Case Notes

WTO's *Alcoholic Beverages* Decision

Introduction

In October 1996, the Appellate Body of the World Trade Organization (WTO) ruled against Japan in a dispute involving domestic excise taxes on liquor.[1] Although the dispute itself is unrelated to the environment, the judgment, based on Article III of the General Agreement on Tariffs and Trade (GATT), is freighted with significance for environmental policy. This note explains the new WTO ruling and discusses its policy implications.

Alcoholic Beverages and GATT Article III

Before exploring the *Alcoholic Beverages* dispute, it may be helpful to review the basics of GATT Article III.

Background on Article III

Article III is one of the core disciplines in the GATT. Its purpose is to require 'national treatment' so that imported products are treated no less favourably than domestically-made products. For purposes of this note, the key provisions of Article III are:

1. The contracting parties recognize that internal taxes and . . . regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products . . . 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 . . . 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.

In addition, *Ad* Article III states that:

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

Even though the text of Article III dates back to 1948, there are still many interpretive uncertainties. For example, what does 'to afford protection to domestic production' mean in Article III:1? What are 'like' products in Article III:2?

Leaving aside for the moment these textual ambiguities, how does Article III operate? Suppose a government levies a tax on domestic widget production at $1 per widget. Does the GATT permit governments to impose a $1 tax on imported widgets? Generally, the answer is yes; such a tax would not violate Article III:2. But suppose the government tries to impose a $2 tax on imported widgets. Such a tax would violate GATT Article III:2 because $2 is in excess of $1.

Taxes or regulations inconsistent with GATT Article III are not necessarily GATT violations. They may be saved by GATT Article XX (General Exceptions).[3] Article XX had no role in *Alcoholic Beverages*.

Japan Alcoholic Beverages Panel

The plaintiffs in *Alcoholic Beverages* were Canada, the European Community, and the United States. At issue was whether Japanese excise taxes on brandy, vodka, gin, rum, etc. violated GATT Article III:2 since these taxes were higher than the taxes levied on Shochu, a beverage commonly produced in Japan. (For example, the tax on brandy is 982 yen per litre; the tax on vodka is 377 yen per litre; the tax on Shochu A is 156 yen per litre).[4] In July 1996, the Panel agreed with the plaintiffs that Japan's taxes violated GATT Article III:2.[5] In October 1996, the WTO Appellate Body affirmed this judgment.[6]

The first-level Panel began by pointing out that Article III:2 contains two distinct obligations. Its **first** sentence involves the treatment of 'like' products. Its **second** sentence involves the treatment of 'directly competitive or substitutable' products. According to the Panel, the complaining party bears the burden of proving a violation of these obligations.[7]

Beginning with the first sentence of Article III:2, the Panel considered whether the various alcoholic beverages subject to differing taxes were **like** products. The parties in the dispute disagreed as to the proper legal test for making this judgment. Japan and the United States favoured the 'aim or effect' test articulated by Panels in the US *Malt Beverages* and *Auto Taxes* cases. *Malt Beverages* involved a challenge by Canada to a number of US national and state liquor laws.[8] The GATT Panel held that 'in determining whether two products subject to different treatment are like products, it is necessary to consider whether such product differentiation is being made so as to afford protection to domestic production [quot-

ing Article III:1]'.[9] This Panel report was adopted by the GATT Council.

In the US *Auto Taxes* case, one issue before the GATT was whether US luxury and gas guzzler taxes on automobiles violate Article III:2 in view of the fact that European car manufacturers bear a disproportionate share of the taxes.[10] The Panel ruled in favour of the United States, holding that these taxes did not violate Article III:2.[11] With respect to Article III:2, the Panel declared that 'Article III could not be interpreted as prohibiting government policy options, based on products, that were **not** taken so as to afford protection to domestic production'.[12] Determining whether a tax afforded protection to domestic production required the Panel to examine both the **aim** and **effect** of the tax.[13] Unhappy with this ruling, the European Community blocked adoption of the Panel's report.

Although both Japan and the United States agreed on 'aim or effect' as the proper legal test, they would have applied it differently to the facts in the *Alcoholic Beverages* dispute. In Japan's view, its alcohol taxes did not have a protectionist aim or effect. In the US's view, the taxes did have a protectionist aim and effect.

Both the European Community and Canada rejected the 'aim or effect' test.[14] According to the Community, the determination of **like** products should be done objectively, by comparing the properties, nature, quality, end-uses, and tariff classifications of the products at issue. In the Community's view, any inquiry into the purposes or effects of a tax measure is alien to the principle of Article III.

The WTO Panel sided with the Community and Canada. This Panel gave textual, pragmatic, structural, and jurisprudential reasons for rejecting the test articulated by the two recent GATT Panels. The textual reason was that Article III:2 says nothing about aim or effect.[15] The pragmatic reason was that using this test would make it harder for a plaintiff to prevail.[16] The structural reason was that GATT Article XX would become redundant if, for example, a defendant party could plead a health aim (provided for in Article XX(b)) as a qualifying factor under Article III.[17] The jurisprudential reason was that since adoption of the *Auto Taxes* report had been blocked by the European Community, the Panel was under no obligation to give it any weight.[18] The Panel did not deny that its ruling was contrary to the precedent in the US *Malt Beverages* case, but pointed out that under trade law doctrine, Panels are not bound by prior rulings.[19]

The Panel's next step was to examine the facts to determine which of the beverages involved shared a legal 'likeness' to Shochu. Only vodka met that standard.[20] The Panel noted that Shochu and vodka were alike in many physical characteristics yet differed in alcoholic strength and in the method of filtration used to produce them. Despite these differences, the Panel concluded that Shochu and vodka were **like** products.

The Panel also discussed the relevance of tariff bindings for determining whether two products were **like**. According to the Panel, while such determinations should not be based exclusively on tariff bindings, they could be an important criterion for determining likeness.[21] The Panel pointed to the identical bindings of vodka and Shochu as further evidence of their likeness.[22]

After deciding that Shochu and vodka were **like** products, the Panel moved to the final stage – that is, whether Japan's excise tax on vodka was 'in excess of' its tax on Shochu. As noted above, vodka is taxed higher on a volume basis. The Panel also found that vodka was taxed higher on an alcoholic content basis.[23] In addition, the Panel rejected Japan's contention that its taxes were based on maintaining a constant tax/price ratio. Therefore, the Panel concluded that Japan's excise tax on vodka violated GATT Article III:2's first sentence.[24]

The other major part of the Panel's inquiry involved the discipline of Article III:2's second sentence. This required a determination of whether the alcoholic beverages involved were 'directly competitive or substitutable' vis-à-vis Shochu. The Panel heavily relied on a 1987 report by a GATT Panel that had examined the alcoholic beverages market in Japan and found many of the beverages to be directly competitive or substitutable.[25] This nine-year old report, together with some more recent data, persuaded the WTO Panel that Shochu was directly competitive with or substitutable for 'the other products subject to dispute'.[26]

Having concluded that these alcoholic beverages and Shochu were competitive, the Panel next looked for non-similar taxation, the key factor in the Ad Article III provision quoted above.[27] The Panel examined tax data based on volume and strength of alcohol, and concluded that Shochu and other beverages were **not** similarly taxed.[28] This left only one question: are the differentials in Japan's liquor tax being applied contrary to the principles set forth in Article III:1? Or, in other words, do the tax differentials 'afford protection to domestic production'?

The Panel stated that it was not necessary for plaintiffs to show that the tax legislation has a protective intent or to show a negative effect on the level of a defendant's imports. Instead, if competitive products are not similarly taxed (and assuming the differentials are more than de minimis), the Panel seems to be suggesting that the plaintiff government was entitled to a presumption that Article III:2's second sentence was being violated. The Panel did not explain how it reached this conclusion. It implied that three previous GATT Panels took the same approach, but none of these three Panels provide authority for the WTO's Panel's inferential leap with respect to Article III:2's second sentence.[29]

Therefore, finding that Shochu and the other beverages were not similarly taxed, and noting that the taxes on Shochu were lower, the Panel concluded that the taxes on various alcoholic beverages violated GATT Article III:2's second sentence.[30] The Panel noted Japan's defense that its tax system is designed to maintain a constant tax/price ratio. But this defense was rejected.[31]

Appellate Body Decision

Both Japan and the United States appealed. The US Government agreed with the Panel's judgment, but contested several of its legal arguments. Canada and the European Community did not appeal, but intervened before the Appellate Body largely in support of the Panel.

The Appellate Body affirmed the judgment of the first-level Panel,[32] but found several errors in law. First, it declared that the 'broad and fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures'.[33] On first reading, one might presume that the Appellate Body made this point in order to agree with both appellants (i.e., Japan and the United States) that the Panel should have considered protectionist aims and effects in ascertaining product likeness. But this is not what the Appellate Body had in mind. Indeed, it did not even address this key complaint of both appellants. Rather, the Appellant Body seized the occasion to establish a new doctrine that Article III:1 'informs the rest of Article III'.[34] The implications of this new doctrine for other parts of Article III remain to be seen.

Next, the Appellate Body considered Article III:2's first sentence. The Appellate Body agreed with the Panel's decision, but disagreed on some fine points of GATT law.[35] One concern was the Panel's consideration of tariff bindings as a criterion for determining product likeness.[36] The Appellate Body did not disagree with the Panel's findings, but warned that in some cases tariff bindings would not be a reliable criterion for determining product likeness. More concretely, the Appellate Body objected to a statement by the Panel that two products subject to the same tariff binding should not be subject to different levels of internal taxation.[37]

The Appellate Body then moved to Article III:2's second sentence. The higher tribunal agreed with the Panel's decision, but faulted the Panel's legal analysis.[38] It honed in on the weak link in the Panel's chain of reasoning, namely its intimation that dissimilar taxation necessarily affords protection to domestic production. The Appellate Body declared that the Panel blurred these factors and erred in law by failing to conduct a separate inquiry on whether the dissimilar taxes were being applied so as to afford protection.[39] According to the Appellate Body, a Panel should conduct a 'comprehensive', 'careful' and 'objective' analysis of the design, architecture, and structure of the taxes being considered.[40] In so doing, Panels 'should give full consideration to all the relevant facts and all the relevant circumstances in any given case'.[41]

This part of the Appellate Body's judgment is a bit confusing. The Appellate Body seems to be saying that although the Panel committed an error, it was a harmless error because the Panel made the requisite finding in a blurred way. Specifically, the Appellate Body suggests that the Panel made a finding that the taxes on Shochu and other beverages were so dissimilar that the Liquor Tax Law afforded protection to domestic protection.[42] But if the Panel did not conduct a separate and comprehensive analysis, one wonders how the Appellate Body is so sure that the Panel made the correct decision. This is a situation where a typical appellate court would have remanded the case, but the Appellate Body is handicapped by its lack of remand powers.

In reaching its decision, the Appellate Body found it helpful to clarify the meaning of the Article III:1 phrase 'applied to imported or domestic products so as to afford protection to domestic production'. No previous trade Panel had done so. The Appellate Body declared that Panels need not inquire into legislative or administrative intent.[43] This holding is revealing of judicial activism since none of the parties urged it on the Appellate Body, or even raised the issue.

Although the Appellate Body was not shy about making declarations *sua sponte*, it was a bit neglectful in addressing some of the key pleadings of the appellants. For example, Japan argued that the Panel did not give due consideration to its contention that using a yardstick of tax/price ratio would show its Liquor Tax law to be consistent with both sentences of Article III:2.[44] The Appellate Body gave no response. Japan's claim seems weak to this commentator. However, the purpose of the appellate procedure is to provide an opportunity for review and by ignoring appellant's pleadings, the Appellate Body is failing to accord due process.

The Appellate Body concluded with recommendations that the WTO Dispute Settlement Body ask Japan to bring its Liquor Tax Law into compliance with the GATT.[45] The WTO did this in November 1996 and Japan soon agreed to revise its law.[46] Following concerns that Japan was moving too slowly, the US Government demanded binding arbitration on the issue of how long these legislative changes should take. In mid-February, the arbitrator ruled that Japan must change its law by February 1998.[47]

Policy Implications

This section considers firstly the implications for national environmental policy-making and secondly the implications for the WTO adjudicatory system.

Environmental Implications

The most important implication of *Alcoholic Beverages* is the nullification of the tighter interpretations of 'like product' formulated by the *Malt Beverages* and *Auto Taxes* Panels. These two Panels had sought to reshape GATT jurisprudence so as to avoid interfering in origin-neutral taxes and regulations.[48] But this deferential stance was alarming to many people in the GATT community. 'To the delight of isolationists and environmentalists', decried one critic of the *Auto Taxes* decision, the 'Panel introduced a new reading of Article III that prohibits only those measures with both the aim and the effect of protecting domestic production'.[49]

Despite its short life in trade jurisprudence, the *Auto Taxes* ruling served an important political purpose. Coming just a few weeks before the vote in the US Congress on the Uruguay Round implementing legislation, the

decision helped the Clinton Administration convince wavering environmentalists that the GATT was greening itself.[50] For example, US Trade Representative Mickey Kantor declared that '[t]he recent GATT Panel report on the European Community's challenge to three US automobile laws laid to rest fears that WTO Panels will interpret the GATT in a way that challenged our ability to safeguard our environment'.[51] Now *Auto Taxes* itself has been laid to rest.

The new broadened interpretation of 'like' product formulated by the *Alcoholic Beverages* Panel may challenge the ability of governments to safeguard their domestic environment. It is unclear whether tax rates that distinguish between products based on environmental attributes will survive WTO scrutiny.[52] For example, is a high-fuel-economy automobile a **like** product to one with low fuel economy? Are two chemicals used for a similar purpose a **like** product even if they differ in ozone depletion potential? Is recycled paper **like** virgin paper? Is toxic waste **like** non-toxic waste? Is tropical timber **like** temperate timber? Are indigenous people **like** everyone else? According to the Appellate Body, like product decisions are subject to the discretionary judgment of trade Panels.[53] It remains to be seen whether future Panels will take ecological aims into account.[54]

Although much of 'trade and environment' legal scholarship has focused on GATT's General Exceptions (Article XX), the national treatment rule in Article III may be even more important. Because environmental taxes will often affect imports, WTO Panels will be asked to determine whether such taxes violate Article III.[55] Although taxes adjudged to violate Article III may be defended under Article XX, this will be a difficult task. No GATT or WTO Panel has ever accepted an Article XX environmental defense.

It should be noted that the above discussion is unconnected to the controversial issue of 'processes and production methods'.[56] This is the doctrine that governments may distinguish otherwise **like** products based on characteristics of the producer or the production process.[57] Until recently, there was only one adopted GATT ruling on that issue – the *Malt Beverages* case. One of the laws challenged by Canada was a Minnesota excise tax credit for small volume beer producers. The purpose of the tax credit was to encourage greater competition and diversity. This tax credit was available to all micro-breweries in Minnesota, in other states, and in foreign countries.[58] Canada presented no evidence that the tax credit had been denied to its qualifying breweries, but instead argued that any tax distinction between large and small breweries violates GATT Article III:2.[59] To the surprise of many observers, the Panel agreed with Canada and the US Government acquiesced. According to the Panel, beer from large breweries is a **like** product to beer from micro-breweries.[60]

In 1996, there was a similar holding in the US *Gasoline* case. That Panel ruled that Article III:4 'does not allow less favourable treatment dependent on the characteristics of the producer and the nature of the data held by it'.[61] This ruling was upheld by the Appellate Body.[62] This set of decisions has significance for environmental policy because the WTO has now spoken clearly that Article III does not countenance tax or regulatory distinctions linked to the production process. Or to put it more precisely, governments that utilize such taxes or regulations may have to grant immunity to imported products.

Although the *Alcoholic Beverages* Panel did not put forward a new interpretation of 'directly competitive or substitutable product', its holding is still significant because this is only the second time in history that a Panel has used this provision to find a tax to be GATT-illegal. In the market of the 1990s, dissimilar products can be competitive (or substitutable) with each other. For example, bottles are competitive with cans. Biodegradable packaging is competitive with non-biodegradable packaging. Solar energy is competitive with carbon energy. Many environmentalists would think it important that governments retain authority to craft policies based on such distinctions. While it seems unlikely that the WTO would want to subvert environmental policy, the potential for interference exists whenever tax incentives are applied in a way that affords protection to domestic products.

Jurisprudential Implications

There have now been two decisions by the Appellate Body.[63] Based on this limited sample, a few observations can be made. First, the members of the Appellate Body are an erudite group. For example, in the *Alcoholic Beverages* decision, the Appellate Body cites five judgments by the International Court of Justice, three judgments by the Permanent Court of International Justice, and two decisions from international arbitrations. It remains to be seen, however, whether the Appellate Body intends to try to harmonize 'international trade law' with other branches of international law.

Second, there has been criticism in some quarters about past reliance by Panels upon GATT's negotiating history.[64] Nevertheless, the Appellate Body continues such reliance – once in *Gasoline* and twice in *Alcoholic Beverages*.[65] This practice could become important in future cases involving Article XX.

Third, the Appellate Body is not hesitant to point out 'error' in first-level Panels. It did so two times in *Gasoline* and eight times in *Alcoholic Beverages*.[66] Such review should make Panels more careful.

Fourth, the Appellate Body points out that adjudging 'like' products involves 'an unavoidable element of individual, discretionary judgment'.[67] The Appellate Body also notes that WTO rules 'are not so rigid or so inflexible as not to leave room for reasoned judgments . . . '.[68] These points reinforce the importance of the composition of Panels. Concerned governments need to continue pushing for Panelists with environmental expertise whenever the WTO reviews environmental legislation.

Conclusion

Although the *Alcoholic Beverages* Panel and the Appellate Body probably reached the right decision given the facts in the dispute, the way in which Article III is interpreted could spell trouble for policy-based taxes. The Appellate Body states that 'Members of the WTO are free to pursue their own domestic goals through internal taxation or regulation so long as they do not do so in a way that violates Article III or any of the other commitments they have made in the *WTO Agreement*'.[69] By strengthening WTO supervision, the *Alcoholic Beverages* decision leaves governments less free to pursue their own domestic environmental goals.

Notes

1. *Japan–Taxes on Alcoholic Beverages*, Report of the Appellate Body, 4 October 1996, can be obtained from the WTO website http://www.wto.org. and 1997 Westlaw 87372.
2. GATT, at *ad* Article III:2.
3. Article XX provides a series of exceptions to regular GATT disciplines. For example, Article XX(b) provides an exception for measures 'necessary to protect human, animal or plant life or health'.
4. *Japan–Taxes on Alcoholic Beverages*, Report of the Panel, (96-2651), 11 July 1996, at Annex, can be obtained from the WTO website, n.1 above.
5. *Id.,* at para. 7.1.
6. *Japan–Taxes on Alcoholic Beverages*, Report of the Appellate Body, n.1 above, at 31–32.
7. *Japan–Taxes on Alcoholic Beverages*, Report of the Panel, n.4 above, at para. 6.14.
8. *United States–Measures Affecting Alcoholic and Malt Beverages,* Report of the Panel, GATT, BISD, 39th Supp., at 206.
9. *Id.,* at para. 5.25. The Panel makes the same point for government regulations at paras. 5.71–5.72.
10. *United States–Taxes on Automobiles*, Report of the Panel, 29 September 1994, (1994) 33 ILM 1397 (holding US luxury and gas guzzler taxes to be consistent with the GATT and US fuel economy regulations to be a GATT violation).
11. Steve Charnovitz, 'The GATT Panel Decision on Automobile Taxes', *Int'l Env't Rep*, 17 (1994) 921.
12. *United States–Taxes on Automobiles*, Report of the Panel, n.10 above, at para. 5.8 (emphasis added).
13. *Id.*, at paras. 5.9, 5.10.
14. *Japan–Taxes on Alcoholic Beverages*, Report of the Panel, n.4 above, at paras. 4.21–4.23.
15. *Id.*, at para. 6.16.
16. *Id.* It is interesting to note that four of the first five WTO Panels decided in favour of the plaintiff country.
17. *Id.*, at para. 6.17. The Panel inverts the well-known thesis of Frieder Roessler who was Director of the GATT Legal Affairs office at the time of the *Auto Taxes* ruling. Roessler argues that Article III needs to give deference to non-protectionist aims because not every legitimate governmental purpose is provided for in GATT Article XX. See Frieder Roessler, 'Diverging Domestic Policies and Multilateral Trade Integration', in Jagdish Bhagwati & Robert E. Hudec (eds.), *Fair Trade and Harmonization*, Vol. 2 (1996) 29-30.
18. *Japan–Taxes on Alcoholic Beverages*, Report of the Panel, n.4 above, at para. 6.18.
19. *Id.*, at paras. 6.10, 6.18.
20. *Id.*, at para. 6.23.
21. *Id.*, at para. 6.21.
22. *Id.*, at para. 6.23.
23. *Id.*, at para. 6.24.
24. *Id.*, at para. 6.27, 7.1(i).
25. *Id.*, at para. 6.32; *Japan–Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, Report of the Panel, GATT, BISD, 34th Supp., at 83, 117. The WTO *Alcoholic Beverages* Panel did not explain why a nine-year GATT report was a useful indicator of the contemporary market in Japan.
26. *Japan–Taxes on Alcoholic Beverages*, Report of the Panel, n.4 above, at para. 6.32. In its concluding paragraph, the Panel lists these other products as whisky, brandy, rum, gin, genever, and liqueurs; *id.*, at para. 7.1(ii). The Appellate Body calls this failure to include all of the products listed in the Panel's terms of reference an error of law; see *Japan–Taxes on Alcoholic Beverages*, Report of the Appellate Body, n.1 above, at 26. The Appellate Body adds these additional products to its holding; *id*, at 32. It is unclear whether the Appellate Body is making new findings of fact, or is simply correcting a drafting error by the Panel of failing to detail in para. 7.1(ii) all of the products alluded to in para. 6.32.
27. See text accompanying n.2 above.
28. *Japan–Taxes on Alcoholic Beverages*, Report of the Panel, n.4 above, at para. 6.33. The Panel also found that the dissimilarities were not de minimis. Japan argued that the beverages were similarly taxed on a tax/price ratio, but the Panel did not find this convincing.
29. *See Japan–Customs Duties, Taxes and Labelling Practices on Imported Wines* and *Alcoholic Beverages*, Report of the Panel, n.25 above, at para. 5.11 (providing four reasons for finding a violation of Article III:2's second sentence); *United States–Taxes on Petroleum and Certain Imported Substances*, Report of the Panel, GATT, BISD, 34th Supp., at 136 (no discussion of Article III:2's second sentence); *Italy–Discrimination Against Agricultural Machinery*, GATT, BISD, 7th Supp., at 60 (no discussion of Article III:2's second sentence).
30. *Japan–Taxes on Alcoholic Beverages*, Report of the Panel, n.4 above, at para. 6.33, 7.1(ii).
31. *Id.*, at para. 6.34.
32. *Japan–Taxes on Alcoholic Beverages*, Report of the Appellate Body, n.1 above. The Appellate Body also holds that the first-level Panel erred in stating that the adoption of WTO Panel reports constitutes 'subsequent practice' under international law. See *id.*, at 12–15.
33. *Id.*, at 16.
34. *Id.*, at 18.
35. *Id.*, at 23.
36. *Id.*, at 21–22.
37. *Id.*, at 22.
38. *Id.*, at 32.
39. *Id.*, at 27, 30, 32.
40. *Id.*, at 29–30.
41. *Id.*, at 29.
42. *Id.*, at 29–31.
43. *Id.*, at 27–28 (stating that the lack of a protectionist objective is irrelevant).
44. *Id.*, at 3, 8. The other three parties responded to this point. See *id.* at 6 (US response), 7 (EC response), and 8 (Canada response). In addition, the Commission suggested that this matter was factual, not legal.
45. *Id.,* at 32.
46. 'Japan Set to Comply with WTO Liquor Ruling, Will Revise Domestic Liquor Taxes', *J Comm*, (18 December 1996), at 4A.
47. John Maggs, 'WTO Official Shoots Down Japan's Bid To Delay Cuts in Liquor Taxes', *J Comm*, (18 February 1997), at 5A.
48. See Ernst-Ulrich Petersmann, 'International Trade Law and International Environmental Law–Prevention and Settlement of International Disputes in the GATT', *J World Trade*, 27 (February 1993) 43, 64.
49. James H. Snelson, 'Can GATT Article III Recover from its Head-on Collision with *United States – Taxes on Automobiles*', *Minn. J. Global Trade*, 5 (1996) 467, 502. See also Charles T. Haag, 'Legitimizing *Environmental* Legislation under the GATT in Light of the CAFE Panel Report: More Fuel for Protectionists', *U Pitt L Rev*, 79 (1995) 101 (arguing that deliberately inefficient measures violate Article III).
50. Charles T. Haag, n.49 above at 79, 103 (stating that the most significant impact of the *Auto Taxes* decision was the passing of the Uruguay Round's implementing legislation).
51. Eric Phillips, 'World Trade and the Environment: The CAFE Case', *Mich J Int'l L*, 17 (1996) 827.
52. See Kazumochi Kometani, 'Trade and Environment: How Should WTO Panels Review Environmental Regulations Under GATT Articles III and XX?', *NW J Int'l L & Bus.*, vol. 16 at 441, 447 (pointing to the dangers of a broad reading of *like* product).
53. *Japan–Taxes on Alcoholic Beverages*, Report of the Appellate Body, n.1 above, at 21.

54. The European Commission argues that even among *like* products, panels have flexibility to allow tax gradations based on certain product characteristics. *Japan–Taxes on Alcoholic Beverages*, Report of the Panel, n.4 above, at para. 4.45.
55. While environmental regulations will also affect imports, Article III may be less critical for regulations. This is because the WTO contains two separate agreements – 'Technical Barriers to Trade' and 'Sanitary and Phytosanitary Measures' – with tighter disciplines than Article III.
56. See generally Henry L. Thaggert, 'A Closer Look at the Tuna-Dolphin Case: "Like Products" and "Extrajurisdictionality" in the Trade and Environment Context', in James Cameron *et al.* (eds), *Trade and the Environment – The Search for Balance*, Vol. 1 (Cameron May Publishers, 1994).
57. See Steve Charnovitz, 'Green Roots, Bad Pruning: GATT Rules and their Application to Environmental Trade Measures', *Tulane Envtl L J*, 7 (1994) 299, 311–23.
58. *United States– Measures Affecting Alcoholic and Malt Beverages,* n.8 above, at para. 3.35.
59. *Id.*, at paras. 3.34, 3.36.
60. *Id.*, at para. 5.19. The panel did not seem to use the 'aim or effect' test it articulated elsewhere in its report. According to one participant, the Canadian Government told the Panel that if it allowed the US tax credit, then Canada could respond by giving a tax credit to its breweries, all of which are smaller than the large US breweries.
61. *United States– Standards for Reformulated and Conventional Gasoline*, Report of the Panel, 29 January 1996, reprinted in (1996) 35 ILM 274, at para. 6.11. See Steve Charnovitz, 'The WTO Panel Decision on U.S. Clean Air Act Regulations', *Int'l Env't Rep* , 19 (1996) 191.
62. *United States – Standards for Reformulated and Conventional Gasoline*, Report of the Appellate Body, 29 April 1996, (1996) 35 ILM 603.
63. *Id.*; *Japan–Taxes on Alcoholic Beverages*, Report of the Appellate Body, n.1 above. As this article went to press, two new reports of the Appellate Body were circulated.
64. See, e.g., P.J. Kuyper, 'The Law of GATT as a Special Field of International Law', *Neth YB Int'l Law*, (1994) 227–30, 255–56.
65. *United States– Standards for Reformulated and Conventional Gasoline*, Report of the Appellate Body, n.62 above, at 22; *Japan–Taxes on Alcoholic Beverages*, Report of the Appellate Body, n.1 above, at 17, 24.
66. *United States– Standards for Reformulated and Conventional Gasoline*, Report of the Appellate Body, n.62 above, at 16, 29; *Japan–Taxes on Alcoholic Beverages*, Report of the Appellate Body, n.1 above, at 14, 21–22, 26–27, 30, 32.
67. *Japan–Taxes on Alcoholic Beverages*, Report of the Appellate Body, n.1 above, at 21.
68. *Id.*, at 31.
69. *Id.*, at 16.

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The Commission for Environmental Co-operation and the Cozumel Case

Introduction

The North American Agreement on Environmental Co-operation (NAAEC), negotiated among Canada, the United States, and Mexico, went into effect along with the North American Free Trade Agreement (NAFTA) on 1 January 1994. It is the first time that an agreement for regional co-operation on the environment has been negotiated alongside a trade agreement.

The underlying pressure for this new trinational approach to environmental co-operation was inextricably linked to expanded North American economic integration. While the Canada-United States Free Trade Agreement had been negotiated in 1988-89 with little attention to the environment, NAFTA brought a complete set of environmental issues to the table that stemmed from the fact that it is a trade agreement negotiated between two developed countries, whose economies were already closely integrated, and a developing country, whose economy had a long-standing history of being relatively closed. Many of these environmental issues were similar to those being raised by some interest groups in the lead up to the creation, in 1994, of the World Trade Organization and an optimism, momentum and sense of unique opportunity existed among a constituency heretofore omitted from traditional bilateral and multilateral trade negotiations: environmentalists.

Among the most important environmental issues associated with the NAFTA negotiations were: that increased competition would encourage countries to lower their environmental standards in order to attract investment, thereby creating so-called pollution havens; that increased industrial activity would lead to increased pollution (particularly on the US-Mexican border) and increased consumption of natural resources including fossil fuels; that domestic and implementation of international environmental laws would be challenged as creating unnecessary trade barriers thereby threatening the integrity of multilateral agreements such as the Montreal Protocol or the Convention on the International Trade in Endangered Species (CITES) that include trade-restricting provisions to facilitate their enforcement; and, that countries would maintain high levels of environmental protection in theory, but in practice would reduce their emphasis on the enforcement of environmental laws in order to gain a competitive advantage.

In response to a strong domestic environmental lobby, the US Administration made a commitment to consider environmental issues in the negotiation of NAFTA and once negotiated in 1992, NAFTA was hailed as the 'greenest' trade agreement ever. It did indeed include a number of important provisions on the environment that went some way to addressing a number of the issues that the environmental community and other interest groups had been lobbying hard for.

In its preamble, NAFTA recognizes sustainable development as one of its goals. In order to address the concern that countries would lower standards in order to attract investment and to avoid a so-called 'race to the bottom', NAFTA's Article 1114 states that a Party should not attract investment by waiving environmental obligations or lowering standards. In an attempt to protect the integrity of the trade-restrictive enforcement provisions in multilaterally negotiated environmental treaties, NAFTA's Article 104 exempts from challenge certain multilateral agreements including the Montreal Protocol, CITES and the Basel Convention on the Transboundary Movement of Hazardous Waste. However, these provisions, along with additional measures on dispute settlement did not fully address the concerns of many North Americans regarding NAFTA's potential negative effects on