

World Trade Institute

MILE 7

**ANALYSIS OF THE “NO LESS FAVOURABLE” TREATMENT
STANDARD IN ARTICLE III:4 OF GATT WHEN REVIEWING
ORIGIN-NEUTRAL REGULATIONS**

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30 September 2007

Acknowledgement

I am grateful to Thomas Cottier, Martin Molinuevo, Ivaylo Ivanov, Nicole Pohl, Susan Plattner and Lothar Ehring for valuable exchanges. Any errors are my own.

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Abstract

The focus of the thesis is the analysis of the “no less favourable” treatment standard in Article III:4, GATT when origin-neutral measures are reviewed by WTO adjudicators. The approach to examining the standard determines the limits of the concept of de facto discrimination in the context of Article III:4. There are two main contrasting and competing positions for a proper approach. While one of the perspectives limits the examination to establishing that the measure at issue causes detrimental impact to imports, the second perspective calls for additional consideration of the purpose of the regulation. The review of jurisprudence reveals that adjudicators have failed to establish clear criteria for the analysis of the “no less favourable” treatment requirement with regard to origin-neutral regulations. Further elaboration is needed by WTO adjudicators in order to set distinct guidelines to be followed by national regulators and WTO panels for the understanding of the “no less favourable” treatment standard.

The thesis aims to present and explore the case law and legal literature regarding the understanding of the “no less favourable treatment” standard and to propose further points in this debate.

I. Introduction

The core of the national treatment principle embodied in Article III:4 of the General Agreement on Tariffs and Trade (GATT) is the standard established for treatment of imports by domestic regulations—a Member must accord to foreign products “treatment no less favourable” than the one accorded to like domestic products. GATT and World Trade Organization (WTO) jurisprudence have interpreted Article III¹ to cover cases of implicit discrimination in which origin-neutral measures are reviewed. The very broadly written language of Article III:4 renders difficult for WTO adjudicators the interpretation and finding of proper criteria in the examination of origin-neutral measures’ consistency with the provisions of the Article. The central topic of the analysis of Article III:4 is the inquiry into the “no less favourable” treatment requirement. In addition, two other elements are scrutinized: whether the imported and domestic products at issue are “like” products and whether the measure at issue is a “law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution, or use”. **This paper focuses on the perspectives to the examination of the “no less favourable” treatment requirement when origin-neutral measures are under review.** The importance of the approach to it comes from the very essence of the national treatment principle as means for disciplining the internal policies of WTO Members. Different views to the examination of the “no less favourable” treatment standard determine the level of intrusiveness of Article III:4 into domestic regulatory autonomy and the result of potential conflicts between free trade and various other policy objectives. WTO jurisprudence has not yet clarified the proper interpretation and approach to the “no less favourable” treatment standard. Clear interpretation of the precise criteria for examining the “no less favourable” treatment requirement will facilitate the process of adoption of internal regulations that are consistent with Article III:4, and also will give distinct directions to WTO adjudicators when assessing the lawfulness of these regulations.

Throughout this paper I qualify the “no less favourable” treatment requirement in Article III:4 **as a standard**. Firstly, this requirement sets a standard of conduct that governments must follow when adopting internal regulations. Along these lines the Panel in *US-Section 337*² referred to the “no less favourable” treatment requirement as a standard³. Secondly, if using the classification of the provisions of a treaty as rules and standards, the “no less favourable” treatment requirement falls under the latter type. The difference between rules and standards

¹ All the Articles employed in the analysis below are GATT Articles, unless otherwise indicated.

² For full case titles see Table of dispute settlement cases, p.48

³ See Panel Report Section-337, para. 5.11

lies in the (in)completeness of specification-while rules are well specified, standards establish general guidance.⁴ The discussion below will reveal that the “no less favourable” treatment requirement is a very broadly written provision and therefore, should be classified as a standard.

This paper firstly reviews the concept of de facto discrimination in GATT context. The following section draws comparison between the analysis of the “no less favourable” treatment standard in de jure and de facto discrimination cases. The discussion continues with the conceptual approaches to the examination of the “no less favourable” treatment standard when origin-neutral regulations are under review. The paper then presents analysis of GATT and WTO dispute settlement practice regarding the examination of the “no less favourable” treatment standard. In the last section, the discussion further explains the ideological rationale behind the different perspectives to the standard and presents the issues that arise when examining the regulatory purpose as part of the “no less favourable” treatment analysis under Article III:4 of GATT.

II. The concept of de facto discrimination

The national treatment obligation set in Article III of the GATT is one of its cornerstones which aims at ensuring fairness in international trade relations.⁵ Interpreting Article III to cover only regulations that are de jure discriminatory will undermine this function of the national treatment principle. Accordingly, the understanding of Article III evolved so as to encompass measures which although facially origin-neutral are de facto discriminatory .

The problem of protection by means of facially non-protectionist measures is not new to trade analysts. In 1940, the economist *Winslow* clearly defined the issue with regard to non-tariff barriers. According to him, various trade controls such as quotas, subsidies, countervailing duties, antidumping legislation, tariff bargaining, quarantines, marks of origin, customs formalities can be separated into measures which give “indirect” protection and measures which do not, whereby the test is whether they are “actually intended or used to give economic protection when they are nominally intended for other purposes”.⁶ *Winslow* points out that the main question is whether domestic regulations are “intended or used to harass the importers, as distinct from measures which directly affect imports as such” effectively drawing the line between measures that are on their face intended for non-protectionist policy

⁴ For extensive analysis of rules and standards division of the provisions of a treaty, see Trachtman (1999)

⁵ See Zampetti (2006), p. 135-136

⁶ Winslow (1940), p.2

purposes but de facto discriminate against imported goods and measures that are de jure discriminatory.

In 1970, *Dam* presented the problem of facially neutral regulatory measures with discriminatory effect in his seminal treatise “The GATT: Law and International Economic Organization”.⁷ The author observed that internal taxes were for the first time serious subject of negotiations during the Kennedy Round. The two main issues were the US taxes on spirits and the European taxes on cars which according to *Dam* revealed “certain difficulties in the application of the principle of equal treatment of “like” products”. The US tax system on its face appeared to be non-discriminatory but in practice imported bottled spirits bore substantially higher rate of tax compared to domestic spirits. This is a classic case of a facially neutral tax regulation where, as *Dam* points out, the protectionist element enters only when one considers the *commercial patterns of the traded good and the time of imposing the tax*. Nevertheless, no result regarding such a type of non-tariff barrier was achieved during the Kennedy round of negotiations, although the US tax system was strongly attacked.⁸ It is clear from *Dam’s* account that GATT members were not ready to address the problem of de facto discriminatory internal regulations during the 60ies.

As the knowledge of GATT rules increased among government officials, the number of cases involving implicit discrimination also increased.⁹ Furthermore, as tariff barriers were significantly reduced in successive rounds of negotiation in the GATT system, governments willing to maintain protection increased the use of non-tariff barriers. Part of this tendency was the more frequent use of internal regulatory measures which do not discriminate on their face but are inventively constructed in a way to burden imports. Protection was disguised in the form of carefully crafted origin-neutral regulations. The GATT system is built on flexible rules which create strong temptation for governments to cheat.¹⁰ The national treatment obligation is the one that affects most directly governments’ domestic regulatory freedom and policies and thus often invites breach. Or, as *Jackson* observes, discrimination in favour of local products seems to be one of the basic human urges.¹¹ When this “basic human urge” meets the flexible and broadly written Article III:4 of the GATT, creating facially origin-neutral regulations seems a logical consequence. GATT panels in the late 1980ies addressed precisely this tendency in government practices, by extending the nondiscrimination obligations to cover not only explicit discrimination but also de facto discrimination cases.¹²

⁷ See *Dam* (1970), p.129

⁸ *Ibid.*, p.130

⁹ See *Jackson* (1989), p.212

¹⁰ *Hudec* (1993), p.265

¹¹ *Jackson* (1969), p. 272

¹² See summary of selected GATT cases, p.18

This was part of a course in GATT dispute settlement practice whereby panels were responding to flexible rules by interpreting them so as to create clearer and more precise criteria to be taken into account in government decision-making.¹³

Furthermore, the concept of de facto discrimination was understood in a way to cover **two types of cases**.¹⁴ In the **first situation**, an origin-neutral **domestic regulation treats two groups of similar products differently** and most of the imported products fall into the disadvantaged category.¹⁵ In the **second situation, a facially-neutral measure treats equally** imports and domestic products and is **more burdensome for importers to comply with**.¹⁶ In this instance, differential treatment will be necessary so as to avoid de facto discrimination of imported goods.

To sum up, logically, the interpretation of Article III:4 evolved to discipline not only explicitly discriminatory measures but also regulations which are drafted in an origin-neutral manner but with the effect of favouring domestic products to the detriment of imported ones. From the late 80ies on, GATT panels provided quasi-judicial response to de facto discrimination¹⁷ which was vigorously reaffirmed later in WTO Panel and Appellate Body (AB) practice. The outstanding question that remained was whether and how to differentiate the examination of de jure and de facto discrimination cases under Article III:4.

III. Analysis of the “no less favourable” treatment requirement of Article III:4 in de jure and de facto discrimination cases

Article III:4 does not explicitly distinguish between origin-based and facially-neutral regulations. As pointed out above, **three elements** should be examined when assessing the consistency of a regulation with Article III:4. Establishing whether the measure at issue is a law, regulation, or requirement affecting the internal sale, offering for sale, purchase, transportation, distribution, or use of imported products is identical in cases of explicit and implicit discrimination. On the other hand, the fundamental differences between origin-based

¹³ Hudec (2003), p.266

¹⁴ See Farber and Hudec (1994), p.10

¹⁵ There is formally different treatment of two similar or competitive products and imported products are adversely affected by it (see Ortino (2004), pp.250, 319) In this situation, there is asymmetric distribution of domestic goods and imports in the two groups of similar products-most of the imports fall in the disfavoured group and most of domestic goods in the favoured group. This asymmetric distribution reveals the negative impact of the measure on imported goods(see Ehring, p.4).

¹⁶ There is formally identical treatment of identical products and the imported products are adversely affected by it (see Ortino (2004), pp.250, 319). Ehring (2002, pp. 3-4) emphasizes that this situation is characterized by disparate intensity of the burden of the measure to domestic producers and importers despite the equal treatment by the measure (the author defines this type of situation as asymmetric intensity).

¹⁷ Steger (2002), p.143. A legislative response was also introduced-GATS national treatment provision explicitly addresses de facto discrimination.

and origin-neutral measures determine different approaches to both likeness and “no less favourable” treatment inquiries.¹⁸ De jure discriminatory measures distinguish between *identical* products on the basis of their origin and analysis of the “likeness” issue is not needed. On the contrary, a substantive inquiry into the likeness of the products at issue is necessary when establishing whether facially-neutral regulations violate Article III.¹⁹

There is nothing in the text of Article III:4 which points at differences in the analysis in de jure and de facto discrimination cases of the third requirement-the “no less favourable” treatment standard. It is left to adjudicators to establish the necessary criteria for assessment of the standard with regard to origin-based and origin-neutral measures.

When a case involves a measure that **on its face** discriminates against foreign products the analysis of the “no less favourable” treatment standard should be straightforward. Identifying de jure discrimination is easy because the text of the regulation itself differentiates between products on the basis of their origin. As the products involved are identical and the measure employs their origin as criterion for differentiation, the focus of the analysis under Article III:4 is finding of less favourable treatment. Distinctions based on national origin are a priori illegitimate.²⁰ Therefore, a regulation explicitly referring to the origin of products *prima facie* and automatically violates Article III:4 as long as foreign products receive less favourable treatment.²¹ Accordingly, finding of differential impact of the measure to the detriment of imported products will be sufficient for establishing violation of Article III:4.

On the contrary, there is a presumption that facially-neutral measures accord “no less favourable” treatment to foreign products because such measures subject both domestic and foreign products falling in the same regulatory subgroup to the same legal requirements.²² Thus, determining when origin-neutral regulations violate the “no less favourable” treatment requirement is a more complex exercise.²³ Adjudicators face a measure which does not distinguish between domestic and imported products on its face. As all regulations, it might be more burdensome to some foreign products compared to some domestic products. Besides, the measure may pursue protectionist or non-protectionist objectives. Therefore, the assessment whether a facially-neutral measure satisfies the “no less favourable” treatment standard is **a difficult task** which presents the conceptual challenge of choosing the proper approach to it. **The two significant issues that arise in this regard are: how to establish detrimental impact of the measure on imported goods and whether a finding of**

¹⁸See Fauchald (2003), pp. 443-444

¹⁹ See Regan (2002), p.456 and Ortino (2004), p.250

²⁰ Hudec (1998), p.8

²¹ Howse and Regan (2000), p.269, Regan (2002), p.556

²² Regan (2002), p.469; see also Ehring (2002), p.21

²³See Howse and Turk (2001), p.285, Lester and Leitner (2001), p. 14, Trachtman (1997), p.20

differential treatment is a sufficient condition to conclude that the regulation is inconsistent with the “no less favourable” treatment standard. The following sections will discuss the perspectives to these two questions which are crucial for the understanding and application of the standard.

IV. Assessment of differential impact to imports in de jure and de facto discrimination cases

Assessment of the “no less favourable” treatment standard in Article III:4 requires a finding that the measure under review accords differential treatment to the detriment of foreign products. Conducting the differential impact test with regard to measures which explicitly refer to the origin of the products and facially neutral measures reveals two different approaches.

The approach to explicitly discriminatory measures is grounded on their deliberate character which calls for treating such measures with exceptional severity.²⁴ The Panel Report in *US-Section 337* case is evidence for a rigorous perspective to the analysis of de jure discriminatory regulations. It established a stringent interpretative standard regarding the finding of differential treatment when origin-based measures are under review. The Panel stressed that the purpose of Article III:4 is the protection of expectations on the competitive relationship between imported and domestic products. It noted that the Article can serve this purpose not as means for rectifying less favourable treatment of imports but as means of forestalling it.²⁵ The Panel emphasized that:

...the “no less favourable” treatment requirement of Article III:4 has to be understood as applicable to each individual case of imported products. The Panel rejected any notion of balancing more favourable treatment of some imported products against less favourable treatment of other imported products. If this notion were accepted, it would entitle a contracting party to derogate from the “no less favourable” treatment obligation in one case, or indeed in respect of one contracting party, on the ground that it accords more favourable treatment in some other case, or to another contracting party. Such an interpretation would lead to

²⁴ Hudec (1998), p.4

²⁵ See Panel Report *US-Section 337*, para. 5.13

great uncertainty about the conditions of competition between imported and domestic products and thus defeat the purposes of Article III.²⁶

In other words, forestalling less favourable treatment with regard to origin-based measures could be achieved only with application of a standard which prohibits **any detriment to each individual case** of imported products. *Hudec* praises this interpretative standard of the “no less favourable” treatment requirement set by the Panel, pointing out that a rule requiring overall balance could not be a clear guidance for governments when drafting regulations, would invite imposing of a disadvantage on foreign products and would create difficulties for panels when assessing overall balance; in contrast, a strict rule which strikes down even the possibility of disadvantage is a clear standard for the government and for panels which will analyze the individual elements of the procedure.²⁷ When a measure explicitly and deliberately discriminates on the basis of origin, the defending state is obliged to prove that in all circumstances imported products are treated no less favourably than domestic products. The adjudicator views de jure discrimination as particularly reprehensible and any negative impact on imports yields invalidation of the measure at issue.

The difference between a measure which purposefully employs the origin of the product as criterion for differential treatment and an origin-neutral regulation reasons **different approach** to establishing detrimental impact. In practice, every origin-neutral regulation is capable of affecting negatively some imported products.²⁸ *Arguably, not all governmental origin-neutral regulations which involve some negative impact on imports must be invalidated.*²⁹ Thus, the stringent test employed for de jure discriminating regulations is relaxed in cases involving facially neutral measures.³⁰

In *EC-Asbestos* the AB laid down the necessary approach when analyzing the “no less favourable” treatment standard with regard to origin-neutral regulations: **aggregate comparison of the group of imported products and the group of domestic products which reveals the overall impact of the measure on all domestic and imported**

²⁶ *Ibid.*, para.5.14

²⁷ *Hudec* (1993), p.267

²⁸ The issue whether such a negative impact is purposeful or no is a different issue which will be discussed at length below.

²⁹ See Farber and *Hudec* (1994), p.1428

³⁰ *Hudec* observes that the substance of GATT rules has been influenced primarily by violations involving explicit discrimination and that “one should see some pressure for relaxing the more rigorous elements of those rules in cases involving de facto discrimination” (*Hudec* (1998), p.6). It seems that the establishment of different sets of analysis with regard to the “no less favourable” treatment standard in de facto and de jure discrimination cases in dispute settlement practice reflects this tension for relaxing the more stringent interpretations of GATT rules when facially neutral measures are at issue.

products.³¹ In contrast with the analysis of the origin-based measures, when origin-neutral regulation is under review an **overall weighing analysis is warranted**. Detrimental impact will be found in cases where the group of imported products as a whole is negatively affected compared to the group of like domestic products as a whole.

Once differential treatment to the detriment of imports is established, a second vital question arises: whether the analysis if a facially-neutral regulation satisfies the “no less favourable” treatment standard should stop there or whether additional examination of the regulation under review is necessary. On the contrary, when reviewing origin-based measures, once detrimental impact is established, the “no less favourable” treatment standard is not satisfied, Article III:4 is violated and regulatory purpose can only enter into consideration in a motion under Article XX.

V. Competing approaches to the analysis of the “no less favourable” treatment standard in Article III:4

Two contrasting and competing views have emerged with regard to the proper approach to the examination of the “no less favourable” treatment standard under Article III:4 when origin-neutral measures are reviewed. The first one considers that a finding of detrimental effect to imports caused by a regulation is sufficient to establish that the regulation accords less favourable treatment to imports and a violation of Article III:4 of GATT. The second one, while accepting that finding of detrimental impact is necessary, supports the position that additional considerations are crucial part of the analysis of the “no less favourable” treatment standard. The main topic of the discussion can be summarized as follows: whether the assessment of the “no less favourable” treatment obligation set in Article III:4 should be limited to comparison between the treatment accorded by a domestic regulation to foreign and domestic like products or whether additional factors and a broader inquiry should be made before reaching a conclusion of inconsistency of a government’s measure with its national treatment obligation.³²

1. Disparate impact view (economic approach)

³¹ For detailed discussion see the analysis of *EC-Asbestos*, p. 23

³² See Fauchald (2003), p.471

This position is given different labels: economic approach (substantial lessening of competition test³³), pure discriminatory effect test³⁴, objective approach³⁵, disparate impact view³⁶-and is the conventional view among trade analysts³⁷. The approach limits the inquiry about the “no less favourable” treatment standard in Article III:4 to objective economic analysis whether the regulation at issue causes disparate impact on imports. The necessary and sufficient test for a finding of (no) less favourable treatment is drawing the comparison between the measure’s impact on the group of imports and the group of like domestic products. Establishing negative impact on the group of imported products as a whole and, respectively, positive impact on the group of like domestic products (the majority of domestic goods fall within the favoured subgroup and the majority of imports fall within the disfavoured subgroup of like products) will lead to a conclusion of less favourable treatment accorded to imports by the measure under review. Countries retain their regulatory autonomy but if domestic regulations distort competitive opportunities for imports, a violation of Article III:4 occurs. **Under this approach, assessment of regulatory purposes should not be taken into account** and is not part of the objective detrimental impact analysis of the “no less favourable” treatment standard. Interpretation of the less favourable treatment requirement in light of the anti-protectionist purpose of Article III:1 is also limited to establishing disparate impact to imports.³⁸ The purpose of the regulator-no matter if protectionist and purposeful or non-protectionist with incidental consequences-is irrelevant for the analysis. Article XX is the only recourse of a government that has adopted a regulation aiming at values different from favouring domestic production but with distorting impact on competitive equality of foreign and domestic goods.

In the following paragraph, I will highlight the main arguments in favour of the economic approach advanced by its supporters.

According to *Trebilcock* and *Giri* an economic approach to Article III which is limited to establishing disparate effect, is closer and more consistent to the purpose of the national treatment principle-the provision of effective equality of competitive opportunities.³⁹ Detecting when this equality is disturbed needs an objective test-establishing if the domestic regulation at issue favours domestic production to the detriment of imports. Negative impact on imports (actual or possible) is clear evidence that the equality of competitive opportunities

³³ Trebilcock and Giri (2004), p.65

³⁴ Ortino (2004), p.339

³⁵ Horn and Weiler (2004), p.133

³⁶ Regan (2003), p.756

³⁷ See Regan (2003), p.756

³⁸ As Horn and Weiler point out, the meaning of “as to afford protection to domestic production” in Article III:1 is understood by the supporters of the economic approach as applicable to the effects of the measure and not to its purpose (see Horn and Weiler (2004), p.133)

³⁹ See Trebilcock and Giri (2004), pp.60-66

is broken and that less favourable treatment is accorded to imported goods. The appropriate and sole question that should be answered is **whether competition between domestic and imported products is substantially lessened** by the application of the measure at issue. One of the advantages of such limited inquiry is that it is objective and empirical. Value judgments by the adjudicator are not required. *Trebilcock* and *Giri* support the view that Article XX adequately answers in a transparent way the need for justification of non-protectionist regulations which happen to have disparate impact on imports. The authors argue also that the clear division between Article III and XX appropriately allocates the burden of proof between complainant and respondent-the complainant must prove the negative impact of a regulation under Article III:4 and then the burden of proof shifts in a motion under Article XX where the respondent must prove that the regulation can be justified under its provisions. A broader test which includes establishing of regulatory purpose will place heavier burden on the complainant for proving something that is not in its possession. Contrary to this view, it can be argued that once differential treatment is proven to exist there will be a presumption of protectionist purpose unless the respondent does not prove otherwise.⁴⁰ In addition, if regulatory purpose is viewed as an objective category that can be discerned from the structure and design of a regulation, revealing it will not require possession of inaccessible information-objective analysis of the contested measure will be the additional burden for the complainant.

To sum up, the supporters of the economic approach limit the analysis of the “no less favourable” treatment standard to establishing of commercial disadvantage to foreign goods. The only possible defense for a defendant country will be recourse to the demanding provisions of Article XX. The competing perspective to the analysis of origin-neutral regulations aims at bringing in the aim of the internal regulation as a decisive element of the “no less favourable” treatment discussion.

2. Regulatory purpose as an element of the analysis of the “no less favourable” treatment standard

The supporters of the second approach⁴¹ are of the view that establishing that a regulation has a disparate effect on imported goods is a necessary⁴² and initial but not sufficient test for finding of (no) less favourable treatment. In their view, a second crucial test must be

⁴⁰ See Horn and Weiler (2004), p.142. For discussion of the burden of proof issue see also Regan (2002), p.449, footnote 23.

⁴¹ The approach is given different labels-“aims and effects” approach (Trebilcock and Howse (2005), p.108), “effect and purpose” approach (Horn and Weiler (2004), p.137), inherently discriminatory nature test (Ortino (2004), p.340)

⁴² The supporters of the regulatory purpose approach do not object the economic methodologies for establishing disparate treatment (see Trebilcock and Howse (2005), p. 109)

conducted-examination whether the regulatory purpose of the measure under review is protectionist or not. To be found in violation of the “no less favourable” treatment standard, a regulation should not only affect imports negatively but should also be imposed with the intentional purpose to cause such a negative impact. Accordingly, a measure which on its face is origin-neutral, adopted in pursuit of a non-protectionist purpose and which incidentally has disparate impact on imports will satisfy the “no less favourable” treatment standard.

According to the “aims and effects” supporters, the purpose of Article III should be understood as avoiding *purposeful* protectionism. In their view, protectionism cannot be limited to mere disparate impact on foreign goods but should be defined with reference to a protectionist purpose.⁴³ Intuitively, the concept of protectionism is invariably perceived in connection with some purposeful behavior.⁴⁴ An origin-neutral measure accords “no less favourable” treatment to imports not for the sole reason of disparate impact on imports but if it is adopted for the purpose to favour domestic goods to the detriment of imports, i.e. for protectionist reasons. It is argued that it is not fair to invalidate a regulation which aims at legitimate non-protectionist purposes but which also incidentally and not intentionally causes negative impact on imports.⁴⁵ On the contrary, the supporters of the economic approach view the concept of protectionism in Article III as limited to establishing disproportionate impact on imports without any reference to purpose.

Furthermore, the regulatory purpose inquiry does not suggest analysis of subjective legislative intent.⁴⁶ It should be based on objective evidence—the text, context, structure, foreseeable impact of the regulation. This conclusion can be reasoned on the basis of AB’s statements with regard to the aim of the measure in its Report in *Chile-Alcohol*.⁴⁷ The AB underlines that an analysis of the issue of “so as to afford protection” should include the purposes or objectives of a Member’s legislature and government as a whole to the extent that they are given *objective* expression in the statute itself.⁴⁸ The AB emphasized that:

we consider that a measure's purposes, objectively manifested in the design, architecture and structure of the measure, *are* intensely pertinent to the task of

⁴³ Regan (2001) emphasizes that measures with disparate impact on foreign goods does not cause inefficiency, while protectionist measures do.

⁴⁴ See Trebilcock and Howse (2005), p.109 and Horn and Weiler (2004), p.144

⁴⁵ See Horn and Weiler (2004), p.143

⁴⁶ As opposed to what the original “aims and effects test” seemed to imply (Trebilcock and Howse (2005), p.109); see also Regan (2002), p.478, Regan (2003), p.738

⁴⁷ The AB in *Chile-Alcohol* reviews the proper interpretation of the term “so as to afford protection” as incorporated in Article III:2, second sentence.

⁴⁸ See AB Report *Chile-Alcohol*, para. 62, emphasis in the original

evaluating whether or not that measure is applied so as to afford protection to domestic production.⁴⁹

Clearly, the AB stresses that the regulatory purpose-understood and deduced through analysis of the objective features of the measure, not of any subjective elements behind it- is an important element in the analysis whether a measure is applied so as to afford protection to domestic production.⁵⁰ The AB views the identification of regulatory purpose as an objective inquiry how the measure under review is constructed and how its design determines its application in practice. It seems that demonstrating non-protectionist regulatory purpose is a question of inherency-whether the negative impact on imported goods is inherent in the nature of the regulation. As *Hudec* points out, inherency is a clear factor for distinguishing deliberate protectionist trade effects from incidental ones.⁵¹ A test whether a regulation inherently, by way of its structure, discriminates against imports would mean that incidental detrimental effect caused by the regulation would not qualify the measure as illegal.⁵²

Moreover, some authors advocate the analysis of additional factors when identifying the regulatory purpose of a domestic regulation. *Regan* opines that the political forces behind the adoption of a measure should be explored.⁵³ He is also of the view that “subjective” evidence for protectionist purposes, such as ministerial statements, should also be considered. Although *Regan* rejects that subjective intentions of the legislators should be taken into account, his proposal to look at the legislator as a conduit of certain political forces which should be identified⁵⁴, seems in practice an evaluation about the subjective impulse behind the measure. Looking into statements and committee reports during adoption of a regulation is also an inquiry about subjective motivations that have driven the political process of adoption of the regulation.⁵⁵ Such an approach to exploring the aim of the measure seems contrary to the AB’s view, laid down above, which calls for analysis of the objective elements of the measure

⁴⁹ *Ibid.*, para.71, emphasis in the original

⁵⁰ It should be reminded that the analysis of “so as to afford protection” is relevant to the examination of the “no less favourable” treatment standard as emphasized by the AB in paragraph 100 of its Report in EC-Asbestos (cf. analysis of the Asbestos dispute, p.23).

⁵¹ *Hudec* (1998), p.16, note 21; 42 which refers to the inherency analysis employed by the Panel in US-Auto Taxes

⁵² See *Ortino* (2004), p.340, *Howse and Turk* (2001), p.298, footnote 55

⁵³ See *Regan* (2002), p.458. Similarly, *Farber and Hudec* view intent as applied to a collective group as legal fiction and conclude that protectionist motivation means that protectionist effect played stronger causative role in the adoption of the regulation than the purported regulatory benefits and an indication for such a role would be the weakness of those benefits. (see *Farber and Hudec* (1994), footnote 128)

⁵⁴ See *Regan* (2001), p. 1884, *Regan* (2002), pp.458-464

⁵⁵ *Porges and Trachtman* (2003), p.796, opine that the present system while not eliminating the possibility of looking into subjective intentions (as seen in *Canada-Periodicals*) will avoid it and Panels and AB will evaluate the aims of the measure based on its objective structure.

under review in order to reveal its purpose.⁵⁶ Nevertheless, some leeway for exploring more subjective factors could be possible in future cases.⁵⁷

Further below, I will discuss the roots and implications of the economic approach and the regulatory purpose perspective.⁵⁸ The following section presents a review of GATT and WTO case law regarding the “no less favourable” treatment standard. The analysis of dispute settlement practice will reveal the understanding and approach to the standard by adjudicators.

VI. The Case Law

Article III:4 of the GATT employs very broadly written language.⁵⁹ The “no less favourable” treatment criterion is not elaborated upon with regard to its proper analysis in the text of the Article. As a result, dispute settlement practice had to develop and clarify the approach to the standard’s application to origin-neutral measures. The following sections will present what so far had been articulated by panels and the AB with regard to the criteria for assessment of the “no less favourable” treatment requirement when reviewing origin-neutral measures’ consistency with Article III:4. I will start with a sketchy review of GATT panels’ practice and will continue with analysis of the relevant WTO cases.

1. Less favourable treatment in GATT dispute settlement

GATT jurisprudence does not present an elaborate analysis of the concept of de facto discrimination. Nevertheless, cases of de facto discrimination appeared very early, mostly

⁵⁶ Fauchald (2003), p.479, opines that the skepticism in AB practice about subjective intent renders its examination principally irrelevant although it could possibly play a role in specific cases.

⁵⁷ For example in *DR-Cigarettes*, the AB concluded that the Panel which relied on a written declaration from the Director-General of Internal Taxes (see footnote 107 for further analysis) has conducted an objective assessment consistent with Article 11 of the DSU. The AB emphasized that “a panel enjoys a margin of discretion in weighing such evidence, commensurate with its role as trier of fact” and referred to its discussion in *US-Carbon Steel* that evidence as to the scope and meaning of a law “will typically be produced in the form of the text of the relevant legislation or legal instruments, which may be supported, as appropriate, by evidence of the consistent application of such laws, the pronouncements of domestic courts on the meaning of such laws, the opinions of legal experts and the writings of recognized scholars” (see AB Report, para. 111-112). In this light, possibly, subjective statements (for example statements done in the legislature) could also enter a list of eligible evidence when discerning the purpose of a regulation.

⁵⁸ See below “Further thoughts and analysis”, p.36

⁵⁹ See Jackson (2007), p.11. Horn and Mavroidis define GATT as *incomplete contract* (which does not contain all the necessary information for its operation) with vague provisions to be clarified by future adjudication, see Horn and Mavroidis (2004), p.54

concerning the MFN obligation, often resulting in findings of lack of likeness so the “no less favourable” treatment requirement could not be addressed.⁶⁰

Hudec’s in depth analysis of the GATT dispute settlement practice reveals that the system until the late 1980ies addressed predominantly disputes concerning border measures and explicitly discriminatory measures.⁶¹ The author observes that out of the first 207 legal complaints filed in GATT between 1948 and 1990 only a handful of cases involved claims of de facto discrimination by internal regulatory measures under Article III. The first affirmative ruling sustaining a claim of de facto discrimination with regard to internal measure is the Panel decision in *Japan-Alcoholic Beverages* in 1987.

The following paragraph will show the perspective of some GATT Panels to the “no less favourable” treatment requirement.⁶² The cases presented here involve origin-based measures and they give valuable perspective for the interpretation of Article III:4 and the “no less favourable” treatment standard in later cases that involve origin-neutral measures.⁶³

The very first Panel that interpreted Article III:4 in 1958’s *Italy-Agricultural Machinery* Report stressed that the intention of the drafters of Article III:4 is to provide equal conditions of competition for imported and domestic goods once imports had been cleared through the customs and that the Article covers any laws or regulations which might adversely modify the conditions of competition between domestic and imported products on the internal market.⁶⁴ This logic has been followed ever since by GATT adjudicators.⁶⁵ The most elaborate interpretation of the “no less favorable” treatment standard of Article III:4 was made by the Panel in the *US-Section 337* dispute.⁶⁶ The Panel stated in the very beginning of its analysis that the words “no less favourable” treatment in Article III:4 of the GATT are an expression of the underlying principle of equality of treatment of imported products as compared to the treatment given to domestic products and that these words call for effective equality of opportunities for imported products in respect of the application of laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation or use of

⁶⁰See Ehring (2002) p.9-10: Cases resulted in denial of likeness: Australian Subsidy on Ammonium Sulfate (1950), Germany-Sardines (1952) concerning Article I:1; EEC-Animal Feed Proteins (1978) concerning Articles III:1 and III:4; Spain-Soybean Oil (1981) concerning Article III:4.

⁶¹ Hudec (1993); see also Hudec (1998), p.6

⁶² The review of GATT cases involving interpretation of the “no less favourable” treatment requirement is not exhaustive. For detailed analysis of GATT Reports reviewing de facto discriminatory measures see Ortino (2004), pp. 321-325 and Ehring (2002), pp. 7-12

⁶³ Three GATT cases involve an origin-neutral measure’s review under Article III:4-EEC-Animal Feed Protein, US-Malt Beverages (both Panels found that the products at issue were not like so further consideration of less favourable treatment was not necessary) and Canada-Alcohol II (see Ortino (2004), p.321-325)

⁶⁴ See Panel Report *Italy-Agricultural Machinery*, paras 11-13

⁶⁵ Most recently the WTO Panel in *Turkey-Rice* referred to the Panel Report in *Italy-Agricultural Machinery* when analyzing the consistency of domestic purchase requirement with Article III:4, which shows the significance of this first GATT Report for the understanding of the “no less favourable” treatment standard.

⁶⁶ Paragraphs 5.11 -5.14 of the Report *The Panel Report in US-Section 337* was qualified by Hudec (2003) as “a careful and very craftsmanlike piece of legal work”

products”.⁶⁷ This Panel Report is the first to formally acknowledge the existence of cases of de facto discrimination without further elaboration. Moreover, the Panel opined that the purpose of Article III:4 is **to protect expectations of the competitive relationship between imported and domestic products**. It considered that in order to establish whether the “no less favourable” treatment standard of Article III:4 is met, it had to assess whether the regulation at issue *may* lead to the application to imported products of no less favourable” treatment, i.e. its “potential impact, rather than the actual consequences” for specific imported products.⁶⁸ The interpretative guidelines set by the *US-Section 337* Panel Report will be used by subsequent GATT and WTO panels as a reference point when interpreting Article III:4. Thus, the *US-Malt Beverages* Panel referring to *US-Section 337* Report, highlighted that the requirement of Article III:4 is one addressed to relative competitive opportunities- adding another important benchmark for the understanding of the Article -created by the government in the market, not addressed to the actual choices made by enterprises in that market.⁶⁹

The Panel in the unadopted Report *US-Auto Taxes* analyzed Article III:4 and the “no less favourable” treatment requirement as regards an origin-neutral measure.⁷⁰ In its analysis the Panel importantly emphasized that one of the central purposes of Article III is **to ensure the security of tariff bindings** and that “Contracting parties could not be expected to negotiate tariff commitments if these could be frustrated through the application of measures affecting imported products subject to tariff commitments and triggered by factors unrelated to the products as such”⁷¹. The Panel opined that Article III:4 does not permit less favourable treatment of an imported product based on factors not directly relating to the product as such. This short review of GATT jurisprudence reveals that GATT panels addressed the “no less favourable” treatment requirement in light of the purpose of Article III:4-the provision of equal conditions of competition for domestic goods and imports. The “no less favourable” treatment standard was not closely examined with respect to the few origin-neutral measures reviewed under Article III:4. Nevertheless, GATT panels strengthened the national treatment provision by acknowledging that it covers facially neutral domestic regulations, thus advancing a more transparent, rule-based trading system.⁷²

⁶⁷See Panel Report Italy-Agricultural Machinery, para. 5.11, emphasis added

⁶⁸ Ibid., para. 5.13. The Panel in EC-Oilseeds I also stressed that “the exposure of a particular product to a risk of discrimination constitutes, by itself, a form of discrimination”

⁶⁹Ibid., para. 5.31

⁷⁰ The regulation at issue accorded differential treatment as regards fleet averaging to full line manufacturers and limited-line manufacturers without referring to the origin of the cars-which according to the EC was prejudiced against European car manufacturers-see Panel Report US-Auto Taxes, paras 5.50-5.55; for arguments of the parties as regards Article III:4, see paras 3.226-3.299 . The first factor analyzed by the Panel as regards Article III:4: separate foreign fleet accounting is de jure origin-based, see paras 5.47-5.49

⁷¹ See para 5.53, Panel Report US-Auto Taxes

⁷² Maruyama (1998), p. 651

2. WTO jurisprudence involving interpretation of the “no less favourable” treatment standard

The problem of de facto discrimination was identified in GATT dispute settlement practice and the task of a more articulate interpretation was shifted to WTO panels and the Appellate Body. WTO jurisprudence reveals preoccupation with the threshold issue of likeness when reviewing origin-neutral measures. In spite of this tendency, there are some important interpretative guidelines regarding the “no less favourable” treatment standard which will be discussed below.

2.1. Japan-Film

The first WTO case regarding de facto discrimination under Article III:4 of GATT is *Japan-Film*. The Panel in this case analyzed whether the eight Japanese distribution measures at issue accorded less favourable treatment to imported film and paper than the one accorded to like domestic products on the Japanese market.

The Panel, referring to the Panel report in *US-Section 337*, underlined that the standard for assessing “less favourable treatment in Article III:4 is the provision of effective equality of competitive conditions on the internal market.”⁷³ It found that the measures at issue are formally neutral and that in their application⁷⁴ they do not cause detrimental impact on imported products. The Panel, referring to its analysis of the non-violation claim of the United States, stated that it was not persuaded that the measures at issue are “*directed at promoting vertical integration in the photographic materials distribution sector with a view to impeding market access for foreign products*”.⁷⁵ In its non-violation analysis the Panel considered the purpose⁷⁶ of the Japanese measures, finding that the measures are directed at “improving transaction efficiency in the sector which is not inherently unfavorable to imports” and are not directed at promoting vertical integration in the sector with a view to impeding market access to imports.⁷⁷ It seems that the Panel, when assessing the “no less

⁷³ Panel Report Japan-Film, para 10.379.

⁷⁴ The Panel defined that a measure is de facto discriminatory when it upsets in its application the relative competitive position between domestic and imported products (see para. 10.380)

⁷⁵ Panel Report Japan-Film, para. 10381, emphasis added

⁷⁶ The Panel analyzed in its non-violation discussion **the issue of relevance of intent to causality**: “...intent may not be irrelevant. In our view, if a measure that appears on its face to be origin-neutral in its effect on domestic and imported products is nevertheless shown to have been intended to restrict imports, we may be more inclined to find causal relationship in specific cases, bearing in mind that intent is not determinative where it in fact exists.” (see para. 10.87).

⁷⁷ Panel Report Japan-Film, para. 10.171

favourable” treatment standard in Article III:4, took into account the regulatory purpose of the Japanese measures which it already discussed with regard to the non-violation claim,.

Furthermore, the Panel also noted that there were serious difficulties of timing in the US arguments on *causation* concluding that there is no *meaningful nexus* between the Japanese measures and the market structure in Japan because this market structure was preexisting. The structure of the market and the competitive conditions present in the market were not changed by the challenged measures. Thus the Panel established an important standard for examination of the “no less favourable” treatment requirement in Article III:4-**a meaningful nexus should exist** between the challenged measure and the negative impact on the competitive conditions in the market for a conclusion of less favourable treatment to be reached.

The interpretations of the Panel are important because they addressed significant conceptual issues regarding de facto discrimination for the first time in WTO dispute settlement. The Report was not appealed and the AB did not have the opportunity to introduce its view about the problems raised in the dispute.

2.2. Korea-Beef

The AB elaborated extensively on the “no less favourable” treatment standard of Article III:4 with regard to an *explicitly* discriminatory regulation in *Korea-Beef*. The AB underlined that “according treatment no less favourable” means according conditions of competition no less favourable to the imported product than to the like domestic product and that the assessment should be focused on whether a measure modifies the conditions of competition in the relevant market to the detriment of imported products.⁷⁸ In its discussion on the interpretation of the “no less favourable” treatment requirement in paragraph 4 of Article III, the AB referred to its Report in *Japan-Taxes on Alcoholic Beverages*, citing the following excerpt: “The broad and fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures. More specifically, the purpose of Article III “is to ensure that internal measures not be applied to imported or domestic products so as to afford protection to domestic production...”⁷⁹ Thus, *the AB highlighted that the “no less favourable” treatment standard in Article III:4 should be interpreted in light of the fundamental purpose of Article III-avoiding protection and invalidating measures that are applied so as to afford protection to domestic production.* Throughout its discussion of the consistency of the Korean measures with Article III:4 the AB repeatedly underlined and focused its analysis on whether the Korean measure (dual retail system) modified the

⁷⁸ AB Report Korea-Beef, paras 135 and 137

⁷⁹ *Ibid.*, para. 135

conditions of competition in the Korean beef market to the disadvantage of imported products. After finding that the dual retail system accords less favourable treatment to imported products because of lack of equality of competitive conditions, the Panel made an important remark that a market structure (the dual distribution system in this instance) that is not directly or indirectly imposed by law or government regulation, but is rather solely the result of private entrepreneurs acting on their own calculations on comparative costs is not unlawful under Article III:4 of the GATT.⁸⁰

The interpretative remarks of the AB in Korea-Beef regarding Article III:4 are constantly referred to by subsequent Panel and AB reports.

2.3. The Asbestos dispute

The most deliberate and insightful interpretation of the “no less favourable” treatment standard of Article III:4 was made by the Appellate Body in *European Communities (EC)-Asbestos*. The AB engaged in paragraph 100 of its Report in the following discussion of the standard, on its own initiative and in an effort to clarify the meaning of the “no less favourable” treatment requirement of Article III:4:

[...] ...we observe that there is a second element that must be established before a measure can be held to be inconsistent with Article III:4. Thus, even if two products are "like", that does not mean that a measure is inconsistent with Article III:4. A complaining Member must still establish that the measure accords to the group of "like" *imported* products "less favourable treatment than it accords to the group of "like" *domestic* products. The term "less favourable treatment expresses the general principle, in Article III:1, that internal regulations "should not be applied ... so as to afford protection to domestic production". If there is "less favourable treatment of the group of "like" imported products, there is, conversely, "protection" of the group of "like" domestic products. However, a Member may draw distinctions between products which have been found to be "like", without, for this reason alone, according to the group of "like" *imported* products "less favourable treatment than that accorded to the group of "like" *domestic* products. In this case, we do not examine further the interpretation of the term "treatment no less favourable" in Article III:4, as the

⁸⁰ Ibid., para. 149

Panel's findings on this issue have not been appealed or, indeed, argued before us.⁸¹

This discussion is placed at the end of a section of the Report concerning the meaning of “like products” in Article III:4 of GATT. The fact that the comments made by the AB in paragraph 100 are not part of the legal reasoning in reaching the decision of the case (the less favourable treatment analysis of the Panel was not appealed) reveals the importance that the AB attributes to the “no less favourable” treatment requirement. The AB, in the very beginning of paragraph 100, underlined the significance of the “no less favourable” treatment standard as a second step (after establishing likeness of domestic and imported products) in the analysis of consistency of a measure with Article III:4.

Paragraph 100 has drawn many interpretations by commentators which reflect the two main different concepts for determination of (no) less favourable treatment in the context of Article III:4—the disparate impact approach and the regulatory purpose perspective. Importantly, the AB gives distinct directions on how to establish disparate impact on foreign goods when analyzing the “no less favourable” treatment standard.

A. Comparison of the treatment accorded by the measure to imported and domestic products (disparate impact test)

The AB answered in paragraph 100 the important question of how to compare the treatment accorded to imported and like domestic products in determination of less favourable treatment under Article III:4. The possible approaches are two.⁸² If the so called diagonal test is employed, a panel only needs to find that *some* imported products are treated less favorably than *some* domestic products, to reach a conclusion for less favourable treatment. In other words, protection of part of domestic production to the detriment of part of imported production is sufficient for a violation of Article III:4 to occur. The other possible test is the asymmetric impact test (discriminatory effect test⁸³). Under this test, the question that should be asked is whether the group of imported products as a whole receives less favourable treatment than the group of domestic products as a whole, i.e. comparison should be drawn between the *entire, aggregate groups* of domestic and imported products.

The *Panel* in the Asbestos dispute employed the diagonal approach. It stated that inasmuch as the French regulation does not place an identical ban on PVA, cellulose or glass fibre and fibro-cement products containing PVA, cellulose or glass fibres, “we must conclude that *de*

⁸¹ AB Report EC-Asbestos, para. 100

⁸² See for extensive analysis Ehring (2002)

⁸³ Davey and Pauwelyn (2000), Lester and Leitner (2001)

jure it treats imported chrysotile fibres and chrysotile-cement products less favourably than domestic PVA, cellulose or glass fibre and fibro-cement products”.⁸⁴ Thus, the Panel didn’t analyze the distribution of domestic and foreign products across the two regulatory categories of banned (disfavoured) and allowed (favoured) products. The Panel did not compare the measure’s overall impact on all domestic and foreign products but assumed that if there are any imported products covered by the ban and any like domestic products not covered by the ban, less favourable treatment is being accorded to imports. The French measure at issue drew distinction between like (in the view of the Panel) products and *for this reason alone*-to use the words that the AB deliberately used in paragraph 100-was found to accord to imported products less favourable treatment than that accorded to like domestic products. **It is clear that the diagonal approach allows finding of less favourable treatment in all cases concerning origin neutral measures when there are some imported products in the subgroup receiving unfavourable treatment and some domestic products in the subgroup receiving favourable treatment**, therefore functioning as a simple guillotine⁸⁵ and not as a sensitive filter⁸⁶. Thus, the diagonal test places a very heavy burden with regard to origin neutral measures requiring not a single imported product to be less favourably treated than a single like domestic product.

The AB, evidently concerned with the diagonal approach used by the Panel, took the initiative to outline the proper analysis in an *obiter dictum*, thus placing great importance on the matter of comparison of imported and domestic products when determining less favourable treatment. Emphasizing the significance of the “no less favourable” treatment standard as a second stage of the analysis of a violation of Article III:4, GATT, **the AB stated that “a complaining Member must...establish that the measure accords to the group of “like” imported products less favourable treatment than it accords to the group of “like” domestic products”**.⁸⁷ The AB clearly identifies two *groups*⁸⁸ of products that should be compared-the *group* of “like” imported products and the *group* of “like” domestic products. Accordingly, each group-of domestic and of imported products-includes all “like” products-both favoured and disfavoured. **Thus, the AB endorses the asymmetric impact**

⁸⁴ Panel Report EC-Asbestos, para. 8.155, emphasis in the original

⁸⁵ Pauwelyn (2007), p.9

⁸⁶ Ehring underlines that only the asymmetric impact test can be used as an additional legal requirement and a real filter (Ehring (2002), p.19)

⁸⁷ Throughout paragraph 100 the AB uses italics to point at the origin of the goods that are compared (domestic and imported). It seems that it addresses the fact that in its analysis of the “no less favourable” treatment standard (in para. 8.155 and 8.156 of the Panel Report) the Panel did not refer to the origin of the compared products. Thus, the AB stressed that Article:4 and the national treatment principle that it embodies are concerned with origin-based discrimination and that the burden of a facially origin-neutral measure must affect imports in order to be qualified as *de facto* origin-based and discriminatory under Article III:4 (see Ehring (2002) p.19)

⁸⁸ In the following sentences of paragraph 100 the AB again underlined that the comparison is between the groups of like domestic and imported products

test-aggregate analysis of the entire group of imported and the entire group of domestic products is the proper approach in order to reach a finding disparate impact. This test relaxes the stringent conditions of the diagonal approach, allowing some domestic products to be treated more favourably than some imported products when the overall treatment of the group of imported products is no less favourable than the overall treatment of the group of like domestic products.

The interpretation of the AB's message in paragraph 100 that when analyzing the "no less favourable" treatment standard under Article III:4 comparison should be made between the entire class of imported products and the entire class of like domestic products is broadly accepted by GATT commentators.⁸⁹ The different understandings of paragraph 100 are based on whether the finding of differential impact based on aggregate comparison of the groups of imported and like domestic products is sufficient to reach a conclusion of less favourable treatment or additional analysis is warranted. While for some authors the analysis of the "no less favourable" treatment standard should be objective and limited to disparate impact inquiry without further examination of legislative purposes⁹⁰, others view the examination of regulatory purpose as a decisive second level of the analysis.

B. Regulatory purpose test as part of the analysis of the "no less favourable" treatment standard

The AB clearly emphasized the proper comparison for conducting the disparate impact test that should be undertaken when assessing the "no less favourable" treatment standard. *It could finish its analysis there but it continued its discussion.* The AB stressed that "the term less favourable treatment expresses the general principle, in Article III:1, that internal regulations "should not be applied ... so as to afford protection to domestic production. If there is "less favourable treatment of the group of "like" imported products, there is, conversely, "protection" of the group of "like" domestic products". For some analysts this statement is a clear indication of a crucial stage of the less favourable treatment inquiry under Article III:4.⁹¹

To begin with, the AB's interpretation of less favourable treatment with specific reference to Article III:1 seems to overturn⁹² its previous view in EC-Bananas III that the examination of violation of Article III:4 "does *not* require a separate consideration whether a measure

⁸⁹ Among others: Ehring (2002) p.19, Howse and Turk (2001), p. 297/Pauwelyn (2007), p.9, Ortino (2004), p.337

⁹⁰ See Ehring (2002), p.20

⁹¹ See Regan (2002, 2003), Howse and Turk (2001), Porges and Trachtman (2003), p.796. According to Porges and Trachtman Hudec also thought that the Asbestos decision brought back the aims and effects test in the analysis of Article III:4.

⁹² As Regan comments "flew in the face of a seemingly contrary assertion in EC-Bananas"(Regan (2003), p.749)

"afford[s] protection to domestic production""⁹³. In paragraph 100 the AB strongly emphasized the status of the "no less favourable" treatment standard of paragraph 4 as an *expression* of the general principle embodied in paragraph 1 of Article III that **internal regulations should not be applied so as to afford protection to domestic production**. Therefore, the concept of less favourable treatment is informed and should be understood and interpreted in the light of the anti-protectionist principle laid down in Article III:1.⁹⁴ A finding of less favourable treatment of imported products implies and is based on finding of protection of the group of like domestic products.

Accordingly, the explicit reference to Article III:1 in the AB's interpretation of the "no less favourable" treatment standard of Article III:4 gives a powerful argument for the supporters of aims and effects test as part of the analysis of the standard.⁹⁵ *Howse* and *Turk* opine that with its discussion in paragraph 100 the AB has in effect brought "aims and effects" back into the analysis of Article III:4 at the second stage (after considering likeness) when considering whether there is less favourable treatment.⁹⁶ According to *Regan*⁹⁷, the AB in paragraph 100 mandates explicit account to be taken of Article III:1's policy objective (internal measures not to be applied so as to afford protection) when assessing less favourable treatment. He continues his analysis referring to the Report of the AB in *Chile-Alcohol* where the AB stated that in deciding whether a measure is applied "so as to afford protection" the purposes or objectives of a Member's legislature and government as a whole should be considered-in other words, the regulatory purpose of the measure should be analyzed.⁹⁸ Therefore, *Regan* concludes that in assessing the "no less favourable" treatment standard in Article III:4, account should be taken of the regulatory purpose of the measure. *Regan's* reading of paragraph 100 suggests that the regulatory purpose gives content to the "no less favourable" treatment standard and that an origin-neutral measure does accord less favourable treatment to imported products if it is adopted for the purpose of disadvantaging foreign products.⁹⁹

⁹³ AB Report EC-Bananas III, para. 216

⁹⁴ *Howse and Turk* (2001)

⁹⁵ The "aims and effects" doctrine was based on the policy objective stated in Article III:1 that internal measures should not be applied "so as to afford protection" interpreted as calling for analysis of the aims and effects of the measure at issue. The test was introduced as part of the likeness consideration in US-Measures Affecting Alcoholic and Beverages (DS23/R, adopted 19 June 1992, BISD39S/206 [1993] and in US-Taxes on Automobiles, Report of the Panel. 11 October 1994 (not adopted), DS31/R, 33 I.L.M.1397 (1994). The aims and effects approach was explicitly rejected by the Appellate Body in Japan-Alcoholic Beverages, Report of the Appellate Body, 4 October 1996, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R

⁹⁶ See *Howse and Turk* (2001). *Porges and Trachtman* are also of the view that the AB have placed with Asbestos an additional substantive test under the rubric of less favourable treatment-the "inevitable aims and effects" test as part of the determination whether the regulation is applied "so as to afford protection" (*Porges and Trachtman* (2003), p..796)

⁹⁷ See *Regan* (2002), p.443

⁹⁸ AB-Report Chile Alcohol, para. 62

⁹⁹ See *Regan* (2002), pp.468-471

In my view, it should be stressed that the AB deliberately made a point of highlighting that “less favourable” treatment in paragraph four should be interpreted in relation and as an expression of the general-comprehensive for the whole Article-principle that internal regulations should not be applied so as to afford protection to domestic products. The AB stresses the relation between paragraphs four and one of Article III in paragraph 100 of the Report *as a logical continuation of pointing out this relation throughout its preceding discussion of likeness*.¹⁰⁰ The AB explained in the preceding paragraphs that the general principle laid down in Article III:1 informs the rest of Article III and acts “as a guide to understanding and interpreting the specific obligations contained” in the other paragraphs of Article III, including paragraph 4 and underlined the “particular contextual significance” of Article III:1 for interpreting Article III:4 as setting the general principle pursued by the provision.¹⁰¹ In the words of the AB, there must be consonance between the objective pursued by Article III-avoiding protectionism in the application of internal regulatory measures as enunciated in the general principle articulated in Article III:1-and the interpretation of the specific expression of this principle in the text of Article III:4.¹⁰² Paragraph 100 comes after this discussion *to restate the view of the AB about the importance of paragraph one in the interpretation of paragraph four, this time, with regard to the “no less favourable” treatment standard laid down in Article III:4*.

Interpreting the “no less favourable” treatment standard in light of paragraph one’s policy objective requires clear position on behalf of the adjudicator on what constitutes protection.¹⁰³

If protection is understood as mere disparate impact, the analysis of the standard will be limited to comparison of the treatment accorded to imported and domestic products. If the term implies deliberate behavior, then examination of the regulatory purpose of the regulation under review will be a necessary stage of the analysis.¹⁰⁴

In conclusion, paragraph 100 of the AB Report in the Asbestos dispute does not answer definitively what should be the proper analysis of the “no less favourable” treatment standard and leaves the door open for various interpretations until the AB engages in a more purposeful

¹⁰⁰ Paragraph 100 is at the end and part of section VI (B) of the Report which discusses the meaning of the term “like products” in Article III:4

¹⁰¹ See AB Report EC-Asbestos, paras 93,97, 98

¹⁰² Ibid., paras 97 and 98

¹⁰³ Horn and Mavroidis (2004) point out that although the notion of protection is central to the understanding of Article III:4, it has not been clearly defined in the case law. They underline that the interpretation of “so as to afford protection” criterion in Article III is not clear as well. They opine that the criterion is about the protection of expectations concerning the intent behind domestic regulations.

¹⁰⁴ One way of informing the notion of protection under Article III is determining whether the rule is qualified as market access provision or as domestic regulation discipline. In the former case, any measure which causes disparate impact on imports will impede market access and necessarily violate Article III. In the latter case, the analysis of the Article will cover not only disparate impact but also examination of the quality of the regulation-whether it purposefully places imports at disadvantage.

discussion on the issue.¹⁰⁵ The next case involving analysis of the “no less favourable” treatment requirement by the AB is *DR-Cigarettes*, which together with the discussion in paragraph 100 of *EC-Asbestos*, is also viewed by some commentators as evidence that elements of the rejected (in the context of likeness) aims and effects doctrine are gradually returning in the interpretation of the national treatment principle.¹⁰⁶

2.4. Dominican Republic (DR)-Cigarettes

DR-Cigarettes is the most recent case where the AB engaged in a discussion about the “no less favourable” treatment standard of Article III:4. In this case the AB further elaborates the standard, while leaving many questions unanswered.

The measure at issue regarding Article III:4 is an origin-neutral measure—a requirement for both domestic producers and importers to post a bond in order to ensure the payment of taxes (the “bond requirement”). The *Panel* in *DR-Cigarettes* found that the bond requirement is applied in an equal manner to domestic and imported products both formally (*de jure*) and in practice (*de facto*), and that it does not accord less favourable treatment to imported cigarettes than that accorded to like domestic products.¹⁰⁷

Honduras challenged the Panel’s finding that the bond requirement does not violate Article III:4. The *Appellate Body* started its analysis by citing *Korea-Beef* AB Report that the focus of the inquiry when assessing the “no less favourable” treatment standard is whether the measure modifies the conditions of competition to the detriment of imported products. The AB also referred to the fourth and fifth sentences of *Asbestos* dispute’s paragraph 100 (where, as discussed above, the AB emphasizes the relation between paragraph four and paragraph one of Article III, pointing out that the fundamental basis of the “no less favourable” treatment

¹⁰⁵ It should be reminded that paragraph 100 is an *obiter dictum* and as such a voluntary statement of the AB. The AB leaves further interpretation of the term “treatment no less favourable” in Article III:4 “as the panel’s findings on this issue have not been appealed or, indeed, argued, before us”. (cf. para.100, AB Report *EC-Asbestos*)

¹⁰⁶ Leroux (2007), p.34

¹⁰⁷ Panel Report *DR-Cigarettes*, para. 7.284-7.311. One of the claims of Honduras was that there was no liability that the bond requirement would serve to secure and that therefore it resulted in less favourable treatment for imports. Looking at the bond’s legal nature as a guarantee against damage and taking account of the tax authorities’ powers to reassess and readjust the applicable tax liabilities the Panel concluded that “there is no reason to question its assertion that, in practice and in the exercise of its enforcement powers, the Dominican Republic tax authorities regard the bond as a guarantee of compliance for internal tax obligations”(see paras 7.92-7.93) Interestingly, the Panel relied on a written declaration from the Director-General of Internal Taxes, to find that in the exercise of its enforcement powers, the Dominican Republic tax authorities regard the bond as a guarantee of compliance with internal tax obligations (see para. 7.291). This fact reveals the interest of the Panel in the regulatory purpose of the measure as understood by the director of the agency enforcing it (this approach by the Panel is contested by Honduras in its appeal arguing that that the Panel failed to undertake objective assessment as it relied on the unsubstantiated views of one officer of an Agency of the DR—an argument rejected by the AB). It seems that the Panel examined the purpose of the regulation at issue not only as objectified in the statute and in practice. It looked into how authorities were *regarding* the bond, in other words the subjective perception of the authorities about the function of the bond.

analysis is the finding of protection of domestic products to the detriment of imports) concluding that a measure accords less favourable treatment if it gives domestic like products competitive advantage in the relevant market over imported like products.¹⁰⁸ The AB continued its discussion with an important statement: “We recognize that a measure that applies equally to importers and domestic producers might, in some circumstances, nevertheless be inconsistent with Article III:4 of the GATT 1994”.¹⁰⁹ Here, the AB points at a situation of de facto discrimination case whereby a measure is equally applied to domestic and foreign products but nevertheless “*in some circumstances*” does accord less favourable treatment to the class of imported like products and violates Article III:4.¹¹⁰ The AB noted that the Panel did not exclusively rely on the fact that the bond requirement had been applied in an equal manner.¹¹¹

One of Honduras’ arguments was that the bond requirement accords less favourable treatment to foreign imported cigarettes because, *as the sales of domestic cigarettes are greater than those of imported cigarettes on the Dominican Republic market, the pre-unit cost of the bond requirement for imported cigarettes was higher than for domestic products.*¹¹² The AB stated that:

...the existence of a detrimental effect on a given imported product resulting from a measure does not necessarily imply that this measure accords less favourable treatment to imports if the detrimental effect is explained by factors or circumstances unrelated to the foreign origin of the product, such as the market share of the importer in this case.¹¹³

It seems that the AB opines that the less favourable treatment analysis should not be limited to finding of existence of a detrimental effect on a given imported product resulting from the measure.¹¹⁴ A Panel should examine if the detrimental effect can be explained by factors or

¹⁰⁸ AB Report DR-Cigarettes, para. 93. Tantalizingly, the AB conclusion focuses only on the economic perspective of the “no less favourable” treatment analysis which might be interpreted as understanding of protection as mere disparate impact.

¹⁰⁹ Ibid., para. 94

¹¹⁰ Differential treatment should be accorded in such cases in order to satisfy the “no less favourable treatment requirement.”

¹¹¹ The AB noted that the Panel relied also on the findings that Dominican tax authorities did have the power to reassess and adjust tax liabilities, that the bond serves as guarantee for payments resulting from reassessment and that tax authorities may use the bond to enforce tax liabilities other than the Selective Consumption tax.

¹¹² AB Report DR-Cigarettes, para. 96. The per-unit cost of the bond requirement is result of dividing the cost of the bond by the number of cigarettes sold on the Dominican Republic marker.

¹¹³ Ibid., para. 96

¹¹⁴ I suppose that the AB mistakenly used the wording “given imported product” as opposed to the group of foreign products. Further clarification is needed as to what the AB meant when referring to detrimental effect on a “given imported product” because this could be understood as considering only limited number (subgroup) of imported products as opposed to the entire group of like imported products (see Lester and Leitner (2005), p.8).

circumstances related to the foreign origin of the product. The AB further stated that in the analyzed situation the “mere demonstration that per-unit cost of the bond requirement for imported cigarettes was higher during a particular period is not *sufficient*¹¹⁵ to establish less favourable treatment under Article III:4” because it is explained by the fact that the importer has a smaller market share than domestic producers and **does not depend on the foreign origin of imported cigarettes**.¹¹⁶ The AB furthermore agreed with the Panels’ reasoning that a fixed expense, such as the annual fee for the bond, leads necessarily to different per-unit costs among supplier firms to the extent these firms have different sales on the market. The AB also reiterated the view of the Panel that *as long as difference in costs does not alter the conditions of competition* in the relevant market to the detriment of imported products, that fact itself should not be enough to conclude that the expense creates less favourable treatment for imported products.¹¹⁷ Thus, the AB upheld the Panel’s finding that the bond requirement satisfies the “no less favourable” treatment standard.

I will start with one possible explanation of what the AB might be saying. The AB could be addressing the cause-and-effect relation that should be established when analyzing the “no less favourable” treatment standard- disparate impact must be “dependant” on origin-related factors. While not employing de jure the origin of the products as a basis for differential treatment, a regulation will be de facto discriminatory if in its application it causes detrimental impact on imports as a result of origin-related factors that it employs.

The AB seems to distinguish between two types of factors that could be employed by a regulation-those related to the foreign origin of the goods and those that do not depend on the foreign origin of the products. For example, origin-related factors would be factors which are related to conditions peculiar for specific geographical region.¹¹⁸ These factors, if employed by a regulation, will inherently and invariably put imported products at disadvantage. If such factors are the cause of disparate impact on imports, they will reason a conclusion of de facto discrimination. On the other hand, factors which could not be related to foreign origin-like market shares in *DR-Cigarettes*-will not be sufficient for a finding of less favourable treatment.

The EC expressed its concern with AB’s interpretation and noted that the statements that detrimental effects existed for the given importer in this case as compared to two domestic producers should be read in light of previous jurisprudence that established that the proper comparison should be between the whole groups of domestic and imported products (see discussion below).

¹¹⁵ AB Report DR-Cigarettes, para. 96, emphasis in the original

¹¹⁶ Ibid., para. 96

¹¹⁷ Ibid., para. 98

¹¹⁸ Ortino points out geographical origin, residence or local qualification as possible origin-related factors (see International Economic Law and Policy Blog at http://worldtradelaw.typepad.com/ielpblog/2006/03/ecbiotech_a_tru.html, visited 26.09.2007)

Therefore, regulators are given the freedom to carefully choose from the second group of factors and put imports at disadvantage without violating the national treatment requirement. No matter if the factor intentionally employed by the regulator would adversely affect the conditions of competition, a national treatment violation will not be substantiated if the factor is not related to the foreign origin of the product. This logic reveals a limited concept of de facto discrimination because a number of factors which are not origin-related are left aside in its determination.

Article III:4 addresses the issue of protection of expectations for equality of competitive opportunities. The regulation under review in *DR-Cigarettes* uses as criterion for determination of the amount of the bond the market share-a category which is not constant every year. In my view, the mere fact that the bond might be higher for importers is already a reason for not satisfying the expectations for equality of competition and implying risk of discrimination¹¹⁹ and therefore not meeting the “no less favourable” treatment standard.¹²⁰

Another possible perspective to AB’s statements is that it might be saying that if detrimental treatment to imports is established and it is incidental result of *non-protectionist* non-origin-related factor (like the market structure in this case) less favourable treatment cannot be substantiated. One could argue that considering here a non-protectionist factor, like market structure, as evidence that the regulation is not de facto discriminatory, might in future cases be taken to another level-justifying “no less favourable” treatment with non-protectionist regulatory purpose of the measure.¹²¹

Interestingly, at the DSB meeting when the AB Report was adopted, the EC voiced its uneasiness about the AB’s confusing interpretation of the “no less favourable” treatment standard in the case. The EC was especially concerned with AB’s reference to “what was and what was not “related to” or “dependent on” a product’s “foreign origin””. It stated that this should be understood in accordance with previous practice which has established that less favourable treatment must exist for the group of like imported products as compared to the group of like domestic products.¹²² The AB did not conduct such a comprehensive comparison. The EC further underlined that it was not shown in the case that importers as a group had smaller market share than the group of domestic producers. Accordingly, the conclusion of the EC was that there was no basis to find less favourable treatment in the case.

¹¹⁹ See Panel Report EEC-Oilseeds I which stated that “the exposure of a particular product to risk of discrimination constitutes, by itself, a form of discrimination”(see para.11 of the Panel Report).

¹²⁰ However, the AB restates the Panel’s statement that as long as difference in costs does not alter the conditions of competition in the relevant market to the detriment of imported products, that fact itself should not be enough to conclude that the expense creates less favourable treatment for imported products (See AB Report *DR-Cigarettes* ,para. 98)

¹²¹ See Pauwelyn (2007), p.10; see also Cossy (2006), p. 28

¹²² See para. 87 of the Minutes of Meeting of the Dispute Settlement Body, WT/DSB/M/189, 17 June 2005

The elaborations of the AB on the “no less favourable” treatment standard in *DR-Cigarettes* call for further clarifications in future AB Reports. It remains to be unveiled and further discussed what the AB considers as factors or circumstances related/unrelated to the foreign origin of the product or factors dependant on the foreign origin of imported goods.¹²³ Furthermore, future practice will show if allowing factors unrelated to the foreign origin of the products to be taken into account will open the door for aims and effects test.¹²⁴ The AB should be criticized for its confusing discussion of the proper criteria to be employed in an Article III:4 inquiry into the “no less favourable” treatment standard and for not giving clear guidelines for future panels in this regard.

2.5. Mexico-Soft Drinks

The facts of the dispute are of interest because they reveal a typical case of de facto discrimination-the measures under review (soft drink tax, the distribution tax and the bookkeeping requirements) are facially origin-neutral but in practice disadvantage imports. The Mexican tax system was organized in a way that it created different regime for two groups of soft drinks and syrups based on whether they are sweetened with cane sugar or non-cane sugar sweeteners. The first group (drinks and syrups using cane sugar) was exempted from the tax while the second group (drinks and syrups using non-cane sugar sweeteners) was subject to the payment of the tax. A WTO Panel reviewed the Mexican measures for their consistency with Article III:4 of the GATT and examined closely whether the “no less favourable” treatment standard was satisfied by these measures.¹²⁵

The Panel noted that the Mexican measures created economic incentive for producers to use cane sugar as a sweetener and thus *significantly modified the conditions of competition* in favour of cane sugar and to the detriment of non-cane sugar sweeteners, according less favourable treatment to the latter.¹²⁶ The Panel further stressed, that although the regulation at issue was facially origin neutral, in fact it distinguished between domestic and imported products, because domestically produced sweeteners consist mostly of cane sugar and imported ones as a group-of non-cane sugar. On this basis, the Panel concluded that in practice the challenged measures “detrimentally affect the competitive situation of the imported sweeteners that the producers of soft drinks and syrups could have chosen..., when

¹²³ See Lester and Leitner (2005), p.8 The authors point out that in previous cases under Article III:2 the AB considered factors unrelated to the origin of the foreign product when establishing a violation of the national treatment obligation (for example in *Chile-Alcohol*-violation of Article III:2 was based on alcohol content).

¹²⁴ Cossy (2006), p.28

¹²⁵ Panel Report Mexico-Soft Drinks, paras 8.114-8.123

¹²⁶ See *ibid.*, paras 8.117-8.118

compared to that of the most widely available domestic sweetener (i.e. cane sugar)".¹²⁷ Consequently, the Panel found that the challenged measures accord less favourable treatment to imported non-cane sugar sweeteners than that accorded to like products of national origin in a manner inconsistent with Article III:4.

The analysis of the Panel reflects disparate impact approach to the examination of the "no less favourable" treatment standard as the Panel did not examine the regulatory purpose of the measures under review. The Panel analyzed the distribution of imported and domestic products across the regulatory subcategories of favoured and disfavoured products. It found that imported products fall predominantly in the disfavoured subcategory and domestic ones in the favoured subcategory.¹²⁸ The finding of the Panel regarding the less favourable treatment standard was not appealed before the AB.

2.6. EC-Biotech

The "no less favourable" treatment requirement was most recently analyzed with regard to a facially neutral measure by a WTO Panel in *EC-Biotech*.¹²⁹ Interestingly, the Panel in this case *started its examination of an alleged Article III:4 violation by an origin-neutral EC regulation, not with the likeness inquiry of biotech and non-biotech products but with the "no less favourable" treatment analysis.* The Panel stated that for the purposes of its analysis it will assume that the alleged measures constitute a "requirement" under Article III:4 and that it will focus firstly on the "no less favourable" treatment obligation instead of the "like products" element.¹³⁰

In its analysis of the "no less favourable" treatment standard the Panel strongly emphasized, in light of AB's interpretations in *EC-Asbestos* and *DR-Cigarettes*, that when alleging a violation of the national treatment obligation under Article III:4, the complaining party must show differential treatment explained by the foreign origin of the products at issue. It observed that the complainant Argentina failed to show treatment of biotech and non-biotech products which differed depending on their origin, i.e. that both domestic biotech and non-biotech products (the group of domestic products) were treated in a more favourable way than the group of like imported products.

¹²⁷ Panel Report Mexico-Soft Drinks, para. 8.121

¹²⁸ Interestingly, in the beginning of its analysis the Panel stated that it refrains from ruling whether such a finding is necessary for establishment of a claim of less favourable treatment under Article III:4.(see para 8.115 of the Panel Report)

¹²⁹ See Panel-Report EC-Biotech, para 7.2499 -7.2517

¹³⁰ Ibid., para. 7.2511

In the words of the Panel, showing that imported biotech products cannot be marketed while domestic non-biotech products can be marketed is not sufficient to raise a presumption that less favourable treatment is accorded to the group of like *imported* products than to the group of like *domestic* products.¹³¹ The Panel, therefore, *rejected a diagonal comparison* (limited to inquiry whether there are any foreign products in the disfavoured subcategory of like products that cannot be marketed and any domestic products in the favoured subcategory of marketable products) *in favour of aggregate comparison* between the groups of domestic and imported goods. The failure of Argentina to prove less favourable treatment based on the foreign origin of the products at issue, reasoned a finding that “no less favourable” treatment obligation under Article III:4 was not violated. Accordingly the Panel did not proceed with examination of the likeness issue and whether the regulation under review constitutes “requirement” under Article III:4.

From regulatory purpose perspective, the analysis of the Panel might be interpreted in a way that only differential treatment based on foreign origin as opposed to legitimate, neutral regulatory concerns, constitutes less favourable treatment under Article III:4.¹³² According to *Pauwelyn*, the Panel’s interpretation of the “no less favourable” treatment standard restates the implied requirement of “something more” than disparate impact on the group of imports as opposed to the group of domestic products.¹³³ It seems though, in my view, that the Panel did not address regulatory purpose in its analysis-it only began the exercise of comparison of the treatment accorded to the groups of imported and domestic products. It could not complete it because Argentina did not substantiate detrimental impact on imports as a whole based on origin.

The Panel Report in EC-Biotech was not appealed and the AB could not comment on the analysis of the “no less favourable” treatment standard and on the reverse inquiry which contrary to the traditional sequence examines firstly the “no less favourable” treatment obligation and then the likeness issue.

In conclusion, the tendency of developing more flexible and nuanced legal doctrines when origin-neutral regulations are under review had started in the GATT dispute settlement in the late 1980ies and early 1990ies.¹³⁴ The review of WTO dispute settlement practice reveals that

¹³¹ Ibid., para. 7.2514 emphasis in the original

¹³²Howse (International Economic Law and Policy Blog at http://worldtradelaw.typepad.com/ielpblog/2006/03/ecbiotech_a_tru.html, visited 26.09.2007).

¹³³ Pauwelyn (2007), pp.10-11

¹³⁴ See Farber and Hudec (1996), p.80

panels and the AB are still struggling to define a clear approach to the examination of the “no less favourable” treatment standard in de facto discrimination cases. The AB has been trying to refine the analysis of the “no less favourable” treatment standard when reviewing origin-neutral measures but had reached only halfway. Although, the AB seems to indicate that detrimental impact on imports might not be the only element to be established in order to reach a conclusion for violation of the standard, it did not set distinct criteria to guide panels in future cases in their inquiry into the “no less favourable” treatment requirement.

VII. Further thoughts and analysis

This section focuses on the **different conceptual perspectives** on GATT and the national treatment principle which influence the interpretation of the “no less favourable” treatment standard in Article III: 4. I will also discuss **the issues that arise from analysis of the standard which takes into account the purpose of the regulation under review.**

The national treatment obligation as integration clause

The differences in the preferred approach to the examination of the “no less favourable” treatment standard are rooted in different understandings of the national treatment obligation as integration clause.¹³⁵ One of the perspectives is that Article III creates *a general right of market access* for foreign goods. Consequently, any measure that impedes this general right (no matter protectionist or non-protectionist) violates the national treatment obligation and can be only justified under Article XX. This view resonates in the disparate impact approach to the “no less favourable” treatment requirement: once a competitive disadvantage caused by domestic regulation to imports is established, the “no less favourable” treatment condition is not satisfied and the general market access right is infringed. Article XX is then the recourse for justification of the measure if it meets one of the enumerated requirements. Furthermore, the national treatment obligation is created with a clear purpose in mind-**to ensure the security of tariff concessions.** As mentioned above, the Panel in *US-Auto Taxes* outlined that the Contracting parties could not be expected to negotiate tariff commitments if these could be frustrated by application of measures affecting imports. Which leads to the following question- does a WTO member expect that a tariff concession could be disrespected for a

¹³⁵ For account of integration concepts see Ortino (2004), pp.17-30 and Howse and Regan (2000), pp. 257, 276. By definition negative integration mandates rules about what policy measure countries may not adopt whereas positive integration is present where supranational laws prescribe what domestic policies must be adopted (see Trebilcock (2002), p.4). The national treatment principle is usually perceived in the literature as negative integration clause (see Horn and Mavroidis (2004), Steger (2002), p.143). For an opinion that the national treatment rule implies positive integration see Ortino (2004), pp17-24).

purpose not explicitly negotiated and set in the GATT? In this respect, the economic approach seems to address adequately the issue of security and clarity as regards negotiated tariff bindings.

The second perspective is that Article III creates a *negative right* that market access must not be restricted by discriminatory measures (origin-based or origin-neutral measures which purposefully disadvantage imports). In this context, when a measure is origin-neutral and non-protectionist it does not violate the national treatment obligation although it might have negative impact on imports. This view influences the regulatory purpose approach to the examination of the “no less favorable” treatment standard. The latter is satisfied when domestic regulations pursue genuine, legitimate and non-protectionist purposes even if they adversely affect imports. The two views to Article III and the GATT-*the general right of access view and specific right against discrimination position-represent the “deepest intuitive divide” in understanding the GATT*¹³⁶ and about the interaction that the national treatment rule sets between free trade¹³⁷ and other legitimate regulatory concerns. The choice of one of the approaches is a choice of priorities-when employing the economic approach, the rule is free trade and the exclusive list of legitimate regulatory purposes comes as an exception to the rule, the reverse logic is valid for the regulatory purpose approach-the rule is regulatory autonomy and freedom, which will be questioned only when purposefully protectionist.¹³⁸ Thus, the qualification of Article III:4 as market access provision or domestic regulation rule is crucial. While market access restrictions are prima facie prohibited by the GATT regardless of genuine non-protectionist concerns, domestic regulations are only prohibited when intentionally discriminatory.¹³⁹

The national treatment obligation as a rule of allocation of regulatory authority among states

Article III:4 as negative integration clause prescribes what countries must not do when adopting domestic regulations. Governments are left with the freedom to pass various measures as long as they do not accord less favourable treatment to imported goods in favour of domestic production. In other words, the importing state can exercise territorial authority over imports under the limitations of Article III:4. Therefore, the national treatment principle

¹³⁶ See Howse and Regan (2000), p.257, 276

¹³⁷ Depicting the general right of market access view as free trade perspective is not entirely correct in light of the purpose of the provision-securing tariff concessions -which seems to refer more to the expectations regarding what has been negotiated.

¹³⁸ Horn and Weiler (2004), p.144

¹³⁹ For distinction between market access and domestic regulation see Pauwelyn (2005). The author underlines that domestic regulation should not be regarded as market access restriction simply because it bans certain imports because as a result, regulatory freedom would be undermined.

embodied in Article III can be viewed as a rule of allocation of regulatory authority among states.¹⁴⁰ The interpretation that Article III:4 covers de facto discriminatory measures determines a limit on the regulatory authority of a government with regard to the treatment of imports. Thus, it makes the national treatment rule more intrusive into governments' regulatory authority while it still remains negative in its nature.¹⁴¹ The approach to the "no less favourable" treatment standard in de facto discrimination cases will determine the limits of regulatory authority of Member States-whether and to what extent disparate impact on imports could be allowed when a non-origin-based domestic regulation is pursuing non-protectionist objectives.

The national treatment obligation in light of the allocation of jurisdiction between national governments and the WTO

From a different angle, the approach to the "no less favourable" treatment standard is a matter of allocation of jurisdiction between national governments and the WTO. Disciplining domestic regulatory measures is a delicate task which requires finding the proper balance between the trade objectives of the WTO system and legitimate regulatory objectives of member states.¹⁴² The chosen substantial test to be proven when reviewing of domestic regulation by WTO adjudicators with regard to the "no less favourable" treatment requirement will determine the degree of interference of the national treatment rule with domestic regulatory autonomy. The proposed tests for examination of the "no less favourable" treatment standard reveal different extent of deference to governmental decisions by WTO adjudicators. Under the economic approach justification of disparate impact on imports is possible only on the policy grounds of Article XX. Thus governments' regulatory freedom is limited to the list of regulatory purposes enumerated in Article XX.¹⁴³ On the other hand, the regulatory purpose approach aims at protecting regulatory autonomy by bringing in virtually unlimited variety of non-protectionist regulatory concerns that will be taken into account when determining less favourable treatment. For WTO adjudicators, choosing the economic approach and deciding only on the values explicitly laid down in Article XX could be more comfortable from a legitimacy point of view than a discretionary analysis of the "no less favourable" treatment requirement with elaboration on unlimited non-explicit list of aims that could be invoked by a defendant under Article III:4.¹⁴⁴ From a different angle, the issue of

¹⁴⁰ See Trachtman (2007), p.634

¹⁴¹ Steger (2002), p. 141

¹⁴² See Hudec (1998), p.2

¹⁴³ *Verhose* opines that this restricts policy choices and is dangerous for governments regulatory autonomy (see Verhoosel (2004), p.51)

¹⁴⁴ See Horn and Weiler (2004), p.143

legitimacy could be less troublesome under the economic approach which offers more deference to democratic governance decisions.

The regulatory purpose analysis

One of the rationales for the regulatory purpose approach to the “no less favourable” treatment standard in de facto discriminatory cases is the fact that under review are regulations which are origin-neutral and therefore a more delicate balancing examination is needed compared to the one for overtly discriminatory measures. All regulatory measures do have impact on both domestic production and imports. A regulation that affects adversely imports today might equally hurt domestic production tomorrow. As *Hudec* observes, the fact that in some cases a measure causes negative impact to imports could be possibly a random result of unintended factors.¹⁴⁵ Accordingly, if such unintended and random market effects justify invalidating a regulation, a significant hurdle will be raised before regulatory decision-making. For example, if domestic producers adjust to new regulatory requirements while foreign producers do not, importers could easily attack the measure in the near future as violation of the national treatment principle.¹⁴⁶ This principle aims at securing equal competitive opportunities and creating regulatory environment which is impartial and does not create additional burdens for importers. Once an origin-neutral regulation is adopted and applied in a manner to maintain equal competitive opportunities, disproportionate trade effects on foreign goods due to random factors should not be a reason for striking down the measure as inconsistent with the “no less favourable” treatment standard. A regulatory purpose test analyzing the objective features of the regulation at issue will reveal whether its disproportionate impact is incidental to the regulation or is inherent to its structure and design. In this spirit, *Hudec* had consistently argued that panels are strongly affected by their perceptions of the motives of the regulator when reviewing origin-neutral measures.¹⁴⁷ His judgment was that “overt or not, consideration of motive seems inevitable...and a more explicit treatment of the issue by tribunals probably would be helpful”¹⁴⁸ because the parties can openly address the matter before the adjudicator. He condemned the rejection of the aims- and effects-test in determination of likeness, pointing out that the approach is there to stay, however “underground”.¹⁴⁹ The author, furthermore, saw the interpretation of the “no less favourable” treatment standard in a way to cover only more egregious measures that involve

¹⁴⁵ Hudec (1998), p.31

¹⁴⁶ See Fauchald (2003), p.476

¹⁴⁷ Hudec (1998) p.24, Farber and Hudec (1994), pp. 1439-40

¹⁴⁸ See Farber and Hudec (1994), pp. 1439-40

¹⁴⁹ Hudec (1998), p.25

little or no regulatory purpose as the “trick” to make Article III:4 more flexible and sensitive to regulatory choices.¹⁵⁰

Balancing the regulatory purpose against the affected interests of importers

Taking account of legitimate regulatory purposes in the analysis of the “no less favourable” treatment standard under Article III:4 raises additional conceptual problems before WTO adjudicators. After establishing disparate impact on imports, WTO panels will have to discern the regulatory purpose of the regulation under review by examining its objective structural features. If the conclusion is that the purpose of the regulator hidden in an origin-neutral form is to place foreign products at disadvantage, the measure will be found to violate the “no less favourable” treatment requirement of Article III:4. On the other hand, establishing non-protectionist regulatory purpose calls for additional considerations.

When a regulation is found to pursue bona fide purpose the adjudicator faces the question of **weighing** this purpose against the detrimental impact on imports caused by the measure. What should be the proper approach in such kind of weighing exercise?¹⁵¹

Verhoosel advocates a **necessity test** as part of assessing whether an origin-neutral regulation violates Article III:4, without recourse to Article XX.¹⁵² He opines that WTO Members perform in good faith their national treatment obligation set in Article III only when they try to avoid unnecessary adverse effects on imported products. Accordingly, de facto discrimination can be established only by examining the relation between the means (the measure) and the aim by employing a necessity test—a domestic regulation is de facto discriminatory if it is unnecessarily trade restrictive. If applying *Verhoosel’s* concept to the analysis of the “no less favourable” treatment standard, after finding of disparate impact and bona fide regulatory purpose, the adjudicator should evaluate if the measure is necessary for the achievement of the revealed legitimate regulatory aim. Requiring a necessity analysis as part of evaluating less favourable treatment in Article III:4 with regard to origin neutral measures means using the most stringent filter among the ones introduced by Article XX. It will lead in some circumstances where Article XX requires a less stringent link to be established (“related to” test) to a situation where the rule is stricter than the exception and where de jure discrimination (requiring the less stringent Article XX “related to” test) will be easier to justify than de facto discrimination (requiring a necessity test under Article III:4).¹⁵³

¹⁵⁰ Farber and Hudec (1994), p.1428

¹⁵¹ For analysis of the trade-off devices which address the conflict between trade and other values see Trachtman (1997). According to him such trade-offs devices include anti-discrimination rules, simple means-and-ends rationality tests, least trade restrictive alternative tests, proportionality tests, balancing tests and cost-benefit analysis.

¹⁵² See for extensive argumentation Verhoosel (2004)

¹⁵³ See Pauwelyn (2007), p. 13

A necessity test is not compatible with the view that the standard of review of origin-neutral measures should be released from the rigorous requirements of Article XX.¹⁵⁴ A more relaxed test is the one suggested by *Hudec*, which instead of examining if there is no less restrictive alternative to the regulation at issue will be able “to treat regulatory purpose in a more flexible manner by merely asking that governments demonstrate that the choice of a particular form was a **reasonable regulatory judgment** in the circumstances”.¹⁵⁵ Reasonable regulatory judgment could be evaluated, for example, based on the efficiency principle that *Matoo* and *Subramanian* put forward for justification of measures with incidental detrimental effect to imports.¹⁵⁶ According to the *efficiency principle*, if the regulator chooses to pursue an objective with an instrument other than the first-best instrument, the government should demonstrate why instruments above were not chosen. Therefore, even if the measure at issue is not the least trade restrictive (would not satisfy a necessity requirement), when the defendant presents a sound case why the first-best option was not feasible for adoption, a violation of the “no less favourable” treatment standard would not be established.

Another position, defended by *Pauwelyn*, suggests that in the analysis of the “no less favourable” treatment standard in de facto discrimination cases the nexus to be established between the regulation under review and its purpose should be flexible.¹⁵⁷ The author opines that such a test will allow panels to address the specificities of the origin-neutral measure in each case, the way the AB had applied different rigor regarding the necessity test under Article XX depending on the “relative importance of common interests or values” pursued by the measure under review. Thus, different approaches-applying the stringent test of necessity or less rigorous tests like “related to” - are left in adjudicator’s discretion in the examination of the link between the regulation and its purpose in the analysis of the “no less favourable” treatment requirement depending on the relative importance of the regulatory purpose.

I will offer a possible approach which is based on the view that regulatory purpose should be taken into account in light of the extent to which the geographic distribution of discriminatory effects caused by the measure is clearly to the disadvantage of products of certain foreign origin.¹⁵⁸ In other words, when the magnitude of the detrimental impact to imports is substantial, the regulatory purpose taken into account in Article III:4 analysis would not justify finding of “no less favourable” treatment. To take this one step further, a

¹⁵⁴ Hudec (1998), p.6 Hudec points out that the stringent requirements of Article XX seem more appropriate when examining de jure (deliberately) discriminatory measures and seems excessive for an origin-neutral regulation adopted without discriminatory intent (Hudec (1998) p.5)

¹⁵⁵ Hudec (1998), p.15, footnote 19, emphasis added. Hudec does not specify what would be the assessment whether a regulatory judgment is reasonable.

¹⁵⁶ See *Matoo and Subramanian* (1998), p.318

¹⁵⁷ See *Pauwelyn* (2007), pp.12-14

¹⁵⁸ See *Fauchald* (2003), p.478. *Ortino* opines that regulations that *predominantly* favour domestic production considered as a whole should be invalidated (see *Ortino* (2004), p.341).

defendant will then have recourse to Article XX to justify its measure under one of its limited options. In my view, this perspective reveals a different dimension of the analysis of the “no less favourable” treatment standard. While the perspective of having unlimited list of regulatory purposes to justify “no less favourable” treatment in Article III:4 itself, will make the use of Article XX possible only in de jure discrimination cases, in this version of the analysis **the most egregious situations where origin-neutral measures cause significant negative impact on imports will be justifiable only under Article XX, not Article III:4. When the magnitude of the disproportionate treatment is not substantial, a balancing analysis will take place within the inquiry of the “no less favourable” treatment requirement.** In this situation it might be plausible to suggest more deference to national regulators’ decisions based on the fact that the detrimental impact on imports is not substantial. A weak linkage test between the measure and the purpose could be employed (respecting national regulators’ judgment and autonomy) because the origin-neutral measure’s discriminatory effects are not of great magnitude and secondary to a legitimate non-protectionist purpose. On the other hand, significant detrimental impact on imports will result in limited recourse to the options for justification under Article XX.

In conclusion, the different perspectives to a possible weighing exercise when employing the regulatory purpose approach show different ways of balancing the conflict of values when establishing (no) less favourable treatment under Article III:4. All the proposals so far are just theoretical attempts until dispute settlements practice establishes a uniform understanding of the core requirement of Article III:4. Explicit treatment by the AB of the issue of the role of regulatory purpose in the analysis the “no less favourable” treatment standard is a requisite for effective application of the national treatment principle.

VIII. Concluding remarks

Defining the concept of de facto discrimination in the context of Article III:4 is informed and delineated by the approach to the “no less favourable” treatment standard. The interpretation of the standard determines whether de facto discrimination is limited to the notion of disparate impact to imports or whether it implies purposeful conduct by governments.

The broadly written language of the “no less favourable” treatment requirement does not set a specified rule. By choosing a standard, GATT drafters decided to leave to adjudicators the determination of its application. Dispute settlement practice has not given definitive answers to the proper approach to the examination of less favourable treatment in cases of implicit discrimination and has opened the door for differing understandings by trade analysts. The

varying perspectives could be probably reasoned by the lack of coherent view about the role of the national treatment obligation¹⁵⁹ which does not help solidifying the rule-based system promoted by the GATT/WTO. Adjudicators have been preoccupied with the issue of “likeness” when examining Article III:4 and necessary attention have not been devoted to the core of this provision-the “no less favourable” treatment standard.¹⁶⁰

Hudec observed that “there will always be some regulatory issues for which there is no alternative but a flexible or discretionary standard”.¹⁶¹ The “no less favourable” treatment standard seems to be one of these issues. So far the AB failed to give unambiguous guidelines for the interpretation of this Article III:4 requirement which is central to the understanding of the national treatment principle. Article 3:2 of the DSU mandates that the role of the WTO adjudicator is to provide security and predictability to the multilateral trading system through clarifying the existing provisions of the WTO agreements. The general language of Article III:4 needs further elaboration. Amending Article III:4 is not a possible task in the foreseeable future. The AB has to live up to its duty to fine-tune the interpretation of the Article in order to give clear directions to regulators for their day-to-day business of decision-making and crafting regulations, and to WTO panels which will be called to assess the consistency of these regulations with the provisions of the GATT.

¹⁵⁹ Horn and Mavroidis (2004), p.39

¹⁶⁰ For critique of the preoccupation of panels and the AB with the issue of likeness see Pauwelyn (2007). The author defends analysis of Article III:4 which starts with examination of the “no less favourable treatment standard and examines the “likeness” issue at a second stage.

¹⁶¹ Hudec (1993), p.270

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<i>Canada-Alcohol II</i>	Panel Report, <i>Canada - Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies</i> , adopted on 18 February 1992 (DS17/R - 39S/27)
<i>Canada – Periodicals</i>	Appellate Body Report, <i>Canada – Certain Measures Concerning Periodicals</i> , WT/DS31/AB/R, adopted 30 July 1997, DSR 1997:I, 449
<i>Chile – Alcoholic Beverages</i>	Appellate Body Report, <i>Chile – Taxes on Alcoholic Beverages</i> , WT/DS87/AB/R, WT/DS110/AB/R, adopted 12 January 2000, DSR 2000:I, 281
<i>DR – Cigarettes</i>	Panel Report, <i>Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes</i> , WT/DS302/R, adopted 19 May 2005, modified by Appellate Body Report, WT/DS302/AB/R
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