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GATT/WTO Constraints on National Regulation: Requiem for an Aim and Effects Test

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GATT/WTO Constraints on National Regulation: Requiem for an "Aim and Effects" Test

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I. Introduction

This article examines the role of the WTO dispute settlement process in policing domestic regulatory measures enacted by its member governments. "Domestic regulatory measures" are measures that a government characterizes as an exercise of its authority to regulate its domestic affairs.

In any federal regime dedicated to maintaining open markets—whether it is the GATT/WTO regime to liberalize trade between WTO member states, or the European Community (EC) regime to create free trade between EC member states, or the United States regime to maintain an open market among its fifty U.S. states—experience teaches that domestic regulations sometimes have a negative impact on trade. In some cases the negative trade effects are unintended, but on other occasions it has been clear that member governments are using domestic regulations to give local producers a competitive advantage. This tendency to misuse domestic regulatory measures for protectionist purposes is inevitable in a world where the commercial interests of foreign states have little or no representation in the political life of the state enacting the measure.

As a consequence, all such federal systems have found it essential to police member-state regulatory measures in order to prevent governments from imposing trade-restricting regulatory measures that are inconsistent with their trade objectives.

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The policing activity of domestic regulatory measures is a delicate task, one that requires reaching an acceptable balance between the trade objectives of the regime and the legitimate regulatory claims of member states. It is a particularly delicate task for the WTO, because although the WTO legal system was built upon a solid record of accomplishment laid down by the GATT legal system from 1948 to 1994, the WTO itself is a relatively new organization and its legal system contains several important new elements that have not yet been fully accepted by its member governments. It is with the particular delicacy of this task in mind that this paper will examine what the WTO dispute settlement system has done during its first three years to shape the legal rules that will determine how the WTO polices member-state regulatory activity.

The WTO inherited a basic structure of policing rules from the 1947 GATT agreement. The core GATT provisions for this purpose are the two-step set of rules in articles III and XX. Article III governs "internal" taxes and regulations—those taxes and regulations that apply to imports after the imports have cleared customs and entered domestic commerce. The general rule of article III is that internal taxes and regulations must treat imports no less favorably than like domestic products—an anti-discrimination rule known in GATT parlance as the "national treatment" principle. If a domestic regulatory measure is found to discriminate against imports in violation of article III, the regulating government can seek to justify that discrimination by proving that it is necessary to the achievement of some legitimate regulatory purpose. GATT article XX defines this exception. The text of the relevant parts of articles III and XX are reproduced in an appendix to this article.

This article organizes its discussion of the cases interpreting the GATT articles III and XX rules by focusing on the distinction between two types of "discrimination" in regulatory measures. The first is regulatory measures that discriminate explicitly by providing different standards for domestic and foreign goods or services. The second is regulatory measures that make no explicit distinction between foreign and domestic goods (called "origin-neutral"), but which have a disproportionate impact on foreign goods or services that is for some reason viewed as wrong or illegitimate. Recent WTO decisions call these two categories "de jure discrimination" and "de facto discrimination." European Community law uses the terms "distinctly applicable" and "indistinctly applicable" to describe these two types of discrimination.

This article devotes most of its attention to cases involving "origin-neutral" regulations that are claimed to be instances of de facto discrimination. The discussion of de facto discrimination is organized around a debate over a new approach to GATT articles III and XX, known as the "aim and effects" approach. The criteria of decision called for by the "aim and effects" approach raises the most important questions concerning how the WTO's policing function ought to be designed. Tracing the success or failure of the "aim and effects" approach is thus a good way to describe the key elements of the current approach being followed by the WTO in policing national regulatory measures—both under

GATT articles III and XX, and in other related areas such as the General Agreement on Trade in Services (GATS), the Standards Code, and the Agreement on Sanitary and Phytosanitary Measures (SPS Code).

II. Explicit (or De Jure) Discrimination

The typical case of explicit discrimination involves a law or regulation that imposes a different and more burdensome rule for foreign goods. Examples of explicit discrimination complained of in GATT disputes include an Italian consumption subsidy paid only on the purchase of Italian farm tractors,[1] a U.S. internal tax on petroleum where the rate on foreign petroleum was a few cents higher than the tax on U.S. petroleum,[2] and a special and more onerous U.S. patent-enforcement procedure applicable only to claims of infringement against foreign products.[3] The explicitly different treatment of foreign products constitutes a wrong, of course, only when it has a more burdensome impact on foreign goods than on domestic goods. Cases of explicit discrimination stand out because the explicitly different treatment is viewed as evidence that discrimination against foreign goods is a deliberate policy.

A. More Severe Rules for Explicitly Discriminatory Measures?

Because of its deliberate character, explicit discrimination is likely to cause a greater-than-normal degree of opposition, leading one to look for legal doctrines that treat such measures with exceptional severity. Both U.S. and EC jurisprudence seem to contain more rigorous rules for measures involving explicit discrimination. Under U.S. Dormant Commerce Clause jurisprudence, for example, it has often been said that cases of explicit discrimination are "per se unconstitutional," a phrase that suggests that it will be next to impossible to find any regulatory justification for them.[4] Under EC law, the basic Directive applying the article 30 prohibition against quantitative restrictions and equivalent measures makes a distinction between explicitly discriminatory measures and those which are "origin-neutral," stating a less rigorous "proportionality" standard for the latter.[5]

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1. Italian Discrimination Against Imported Agricultural Machinery, Oct. 23, 1958, GATT B.I.S.D. (7th Supp.) at 60 (1959).

2. United States—Taxes on Petroleum and Certain Imported Substances, June 17, 1987, GATT B.I.S.D. (34th Supp.) at 136 (1988).

3. United States—Section 337 of the Tariff Act of 1930, Nov. 7, 1989, GATT B.I.S.D. (36th Supp.) at 345 (1990).

4. *See, e.g.*, City of Philadelphia v. New Jersey, 437 U.S. 617 (1978). Although explicit discrimination clearly does receive a higher kind of "strict scrutiny," the U.S. Supreme Court has occasionally been willing to uphold discriminatory regulations where the discrimination could be shown to be necessary for health and safety reasons. *See* Maine v. Taylor, 477 U.S. 131 (1986).

5. Commission Directive No. 70/50, art. 2-3 (Dec. 22, 1969). For a summary description of the somewhat uneven case law treatment of this distinction, *see* Josephine Steiner, Textbook on EC Law 98-102 (4th ed. 1994).

To date, GATT/WTO legal texts have not created separate rules for explicitly discriminatory regulatory measures. For example, GATT article XX, which provides that measures otherwise in violation may be justified if they are needed to carry out legitimate social policies, does not make any distinction between explicit discrimination and de facto discrimination. Nor has such a distinction been made in interpreting article XX.

Looking at the rather demanding substance of some of these apparently uniform GATT rules, one is moved to ask whether they might not have been developed with explicit discrimination in mind. For example, article XX's policy justifications are quite limited, reserved to what might be called the most compelling sort of regulatory interests. Likewise, the interpretation of article XX has made its requirements exceptionally demanding. The burden of proof is on the country claiming the exception, and it must be shown that there is no less burdensome alternative to the measure in question. These standards seem more appropriate for a measure involving deliberate discrimination, and seem a bit excessive for an ordinary, facially neutral regulatory measure with no evidence of discriminatory intent.[6]

Another kind of special rigor that seems appropriate primarily for cases involving explicit discrimination is the sometimes minimal degree of actual or potential harm that is accepted in finding a violation of article III. For example, the Section 337 case found that the elements of the special 337 procedure would constitute less favorable treatment even if they were merely capable of being burdensome to any one foreign supplier, no matter how much they might benefit other foreign suppliers.[7] Although the panel never suggested that the explicitly discriminatory character of the regulation in this case was relevant to this rather rigorous standard of harm, in other legal systems one would not expect to see such rigorous standards applied in cases involving "origin-neutral" measures.

Historically, GATT has been principally occupied with border measures and explicitly discriminatory measures, with de facto discrimination only becoming a major concern relatively recently.[8] It is interesting, for example, that none of

6. Under European Community law, commentators have observed that the analogue to GATT article XX, article 36 of the Rome Treaty, has been viewed as imposing a more strict test of regulatory justification appropriate for explicitly discriminatory measures, whereas "origin-neutral" measures are tested under a more generous "rule of reason" approach to regulatory justification. *See* STEINER, *supra* note 5, at 98-99.

7. United States—Section 337 of the Tariff Act of 1930, *supra* note 3, paras. 5.14-.16. *See also* United States—Denial of Most-Favoured-Nation Treatment as to Non-Rubber Footwear from Brazil, June 19, 1992, GATT B.I.S.D. (39th Supp.) at para. 6.10 (1993).

8. Of the first 207 legal complaints filed in GATT between 1948 and 1990, only a small handful involved claims of de facto discrimination by internal regulatory measures. *See generally* ROBERT HUDEC, ENFORCING INTERNATIONAL TRADE LAW: THE EVOLUTION OF THE MODERN GATT LEGAL SYSTEM app. pt. I, 373-585 (1993) (summary of cases). To the author's knowledge, the first affirmative ruling sustaining a claim of de facto discrimination with regard to an internal measure was the 1987 panel decision in Japan—Customs Duties, Taxes and Labeling Practices on Imported Wines and Alcoholic Beverages, Nov. 10, 1987, GATT B.I.S.D. (34th Supp.) at 83 (1988).

the main cases establishing the rigorous interpretation of GATT article XX involved de facto discrimination.[9]

If it is true that the substance of current GATT rules has been influenced primarily by violations involving explicit discrimination, one should expect to see some pressure for relaxing the more rigorous elements of those rules in cases involving de facto discrimination. Several of the developments discussed in later sections of this paper appear to provide support for this hypothesis. The "aim and effects" approach can be viewed as an effort to relax the rigor of articles III and XX with regard to "origin-neutral" regulatory measures. Likewise, both the Standards Code and the SPS Code, which apply primarily to "origin-neutral" measures, also seem to adopt elements of the "aim and effects" approach, arguably for the same reason. All three of these examples are discussed in greater detail in subsequent sections.

The one WTO case decided to date that involves an explicitly discriminatory internal regulatory measure is the *Reformulated Gasoline* decision.[10] The gasoline product standard at issue in the case set a different and potentially more onerous standard for foreign gasoline suppliers, discrimination that was clearly in violation of GATT article III. The panel and the Appellate Body both affirmed the general doctrine of strict construction for article XX defenses, but neither attached any particular significance to the explicit nature of the discrimination in this regard. The decision is discussed in greater detail in Section III.C. below.

III. Origin-Neutral (or De Facto) Discrimination

The term "de facto discrimination" refers to regulatory measures that do not explicitly distinguish between foreign and domestic products, but which nevertheless impose burdens on foreign products that are considered wrongful or illegitimate. The central issue with regard to de facto discrimination is the criteria according to which the burdens on foreign products are determined to be wrongful.

The central finding required for a violation of GATT article III:2 (internal taxes) or article III:4 (other internal regulations) is the conclusion that imports are being treated less favorably than domestic products. For a regulatory measure to produce any difference in treatment at all, the regulation must divide products subject to the regulation into two or more categories. The finding of discrimination ultimately rests on a finding that the product distinction is illegitimate. Distinctions based on national origin, of course, are *a priori* illegitimate. For product distinc-

9. *See* HUDEC, *supra* note 8, at 408 (list of cases interpreting article XX).

10. World Trade Organization: Report of the Panel in United States—Standard for Reformulated and Conventional Gasoline and Like Products of National Origin, WT/DS2/R, Jan. 29, 1996, 35 I.L.M. 274 [hereinafter Reformulated Gasoline Panel Report]; World Trade Organization Appellate Body: Report of the Appellate Body in United States—Standards for Reformulated Conventional Gasoline, WT/DS2/AB/R, May 20, 1996, 35 I.L.M. 603 [hereinafter Appellate Body Report on Reformulated Gasoline].

tions not based on national origin, GATT article III provides two other grounds of invalidity.

A. The Product-Process Doctrine

Although only recently recognized in GATT case-law,[11] it has long been assumed that the only kind of product distinction that can be recognized under article III is a distinction based on the qualities of the products themselves—product distinctions phrased in terms of product qualities themselves, or else, in terms of other characteristics that indirectly govern product qualities, such as characteristics of the production process (slaughterhouse cleanliness) or characteristics of the producer (possession of a license certifying requisite skills). Under this so-called "product-process" doctrine, product distinctions based on characteristics of the production process, or of the producer, that are not determinants of product characteristics are simply viewed as *a priori* illegitimate. Product distinctions of this kind cannot be used as a justification for different treatment of foreign and domestic goods. When dealing with a product distinction based on such non-product criteria, WTO panels are instructed to ignore the non-product criteria and to determine whether any difference of treatment between foreign and domestic products can be justified under the other test of legitimacy provided in article III—the "like product" test and its allied doctrines.

Although the "product-process" doctrine is obviously a major determinant of the kind of domestic regulatory measures GATT/WTO law will or will not permit, the space constraints imposed on this paper make it impossible to cover that aspect of the topic together with all of the other elements. Since the other side of article III discrimination law, the "like product" test, has undergone some rather significant development under the WTO dispute settlement process, the author has chosen to concentrate on those developments and to defer discussion of the "product-process" doctrine to a later publication.

B. The "Like Product" Standard

1. *The Traditional Approach*

The second ground on which GATT article III allows governments to challenge the validity of "origin-neutral" product distinctions is the "like product" con-

11. GATT Panel decisions employing the doctrine were: United States—Restrictions on Imports of Tuna (Tuna/Dolphin I), GATT B.I.S.D. (39th Supp.) at 155 (1993) (unadopted); *United States—Restrictions on Imports of Tuna (Tuna/Dolphin II)*, DS29/R (June 16, 1994) (unadopted); United States—Measures Affecting Alcoholic and Malt Beverages, June 19, 1992, GATT B.I.S.D. (39th Supp.) at 208 (1993); *United States—Taxes on Automobiles*, WT/DS31/R (Oct. 11, 1994) (unadopted). Two WTO panel decisions discussed the doctrine with approval, although in neither case did the Appellate Body expressly rule on it. *See* Reformulated Gasoline Panel Report, *supra* note 10, paras. 6.11-.13; *Canada—Certain Measures Concerning Periodicals—Report of the Panel*, WT/DS31/R, paras. 5.24-.25 (Mar. 14, 1997) [hereinafter Panel Report on Canadian Periodicals] (visited July 26, 1998) <http://www.wto.org/wto/online/ddf.htm> [hereinafter WTO Website].

cept. The central principle is that internal tax or other regulatory measures must treat all "like products" the same—or, to be more precise, such measures cannot treat imports less favorably than the "like" domestic products. Thus, if a government wishes to challenge an "origin-neutral" product distinction that is imposing greater burdens on its exports than on competing domestic products, it will normally try to argue that its exports are "like" some or all of the domestic products that are being treated more favorably. If that conclusion is accepted, the regulating government must accord those exports treatment no less favorable than that accorded to the "like" domestic products.

With regard to internal taxes, but not other internal regulations, article III offers a second line of attack. The second sentence of article III:2 states, in effect, that differential taxes based on product distinctions between "not-like" but directly competitive products are also invalid if the tax difference results in protection of domestic production. The second sentence of article III:2 plays an important role in the legal developments discussed below.

The criteria used to distinguish "like" from "not like" products have never been sharply defined in GATT law. This has been due in part to the fact that the "like product" concept is employed in a variety of different GATT provisions that serve a variety of different purposes, with the result that individual precedents often differ because of their different contexts.[12] Even when inquiry is limited to cases applying the "like product" concept under the same legal provisions, such as article III, one finds that GATT legal rulings seem to be content with applying a series of factors that emphasize different, and not necessarily consistent, kinds of "likeness." Most cases test the "likeness" of two products by looking to factors such as (1) their physical similarity, (2) whether they are separated or classified together in customs tariffs around the world, (3) whether consumers treat them as commercially interchangeable in the marketplace, and (4) whether they have the same end uses.[13] Rather than trying to build up a consistent set of decisions applying these factors, GATT tribunals have hastened to insist that such analysis must be done on a case-by-case basis; in effect, saying that they are not required to supply any general definitions that reconcile one decision with another.

12. For example, the "like product" concept employed in article I:1 deals primarily with product distinctions in tariffs where (1) protection is an acknowledged purpose, and (2) fine product distinctions have traditionally been accepted as an appropriate means for denying the benefit of tariff concessions to those "free riders" who refuse to pay with reciprocal concessions. By contrast, the "like product" concept employed in article III operates in a legal context where (1) the policy is to avoid protection entirely, and (2) fine product distinctions have traditionally been a badge of wrongful, "discriminatory" intent.

13. *See, e.g., Japan—Taxes on Alcoholic Beverages—Report of the Panel*, WT/DS8/R WT/DS10/R WT/DS11/R, para. 6.21 (July 11, 1996), at WTO Website, *supra* note 11 [hereinafter Alcoholic Beverages Panel Report]. Most GATT/WTO panel decisions have cited a 1970 GATT Working Party Report as the source of this list of factors. Border Tax Adjustments, Dec. 2, 1970, GATT B.I.S.D. (18th Supp.) at 97 (1972).

Generations of scholars and students have found it difficult to explain what kinds of policy goals this package of "like product" criteria are designed to foster. To be sure, "likeness" generally indicates that two products are competitive, and it is clear that the relative degree of competitiveness between two products will determine the economic effects that differential treatment will have upon the less favored product. However, a mere listing of these factors gives no guidance as to which of the several possible degrees of competitiveness they suggest is meant to be required, or why. Moreover, some parts of the "like product" analysis appear to be concerned with product characteristics that do not pertain to competitiveness at all—for example, the additional characteristics (whatever they may be) that distinguish the "like" products referred to in the first sentence of article III:2 from the "directly competitive" products referred to in the Ad Note to the second sentence of article III:2. It is difficult to understand why important issues of regulatory policy should turn on these sterile concepts of physical likeness. Finally, whereas in most regulatory systems the issue of discrimination is usually addressed by asking whether a difference of treatment is rationally related to a legitimate regulatory purpose, the traditional definition of "like product" appears to have no purpose-oriented criteria at all.

As a consequence, there has always been some concern that the "like product" test would fail to prohibit some product distinctions that should be prohibited, and prohibit some product distinctions that should not be prohibited. The latter problem of over-inclusiveness is, to some degree, correctable to the extent that desirable product distinctions can be justified under GATT article XX as being necessary to the achievement of important social policies. However, as noted earlier, article XX imposes rather severe limitations on this type of regulatory justification. While such burdensome requirements may be appropriate for measures that are explicitly and purposefully discriminatory, it is more difficult to explain why governments must meet such high standards to justify "origin-neutral" regulatory measures which are guilty of nothing more than transgressing certain abstract notions of "likeness."

2. *The "Aim and Effects" Approach*

Recently, an effort was made to redefine the "like product" concept of GATT article III in order to bring the criteria governing WTO legal restraints on domestic regulatory measures closer to recognized GATT policy goals. In the 1992 *Malt Beverages* case,[14] Canada challenged several product distinctions in U.S. state and federal regulatory laws affecting alcoholic beverages on the ground that the relevant Canadian products were "like" certain more favorably treated U.S. products. Thus, they had to be treated like them. The panel in that case chose to interpret the "like product" concept by considering, in addition to the various

14. United States—Measures Affecting Alcoholic and Malt Beverages, *supra* note 11, at 208.

"likeness" factors, the policy objective stated in paragraph 1 of article III. The objective states that internal regulatory measures (both taxes and non-tax regulations) "should not be applied . . . so as to afford protection to domestic production."[15] The panel interpreted these words to mean that legitimacy of internal taxes and regulations should be determined primarily on the basis of their purpose and their market effects, i.e., whether they have a bona fide regulatory purpose and whether their effect on conditions of competition is protective. This new approach would ultimately become known as the "aim and effects" approach.

Two issues in the *Malt Beverages* case illustrate the new approach to the "like product" concept. The first involved a Mississippi tax on wine which had imposed different tax rates according to the type of grape from which the wine had been made, imposing a lower tax on wine made from the type of grape suitable to warmer climates that was grown by Mississippi vintners.[16] When the United States was unable to provide any bona fide regulatory purpose for making the distinction between grape varieties, the panel was able to conclude that the only evident purpose of the product distinction was to protect local producers. Since the effect of the tax differential was protective, the panel was able to conclude that the product distinction had both the "aim and effect" of protecting domestic production. Based largely on these findings,[17] the panel report concluded that the two categories of wine were "like products" which had to be treated the same.

The second example involved several state regulations on beer which contained more onerous point-of-sale restrictions on beer with alcohol levels exceeding 3.2 percent.[18] Canada argued that all beer was a "like product." The panel began by noting several "likeness" factors both for and against Canada's claim. Instead of ruling on the basis of those factors alone, the panel went on to analyze the regulatory purposes and competitive effects of the regulations. The panel was able to identify several reasons of social welfare policy, and in some cases revenue-collection, for making this product distinction. It also concluded that the product distinction did not create adverse conditions of competition for Canadian brewers because Canadian brewers produced both types of beer. On the basis of this more extended analysis, the panel concluded that, despite their physical similarity, the two kinds of beer were "not like," thereby validating the regulatory distinction between them.

This new "aim and effects" approach was obviously not a finished legal standard. It did not define all the variations of purpose and market effect which might be involved in any challenged regulatory measure, much less how various

15. *Id.* para. 5.25.

16. *Id.* paras. 5.23-.26.

17. Although the panel did mention the evident likeness of the various wines, by far the largest part of its analysis was devoted to the analysis of aims and effects.

18. *Id.* paras. 5.70-.77.

combinations of these and other elements should be balanced against each other. Cases where the various factors point in different directions (for example, where a product distinction has a bona fide regulatory purpose but also has protective market effects) would obviously require more complex balancing that would have to be worked out in subsequent litigation.

Nonetheless, the differences between the new "aim and effects" approach and the traditional "like product" test were fairly clear. The "aim and effects" approach offered two principal improvements to the traditional analysis. First, it consigned the metaphysics of "likeness" to a lesser role in the analysis, and instead made the question of violation depend primarily on the two most important issues that separate bona fide regulation from trade protection—the trade effects of the measure, and the bona fides of the alleged regulatory purpose behind it. Second, by making it possible for the issue of regulatory justification to be considered at the same time the issue of violation itself is being determined, the "aim and effects" approach avoided both the premature dismissal of valid complaints on grounds of "un-likeness" alone, and excessively rigorous treatment given to claims of regulatory justification under article XX whenever the two products were ruled "like."[19] This second improvement had the added advantage of bringing article III analysis in line with the analytic framework of the new Standards Code and SPS Code, both of which had adopted a one-stage test of violation where the question of regulatory justification is treated simultaneously with the issue of protective trade effects.

Unfortunately, the new "aim and effects" approach did not fit very well with the relevant GATT texts on this issue—particularly GATT articles III:2 and XX. The first textual problem was that the "aim and effects" approach had been offered as a way of analyzing "like product" claims under the first sentence of article III:2. Although the "aim and effects" analysis was based on the general policy stated in article III:1, the first sentence of article III:2 contains no textual reference to the policy of article III:1. However, the second sentence of article III:2, with its Ad Note, expressly calls for application of the article III:1 policy with respect to the particular kind of tax differential covered by that sentence. The express direction contained in the second sentence of article III:2 made it quite difficult to argue that the very same direction could be read into the first sentence by implication. The second textual problem was that the "aim and effects" approach rendered article XX virtually redundant. That is, if panels were required to consider the regulatory purpose of a measure (its "aim") when deciding the issue of violation under article III, all of the regulatory justifications provided in article XX would already have been considered and disposed of in

19. For example, instead of asking for proof that there is no less restrictive alternative to the challenged form of regulation, WTO panels might 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.

the first-stage determination of violation, leaving no reason to conduct the same inquiry again under article XX.

The new "aim and effects" approach was applied and elaborated in a second GATT panel decision in a 1994 case called *United States: Taxes on Automobiles*.[20] The case involved U.S. regulations that rested on product distinctions between automobiles—a section of a larger luxury tax law which distinguished between autos on the basis of their value, and a conservation/pollution regulation that distinguished between automobiles according to their gasoline consumption per mile. These product distinctions bear more heavily on the larger and more expensive type of automobiles that constitute the predominant share of European automobile exports to the United States, and there was some evidence that the protective effects of these measures had not been ignored during the reenactment of one of the taxes. The panel nonetheless found both regulations served a bona fide regulatory purpose, and found the competitive effects neither clear enough nor "inherent" enough[21] to be classified as "protective." On this basis, the panel concluded that, despite the physical similarities of the products in question, these product distinctions were permissible—or in article III parlance, that the various classifications of autos were not "like products."

The European Community took vigorous exception to the panel decision in the *Auto Taxes* case. It blocked adoption of the panel report and set out to challenge the "aim and effects" approach at the earliest possible occasion. The new WTO dispute settlement procedure provided the European Community with the opportunity. The first WTO case to raise the issue was the case entitled *Japan—Taxes on Alcoholic Beverages*.[22]

3. *WTO Rulings on the "Aim and Effects" Approach*

The *Japan—Alcoholic Beverages* case involved a three-country complaint by the European Community, the United States, and Canada alleging that certain alcoholic beverage taxes in Japan violated article III:2 in two respects: (1) they imposed taxes on certain foreign beverages which were higher than the taxes upon "like" domestic products in violation of the first sentence of article III:2;

20. WT/DS31/R (Oct. 11, 1994) (unadopted).

21. The question of "inherency"—whether the disproportionate effects on foreign goods are inherent in the nature of the regulation—is clearly an important factor in distinguishing incidental from more deliberate trade effects, *see infra* text at notes 38 and 43 below. However, the panel's application of that factor to the facts of the case was subject to criticism. *See* Aaditya Mattoo & Arvind Subramanian, *Regulatory Autonomy and Multilateral Discipline: The Dilemma and a Possible Resolution*, 1 J. INT'L ECON. L. (Apr. 1998).

22. The panel report on the three complaints is a single document bearing three document numbers, WT/DS8/R, WT/DS10/R, and WT/DS11/R. *See* Alcoholic Beverages Panel Report, *supra* note 13. Likewise the Appellate Body report also bears three document numbers, WT/DS8/AB/R, WT/DS10/AB/R/, and WT/DS11/AB/R. *See Japan—Taxes on Alcoholic Beverages—AB-1996-2—Report of the Appellate Body, at* WTO Website, *supra* note 11 [hereinafter Appellate Body Report on Alcoholic Beverages].

and (2) they imposed higher taxes upon a broader group of foreign beverages "so as to afford protection" to directly competitive domestic products in violation of the second sentence of article III:2. In the course of arguing the case to the panel, the European Community delivered a long and carefully articulated attack against the "aim and effects" approach, asking the panel to return to the more traditional "like product" test instead. The European Community cited the textual arguments mentioned above, and also took very strong exception to the effort to identify the aim or purpose of regulatory measures, particularly to the extent it involved judgments about the actual motivation of those who enacted the measure in question. The United States, although seeking the same result as the European Community, joined Japan in defending the "aim and effects" approach by asking the panel to apply it in this case.[23] The United States stressed the lack of policy relevance of the traditional "like product" criteria, pointed out that literal application of the likeness test created its own textual anomalies,[24] and called attention to the consistency between the "aim and effects" approach and the approach taken by the new Standards Code and SPS Code.

The panel, and the Appellate Body on appeal, both rejected the "aim and effects" approach to the "like product" test of the first sentence of article III: 2. They cited the textual problems with applying the "aim and effects" approach to the first sentence including both the interplay of the first and second sentences of article III:2 and the potential redundancy of article XX. The Appellate Body placed particular emphasis on the fact that, in contrast to the explicit command in the second sentence of article III:2, the first sentence contained no explicit instruction to apply the general policy stated in article III:1. The Appellate Body treated this distinction as evidence suggesting that the drafters of article III:2 viewed the very simple (and very strict) "like products" test in the first sentence of article III:2 as the means by which they wanted to carry out the general policy of article III:1 when tax distinctions between nearly identical products were involved. The Appellate Body narrowed the scope of the first sentence by announcing that the term "like product" should be given a very narrow reading in that provision.

Having thus refused to apply the "aim and effects" approach to the "like product" test in the first sentence of article III:2, the panel and the Appellate Body next had to decide whether to follow that approach, or something like it, with regard to the separate test stated in the second sentence of article III:2. It

23. Although Canada remained largely on the sidelines, it did indicate a preference for the EC position. *See* Alcoholic Beverages Panel Report, *supra* note 13, para. 4.23.

24. The United States pointed out that the two sentences of article III:2 prohibited tax distinctions between "like products" *and* (protective) tax distinctions between directly competitive products, whereas article III:4, covering non-tax internal regulations, prohibited only distinctions between "like products." Therefore, unless "like product" were to have a far broader scope in article III:4 than in article III:2, GATT article III would have provided much broader protection against discriminatory tax distinctions than against discriminatory regulatory distinctions.

will be recalled that the second sentence, in dealing with tax distinctions between groups of not-like-but-directly-competitive products, calls for panels to determine whether the tax distinction violates the policy of article III:1—the exact policy statement upon which the "aim and effects" approach itself was based. The question was whether the panel or the Appellate Body would accept the invitation to apply something like an "aim and effects" test once they had been given this textual authority.

The panel stood firm on its view that panels should not inquire into the purpose or motivation behind domestic regulatory measures, and thus interpreted the reference to the policy of article III:1 as calling only for an analysis of whether the measure had a protective effect on competitive conditions—in essence, an "effects" test with no "aim" test.[25]

The Appellate Body ruled that the second sentence of article III:2 required something more than just an analysis of protective effect. The Appellate Body took pains to make clear that it was not talking about the analysis of regulatory purpose called for by the "aim" in "aim and effects." However, the "aim" analysis it seemed most concerned with rejecting was a search for the actual motivation behind a measure, repeatedly stressing that the intent of legislators or regulators was irrelevant. The additional element the Appellate Body called for was an investigation of something called "protective application," a concept that for all the world looked like an objective analysis of regulatory purpose. The Appellate Body called attention to the fact that the policy statement in article III:1 had stated that internal measures "should not be applied . . . so as to afford protection to domestic production." Focusing on the word "applied" the Appellate Body said:

> We believe it is possible to examine objectively the underlying criteria used in a particular tax measure, its structure, and its overall application to ascertain whether it is applied in a way that affords protection to domestic products.
>
> Although it is true that the aim of a measure may not be easily ascertained, nevertheless its protective application can most often be discerned from the design, the architecture, and the revealing structures of a measure. The very magnitude of the dissimilar taxation in a particular case may be evidence of such a protective application, as the Panel rightly concluded in this case.[26]

The quotation makes a great deal more sense if one substitutes the word "purpose" for "application." Indeed, neither the Appellate Body's insistence on different words nor its insistence on objective analysis serve to mark a clear distinction between its "protective application" concept and the "aim and effects" analysis. Under at least some understandings of the "aim and effects" approach, such as the one argued by the United States in this case,[27] it could be

25. Alcoholic Beverages Panel Report, *supra* note 13, para. 6.33.
26. Appellate Body Report on Alcoholic Beverages, *supra* note 22, at 18.
27. *See* Submission by the United States (Appellant), Aug. 23, 1996, at 24.

argued that the analysis of "aim" was never meant to go beyond an objective analysis of purpose in the first place.

The decision in the *Japan—Alcoholic Beverages* case itself did not make clear just how far the Appellate Body's rejection of the "aim and effect" approach would be carried. Both the panel and Appellate Body rulings relied to a very considerable degree on the very peculiar, almost unique, architecture of the two sentences of article III:2. It was at least possible that the Appellate Body, appreciating the sterility of the traditional "like product" test, might be willing to consider employing some version of the "aim and effects" approach, such as its "protective application concept" in other parts of article III where the text permitted more interpretive freedom. In particular, article III:4—the other main pillar of article III, which prohibits discrimination against foreign products in non-tax internal regulations—did not have the restrictive two-sentence architecture of article III:2, and could plausibly be interpreted as calling for a different approach to carrying out the policy stated in paragraph 1 of article III.

This unanswered question was tested very promptly by another WTO panel. In the 1997 decision in the *Bananas III* case, a WTO panel actually did propose an interpretation of article III:4 which incorporated the "protective application" analysis the Appellate Body had called for in applying the second sentence of article III:2.[28] The panel did not present a very elaborate analysis in support of this approach. In just a few sentences, it explained (1) that the Appellate Body had stated that the general policy of article III:1 informs the other provisions of article III, (2) that article III:1 announces a general principle that internal measures should not be applied "so as to afford protection," and (3) that the Appellate Body had said that protective application "can most often be discerned from the design, the architecture and the revealing structure of the measure."[29] The panel then ruled, in conclusory fashion, that after having investigated these factors it had found that the EC banana regime had been applied so as to afford protection.

The Appellate Body rather sharply rejected the panel's initiative. Without pausing to debate the possible reasons for treating article III:4 differently from article III:2, the Appellate Body reminded the panel that, like the first sentence of article III:2, the text of article III:4 contains no explicit reference to the general principles of article III:1. On that basis alone, the Appellate Body ruled that it would be inappropriate for a panel to make any further inquiry about "protective application" when applying the "like product" test of article III:4.[30]

28. *European Communities—Regime for the Importation, Sale and Distribution of Bananas—Complaint by the United States—Report of the Panel*, WT/DS27/R/USA, paras. 7.181, 7.249 (May 22, 1997), *at* WTO Website, *supra* note 11 [hereinafter Bananas Panel Report].

29. *Id.* para. 7.181.

30. *European Communities—Regime for the Importation, Sale and Distribution of Bananas—AB-1997-3*, WT/DS27/AB/R, paras. 215-16 (Sept. 9, 1997), *at* WTO Website, *supra* note 11 [hereinafter Appellate Body Report in Bananas Case].

If there were any doubt about whether the Appellate Body intended to confine its "protective application" concept to texts that expressly authorize such inquiry, that doubt was erased several pages later in same *Bananas III* opinion when the Appellate Body refused to apply that concept to the National Treatment provision of the new WTO GATS agreement because, like GATT article III:4, the GATS National Treatment article contains no explicit reference to a text similar to the purpose statement in GATT article III:1. The *Bananas III* ruling is discussed in more detail in Section III.D. of this paper.

The Appellate Body's responses to these various efforts to employ an "aim and effects" approach suggests an unusually strict attachment to the exact words of the relevant GATT or GATS provisions. One might understand such textual literalism in defense of legal criteria believed to be correct and appropriate, but it is disappointing to see the Appellate Body following such a literalist approach when it results in extending the empty formalism of the traditional "like product" analysis. The disappointment becomes even greater when it is recognized that the issues in these cases go to the very core of the WTO's policing function over domestic regulatory policy—in some respects the most important element of its legal character. We know from the experience of the United States Supreme Court and the European Court of Justice, both of whom are called upon to make very similar rulings, that these are extremely sensitive and difficult issues. Developing an accepted and effective jurisprudence in this area requires a high degree of sensitivity to the balance of interests involved, and a high degree of creativity in fashioning answers that provide a satisfactory balance. It is not encouraging to think that the Appellate Body has launched itself upon this delicate and sensitive task bound hand and foot to the words of an old, and often badly drafted, instrument.

It may be the very sensitivity of this area, however, that explains the choices made by the Appellate Body thus far. As noted earlier, the fact that this policing activity intrudes upon domestic regulatory sovereignty leaves the new WTO legal institutions particularly exposed to damaging criticism from national governments that do not yet fully accept the WTO's authority in this area. Recognizing this very exposed position, the Appellate Body may well have concluded that the safest refuge from political criticism was to stay as close as possible to the shelter of the legal texts accepted by governments. If that was the reason, one can question whether the price that was paid for acceptance in the short run may not have been too high in terms of its long term effects on GATT legal doctrine. However, as is often said in reply to such criticism, in order to get to the long run at all, one must first survive the short run.

4. *Where Does the "Like Product" Test Stand Today?*

A final appraisal of the Appellate Body's response to the "aim and effects" approach would be incomplete without looking at what is likely to happen in "like product" cases in the future. One must pay attention, in particular, to the Appellate Body's instructions on future administration of the "like product"

concept. Because of the lack of policy coherence in the traditional "like product" test over the years, panels and other GATT bodies have made a practice of repeating the slogan that "like product" must be defined on a case-by-case basis. The Appellate Body decision in *Japan—Alcoholic Beverages* not only reemphasized that case-by-case approach several times, but went on to add several layers of additional discretion. The Appellate Body announced that the "like product" concept was an accordion that can be made larger or smaller depending upon the particular legal and factual context in which that issue is being decided.[31] Likewise, the decision went on to stress that application of the concept would always involve an irreducible amount of subjective discretion on the part of decision-makers.[32]

Tribunals usually call for such discretion when they are being asked to resolve important issues under legal criteria that make little or no policy sense. The normal response of most tribunals to such a task is to decide the case as best they can by making a seat-of-the-pants judgment about whether the defendant government is behaving correctly or incorrectly—a process of judgment known in some circles as the "smell test." Once the tribunal comes to a conclusion about who should win, it fashions an analysis, in terms of the meaningless criteria it has been asked to apply, that makes the case comes out that way. Given the likelihood that decisions written in this manner will have a high degree of inconsistency, the tribunals naturally seek to give such decisions as much armor-plating as possible by claiming the widest possible range of discretion. This pattern of decision-making actually works a good deal better than one might think. So long as the tribunal gets it right most of the time—that is, decides its cases according to the larger community's perception of right and wrong behavior—the decisions tend to be accepted, and in an opaque sort of way they even succeed in guiding conduct toward the proper goals. Indeed, there are those who will argue that the U.S. Supreme Court has been doing something similar to this under the Dormant Commerce Clause for the past two hundred years.

In order to know what panels will actually do with "like product" cases in the future, one has to speculate about the kinds of criteria panel members are likely to rely on when they apply the "smell test" to the regulatory measures brought before them. In this author's view, the criteria that GATT/WTO tribunals are likely to apply are those suggested by the "aim and effects" approach. Indeed, it is the author's guess that most previous "like product" decisions by GATT panels have been based, consciously or unconsciously, on an intuitive application of the same criteria. It does not require any special insight to reach this conclusion. Common sense tells us that whenever a panel member is asked to decide whether a particular regulatory measure is or is not playing by the rules, that panel member will instinctively want to know whether the measure has a bona fide regulatory

31. Appellate Body Report on Alcoholic Beverages, *supra* note 22, at 20-21.
32. *Id.* at 22.

purpose and to what extent its market effects are protective. When one says that GATT/WTO panel members are generally able to tell the difference between a bona fide regulation and a disguised trade restriction, one is most likely talking about their ability to make judgments about these two issues.

If it is true that panels applying the traditional "like product" test were already being guided by seat-of-the-pants application of the "aim and effects" approach, one must take a slightly different perspective on the entire legal controversy over whether to adopt the "aim and effects" approach. One can see that the architects of the "aim and effects" approach were not really trying to change the underlying criteria of decision in these cases. Instead, they were simply trying to bring this covert analysis into the open, where, supposedly, the quality of decision is improved because the parties are given an opportunity to address the real criteria of decision openly. The real meaning of the negative response of the Appellate Body is simply that such transparency is not likely to occur for a while. This does not mean, however, that the "aim and effects" approach has been exterminated. It simply means that it will remain underground.

Indeed, if it is true that most GATT/WTO tribunals have been deciding these issues according to an "aim and effects" approach and will continue to do so in the future, the large amount of discretion authorized by the Appellate Body decision in *Japan—Alcoholic Beverages* will actually make it a little easier for those tribunals to keep doing so. This, in turn, means that the eventual political acceptability of the WTO's policing function over domestic regulatory measures will continue to depend, as in the past, not on the persuasiveness of the legal standards being applied, but on the ability of WTO tribunals to find the right answers in these cases—i.e., their ability to know when to prohibit those regulatory measures viewed as illegitimate by the larger community, and when to let pass those measures that the community views as bona fide regulation. If the answers are largely right, the occasional absurdity of the legal rationale will probably not matter.

5. *A Postcard from the Future*

If it is true that the "aim and effects" approach makes the most intuitive sense when trying to discern the difference between bona fide domestic regulatory measures and disguised trade restrictions, one would expect that the Appellate Body decision in the *Japan—Alcoholic Beverages* case would have left most participants in the WTO dispute settlement process dissatisfied with the rather wooden kinds of legal tools that they had been left to work with. One would expect, therefore, to see evidence of efforts to circumvent such a doctrinal straightjacket. It is perhaps relevant, therefore, to note that in the first twelve months after the decision in *Japan—Alcoholic Beverages,* no less than four major dispute settlement proceedings witnessed a serious effort to introduce versions of the "aim and effects" approach into the legal analysis of violation. First, as just noted, in the panel phase of *Bananas III*, the panel itself tried to introduce analysis

of protective purpose into article III:4.[33] Second, in the appellate phase of *Bananas III*, the European Community (the dedicated opponent of the "aim and effects" approach) argued that the one-dimensional, head-count approach to identifying de facto discrimination under the GATS agreement had to be blended with considerations of protective purpose.[34] Third, at both levels of the *Canadian Periodicals* case, Canada (which had supported the EC's assault on the "aim and effects" approach) found itself arguing that the "like product" test of article III:2 had to be accompanied by consideration of whether the legislation had a "discriminatory" purpose.[35] Finally, the panel decision in the *Hormones* case added an extensive analysis of regulatory purpose, in part based on GATT article III:1, in applying article 5.5 of the SPS Code.[36] The author would suggest, of course, that these four instances are merely the tip of an iceberg.

C. Article XX Doctrine After the "Aim and Effects" Debate

The Appellate Body's refusal to accept the "aim and effects" approach as part of the "like product" analysis did not mean that the purpose of a regulatory measure had been ruled out of consideration entirely. It merely meant that questions of regulatory purpose were left where they had been before—an issue that had to be raised, if at all, as a special justification to be tested under article XX. To assess the full consequences of the "aim and effects" rulings, one thus has to ask what, if anything, has happened to article XX in the recent WTO cases.

The first WTO case to reach the Appellate Body, the *Reformulated Gasoline* case,[37] had a lot to say about article XX. For the most part, however, the changes made by the Appellate Body concerned the doctrinal architecture of article XX rather than the substance of its rules. The Appellate Body's ultimate decision in the *Reformulated Gasoline* case proved to be a quite traditional article XX analysis, rejecting a U.S. claim that a discriminatory U.S. regulation had been enacted for a bona fide regulatory purpose. Adopting essentially the same analysis used by the panel below, the Appellate Body found that the United States did have alternative measures available to it that could have accomplished the regulatory

33. Bananas Panel Report, *supra* note 28.

34. Appellate Body Report in Bananas Case, *supra* note 30, paras. 240, 242.

35. Panel Report on Canadian Periodicals, *supra* note 11, paras. 3.98-.110; *Canada—Certain Measures Concerning Periodicals—AB-1997-2—Report of the Appellate Body*, WT/DS31/AB/R at 6 (June 30, 1997), *at* WTO Website, *supra* note 11 [hereinafter Appellate Body Report on Canadian Periodicals] (denying that it is arguing the "discredited 'aims and effects' test," but nonetheless asking that measures with no inherent bias against imports not be found in violation simply on the basis of tax differentials).

36. *EC Measures Concerning Meat and Meat Products (Hormones)—Complaint by the United States—Report of the Panel*, WT/DS26/R/USA paras. 8.183, 8.184 (Aug. 18, 1997), *at* WTO Website, *supra* note 11; *see also id.* para. 8.202.

37. Reformulated Gasoline Panel Report, *supra* note 10; Appellate Body Report on Reformulated Gasoline, *supra* note 10.

objective without employing discrimination. On this basis, the Appellate Body concluded that the discriminatory element in the regulation was not necessary to the attainment of its environmental objectives. In itself, this part of the opinion added nothing to traditional article XX analysis.

The changes made by the Appellate Body were primarily changes that brought the operation of article XX into greater compatibility with the words of that provision. The first step was to reject the existing GATT interpretation of the article XX(g) exception for conservation measures. The wording of article XX(g) had presented a problem for previous GATT panels. The general understanding of article XX was that governments were entitled to an excuse for a measure in violation only in those cases where the violative aspects of the measure were necessary to the attainment of one of the important social policy objectives listed there. This condition was easy enough to enforce if the words of provision said that the violative measure had to be "necessary" to the attainment of one of those policy objectives. The trouble was that article XX(g) merely required that the measure "relate" to the conservation objectives listed. To keep article XX(g) from becoming a wholesale license for excusing GATT violations, panels had worked out an ingenious (and arguably disingenuous) way of interpreting "related" so that it meant the same thing, more or less, as "necessary." Since most of the measures seeking excuse under article XX(g) were environmental measures, the appearance of deviousness in the interpretation of article XX(g) had added to the already heavy volume of complaints from the environmentalist quarters about GATT's lack of sensitivity to environmental policy. The Appellate Body addressed this problem by adopting a common sense interpretation of the word "related," a change which by itself would have made it possible to excuse a very large number of GATT violations in this area.

The Appellate Body opened the door even further by rejecting the prevailing interpretation of article XX which held that the "measure" whose necessity had to be tested under article XX was the GATT-illegal part of the challenged regulation. Instead, the Appellate Body ruled that the "measure" to be tested was the entire regulation in which the GATT-illegal provision appeared. Since the regulation as a whole was usually a necessary part of some legitimate regulatory program, the effect of this second ruling would appear to have been that virtually every challenged ruling would have been prima facie excused under article XX.

Having interpreted the main body of article XX so that most challenged regulations would have been prima facie excused under that provision, the *Reformulated Gasoline* opinion then went on to recapture the traditional understanding of article XX—the understanding that the violative measure itself had to be necessary to attaining the claimed regulatory purpose. The Appellate Body found the basis for such a rule in the preambulatory conditions stated in article XX, known as the chapeau. The chapeau states that the excuse provided in article XX shall not be available to measures that are "applied in a manner which would constitute

a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade."[38] Earlier GATT panels had kept their distance from this language, probably because they wished to avoid the more obviously judgmental sorts of decisions its very general language would seem to require. The Appellate Body had evidently preferred to grasp that nettle rather than stretching the words in the main body of article XX to accomplish the same result less openly.

The Appellate Body provided a rather broad and impressionistic definition of the words of the chapeau, saying that the text involved several overlapping concepts that were not easy to separate. The one concrete conclusion it reached was that these words did cover the traditional kind of article XX conclusion the panel and the Appellate Body had reached about the U.S. gasoline regulation that was before them—that when the discriminatory element of a regulation is found not necessary to the policy objective it is claimed to serve, that measure can be classified as either "arbitrary or unjustified discrimination" or "a disguised restriction on international trade." The Appellate Body may have used different words, but they achieved the same result.

Article XX has been criticized as an inadequate vehicle for dealing with the "aim" part of the "aim and effects" approach, because its enumerated list of social policies that can justify measures otherwise found in violation is too narrow to cover all of the many kinds of policies that should be considered valid bases for regulatory actions. A few recent panel decisions have enlarged the meaning of individual article XX policies,[39] and the *Reformulated Gasoline* case itself contributed a ruling that clean air was an exhaustible natural resource under article XX(g). However, no panel ruling will ever be able to change the limiting structure of article XX itself. So long as policy justifications are confined to the policies listed in article XX, that limitation will continue to affect balance in the WTO's policing function.

D. De Facto Discrimination Outside the "Like Product" Context

1. *The GATS Agreement*

Under GATT article III, most national treatment issues will involve a "like-product" issue, because, under the "product-process" doctrine, governments are not permitted to make regulatory distinctions based on criteria other than the characteristics of the products. Under the national treatment provision in GATS article XVII, however, no such *a priori* limitation is imposed on regulatory distinctions involving service transactions and service providers. Thus, a govern-

38. Appellate Body Report on Canadian Periodicals, *supra* note 35, at 8.

39. *See, e.g.*, Canada—Measures Affecting Exports of Unprocessed Herring and Salmon, Mar. 22, 1988, GATT B.I.S.D. (35th Supp.) at 98 (1989) (fish stocks held to be exhaustible natural resource).

ment is permitted to distinguish between otherwise "like" service providers by imposing regulatory distinctions based on some other characteristics of the service provider or service transaction. When such regulatory distinctions are applied in an "origin-neutral" manner (that is, without distinction as to the nationality of the service provider), cases will exist where the effect of those regulatory distinctions creates a disproportionate burden on foreign suppliers vis-a-vis domestic suppliers. In such cases, foreign suppliers can raise the issue of whether the regulation is discriminatory—that is, illegitimate in some fashion because of the disproportionate trade effects and/or because of some other indication of bad faith.

GATS article XVII explicitly invites this sort of inquiry about de facto discrimination by stating, in paragraph 3, that "origin-neutral" regulations may be charged with providing "less favorable treatment" if they "modify conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Members."[40] Although the text seems to invite nothing more than an economic analysis of the competitive impact of the regulation in question, a one-dimensional analysis of competitive impact has obvious shortcomings as a normative basis for prohibiting national regulations. Given that all regulatory measures impose some burden on the regulated businesses, and that such burdens are often distributed according to fortuitous market circumstances that are not even known (or at least not investigated) at the time the regulation is promulgated, the fact that in some cases a measure causes a disproportionate burden on foreign interests may be nothing more than a matter of random distribution of unintended effects. These effects could just as easily, and often do, turn out to be disproportionately burdensome to domestic interests.[41] To say that such unintended and essentially random market effects justify invalidating the regulation is a normative proposition that would not find much acceptance in most WTO capitals. To the contrary, one would expect most governments to demand at least some evidence of bad faith, or at least gross negligence, before assenting to that conclusion.[42]

The decision in the *Bananas III*[43] case presented a good example of how a very simple, one-dimensional trade-effects analysis could be used to find that an

40. General Agreement on Trade in Services art. XVII, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, 33 I.L.M. 1168 (1994) [hereinafter GATS].

41. This would appear to have been the case, for example, with the general luxury tax law that was involved in the *U.S. Auto Taxes* case in which the original tax law turned out to have such a seriously adverse impact on U.S. furriers, jewelers, and luxury boat builders that the Congress was forced to repeal those parts of the tax shortly thereafter.

42. The so-called "inherency" analysis in the *US Auto Taxes* decision was apparently an effort to distinguish between purely random trade effects and those that have some element of purpose, or at least fault, behind them. *See also* the EC argument in the *Bananas III* case and the text accompanying note 48 *infra*.

43. Bananas Panel Report, *supra* note 28; Appellate Body Report in Bananas Case, *supra* note 30.

"origin-neutral" regulation constituted de facto discrimination. In an effort to shift some of the economic rents generated by a tariff quota on Latin American bananas to banana wholesalers who would deal in less competitive (and less profitable) bananas from the European Community and from Africa-Caribbean-Pacific (ACP)[44] countries, the European Community promulgated a regulation assigning thirty percent of the valuable quota licenses on Latin American bananas to wholesalers who dealt in EC and ACP bananas.

While the regulation clearly discriminated against foreign goods by explicitly rewarding the purchase and resale of EC and ACP bananas (and thus was clearly a violation of GATT article III:4), as a services regulation the license allocation was "origin-neutral" on its face, because the benefits were equally available to any wholesaler who dealt in the requisite goods regardless of the wholesaler's nationality. The stated regulatory policy was also "origin neutral," for the goal of inducing wholesalers to handle EC/ACP bananas could itself be achieved just as well by offering the subsidy to any wholesalers regardless of nationality. The issue was whether such an "origin-neutral" regulation could nevertheless be characterized as discriminatory either because of its purpose or because of its actual effects upon foreign wholesalers.

As noted above, GATS article XVII:3 states that "formally identical treatment . . . shall be considered to be less favorable if it modifies the conditions of competition in favor of [like domestic competitors]."[45] After a meticulous examination of the data pertaining to the nationality of affected wholesalers, the panel concluded that the regulation did modify the conditions of competition in favor of domestic wholesalers.[46] The panel's conclusion appears to rest entirely on the finding that over ninety percent of the disadvantaged wholesalers, those who dealt in Latin American bananas, were nationals of the complaining countries while the advantaged wholesalers who dealt in EC and ACP bananas were over seventy-five percent European or ACP in nationality. Although the openly redistributive nature of the regulation clearly suggested the possibility that the nationality of those whom it benefitted and burdened would have exerted a major influence over its enactment, and that governments could not help but know the identity of those benefitted and burdened, the panel did not acknowledge that it had reached any conclusion about the purposes of the regulation. For all one can tell from the panel opinion, the analysis of whether the regulation was discriminatory depended solely on a head count of the nationality of the affected suppliers, whatever the underlying reason for this distribution. The panel reached essentially

44. The Africa-Caribbean-Pacific members of the Lomé Convention.

45. GATS, *supra* note 40, art. XVII.

46. Bananas Panel Report, *supra* note 28, paras. 7.332-.338. A parallel analysis was employed to support findings that the disproportionate impact of this regulation between wholesalers of ACP nationality and wholesalers of other nationalities constituted a violation of the GATS MFN obligation in GATS article II.

the same conclusion, on the same grounds, with respect to three other similar license-allocation rules.[47]

On appeal, the European Community urged the view that this head-counting approach was too inflexible an approach with regards to the issue of de facto discrimination, and urged the Appellate Body to follow the "aim and effects" approach of the U.S. *Auto Taxes* case. In particular, (1) that the Appellate Body should consider the presence or absence of a bona fide regulatory purpose behind these subsidy elements in the Community's banana regulations, and (2) that it should inquire further into the nature and quality of the disproportionate impact on foreign nationals by considering whether that impact was merely incidental or actually inherent in the design of the measure.[48]

The Appellate Body once again rejected the invitation to extend the "aim and effects" approach to a different context. With an explanation reminiscent of its ruling against extending that approach to article III:4, the Appellate Body said,

> [w]e see no specific authority in either article II or article XVII of the GATS for the proposition that the "aims and effects" of a measure are in any way relevant in determining whether that measure is inconsistent with those provisions. In the GATT context, the "aims and effects" theory had its origins in the principle of article III:1 that internal taxes or charges or other regulations "should not be applied to imported or domestic products so as to afford protection to domestic production". There is no comparable provision in the GATS. Furthermore, in our Report in Japan—Alcoholic Beverages, the Appellate Body rejected the "aims and effects" theory with respect to article III: 2 of the GATT 1994. The European Communities cites an unadopted panel report dealing with article III of GATT 1947, United States—Taxes on Automobiles, as authority for its proposition, despite our recent ruling.[49]

The Appellate Body's insistence on explicit textual instruction before allowing itself to consider the nature and purpose of challenged regulatory measures was consistent with its earlier "aim and effects" rulings. Here, as in the *Japan—Alcoholic Beverages* case, the Appellate Body seems to be giving dispositive weight to a presumption that the draftsmen intended the specific words of each provision to be the only way their general policy was to be carried out, and did not want WTO tribunals fashioning further criteria based on that general policy unless explicitly invited to do so.

This interpretation places a tremendous burden on the words of the legal text, suggesting that WTO draftsmen possess a rather uncommon degree of perfection in foresight and expression. Once again, however, this interpretative approach may have been viewed as the only safe course for a new and very exposed legal institution to follow.

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47. *See* Bananas Panel Report, *supra* note 28, paras. 7.362-.368 (allocation of third-country licenses to ripeners), paras. 7.378-.380 (exemption of Category B operators from BFA export certificate requirement), and paras. 7.392-.393 (allocation of hurricane licenses).

48. *See* Appellate Body Report in Bananas Case, *supra* note 30, paras. 240, 242.

49. *Id.* para. 241.

The ultimate result of this strict adherence to the rather one-dimensional criteria stated in GATS article XVII will probably be to encourage the same kind of covert decision-making that we suggested was taking place in the article III "like product" cases. That almost certainly happened in the *Bananas III* case itself. The author finds it impossible to believe that neither the panel nor the Appellate Body were influenced by either the evident purpose or the obvious foreseeability of the economic consequences of the regulations involved in *Bananas III*, or that they would have really been willing to decide this case according to a pure head-counting measure of the regulation's impact. The legal ruling in *Bananas III* may well drive such additional considerations underground, but it is unlikely ever to eliminate them from the thinking of the decision-makers.

It will be interesting to see how future WTO panels, and the Appellate Body itself, decide these cases when the underlying considerations of purpose and protective effects point to a different result from the formal criteria. Unlike the GATT article III cases, WTO tribunals operating under the GATS do not appear to have anything as flexible as the protean "like product" concept to cover their tracks.

2. *The Standards Code*

Textual literalism will not prevent panels, adjudicating cases under the Standards Code, from applying an "aim and effects" approach to the problems raised under that agreement. Article 2.2 of the Standards Code explicitly calls for attention to the protective "aim and effects" of product standards:

> 2.2 Members shall ensure that technical regulations are not prepared, adopted or applied with a view to or with the effect of creating unnecessary obstacles to international trade. For this purpose, technical regulations shall not be more trade restrictive than necessary to fulfil a legitimate objective, taking account of the risks non-fulfillment would create. Such legitimate objectives are, inter alia: national security requirements; the prevention of deceptive practices; protection of human health or safety, animal or plant life or health, or the environment.[50]

By stating the prohibition to include regulations "adopted or applied with a view to . . . creating unnecessary obstacles to international trade,"[51] the first sentence clearly authorizes tribunals to examine the purpose of the measures in question. Most likely, tribunals will resist reading this provision as a license to inquire into the subjective motive of legislators and regulators—traditionally a no-man's-land for courts. Rather, panels are likely to consider the objective indicators of purpose that the Appellate Body suggested should be looked to when investigating what it calls the "protective application" of measures under the second sentence of article III:2.[52] As noted above, this more limited type of

50. Agreement on Technical Barriers to Trade art. 2, Apr. 12, 1979, GATT B.I.S.D. (26th Supp.) at 8 (1980) [hereinafter Standards Code].

51. *Id.*

52. *See supra* text accompanying note 25.

purpose investigation was probably all that the architects of the "aim and effects" approach intended in the first place.

Moreover, the text of Standards Code article 2.2 should also discourage the simplistic sort of effects test suggested by the head-counting approach of the *Bananas III* decision. The only "effect" that is prohibited is the creation of an "unnecessary obstacle to international trade," a phrase that is defined in the second sentence as requiring the balancing of the amount of trade restriction against the regulatory purpose of the measure. There are at least two noteworthy elements in the method that article 2.2 employs to structure the balancing of trade effects with regulatory purpose.

First, with regard to the simpler issue of whether the trade restricting effects of a regulatory measure are really necessary to accomplishing its purpose—the issue normally covered in article XX analysis—article 2.2 liberates the analysis from the handicaps created by the two-stage approach under the traditional "like product" test of GATT article III (and, very likely, under the *Bananas III* interpretation of GATS article XVII). Under article 2.2, the issues of trade effects and regulatory justification are considered on the same level, without any conclusion as to violation until both sides of the equation have been fully considered. Moreover, although the list of legitimate purposes in article 2.2 is not as large as the list in GATT article XX, the list in article 2.2 is only exemplary and would not foreclose governments from justifying measures under other routine but less compelling regulatory purposes.

Second, article 2.2 appears to authorize tribunals to go further than the "necessity" analysis of GATT article XX in order to resolve the most difficult cases in this area—for example, cases where the trade restriction may be necessary for full realization of a legitimate policy objective but where the amount of trade restriction appears disproportionate to the gain to be achieved, or in the other direction, cases where there may be less restrictive alternatives but the differences are small. The instruction in article 2.2 to "[take] account of the risks non-fulfilment would create"[53] would seem to authorize tribunals to address such difficult issues by balancing the need for the regulation with the trade harm it creates. U.S. and European courts have performed such balancing when faced with such difficult cases under the Dormant Commerce Clause or under the similar doctrines of articles 30 and 36 of the Rome Treaty.[54] WTO tribunals are also quite likely to engage in such balancing when deciding difficult cases, whatever the governing legal standard. Article 2.2 takes the "aim and effects" ap-

53. Standards Code, *supra* note 50, art. 2.2.

54. *See, e.g.*, Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970). *See also*, Donald Kommers & Michel Waelbroeck, *Legal Integration and the Free Movement of Goods: The American and European Experience, in* INTEGRATION THROUGH LAW: EUROPE AND THE AMERICAN FEDERAL EXPERIENCE 218 (Cappelletti et al. eds., 1985) ("The Court of Justice uses a balancing test very similar to the analytical framework adopted by the Supreme Court in *Pike v. Bruce Church, Inc.*").

proach to its next logical step by calling for transparent litigation of such balancing issues.

Assuming that article 2.2 is allowed to develop as it is written, it should provide a model for the way to deal with similar problems of de facto discrimination under GATT article III and GATS article XVII. At the very least, it should influence the covert analysis that is bound to occur in those cases, whatever their formal rules. Over time, the influence of article 2.2 may bring about the negotiation of new and better legal texts for cases of de facto discrimination under those articles.

Thus far, the WTO dispute settlement system has not rendered any decisions applying article 2.2 of the Standards Code. Article 2.2 was raised as one of the rules violated by the U.S. gasoline regulation complained about in the *Reformulated Gasoline* case, but with the apparent consent of the parties, the panel, and later the Appellate Body, chose to decide the case under GATT articles III and XX. The choice to proceed in this manner raised some questions, because the usual understanding is that the more specific agreement (the Standards Code) prevails over the more general (GATT articles III and XX). Upon further consideration, however, it seems that the Standards Code may not provide a full set of rules for the type of measure involved in that case. The U.S. gasoline regulation in *Reformulated Gasoline* was an explicitly discriminatory regulation. Article 2.1 of the Standards Code contains a flat prohibition against such discrimination, but the Standards Code does not contain an equivalent to GATT article XX—a provision that permits members to prove a regulatory justification for discriminatory measures. Since the only serious U.S. defense in the case was its article XX defense, the Standards Code did not seem suitable for litigating the United States' side of the case. The "purpose" provisions of article 2.2 would have provided a platform for making a similar purpose defense, if the measure had been analyzed under article 2.2, but it would be difficult to argue that an explicitly discriminatory measures must be adjudicated under article 2.2 rather than 2.1, or that article 2.2 provides a defense to the flat prohibition in article 2.1. It was probably wiser not to become entangled in these issues.

What this experience teaches is that the Standards Code will probably be employed to adjudicate only "origin-neutral" product standards (de facto discrimination), while explicitly discriminatory standards will continue to be dealt with under GATT articles III and XX. Given that Standards Code article 2.2 is somewhat more receptive to claims of regulatory justification than is GATT article XX, such a division of labor would appear to be an arrangement where, in practice if not in actual legal text, the WTO will have a more rigorous set of legal rules for explicitly discriminatory measures than for "origin-neutral" measures. If so, this would appear to be a first step toward establishing a distinction between de jure and de facto discrimination that appears to have long been a part of the parallel U.S. and EC legal doctrines in this area.

3. *The SPS Code*

The text of the SPS Code is not as clear as the text of article 2.2 of the Standards Code with regard to the criteria and method of analysis to be used in investigating claims of de facto discrimination. Rather than clearly setting out the analysis to be made for such claims, the government drafters have yielded to the temptation of resolving hard issues by borrowing language and concepts that appear in older, well-accepted agreements. Unfortunately, the borrowed texts are often unclear from the beginning and sometimes become even less clear in their new setting.

In the author's judgment, the key language that will govern the possible use of the "aim and effects" approach under the SPS Code is text of SPS article 2.3 that is partially repeated in SPS article 5.5. The text of SPS article 2.3, drawn from the chapeau of GATT article XX, provides:

> 3. Members shall ensure that their sanitary and phytosanitary measures do not arbitrarily or unjustifiably discriminate between Members where identical or similar conditions prevail, including between their own territory and that of other Members. Sanitary and phytosanitary measures shall not be applied in a manner which would constitute a disguised restriction on international trade.[55]

The Appellate Body's *Reformulated Gasoline* decision was the first to offer a considered definition of this language in the article XX context.[56] Even that definition was rather impressionistic, treating the two types of "discrimination" and the "disguised restriction" as overlapping versions of the same general idea. In the case itself, the chapeau language was used as the basis for an examination of a regulatory purpose claimed by the United States. The United States claimed that a discriminatory element of a particular environmental regulation was necessary to achieve the objectives of the regulation. The Appellate Body, having found that there were non-discriminatory alternatives available to the United States, concluded that the discrimination was not necessary—or, in other words, that the discrimination was not serving the regulatory purpose claimed for it. This absence of bona fide regulatory purpose made the challenged discrimination "unjustified," perhaps "arbitrary" as well, and also a "disguised restriction on international trade" in the sense that the claimed regulatory purpose was clearly only a "disguise."

Translated into the context of the SPS Code, where it serves as a standard for dealing with claims of de facto discrimination, the chapeau language would seem to authorize the same kind of examination of regulatory purpose that is authorized by the term "unnecessary obstacle to international trade" in article 2.2 of the

55. Agreement on the Application of Sanitary and Phytosanitary Measures art. 2.3, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS: THE LEGAL TEXTS (1994).

56. The "disguised restriction" text has had a particularly muddled interpretative history. A few early GATT interpretations thought it required that trade restrictions be declared openly, a meaning which seems clearly wrong. *See*, HUDEC, *supra* note 8, at 483, 490.

Standards Code. Both standards involve the same central element—the contention that the claimed regulatory purpose of the measure does not justify its restrictive effect. Therefore, both require tribunals to examine the existence of a bona fide regulatory purpose, whether the measure is really necessary to accomplish the purpose, and arguably, whether the harm to be avoided by the regulatory purpose justifies the degree of trade restriction. The part of the chapeau text that comes closest to capturing this purpose orientation, and bringing the two tests together, is the reference to "disguised restriction on international trade"—with the emphasis on "disguised."

The meaning of the borrowed chapeau language has been examined in the one WTO dispute settlement proceeding to have considered the SPS Code—the August 1997 panel report in the *Hormones* case[57] and the January 1998 Appellate Body decision affirming the main conclusions of that panel report.[58] The panel examined the use of that language in article 5.5 of the SPS Code, which prohibits arbitrary or unjustifiable distinctions in the level of protection against risk which result in "discrimination or a disguised restriction on international trade."[59] In interpreting this language, the panel began by reciting the Appellate Body's not-very-illuminating definition of the chapeau text in *Reformulated Gasoline*.[60] But then the *Hormones* panel made a most interesting association between the chapeau terminology and the Appellate Body's discussion of "protective application" in the *Japan—Alcoholic Beverages* decision—the part of that decision that endorses what looks like an objective examination of regulatory purpose (or "aim") when applying the second sentence of GATT article III:2.[61] The *Hormones* panel was particularly taken with the Appellate Body's specific suggestion that the very size of a tax differential could be proof of "protective application" (*i.e.*, protective purpose), and wanted to use that precedent as authority to conclude that the very size of the risk differentials in the EC's treatment of various meats could be used as proof of "discrimination or a disguised restriction" (*i.e.*, a protective purpose). In sum, whether consciously or intuitively, the *Hormones* panel was drawn to this purpose-type analysis as a valid way to make sense of the "discrimination or disguised restriction" standard.

Later in the same analysis, the *Hormones* panel cited several other factors in support of its conclusion that the EC's Hormones regulation constituted "discrimination or a disguised restriction on international trade." One was a number of

57. *EC Measures Concerning Meat and Meat Products (Hormones)—Report of the Panel*, WT/DS26/R WT/DS48/R (Aug. 18, 1997), *at* WTO Website, *supra* note 11, [hereinafter Hormones Panel Report].

58. *EC Measures concerning Meat and Meat Products (Hormones)—AB-1997-4—Report of the Appellate Body*, WT/DS26/AB/R WT/DS48/AB/R (Jan. 16, 1998), *at* WTO Website, *supra* note 11 [hereinafter Hormones Appellate Body Report].

59. Hormones Panel Report, *supra* note 57, para. 4.225.

60. *Id.* para. 8.182.

61. *Id.* paras. 8.183-.184. *See id.* para. 8.202.

recitations in the official documents explaining the Hormones regulation, stating that the regulation also had a variety of economic purposes, including the rationalization of the EC beef market and reducing beef surpluses in ways that would provide more favorable treatment to domestic producers.[62] The panel did not explain how it weighed these economic purposes against the health purposes of the measure, but the implication is that these materials added credibility to the charge that the measure did have a protective purpose. Regardless of whether or not that conclusion was appropriate, the significant fact is that the *Hormones* panel once again considered an analysis of purpose to be relevant to the application of the "discrimination or disguised restriction" test.

Given the history of the Appellate Body's reaction to panel reports adopting methods of analysis resembling the "aim and effects" test, there was reason to wonder whether the purpose orientation of the *Hormones* panel's interpretation of the chapeau language would survive appellate review. This time, however, the Appellate Body endorsed the approach. Although the Appellate Body disagreed with the panel's conclusion that the evidence showed a trade-restricting purpose behind the Hormones regulation, and thus actually reversed the panel's finding that the Hormones regulation violated article 5.5, the Appellate Body offered no criticism of the purpose analysis itself.[63] Indeed, the Appellate Body threw itself into a detailed analysis of the evidence relating to the issue of purpose, giving every indication that it thought the purpose analysis was a proper issue to be considered under article 5.5.

The Appellate Body's acceptance of the purpose analysis in the *Hormones* case was consistent with its earlier "aim and effects" decisions. Once again, the legal text was the key. The legal text in question was the language of the article XX chapeau, and the Appellate Body had already interpreted and applied that language in the *Reformulated Gasoline* case to authorize the traditional article XX analysis of regulatory purpose. Where the text tells WTO panels to analyze the regulatory purpose of a measure, the Appellate Body will support that analysis. On this ground, one can feel fairly confident that the Appellate Body will also approve the application of such purpose analysis under article 2.2 of the Standards Code.

A final element of the *Hormones* panel report deserves mention. As a third justification for its conclusion that the Hormones regulation violated SPS article 5.5, the panel offered a head-count analysis showing that over seventy percent of U.S. beef imported into the EC was treated with growth hormones at the time of the regulation, whereas only about forty percent of domestic EC beef was so treated.[64] The implication was that the regulation was disproportionately burdensome on U.S. suppliers. This factor is a reminder that operative language in article 5.5 does speak of "discrimination" and "restrictions on trade," and that

62. *Id.* para. 8.204.
63. Hormones Appellate Body Report, *supra* note 58, paras. 239-246.
64. Hormones Panel Report, *supra* note 57, para. 8.205.

this language does suggest that a finding of violation must rest not only on wrongful purpose but also on some kind of market effects that disadvantage imports in particular. In other words, the language in question requires consideration of not only "aim" but also "effects."

This is not so clear in other provisions of the SPS Code. In particular, the text of article 2.2 requires that measures be based on scientific principles, but says nothing to limit such complaints to only those measures that have a distinctively burdensome harmful effect on imports. Harmful trade effects have normally been the political justification for GATT/WTO intrusion into domestic regulatory matters. The SPS Code would be a much more difficult pill to swallow if it really does allow the WTO to attack sanitary measures solely on the ground that they lack scientific foundation—a ground that, by itself, would probably not authorize national courts to invalidate such a regulation.

Nonetheless, the Appellate Body's *Hormones* decision has already so construed the SPS Code. By affirming the panel's finding of violation under article 5.1 without affirming the panel's finding of violation under article 5.5, the Appellate Body has found a violation without a finding of discriminatory trade effects. The words of the SPS Code left no choice.

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APPENDIX: GATT ARTICLES III AND XX (Selected Extracts)

GATT Article III: National Treatment on Internal Taxation and Regulation

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

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

Ad Article III:2:

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

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

GATT Article XX: General Exceptions

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:

(a) necessary to protect public morals;
(b) necessary to protect human, animal or plant life or health;
(c) relating to the importation or exportation of gold and silver;
(d) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including those relating to customs enforcement, the enforcement of monopolies . . . the protection of patents, trade marks and copyrights, and the prevention of deceptive practices;
(e) relating to the products of prison labor;
(f) imposed for the protection of national treasures of artistic, historic or archaeological value:
(g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.