute Appellate Body Report on *Japan—Alcoholic Beverages*, I.T.L.R. vol. 1, iss. 2 at 231 (July 11, 1996) [hereinafter 1996 *Alcoholic Beverages Appellate Body*].

9. *Id.* at 242.

10. See discussion of different ways in which the term "like product" is applied in Article III:2 and Article III:4, *infra* text accompanying notes 14-25.

be read ironically—as an expression of the frustration of and retreat from developing an intelligible standard for the application of the term in Article III.

This Comment analyzes the use of the term “like product” in Article III and the broader implications of different applications of the term. A major consideration is whether the term “like product” denotes a requirement for a finding of such in the application of the provision, or whether the term denotes a violation of the provision and thus reflects nothing more than a conclusion. Part I reviews the major cases dealing with the Article III “like product” definition in order to outline the reasoning behind each of the two interpretations of “like product.” Part II scrutinizes the merits of each interpretation in light of the purpose of Article III. The Comment concludes that the Article III:2 should employ a modified version of the aim-and-effect test and should de-emphasize the term “like product” in order to prevent continued confusion in the future.

I.

THE DEVELOPMENT OF THE “LIKE PRODUCT” TESTS

Article III is the central provision in the General Agreement regulating the application of domestic policies to imported products. It requires contracting parties (now members under WTO) to accord national treatment to imported products. Article III, known as the national treatment obligation, focuses on discrimination against imports for the benefit of domestic production in the importing country. The purpose of this article is to ensure that that an imported product is treated in the same way in terms of taxation and regulatory treatment as a “like” domestically produced good after that imported product has cleared customs.¹¹ In essence, Article III protects imports from governmental measures which protect domestic goods through the imposition of unfair competitive conditions that favor domestic producers. The Article has many parts, but only three paragraphs are relevant to the immediate discussion.

Paragraph four of Article III (Article III:4) prohibits discrimination against imports through the imposition of regulatory treatment on imported products that differs from the treatment of domestically produced products. Article III:4 reads in part:

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

This provision applies to all internal measures except those of a fiscal nature. Internal fiscal measures, such as internal taxes, are governed by the first sentence of the second paragraph of Article III (Article III:2) which states that:

The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind *in excess* of those applied, directly or indirectly, to *like domestic products* (emphasis added).

11. Article III:2 deals with tax treatment. Article III:4 deals with regulatory treatment.

The second sentence of Article III:2 broadens this rule by declaring that:

no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.

The first paragraph of Article III (Article III:1) lays out the general policy of the article. Paragraph 1 of Article III states, *inter alia*, that:

The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products . . . should not be applied to imported products *so as to afford protection to domestic production* (emphasis added).

Note that the second sentence of Article III:2 directly references Article III:1, whereas the first sentence does not. This difference is a source of confusion, as will be discussed later in this Comment.

Furthermore, the scope of second sentence of Article III:2 is limited by an Interpretive Note *ad* Article III, paragraph 2, to apply only to "directly competitive or substitutable" products. The *ad* Article states:

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

The term "like product," which appears in Article III:4 and particularly in the first sentence of Article III:2, has given GATT and WTO panels many interpretive difficulties. This difficulty arises, in part, from the fact that the term appears repeatedly throughout the General Agreement.¹² The first ambiguity that arises is whether or not the term has a uniform application throughout the General Agreement. *The Working Party Report on Border Tax Adjustments (Border Tax)* resolved this question, stating that the Contracting Parties have never developed a general definition of "like product" for application to all the provisions of the General Agreement.¹³ The *Border Tax* report further elaborates that:

With regard to the interpretation of the term 'like or similar products', which occurs some sixteen times throughout the General Agreement, it was recalled that considerable discussion had taken place . . . but that no further improvement of the term had been achieved. The Working Party concluded that problems arising from the interpretation of the terms 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

12. Report of the Working Party on Border Tax Adjustments, GATT B.I.S.D. II/18S/97 at ¶ 18 (1947) [hereinafter *Border Tax*].

13. The Panel notes that GATT drafting history confirmed that "the expression ("like product"), had different meanings in different contexts of the Draft Charter," indicating that the meaning of "like product" changed according to the context of the article in which it was being used. *See, e.g.,* 1996 Alcoholic Beverages Appellate Body, *supra* note 8, at 242; GATT Dispute Panel Report on United States—Taxes on Petroleum and Certain Imported Substances, L/6175-34S/136, B.I.S.D. 34th Supp., 1987 WL 421960 (GATT) at ¶ 5.1.1 (June 17, 1987) [hereinafter *Taxes on Petroleum Panel*].

given market; consumers' tastes and habits, which change from country to country; the product's properties, nature and quality.¹⁴

This language has become something of a mantra for subsequent panel and appellate body reports that have tried to apply the term "like product" in Article III cases. A restatement of the *Border Tax* criteria—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—precedes virtually every attempt to interpret and apply the term to a given case. Regularly, the *Border Tax* criteria are invoked without any subsequent discussion of their relevance or the manner of their application. Such neglect to explain the application of these criteria—which may appear to be straightforward but actually are not—is suspicious.

Since more GATT panels have focused on the application of "like product" with paragraph two rather than paragraph four, this Comment will focus the bulk of its analysis on Article III:2 and use Article III:4's application of the term to highlight and contrast certain points.

A. *The Article III:2 "Like Product" Test*

1. *A Literal (and Obvious?) Reading: The Two-Step "Product" Test of Panel Report on Japan—Alcoholic Beverages*

The 1987 Panel Report on *Japan—Custom Duties, Taxes and Labeling Practices on Imported Wines and Alcoholic Beverages (1987 Alcoholic Beverages)*, concerned Japan's differential tax treatment of shochu, a traditional Japanese hard liquor, versus other alcoholic beverages, such as whisky and vodka.¹⁵ A major issue for the parties in the case was what kind of a comparison between imported and domestically produced products was necessary to determine their "likeness" for the Article III:2 analysis.

Rejecting Japan's argument that an actual product comparison was unnecessary, the panel affirmed the necessity of a "like product" determination in applying the first sentence of Article III:2, and it adopted a two-step test for determining whether internal taxes conformed with Article III:2. The panel found:

that the ordinary meaning of Article III:2 in its context and in light of its object and purpose supported the past GATT practice of examining the conformity of internal taxes with Article III:2 by determining, firstly, whether the taxed import and domestic products are 'like' or 'directly competitive or substitutable' and, secondly, whether the taxation is discriminatory (first sentence) or protective (second sentence of Article III:2).¹⁶

The first step was the evaluation of whether the taxed imported product and untaxed domestic product were "like" or "directly competitive or substitutable." If a finding of likeness or of direct competition or substitutability between the

14. *Border Tax*, *supra* note 12, at ¶ 18.

15. GATT Dispute Panel Report on *Japan—Customs, Duties, Taxes and Labeling Practices on Imported Wines and Alcoholic Beverages*, L/6216-34S/83, 1987 WL 421964 (GATT) (Nov. 10, 1987) [hereinafter 1987 Alcoholic Beverages Panel].

16. *Id.* at ¶ 5.5.

imported product and the domestic product was made, then the second part of the inquiry was to compare the fiscal burdens on the respective products, which would determine whether a violation of Article III had occurred.¹⁷ I will refer to this type of test as a two-step product test, because the step preceding the evaluation of the regulation involves a comparison of the imported and domestic products themselves.

The panel laid out some guidelines for applying the initial step of the two-step test to determine the "likeness" between the imported and domestic products. The panel noted that the "wording 'like' products (in French text: 'produits similaires') has been used also in other GATT articles on non-discrimination (e.g. Article I:1) in the sense not only of 'identical' or 'equal' products but covering also products with similar qualities."¹⁸ Thus, the panel stated a rather broad scope of what could constitute "like products." In addition, it reaffirmed that the Contracting Parties had never developed a general definition of "like product" for Article III:2 nor for GATT generally and that it had been prior GATT panel practice to determine what constituted "like products" on a case-by-case basis according to the criteria spelled out in the *Border Tax* report.¹⁹

Regarding the criteria spelled out in the *Border Tax* report, the panel noted that "likeness" between two products must be accounted for by both "objective" criteria (such as composition and manufacturing process) and the criteria of the "subjective" consumers' viewpoint (such as consumption patterns and manner of use by consumers).²⁰ However, the panel qualified these points by saying with regard to objective criteria that minor difference in taste, color, and other properties would not prevent products from qualifying as "like products."²¹ With regard to subjective criteria, the panel noted that consumer habits were variable and could be affected by taxation and pricing, so that traditional Japanese consumer habits would not be enough to defeat a finding of "like"-ness.²² Thus, the broad scope of the term "like product" combined with the indefiniteness and vague standards in how the "like product" determination is to be made allows a great deal of room for a panel to make subjective and discretionary judgments.

Notable in the second part of the test is the different treatment of the regulation depending on the finding made in the first part of the test. Should "like" products be found, then the subsequent determination is whether or not the tax is discriminatory. In essence, it is a trade effects evaluation. Only if the products are not found to be "like" and instead fall into the broader category of "directly

17. *Id.* at ¶ 5.5(d).

18. The Panel cites GATT Dispute Panel Report on Tariff Treatment by Spain of Imports of Unroasted Coffee, B.I.S.D. 28S/102, at 112 (1981) [hereinafter *Unroasted Coffee*], which is peculiar because it is an Article I (Most Favored Nation) panel decision. *Id.* at ¶ 5.5(a).

19. The Panel notes that GATT drafting history confirmed that "the expression ('like product') had different meanings in different contexts of the Draft Charter," indicating that the meaning of "like product" changed according to the context of the article in which it was being used. *Id.* at ¶ 5.6.

20. *Id.* at ¶ 5.7.

21. *Id.* at ¶ 5.6 (agreeing with an earlier panel report adopted by the Contracting Parties).

22. *Id.* at ¶ 5.7.

competitive or substitutable” products would the subsequent inquiry be limited to a determination of whether the tax was protective. As a result, the finding of “likeness” triggers a very trade protective standard, invalidating any discriminatory effect.

To give some limit to the scope of a panel’s application of the provision, the panel also stated that the Article III:2 prohibition of discriminatory or protective taxation must be read within the context of the General Agreement’s goal of liberalizing custom duties.²³ Thus, Article III:2 is meant to ensure that the reasonable expectation of competitive benefits accruing under tariff concessions would not be nullified or impaired by internal tax discrimination against like imported products.²⁴

In conclusion, the panel speculated that even if likeness was not found, there was a “directly competitive or substitutable” relationship between the imported and domestic product, since one product provided consumers with an alternative to the other.²⁵ Apparently, the panel decided not to engage in the difficult task of making an authoritative determination of whether or not shochu and the imported alcoholic beverages were “like products.” Instead, the panel relied on the second sentence of Article III:2 in order to find the products to be directly competitive or substitutable and therefore in violation of the national treatment obligation.

2. *In Search of the National Treatment Obligation: Striving for Aim-and-Effect in United States—Measures Affecting Alcoholic and Malt Beverages and United States—Taxes on Automobiles*

The two subsequent panel reports dealing with the issue of applying the term “like product” in an Article III:2 context began to reconsider the question along very different lines. The first to broach the new approach was the 1992 Panel Report entitled *United States—Measures Affecting Alcoholic and Malt Beverages*.²⁶ This report examined the excise tax exemption accorded by the state of Mississippi to wine made from scuppernong grapes, a particular variety

23. *Id.* at ¶ 5.5(b).

24. *Id.* This finding would be superseded by subsequent panel decisions and eventually by 1996 Alcoholic Beverages Appellate Body, *supra* note 8, at 240, in favor of a reading of Article III as protecting all trade, not just trade under tariff bindings. (“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 regulatory measures so as to afford protection to domestic production.”) *See also* Jackson, *National Treatment*, *supra* note 3, at 209 (stating that one policy is to prevent a tax or regulatory measure from defeating a tariff binding, but Article III:2 also applies to all products and not just bound products, so that the rule assists in reducing restraints on imports generally).

25. 1987 Alcoholic Beverages Panel, *supra* note 15, at ¶ 5.7.

26. GATT Dispute Panel Report on United States—Measures Affecting Alcoholic and Malt Beverages, DS23/R - 39S/206, 1992 WL 799397 (GATT) (June 19, 1992) [hereinafter Malt Beverages Panel].

of grape that only grew in Mississippi and in parts of the Mediterranean region (Mississippi Wine Tax).²⁷

While the panel initially followed the language of the panel report in *1987 Alcoholic Beverages*, reciting the *Border Tax* considerations and criteria,²⁸ it focused on an issue not considered by the prior panel—the notion that the like product determination under Article III:2 should relate to the purpose of the article as a whole.²⁹ While the *Alcoholic Beverages* panel report had stated that the like product determination should be made with regard to the purpose of the General Agreement as a whole, it did not explicitly consider applying the determination in light of the specific purpose of the national treatment obligation. In a less than novel but nevertheless significant observation, the panel stated that the basic purpose of Article III is to prevent the use of internal taxes and regulations to protect domestic production. Article III was *not* designed to prevent Contracting Parties from using their fiscal and regulatory powers for purposes *other than* to afford protection to domestic production.³⁰ Specifically, Article III is not to prevent Contracting Parties from differentiating for policy purposes unrelated to the protection of domestic production.³¹ Because differential treatment is permitted, the provision permits legitimate discrimination between imports and domestic goods. Thus, in applying the provision, the panel considered it necessary to account for this basic purpose—limited in scope to nullifying protectionist state measures—in applying the term “like product” and in the determination of whether two products subject to different tax or regulatory treatment are in fact “like.”³² The “like product” inquiry thus became an inquiry not simply of whether the *Border Tax* criteria and the considerations put forth by the *Alcoholic Beverages* panel were satisfied but, rather, whether it made sense to distinguish the products in the manner as contested for tax or regulatory pur-

27. *Id.* at ¶¶ 5.1, 5.23-5.26. At issue was a tax exemption based on a category of wine made from grapes that only grew in the United States and the Mediterranean region. The U.S. argued that this wine constituted a product unlike and different from other wines.

28. *Id.* at ¶¶ 5.21-5.26.

29. *Id.* at ¶ 5.24. Notably, the Panel does not mention the use of Article III to protect negotiated tariff concessions as was suggested in a prior case.

30. *Id.* at ¶ 5.24.

31. *Id.* In addition, the panel stated, “[I]t is imperative that the like product determination in the context of Article III be made in such a way that it not unnecessarily infringe upon the regulatory authority and domestic policy options of the contracting parties.” *Id.* at ¶ 5.26.

32. “The basic purpose of Article III is to ensure, as emphasized in Article III:1, ‘that the internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, purchase, transportation, distribution or use of the products . . . should not be applied to imported or domestic products so as to afford protection to domestic production.’ The purpose of Article III is thus 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. The Panel considered that the limited purpose of Article III has to be taken into account in interpreting the term ‘like product’ in this Article. 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.’” *Id.* at ¶ 5.25.

poses in a way that does not violate Article III's basic prohibition against protection of domestic industries.³³

In applying this novel consideration, this panel confidently found that unsweetened still wines were indeed like products (in contrast with the panel in *1987 Alcoholic Beverages* which evaded the determination).³⁴ It also reiterated the relevance of the second sentence of Article III:2 as an important safety net provision, stating that even a special variety grape wine unlike other wines would at least be directly competitive or substitutable products. Therefore, a differential tax would be inconsistent with the national treatment obligation.³⁵

Malt Beverages introduced a different approach to the application of the first sentence of Article III:2. Instead of focusing on the term "like product," it focused on examining the regulation itself to see if the regulatory distinctions between imported and domestic products were based on valid governmental motives. This inquiry focuses on the regulation at issue rather than the products. Furthermore, this test is comprised of one step, with its one step being an examination of the regulation itself (although that examination may itself require more than one step). The Comment will refer to this line of thinking as the one-step regulation test.

The demise of the two-step product test and its replacement by a one-step regulation test is a natural outgrowth of the considerations raised in the above panel report and in the subsequent case. The 1994 Panel Report entitled *United States—Taxes on Automobiles (Taxes on Automobiles)*³⁶ fell in the limbo of the demise of the GATT as a trade governing body and its replacement by the WTO and was never adopted by the Contracting Parties.³⁷ Nevertheless, the case is important to examine because it elucidated the one-step regulation test and addressed the question of what may be the basis of a legitimate differential tax or regulatory treatment of imported and domestic "like" products under Article III. The *Taxes on Automobiles* panel inquired into whether Article III:2 applied to the Luxury Tax, a measure in the United States which imposed a retail excise tax on certain luxury products, including passenger vehicles priced over \$32,000.

The panel's reasoning focused on the question of what differences between products may form the basis of valid regulatory distinctions by governments that accord different treatment to imported products. Conversely, the panel asked which similarities between products would prohibit regulatory distinctions that

33. The Mississippi Wine Tax is an example of such. *Id.* at ¶ 5.26.

34. *Id.* at ¶ 5.26.

35. *Id.*

36. GATT Dispute Panel Report on United States—Taxes on Automobiles, DS31/R, 1994 WL910937 (GATT) (Oct. 11, 1994) [hereinafter *Taxes on Automobiles Panel*].

37. See James H. Snelson, Note, *Can GATT Article III Recover From Its Head-on Collision With United States—Taxes on Automobiles?*, 5 MINN. J. GLOBAL TRADE 467, 487 (1996). See also 1996 Alcoholic Beverages Appellate Body, *supra* note 8, at 238-239, on the status of adopted panel reports (stating that unadopted panel reports have no legal status in the GATT or WTO system since they have not been endorsed through decisions by the Contracting Parties to GATT or WTO Members, but their reasoning nevertheless could be a useful guide in future cases).

accord less favorable treatment to imported products.³⁸ It considered that Article III:2 had to be read in light of the central purpose of Article III, which was expressed in the first paragraph of Article III. Referring back to *Malt Beverage*, the panel reiterated that the "like product" test required consideration of whether the product differentiation was being made "so as to afford protection to domestic production" or not.³⁹ Thus, the panel reasoned that Article III served only to prohibit regulatory distinctions between products that protect domestic production; otherwise, Article III permits fiscal and regulatory distinctions to achieve other legitimate (e.g. non-protectionist) policy goals.⁴⁰

The panel also integrated the oft-cited language of the *Border Tax* considerations and criteria into its argument that regulatory distinctions could be made if based on legitimate, non-protectionist policy grounds.⁴¹ Essentially, the panel was conscripting both the language of the General Agreement as well as prior GATT panel reports to emphasize the centrality of protectionism analysis in applying Article III:2. Thus, the panel concluded that Article III could not be interpreted as prohibiting governmental policy options, based on product distinction, that were not taken so as to afford protection to domestic production.⁴²

In a bold move, the panel rejected the two-step approach in applying Article III:2 in favor of a single test. The panel observed that the first step of the two-step test necessarily included in all but the most straightforward cases a determination of the *aim and effect* of the particular tax measure, so that a second step of determining whether or not the regulation afforded protection to domestic production would be redundant.⁴³ The panel concluded that issues of likeness under Article III should be analyzed primarily in terms of whether less favorable treatment was based on a regulatory distinction taken "so to afford protection to domestic production."⁴⁴ To accomplish this task, the panel proposed the new single-step aim-and-effect test, focusing on whether the tax had the "aim and effect" of protecting domestic production, to determine whether Article III:2 required taxes to be invalidated. Tax distinctions fail this new aim-and-effect test if (1) discrimination was a "desired outcome and not merely an incidental consequence of the pursuit of a legitimate policy goal," (i.e. aim) and (2) the regulatory distinctions between goods accord "greater competitive opportunities to domestic products than to imported products" (i.e. effect).⁴⁵ In other

38. Taxes on Automobiles Panel, *supra* note 36, at ¶ 5.6.

39. *Id.* (referencing Malt Beverages Panel, *supra* note 26).

40. *Id.* at ¶ 5.7.

41. *Id.* at ¶ 5.8 ("The Panel noted that earlier practice of the CONTRACTING PARTIES had been to determine the permissibility of regulatory distinctions under Article III on a case-by-case basis, examining likeness in terms of factors such as '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.' The Panel noted that regulatory distinctions based on such factors were often, but not always, the means of implementing government policies other than the protection of domestic industry.").

42. *Id.* at ¶ 5.8.

43. *Id.* at ¶ 5.9. See also *id.* at ¶¶ 5.12-5.15, for an application of the aim-and-effect test to the Luxury Tax Threshold.

44. *Id.* at ¶ 5.9.

45. Snelson, *supra* note 37, at 484.

words, the sole determination of this test was whether or not a measure was a protectionist measure.

As for the second sentence of Article III:2, the panel stated that its effect was to extend the scope of the national treatment obligation from “like” products to “directly competitive or substitutable” products, in cases where the measure is applied “so as to afford protection to domestic production.”⁴⁶ This could be problematic, as discussed in Part III, because it means that “like product” and “directly competitive or substitutable product” become interchangeable and redundant terms because both are merely proxies for the determination of the aim and effect of a national regulation. If this is so, it means a departure from any literal textual reading of Article III:2, eliminating any distinction between the first and second sentences of that provision.

Thus, *Taxes on Automobiles* eviscerates the original two-step “like product” test in two ways: first, by making the “like product” finding nothing more than a proxy for the determination of whether or not a regulation was protectionist, and, second, by subsuming the “directly competitive or substitutable product” test of the second sentence of Article III:2 into the reformulated “like product” test of the first sentence so that the two tests, and hence their respective legal duties, are indistinguishable.

After proceeding to an application of the aim-and-effect test, the panel found that the Luxury Tax did not create the effect of competition that divided the products inherently into two (imported and domestic) classes,⁴⁷ and that the distinction did not have the aim of affording protection to domestic protection.⁴⁸ Hence, the panel found neither like products nor directly competitive or substitutable products.

3. *From Completely Wrong to Merely Inconsistent: The Panel and Appellate Body Reports on Japan—Taxes on Alcoholic Beverages*

The 1987 *Alcoholic Beverages* dispute was revived in 1995 as the European Community, the United States and Canada lodged complaints with the newly-created WTO that Japan’s compliance with the earlier panel ruling was still inconsistent with Article III:2. The result was the 1996 *Panel Report on Japan—Taxes on Alcoholic Beverages (1996 Alcoholic Beverages Panel)* which squarely demolished the emerging aim-and-effect doctrine.⁴⁹ It did so largely by relying on the *Vienna Convention on the Law of Treaties* to interpret Article III.⁵⁰ The result is remarkable. The panel was able to dismiss all the considerations raised by the United States and Japan in favor of an aim-and-effect test with the simple argument that the test did not adhere to a literal reading of the

46. *Taxes on Automobiles Panel*, *supra* note 36, at ¶ 5.16.

47. *Id.* at ¶ 5.14.

48. *Id.* at ¶ 5.15.

49. WTO Panel Report on Japan—Taxes on Alcoholic Beverages, WT/DS8/R, WT/DS10/R, WT/DS11/R, 1996 WL 406720 (WTO) (July 11, 1996) [hereinafter 1996 Alcoholic Beverages Panel].

50. *Id.* at ¶ 6.11.

text of Article III:2.⁵¹ The panel made its literalist bent obvious by further noting that the first sentence of Article III:2 made no reference to Article III:1, so that the assumption of the aim-and-effect test that the first sentence could make a reference to the limitation of "so as to afford protection" is wrong.⁵² Furthermore, neither the wording of Article III:1 nor Article III:2 supports a distinction between origin-neutral and origin-specific measures as required in the aim-and-effect test.⁵³ By relentlessly pressing home its literal reading of the text of Article III, the panel ignored all the legal and policy arguments behind the aim-and-effect test. Specifically, the panel insisted that the text of the article indicated that there were two separate legal obligations in Article III:2, one embodied by the first sentence concerning "like" product and another embodied by the second sentence concerning "directly competitive or substitutable" products.⁵⁴ This assumption of two separate legal obligations in the article made it impossible to read Article III:2 in the manner proposed by the aim-and-effect test, which would tend to equivocate the scope of the first and second sentences. For good measure, it made clear that it rejected the reasoning of *Malt Beverages* and *Taxes on Automobiles* as inconsistent with a literal reading of the article.⁵⁵

The panel revived the 1987 *Alcoholic Beverages* two-step "like product" test and added an extra step. The steps are a determination of (1) whether products are like, (2) whether the contested measure is an "internal tax" or "other internal charge" (not an issue in the disputes discussed in this Comment), and (3) whether the tax imposed on foreign products is in excess of the tax imposed on like domestic products.⁵⁶ Thus, the application of the term "like product" was a required and independent step in the application of the first sentence of Article III:2. Applying the test, the panel concluded that shochu and vodka were like products and that shochu, whisky, brandy, rum, gin genever and liqueurs were "directly competitive or substitutable products," that there was discriminatory treatment in both cases, and hence Article III was violated on both counts.⁵⁷

The recently-created appellate body reviewed the 1996 *Alcoholic Beverages Panel* report in the 1996 *Appellate Body Report on Japan—Taxes on Alcoholic Beverages (1996 Alcoholic Beverages, Appellate Body)*⁵⁸ and found that the panel had erred in law by failing, among other things, to take into account Article III:1 in interpreting both the first and second sentences of Article III:2. This, of course, sounds like the very consideration that was developed in *Malt Beverages* and *Taxes on Automobiles*. However, the appellate body cites to neither panel report in coming to this conclusion and makes no mention at all of *Taxes on Automobiles* in its report.⁵⁹ Nevertheless, its conclusion that the

51. *Id.* at ¶ 6.16.

52. *Id.*

53. *Id.*

54. *Id.* at ¶ 6.11.

55. *Id.* at ¶ 6.18.

56. *Id.* at ¶ 6.19.

57. *Id.* at ¶ 7.1.

58. 1996 *Alcoholic Beverages Appellate Body*, *supra* note 8.

59. See *id.* at note 40, which only cites the *Malt Beverages Panel* report, *supra* note 26, at ¶ 6.12.

panel's reading was in error is significant—it undermines a necessary conclusion derived from a strict literalist reading of Article III. If one were to read Article III:2 literally, one cannot consider Article III:1 when applying the first sentence. The appellate body insists that Article III:1 must be accounted for in both sentences of Article III:2. To do so would mean abandoning the literalist approach. This in itself does fatal damage to the reasoning in the panel decision below. Despite pointing out this error that undermines the reasoning of the panel decision, the appellate body upheld the panel decision, reaffirming its decision to interpret “like products” on the basis of a textual analysis of GATT Article III:1 and III:2 rather than on the aims and effect of the offending legislation. In doing so, it reaffirmed the two-step product test, but it significantly confused the issue by raising considerations contradictory to the literalist approach. As a result, it is not surprising that the appellate body did not integrate its findings into its subsequent analysis of the article.

The appellate body began its discussion of the interpretation of Article III in Part G of the report with a discussion of its broad and fundamental purpose, which is to avoid protectionism in the application of internal tax and regulatory measures and to ensure equality of competitive conditions for imported products in relation to domestic products.⁶⁰ The appellate body stated that Article III:1 contained general principles which informed the application of Article III:2, arguing that such an interpretation was the only permissible one in order to give effect to Article III:2.⁶¹ In saying this, the appellate body implicitly rejected the notion advanced in the panel report that Article III:2 was to be read primarily within the context of the General Agreement's goal of liberalizing custom duties.⁶² The appellate body also downplayed the significance of Article III as a means of protecting negotiating tariff concessions and commitments under Article II, reasoning that the scope of Article III covered more than just the products that are subject to tariff concessions under Article II to include any internal regulatory measure that affects a product in a way that affords protection to domestic production.⁶³

The appellate body also suggested in part G of the report that Article III:1 informs the first sentence and the second sentence of Article III:2 in different ways,⁶⁴ and it made much of the fact that the first sentence of Article III:2 does not make reference to Article III:1.⁶⁵ Rather than indicating that Article III:1

60. *Id.* at 240 (citing *Taxes on Petroleum Panel*, *supra* note 13, at ¶ 5.1.9; 1987 Alcoholic Beverages Panel, *supra* note 15, at para.5.5(b)). It is notable that the Body's reference to the panel report below is not supported. The 1987 Alcoholic Beverages panel, in fact, stated, “[t]he context of Article III:2 shows that Article III:2 supplements, within the system of the General Agreement, the provisions on the liberalization of custom duties and of other charges by prohibiting *discriminatory* or protective taxation against certain products from other GATT contracting parties (emphasis added).”

61. 1996 Alcoholic Beverages Appellate Body, *supra* note 8, at 241.

62. *See* 1996 Alcoholic Beverages Panel, *supra* note 49, at ¶ 6.13.

63. *Id.*

64. 1996 Alcoholic Beverages Appellate Body, *supra* note 8, at 241. The Appellate Body reasons according to the principle of effectiveness in treaty interpretation.

65. *Id.*

was irrelevant to the application of the first sentence of Article III:2, the appellate body argued that the absence of such reference merely reflected the non-necessity of such a reference because the first sentence of Article III:2 is itself an application of the general principle contained in Article III:1.⁶⁶ Thus, Article III:2, first sentence, requires an examination of whether the tax could be applied "so as to afford protection." As a result, the appellate body found that the panel had erred to take into account Article III:1 in interpreting Article III:2's first and second sentences. This finding did not affect the outcome of the case.⁶⁷ Nevertheless, the appellate body, despite its failure to refer to them, can be considered to be narrowly affirming *Malt Beverage* and *Taxes on Automobiles*' reading of Article III:2 in light of Article III:1.

By no means however, did the appellate body affirm the aim-and-effect test. In contrast, the appellate body noted that the second sentence of Article III:2 specifically invokes Article III:1 because the prohibition against protection of domestic production is not inherent in the language of Article III:1.⁶⁸ If imported and domestic products are found to be not "like products" and thereby satisfy the first sentence of Article III:2, they still may fall within the prohibition of the second sentence, which addresses the broader category of "directly competitive or substitutable products."

The appellate body's discussion of what constitutes "like products" in part H(1)(a) is surprising in light of *Malt Beverages* and *Taxes on Automobiles*. Unsurprisingly, it reiterated the *Border Tax* considerations and criteria. However, what follows is a less than helpful and vague discussion of what constitutes a "like product," with a particularly unhelpful and peculiar reference to an accordion.⁶⁹ Considering that it insisted on a literal "like" product comparison by adhering to the two-step product test, it is surprising that the appellate body gave such little guidance as to what constitutes "like" products. The appellate body emphasized the narrowness of the range of "like products" in Article III:2's first sentence, when compared to the range of "like products" in other GATT and WTO provisions, and further stated that the definition of "like product" should be construed narrowly.⁷⁰ The appellate body based this holding on the view that the second sentence of Article III:2 is the broader category of products which acts as a fall-back provision for products that fall outside of the reach of the first sentence of Article III:2. But the appellate body gave no additional guidance in

66. *Id.*

67. *Id.* at 242.

68. *Id.* at 243-44 ("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.").

69. The Appellate Body states, "[t]he concept of 'likeness' is a relative one that evokes the image of an accordion. The accordion of 'likeness' stretches and squeezes in different places as different provisions of the *WTO Agreement* are applied. The width of the accordion in any one of those places must be determined by the particular provision in which the term 'like' is encountered as well as by the context and the circumstances that prevail in any given case to which the provision may apply." *Id.* at 242.

70. *Id.* at 241.

outlining the limits of what are “like products.” Instead, it stated that there is “an unavoidable element of individual, discretionary judgement” in the like product determination.⁷¹ By announcing such discretion to future panels without elaboration of any further guidelines in the “like product” determination, the appellate body granted future panels more than just an element of discretion—it gave the panel full and autonomous discretion over the issue. As a result, the appellate body appeared to have decided that the “like product” determination is largely a question of fact in the exclusive domain of the panel and thus irreviewable by the appellate body.

As for applying the second sentence of Article III:2, the appellate body granted broad discretion to the panel in making this determination of fact on a case-by-case basis.⁷² Although physical characteristics, tariff classifications and the elasticity of substitution in a market are factors, the appellate body affirmed the panel’s view that the decisive criterion for finding a “directly competitive or substitutable product” is whether the products have common end-uses, as shown by elasticity of substitution.⁷³

Essentially, the appellate body reaffirmed the two-step product test but added in issues raised by the reasoning behind the aim-and-effect test. As will be discussed later in this Comment, these elements are incompatible and therefore make for an unlikely synthesis.

B. “Like Product” Test Under Article III:4

The other Article III provision with a “like product” determination is found in paragraph four.⁷⁴ The language of Article III:4 requires that imported products receive “treatment no less favorable than that accorded to like products of national origin.” This paragraph, like the first sentence of Article III:2 makes no explicit reference to Article III:1. It prohibits laws, regulations and requirements that affect internal sales, offerings for sales, purchases, transportation, distribution or use that unfairly burden “like” imports. Otherwise, Article III:4 does not prohibit differential treatment between “like” products if it is “no less favorable,” and furthermore it does not prohibit different treatment when the products are not “like” products.⁷⁵ The “like product” issue in the context of

71. *Id.* at 242.

72. *Id.* at 244 (“How much broader that category of “directly competitive or substitutable products” may be in any given case is a matter for the panel to determine based on all the relevant facts in that case.”)

73. *Id.*

74. General Agreement, *supra* note 1, art. III, ¶ 4:

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

75. *See, e.g.*, Malt Beverages Panel, *supra* note 26, at ¶ 3.121 (stating the United States’ argument).

Article III:4 has arisen less often than it has with Article III:2 and hence this Comment will address it in less detail.

In 1996 *Alcoholic Beverages*, the panel merely made reference to Article III:4 in its discussion of Article III:2. In a rare direct reference, it said that an interpretation of "like product" in Article III:4 as meaning "more or less the same product" was too strict an interpretation.⁷⁶ Otherwise, the approach of the panel here was to discuss the Article III:4 "like product" determination in the same breath as that of Article III:2, applying the same test.⁷⁷ Therefore, it can be inferred that this panel conceived that the Article III:4 and Article III:2 applications of "like product" involved the same two-step test.

Subsequently, in *Malt Beverages*, the panel addressed the question of whether or not low and high alcohol content beer were "like" products within the meaning of Article III:4 in order to determine whether or not the United States' categorization of beer according to alcohol content for purposes of regulating sale, distribution and labeling violated the national treatment obligation.⁷⁸ Referring to its earlier application of a "like product" examination under Article III:2, the panel proposed a different two step analysis: first, looking at the product's physical characteristics and, second, ensuring that the internal regulation is not applied so as to afford protection to domestic production.⁷⁹ It is notable that like the first sentence of Article III:2, Article III:4 makes no direct reference to Article III:1. Nevertheless, the panel assumed that Article III:4 embodied the requirements of Article III:1.

The way which the panel treated a finding of "like product" cannot be correct. The panel noted that once a product is found to be "like," then any regulatory differentiation between the "like" products would be inconsistent with the requirements of Article III, even if the regulation were *not* applied so as to afford protection to domestic industry.⁸⁰ Thus, it concluded, the "like product" determination must be made carefully in a way that does not necessarily infringe upon the regulatory authority and domestic policy options of the contracting parties.⁸¹ This reasoning is circular: the panel recommended that an empirical finding of fact be colored by policy considerations. But as mentioned above, *Malt Beverages* is something of a transition case, a step in the evolution from the two-step product test to the one-step regulation test. As a result, the panel has not yet resolved its confusion over the tautology derived from the text of the article and prior panel practice. It was unaware that its fears were unfounded because it should be the case that one cannot find "like-products" if the regulation is not applied so as to afford protection to domestic industry. After all, the term "like product" under the one-step test is nothing more than a conclusion of

76. 1987 Alcoholic Beverages Panel, *supra* note 15, at ¶ 5.5(b) (discussing Panel Report on Spain's restrictions on the domestic sale of soybean oil).

77. See, e.g., *id.* at ¶ 5.5(d) (applying the same two-step "like product" determination test to both internal taxation and internal regulations).

78. *Id.* at ¶ 5.71.

79. *Id.*

80. *Id.* at ¶ 5.72.

81. *Id.*

the fact that the measure under investigation impermissibly violates the national treatment obligation by affording protection to domestic production, a conclusion to which the reasoning in *Malt Beverages* invariably leads.

Furthermore, the weight that the panel gave each part of the two-step test in its application is revealing. The panel stated in one sentence, without further elaboration, the requirement of an examination of the physical characteristics of the products.⁸² Compare this cursory treatment to their examination of whether the differentiation was such as to afford protection to domestic industry. The protectionist-purpose examination involved a detailed inquiry into whether the product was both imported and produced domestically, the lack of specific discrimination against imports *per se*, the market and consumer tastes, and the policy goals and legislative background of the laws at issue.⁸³ Given that so little attention was given to the first part of the determination of physical similarity, it appears to be somewhat irrelevant and unnecessary to the actual application of the provision. Furthermore, such a physical comparison advances no policy objective and serves no apparent purpose. Thus, it appears that the standard applied by the panel in practice really is not in any meaningful sense a two-part inquiry at all.

In *Taxes on Automobiles*, the panel applied the same rule to Article III:4 as it did to Article III:2. The panel read Article III:4 and III:2 together in the context of the purpose of the article, as embodied in Article III:1. Thus, Article III only prohibits a regulatory distinction between products when applied so as to afford protection to domestic products as determined by the aim-and-effect test, and it does not prohibit fiscal and regulatory distinctions when applied to achieve legitimate policy goals.⁸⁴

The *1996 Alcoholic Beverages Panel*, as with the first sentence of Article III:2, reversed the trend of the prior two panel decisions by insisting on a literal reading of the Article III. The panel reasoned that because Article III:2 refers to Article III:1 whereas Article III:4 does not, the term "like product" must be interpreted differently in each of the provisions to account for that difference.⁸⁵ Primarily, the term "like product" should be construed narrowly in Article III:2 because it must be read in the context of the second sentence's term "directly competitive or substitutable" products. This is a broader term referring to Article III:1 encompassing those products that fall outside of the category of "like" products. In contrast, Article III:4 uses "like product" in isolation.⁸⁶

82. *Id.* at ¶ 5.73 ("The Panel recognized on the basis of their physical characteristics, low alcohol beer and high alcohol beer are similar.")

83. *Id.* at ¶¶ 5.73-5.74.

84. *Taxes on Automobiles Panel*, *supra* note 36, at ¶ 5.7.

85. *1996 Alcoholic Beverages Panel*, *supra* note 49, at ¶ 6.20.

86. *Id.* at ¶ 6.21.

II.

ANALYSIS OF THE TWO "LIKE PRODUCT" TESTS AND THEIR
COMPARATIVE MERITS

The most pressing issue in resolving how to apply Article III:2 is how to determine whether imported and domestic products are "like" under the first sentence of the article. A core issue in resolving this question is whether the first sentence inquiry requires an actual examination of the product's characteristics or whether the focus should be on the regulation itself. The confusion in the application of the first sentence of Article III:2 arises in large part from the confusion about the term "like product" as used in the panel and appellate body decisions. In some decisions, the term represents a factual finding involving an actual comparison of the products at issue. In later decisions, namely *Taxes on Automobiles*, the use of the term acts as a proxy for a panel finding that the purpose of the GATT provision has been frustrated by the tax or regulatory measure at issue. Thus, the first section of this part of the Comment will examine whether a comparison between imported and domestic products using the *Border Tax* criteria is of any benefit. Next, in order to determine the necessity of such a comparison, the Comment will discuss the scope and purpose of the Article III national treatment obligation. Assuming that the aim-and-effect test is the correct standard for applying Article III:2, the Comment will then discuss issues related to determining regulatory motivation and effect. Finally, the effects of the different interpretations on the interaction between the first and second sentences of Article III:2 will be discussed.

The "precedent" effect of GATT panel reports should be noted as an initial matter in order to make clear the fact that *Taxes on Automobiles* remains relevant to the analysis. Although panels tend to refer to earlier-adopted reports and even use them in their reasoning as if they were binding precedent, there is no such doctrine under international law.⁸⁷ Such reports may only have persuasive effect. However, once a prior-adopted panel report has become part of GATT practice, and can in that sense be relied upon for interpreting the General Agreement, it will have a stronger effect than when first adopted (even though the Contracting Parties are free to revoke it).⁸⁸ The main issue of contention, however, concerns *Taxes on Automobiles*, an unadopted panel report. The panel in *1996 Alcoholic Beverages* stated that unadopted panel reports have no legal status in the GATT or WTO system since they have not been endorsed through decisions of the Contracting Parties to GATT or WTO Members and thus did not constitute subsequent practice.⁸⁹ Although such reports are not considered particularly influential in GATT as decisions, they may have influence if they are well reasoned. Therefore, even such a report could conceivably become part

87. JOHN H. JACKSON, *RESTRUCTURING THE GATT SYSTEM* 67 (1990). See also *1996 Alcoholic Beverages Appellate Body*, *supra* note 8, at 238.

88. JACKSON, *RESTRUCTURING*, *supra* note 87, at 68.

89. *1996 Alcoholic Beverages Panel*, *supra* note 49, at ¶¶ 6.10, 6.18.

of the overall practice of GATT.⁹⁰ Thus, it is completely feasible for the WTO to incorporate the reasoning of the unadopted report of *Taxes on Automobiles* into future WTO practice.

A. *What is "Like"?: The Weakness of the Border Tax Criteria*

The two-step "products" test of the *Alcoholic Beverages* report requires a comparison of the imported and domestic products at issue. Although the wording of Article III may seem to indicate the need to do so, it is not altogether certain that such a comparison would be of any use. Formalism for the sake of formalism has always been a weak legal argument. Thus, to determine whether or not this comparison in fact serves a purpose beyond formalism, a closer examination is required. Since the comparison is done most often under the auspices of the considerations and criteria laid out by the *Border Tax* report, it is best to start there.

Despite the repeated invocation of the *Border Tax* considerations and criteria, their recital does not lend much assistance in the actual application of the first sentence of Article III:2. As noted above, the *Border Tax* criteria play no functional role in the aim-and-effect test; however, they do constitute an integral part of the two-step product test. Assuming the application of the first sentence is in two parts, then the first step "like product" determination is equivalent to a determination of the similarities between the imported and domestic products' characteristics.

The question arises as to what characteristics one is to compare in order to determine the existence of "like" products. As far as a comparison of the products' physical characteristics (e.g. under the *Border Tax* criteria, "the product's properties, nature and quality"), prior panels have not gone into much detail about how this comparison is to be made, nor about the standards of similarity and dissimilarity which are meant to guide the evaluation.⁹¹ One proposal for clarifying such standards was to look to the tariff schedules of international classification systems in order to back up a finding of "likeness" with an example from customary international practice.⁹² Attractive as this alternative sounds,

90. *Id.* at 6.10; JACKSON, *RESTRUCTURING*, *supra* note 87, at 68. Note that the adoption of the WTO has resulted in a change in the procedure for adopting panel reports whereby panel reports are automatically adopted, unless appealed or blocked by a consensus. WTO Agreement, *supra* note 7. See also JEFFEREY J. SCHOTT, *THE URUGUAY ROUND: AN ASSESSMENT* 126-28 (1994).

91. To account for the lack of discussion of this issue, it can be argued that inherent characteristics, despite being termed "objective" later on in my discussion, are really a function of each person's subjective experience of the product. Such a determination may be largely subject to the individual whim of the adjudicator. Or another possible explanation for the absence of further discussion on the subject may be that such a determination does not actually matter much in the application of Article III:2, second sentence.

92. See, e.g., European Communities' argument that one of the criteria relevant to the determination of "likeness" is the products' classification in Harmonized System nomenclature. 1996 Alcoholic Beverages Panel, *supra* note 49, at para. 4.20. See 1996 Alcoholic Beverages Appellate Body, *supra* note 8, at 242 (a uniform tariff classification of products can be relevant in determining what are "like products"). But there is a major difference between tariff classification nomenclature and tariff bindings or concessions made by Members of the WTO under Article II of the General Agreement, *supra* note 1. 1996 Alcoholic Beverages Appellate Body, *supra* note 8, at 242-43 (discussing

customary practice may be for reasons entirely unrelated to the purposes of the national treatment obligation and therefore such an approach does not adequately justify invalidating national policy. But the appellate body has not adopted such an approach. As the law currently stands, the appellate body has endorsed *ad hoc* discretionary panel determinations of physical similarities. This is obviously unsatisfying and causes unpredictability. It would not be proper for the WTO to expect nations to abide by its regime for long if it is incapable of setting forth clear guidelines for nations to follow in passing legislation to avoid an Article III violation.⁹³

A complementary approach is to compare the two products' market characteristics (e.g. under the *Border Tax* criteria, "the product's end-uses in a given market; consumers' tastes and habits, which change from country to country"). To do this, prior panels have relied on statistical evidence. This approach seems more appealing because it is less subjective. However, this determination begins to look much like the determination required in the second sentence of Article III:2 for finding "directly competitive or substitutable" products. Indeed, because there is overlap between "directly competitive or substitutable" and "like" products in that "like" products invariably do compete with each other in a market, the factor which distinguishes the two is not market characteristics but rather physical and other non-market characteristics. Furthermore, this approach would be contrary to the strict division of duty between the first and second sentences, as advocated by the *1996 Alcoholic Beverages Panel*. As a result, if "like" product is to mean anything different from "directly competitive or substitutable," it will be on the basis of similarity of characteristics other than market ones.

The difficulties mentioned above stem from the larger problem plaguing the endeavor of trying to compare the things themselves as we commonly perceive them, typically through their physical characteristics, to determine their "likeness." Comparing things in this manner requires that one assume that there is some appropriate, accurate and certain epistemological manner of ascertaining the identity of the imported and domestic products in order to make a valid comparison. The practice under the two-step product test has been something of an *ad hoc* discretionary and factual determination by the panel which tends not to be explained in the report except by recital of the criteria by which the products are judged. Even when it is explained in cursory fashion, the explanation is not based on any criteria relevant to the question why such a distinction between the imported and domestic products upholds the national treatment obligation.

why it is not a good idea to rely completely on a nation's tariff binding classifications because they could cut across several Harmonized System's tariff headings (which has been recognized in General Agreement practice as providing a useful basis for confirming "likeness" in products) and may represent the results of trade concessions negotiated among Members of the WTO rather than any similarity of products. But this, of course, raises the nagging question of how to determine similarity of products, a question which the Appellate Body fails to address).

93. See, e.g., the argument of the United States in *1996 Alcoholic Beverages Panel*, *supra* note 49, at ¶ 4.46 (stating that a "pure effects" test, such as the one proposed by the European Community and approved by the Panel, would give neither guidance nor certainty to legislators).

This ambiguity, I believe, arises from the fact that the panels have not seriously considered the question of what would be the proper epistemological perspective to view the products.

In order to determine the proper epistemological perspective, it is useful to start with the question of when does a "like product" question arise in Article III cases. The fact of the matter is that the question of whether a domestic and an imported product are "like products" only sometimes arises in Article III:2 (or Article III:4) disputes. An Article III violation may arise in several ways, but the "like product" issue arises only when a *category* for the tax or regulation of imported products is contested by the importing party as being drawn too narrowly so that it has the effect of putting imports at a disadvantage.⁹⁴ A party would only make the assertion that imported and domestic products are "like" if one or the other were excluded from a category, with the goal of having the adjudicating body classify both products as belonging to the same category. At the very least, the "like product" determination must be as stated here:

[T]he starting point of the [like product] analysis cannot be the concrete objects to which an internal tax or regulation is applied but only the abstract categories of products distinguished by the contracting party. For instance, in the context of an analysis under Article III it is meaningless to say that the imported cup in my left hand is like the cup of domestic origin in my right hand because their properties, nature, quality, and end-uses are the same and that, consequently, the cup in my left hand must be accorded no less favorable treatment than the one in my right hand. It may be true that the two objects might be the same when considered as cups but the fact that they are cups may not at all be relevant under the domestic regulation at issue. One of the cups might under that legislation fall under the category of "nonrecyclable beverage container" (subject to environmental tax), "material producing poisonous gases when incinerated" (subject to a sales prohibition), or "household utensil" (subject to a reduced value-added tax). To compare the objects as cups when they are not distinguished by the contracting parties as such is arbitrary.⁹⁵

Thus, the identity of a product is a function of the category within which a party intends to place it. Yet the prior reports have not approached "like product" determinations as a question of proper categorization; instead, they have tended to compare the products as objects in and of themselves, as perceived through our everyday senses and outside their regulatory classifications, by constant reference to the *Border Tax* criteria. The GATT and WTO adjudicatory bodies appear to have continued to use the *Border Tax* criteria primarily out of habit and convenience. The necessity of the criteria might appear to be a fair assumption since these criteria have been repeated by almost every GATT entity that has adjudicated a "like product" issue.⁹⁶ However, as mentioned above, prior adopted reports hold no power as precedent (despite being considered sub-

94. See, e.g., the Mississippi wine tax in Malt Beverage Panel, *supra* note 25.

95. Frieder Roessler, *Diverging Domestic Policies and Multilateral Trade Integration*, in FAIR TRADE AND HARMONIZATION: PREREQUISITES FOR FREE TRADE? Jagdish Bhagwati and Robert E. Hudec, eds., 29 (1996).

96. These statements are usually made in reference to the Report of the Working Party on Border Tax Adjustments, *supra* note 12. This report was the first time these criteria were enumerated.

sequent practice), and it is also acknowledged that the General Agreement provides no definition of "like product." Thus, we are not bound to *Border Tax* as providing the guiding criteria for determining "likeness" of products except by the force of its reasoning, which frees us to search for a more appropriate set of criteria.

The use of categories to determine the existence of "like" products, however, ultimately leads to adoption of the aim-and-effect test. The reason is that the scope of particular categories must be defined. Defining the scope of such categories, in turn, relies on the purpose of the very act of categorizing. In the context of Article III, the relevant categories are those which are created by national legislation or regulation affecting competition between imported and domestic products. The most obvious categories that come to mind when one thinks of such regulation are imported products and domestically produced products. According to the two-step products test, such a classification is on its face in violation of Article III if the products at issue are "like." But such a conclusion does not prove that the policy supporting national treatment obligation has been compromised. To argue that a finding of likeness and a finding of discriminatory effect between like imported and domestic products is *per se* a violation of the obligation is to ignore the real question at issue.⁹⁷ The real question is what purpose do the categories used by national regulation of products inside a nation's borders serve.⁹⁸ This requires that one look at the aim-and-effect of the regulation. Therefore, I propose something even more radical than merely jettisoning the *Border Tax* criteria. I propose jettisoning the entire "like product" test as an independent step and as a factual determination.

Such an approach is necessary in order to achieve the goals of Article III. If the "like product" determination is a separate independent test, then it acts as a necessary condition for the finding of a violation of the first sentence of Article III:2. As a necessary condition, it is important that this step not frustrate the purpose and goals of the provision. The 1987 *Alcoholic Beverages* panel advanced a two-step test which had as its first step a determination of "likeness," which was independent of the second step of determining whether there was protection afforded to domestic products. As mentioned before, this first step was quite straightforwardly an examination of the *Border Tax* criteria.⁹⁹ Ultimately, the problem with a separate determination of "likeness" in the application of Article III:2's first sentence is that the process of the determination of "likeness" would occur independently of the purpose of Article III, making it a prior and necessary condition of the application of Article III:2's first sentence.

97. See the argument of the European Community, 1996 *Alcoholic Beverages* Panel, *supra* note 49, at ¶ 4.22 (stating that once it is established that two products are "like" and that the imported product is subject to a higher tax, then the finding of a violation of Article III:2, first sentence, is automatic. It is irrelevant whether or not the tax differential has a protectionist aim.)

98. See, e.g., the argument of the United States, *id.*, at ¶ 4.24 (stating that the notion of "likeness" cannot be separated from the purpose of Article III:2 with respect to which products are "like," and the objectives of the regulatory scheme that draws a distinction between two otherwise similar products.)

99. 1987 *Alcoholic Beverages* Panel, *supra* note 15, at ¶ 5.6.

Such a system may possibly frustrate the purpose of Article III's national treatment prohibition. This danger is manifested primarily in terms of under-inclusiveness and over-inclusiveness, discussed in the following section.

As suggested earlier, the appellate body in *Alcoholic Beverages* did not really try to resolve this dilemma because it did not see it. Rather, it rejected any challenge to the panel's use of the two-step product test, and merely tipped its hat to any concern for the purpose of Article III (found in Article III:1). However, it did not integrate the "like product" determination into a policy analysis of the intent behind or effect of the tax or regulatory classification. The appellate body, in fact, approved of granting a great deal of discretion to the panel for applying the enumerated criteria as part of its determination of "likeness," stating that "[t]his will always involve an unavoidable element of individual, discretionary judgement" and that "panels can only apply their best judgement in determining whether in fact products are 'like'."¹⁰⁰ This surrender to the inevitability of panel subjectivity may be the natural result of the appellate body's reference to the insidious and mischievous *Border Tax* criteria. If so, my initial contention that the *Border Tax* criteria was indicative of the problematic nature of the product test is now blunted by the alternative of using categorization of products as the focus of the "like product" determination by looking. However, even if we reformulate the two-step test of *Alcoholic Beverages* by replacing the *Border Tax* criteria in the first step "like product" determination with an evaluation of whether the products fall into their proper regulatory categories, the potential of the two-step test to frustrate the purpose of Article III remains. How this might occur is discussed in the following section. This potential to frustrate the policy of Article III is the primary rationale behind my argument in favor of the aim-and-effect test.

B. Clarifying the Purpose of Article III—Discriminatory Effect Versus Protective Intent

We should clarify the appropriate standard, such as the *Border Tax* criteria, by which "like" products and "directly competitive or substitutable" products are differentiated because the products receive different treatment under the two-step products test. The former gives rise to the application of a discrimination standard and the latter a protectionist motivation standard. Yet, if we assume that the first sentence of Article III:2 embodies the national treatment obligation, we must determine whether or not the "likeness" of products is an adequate justification for a substantially harsher standard in assessing national regulation. I argue that it does not.

To understand what is required of the term "like" product, we should start from the beginning, with the purpose of Article III itself and an understanding of the national treatment obligation. While it has been recently reaffirmed by the appellate body that the purpose of Article III (as embodied in the first paragraph), plays a role in the interpretation of each subsequent provision in the

100. 1996 *Alcoholic Beverages* Appellate Body, *supra* note 8, at 242.

article, the implications of that assertion have not been fully clarified. As for the "like product" determination of the first sentence of Article III:2, the appellate body assumed that because the first sentence does not make explicit reference to the first paragraph, the very application of the sentence incorporates the considerations contained in the first paragraph.¹⁰¹ This assertion was drawn in contrast with the second sentence of Article III:2 which does make explicit reference to Article III:1. However, the question of what the purpose of Article III is, as embodied in the first paragraph, does not produce a necessarily straightforward answer. Of course, this question is significant since it will play a role in the application of any provision under the article.

The first question is what is the purpose of Article III. Article III:1 states that taxes, charges or regulations should not be applied so as to afford protection to domestic production. This statement raises the question of whether Article III:1 prohibits only taxes, charges or regulations that have protectionist motives or whether it prohibits the much broader category of any tax, charge or regulation that has a discriminatory effect on imported goods. In *Malt Beverages*, the panel said that it is permissible for contracting parties under Article III:2 to differentiate between imported and domestic products so long as it is for policy purposes unrelated to the protection of domestic production.¹⁰² The panel in *Taxes on Automobiles* followed a similar line of reasoning with its aim-and-effect test.¹⁰³ Thus, these two panels clearly suggest that in order for a measure

101. See, e.g., 1996 Alcoholic Beverages Appellate Body, *supra* note 8.

102. Malt Beverages Panel, *supra* note 26, at ¶ 5.24. Objective criteria were stated as follows: "[u]nder Article III:2 a regulatory distinction could legitimately be made between any two products, as long as the distinction was based on *objective criteria aimed at a policy* other than the protection of domestic production." Taxes on Automobiles Panel, *supra* note 36, at ¶ 5.20. This raises the question of what are "objective" criteria. See Snelson, *supra* note 37, at note 120: "Ironically, the liquor cases laid the foundation for GATT tolerance of facially neutral taxes, even as they found Mississippi wine and Japanese liquor taxes inconsistent with Article III:2. These taxes were offensive because the tax distinctions were unsupported by any objective basis. In the parlance of the United States—Taxes on Automobiles, no aim other than protectionism explained the tax distinctions." But then Snelson contends that the Panel in Taxes on Automobiles was compelled to develop a new mechanism for evaluating facially neutral regulations under Article III because the taxes in this case were not so obviously offensive as those found in the liquor cases. *Id.* at 488.

103. Taxes on Automobiles Panel, *supra* note 36, at ¶ 5.8. Note the aim-and-effect test of Taxes on Automobiles, *id.* at ¶¶ 5.12 - 5.13. The test requires that one first consider whether the *aim* of establishing the threshold within the luxury tax was to afford protection to domestic industry. Then, one must consider whether the threshold distinction in the luxury tax had the *effect*, in terms of the conditions of competition, of affording protection to domestic production. The panel held that the threshold was not implemented so as to afford protection to domestic production, that automobiles above and below that threshold value could not, for purposes of the luxury tax, be considered like products under Article III:2, first sentence, and that different treatment could therefore be accorded under the luxury tax to automobiles above and below the threshold. *Id.* at para. 5.15. It appears the analysis of discriminatory effect is limited to conclusive evidence of a change in the conditions of competition favoring the importing country's producers. See, e.g., Taxes on Automobiles Panel, *supra* note 36 at para. 5.13. Facial discrimination is not sufficient if there is no aim to protect domestic production. Also note that the test is aim *and* effect. The panel decided that effect cannot be an independent basis for a finding of a violation of Article III:2, but rather, must be coupled with the importing government's protectionist aim or intent. The aim-and-effect seems to require a showing of both protectionist aim and discriminatory effect so that discrimination by itself (without protectionist intent), may not be sufficient. *Id.* at ¶¶ 5.9, 5.12-5.15. However, facial discrimination may be sufficient to satisfy the discriminatory effect requirement since this test does not

to be found in violation of Article III:2, the measure must have been motivated by a legislative intent to protect domestic industry.¹⁰⁴

The appellate body report for *Alcoholic Beverages* is significantly less clear.¹⁰⁵ First, it broadly asserts that Article III:2 must be read in light of the purpose of Article III as contained in the first paragraph.¹⁰⁶ The appellate body explicitly stated that the “broad and fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures.”¹⁰⁷ But the appellate body was unclear as to what its application of the term “protectionism” means. First, it stated that the prohibiting protectionism requires Members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products, which amounts to equality of treatment.¹⁰⁸ Equality of treatment implies a no-discrimination standard, especially if no other determination is required in order to apply the standard. Furthermore, in spelling out the application of the first sentence of Article III:2, the appellate body implies that the purpose of the national treatment obligation is to prevent any discrimination. It does so by first saying that Article III:2’s first sentence acts as an application of the general principle contained in Article III:1. Then it states that the application of Article III:2, first sentence, requires an inquiry into whether or not there was a charge applied to a imported product “in excess” of that applied to a like domestic good.¹⁰⁹ Specifically, it states that if a WTO Member has placed a tax on imported products that are in excess of those on like domestic products, then:

the Member that has imposed a tax is not in compliance with Article III. Even the smallest amount of “excess” is too much. “The prohibition of discriminatory taxes in Article III:2, first sentence, is not conditional on a ‘trade effects test’ nor is it qualified by a *de minimis* standard.”¹¹⁰

The focus on whether the charge was “in excess” indicates that the appellate body understood the requirement of Article III:1 to prohibit any form of discrimination.¹¹¹ Once “likeness” between imported and domestic products is found,

elaborate on the level of discrimination required, so we can assume the prior report’s position (that facial discrimination suffices), remains valid.

104. Assuming that the purpose of Article III is to prevent measures informed by protectionist intent, the question arises as to what extent should regulatory purpose be examined. See Snelson, *supra* note 37, at 491 (rejecting a superficial examination of regulatory purpose and advocating the need for a comprehensive review of a measure’s real goal).

105. Cf. 1987 Alcoholic Beverages Panel, *supra* note 15. The drafting history of the GATT confirms that Article III:2 was designed with “the intention that internal taxes on goods should not be used as a means of protection.” *Id.* at ¶ 5.5(c) (citing UN Conference on Trade and Employment, Reports of Committees, at 61 (1948)).

106. 1996 Alcoholic Beverages Appellate Body, *supra* note 8, at 240.

107. *Id.*

108. *Id.* (“[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.”) quoting GATT Dispute Panel Report on Italian Discrimination Against Imported Agricultural Machinery, B.I.S.D. 7S/60, ¶ 11 [hereinafter *Agricultural Machinery*].

109. 1996 Alcoholic Beverages Appellate Body, *supra* note 8.

110. *Id.* at 243.

111. The 1987 Alcoholic Beverages Panel argued that the purpose of Article III:2 was to prohibit discriminatory or protective taxation against certain products from other GATT contracting

then charges "in excess" must be found in order to find a violation of Article III:2. Keeping in mind that the determination of "like" product does not involve considerations of the purpose of the article (despite what the appellate body says), the practical effect of the appellate body's test is to strike down all statutes with any discriminatory effect. Thus, the two contesting versions of the purpose of Article III:2 are (1) the prevention of measures with protectionist intent, and (2) the prevention of measures with discriminatory effect.

So who is right? The answer lies in understanding the national treatment obligation. At its most basic, the obligation imposes the principle of nondiscrimination as between domestically produced goods and the "like" imported goods. Looking at past panel reports, we can begin to discern the purpose of Article III. The 1958 Panel Report on *Italian Discrimination against Imported Agricultural Machinery* provided that "it was considered . . . that the intention of the drafters of the [General] 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 (emphasis added)."¹¹² Thus, the focus of Article III prohibition has been on indirect protection, which requires an affirmative legislative act. Treating products "in the same way," however, is ambiguous. Frieder Roessler argues that Article III does not require formally equal treatment but only no-less-favorable treatment, which in turn clearly permits contracting parties to treat domestic and imported products differently. His argument is premised on making Article III:4, which uses the language of "treatment no less favorable," the core national treatment provision that embodies the principles of national treatment.¹¹³

The question that follows is how should protectionism—manifested as treatment that is not "no-less-favorable"—be measured? Two standards have been considered in GATT practice: the treatment is less favorable if it has an *economic impact* that is less favorable, or, alternately, the treatment is less favorable if it accords *competitive opportunities* that are less favorable.¹¹⁴ The trade effects (i.e., economic impact), criterion has been consistently rejected by the GATT Contracting Parties since the 1949 Report of the Working Party on

parties, primarily for the purpose of ensuring that the reasonable expectation of competitive benefits accruing under tariff concessions would not be nullified. 1987 Alcoholic Beverages Panel, *supra* note 15, at ¶ 5.5(b). Later, the appellate body explicitly downplayed the issue of protecting tariff concessions, stating that the obligation of Article III also extends to products not bound under Article II. 1996 Alcoholic Beverages Appellate Body, *supra* note 8, at 240. It also stated that the purpose and object of Article III:2 is to promote non-discriminatory competition among imported and like domestic products. *Id.* at 241. It supported this position by examining the application of Article III:2, first sentence, based on two questions, the first being an indeterminate "like product" analysis and the second being a determination of whether the differential imposed on imported products was "in excess of" that imposed on domestic goods. The determination of "in excess of" indicates that any discriminatory effect that burdens imports constitutes a violation.

112. GATT Dispute Panel Report—Italian Discrimination Against Imported Agricultural Machinery L/833, 7S/60, 63-64, ¶ 11 (October 23, 1958).

113. Roessler, *supra* note 95, at 26.

114. *Id.*

*Brazilian Internal Taxes.*¹¹⁵ The rationale for this rejection was given in the 1987 Panel Report entitled *United States—Taxes on Petroleum and Certain Imported Substances*, which asserted that Article III:2 obliged contracting parties to establish competitive conditions for imported products in relation to domestic products and protected the contracting parties' expectations under these competitive conditions; it did not protect expectations on export volumes.¹¹⁶ Essentially, Article III's national treatment obligation requires effective equality of opportunities for imported products in relation to domestic products, not equal-

115. 2 B.I.S.D. 181, ¶ 16 (1952). See also Roessler, *supra* note 95, at 27: "The delegate of Brazil submitted the argument that if an internal tax, even though discriminatory, does not operate in a protective manner, the provisions of Article III would not be applicable. He drew attention to the first paragraph of Article III, which prescribes that such taxes should not be applied 'so as to afford protection to domestic production' The delegate for Brazil . . . suggested that where there were no imports of a given commodity or where imports were small in volume, the provisions of Article III did not apply [The majority of the working party] argued that the absence of imports from contracting parties during any period of time that might be selected for examination *would not necessarily be an indication that they had no interest in exports of the product affected by the tax*, since their potentialities as exporters, given national treatment, should be taken into account. These members of the working party therefore took the view that the provisions of the first sentence of Article III, paragraph 2, were equally applicable whether imports from other contracting parties were substantial, small or non-existent." (emphasis added).

116. B.I.S.D. 34th Supp. 136, ¶ 5.1.9 (1988), stating:

An acceptance of the argument that measures which have only an insignificant effect on the volume of exports do not nullify or impair benefits accruing under Article III:2, first sentence, implies that the basic rationale of this provision—the benefit it generates for the contracting parties—is to protect expectations on export volumes. That, however, is not the case. Article III:2, first sentence, obliges contracting parties to establish certain competitive conditions for imported products in relation to domestic products. Unlike some other provisions in the General Agreement, it does not refer to trade effects. The majority of the members of the Working Party on the 'Brazilian Internal Taxes' therefore correctly concluded that the provisions of Article III:2, first sentence, 'were equally applicable, whether imports from other contracting parties were substantial, small or non-existent' (B.I.S.D. Vol. II/185). The Working Party also concluded that 'a contracting party was bound by the provisions of Article III whether or not the contracting party in question had undertaken tariff commitments in respect of the goods concerned' (B.I.S.D. Vol. II/182), in other words, the benefits under Article III accrue independent of whether there is a negotiated expectation of market access or not. Moreover, it is conceivable that a tax consistent with the national treatment principle (for instance, a high but non-discriminatory excise tax) has a more severe impact on the exports of other contracting parties than a tax that violates that principle (for instance a very low but discriminatory tax). The case before the panel illustrates this point: the United States could bring the tax on petroleum in conformity with Article III:2, first sentence, by raising the tax on domestic products, by lowering the tax on imported products or by fixing a new common tax rate for both imported and domestic products. Each of these solutions would have different trade results, and it is therefore logically not possible to determine the difference in trade impact . . . resulting from the non-observance of that provision. For these reasons, Article III:2, first sentence, cannot be interpreted to protect expectations on export volumes; it protects expectations on the competitive relationship between imported and domestic products. A change in the competitive relationship contrary to that provision must consequently be regarded *ipso facto* as a nullification or impairment of benefits accruing under the General Agreement. A demonstration that a measure inconsistent with Article III:2, first sentence, has no or insignificant effects would therefore in the view of the Panel not be a sufficient demonstration that the benefits accruing under that provision had not been nullified or impaired even if such a rebuttal were in principle permitted.

ity of trade.¹¹⁷ Although this language of effective equality of treatment originally arises out of Article III:4's language of according imports "treatment no less favorable" than that accorded a like domestic product, it is also similar to the obligation in Article III:2.¹¹⁸ Favor requires favoritism, a conscious act. Hence, the "treatment no less favorable" standard is compatible with a reading of Article III:1 which prohibits regulations motivated by protectionism. Furthermore, since Article III tolerates trade effects that may result in incidental discrimination against imports, its prohibition must be narrower than an outright ban on any discriminatory effect; thus, Article III:1 can be read to only prohibit measures showing protectionist intent.

Having determined that the purpose of Article III is to prevent protectionist-motivated regulations from burdening imports to the advantage of domestic production, a conclusion that the first sentence of Article III:2 should incorporate the terms of Article III:1 does not necessarily follow. While one could correctly assume that Article III:2 cannot be in conflict with Article III:1, it does not follow that the application of Article III:2, first sentence, must include a test based on Article III:1. Thus, the justification for including consideration of protectionist intent must arise from the actual application of the "like" product provision. As discussed earlier, the use of the *Border Tax* criteria without reference to anything more could do mischief to and frustrate the national treatment obligation. This possibility alone is a sufficient reason to incorporate Article III:1 into the reading of the first sentence of Article III:2. Determination of "likeness" according to *Border Tax* criteria defeats the intent and purpose of the first sentence of Article III:2 because it ties the arbitrary evaluation of imported and domestic products to a no-discriminatory effect standard. The no discriminatory effect standard is too harsh and, when combined with a test of "likeness" focused on the products' characteristics, is also too legally arbitrary to uphold the national treatment obligation. Furthermore, there is no inherent reason why two products that are similar under the *Border Tax* criteria should, on account of their identity, receive preferred GATT treatment (e.g. no discriminatory effect allowed), when their cousin "directly competitive or substitutable products" (e.g. shielded from protectionist measures only) does not.

The application of the *Border Tax* criteria leads to absurd and unreasonable results.¹¹⁹ For example, the use of the criteria could lead to under-inclusiveness. Protectionist measures may be overlooked if too much emphasis is placed on a finding of similarities in the products' characteristics. This, in actual practice, would be unlikely to pose a real problem since there is always the fallback

117. GATT Dispute Panel Report on United States—Section 337 of the Tariff Act of 1930, B.I.S.D. 36th Supp. 345, ¶ 5.11 (1990).

118. See *Taxes on Petroleum Panel*, *supra* note 13, at 158, ¶ 5.10, stating "Article III:2, first sentence, obliges contracting parties to establish certain competitive conditions for imported products in relation to domestic products. Unlike some other provisions in the General Agreement, it does not refer to trade effects."

119. Article 32 of the Vienna Convention on treaty interpretation permits supplementary means of interpretation if interpretation by ordinary meaning of the terms of the treaty under Article 31 leads to "a result which is manifestly absurd or unreasonable." See 1996 *Alcoholic Beverages Appellate Body*, *supra* note 8, at 237.

provision of “directly competitive or substitutable” of the second sentence, which should absorb most cases falling outside of the “like” classification. Nevertheless, this fact merely indicates that a finding of “likeness” is really more or less legally insignificant and that the focus should be on competitive relationships.

The real danger, however, is the over-inclusiveness of the category of “like” products, which has the potential for invalidating perfectly legitimate legislation that does not burden trade. What is at stake is the fact that a measure, which is non-protectionist in legislative motive and *de minimis* discriminatory effect, will be found to have violated the national treatment obligation simply because the import and domestic products are similar, e.g. “like,” whereas a compatriot measure affecting directly competitive or substitutable products will be found to not be in violation of Article III:2. There is no rationale for the distinction between “like” and “directly competitive or substitutable” other than the text of the article. As such, it is arbitrary. Furthermore, the two-step products test would permit a panel to automatically condemn a non-protective regulation.¹²⁰ As a result, the two-part products test would disqualify what are potentially valid and legitimate measures. This would force policy harmonization and encroach on the policy options available to legislators and regulators to an extent unanticipated when GATT was drafted.¹²¹ Therefore, the two-part test would be overly invasive of national sovereignty and hence, practically, politically untenable.

An objection to the above analysis might be that the purpose and effect of a regulatory distinction should not be taken into account in the determination of the likeness of products under Article III. Rather, such a determination should be made in the context of Article XX, which establishes broad exceptions from the obligations under the General Agreement for measures required in the pursuit of policy objectives other than that of affording protection. The European Community in *1996 Alcoholic Beverages Panel* argued that examination of the aim of a regulation is relevant *only* under the general exceptions to GATT in Article XX.¹²² This approach, however, is too limited. Article XX lists only ten policy goals as justifying measures deviating from the other provisions of the General Agreement, but there are far more legitimate policy goals that can only be attained by distinguishing between different product categories. If one were to examine the purpose of product distinctions only in the context of Article XX, this would severely constrict policy options for WTO Members and therefore hardly be acceptable to them.¹²³

120. The European Community recognized that the Malt Beverages Panel was concerned with over-inclusiveness of the two-part products test in that it could be excessively rigid and lead to the automatic condemnation of innocuous regulatory distinctions, but claimed that these concerns were exaggerated because the general exceptions to GATT under Article XX and the notion of dual flexibility which the Community advanced would account for the problem. *1996 Alcoholic Beverages Panel*, *supra* note 49, at ¶ 4.38.

121. See argument of the United States, *id.* at ¶ 4.26.

122. *Id.* at ¶ 4.22. See also *id.* at ¶¶ 4.13, 4.14, 4.22, 4.37, 4.38, 4.41, 4.44.

123. Roessler, *supra* note 95, at 30.

Nevertheless, the panel in *1996 Alcoholic Beverages* adhered to the notion that Article XX was adequate to protect legitimately discriminatory regulations from invalidation. It did so because it reasoned that the aim-and-effect test would make Article XX redundant or useless since the aim-and-effect test did not contain a definitive list of the grounds to justify departure from the obligations of Article III.¹²⁴ This is a reflection of the European Community's concern that the safeguards which buttress the application of Article XX would be absent and that panels would be left without guidance as to what may constitute a "legitimate policy objective."¹²⁵ These concerns are unwarranted as they can be easily addressed. Safeguards are in proper procedures.¹²⁶ The appellate body could very easily discern procedures which parties to a dispute would consider fair. Under the new system of automatic approval of reports under the WTO, a majority of Member nations would have to dissent from its adoption. This gives the appellate body much more latitude in creating a proper standard of review with procedural safeguards to create a sense of fairness in the proceedings and a sense of legitimacy to its judgments. Instead of taking the initiative, the appellate body has tied its hands by declining to do so.

A major issue concerning the fairness of a determination of regulatory aim is burden of proof. Under the aim-and-effect test, the initial burden of proof would fall on the complainant, who would be required to produce a *prima facie* case that the a measure had both the aim and effect of affording protection to domestic production. Once the complainant had demonstrated that this was the case, then it would be up to the defending party to present evidence to rebut the claim.¹²⁷ The panel in *1996 Alcoholic Beverages* repeats this very statement as if it were a self-evident revelation of the injustice of such an approach and an argument against its feasibility.¹²⁸ But, of course, it is nothing more than a tautology. The initial burden of proof is merely to prove a *prima facie* case. This amounts to little more than the burden of presentation or the burden of coming forward. Proving a *prima facie* case is not to prove the case itself. Thus, the weight would be on the defending party to show that protectionist aims did not motivate the issuance of the regulation at issue. Besides, when one considers that the United States, as the complainant in *Alcoholic Beverages* cases, did not feel so burdened by such a procedure as to propose it, is indicative of its feasibility and fairness.

If it should be that the appellate body's discussion of the so-called necessity of considering Article III:1 when reading both sentences of Article III:2 has no

124. *1996 Alcoholic Beverages* Panel, *supra* note 49, at ¶ 6.17.

125. *Id.* at ¶ 4.41.

126. Procedure creates the belief that the application of the substantive law is done so fairly and that there will be legitimacy for the application of the substantive rule. This would allow for a shift away from the pragmatic negotiated approach to trade law to a more formal legalistic approach to which the WTO aspires. Thus, the false antithesis between legalism and pragmatism can be broken down by recourse to procedures for achieving defined goals. KENNETH DAM, *THE GATT: LAW AND THE INTERNATIONAL ECONOMIC ORGANIZATION*, 4-5 (1970).

127. *See, e.g.*, argument of the United States in *1996 Alcoholic Beverages* Panel, *supra* note 49, at ¶ 4.32.

128. *Id.* at ¶ 6.17.

effect in the actual application of the first sentence of Article III:2, why does the appellate body overturn the lower panel's report on this point? In the some nine years after the original *Alcoholic Beverages* panel decision, two other panels have addressed the "like product" issue of Article III in detail.¹²⁹ It is possible that the appellate body is responding to the approach to Article III found in *Malt Beverages* and *Taxes on Automobiles*. However, the appellate body appears to have misunderstood what is at stake in the holdings of these two panels. These two panels found that a reading of the first sentence of Article III:2, which banned all discriminatory treatment, impossibly harsh and they argued that the sentence must permit national governments to discriminate against imports if there was a valid purpose to the regulation. The panel scoped out a broad area for valid purpose, essentially anything that was *not* "to afford protection to domestic protection." Thus, this sounds like a ban on national measures that are protectionist in nature. *Taxes on Automobiles*, going much further in rejecting the two-part test than *Malt Beverages* did, spelled out an alternative test. This test is the aim-and-effect test, where a tax measure will be found to be in contravention of the first sentence of Article III:2 if it (1) does not have trade neutral effects, and (2) has a protectionist aim (note that the order of the actual test is the reverse of the order of the terms in the name of the test).¹³⁰ As a result, the declaration of a finding of "like product" is no more than a conclusory statement that the first sentence Article III:2 has been violated.

This conclusion may be viewed in another way. The "likeness" of two products is not a function of everyday perception. Instead, the perception of "likeness" must consciously account for the required perspective. In the case of Article III, the required perspective is prescribed by Article III:1 which declares that domestic taxes and regulations should not be applied "so as to afford protection to domestic production." The term "so as to" suggests that both the intent and the effect of the regulation or tax are relevant. In determining whether two products are alike, the central issue thus is whether the product categories under which they fall have been distinguished with the intent and the effect of affording protection.¹³¹ Thus, the focus of any Article III examination should be on the regulation or tax itself and not on the products affected, and hence the proper test is the aim-and-effect test.

C. *Issues in Distinguishing Legitimate Discrimination from Invalid Protectionism*

A significant point in the application of the aim-and-effect test is the issue of proof itself. The panel in *1996 Alcoholic Beverages* focused on problems in discerning the aim of a regulation, which it claims sometimes can be indiscernible. It also raised the issue of the complainant's ability to access legislative

129. See *Malt Beverages Panel*, *supra* note 26, and *Taxes on Automobiles Panel*, *supra* note 36.

130. This test may be better termed as the "effect-and-aim" test, since it requires a finding of trade non-neutral effect before moving on to an inquiry into protectionist aim (since the reverse would make the determination of trade neutrality moot).

131. See *Roessler*, *supra* note 95, at 29.

materials and the ambiguity in determining which legislative materials in each particular country would be primarily determinant of the aims of the legislation.¹³² Certainly, the determination of the proper means of proving the aim of a regulation needs to be clarified, but it need not be an obstacle to the adoption of the aim-and-effect test.

While it is beyond the scope of this Comment to extensively discuss how panels should in practice discern legitimate discrimination from impermissible protection of domestic production, I would like to raise a few points for consideration. Roessler makes the distinction between policies that discriminate between domestic and foreign products and policies that merely discriminate between different categories of products without taking into account their origin. He refers to the former as "trade policies," which the General Agreement is meant to constrain, and the latter as "domestic policies," which is beyond the scope of the General Agreement and belongs exclusively to the WTO Members' governments.¹³³ Our focus, then, is on how to discern trade policies, which the WTO can invalidate, from domestic policies, which are outside the WTO's jurisdiction. In other words, we need to find a standard for legally establishing protectionist aim in a regulation.

The United States proposed something of a test in its submission before the Panel in *1996 Alcoholic Beverages*. It can be broken down as such:

- (1) look at the stated policy objectives for the tax or legislative measure in question, the statements by the legislators, preparatory work and the wording of the legislation as a whole;
- (2) look at the treatment of the products on either side of the regulatory distinction drawn, and whether it was known at the time the legislation was enacted that it would draw a line between one group of products that would be foreign and another group that would be domestic; and
- (3) and examine the incentives created by the legislation, and whether these incentives would lead to a result consistent with the stated policy behind the legislation or a change in competitive opportunities that favor domestic products.¹³⁴

The question boils down to whether the legislation or regulation appeared arbitrary or contrived in the context of the stated policies pursued.¹³⁵ These considerations are a good start, but other issues still loom.

Some commentators have analogized the role of the panel in finding protectionist aim to the U.S. Supreme Court's role in dormant commerce clause cases.¹³⁶ The U.S. Supreme Court has a well-developed doctrine for assessing whether a State regulation is impermissibly protective of local production in a manner that violates free interstate commerce. This analogy, while a useful

132. 1996 Alcoholic Beverages Panel, *supra* note 49, at ¶ 6.16.

133. Roessler, *supra* note 95, at 21.

134. See 1996 Alcoholic Beverages Panel, *supra* note 49, at ¶¶ 4.17, 4.30.

135. *Id.* at ¶ 4.30.

136. Snelson, *supra* note 37, at 491.

starting place, is only of limited help because the Constitution organizes a federation under a sovereign power with supreme authority over the States on issues of trans-border trade. This is not the case with the WTO and its Members. The WTO is still a voluntary organization, and while the Uruguay Round has made WTO significantly more legalistic in its approach to Members states' policies than was the case under GATT, the Member states retain their sovereign power and hence will tolerate only so much interference in their domestic policy-making.

The particularities of international trade law require one to appreciate the fact that international trade is largely a matter of domestic politics, because trade flows originate in domestic price structures, which depend upon the organization of production and government policies in individual countries. Production and policy, in turn, depend on political choices both past and present.¹³⁷ Societies may differ radically in the way they organize trade, such as Western market-oriented economies compared to Eastern command-oriented economies. Hence, trade between such societies will inevitably be limited since each society prefers to trade on the basis of their own societal structure.¹³⁸ However, such preferences cannot be viewed as inherently protectionist.

Determining protectionist intent is complicated by the requirement of complex institutional analysis. Each nation has a different set of government actors involved in trade policymaking. The lead agency on trade policy varies significantly across countries. Except in the United States, legislatures play only a modest role in trade policy-making decisions. Furthermore, issues of the degree of centralization of trade policymaking also affect the analysis. Also at issue is whether the process is predictable and transparent or *ad hoc* and arbitrary. There are also issues of organizational links between political leadership and bureaucratic interests, trade and finance agencies, and trade and domestic budget agencies.¹³⁹ The need for research and study into this area of establishing the proper standards for evaluating regulatory aim is indeed extensive.

D. The Relationship Between the First and Second Sentences of Article III:2—Is There a Difference Between Being “Like” and “Directly Competitive or Substitutable”?

Supporters of the two-step products test have assailed the aim-and-effect test for not strictly adhering to the text of Article III. Specifically, the 1996 *Alcoholic Beverages Panel* has argued that the first and second sentences of Article III must be distinguished on the grounds that (1) the first sentence makes no reference to Article III:1 whereas the second sentence does, and (2) the first sentence concerns “like” products whereas the second sentence concerns “directly competitive or substitutable” products. The panel assumes that these two are interrelated such that the existence of one distinction proves the necessity of

137. HENRY R. NAU, ED., *DOMESTIC TRADE POLICIES AND THE URUGUAY ROUND* xiii (1989).

138. *Id.*

139. *Id.* at 6-7.

the other. Such a facile assumption itself does not prove the necessity of maintaining the distinction.

The only case in which "like" products are appropriately distinguished from "directly competitive or substitutable" products is when two products are (1) accorded different treatment on account of their respective classification, and (2) the difference in their classification goes to some purpose in support of the national treatment obligation. However, this is not the case. The two *Alcoholic Beverages* panels interpreted Article III:2 to require that "like" products be treated under a discrimination standard whereas "directly competitive or substitutable" products be treated under a protectionist motive standard. The panel in *1996 Alcoholic Beverages* assumed that the first sentence excluded reference to protective motivation, and hence consideration of Article III:1 was irrelevant.¹⁴⁰ Yet the appellate body held that the first sentence of Article III:2 was an application of the requirements of the purpose of the national treatment obligation as embodied in Article III:1.¹⁴¹ These are very different ways of reading the first sentence of Article III:2, but because the appellate body has ruled on the issue, we can dismiss the reasoning of the panel below. As discussed above, the distinction between "like" and "directly competitive or substitutable" products is a consequence of the awkward way in which the article was drafted. If both the first and second sentences must account for protectionist effect, then the legal necessity of a distinction between "like" and "directly competitive or substitutable" products collapses. Recall that we have seen that Article III:1 does not permit the invalidation of national regulation based on mere discriminatory effect absent a finding of protectionist motive. As Article III:2 in its entirety falls within the scope of Article III:1, the need for a distinction between "like" and "directly competitive or substitutable" dissolves as they both serve the same end of identifying protectionist national measures.

The appellate body in *Alcoholic Beverages* discussed the rules for treaty interpretation. Citing Article 31 of the Vienna Convention, it adopted the rule that the General Agreement should be interpreted in accordance with the ordinary meaning of the terms in their context and in light of the treaty's object and purpose.¹⁴² Because Article III:2 of the General Agreement includes separate provisions for "like" products and "directly competitive or substitutable" products, it appears that making the terms functionally synonymous under the above analysis may contradict the requirements of the Convention. However, the above analysis also indicates that a reading according to the explicit terms of Article III:2 would contravene the object and the purpose of the national treatment obligation. It would also lead to the unreasonable and absurd result of being over-inclusive, thereby invalidating legitimate domestic policies.¹⁴³

140. 1996 Alcoholic Beverages Panel, *supra* note 49, at ¶ 6.16.

141. 1996 Alcoholic Beverages Appellate Body, *supra* note 8, at part H(1), 241.

142. *Id.* at part D, 237.

143. Vienna Convention, Article 32, permits recourse to supplementary means of interpretation when interpretation according to Article 31 "leads to a result which is manifestly absurd or unreasonable." See 1996 Alcoholic Beverages Appellate Body, *supra* note 8, at 237.

In addition, the literal wording of the provisions of the General Agreement may not facilitate the intended ends of the Agreement. Some commentators have noted that the rules of GATT tend to fail to take account of the teachings of economic theory because most of the significant theoretical international trade work did not appear in technical economic literature until the 1950s and did not appear in popular discussion of international economic problems until even later.¹⁴⁴ Thus, it is very possible that the explicit terms of the General Agreement may not be the best way to achieve the goal of liberalizing international trade. Hence, the fact that this analysis equivocates “like” products and “directly competitive or substitutable” products should not be a serious argument against its adoption.

III.

CONCLUSION: A “LIKE” PRODUCT TEST THAT MAKES SENSE

The WTO’s appellate body has unfortunately reversed the promising trend of greater flexibility in interpreting Article III and has affirmed the literalist approach to the reading of the provision. The literalist approach fails on several counts. It fails by requiring a comparison of the imported and domestically produced products which, at best, is irrelevant to and, more likely, frustrates the national treatment obligation. Instead, the proper test needs to account for the purpose of Article III’s national treatment obligation.

By looking at the characteristics of the products, this first step of the two-step product test advocated by the literalist approach does not, and in fact cannot, consider the purpose of Article III. That inquiry is either reserved for the second step of the test, if that step applies at all. As the purpose of Article III does not guide the application of the first step, the panels have thought that it is the *Border Tax* criteria which does. However, we have seen that the *Border Tax* criteria are both unclear and potentially harmful to the national treatment obligation. In other words, the *Border Tax* criteria could possibly contravene the purpose of Article III. A better approach is to consider the purpose of Article III in the application of *all* of its provisions. To do so, it is necessary to eliminate the first step of comparing the imported and domestically produced products as objects. Instead, the regulations which define the products must be compared. Such an evaluation would involve an examination of the aim and the effect of the regulation, with the prohibited aim being the primary determination. The aim that is prohibited must be of improper motive under the national treatment obligation. Because the obligation does not prohibit discrimination between products for legitimate reasons, the scope of improper aim is limited to protectionist aims.

While such a test is more difficult to administer than the test proposed by the *Alcoholic Beverages* reports, it is ultimately fairer. If the WTO wishes to maintain its legitimacy and the good graces of its Membership, it should strive for the fairest proceedings possible.

144. DAM, *supra* note 126, at 5-6.