GENERAL AGREEMENT ON

TARIFFS AND TRADE

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UNITED STATES - TAXES ON PETROLEUM AND CERTAIN IMPORTED SUBSTANCES

Report by the Panel

1. INTRODUCTION

1.1 In a communication dated 7 November 1986 Canada requested consultations with the United States under Article XXII:1 on taxes on petroleum and certain imported substances levied under the "Superfund Amendments and Reauthorization Act of 1986" (L/6085). The European Economic Community (EEC) made the same request in a communication dated 30 October 1986 (L/6080). Mexico asked the United States to consult on the tax on petroleum in accordance with Article XXIII:1 in a communication dated 10 November 1986 (L/6093).

1.2 Canada, the EEC and Mexico held joint consultations with the United States under Article XXII:1 on 21 November 1986. As no satisfactory settlement was reached, Canada, in a communication dated 20 January 1987, asked the CONTRACTING PARTIES to establish a panel to examine the matter under Article XXIII:2 (L/6121). The EEC made the same request in a communication dated 22 January 1987 (L/6123). Mexico, in a communication dated 13 January 1987, referred the matter to the Director-General with the request that he use his good offices in accordance with the procedures under Article XXIII adopted by the CONTRACTING PARTIES in 1966 (L/6114 and BISD 14S/18).

1.3 The Council, at its meeting on 4 February 1987, considered the request for the establishment of a panel by Canada and the EEC. As to the complaint by Mexico, the Director-General informed the Council that, after consultations with the interested delegations and taking into account that two requests for a panel in the same matter were before the Council, he could inform the contracting parties that Mexico and the United States had agreed that this matter be pursued in a panel. It was suggested in the Council that, in the interests of efficiency and expediency, the three complaints be examined by a single panel. Canada, the EEC and Mexico agreed with this suggestion provided that their rights under the panel procedures were thereby not impaired (C/M/206).

1.4 The Council agreed to establish a panel with the following terms of reference:

> "To examine, in the light of the relevant GATT provisions, the matters referred to the CONTRACTING PARTIES by
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> (a) Canada in document L/6085,
> (b) the European Economic Community in document L/6123, and
> (c) Mexico in document L/6114,

and to make such findings as will assist the CONTRACTING PARTIES in making the recommendations or in giving the rulings provided for in Article XXIII:2."

The Council adopted this decision subject to the following understanding:

"1. The Panel will organize its examination and present its findings to the Council in such a way that the procedural rights which the parties to the dispute would have enjoyed if separate panels had examined the complaints are in no way impaired. If one of the complainants so requests the panel will submit a separate report on the complaint of that party.

2. The written submissions by each of the complainants will be made available to the other complainants and each complainant will have the right to be present when one of the other complainants presents its views to the Panel" (C/M/206).

1.5 The Council authorized its Chairman to designate the chairman and members of the Panel in consultation with the parties concerned (C/M/206). The Council Chairman informed the contracting parties on 27 February 1987 that agreement had been reached on the following composition of the Panel (C/146):

Chairman: Mr. Michael D. Cartland

Members: Mr. Christer Manhusen
Mr. Kyotaka Akasaka

1.6 At the Council meeting on 4 February 1987 Argentina, Australia, Chile, Colombia, Indonesia, Kuwait, Malaysia, Nigeria and Norway reserved their rights to make a submission to the Panel in accordance with paragraph 15 of the Understanding regarding Notification, Consultation, Dispute Settlement and Surveillance (C/M/206 and BISD 26S/213). The Panel addressed letters to these contracting parties offering them the possibility to be heard by the Panel. Australia, Indonesia, Kuwait, Malaysia, Nigeria and Norway made use of this possibility. Their views are summarized below in paragraphs 4.1 to 4.6.

1.7 The Panel met with the parties on 2 and 30 March and on 4 May 1987 and with interested third parties on 31 March 1987. It submitted its report to the parties to the dispute on 27 May 1987.

1.8 The terms of reference of the Panel were adopted on the understanding that the Panel present its findings to the Council in such a way that the procedural rights which the parties to the dispute would have enjoyed if separate panels had examined their complaints are in no way

impaired (see above para. 1.4). The Panel noted that, while the three complaining parties had requested findings on the tax on petroleum, only Canada and the EEC but not Mexico had requested findings on the tax on certain imported substances. The parts of this report containing the arguments and conclusions therefore deal with the tax on petroleum and the tax on imported substances in separate sections so as to permit separate decisions by the Council on each of the two taxes should this be necessary to protect the procedural rights referred to in the Council decision.

2. FACTUAL ASPECTS

2.1 The "United States Superfund Amendments and Reauthorization Act of 1986" (hereinafter referred to as the "Superfund Act") was signed into law on 17 October 1986. The Superfund Act reauthorized a programme to clean up hazardous waste sites and deal with public health programmes caused by hazardous waste. It provided for excise and corporate income taxes and appropriations to pay for the cost of these programmes. The Superfund Act introduced in particular a new broad-based corporate income tax and authorized yearly appropriations from general government revenues. It further (a) re-imposed an excise tax on petroleum at higher rates, (b) re-imposed a tax on certain chemicals ("feedstock chemicals"), and (c) imposed a new tax on certain imported substances produced or manufactured from taxable feedstock chemicals.

2.2 The tax on petroleum, which had been imposed at the rate of 0.79 cent per barrel for both domestic and imported products, was increased to 8.2 cents per barrel for "crude oil received at a United States refinery" and 11.7 cents a barrel for "petroleum products entered into the United States for consumption, use or warehousing." The term "crude oil" is defined to include crude oil condensate and natural gasoline. The term "petroleum products" is defined to comprise not only the products defined as "crude oil" but also refined gasoline, refined and residual oil, and certain other liquid hydrocarbon products. The tax increases went into effect on 1 January 1987.

2.3 The Superfund Act reimposed a tax on certain chemicals with effect from 1 January 1987. The taxable chemicals and the applicable tax rates are listed in Annex I. The tax rates were set at the lower of either $4.87 per ton for petrochemicals and $4.45 per ton for inorganic chemicals or a dollar amount equivalent to 2 per cent of the 1980 wholesale price of the chemical. The tax is borne by the chemicals whether they are sold by the manufacturer, producer or importer thereof. The tax is not imposed if the manufacturer or producer of the taxable chemical sells it for export or for resale by the purchaser to a second purchaser for export.

2.4 The Superfund Act further imposes a new tax on certain imported substances sold or used by the importer thereof. This tax enters into effect on 1 January 1989. The Superfund Act establishes an initial list of taxable substances, which is reproduced in Annex II. The taxable substances are derivatives of the chemicals subject to the tax on certain chemicals

described in the preceding paragraph. A substance shall be added to the list if the Secretary of the Treasury, in consultation with the Administrator of the Environmental Protection Agency and the Commissioner of Customs, determined that chemicals subject to the tax on certain chemicals constitute more than 50 per cent of the weight of the materials used to produce such substance (determined on the basis of the predominant method of production). He may also, to the extent necessary to carry out the purposes of the legislation, add any substance to the list if the value of the taxable chemicals constitutes more than 50 per cent of the total value of the materials used to produce the substance. The Secretary of the Treasury may also withdraw items from the list of taxable substances as necessary to carry out the purposes of the legislation.

2.5 The amount of tax on any of the imported substances equals in principle the amount of the tax which would have been imposed under the Superfund Act on the chemicals used as materials in the manufacture or production of the imported substance if the taxable chemicals had been sold in the United States for use in the manufacture or production of the imported substance.

2.6 Importers will be required to provide sufficient information regarding the chemicals inputs of taxable substances to enable the tax authorities to determine the amount of tax to be imposed. If the importer fails to furnish such information a tax shall be imposed equivalent to five per cent of the appraised value of the product at the time it was entered into the United States for consumption, use, or warehousing. However, the Secretary of the Treasury may prescribe by regulation, in lieu of the five per cent rate, a rate which would equal the amount that would be imposed if the substance were produced using the predominant method of production.

3. MAIN ARGUMENTS

3.1 Tax on petroleum

3.1.1 Canada, the EEC and Mexico stated that the tax on petroleum was levied at the rate of 11.7 cents a barrel on imported products while domestic products were subject to a tax of only 8.2 cents a barrel. The United States thus imposed an internal tax on imported products in excess of the tax applied to like domestic products and therefore acted inconsistently with Article III:2 of the General Agreement. According to GATT practice an infringement of obligations assumed under the General Agreement was considered prima facie to constitute a case of nullification or impairment within the meaning of Article XXIII (BISD 26S/206). Canada, the EEC and Mexico therefore requested the Panel to find that the tax on petroleum was inconsistent with Article III:2 of the General Agreement and nullified or impaired benefits accruing to them under the General Agreement and to recommend that the United States bring the tax on petroleum in conformity with the General Agreement.

3.1.2 The United States said that it was correct that the tax on petroleum was applied to imported products at a rate that was higher than the rate applied to like domestic products. However, the tax differential was so small that its commercial effects were insignificant. The tax amounted to approximately US$0.0007 per litre for imported goods and US$0.0005 per litre for domestic goods. The difference of US$0.0002 per litre was insignificant when compared to day-to-day changes in contract prices for petroleum. The United States submitted to the Panel detailed statistics comparing the tax differential with price developments in the petroleum market. According to these statistics the difference between the highest and lowest spot prices per barrel of oil of the type "West Texas Intermediate" was US$3 in December 1986, or 15 cents per trading day during that month. The contract prices for one-month futures had risen by US$2.63 per barrel in December 1986 and day-to-day fluctuations during that month were on average 30 cents within each trading day. The United States contended that, given such price fluctuations, the small tax differential of 3.5 cents could not appreciably influence petroleum buyers' decisions and that these were accustomed, as a matter of ordinary commercial practice, to ignore price and quality variations of considerably greater importance. In its view the tax differential was also too small to stimulate investments in domestic oil production. The United States oil production had fallen in recent years (between the beginning of 1986 and mid-March 1987 by about 700.000 barrels per day) and a tax differential of 3.5 cents per barrel could not reverse this trend.

3.1.3 The United States further stated that the tax differential's effect on overall demand for imported petroleum was minimal or nil. The consumers' response to changes in the price of oil was so inelastic that the small tax differential could not have a noticeable effect on demand. At current market prices the 3.5 cents per barrel tax differential amounted to approximately 0.19 per cent of the price. Using -0.1 as a reasonable estimate of the short-term price elasticity of crude oil demand, a 0.19 per cent price increase on the 4.8 million barrels per day of net imports of crude oil and petroleum products into the United States, averaged into total United States crude oil and petroleum products demand of 16.4 million barrels per day, amounted to a price increase of less than 0.06 per cent overall, resulting in a demand decrease of about 900 barrels per day or US$6 million per year at current prices. In spite of the tax differential the United States would thus import approximately the same volume of oil and petroleum products as before. For these reasons the United States asked the Panel to find that the tax on petroleum did not have adverse trade effects and consequently did not nullify or impair benefits accruing to Canada, the EEC or Mexico under the General Agreement.

3.1.4 Canada, the EEC and Mexico noted that the United States had not presented any arguments to counter their contention that the tax on petroleum was contrary to Article III:2 but had merely attempted to demonstrate that the commercial effect of the tax differential was insignificant. This argument was not a valid legal defence. It had already been recognized in 1949 by the majority of the members of the

Working Party on Brazilian Internal Taxes "that, whether or not damage was shown, taxes on imported products in excess of those on like domestic products were prohibited by Article III, and that the provisions of Article III were intended to prevent damage and not merely to provide a means of rectifying such damage" and that "the provisions of the first sentence of Article III, paragraph 2, were equally applicable whether imports from other contracting parties were substantial, small or non-existent" (BISD Vol. II/184 - 185). The view expressed in this Working Party had also been expressed by the United States when it rejected in November 1981 the report of the Panel on "Spain - Measures Concerning Domestic Sale of Soyabean Oil" (L/5161 and C/M/152).

3.1.5 The United States replied that it was not arguing that trade effects were relevant in determining whether or not a measure was consistent with Article III. It was arguing that the procedures of Article XXIII applied to cases of nullification and impairment and that it was established GATT practice that, even if a measure was considered prima facie to constitute a case of nullification and impairment under Article XXIII, the party against whom the action had been brought could rebut the allegation of nullification or impairment. This practice was reflected in paragraph 5 of the Annex to the 1979 Understanding on dispute settlement which stated that it was in the case of a prima facie case of nullification or impairment "up to the contracting party against whom the complaint has been brought to rebut the charge" (BISD 26S/216). The United States emphasized that it had provided ample evidence to rebut the charge of nullification or impairment.

3.1.6 Mexico noted that the United States' position was ambivalent. On the one hand the United States did not admit a breach of Article III, on the other it evoked the concept of prima facie nullification and impairment which was relevant only in the case of a breach of obligations. Canada, the EEC and Mexico disagreed that the 1979 Understanding on dispute settlement could be interpreted to allow for a rebuttal of the presumption that a breach of GATT obligations, in itself, causes nullification or impairment. Paragraph 4 of the Annex to the Understanding clearly stated that, in the absence of a mutually agreed solution to a dispute, "the first objective of the CONTRACTING PARTIES is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the General Agreement." Paragraph 4 did not state that the CONTRACTING PARTIES aimed at the withdrawal of inconsistent measures only if these had adverse trade effects. According to paragraph 5 of the Annex to the 1979 Understanding on dispute settlement cited by the United States the possibility to rebut the presumption that a breach of the rules had an adverse trade impact was not given in the context of a decision of the CONTRACTING PARTIES on nullification and impairment but in the context of a decision on whether, in the case of a measure inconsistent with the General Agreement, the circumstances were serious enough to authorize compensatory action. Paragraph 5 of the Annex recognized that, if a measure inconsistent with GATT was not immediately withdrawn, the adversely affected contracting parties may make claims regarding the

compensatory actions to which they were entitled. The function of the paragraph was to place the onus on the contracting party maintaining the inconsistent measure to rebut these claims. A contextual analysis of paragraphs 4 and 5 of the Annex to the 1979 Understanding on dispute settlement thus clearly showed that there was an irrefutable presumption that a breach of the rules of the General Agreement caused nullification or impairment within the meaning of Article XXIII and that the question of trade effects was relevant only for a decision to authorize compensatory action and for determining the extent of compensation owed when the immediate withdrawal of an illegal measure could not be secured. The Panel on "Canada - Administration of the Foreign Investment Review Act" had clearly proceeded on this basis. It had stated in its report adopted in 1984 that it believed "that an evaluation of the trade effects was not directly relevant to its findings because a breach of a GATT rule is presumed to have an adverse impact on other contracting parties" (BISD 30S/167).

3.1.7 The United States replied that it was not asserting that it was necessary for a finding of nullification or impairment to first establish statistical evidence of damage. The report of the Panel on "Treatment by Germany of Imports of Sardines" had made clear that this was not necessary (BISD 1S/56). However, it was also clear that, if the party complained against could demonstrate the absence of trade effects, the Panel had to take this into account.

3.1.8 Canada, the EEC and Mexico said that one of the benefits accruing to them under the General Agreement certainly was the observance by other contracting parties of the fundamental GATT principle of national treatment. Mexico pointed out that one of the basic benefits accruing under the General Agreement was precisely that of having a contractual instrument which made it possible to know in advance the rules and principles that applied between the parties and that would be observed by them. If a violation of these rules and principles were permitted on the grounds that the violation had insignificant trade effects, it would establish a dangerous precedent that would weaken the GATT. Mexico stated that, in the present case, a basic benefit accruing under the General Agreement had been nullified or impaired, namely that of national treatment in matters of internal taxation and regulation, a benefit which Mexico did not have before acceding to the General Agreement.

3.1.9 Canada, the EEC and Mexico emphasized that if the Panel were to examine the trade effects of the tax differential it would have to conclude that the tax differential did adversely affect their trade. Canada stated that the United States imported, according to the indications given to the Panel (see paragraph 3.1.3 above), at present about 4.8 million barrels per day. At this volume of imports the tax differential of 3.5 cents per barrel applied to imported products resulted in revenues to the United States government of more than US$61 million annually. Canada's share of the resulting fiscal burden was about US$9 million. These amounts were not commercially insignificant. The EEC said

that the annual cost of the tax differential was US$8.7 million for Community suppliers, estimated on the basis of 1985 supplies. In the highly competitive and price sensitive oil market a price differential of 3.5 cents could very well determine the buyer's decision on whether to give preference to imported or domestic products. The tax differential gave buyers an incentive to buy domestic products whether prices were volatile or not and whether total demand for petroleum was elastic or not. The effect of the tax differential on investments was not relevant for the determination of nullification and impairment because, in the application of this concept, the question of whether the conditions of competition for imported products had been changed relative to those for domestic goods was relevant but not the question of whether the change in competitive relationships had stimulated domestic investments. The EEC therefore considered the United States submissions on oil price volatility, price elasticity and production effects to be irrelevant even if it were accepted that the charge of nullification and impairment caused by an illegal measure could be rebutted by demonstrating that the measure had insignificant trade effects.

3.1.10 Mexico stated that the tax differential meant that imported products paid a tax almost 43 per cent higher than that applied to domestic products. This gave a clear advantage to United States suppliers. In the first quarter of 1987 the tax differential had cost Mexico already about US$2 million. If the present volume of petroleum exports to the United States were maintained, the cost to Mexico during 1987 would amount to about US$8 million. That sum was not commercially insignificant, especially for a developing country like Mexico which needed foreign exchange earnings to finance its development and to service its debt.

3.1.11 The United States said that while the revenue effect of the tax differential may be significant, the trade effect was not; the 3.5 cents per barrel was a cost to the importer, not the exporting country and would (as assumed under the border tax adjustment provisions of the General Agreement) be passed through to consumers in any event. Moreover, the revenue amounts cited by Canada, the EEC and Mexico should be seen in relation to the total sales. Compared to the US$3.9 billion petroleum imports from Canada, the US$9 million additional tax revenue amounted to only 0.2 per cent. Canada, the EEC and Mexico asked the United States: If the tax differential did not have any impact on imports, as the United States claimed, what then was the purpose of the differentiation between imported and domestic products? If the effect of the tax differential was indeed insignificant there should be no economic difficulty in immediately removing the discrimination.

3.1.12 Canada raised concerns that petroleum products exported from Canada which were made from synthetic petroleum could be subject to the tax while similarly produced domestic petroleum products might not be taxed. The United States responded that the Superfund Act was silent as to whether synthetic products should be included in the definition of "petroleum products entered into the United States". Therefore, this matter was being

considered in the context of proposed legislation to effect technical corrections to the Superfund Act, and could be considered when regulations were formulated to implement the Act.

3.2 Tax on Certain Imported Substances

3.2.1 The United States objected to an examination of this tax by the Panel. The tax did not go into effect before 1 January 1989 and therefore had no immediate effect on trade. It could not cause nullification or impairment and was consequently outside the scope of Article XXIII. According to paragraph 5 of the Annex to the 1979 Understanding on dispute settlement, contracting parties had recourse to Article XXIII only when in their view a benefit accruing to them under the General Agreement was being nullified or impaired (BISD 26S/216). This implied that the function of panels was not to render hypothetical conclusions on measures that were not yet in effect.

3.2.2 Canada and the EEC considered it appropriate for the Panel to examine the tax. The legislation establishing the tax was in force and the date for its implementation fixed. Already before its actual implementation the tax could affect decisions on investments and supply contracts. The CONTRACTING PARTIES had in this case the opportunity to act before more serious trade damage had occurred and there was no valid reason not to seize that opportunity. Canada and the EEC pointed out that the CONTRACTING PARTIES had in previous cases taken decisions on legislation that was not in operation. Before the Panel on "United States - Prohibition of Imports of Tuna and Tuna Products from Canada", the United States had argued that "the lifting of the import prohibition had removed the practical source of complaint by Canada and rendered the dispute before the Panel hypothetical". Canada had argued that "in the absence of a ratified agreement, there remained a risk, that the discriminatory prohibition ... could be reimposed, or indeed extended, to other products", and that there was "a threat of further discriminatory United States import restrictions being imposed". The Panel had considered the matter and had "decided to proceed with the work and establish a complete report" (BISD 29S/103-106). That measures imposed inconsistently with the General Agreement could nullify or impair benefits accruing under the General Agreement before they were actually applied to specific imports had also been recognized by the CONTRACTING PARTIES when they adopted the report of the Panel on "Japanese Measures on Imports of Leather". This Panel had stressed that in spite of the fact that the leather quota had not been filled, "the existence of a quantitative restriction should be presumed to cause nullification or impairment not only because of any effect it had had on the volume of trade but also for other reasons e.g., it would lead to increased transaction costs and would create uncertainties which could affect investment plans" (BISD 31S/113).

3.2.3 The United States replied that the present case differed from the previous cases because in the present case the precise manner in which the measure at issue would be implemented had not yet been determined. The regulations implementing the tax on certain imported

substances would be drafted only in 1988, after the Secretary of the Treasury had submitted a study to Congress on the issues related to the implementation of the tax. Only after these regulations were available could the tax and its trade effects be subjected to a definitive assessment. At this stage, the Panel therefore did not have enough information to examine the tax.

3.2.4 Canada and the EEC said that the essential elements of the tax were already known: the Superfund Act established an internal tax on certain imported substances without imposing an equivalent tax burden on like domestic products. The implementing regulations could not change that. The Panel could find that the legislation, if implemented in its current form, would be contrary to Article III:2.

3.2.5 The United States contended that, if the Panel were to decide to examine the tax, it would have to conclude that the tax constituted a border tax adjustment fully consistent with Articles II:2(a) and III:2 of the General Agreement. The principle to be applied in implementing the legislation was that the amount of tax to be imposed on the imported substances would equal the amount of tax that would have been imposed on the chemicals used in producing the imported substances if the chemicals had been sold in the United States for an equivalent use. The Superfund Act thus imposed the same fiscal burden on imported and like domestic substances: Substances of domestic origin bore a fiscal burden corresponding to the tax on the chemicals used in their production. Imported substances bore the same burden because the tax on certain imported substances was equal to the tax that would have been levied on the chemicals used in the production of the imported substances had they been produced in the United States. This form of border tax adjustment was explicitly foreseen in Article II:2(a), which read:

> "Nothing in this Article shall prevent any contracting party from imposing at any time on the importation of any product ... a charge equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of Article III in respect of the like domestic products or in respect of an article from which the imported product has been manufactured or produced in whole or in part ..." (emphasis added).

3.2.6 The drafters of the General Agreement had clearly contemplated the possibility for making border tax adjustments in respect of imported products that contained substances subject to an internal tax. Thus they had agreed with respect to the word "equivalent" in Article II:2(a) that it meant:

> "for example, if a [charge] is imposed on perfume because it contains alcohol, the [charge] to be imposed must take into consideration the value of the alcohol and not the value of the perfume, that is to say the value of the content and not the value of the whole" (EPCT/TAC/PV/26, p. 21).

3.2.7 The EEC replied that it followed from the report of the Working Party on Border Tax Adjustment, adopted by the CONTRACTING PARTIES in 1970 (BISD 18S/100), that not all taxes were eligible for border tax adjustment irrespective of the nature and purpose of such taxes. A tax levied on the sale of a product to finance a specific service rendered by the government for the benefit of domestic producers or made necessary by their activities was not eligible for border tax adjustment because this meant that a tax was imposed on products from foreign producers which neither benefited from that service nor caused it to be needed. The GATT had recognized so far only sales taxes and excise taxes to be eligible for border tax adjustment. The tax on certain feedstock chemicals was different from a sales tax or excise tax imposed for general revenue purposes in that it was imposed on specific products for a specific purpose, namely to finance measures to clean up the hazardous waste created by the use of such substances in the process of production in the United States. It was a tax on pollution or potential pollution which was imposed for obvious reasons of administrative convenience and certainty on the products which were likely to pollute rather than on the activity of causing pollution. This tax was not eligible for border tax adjustment since the feedstock chemicals and the imported chemical derivatives were not in the same situation. The EEC and Canada said that the pollution created in the production of the imported substances did not occur in the United States. It was therefore inappropriate to tax these substances upon entry in the United States. It was equally inappropriate to exempt exports sales from the tax on certain chemicals because the pollution caused by the production of these chemicals occurred in the United States whether the chemicals were sold in the domestic market or abroad. Both tax adjustments were therefore inconsistent with the environmental purpose of the Superfund Act. The EEC also pointed out that the tax adjustments departed from the principles adopted by the OECD Council in 1972 in its recommendation on Guiding Principles concerning International Economic Aspects of Environmental Policies (OECD Document C (72) 128 of 6 June 1972). In particular they departed from the Polluter-Pays Principle which meant that the polluter should bear the costs of measures decided by public authorities to ensure that the environment was in an acceptable state. On the basis of this principle the OECD had recommended that differences in environmental policies should not lead to the introduction of compensating import levies or export rebates.

3.2.8 The EEC added that it was incorrect to assume that the border tax adjustments were necessary to avoid giving foreign producers an unfair competitive advantage. In accordance with the Polluter-Pays Principle the foreign competitors of the United States producers of the taxable chemicals and substances could be assumed to have paid for the pollution caused by the production of the chemicals and substances either directly - by paying a tax for the removal of pollution - or indirectly - by meeting regulatory requirements designed to prevent pollution. The

border tax adjustments effected by the United States gave in fact the United States' producers an unfair competitive advantage. A chemical exported from the United States to the EEC was not subjected to any environmental taxes: it was exempted from the tax under the Superfund Act and no corresponding tax was imposed when it was imported into the EEC. Conversely, a substance containing the chemical exported from the EEC to the United States would have to bear the costs of environmental protection twice: once in the exporting country in accordance with the Polluter-Pays Principle and upon importation into the United States under the Superfund Act. What the United States was in fact doing under the label of border tax adjustments was to ask foreign producers to help defray the costs of cleaning up the environment for the United States industries.

3.2.9 The United States stated that the Polluter-Pays Principle had not been adopted by the CONTRACTING PARTIES and it was on the GATT provisions and not on OECD recommendations that the Panel had to base its conclusions. It was therefore irrelevant whether that principle had been observed. Moreover, the Superfund Act's primary function was to raise revenue, not to alter consumer or producer behaviour to take into account the cost of environmental resources. The fiscal motivation behind the Superfund Act was reflected in the fact that it provided also for a new corporate tax - imposed on almost all corporations, whether engaged in polluting activities or not - and appropriations from general tax revenue. For these various reasons the United States considered that it would be inappropriate for the Panel to determine the consistency of the tax on certain imported substances with the General Agreement on the basis of the Polluter-Pays Principle. Environmental policy principles related to trade could conceivably be incorporated into the GATT legal system, but such a far-reaching step required the cooperation of all contracting parties and could be taken only after considerable study and discussion. A reinterpretation of the existing GATT rules on border tax adjustments would not be the proper vehicle to introduce such principles.

3.2.10 The United States added that the EEC was in any case basing its objections on the erroneous assumption that environmental resources were consumed only in the production of goods. In fact certain substances could cause pollution throughout their life-cycle, from production to disposal. That meant that they could cause pollution not only before but also after importation. If the objective of the Polluter-Pays Principle was to internalize all negative externalities caused by polluting activities, environmental taxes had to take into account not only the pollution caused in the production process but also the costs of disposal. When a toxic chemical was exported, the cost of its disposal was exported as well. It would then be quite appropriate to tax not only domestic but also imported products.

3.2.11 The EEC replied that the reasoning advanced by the United States did not apply to several of the products subject to the taxes on certain chemicals and on certain imported substances. For instance, ethylene and benzene were volatile chemicals, the production of which required special measures to prevent pollution. Once polymerized to polystyrene, they no longer caused special pollution problems because they could be disposed of in the same manner as household refuse. Similarly, the production of ethylene created environmental problems; its derivative polyethylene however was a type of paraffin which posed no more disposal problems than candle wax. The same applied to styrene-butadiene latex and synthetic rubbers, which were stable and non-reacting substances, derived from volatile hydrocarbons such as ethylene, propylene, butadiene and styrene.

3.2.12 Canada and the EEC stated that, whether the tax on chemicals was eligible for border tax adjustment or not, the tax on imported substances was in any case not in conformity with Article III:2 because it did not meet the General Agreement's requirements for border tax adjustments. The Working Party on Border Tax Adjustments, the report of which had been adopted by the CONTRACTING PARTIES in 1970, had agreed that the rules of the General Agreement dealing with border tax adjustments "set maxima limits for adjustment (compensation) which were not to be exceeded, but below which every contracting party was free to differentiate in the degree of compensation applied, provided that such action was in conformity with other provisions of the GATT" (BISD 18S/100). One of the criteria against which the tax on certain imported substances thus had to be examined was that a border tax adjustment must not exceed a maximum limit equal to the tax applied to like domestic products. The Superfund Act contained a provision directing the Secretary of the Treasury to impose a 5 per cent of the appraised value tax on imported products unless sufficient information was provided to the Secretary to allow a determination of the amount of tax which would have been imposed on the chemicals used in the production or manufacture of the product. The tax level of 5 per cent was significantly in excess of the maximum tax allowed under the provisions for the tax on certain chemicals. The legislation thus allowed for an internal tax on imported chemicals that was higher than the tax that could ever be applied to domestic chemicals. Canada expressed particular concern about this aspect of the legislation.

3.2.13 The United States emphasized that the tax of 5 per cent of the appraised value applied only if the importer did not furnish the information necessary to permit the levying of a tax equivalent to the tax borne by the like domestic product. In all probability the 5 per cent penalty tax would never be applied because the Superfund Act authorized the Secretary of the Treasury to prescribe by regulation, in lieu of the 5 per cent penalty tax, a tax the rate of which was equivalent to the tax that would be applied if the imported substance had been produced with the predominant method of production.

3.2.14 Canada and the EEC noted that the Superfund Act provided that the Secretary "may" prescribe a lower level of tax, but that the use of this lower level was not required by the Act. The legislation thus effectively prescribed the imposition of an internal tax in excess of that applied to like domestic products in violation of Article III:2 unless the Secretary chose to prescribe otherwise. Moreover the importer could benefit from the normal rates only by providing the Secretary with sufficient information to determine the appropriate level of tax. Domestic producers were not subjected to such a requirement. Given the complexity of the production processes, the fact that proprietary information may be involved and the wide range of products affected, the additional administrative burden imposed on importers could place foreign producers at competitive disadvantage relative to producers in the United States.

3.2.15 The United States stated that the Treasury regulations implementing the tax on certain imported substances were not yet drafted. It was therefore not known which tax rates would actually be applied to imported substances in respect of which insufficient information was made available and how much information importers would actually have to provide. Any conclusions of the Panel would therefore be only of a hypothetical nature. This demonstrated clearly that it was too early to arrive at any conclusions as to the consistency of the tax with the General Agreement.

4. SUBMISSIONS BY INTERESTED THIRD PARTIES

4.1 Australia

4.1.1 Australia stated that the imposition of a higher rate of tax on imported crude oil and petroleum products than that applied to like domestic products was inconsistent with the United States' obligations under Article III:2. The tax differential of 3.5 cents per barrel constituted a form of protection to the identical domestic product which was taxed at a lower rate.

4.1.2 In interpretations of Article III the CONTRACTING PARTIES had agreed that a contracting party was bound by the provisions of Article III, whether or not it had entered into tariff commitments with respect to the goods concerned (BISD, Vol. II/182) and that the question of whether or not the tax breached bindings was therefore irrelevant to the determination of whether the tax was inconsistent with the provisions of Article III. It was however apparent that the imposition of an additional tax, at the point of entry of the product, did in fact breach a number of GATT bindings.

4.1.3 The Working Party on Brazilian Internal Taxes had agreed that the provisions of Article III applied, whether or not imports from other contracting parties were substantial, small, or non-existent (BISD Vol. II/185). Article III thus protected small suppliers (such as Australia in the present case) and substantial suppliers alike. The Working Party had taken the view that, whether or not damage was shown, taxes on imported products in excess of those on domestic products were prohibited by Article III, and that the provisions of Article III were intended to prevent damage and not merely to provide a means of rectifying such damage (BISD Vol. II/184). Similarly, during the discussion in the Council of the Panel report on "Spain - Measures Concerning Domestic Sale of Soyabean Oil" (which had not been adopted by Council but only noted), many contracting parties had stated that neither the language of Article III nor past interpretations of its provisions, nor the 1979 Understanding on dispute settlement, supported an interpretation that internal regulations which protect domestic production must have restrictive effects on directly competitive or substitutable products in order to be found contrary to Article III. The rule embodied in the 1979 Understanding on dispute settlement was "that there is normally a presumption that a breach of the rules has an adverse impact on other contracting parties, and in such cases, it is up to the contracting parties against whom the complaint has been brought to rebut the charge" (BISD 26S/216). Only after a breach of the rules had been found, independent of the question of injurious effects, the question of adverse effects could be considered. Some representatives had also noted that adverse effects could not only be measured by direct effects on import volume in the country maintaining the measure but could manifest themselves as well by other trade-distorting consequences, including possible suppression of growth of trade (C/M/152).

4.1.4 Australia's share of United States' imports of petroleum and petroleum products to date had been relatively small (the largest share in the past 3 years having been 1.1% in 1985). Nevertheless these products were a significant item in Australia's exports. The value of Australia's exports of oil and petroleum products to the United States in Australian dollars for the period 1983/84 - 1985/86 had been as follows:

($A'000)

	1983/84	1984/85	1985/86
Crude petroleum	106,143	736,820	407,091
Refined petroleum	44,974	72,841	36,983

Australia was concerned about the effects on any future growth of trade in these products which this differential tax could have. Australia was not convinced by the United States' argument that the effect of the differential would be insignificant.

4.2 Indonesia

4.2.1 Indonesia pointed out that petroleum and petroleum products played an important rôle in Indonesia's development. These products accounted for nearly 70 per cent of Indonesia's export receipts and 60 per cent of its government revenues. Sales had been affected considerably not only by lower prices but also by unstable demand in the international market. 35 per cent of the total Indonesian production of petroleum and petroleum products had been exported to the United States: 114 million barrels in 1984, 103.7 million barrels in 1985 and 113.8 million barrels in 1986. As the trade in these products was carried out in dollars, the decline in the value of the dollar had caused a significant decline in Indonesia's export earnings in the United States market, namely about 13.3 per cent in 1985 and 44.8 per cent in 1986. Any additional constraints on Indonesia's petroleum and petroleum products exports would aggravate its development problems.

4.2.2 Indonesia emphasized that it supported the environmental objectives of the Superfund Act but objected to the raising of funds in a way that violated the General Agreement - in particular its Article III - , discriminated in favour of domestic products and made developing countries pay for the protection of the environment in an industrialized country.

4.3 Kuwait

4.3.1 Kuwait shared the concern shown by other contracting parties about the tax imposed by the United States on imports of petroleum and petroleum products to finance the Superfund. In its view the adoption of this legislation was contrary to, and incompatible with, the provisions of Article III of the General Agreement.

4.3.2 Kuwait was opposed to all taxes and other measures by industrialized countries affecting the importation of oil, petro-products and petro-chemicals. Such taxes had negative effects on the trade and development of the exporting countries and reduced the volume of international trade in general.

4.4 Malaysia

4.4.1 Malaysia stated that the tax on petroleum, because it discriminated against imported products, was contrary to Article III:2. No matter what the level of difference between the two taxes was, the principle remained that there was a discriminatory element.

4.4.2 International prices for petroleum had fallen drastically, and like all other developing countries producing and supplying petroleum, Malaysia had suffered from a correspondingly drastic decline in foreign exchange earnings from the sale of petroleum. This situation had been further exacerbated by the imposition of the discriminatory tax which gave an advantage to United States domestic oil producers. Malaysia's exports of crude petroleum to the United States in 1982, 1983, 1984 and 1985 were (at the current exchange rates) US$ 110.3 million, US$72.94 million, US$21.58 million and US$21.16 million respectively. The figures, whilst showing a decline, were by no means a measure of the importance Malaysia placed in the United States market for its petroleum. Its petroleum industry was constantly seeking new markets. The imposition of the discriminatory tax adversely affected these endeavours. Malaysia therefore believed that the tax was also inconsistent with Part IV of the General Agreement, in particular Article XXXVII:1.

4.5 Nigeria

4.5.1 Nigeria stated that it recognized the need to solve the problem of hazardous wastes but that it saw no justification for the imposition of discriminatory taxes for that purpose. It rejected the claim of the United States that the trade effect of the differential of 3.5 cents per barrel between imported and domestic oil was nil or minimal. The tax differential was clearly contrary to Article III and for an oil-exporting developing country such as Nigeria it was essential that it be removed in the shortest time possible.

4.5.2 Nigeria said that the United States should be asked to reconsider its position. Developing countries, faced with serious debt and commodity price problems, should not be denied their rights under the General Agreement. The United States should assume the responsibility it had as the largest trading nation for maintaining the credibility of the General Agreement.

4.6 Norway

4.6.1 Norway said that it supported the motives behind the Superfund and that it also did not oppose the use of a tax as a means to reach environmental policy goals provided that the tax was in conformity with international obligations. The tax on petroleum however discriminated against foreign suppliers and therefore violated Article III. The Norwegian authorities were concerned about the tax not only for reasons of principle but also because of its direct economic repercussions.

4.6.2 The total net exports from the oil-producing countries were approximately 18 million barrels per day and of this quantity approximately 5 million barrels per day went to the United States. The United States accounted for one third of world energy consumption, state-trading countries excluded. If discriminatory taxes of the kind imposed by the United States were accepted, they could proliferate and lead to added protection. Norway rejected the argument that the tax differential of 3.5 cents per barrel was negligible. The total tax burden on Norwegian oil exports would amount to about US$3.4 million, of which US$1.0 million would be due to that discriminatory element, estimated on the basis of 1986 exports.

5. FINDINGS AND CONCLUSIONS

5.1 Tax on petroleum

5.1.1 The Panel examined the tax on petroleum in the light of the obligations the United States assumed under the General Agreement and found the following: The tax on petroleum is an excise tax levied on imported and domestic goods. Such taxes are subject to the national treatment requirement of Article III:2, first sentence, which reads:

> "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".

The CONTRACTING PARTIES have not developed a definition of the term "like products" in the above provision. In the report of the Working Party on Border Tax Adjustments, adopted by the CONTRACTING PARTIES in 1970, it was suggested that the problems arising from the interpretation of this term should be examined on a case-by-case basis and that one of the possible methods for determining whether two products were like products was to compare their end-uses in a given market (BISD 18S/102). The domestic products subject to the tax are: crude oil, crude oil condensates, and natural gasoline. The imported products subject to the tax are: crude oil, crude oil condensates, natural gasoline, refined and residual oil, and certain other liquid hydrocarbon products. The imported and domestic products are thus either identical or, in the case of imported liquid hydrocarbon products, serve substantially identical end-uses. The imported and domestic products subject to the tax on petroleum are therefore in the view of the Panel "like products" within the meaning of Article III:2. The rate of tax applied to the imported products is 3.5 cents per barrel higher than the rate applied to the like domestic products. Article III:2, first sentence, applies whether or not the products concerned are subject to a tariff concession and whether or not adverse trade effects occurred (see paragraph 5.1.9 below). The tax on petroleum is for these reasons inconsistent with the United States obligations under Article III:2, first sentence.

5.1.2 The United States did not present to the Panel any arguments to support a legal conclusion different from the one set out above. Its main contention was that the tax differential was so small that its trade effects were minimal or nil and that the tax differential - whether it conformed to Article III:2, first sentence, or not - did not nullify or impair benefits accruing to Canada, the EEC and Mexico under the General Agreement. Canada, the EEC and Mexico considered this defence to be neither legally valid nor factually correct (paragraphs 3.1.1-3.1.11

above). As both sides to the dispute considered this issue to be the central legal question to which the tax on petroleum gives rise, the Panel examined it in particular detail. It reached the following conclusions.

5.1.3 Under Article XXIII of the General Agreement contracting parties may bring complaints, inter alia, if they consider that benefits accruing to them under that Agreement are nullified or impaired. According to established GATT practice, described in the Annex to the 1979 Understanding on dispute settlement,

> "where there is an infringement of the obligations assumed under the General Agreement, the action is considered prima facie to constitute a case of nullification or impairment" (BISD 26S/216).

The question raised by the case before the Panel is whether the presumption that a measure inconsistent with the General Agreement causes a nullification or impairment of benefits accruing under that Agreement is an absolute or a rebuttable presumption and, if rebuttable, whether a demonstration that a measure inconsistent with Article III:2, first sentence, has no or insignificant effects on trade is a sufficient rebuttal.

5.1.4 According to Article XXIII:2 there are two decisions the CONTRACTING PARTIES may take after a claim of nullification or impairment, unresolved through consultations, has been referred to them. First, they may make recommendations or give a ruling on the matter. As to such a decision paragraph 4 of the Annex to the 1979 Understanding on dispute settlement states:

> "In the absence of a mutually agreed solution, the first objective of the CONTRACTING PARTIES is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the General Agreement. The provision of compensation should be resorted to only if the immediate withdrawal of the measure is impracticable and as a temporary measure pending the withdrawal of the measures which are inconsistent with the General Agreement" (BISD 26S/216).

The impact of the inconsistent measure is not mentioned in the above paragraph. This suggests that the practice of the CONTRACTING PARTIES is to make recommendations and rulings on measures found to be inconsistent with the General Agreement independent of the impact of such measures.

5.1.5 The second category of decisions the CONTRACTING PARTIES may take under Article XXIII:2 are decisions to authorize a suspension of concessions or other obligations if they "consider that the circumstances are serious enough to justify such an action". Paragraph 5 of the Annex to the 1979 Understanding on dispute settlement indicates how the CONTRACTING PARTIES are to deal with requests for such an authorization in the case of an infringement of the obligations assumed under the General Agreement. The relevant part of this paragraph reads:

> "A prima facie case of nullification or impairment would ipso facto require consideration of whether the circumstances are serious enough to justify the authorization of suspension of concessions or obligations, if the contracting party bringing the complaint so requests. This means that there is normally a presumption that a breach of the rules has an adverse impact on other contracting parties, and in such cases, it is up to the contracting parties against whom the complaint has been brought to rebut the charge" (BISD 26S/216).

Thus, the 1979 Understanding does not refer to the adverse impact of a measure, and the possibility of a rebuttal, in connexion with the power of the CONTRACTING PARTIES to make recommendations or give rulings on measures inconsistent with the General Agreement; it does so only in connection with the authorization of compensatory action. This, in the view of the Panel, supports the conclusion that the impact of a measure inconsistent with the General Agreement is not relevant for a determination of nullification or impairment by the CONTRACTING PARTIES.

5.1.6 The Panel examined how the CONTRACTING PARTIES have reacted in previous cases to claims that a measure inconsistent with the General Agreement had no adverse impact and therefore did not nullify or impair benefits accruing under the General Agreement to the contracting party that had brought the complaint. The Panel noted such claims had been made in a number of cases but that there was no case in the history of the GATT in which a contracting party had successfully rebutted the presumption that a measure infringing obligations causes nullification and impairment. In a case involving credit facilities granted to farmers that purchase domestically-produced machinery the Panel considered that:

> "If the considered view of the Italian Government was that these credit facilities had not influenced the terms of competition on the Italian market, there would not seem to be a serious problem in amending the operation of the Law so as to avoid any discrimination as regards these credit facilities between the domestic and imported tractors and agricultural machinery" (BISD 7S/66-67).

In a case involving undertakings to purchase domestic products, given by foreign investors to obtain a governmental authorization to invest, the Panel concluded:

> "The Panel carefully considered the effects of the purchase requirements on trade. The Panel concluded that an evaluation of these effects would entail scrutiny and analysis of the implementation of several thousands of often differently worded undertakings as well as speculation on what the purchasing behaviour of foreign investors would have been in their absence. The Panel could not undertake such

> an evaluation and it is therefore not in a position to judge how frequently the purchase requirements cause investors to act differently than they would have acted in the absence of the undertakings and how frequently they therefore adversely affect the trade interests of other contracting parties. The Panel, however, believes that an evaluation of the trade effects was not directly relevant to its findings because a breach of a GATT rule is presumed to have an adverse impact on other contracting parties" (BISD 30S/167).

In the case of an import quota on leather which allegedly had not been fully utilized by the complaining country the Panel stated:

> "The Panel wished to stress that the existence of a quantitative restriction should be presumed to cause nullification or impairment not only because of any effect it had had on the volume of trade but also for other reasons e.g., it would lead to increased transaction costs and would create uncertainties which could affect investment plans" (BISD 31S/113).

The remarks made by the panels in these cases apply, mutatis mutandis, also to the case before the present Panel.

5.1.7 The Panel concluded from its review of the above and other cases that, while the CONTRACTING PARTIES had not explicitly decided whether the presumption that illegal measures cause nullification or impairment could be rebutted, the presumption had in practice operated as an irrefutable presumption.

5.1.8 The Panel then examined whether - even assuming that the presumption could be regarded as rebuttable in the present case - a demonstration that the trade effects of the tax differential were insignificant would constitute a proof that the benefits accruing to Canada, the EEC and Mexico under Article III:2, first sentence, had not been nullified or impaired.

5.1.9 An acceptance of the argument that measures which have only an insignificant effect on the volume of exports do not nullify or impair benefits accruing under Article III:2, first sentence, implies that the basic rationale of this provision - the benefit it generates for the contracting parties - is to protect expectations on export volumes. That, however, is not the case. Article III:2, first sentence, obliges contracting parties to establish certain competitive conditions for imported products in relation to domestic products. Unlike some other provisions in the General Agreement, it does not refer to trade effects. The majority of the members of the Working Party on the "Brazilian Internal Taxes" therefore correctly concluded that the provisions of

Article III:2, first sentence, "were equally applicable, whether imports from other contracting parties were substantial, small or non-existent" (BISD Vol. II/185). The Working Party also concluded that "a contracting party was bound by the provisions of Article III whether or not the contracting party in question had undertaken tariff commitments in respect of the goods concerned" (BISD Vol. II/182), in other words, the benefits under Article III accrue independent of whether there is a negotiated expectation of market access or not. Moreover, it is conceivable that a tax consistent with the national treatment principle (for instance, a high but non-discriminatory excise tax) has a more severe impact on the exports of other contracting parties than a tax that violates that principle (for instance a very low but discriminatory tax). The case before the Panel illustrates this point: the United States could bring the tax on petroleum in conformity with Article III:2, first sentence, by raising the tax on domestic products, by lowering the tax on imported products or by fixing a new common tax rate for both imported and domestic products. Each of these solutions would have different trade results, and it is therefore logically not possible to determine the difference in trade impact between the present tax and one consistent with Article III:2, first sentence, and hence to determine the trade impact resulting from the non-observance of that provision. For these reasons, Article III:2, first sentence, cannot be interpreted to protect expectations on export volumes; it protects expectations on the competitive relationship between imported and domestic products. A change in the competitive relationship contrary to that provision must consequently be regarded ipso facto as a nullification or impairment of benefits accruing under the General Agreement. A demonstration that a measure inconsistent with Article III:2, first sentence, has no or insignificant effects would therefore in the view of the Panel not be a sufficient demonstration that the benefits accruing under that provision had not been nullified or impaired even if such a rebuttal were in principle permitted.

5.1.10 For the reasons given in the paragraphs above, the Panel decided not to examine the submissions of the parties on the trade effects of the tax differential. This decision was based on legal grounds only and should therefore not be interpreted as endorsing either the views of the United States or those of Canada, the EEC and Mexico on the trade effects of the tax differential.

5.1.11 The Panel noted that Canada had raised concerns regarding the taxation of imported products made from synthetic petroleum (paragraph 3.1.12 above). However, since the Superfund Act, according to the United States, is silent on the treatment of such products, the Panel did not specifically examine these concerns. Canada's right to request an investigation of this matter under Article XXIII:2 is therefore in no way affected by the present report.

5.1.12 In the light of the considerations set out in paragraphs 5.1.1-5.1.9 above, the Panel concluded that the tax on petroleum was inconsistent with Article III:2, first sentence and consequently constituted a prima facie case of nullification and impairment and that an evaluation of the trade impact of the tax was not relevant for this finding. The Panel therefore suggests that the CONTRACTING PARTIES recommend that the United States bring the tax on petroleum in conformity with its obligations under the General Agreement.

5.2 Tax on certain imported substances

5.2.1 The Panel noted that the United States objected to an examination of this tax because it did not go into effect before 1 January 1989, and - having no immediate effect on trade and therefore not causing nullification or impairment - fell outside the framework of Article XXIII. The Panel examined this point and concluded the following.

5.2.2 The Panel on "Japanese Measures on Imports of Leather" examined the contention of Japan that an import quota had not been filled and considered that

> "the existence of a quantitative restriction should be presumed to cause nullification or impairment not only because of any effect it had had on the volume of trade but also for other reasons e.g. it would lead to increased transaction costs and would create uncertainties which could affect investment plans" (BISD 31S/113).

The reasoning endorsed by the CONTRACTING PARTIES on that occasion applies also in the present case. The general prohibition of quantitative restrictions under Article XI, which the Panel on Japanese Measures on Imports of Leather examined, and the national treatment obligation of Article III, which Canada and the EEC invoked in the present case, have essentially the same rationale, namely to protect expectations of the contracting parties as to the competitive relationship between their products and those of the other contracting parties. Both articles are not only to protect current trade but also to create the predictability needed to plan future trade. That objective could not be attained if contracting parties could not challenge existing legislation mandating actions at variance with the General Agreement until the administrative acts implementing it had actually been applied to their trade. Just as the very existence of a regulation providing for a quota, without it restricting particular imports, has been recognized to constitute a violation of Article XI:1, the very existence of mandatory legislation providing for an internal tax, without it being applied to a particular imported product, should be regarded as falling within the scope of Article III:2, first sentence. The Panel noted that the tax on certain imported substances had been enacted, that the legislation was mandatory and that the tax

authorities had to apply it after the end of next year and hence within a time frame within which the trade and investment decisions that could be influenced by the tax are taken. The Panel therefore concluded that Canada and the EEC were entitled to an investigation of their claim that this tax did not meet the criteria of Article III:2, first sentence.

5.2.3 The Panel noted that the United States justified the tax on certain imported substances as a border tax adjustment corresponding in its effect to the internal tax on certain chemicals from which these substances were derived (paragraph 3.2.5 above). The Panel further noted that the EEC considered the tax on certain chemicals not to be eligible for border tax adjustment because it was designed to tax polluting activities that occurred in the United States and to finance environmental programmes benefiting only United States producers. Consistent with the Polluter-Pays Principle, the United States should have taxed only products of domestic origin because only their production gave rise to environmental problems in the United States. The United States denied the legal relevance of EEC's arguments and their applicability to the tax on certain chemicals (paragraphs 3.2.7-3.2.11 above). The Panel therefore first examined whether the tax on certain chemicals was eligible for border tax adjustments.

5.2.4 The report of the Working Party on Border Tax Adjustments, adopted by the CONTRACTING PARTIES in 1970, concluded the following on the rules of the General Agreement relating to tax adjustments applied to goods entering into international trade:

> "There was convergence of views to the effect that taxes directly levied on products were eligible for tax adjustment. Examples of such taxes comprised specific excise duties, sales taxes and cascade taxes and the tax on value added ... Furthermore, the Working Party concluded that there was convergence of views to the effect that certain taxes that were not directly levied on products were not eligible for tax adjustment. Examples of such taxes comprised social security charges whether on employers or employees and payroll taxes" (BISD 18S/100-101).

As these conclusions of the CONTRACTING PARTIES clearly indicate, the tax adjustment rules of the General Agreement distinguish between taxes on products and taxes not directly levied on products; they do not distinguish between taxes with different policy purposes. Whether a sales tax is levied on a product for general revenue purposes or to encourage the rational use of environmental resources, is therefore not relevant for the determination of the eligibility of a tax for border tax adjustment. For these reasons the Panel concluded that the tax on certain chemicals, being a tax directly imposed on products, was eligible for border tax adjustment independent of the purpose it served. The Panel therefore did not examine whether the tax on chemicals served environmental purposes and, if so, whether a border tax adjustment would be consistent with these purposes.

5.2.5 The Panel wishes to point out, however, that the Working Party on Border Tax Adjustment agreed that the provisions of the General Agreement on tax adjustment

> "set maxima limits for adjustment (compensation) which were not to be exceeded, but below which every contracting party was free to differentiate in the degree of compensation applied, provided that such action was in conformity with other provisions of the General Agreement" (BISD 18S/100).

Consequently, if a contracting party wishes to tax the sale of certain domestic products (because their production pollutes the domestic environment) and to impose a lower tax or no tax at all on like imported products (because their consumption or use causes fewer or no environmental problems), it is in principle free to do so. The General Agreement's rules on tax adjustment thus give the contracting party in such a case the possibility to follow the Polluter-Pays Principle, but they do not oblige it to do so.

5.2.6 The mandate of the Panel is to examine the case before it "in the light of the relevant GATT provisions" (paragraph 1.4 above). The Panel therefore did not examine the consistency of the revenue provisions in the Superfund Act with the environmental objectives of that Act or with the Polluter-Pays Principle. The Panel notes that the CONTRACTING PARTIES established in 1972 a Group on Environmental Measures and International Trade with the task

> "to examine, upon request, any specific matters relevant to the trade policy aspects of measures to control pollution and protect human environment, especially with regard to the application of the provisions of the General Agreement, taking into account the particular problems of developing countries" (L/3622/Rev.1 and C/M/74).

This Group has never met but still exists. The EEC would thus have a forum available in the GATT in which to pursue the environmental issues which the Panel, because of its limited mandate, could not address.

5.2.7 The Panel, having concluded that the tax on certain chemicals was in principle eligible for border tax adjustment, then examined whether the tax on certain imported substances meets the national treatment requirement of Article III:2, first sentence. This provision permits the imposition of an internal tax on imported products provided the like domestic products are taxed, directly or indirectly, at the same or a higher rate. Such internal taxes may be levied on imported products at the time or point of importation (Note ad Article III). Paragraph 2(a) of Article II therefore clarifies that a tariff concession does not prevent the levying of

"a charge equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of Article III in respect of the like domestic product or in respect of an article from which the imported product has been manufactured or produced in whole or in part."

The drafters of the General Agreement explained the word "equivalent" used in this provision with the following example:

"If a [charge] is imposed on perfume because it contains alcohol, the [charge] to be imposed must take into consideration the value of the alcohol and not the value of the perfume, that is to say the value of the content and not the value of the whole" (EPCT/TAC/PV/26, page 21).

5.2.8 The tax on certain imported substances equals in principle the amount of the tax which would have been imposed under the Superfund Act on the chemicals used as materials in the manufacture or production of the imported substance if these chemicals had been sold in the United States for use in the manufacture or production of the imported substance. In the words which the drafters of the General Agreement used in the above perfume-alcohol example: The tax is imposed on the imported substances because they are produced from chemicals subject to an excise tax in the United States and the tax rate is determined in principle in relation to the amount of these chemicals used and not in relation to the value of the imported substance. The Panel therefore concluded that, to the extent that the tax on certain imported substances was equivalent to the tax borne by like domestic substances as a result of the tax on certain chemicals, the tax met the national treatment requirement of Article III:2, first sentence.

5.2.9 According to the Superfund Act, the tax on certain imported substances will however not necessarily be equal to the tax on the chemicals used in their production. If an importer fails to furnish the information necessary to determine the amount of tax to be imposed, a penalty tax of 5 per cent of the appraised value of the imported substance shall be imposed. Since the tax on certain chemicals subjects some of the chemicals only to a tax equivalent to 2 per cent of the 1980 wholesale price of the chemical, the 5 per cent penalty tax could be much higher than the highest possible tax that the importer would have to pay if he provided sufficient information (paragraph 2.3 above). The imposition of a penalty tax on the basis of the appraised value of the imported substance would not conform with the national treatment requirement of Article III:2, first sentence, because the tax rate would in that case no longer be imposed in relation to the amount of taxable chemicals used in their production but the value of the imported substance. Thus it would not meet the requirement of equivalence which the drafters explained in the perfume-alcohol example mentioned in the preceding paragraph. However, the Superfund Act permits the Secretary of the Treasury to prescribe by regulation, in lieu of the 5 per cent rate, a rate which would equal the

amount that would be imposed if the substance were produced using the predominant method of production (paragraph 2.6 above). These regulations have not yet been issued. Thus, whether they will eliminate the need to impose the penalty tax and whether they will establish complete equivalence between domestic and imported products, as required by Article III:2, first sentence, remain open questions. From the perspective of the overall objectives of the General Agreement it is regrettable that the Superfund Act explicitly directs the United States tax authorities to impose a tax inconsistent with the national treatment principle but, since the Superfund Act also gives them the possibility to avoid the need to impose that tax by issuing regulations, the existence of the penalty rate provisions as such does not constitute a violation of the United States obligations under the General Agreement. The Panel noted with satisfaction the statement of the United States that, given the tax authorities' regulatory authority under the Act, "in all probability the 5 per cent penalty rate would never be applied" (paragraph 3.2.13 above).

5.2.10 The Panel concluded that the tax on certain imported substances constituted a tax adjustment corresponding to the tax on certain chemicals that was in principle consistent with Article III:2, first sentence, and that the existence of the penalty rate provisions as such did not constitute an infringement of Article III:2, first sentence, since the tax authorities had regulatory power to eliminate the need for the imposition of the penalty rate. The Panel recommends that the CONTRACTING PARTIES take note of the statement by the United States that the penalty rate would in all probability never be applied.

ANNEX I

TAX ON CERTAIN CHEMICALS

Taxable Chemicals	Tax per ton (US$)
Acetylene	4.87
Benzene	4.87
Butane	4.87
Butylene	4.87
Butadiene	4.87
Ethylene	4.87
Methane	3.44
Naphthalene	4.87
Propylene	4.87
Toluene	4.87
Xylene[1]	4.87
Ammonia	2.64
Antimony	4.45
Antimony trioxide	3.75
Arsenic	4.45
Arsenic trioxide	3.41
Barium sulfide	2.30
Bromine	4.45
Cadmium	4.45
Chlorine	2.70
Chromium	4.45
Chromite	1.52
Potassium dichromate	1.69
Sodium dichromate	1.87
Cobalt	4.45
Cupric sulfate	1.87
Cupric oxide	3.59
Cuprous oxide	3.97
Hydrochloric acid	0.29
Hydrogen fluoride	4.23
Lad oxide	4.14
Mercury	4.45
Nickel	4.45
Phosphorus	4.45
Stannous chloride	2.85
Stannic chloride	2.12
Zinc chloride	2.22
Zinc sulfate	1.90
Potassium hydroxide	0.22
Sodium hydroxide	0.28
Sulfuric acid	0.26
Nitric acid	0.24

[1] For periods before 1992, the tax on xylene is $10.13.

ANNEX II

TAX ON CERTAIN IMPORTED SUBSTANCES

Initial List of Taxable Substances

Cumene
Styrene
Ammonium nitrate
Polypropylene
Propylene Glycol
Formaldehyde
Acetone
Ethylene glycol
Vinyl chloride
Polyethylene resins, total
Polybutadiene
Styrene-butadiene, latex
Styrene-butadiene, snpf
Synthetic rubber, not containing fillers
Urea
Ferronickel
Ferrochromium nov 3 pct.
Ferrochrome ov 3 pct. carbon
Unwrought nickel
Nickel waste and scrap
Wrought nickel rods and wire
Nickel powders
Phenolic resins
Polyvinylchloride resins
Polystyrene resins and copolymers
Nickel oxide
Isopropyl alcohol
Methylene chloride
Ethyl alcohol for non-beverage use
Ethylbenzene
Acrylonitrile
Methanol
Propylene oxide
Polypropylene resins
Ethylene oxide
Ethylene dichloride
Cyclohexane
Isophthalic acid
Maleic anhydride
Phthalic anhydride
Ethyl methyl ketone
Chloroform
Carbon tetrachloride
Chromic acid
Hydrogen peroxide
Polystyrene homopolymer resins
Melamine
Acrylic and methacrylic acid resins
Vinyl resins
Vinyl resins, NSPF