

**MEXICO – TAX MEASURES ON SOFT DRINKS
AND OTHER BEVERAGES**

Report of the Panel

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| <i>Mexico – Corn Syrup</i> | Panel Report, <i>Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States</i> , WT/DS132/R and Corr.1, adopted 24 February 2000, DSR 2000:III, 1345 |
| <i>Mexico – Corn Syrup (Article 21.5 – US)</i> | Appellate Body Report, Appellate Body Report, <i>Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States – Recourse to Article 21.5 of the DSU by the United States</i> , WT/DS132/AB/RW, adopted 21 November 2001, DSR 2001:XIII, 6675 |
| <i>Turkey – Textiles</i> | Appellate Body Report, <i>Turkey – Restrictions on Imports of Textile and Clothing Products</i> , WT/DS34/AB/R, adopted 19 November 1999, DSR 1999:VI, 2345 |
| <i>Turkey – Textiles</i> | Panel Report, <i>Turkey – Restrictions on Imports of Textile and Clothing Products</i> , WT/DS34/R, adopted 19 November 1999, as modified by the Appellate Body Report, WT/DS34/AB/R, DSR 1999:VI, 2363 |
| <i>US – 1916 Act</i> | Appellate Body Report, <i>United States – Anti-Dumping Act of 1916</i> , WT/DS136/AB/R, WT/DS162/AB/R, adopted 26 September 2000, DSR 2000:X, 4793 |
| <i>US – Certain EC Products</i> | Panel Report, <i>United States – Import Measures on Certain Products from the European Communities</i> , WT/DS165/R and Add. 1, adopted 10 January 2001, as modified by the Appellate Body Report, WT/DS165/AB/R, DSR 2001:II, 413 |

| Short Title | Full Case Title and Citation |
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| <i>US – Gasoline</i> | Panel Report, <i>United States – Standards for Reformulated and Conventional Gasoline</i> , WT/DS2/R, adopted 20 May 1996, as modified by the Appellate Body Report, WT/DS2/AB/R, DSR 1996:I, 29 |
| <i>US – Gasoline</i> | Appellate Body Report, <i>United States – Standards for Reformulated and Conventional Gasoline</i> , WT/DS2/AB/R, adopted 20 May 1996, DSR 1996:I, 3 |
| <i>US – Section 301 Trade Act</i> | Panel Report, <i>United States – Sections 301-310 of the Trade Act of 1974</i> , WT/DS152/R, adopted 27 January 2000, DSR 2000:II, 815 |
| <i>US – Shrimp</i> | Appellate Body Report, <i>United States – Import Prohibition of Certain Shrimp and Shrimp Products</i> , WT/DS58/AB/R, adopted 6 November 1998, DSR 1998:VII, 2755 |
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| <i>US – Shrimp (Article 21.5 – Malaysia)</i> | Appellate Body Report, <i>United States – Import Prohibition of Certain Shrimp and Shrimp Products – Recourse to Article 21.5 of the DSU by Malaysia</i> , WT/DS58/AB/RW, adopted 21 November 2001, DSR 2001:XIII, 6481 |
| <i>US – Shrimp (Article 21.5 – Malaysia)</i> | Panel Report, <i>United States – Import Prohibition of Certain Shrimp and Shrimp Products – Recourse to Article 21.5 of the DSU by Malaysia</i> , WT/DS58/RW, adopted 21 November 2001, as upheld by the Appellate Body Report, WT/DS58/AB/RW, DSR 2001:XIII, 6529 |
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| <i>US – Wool Shirts and Blouses</i> | Panel Report, <i>United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India</i> , WT/DS33/R, adopted 23 May 1997, as upheld by the Appellate Body Report, WT/DS33/AB/R, DSR 1997:I, 343 |
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| <i>Italy – Agricultural Machinery</i> | Panel Report, Italian Discrimination Against Imported Agricultural Machinery, adopted 23 October 1958, BISD 7S/60 |
| <i>Japan – Alcoholic Beverages I</i> | Panel Report, <i>Japan – Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages</i> , adopted 10 November 1987, BISD 34S/83 |
| <i>US – Malt Beverages</i> | Panel Report, <i>United States – Measures Affecting Alcoholic and Malt Beverages</i> , adopted 19 June 1992, BISD 39S/206 |
| <i>US – Nicaraguan Trade</i> | Panel Report, <i>United States – Trade Measures Affecting Nicaragua</i> , 13 October 1986, unadopted, L/6053 |
| <i>US – Section 337</i> | Panel Report, United States Section 337 of the Tariff Act of 1930, adopted 7 November 1989, BISD 36S/345 |
| <i>US – Sugar Quota</i> | Panel Report, <i>United States – Imports of Sugar from Nicaragua</i> , adopted 13 March 1984, BISD 31S/67 |
| <i>US – Superfund</i> | Panel Report, <i>United States – Taxes on Petroleum and Certain Imported Substances</i> , adopted 17 June 1987, BISD 34S/136 |
| <i>US – Tuna (EEC)</i> | Panel Report, <i>United States – Restrictions on Imports of Tuna</i> , 16 June 1994, unadopted, DS29/R |

TABLE OF ABBREVIATIONS USED IN THIS REPORT

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| CFC | <i>Comisión Federal de Competencia</i> (Federal Competition Commission) |
| DSB | Dispute Settlement Body |
| DSU | Dispute Settlement Understanding |
| EC | European Communities |
| GATT | General Agreement on Tariffs and Trade |
| GATT 1947 | General Agreement on Tariffs and Trade 1947 |
| GATT 1994 | General Agreement on Tariffs and Trade 1994 |
| HFCS | High-Fructose Corn Syrup |
| IEPS | <i>Impuesto Especial sobre Producción y Servicios</i> (Special Tax on Production and Services) |
| LIEPS | <i>Ley del Impuesto Especial sobre Producción y Servicios</i> (Law on the Special Tax on Production and Services) |
| MFN | Most-Favoured Nation |
| NAFTA | North American Free Trade Agreement |
| WTO | World Trade Organization |

I. INTRODUCTION

1.1 In a communication, dated 16 March 2004, the United States requested consultations with Mexico pursuant to Articles 1 and 4 of the DSU and Article XXII:1 of the GATT 1994, regarding tax measures imposed by Mexico on soft drinks and other beverages that use any sweetener other than cane sugar.¹

1.2 The United States stated that it believed that these taxes were inconsistent with Mexico's national treatment obligations under Article III of the GATT 1994. In particular, they appeared to be inconsistent with Article III:2 of the GATT 1994, first and second sentences, and Article III:4 of the GATT 1994.

1.3 The consultations took place on 13 May 2004. Pursuant to its request, Canada was joined in those consultations. However the parties failed to reach a mutually satisfactory resolution to this dispute.

1.4 On 10 June 2004, the United States requested the establishment of a panel pursuant to Article 6 of the DSU.² The DSB considered this request at its meetings of 22 June and 6 July 2004, and established the Panel on 6 July with standard terms of reference as follows:

"To examine, in the light of the relevant provisions of the covered agreements cited by the United States in document WT/DS308/4, the matter referred to the DSB by the United States in that document, and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements."³

1.5 On 18 August 2004, the parties agreed to the following composition of the Panel:

Chairman: Mr Ronald Saborío Soto

Members: Mr Edmond McGovern
Mr David Walker

1.6 Canada, China, the European Communities, Guatemala and Japan reserved their rights to participate in the panel proceedings as third parties.⁴

1.7 The Panel met with the parties on 2 and 3 December 2004 and 23 and 24 February 2005. It met with the third parties on 3 December 2004.

1.8 The Panel submitted its interim report to the parties on 27 June 2005. The final report was issued to the parties on 8 August 2005.

II. FACTUAL ASPECTS

A. THE MEASURES

2.1 This dispute concerns certain tax measures imposed by Mexico on soft drinks and other beverages that use any sweetener other than cane sugar.

¹ WT/DS308/1.

² WT/DS308/4.

³ WT/DS308/5/Rev.1.

⁴ Pakistan had reserved its third-party rights at the DSB meeting on 6 July 2004. However, on 20 August 2004, Pakistan informed the DSB that it did not want to participate as a third-party in the panel proceedings.

2.2 The tax measures concerned include: (i) a 20 per cent tax on the transfer or, as applicable, the importation of soft drinks and other beverages that use any sweetener other than cane sugar ("soft drink tax"); (ii) a 20 per cent tax on specific services (commission, mediation, agency, representation, brokerage, consignment and distribution), when provided for the purpose of transferring products such as soft drinks and other beverages that use any sweetener other than cane sugar ("distribution tax"); and, (iii) a number of requirements imposed on taxpayers subject to the "soft drink tax" and to the "distribution tax" ("bookkeeping requirements").

B. RELEVANT MEASURES

2.3 The soft drink tax, the distribution tax and the bookkeeping requirements are set out in the following measures, which are at issue in this dispute: (1) the *Ley del Impuesto Especial sobre Producción y Servicios* (Law on the Special Tax on Production and Services, or LIEPS), as amended effective 1 January 2002, and its subsequent amendments published on 30 December 2002, and 31 December 2003; and (2) related or implementing regulations, contained in the *Reglamento de la Ley del Impuesto Especial sobre Producción y Servicios* (Regulations of the Law on the Special Tax on Production and Services), the *Resolución Miscelánea Fiscal para 2003* (Miscellaneous Fiscal Resolution for the year 2003), and the *Resolución Miscelánea Fiscal para 2004* (Miscellaneous Fiscal Resolution for the year 2004).

2.4 The measures were introduced in the Mexican legislation as a result of the amendments to the LIEPS approved by the Congress of Mexico and published in the Mexican Official Journal (*Diario Oficial*) on 1 January 2002. Since that date, the LIEPS has been amended on three occasions. The amendments were published in the Official Journal on 30 December 2002, on 31 December 2003, and on 1 December 2004.

2.5 The measures are further regulated in the *Reglamento de la Ley del Impuesto Especial sobre Producción y Servicios* (Regulations of the Law on the Special Tax on Production and Services) published in the Official Journal on 15 May 1990, in Title 6 of the *Resolución Miscelánea Fiscal para 2004* (Miscellaneous Fiscal Resolution for the year 2004) published in the Official Journal on 30 April 2004, and in Title 6 of the *Resolución Miscelánea Fiscal para 2003* (Miscellaneous Fiscal Resolution for the year 2003) published in the Official Journal on 31 March 2003, which identify, *inter alia*, details on the scope, calculation, payment and bookkeeping and recording requirements of the IEPS.

C. PRODUCTS INVOLVED

2.6 The dispute concerns two categories of products. First, the products that will be generally referred to as "soft drinks and syrups". Second, the sweeteners used in the preparation of such "soft drinks and syrups" and, particularly, three types of sweeteners: cane sugar, beet sugar and HFCS.

- **Soft drinks and syrups:** With respect to the challenged measures, this broad category includes soft drinks; hydrating or rehydrating drinks; concentrates, powders, syrups, essences or flavour extracts that can be diluted to produce soft drinks and hydrating or rehydrating drinks; and, syrups or concentrates for preparing soft drinks sold in open containers which use automatic, electric or mechanical equipment. The category does not include other drinks such as alcoholic beverages, beers, wine, fruit juices, vegetable juices, water or mineral water. According to the available information, the Mexican market for soft drinks is – as in other parts of the world – dominated by multinational companies, such as *Coca Cola* and *Pepsi Cola*. *Coca Cola* controls around 71.9 per cent of the Mexican carbonated soft drink market,

while *Pepsi Cola* controls around 15.1 per cent. The Peruvian-owned company *Kola Real* holds around 4 per cent of the market and *Cadbury Schweppes* around 2 per cent.⁵

- **Cane sugar:** Cane sugar is a form of sucrose. Sucrose is a disaccharide composed of 50 percent glucose and 50 percent fructose bonded together.⁶ According to the Food and Agriculture Organization of the United Nations (FAO), cane sugar is a non-refined, crystallized material derived from the juices of sugar-cane stalk and consisting either wholly or essentially of sucrose.⁷
- **Beet sugar:** Beet sugar is another form of sucrose. In technical terms, and although derived from a different source, beet sugar may be considered to be both chemically and functionally identical to cane sugar.⁸ The FAO defines beet sugar as a non-refined, crystallized material derived from the juices extracted from the root of the sugar beet and consisting either wholly or essentially of sucrose.⁹
- **High-Fructose Corn Syrup (HFCS):** This is a corn-based liquid sweetener made using a multi-stage production process. It is high in fructose in relation to ordinary corn syrup. HFCS is a liquid, composed of a monosaccharide mixture of varying amounts of glucose and fructose, as well as small amounts of other saccharides. HFCS exists in the following three grades: HFCS-55 is the primary grade of HFCS used in soft drink production. HFCS-42, while used in soft drink and juice production, is also used in the production of bakery products, canned goods, dairy products and other foods. HFCS-90 is typically blended with HFCS-42 to make HFCS-55, but it is also used as a sweetener in juices, candies, bakeries, and food processing.¹⁰ According to the FAO, HFCS is part of the products known as isoglucose, a type of starch syrups where glucose has been isomerised to fructose by using one or more isomerising enzymes. Other syrups of this group are HFSS (high-fructose starch syrup) and HFGS (high-fructose glucose syrup). HFCS is manufactured from corn starch, and is widely used in the production of food and soft drinks.¹¹

III. PARTIES' REQUESTS FOR FINDINGS AND RECOMMENDATIONS

3.1 The United States requests the Panel to find that the challenged tax measures are:

- inconsistent with GATT Article III:2, first sentence, as a tax applied on imported soft drinks and syrups "in excess of those applied to like domestic products" (soft drink tax and distribution tax);
- inconsistent with GATT Article III:2, second sentence, as a tax applied on imported soft drinks and syrups which are "not similarly taxed" to the "directly competitive or substitutable" Mexican products (soft drink tax and distribution tax);
- inconsistent with GATT Article III:2, first sentence, as a tax applied on imported beet sugar "in excess of those applied to like domestic products" (soft drink tax and distribution tax);

⁵ United States' first written submission, para. 31 and exhibit US-18.

⁶ United States' first written submission, para. 22.

⁷United Nations Economic Commission for Europe, at <http://www.unece.org/stats/econ/iwg.agri/handbook.sugar.html> (site consulted on 14 February 2005).

⁸ United States' first written submission, para. 22.

⁹United Nations Economic Commission for Europe, at <http://www.unece.org/stats/econ/iwg.agri/handbook.sugar.html> (site consulted on 14 February 2005).

¹⁰ United States' first written submission, paras. 9-12.

¹¹United Nations Economic Commission for Europe, at <http://www.unece.org/stats/econ/iwg.agri/handbook.sugar.html> (site consulted on 14 February 2005).

- inconsistent with GATT Article III:2, second sentence, as a tax applied on imported HFCS which is "not similarly taxed" to the "directly competitive or substitutable" Mexican cane sugar (soft drink tax and distribution tax);
- inconsistent with GATT Article III:4 as a law that affects the internal use of imported HFCS and accords HFCS "treatment ... less favourable than that accorded to like products of national origin" by:
 - (a) taxing soft drinks and syrups that use HFCS as a sweetener (soft drink tax),
 - (b) taxing the agency, representation, brokerage, consignment and distribution of soft drinks and syrups sweetened with HFCS (distribution tax), and
 - (c) subjecting soft drinks and syrups sweetened with HFCS to various bookkeeping and reporting requirements (bookkeeping requirements)
- inconsistent with GATT Article III:4 as a law that affects the internal use of imported beet sugar and accords beet sugar "treatment ... less favourable than that accorded to like products of national origin" by:
 - (a) taxing soft drinks and syrups that use beet sugar as a sweetener (soft drink tax),
 - (b) taxing the agency, representation, brokerage, consignment and distribution of soft drinks and syrups sweetened with beet sugar (distribution tax), and
 - (c) subjecting soft drinks and syrups sweetened with beet sugar to various bookkeeping and reporting requirements (bookkeeping requirements).

3.2 Mexico requests the Panel to:

- decline to exercise its jurisdiction and recommend to the parties that they submit their respective grievances to an Arbitral Panel, under Chapter Twenty of the NAFTA, which can address both Mexico's concern with respect to market access for Mexican cane sugar in the United States under the NAFTA and the United States' concern with respect to Mexico's tax measures.
- In the event that the Panel does decide to exercise its jurisdiction, Mexico requests it:
 - (a) to pay particular attention to the circumstances that gave rise to the measures at issue in this case to accord particular weight to Mexico's status as a developing country, especially in the context of the broader dispute concerning trade in sweeteners between Mexico and the United States, and to find that the Mexican measures are justified under Article XX of the GATT 1994.
 - (b) to employ particular care in terms of how it formulates its findings and recommendations. In particular, Mexico requests the Panel to record that whatever the parties' legal rights may be under other applicable rules of international law, its findings apply solely to the parties' respective rights and obligations under the WTO agreements and cannot be taken to pre-judge such other legal rights;

- (c) to recommend that the parties take steps to resolve the sweeteners trade dispute within the NAFTA framework; and
- (d) to make certain determinations of facts.¹²

[Parties' and Thirds Parties' Arguments and Annexes Deleted from this Version.]

¹² Written version of Mexico's oral statement during second substantive meeting of the Panel with the parties, para. 36.

VI. INTERIM REVIEW

6.1 The Panel issued its interim report to the parties on 27 June 2005. On 11 July 2005, the United States and Mexico submitted written comments and requested the Panel to review precise aspects of the interim report. On 25 July 2005, the United States and Mexico submitted written comments on each other's comments and requests for interim review.

6.2 The Panel has modified its report, where appropriate, in light of the parties' comments and requests, as explained below. The Panel has also made certain revisions and technical corrections for the purposes of clarity and accuracy. References to paragraph numbers and footnotes in Section VI of this report refer to those in the interim report, except as otherwise noted.

A. CLERICAL AND EDITORIAL CHANGES

6.3 The United States suggests certain changes to correct clerical errors contained in the different sections of the interim report, and to further clarify the report. The Panel has taken account of the United States' suggestions and modified most of the indicated paragraphs. The Panel has also made some additional clerical and editorial changes throughout the report. It has also corrected the numbers of paragraphs from the English and Spanish versions of the interim report issued to the parties.

6.4 Mexico notes that its comments on the United States' responses to questions posed by the Panel after the second substantive meeting had not been included in Annex C of the interim report. The Panel has amended this omission for the final report.

B. FACTUAL ASPECTS

6.5 The United States requests the Panel to modify the interim report's language in certain paragraphs in order to better reflect the facts demonstrated by evidence submitted by the parties. The United States also suggests that some cross-references and citation of evidence be added to the text of the Report. The Panel has modified the language of the report and added the references as requested, as well as other references not indicated by the United States.

C. ARGUMENTS OF THE PARTIES

6.6 The United States suggests modifications in certain paragraphs of the interim report, relating to Mexico's arguments. The Panel has decided to keep the relevant text as it had been originally presented by Mexico.

D. PRELIMINARY RULING

6.7 Mexico requests the Panel to amend paragraph 7.15 of the interim report, in order to clarify that the Panel's findings, conclusions and recommendations in the report only relate to Mexico's rights and obligations under the WTO Agreements, and not to Mexico's rights and obligations under other international agreements or other obligations under international law. Mexico also requests the Panel to delete paragraph 7.16, since in its opinion its measures would be justified under the NAFTA if the dispute were to be submitted in its entirety to dispute settlement under the mechanism established by this agreement.

6.8 The Panel has modified paragraph 7.15 of the interim report, as requested by Mexico, and modified paragraph 7.16 in order to clarify its meaning. The Panel has also made other minor changes.

E. COMMENTS ON PANEL'S FINDINGS

6.9 The parties request a number of modifications and minor corrections in the text of the report. Such requests have been duly considered and adopted, where appropriate, by the Panel. Some suggestions, however, have not been accepted as they would have improperly altered the substance of the findings, as noted below.

6.10 The United States requests the deletion of paragraphs 8.54, 8.115 and 8.153 of the interim report, since in its opinion they did not adequately reflect the United States arguments on the different treatment received by domestic and imported products as a result of the application of the soft drink tax, the distribution tax and the bookkeeping requirements. The Panel rejects the request to delete the paragraphs. However, in the light of the United States request, the Panel clarified their language. The Panel's reasoning is in fact based on the United States argument, supported by factual evidence, that *most* imports are being discriminated against.

6.11 Mexico disagrees with the description made by the Panel in paragraph 8.162, *in fine*, of the interim report.¹⁸⁵ Mexico considers that the paragraph wrongfully suggested that Mexico's position was that certain rules of international law were irrelevant for the purpose of interpreting Article XX of the GATT 1994. Mexico states that the Panel could resort to rules of international law other than the WTO Agreements to evaluate whether its measures were justified as measures necessary to secure compliance by the United States with the NAFTA. Mexico further states that its position throughout the dispute was that such measures were justified under international law. Mexico wishes to note these points for the record, but requests no specific action from the Panel.

6.12 The United States requests the revision of paragraphs 8.184 and 8.185 of the interim report. In its opinion, the Panel's analysis should focus on whether Mexico has met the burden of proof of its affirmative defence (which it has not, in the view of the United States) and not on what it means to enforce or to secure compliance. The United States suggests that the Panel consider the contribution that the measures at issue have made to securing compliance on the part of the United States, rather than focus on whether the outcome of such measures is "certain" or "uncertain". Mexico expressed its strong objection to the United States' request, and asked the Panel to reject it. Although it expresses its disagreement with the Panel's conclusions, Mexico is of the view that paragraphs 8.184 to 8.187 of the interim report need to be maintained, being germane to the Panel's finding that Mexico failed to demonstrate that the impugned measures were intended to secure compliance with laws or regulations that are not inconsistent with the GATT 1994. The Panel has retained the concerned paragraphs, although it has introduced changes in order to clarify their meaning. The Panel notes that its reasoning does not focus on whether the achievement of Mexico's objective through the measures at issue is certain or uncertain. Rather, the Panel considers that international countermeasures (as the ones allegedly imposed by Mexico) are intrinsically unable to *secure* compliance of laws and regulations. In contrast, national measures are, beyond particular factual considerations, usually in a position to achieve to achieve that objective, through the use of coercion, if necessary.

6.13 The United States raises an additional argument in support of the Panel's finding in paragraphs 8.184 and 8.185 of the interim report that Mexico's tax measures do not qualify under Article XX(d) of the GATT 1994, namely that the parties to the NAFTA (including Mexico) agreed on the mechanism necessary to resolve any dispute concerning compliance with that agreement. The argument has not been raised in the course of the dispute, until the interim review stage. Moreover, the United States has not requested consideration of such an argument in the final report.

6.14 The United States questions the use of the Appellate Body Report on *US – Gambling* in support of the Panel's conclusion that "the uncertain outcome of international countermeasures is a

¹⁸⁵ The interim report in Spanish, as issued to the parties, erroneously identified this paragraph as 8.180.

reason for disqualifying them as measures eligible for consideration under Art. XX(d)" in paragraphs 8.186 and 8.187 of the interim report. The United States argues that the referred case was not considering the necessity of a measure "to secure compliance with a law or regulation", but rather for the protection of public morals or the maintenance of public order. The United States adds that the Appellate Body did not say that a measure with uncertain results could never qualify as a reasonably available alternative, but rather it concluded, on the basis of the facts presented in that case, that a process of negotiation about regulation of a service was not an alternative "capable of comparison" to a measure restricting the service. The Panel agrees with the United States on the different context of the *US – Gambling* findings and those of the present case, but it considers that the reference is worthy of being kept as confirmation of the view that the uncertain outcome of international countermeasures is a reason for disqualifying them as measures eligible for consideration under Article XX(d).

6.15 With relation to paragraph 8.192 of the interim report, the United States requests the Panel to consider some of its arguments related to the meaning of the word "law", such as a definition of the term "laws" previously recalled in its submissions, the importance of the use of the word "laws" in plural in Article XX(d) of the GATT 1994 and the different translation into French and Spanish of the word "law", as used in Article XX(d) and in Article 3.2 of the DSU. Mexico did not oppose this request. The Panel has included the appropriate references to the definition presented by the United States and its other arguments related to the ordinary meaning of the word "law", which were considered in the course of the proceedings.

6.16 Finally, the United States requests the deletion of paragraph 8.234 of the interim report, which referred to Mexico's allegations that questioned whether the United States had acted in good faith in the course of the proceedings. Mexico expressly states that it does not object to deleting such paragraph. The Panel has accepted the request.

VII. PRELIMINARY RULING

A. INTRODUCTION

7.1 On 18 January 2005, the Panel issued a preliminary ruling, rejecting Mexico's request for the Panel to decline to exercise its jurisdiction in the case in favour of an Arbitral Panel under Chapter Twenty of the North American Free Trade Agreement (NAFTA).¹⁸⁶ The Panel concluded that, under the DSU, it had no discretion to decide whether or not to exercise its jurisdiction in a case properly before it. Furthermore, even if it had such discretion, the Panel did not consider that there were facts on record that would justify the Panel declining to exercise its jurisdiction in the present case. The Panel informed the parties that it would provide them with a detailed reasoning for that ruling in its final report.

7.2 In order to issue its preliminary ruling, the Panel considered Mexico's request as well as the arguments presented by the United States, the complaining party in the case, and by the third parties. Nothing in the DSU, or in the Panel's working procedures, required the Panel to address Mexico's request in a preliminary ruling. Instead, the Panel could have waited to rule on the request until its final report. It was the Panel's opinion, however, that both the parties and the panel proceeding were better served by an early ruling on the request. Had it been appropriate for the Panel to decline to exercise its jurisdiction, an early decision to this effect would have saved time and resources. On the other hand, if the Panel – as in the event it did – rejected Mexico's request, an early decision would allow the parties to concentrate on the other aspects of the dispute.

7.3 In view of the above, the Panel issued a preliminary ruling rejecting Mexico's request that it decline to exercise its jurisdiction in the case.

¹⁸⁶ See Annex B to this Report.

B. THE PANEL'S JURISDICTION TO HEAR THE PRESENT CASE

7.4 Both parties agreed that the Panel had jurisdiction to hear the United States' claims in the present case.¹⁸⁷ The Panel's jurisdiction in this case was thus not challenged by either of the parties. In light of the above, the Panel was satisfied that it had proper jurisdiction in this case and therefore the authority to consider and make rulings and recommendations on the matters raised by the parties.

C. MEXICO'S REQUEST

7.5 In considering Mexico's request, the Panel first addressed whether it had the discretion to decline to exercise its jurisdiction to hear and decide a case properly brought before it.

7.6 The Panel recalled that Article 11 of the DSU states that:

"The function of panels is to assist the DSB in discharging its responsibilities under this Understanding and the covered agreements. Accordingly, a panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements..."

7.7 In the context of Mexico's request, the term "discretion" would imply that the Panel has the power to decide whether or not to act. Indeed, discretion may be said to exist only if a legal body has the freedom to choose among several options, all of them equally permissible in law. It seems that such freedom for a panel would exist within the framework of the DSU only if a complainant did not have a legal right to have a panel decide a case properly before it.

7.8 As the Appellate Body has stated, the aim of the WTO dispute settlement system is to resolve the matter at issue in particular cases and to secure a positive solution to disputes.¹⁸⁸ A panel has thus to address the claims on which a finding is necessary to enable the DSB to make sufficiently precise recommendations or rulings to the parties. A panel would seem therefore not to be in a position to choose freely whether or not to exercise its jurisdiction. Were a panel to choose not to exercise its jurisdiction in a particular case, it would be failing to perform its duties. More specifically, the panel would be failing to perform its duty to make "an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and to make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements..."

7.9 Moreover, the Panel recalled that, under Articles 3.2 and 19.2 of the DSU, a panel may not add to or diminish the rights and obligations of WTO Members provided in the covered agreements. If a WTO panel were to decide not to exercise its jurisdiction in a particular case, it would diminish the rights of the complaining Member under the DSU and other WTO covered agreements. In this regard, the Panel also recalled Article 23 of the DSU, which provides that Members of the WTO "shall" have recourse to, and abide by, the rules and procedures of the DSU when they seek the redress of a violation of obligations or other nullification or impairment of benefits under the WTO covered agreements. In the Panel's view, the terms of Article 23 of the DSU make it clear that a WTO Member that considers that any of its WTO benefits have been nullified or impaired as a result of a measure adopted by another Member has the right to bring the case before the WTO dispute settlement system.

¹⁸⁷ Mexico's first written submission, para. 93. Mexico's response to Panel question No. 35. United States' written version of oral statements during the first substantive meeting of the parties with the Panel, para. 13. United States' response to Panel question No. 2, para. 10.

¹⁸⁸ Appellate Body Report on *Australia – Salmon*, para. 223.

7.10 That being said, the Panel would point out that it makes no findings about whether there may be other cases where a panel's jurisdiction might be legally constrained, notwithstanding its approved terms of reference. In any event, such a situation would be distinguishable from the case before this Panel, where Mexico argued that the Panel legally had the discretion not to exercise its jurisdiction and requested the Panel to apply such discretion.

7.11 Mexico has argued that the United States' claims are linked to a broader dispute between the two countries related to trade in sweeteners under a regional treaty, the NAFTA.¹⁸⁹ In Mexico's opinion, under those circumstances, it would not be appropriate for the Panel to issue findings on the merits of the United States' claims.¹⁹⁰ In this regard, Mexico emphasized that its request to the Panel was not so much that the Panel decline to exercise its jurisdiction, but rather that it decline to exercise it "in favour of a NAFTA Chapter Twenty Arbitral Panel". In Mexico's opinion, only such a panel under the NAFTA would be in a position to "address the dispute as a whole".¹⁹¹

7.12 According to the information supplied by Mexico, there is a differing interpretation between Mexico and the United States regarding the conditions provided under the NAFTA for access of Mexican sugar to the United States' market.¹⁹² The United States has acknowledged that there is such a difference which has resulted in a dispute under the NAFTA that "is presently in the panelist selection stage".¹⁹³

7.13 However, Mexico did not argue, nor is there any evidence on record to indicate, that there are legal obligations under the NAFTA or any other international agreement to which Mexico and the United States are both parties, which might raise legal impediments to the Panel hearing this case or to the United States bringing its complaint to the WTO. Indeed, when specifically questioned on this point by the Panel, Mexico responded that there was nothing in the NAFTA that would prevent the United States from bringing the present case to the WTO dispute settlement system.¹⁹⁴ Mexico further added that it did not challenge the United States' right to bring its complaint to the WTO dispute settlement system nor to request the establishment of the Panel.¹⁹⁵

7.14 Moreover, neither the subject matter nor the respective positions of the parties are identical in the dispute under the NAFTA which has been mentioned by Mexico and the dispute before us. In the present case, the complaining party is the United States and the measures in dispute are allegedly imposed by Mexico. In the NAFTA case, the situation appears to be the reverse: the complaining party is Mexico and the measures in dispute are allegedly imposed by the United States. As for the subject matter of the claims, in the present case the United States is alleging discriminatory treatment against its products resulting from internal taxes and other internal measures imposed by Mexico. In the NAFTA case, instead, Mexico is arguing that the United States is violating its market access commitments under the NAFTA.

7.15 The Panel was mindful that, under Article 3.10 of the DSU, Members should not link "complaints and counter-complaints in regard to distinct matters". In other words, even conceding that there seems to be an unresolved dispute between Mexico and the United States under the NAFTA, the resolution of the present WTO case cannot be linked to the NAFTA dispute. In turn, any findings made by this Panel, as well as its conclusions and recommendations in the present case, only relate to Mexico's rights and obligations under the WTO covered agreements, and not to its rights and

¹⁸⁹ Mexico's first written submission, paras. 88-92.

¹⁹⁰ *Ibid.*, paras. 102-103.

¹⁹¹ *Ibid.*, para. 13.

¹⁹² *Ibid.*, paras. 5, 27-77.

¹⁹³ United States' response to Panel question No. 7, para. 20.

¹⁹⁴ Mexico's response to Panel question No. 4.

¹⁹⁵ Mexico's response to Panel question No. 34.

obligations under other international agreements, such as the NAFTA, or other rules of international law.

7.16 The Panel additionally noted that Mexico has not argued that its challenged tax measures have been mandated or authorized under the rules of the NAFTA.¹⁹⁶

7.17 Even assuming, for the sake of argument, that a panel might be entitled in some circumstances to find that a dispute would more appropriately be pursued before another tribunal, this Panel believes that the factors to be taken into account should be those that relate to the particular dispute. We understand Mexico's argument to be that the United States' claims in the present case should be pursued under the NAFTA, not because that would lead to a better treatment of this particular claim, but because it would allow Mexico to pursue another, albeit related, claim against the United States. The Panel fears that if such a matter were to be considered then there would be no practical limit to the factors which could legitimately be taken into account, and the decision to exercise jurisdiction would become political rather than legal in nature.

D. RULING BY THE PANEL

7.18 For the reasons indicated above, the Panel decided to reject Mexico's request for the Panel to decline to exercise its jurisdiction in the case in favour of an Arbitral Panel under Chapter Twenty of the North American Free Trade Agreement (NAFTA). The Panel concluded that, under the DSU, it has no discretion to decide whether or not to exercise its jurisdiction in a case properly before it. Furthermore, even if it had such discretion, the Panel did not consider that there were facts on the record that would justify the Panel declining to exercise its jurisdiction in the present case.

VIII. FINDINGS

A. CLAIMS AND ORDER OF ANALYSIS

1. Claims regarding soft drinks and claims regarding sweeteners

8.1 The United States' claims concern three measures adopted by Mexico, namely: a "soft drink tax", a "distribution tax" and a number of "bookkeeping requirements". The "soft drink tax" is a 20 per cent *ad valorem* tax on the transfer or, as applicable, the importation of certain soft drinks and syrups. The "distribution tax" is a 20 per cent tax on the provision of specific services (commission, mediation, agency, representation, brokerage, consignment and distribution), when these services are provided for transferring certain soft drinks and syrups. Finally, the "bookkeeping requirements" are a number of requirements imposed on taxpayers subject to the "soft drink tax" and to the "distribution tax".

8.2 The United States has submitted claims regarding the treatment that Mexico accords both to imports of soft drinks and syrups and to imports of non-cane sugar sweeteners, such as beet sugar and HFCS. The United States emphasizes that although the measures at issue are imposed by Mexico on soft drinks and syrups, this is a dispute which fundamentally concerns the treatment accorded to sweeteners.¹⁹⁷

8.3 Mexico does not contest that this is mainly a dispute about the treatment of sweeteners, rather than about the treatment of soft drinks and syrups. Mexico agrees with the United States that,

¹⁹⁶ However, Mexico has argued that under the NAFTA the examination of the challenged tax measures could be linked to its complaint regarding the United States' market access commitments for Mexican sugar. See, Mexico's second written submission, para. 6. See also, Mexico's response to Panel question No. 58. But see, United States' response to Panel question No. 58, paras. 22-24.

¹⁹⁷ United States' first written submission, para. 1.

although the measures at issue are taxes that apply to soft drinks and syrups, these measures were imposed to "stop the displacement of domestic cane sugar by imported HFCS and soft drinks and syrups sweetened with HFCS". Mexico contends, however, that the dispute concerns, not just the treatment of imported sweeteners in Mexico, but is part of a broader dispute with the United States concerning the bilateral trade in sweeteners under a regional trade agreement, the NAFTA.¹⁹⁸

8.4 Accordingly, the Panel will first examine the United States' claims regarding the treatment of imported non-cane sugar sweeteners in Mexico and will then turn to its claims regarding the treatment of imported soft drinks and syrups.

2. Claims under Articles III:2 and III:4 of the GATT 1994, regarding the treatment of sweeteners

8.5 With respect to the sweeteners, the United States claims that that the soft drink tax and the distribution tax are inconsistent with both Articles III:2 and III:4 of the GATT 1994, whereas the bookkeeping requirements are inconsistent with Article III:4 of the GATT 1994.¹⁹⁹

(a) Claims under Article III:2 of the GATT 1994

8.6 The United States argues that both the soft drink tax and the distribution tax, as they are applied to beet sugar and to HFCS, are inconsistent with the first sentence and with the second sentence of Article III:2 of the GATT 1994, respectively.²⁰⁰

8.7 The United States contends that beet sugar and cane sugar are "like" products, but that only beet sugar when used as a sweetener for soft drinks and syrups is subject to the soft drink tax and the distribution tax. According to the United States, this results in imported beet sugar being subject to taxes in excess of those applied to like domestic products, and that the taxes are therefore inconsistent with the first sentence of Article III:2 of the GATT 1994.²⁰¹

8.8 The United States also contends that HFCS and cane sugar are directly competitive or substitutable products and that the soft drink tax and the distribution tax result in imported HFCS being taxed dissimilarly compared to domestic cane sugar in a manner so as to afford protection to Mexican domestic production. According to the United States, the soft drink tax and the distribution tax are therefore inconsistent with the second sentence of Article III:2 of the GATT 1994.²⁰²

(b) Claims under Article III:4 of the GATT 1994

8.9 The United States further argues that the soft drink tax, the distribution tax and the bookkeeping requirements, as they are applied on HFCS and beet sugar, are inconsistent with Article III:4 of the GATT 1994.

8.10 The United States says that, as sweeteners for soft drinks and syrups, beet sugar, HFCS and cane sugar are "like products" within the meaning of Article III:4 of the GATT 1994. It adds that the Special Tax on Production and Services (*Impuesto Especial sobre Producción y Servicios*, or IEPS)²⁰³ affects the use of beet sugar and HFCS, by conditioning access to an advantage (the exemption from

¹⁹⁸ Mexico's first written submission, paras. 1-14 and 111. Written version of Mexico's oral statement during second substantive meeting of the Panel with the parties, para. 36.

¹⁹⁹ United States' second written submission, paras. 10-13

²⁰⁰ United States' second written submission, paras. 14, 15 and 18.

²⁰¹ United States' second written submission, paras. 18-22.

²⁰² United States' first written submission, paras. 93, 94 and 131-140.

²⁰³ For the remainder of this Section, we will refer to the Mexican Special Tax on Production and Services as IEPS and to the Law that regulates such tax (the Law on the Special Tax on Production and Services, *Ley del Impuesto Especial sobre Producción y Servicios*) as LIEPS.

the tax) on use of a domestic sweetener (cane sugar). Producers of soft drinks and syrups who use imported beet sugar or HFCS to sweeten their products do not enjoy the same advantage. The IEPS thus accords less favourable treatment to imports than to like Mexican domestic products. The United States concludes that the soft drink tax, the distribution tax and the bookkeeping requirements are inconsistent with Article III:4 of the GATT 1994.²⁰⁴

(c) Simultaneous claims under Articles III:2 and III:4 of the GATT 1994

8.11 As noted above, the United States presents claims in relation to sweeteners under both Articles III:2 and III:4 of the GATT 1994. These claims have not been presented as alternatives. Rather, the United States argues that the IEPS as a tax on non-cane sugar sweeteners may be examined under both paragraphs. In its view, the IEPS is both an "internal tax" on non-cane sugar sweeteners for use in soft drinks and syrups within the meaning of Article III:2 and a "law ... affecting the internal ... use" of non-cane sugar sweeteners within the meaning of Article III:4.²⁰⁵ The United States argues that Article III:2 prohibits dissimilar taxation of imported and domestic products, while Article III:4 prohibits less favourable treatment of imported products as compared to domestic products with respect to laws affecting their internal sale, use, etc. Thus, to the extent the less favourable treatment of the imported product takes the form of dissimilar taxation that affects its internal sale and use, the measure at issue may constitute a breach of both Articles III:2 and III:4 of the GATT 1994.²⁰⁶

8.12 The United States argues that, if there is overlap with respect to Articles III:2 and III:4 in this dispute, it is only "because of the particular tax measures Mexico has chosen to employ to discriminate against [non-cane sugar sweeteners]". In its opinion, "a discriminatory excise tax on a product, which also punishes users of that product for using imported inputs, would fit under both provisions".²⁰⁷

8.13 Mexico responds that, under previous WTO jurisprudence, when a measure, such as in this case, is an internal tax or other internal charge, it should be assessed under Article III:2 of the GATT 1994, and not under Article III:4. Non-fiscal regulations, on the other hand, would be covered by Article III:4.²⁰⁸

(d) Panel's analysis of the simultaneous claims

8.14 The Panel asked the parties whether a particular order should be followed when dealing with the United States' claims under Articles III:2 and III:4 of the GATT. As noted, in Mexico's opinion, WTO jurisprudence suggests that, if the challenged measure constitutes a tax measure, it should be assessed under Article III:2 of the GATT 1994, whereas a non-fiscal regulation would be covered by Article III:4 of the GATT 1994.²⁰⁹ In turn, the United States does not express any strong preference on the order in which to analyse the claims. However, it suggests that the Panel could employ the same order used by the United States in its submissions, i.e., first Article III:2 and then Article III:4.²¹⁰

8.15 Accordingly, the Panel will begin its analysis regarding the treatment accorded to sweeteners by Mexico under the challenged measures, by examining whether the soft drink tax and the distribution tax are internal taxes within the meaning of Article III:2. If the measures are internal

²⁰⁴ United States' first written submission, paras. 22, 153-162. United States' second written submission, paras. 12, 13 and 34-36.

²⁰⁵ United States response to Panel question No. 11, para. 26.

²⁰⁶ United States response to Panel question No. 21, para. 43.

²⁰⁷ United States response to Panel question No. 55, para. 16.

²⁰⁸ Mexico's response to Panel questions Nos. 11 and 55. Written version of Mexico's oral statement during second substantive meeting of the Panel with the parties, paras. 53-54.

²⁰⁹ Mexico's response to Panel questions Nos. 11 and 55.

²¹⁰ United States response to Panel question No. 55, para 17.

taxes under Article III:2, the Panel will then continue its analysis on whether the measures are consistent with the requirements of Article III:2.

B. BURDEN OF PROOF

1. General rule on burden of proof

8.16 The general rule is that the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence.²¹¹ Following this principle, the Appellate Body has explained that the complaining party in any given case should establish a prima facie case of inconsistency of a measure with a provision of the WTO covered agreements, before the burden of showing consistency with a provision or defending it under an exceptional provision is taken on by the defending party.²¹² According to the Appellate Body, a prima facie case is "one which, in the absence of effective refutation by the defending party, requires a panel, as a matter of law, to rule in favour of the complaining party presenting the prima facie case."²¹³ To establish a prima facie case, the party asserting a particular claim must adduce evidence sufficient to raise a presumption that what is claimed is true. In this regard, precisely how much and precisely what kind of evidence will be required to establish a presumption that a claim is valid will necessarily vary from case to case.²¹⁴

8.17 In this case, the initial burden of proof rests upon the United States, as a complainant, to establish its prima facie case that the measures at issue are inconsistent with certain provisions of the WTO covered agreements. The burden will then be on Mexico to rebut such a claim.

2. Burden of proof applied to the present case

8.18 In assessing the parties' claims and arguments in this case, the Panel notes that, other than to argue that the measure is not applied "so as to afford protection", Mexico does not respond to the United States' claims on the alleged violations of Article III of the GATT 1994. However, Mexico does not concede to the United States' claims on the alleged violations of Article III, nor does it agree that its tax measures are in violation of Article III. Mexico submits that its decision not to respond to the United States claims does not release the United States from its obligation as a complainant to establish a prima facie case, and that the Panel should make findings only after an examination of whether the conditions required by the different provisions of Article III have been met.²¹⁵

8.19 In this regard, the United States argues that it should not be an arduous task for the Panel to confirm that it has established a prima facie case of inconsistency in this dispute. According to the United States, it has put forward more than ample evidence and legal arguments in its two submissions, its oral statements and responses to the Panel's questions, and all the uncontested facts that have been presented by the United States should be accepted for purposes of the Panel's factual and legal findings in this dispute. The United States also draws the Panel's attention to the approach in *US – Shrimp* and *Turkey – Textiles*, where the panels undertook a brief analysis, based on the evidence before them, confirming that the complaining parties had made their prima facie case and then proceeded to examine the respondents' affirmative defence under Articles XX and XXIV of the

²¹¹ Appellate Body Report on *US – Shirts and Blouses*, p. 14, DSR 1997:I, p. 323 at p. 335. Panel Report on *US – Shrimp*, para. 7.14.

²¹² Appellate Body Report on *EC – Hormones*, para. 104.

²¹³ *Ibid.*

²¹⁴ Appellate Body Report on *US – Shirts and Blouses*, p. 14, DSR 1997:I, p. 323 at p. 335.

²¹⁵ Mexico's response to Panel questions Nos. 9, 18 and 41.

GATT 1994, respectively when, as in this case, the respondents did not make any rebuttals to the complainants' claims.²¹⁶

8.20 The assessment of the consistency of the measures at issue with Article III entails an examination of factors such as like products, excessive or dissimilar taxation between imported and domestic products, protection of domestic industry, and less favourable treatment afforded to imported products. Therefore, to determine whether the United States has established its Article III claims, the Panel will need to examine the claims, arguments and evidence submitted by the parties for each legal requirement under the relevant provision of Article III while, at the same time, being mindful of the relatively succinct analytical approach adopted by the panels in *US – Shrimp* and *Turkey – Textiles* in the absence of any counter-arguments by the respondent.

C. THE UNITED STATES' CLAIMS REGARDING SWEETENERS UNDER THE FIRST SENTENCE OF ARTICLE III:2 OF GATT 1994

1. The United States' claims

8.21 The United States claims that two of the challenged tax measures, specifically the soft drink tax and the distribution tax, are inconsistent with the first sentence of Article III:2, because they are internal taxes imposed on imported beet sugar in excess of the taxes applied to a like domestic product, in this instance, cane sugar.

8.22 The United States argues that beet sugar and cane sugar are "like" products and that the incidence of the challenged taxes on the non-cane sugar sweeteners (in this case, beet sugar) for the production of soft drinks and syrups is much greater than the nominal 20 per cent tax on the final soft drinks and syrups. Such taxes, which are not applied to the like domestic product, would be inconsistent with the first sentence of Article III:2 of the GATT 1994.²¹⁷

2. Mexico's response

8.23 Mexico does not respond to the United States' claims in this regard.²¹⁸

3. Article III:2, first sentence, of the GATT 1994

8.24 Under the first sentence of Article III:2 of the GATT 1994:

"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."

8.25 As articulated by the Appellate Body in its report in *Canada – Periodicals*, the analysis of whether a measure is inconsistent with the first sentence of Article III:2 of the GATT 1994 involves a two-step test:

"[T]here are two questions which need to be answered to determine whether there is a violation of Article III:2 of the GATT 1994: (a) whether imported and domestic products are like products; and (b) whether the imported products are taxed in excess of the domestic products.

²¹⁶ United States response to Panel question No. 9, paras. 22-23; and question No. 12, para. 27. United States second written submission, para. 6. Written version of United States oral statement during second substantive meeting of the Panel with the parties, para. 3.

²¹⁷ United States' second written submission, paras. 18-22.

²¹⁸ Mexico's first written submission, para. 114. Mexico's response to Panel question No. 9.

If the answers to both questions are affirmative, there is a violation of Article III:2, first sentence."²¹⁹

4. Panel's analysis

8.26 In order to examine this claim, and taking into account the fact that Mexico has chosen not to respond to the claims that the measures are inconsistent with Article III, the Panel will consider the United States' legal arguments, as well as all the available evidence.

(a) Likeness of products

8.27 The United States argues that beet sugar and cane sugar are "like products" within the meaning of the first sentence of Article III:2 of the GATT 1994. Indeed, the United States asserts that, although Article III:2 does not require that products be identical to be considered alike, cane and beet sugar are virtually identical with respect to their physical properties and end-uses, are distributed in the same manner to consumers (in this case, producers of soft drinks and syrups) that use them interchangeably and are both classified under heading 1701 of the Harmonized System.²²⁰

8.28 The consistent interpretation of dispute settlement bodies under the GATT 1947 and the WTO has been that the determination that products are "like" under Article III:2, first sentence, must be done "on a case-by-case basis, by examining relevant factors".²²¹ These factors include "the product's end-uses in a given market; consumers' tastes and habits, which change from country to country; the product's properties, nature and quality."²²² Another relevant factor identified by the Appellate Body is tariff classification, which, if sufficiently detailed, "can be a helpful sign of product similarity", and has been used for this purpose in several adopted panel reports.²²³ The Appellate Body has added that the definition of "like products" in Article III:2, first sentence, must be construed narrowly.²²⁴

8.29 In order to address the likeness requirement of the first sentence of Article III:2, the Panel will therefore consider, on the basis of the evidence presented by the parties, the products' properties, nature and quality; their end-uses in a given market; consumers' tastes and habits; and the tariff classification of the products based on the Harmonized System. It will construe the test of likeness in a narrow manner, as has been consistently done under the first sentence of Article III:2 of the GATT 1994.²²⁵

(i) Products' properties, nature and quality

8.30 Physically and chemically, beet sugar and cane sugar are forms of sucrose (a combination of glucose and fructose bonded together) with an identical molecular structure. The main difference between these two forms of sugar is the source from which they are derived, sugar beets and sugar cane respectively.²²⁶

8.31 Both beet sugar and cane sugar are sweeteners and, more precisely, nutritive sweeteners or sweeteners with a caloric content (as opposed to non-nutritive or non-caloric sweeteners, such as

²¹⁹ Appellate Body Report on *Canada – Periodicals*, pp. 22-23, DSR 1997:I, p. 449, at p. 465-66.

²²⁰ United States' second written submission, para. 19.

²²¹ Appellate Body Report on *Canada – Periodicals*, p. 21, DSR 1997:I, p. 449, at p. 466. See also, Appellate Body Report on *Japan – Alcoholic Beverages II*, p. 20, DSR 1996:I, p. 97, at p. 113.

²²² GATT Report of the Working Party on *Border Tax Adjustments*, BISD 18S/97, para. 18, as quoted in Appellate Body Report on *Japan – Alcoholic Beverages II*, p. 20, DSR 1996:I, p. 97, at p. 113.

²²³ Appellate Body Report on *Japan – Alcoholic Beverages II*, pp. 21-22, DSR 1996:1, p. 97, at p. 114.

²²⁴ *Ibid.*, pp. 19-21, DSR 1996:1, p. 97, at 112-114.

²²⁵ Appellate Body Report on *Canada – Periodicals*, p. 21, DSR 1997:I, p. 449, at p. 468. See also, Appellate Body Report on *Japan – Alcoholic Beverages II*, pp. 19-21, DSR 1996:1, p. 97, at pp. 112-114.

²²⁶ United States' first written submission, para. 22. United States' second written submission, para. 19.

saccharine). As such, both may be used as a sweetener in the industrial production of various products, including the soft drinks and syrups that are involved in the present dispute.²²⁷

(ii) *Products' end-uses*

8.32 For the particular end-use that is relevant in this case, the production of soft drinks and syrups, there is no difference between beet sugar and cane sugar. Producers can use beet sugar or cane sugar, or any combination of the two, when preparing soft drinks and syrups.²²⁸

8.33 Being virtually identical in their physical properties and end-uses, beet sugar and cane sugar can be distributed in the same manner, and industrial consumers (in this case, the producers of soft drinks and syrups) can use them interchangeably. In so far as a choice is made between them it will be based on availability and price.²²⁹

(iii) *Consumers' tastes and habits*

8.34 With regard to consumers' perceptions and behaviour in respect of the products, the Panel notices that both beet sugar and cane sugar are almost identical "sugars". There does not seem to be a conspicuous difference in taste between the two products.²³⁰ Furthermore, for the particular end-use that is relevant in this case, i.e. the production of soft drinks and syrups, any difference in taste between beet sugar and cane sugar is even less noticeable. Consumers of soft drinks and syrups would not be aware that one type of sugar has been used, rather than the other, since the use of one or the other does not alter the taste of the product, nor is it normally indicated on the labelling of the soft drink or syrup. The United States has quoted a major soft drink producer who states that "[b]ecause there is no noticeable taste difference, bottlers have the option of using either high fructose corn syrup (HFCS), beet sugar or cane sugar, depending on availability and cost."²³¹

(iv) *Tariff classification of the products*

8.35 Beet sugar and cane sugar are both classified under Harmonized System heading 1701.²³²

(v) *Conclusion*

8.36 Having considered the above factors, the Panel concludes that beet sugar and cane sugar are "like products" within the meaning of the first sentence of Article III:2, as sweeteners in the production of soft drinks and syrups.

(b) *Taxed in excess*

8.37 Having determined that beet sugar and cane sugar are "like products" within the meaning of the first sentence of Article III:2 of the GATT 1994, the Panel will now examine whether, through the

²²⁷ United States' first written submission, paras. 8 and 29. United States' second written submission, para. 19.

²²⁸ United States' first written submission, para. 77. United States' second written submission, paras. 19, 27-29. See also United States' responses to Panel question No. 74, para 68. Exhibit US-40 (a), paras. 412, 415, 416, and 425 (original in Spanish).

²²⁹ United States' first written submission, para. 109. United States' second written submission, paras. 19, 27-29. European Communities' third party written submission, para. 25. Exhibit US-40 (a), paras. 367 and 407 (original in Spanish).

²³⁰ Exhibit US-40 (a), paras. 355 and 391 (original in Spanish).

²³¹ United States' first written submission, para. 77. United States' second written submission, paras. 19, 27-29. See also United States' response to Panel question No. 74, para 68.

²³² United States' second written submission, para. 19. See also United States' response to Panel question No. 74, para. 68.

soft drink tax and the distribution tax, Mexico is subjecting, directly or indirectly, imported products to internal taxes in excess of those applied, directly or indirectly, to like domestic products.

8.38 The United States argues that, by imposing a tax on soft drinks and syrups because they are sweetened with sweeteners other than cane sugar, Mexico has also imposed a tax on the sweeteners themselves. It further argues that, while the tax rate on the soft drinks and syrups is 20 per cent *ad valorem*, the effective rate of the tax, when calculated on the value of the sweeteners in the soft drinks and syrups, far exceeds that figure. This is because the value of the sweeteners is only a fraction of that of the soft drinks or syrups of which they form part. According to the United States, the soft drink tax and the distribution tax result in an effective tax rate of nearly 400 per cent on beet sugar, which is clearly a tax "in excess" of that applied to the like domestic product for the purposes of the first sentence of Article III:2.²³³

8.39 The Panel will focus its analysis on two questions: (i) whether beet sugar contained in soft drinks and syrups is "subject, directly or indirectly," to the soft drink tax and the distribution tax; and, (ii) whether the soft drink tax and the distribution tax subject imported beet sugar to internal taxes "in excess of" those applied to domestic cane sugar.

(i) *Is beet sugar subject, directly or indirectly, to the soft drink tax and the distribution tax?*

8.40 Article III:2 of the GATT 1994 does not cover all internal taxes and internal charges, but only those internal taxes or internal charges that are "applied" by Members, directly or indirectly, to products. The Article also refers in its first sentence to products that are "subject, directly or indirectly, to internal taxes or other internal charges". In the context of the present case, the two expressions (that "a tax be applied on a product" and that "a product be subject to a tax") can be taken to have a common meaning that involves the existence of a link between the relevant tax and the taxed product.

8.41 Although they are contained in the same legislative instrument (the LIEPS), the soft drink tax and the distribution tax are distinct measures that operate in different ways. The United States has asked the Panel to make findings on the consistency of each of these measures (as well as of the bookkeeping requirements) with Mexico's obligations under the GATT 1994.²³⁴ Accordingly, the Panel will consider separately whether beet sugar is subject to internal taxes in the form of the soft drink tax or the distribution tax, or both.

Soft drink tax

8.42 The first sentence of Article III:2 refers to internal taxes or other internal charges that are applied "directly or indirectly" to products. It also refers to products that are subject "directly or indirectly" to internal taxes or other internal charges of any kind. The provision thus requires some connection, even if indirect, between the respective internal taxes or other internal charges, on the one hand, and the taxed product, on the other. The qualifying expression "directly or indirectly" does not eliminate the requirement for such a connection.

8.43 The soft drink tax is regulated by the Law on the Special Tax on Production and Services (*Ley del Impuesto Especial sobre Producción y Servicios*, or LIEPS)²³⁵ and its implementing legislation. The tax is triggered by the importation or the internal transfer of soft drinks and syrups containing

²³³ United States' second written submission, para. 20. United States response to Panel question No. 15, para. 33, and question No. 74, paras. 71-73.

²³⁴ United States response to Panel question No. 22, para. 48.

²³⁵ As noted, for the remainder of this Section, we will refer to the Mexican Law on the Special Tax on Production and Services as LIEPS and to the tax itself (Special Tax on Production and Services, *Impuesto Especial sobre Producción y Servicios*) as IEPS.

sweeteners other than cane sugar and it is charged on the importer or the purchaser as a percentage of the value of the soft drinks or syrups.²³⁶ Because the tax is not proportional to the value of non-cane sweeteners in the drink or syrup, it might be argued that beet sugar is not subject *directly* to the tax. However, because, as explained in the following paragraph, beet sugar is subject at least *indirectly* to the tax, the point need not be decided here.

8.44 In regard to the question of the *indirect* imposition of the soft drink tax on sweeteners, it is significant that: (a) it is the presence of non-cane sugar sweeteners that provides the trigger for the imposition of the tax; and, (b) the burden of the tax can be expected to fall, at least in part, on the products containing the sweetener, and thereby to fall on the sweetener. The Appellate Body has said that "Article III protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products".²³⁷ Taxes *directly* imposed on finished products can *indirectly* affect the conditions of competition between imported and like domestic inputs and therefore come within the scope of Article III:2, first sentence.²³⁸ Indeed, in a previous case the word "indirectly" was considered to cover, *inter alia*, taxes that are imposed on inputs.²³⁹

8.45 Given the facts just stated, the Panel concludes that the operation of the soft drink tax in regard to sweeteners is a factor influencing such competitive relationship and that such non-cane sugar sweeteners are therefore "subject ... to" the tax, albeit that the relationship is indirect. Consequently, non-cane sugar sweeteners are *indirectly* subject to the soft drink tax when they are used for the production of soft drinks and syrups.

Distribution tax

8.46 The distribution tax is also regulated by the LIEPS and its implementing legislation.²⁴⁰ However, the degree of connection between the tax and the relevant products is more remote in the case of the distribution tax than in the case of the soft drink tax.

8.47 The "distribution tax" is a tax on the provision of certain services when those services are provided "for the purpose of transferring" certain products, including soft drinks and syrups.²⁴¹ In general, it is not evident that the distribution tax is a tax imposed on products, even *indirectly*. According to some of the criteria used in a previous WTO case, there may be reasons to consider the distribution tax as a tax on services rather than on products.²⁴² It is not triggered by the sales of the relevant products, but rather by the provision of services related to those products²⁴³; it is imposed at *ad valorem* rates, not on the price of the relevant products, but rather on the value of the related services provided²⁴⁴; a special section of the LIEPS²⁴⁵, separate from the section governing taxes on products, is only applicable to this tax; and, the person legally liable for the payment of the tax is the supplier of the service and not the producer of the relevant products (although the producers are obliged by law to retain the tax²⁴⁶).

²³⁶ Mexico's response to Panel question No. 48.

²³⁷ Appellate Body Report on *Japan – Alcoholic Beverages II*, p. 16, DSR 1996:1, p. 97, at p. 110.

²³⁸ Cf., Appellate Body Report on *Canada – Periodicals*, p. 19, DSR 1997:I, p. 449, at pp. 464-465.

²³⁹ GATT Panel Report on *Japan – Alcoholic Beverages I*, para. 5.8. See also, Panel Report on *Canada – Periodicals*, paras. 3.49 and 5.29.

²⁴⁰ Mexico's response to Panel questions Nos. 81-82.

²⁴¹ LIEPS, article 2 (II.A). Although the tax is also imposed on the provision of services related to other products, such as alcoholic beverages, cigarettes and other tobacco products.

²⁴² Appellate Body Report on *Canada – Periodicals*, pp. 17-18, DSR 1997:1, p. 449, at pp. 463-464. See also, Panel Report on *Canada – Periodicals*, paras. 5.28-5.29.

²⁴³ LIEPS, article 2 (II.A).

²⁴⁴ *Ibid.*, Articles 17 and 3(XII).

²⁴⁵ *Ibid.*, Chapter IV of the Law.

²⁴⁶ *Ibid.*, Article 5-A.

8.48 Until January 2002, the LIEPS imposed payment of the distribution tax on the provision of services related to all soft drinks and syrups, regardless of the sweetener used. Since January 2002, and as a result of amendments introduced in the LIEPS, payment of the distribution tax has been exempted for the provision of services related to soft drinks sweetened with cane sugar. Pursuant to this amendment, the distribution tax is now imposed on certain services related to one group of soft drinks and syrups, while the same services related to another group of soft drinks and syrups are exempted from the tax, based only on whether those soft drinks and syrups are sweetened with cane sugar or with non-cane sugar sweeteners.

8.49 In the case of the soft drink tax, it was noted that the imposition of the tax creates a connection such that non-cane sugar sweeteners, such as beet sugar, can also be regarded to be *indirectly* subject to such tax, because the tax is based solely on the nature of the sweetener used, and because the burden of the tax can be expected to fall, at least in part, on the products containing the sweetener, and thereby to fall on the sweetener.²⁴⁷ The imposition of the distribution tax creates a similar connection, considering again that it is based solely on the nature of the sweetener used, and that the burden of the tax can be expected to fall, at least in part, on the products containing the sweetener, and thereby to fall on the sweetener. Thus, while on its face the distribution tax is a tax *directly* applied on the provision of certain services, in the circumstances of this case, it is also an tax *indirectly* applied on non-cane sugar sweeteners when they are used for the production of soft drinks and syrups.

8.50 In conclusion, the distribution tax is a tax *indirectly* imposed on non-cane sugar sweeteners, such as beet sugar.

(ii) *Do the soft drink tax and the distribution tax subject imported sweeteners to internal taxes in excess of those applied to like domestic sweeteners?*

8.51 If the soft drink tax and the distribution tax are regarded as taxes *indirectly* imposed on non-cane sugar sweeteners²⁴⁸, the evidence supports the conclusion that they subject beet sugar to internal taxes in excess of those applied to cane sugar. Indeed, the soft drink tax subjects the importation or the internal transfer of a certain group of soft drinks, those sweetened with non-cane sugar sweeteners, to the payment of a 20 per cent *ad valorem* tax.²⁴⁹ As for the distribution tax, assuming that the services provided have some value, the 20 per cent *ad valorem* tax on those services will result in an additional tax on non-cane sugar sweeteners.

8.52 The Appellate Body has said that even the smallest amount of excess of the tax that imported products are subject to over the tax applied to like domestic products will satisfy the "in excess" criterion in Article III:2, first sentence. It has also made clear that the prohibition of discriminatory taxes in this provision is not conditional on a "trade effects test", nor qualified by a *de minimis* standard.²⁵⁰

8.53 The United States contends that under the soft drink tax and the distribution tax the effective tax rate to which non-cane sugar sweeteners in soft drinks and syrups are subject is as high as 400 per cent.²⁵¹ Mexico does not dispute this figure. In any event, it is clear that, in *ad valorem* terms, the indirect tax burden on beet sugar as an input resulting from the 20 per cent tax on the value of the finished soft drinks or syrups and that resulting from the 20 per cent tax on the value of services associated with the soft drinks or syrups, based solely on the use of that non-cane sugar sweetener,

²⁴⁷ See para. 8.44 above.

²⁴⁸ See paras. 8.45 and 8.50 above.

²⁴⁹ United States response to Panel question No. 74, paras. 72-75.

²⁵⁰ Appellate Body Report on *Japan – Alcoholic Beverages II*, p.23, DSR 1996:1, p. 97, at p. 115.

²⁵¹ United States' second written submission, para. 20.

would have to be compared with the corresponding burden on cane sugar, the like domestic product, which is zero per cent. In each case, there can be no doubt that the one is "in excess" of the other.

8.54 The United States contends that almost all imported products are being taxed in excess of like domestic products as a result of the application of the soft drink tax and the distribution tax, and that the only sweetener exempted from the measures (cane sugar) is almost exclusively a domestic product. As the following paragraphs explain, the Panel finds that the facts of the case support this contention. However, the Panel refrains from ruling on whether such a finding is necessary in order for the United States to establish its claim under Article III:2, first sentence, of the GATT 1994.

8.55 As described above, the IEPS establishes a different regime for two groups of soft drinks and syrups. One group of soft drinks and syrups is subject, *inter alia*, to the payment of a soft drink tax and a distribution tax, while the other group is exempted from these taxes. The criterion established by the Mexican legislation for the division of soft drinks and syrups into these two groups is whether the soft drinks and syrups are sweetened with cane sugar or with non-cane sugar sweeteners, such as beet sugar.

8.56 Mexico produces cane sugar for the use of the soft drink and syrup industry. Most sugar consumed in Mexico is locally produced.²⁵² In the five years from 1997 to 2001, cane sugar represented less than 1 per cent each year of total Mexican imports of sweeteners.²⁵³ Unlike the United States, Mexico does not produce beet sugar. Consequently, any soft drinks containing beet sugar would contain an imported sweetener.

8.57 Although there is no record of imports of beet sugar into Mexico, not even incorporated in imported soft drinks, the soft drink tax and the distribution tax alter the conditions of competition to the detriment of beet sugar, making it less likely that there would be imports of beet sugar. As the European Communities indicates in its third party submission, in some WTO Members beet sugar may be the sweetener of choice for the production of soft drinks and syrups.²⁵⁴

8.58 The Panel therefore concludes that the situation where beet sugar is liable to higher taxes than those applied to cane sugar is *in effect* one where imported products are subject to taxes in excess of those applied to the like domestic products.

5. Conclusion

8.59 For the reasons stated above, the Panel concludes that the soft drink tax and the distribution tax indirectly subject beet sugar imported into Mexico to internal taxes in excess of those indirectly applied to like domestic products, and are in this respect inconsistent with Article III:2, first sentence, of the GATT 1994.

D. THE UNITED STATES' CLAIMS REGARDING SWEETENERS UNDER THE SECOND SENTENCE OF ARTICLE III:2 OF GATT 1994

1. The United States' claims

8.60 The United States also requests the Panel to find that two of the challenged tax measures, the soft drink tax and the distribution tax, are inconsistent with the second sentence of Article III:2, because directly competitive or substitutable products – HFCS and cane sugar – are not taxed similarly and protection is thereby afforded to domestic production.

²⁵² Exhibit US-15.

²⁵³ United States' first written submission, paras. 19, 20, 23-26 and 56. See also United States' response to Panel question No. 74, paras. 70 and 75. Exhibit US-42.

²⁵⁴ European Communities' third party written submission, para. 25.

8.61 The United States argues that HFCS and cane sugar are "directly competitive or substitutable" products when used as sweeteners for soft drinks and syrups. The United States further contends that, as a result of the soft drink tax and the distribution tax, HFCS and cane sugar are not being similarly taxed in Mexico. According to the United States, the incidence of the taxes on HFCS for the production of soft drinks and syrups is much greater than the 20 per cent tax that is imposed on the final soft drinks and syrups. The United States claims that this dissimilar taxation is being applied by Mexico so as to afford protection to domestic production, inconsistently with the second sentence of GATT Article III:2.²⁵⁵

2. Mexico's response

8.62 Mexico's only response to the United States' claim under the second sentence of Article III:2, regarding the treatment of HFCS, is that its measures are not intended to afford protection to its domestic production within the meaning of Article III of the GATT.²⁵⁶

3. Article III:2, second sentence, of GATT 1994

8.63 The second sentence of Article III:2 of the GATT 1994 says:

"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 [of Article III]."

8.64 In turn, paragraph 1 of Article III of the GATT states:

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

8.65 Finally, the *Ad Note* to Article III:2 of the GATT provides:

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

4. Panel's analysis

8.66 There are three elements to be considered to determine whether a measure is inconsistent with Article III:2, second sentence: first, whether the imported products and the domestic products are "directly competitive or substitutable products" which are in competition with each other; second, whether the directly competitive or substitutable imported and domestic products are "not similarly

²⁵⁵ United States' first written submission, paras. 93-140. United States' second written submission, paras. 14-16.

²⁵⁶ Mexico's first written submission, section III.D. Mexico's response to Panel question No. 83. Written version of Mexico's oral statement during second substantive meeting of the Panel with the parties, para. 18.

taxed;" and third, whether the dissimilar taxation of the directly competitive or substitutable imported and domestic products is "applied ... so as to afford protection to domestic production."²⁵⁷

(a) Directly competitive or substitutable products

8.67 *Ad Note* to paragraph 2 of Article III makes it clear that to fall within the scope of paragraph 2, second sentence, it is sufficient that the relevant products be "directly competitive or substitutable".

8.68 The Appellate Body has said that products are "directly competitive or substitutable" if they are interchangeable or if they offer "alternative ways of satisfying a particular need or taste".²⁵⁸ The phrase connotes a relationship between imported and domestic products at issue that can be essentially described as "in competition" in the marketplace.²⁵⁹ In order to make this assessment, GATT and WTO bodies have examined the following factors: the competitive conditions between the products in the relevant market, in the light of the nature of both products, their physical characteristics, their common end-uses, consumers' perceptions and behaviour in respect of the products, and the products' tariff classifications.²⁶⁰ The Panel will examine these factors in respect of HFCS and cane sugar.

(i) *Products' properties, nature and quality*

8.69 Both HFCS and cane sugar are sweeteners and, more precisely, nutritive sweeteners or sweeteners with a caloric content (as opposed to non-nutritive or non-caloric sweeteners, such as saccharine).²⁶¹ As such, both may be used, during an industrial process, for the purpose of sweetening products such as the soft drinks and syrups that are involved in the present dispute.

8.70 Physically, although not identical, HFCS and cane sugar have similar characteristics. They are both combinations of glucose and fructose, albeit in different proportions. In the case of HFCS, the precise proportions of glucose and fructose depend on the grade of the HFCS. The United States has provided evidence regarding the existence of three types of HFCS: HFCS-42, HFCS-55 and HFCS-90. The number stands for the percentage of fructose in the product. HFCS-42 and HFCS-55 are the grades most commonly used in the production of soft drinks and syrups. In these two formulations, the proportions of glucose and fructose in HFCS are similar to those in cane sugar. This similarity is deliberate, since HFCS is designed to mimic sugar as far as possible, so that it can be used as an alternative industrial sweetener. HFCS-90 may also be used as a sweetener for soft drinks and syrups if it is blended with HFCS-42 to produce HFCS-55. While HFCS is always liquid, sugar can also be consumed in liquid form, particularly for industrial uses such as the production of soft drinks and syrups. Indeed, as part of the process of producing soft drinks and syrups, cane sugar is mixed with water to produce a sugar syrup, which is then added to other ingredients to produce the soft drink or syrup.²⁶²

(ii) *Products' end-uses*

8.71 Cane sugar and HFCS may serve the same end-use, i.e., to be sweeteners in the production of soft drinks and syrups. Indeed, the evidence suggests that HFCS was developed mainly as a cost-

²⁵⁷ Appellate Body Report on *Japan – Alcoholic Beverages II*, p.24, DSR 1996:1, p. 97, at p. 116.

²⁵⁸ Appellate Body Report on *Korea – Alcoholic Beverages*, para. 115.

²⁵⁹ *Ibid.*, para. 114.

²⁶⁰ See, for example, Appellate Body Report on *Japan – Alcoholic Beverages II*, p. 25, DSR 1996:1, p. 97, at p. 117.

²⁶¹ United States' first written submission, para. 29.

²⁶² United States' first written submission, paras. 96-102 and 107. United States response to Panel question No. 72, paras. 56-60. Exhibits US-22 and US-40 (a), paras. 339 to 426 (especially paras. 350 to 355, original in Spanish).

effective alternative to sugar for the production of soft drinks. Producers of soft drinks and syrups will decide whether to use cane sugar or HFCS – or, indeed, beet sugar – or any combination of those sweeteners, very largely on the basis of their relative prices.²⁶³ Some producers may even use blends of sugar and HFCS.²⁶⁴

(iii) *Consumers' perceptions and behaviour*

8.72 Concerning consumers' perceptions, the Panel has already noted that the sweeteners in the present case are an input used in the production of a final product, i.e., soft drinks and syrups. The immediate consumers of the sweeteners are the industrial producers of soft drinks and syrups. The evidence suggests that these producers consider HFCS and cane sugar to be completely interchangeable and will substitute HFCS for cane sugar, if that reduces costs. According to the United States Department of Agriculture, "HFCS deliveries have shown strong growth from the period when first introduced in the 1970s up to the late 1990s. In the period up to 1986, HFCS growth came at the expense of corresponding reductions in sugar deliveries. After 1986, strong demand for carbonated soft drinks helped promote strong demand for HFCS. Since 1999, soft drink consumption growth has fallen and with it, the demand for HFCS."²⁶⁵

8.73 In the particular case of Mexico, the evidence indicates that, as HFCS became available, and before the tax measures were imposed, Mexican producers of soft drinks and syrups started substituting it for cane sugar. The United States Department of Agriculture estimated that "prior to the imposition of the tax in January 2002, Mexico's soft drink industry was using 450,000-480,000 mt of HFCS, or between 75 and 80 percent of total HFCS consumption of 600,000 mt, dry basis".²⁶⁶ When the Mexican Government imposed measures on HFCS (such as anti-dumping duties and the tax measures challenged under the present case), the producers switched back to cane sugar. The United States has also pointed to the fact that industrial producers of fruit and vegetable juices, which are not subject to the IEPS, have continued using HFCS. All this evidence indicates that industrial consumers of sweeteners regard cane sugar and HFCS as interchangeable products for producing soft drinks and syrups.²⁶⁷

8.74 As for final consumers, the evidence indicates that the consumers of soft drinks and syrups do not differentiate between products sweetened with cane sugar and those sweetened with HFCS. HFCS and cane sugar are similar in terms of smell and colour: both are odourless and, when presented as liquids, colourless. The taste, colour and other physical characteristics of soft drinks and syrups sweetened with HFCS and cane sugar are indistinguishable.²⁶⁸ Furthermore, Mexican labelling regulations do not make a distinction between the different sweeteners, so a bottler can switch between different mixtures of HFCS and cane sugar without changing the labelling, and the consumer will not be aware which of them is being used.²⁶⁹ The Panel may therefore conclude that, as between HFCS and cane sugar, the specific caloric sweetener used is not a factor that Mexican consumers take into account when choosing a soft drink or syrup.²⁷⁰

²⁶³ Exhibit US-40 (a), para. 355 (original in Spanish).

²⁶⁴ United States' first written submission, paras. 106-113. Exhibit US-27.

²⁶⁵ United States Department of Agriculture, "Sugar and Sweeteners Outlook" (May 27, 2004), Exhibit US-21, p. 19.

²⁶⁶ Ibid., p. 23.

²⁶⁷ United States' first written submission, paras. 14, 34, and 106-113. Exhibits US-26 and US-27.

²⁶⁸ Exhibit US-22.

²⁶⁹ Exhibit US-37 (a), table 1 (original in Spanish).

²⁷⁰ United States' first written submission, paras. 99, 100 and 111. Exhibit US-40 (a), para. 391 (original in Spanish).

(iv) *Tariff classification of the products*

8.75 Both cane sugar and HFCS are described as "sugars" in the Harmonized System. Cane sugar occupies heading 1701 of the Harmonized System, while HFCS is classified within heading 1702, together with liquid sugar and invert sugar, as part of the group "other sugars". Both products are therefore part of Harmonized System Chapter 17, "Sugars and sugar confectionery".²⁷¹

(v) *Determination by other authorities*

8.76 The determination that HFCS and cane sugar may be regarded as "directly competitive or substitutable products" for producing soft drinks and syrups is supported by a similar conclusion reached by other bodies. In a press bulletin issued in 2003, the Mexican Ministry of Economics announced, in response to requests from industrial consumers of sugar in Mexico, the approval of an import quota of refined sugar as a "preventive measure", in case domestic production was insufficient to satisfy domestic demand. The bulletin goes on to state that the concerns of the industrial consumers of sugar were "mainly the consequence of the entry into force of the Special Tax on Production and Services (IEPS) for soft drinks elaborated with fructose, which generated a replacement of fructose with sugar in the sweeteners market of approximately 500 thousand tonnes..." (*Dichas preocupaciones son consecuencia fundamentalmente de la entrada en vigor del Impuesto Especial sobre Producción y Servicios (IEPS) para refrescos elaborados con fructuosa y que generó una sustitución de fructuosa por azúcar en el Mercado de edulcorantes de aproximadamente 500 mil toneladas*).²⁷²

8.77 A decision by the Mexican Federal Competition Commission in June 1999 similarly concluded that "Refined sugar is used mainly in the production of bottled refreshments, while standard sugar is used in various branches of the food industry. High fructose corn syrup (HFCS) is a substitute mainly for refined sugar" (*El azúcar refinada se utiliza principalmente en la producción de refrescos embotellados, mientras que el azúcar estándar es empleada en diversas ramas de la industria alimentaria. El jarabe de maíz de alta fructuosa (jmaf) es sustituto principalmente del azúcar refinada.*).²⁷³ An earlier report of the same Mexican Federal Competition Commission had defined HFCS as a "close substitute for refined sugar in processing soft drinks" (*un sustituto cercano del azúcar refinada en la elaboración de bebidas gaseosas*).²⁷⁴

(vi) *Conclusion*

8.78 For the reasons indicated above, the Panel concludes that HFCS and cane sugar are "directly competitive or substitutable products" for producing soft drinks and syrups, within the meaning of Article III:2, second sentence.

(b) *Not similarly taxed*

8.79 For the Panel to conclude that an imported product is being "not similarly taxed" when compared to a directly competitive or substitutable domestic product, within the meaning of the second sentence of Article III:2 of the GATT 1994, it must determine that the tax burden on the imported product is heavier than on the domestic product, and that this difference is more than *de minimis*.²⁷⁵

²⁷¹ United States' first written submission, para. 117.

²⁷² Exhibit US-53 (original in Spanish).

²⁷³ Exhibit US-56 (original in Spanish).

²⁷⁴ Exhibit US-55 (original in Spanish).

²⁷⁵ Appellate Body Report on *Japan – Alcoholic Beverages II*, p. 27, DSR 1996:1, p. 97, at p. 119.

8.80 The Panel has already determined that the soft drink tax and the distribution tax are indirectly applied to non-cane sugar sweeteners.²⁷⁶

8.81 The evidence indicates that, as a result of the application of the soft drink tax and the distribution tax, HFCS is being taxed dissimilarly compared to cane sugar. Indeed, as has been noted, the soft drink tax subjects the importation and the internal transfer of a certain group of soft drinks, those sweetened with non-cane sugar sweeteners, to the payment of a 20 per cent *ad valorem* tax. As for the distribution tax, assuming that the services provided have some value, the 20 per cent *ad valorem* tax on those services will result in an additional tax *indirectly* imposed on non-cane sugar sweeteners. When considered as a tax on the input, in *ad valorem* terms the actual tax burden that the soft drink tax and the distribution tax impose on non-cane sugar sweeteners (in particular, on HFCS), is higher than the rate of 20 per cent tax imposed on the finished product. Indeed, the actual tax burden on the input would be relative to the proportion that the value of the input represents of the price of the finished product and the value of the services provided.

8.82 The United States contends that under the soft drink tax and the distribution tax the effective tax rate to which non-cane sugar sweeteners in soft drinks and syrups are subject is as high as 400 per cent.²⁷⁷ Mexico does not dispute this figure. In any event, it is clear that the burden on sweeteners resulting from the 20 per cent tax on the value of the finished soft drinks or syrups and that resulting from the 20 per cent tax on the value of services associated with the soft drinks or syrups, based solely on the use of non-cane sugar sweeteners, would have to be compared with the corresponding burden on cane sugar, the like domestic product, which is zero per cent. The term "not similarly taxed" is taken to mean a difference in tax that is more than *de minimis*.²⁷⁸ The Panel is in no doubt that in each case the difference in taxation between soft drinks or syrups sweetened with HFCS and those sweetened with cane sugar is more than *de minimis*. Consequently, a product (HFCS) which is being taxed at considerably more than 20 per cent is not being "similarly taxed" to one (cane sugar) which is subject to no tax.

8.83 For these reasons, the Panel concludes that the difference in taxation between imported HFCS and domestic cane sugar, resulting from the application of the soft drink tax and the distribution tax, is more than *de minimis* and the two products are therefore "not similarly taxed".

(c) So as to afford protection to domestic production

8.84 The last issue to be considered by the Panel in regard to Article III:2, second sentence, is whether the soft drink tax and the distribution tax are being applied "so as to afford protection" to Mexican domestic production. The United States argues that, with respect to HFCS, the soft drink tax and the distribution tax afford protection to Mexican domestic production of cane sugar.²⁷⁹

8.85 For a violation of Article III:2, second sentence, it is not enough that imports and directly competitive or substitutable domestic products be dissimilarly taxed, the relevant tax must also be applied "so as to afford protection" to domestic production. In that regard, as explained by the Appellate Body:

"[W]e believe that an examination in any case of whether dissimilar taxation has been applied so as to afford protection requires a comprehensive and objective analysis of the structure and application of the measure in question on domestic as compared to imported products. We believe it is possible to examine objectively the underlying criteria used in a particular tax measure, its structure, and its overall application to

²⁷⁶ See paras. 8.45 and 8.50 above.

²⁷⁷ United States' second written submission, para. 20.

²⁷⁸ Appellate Body Report on *Japan – Alcoholic Beverages II*, p. 27, DSR 1996:1, p. 97, at p. 119.

²⁷⁹ United States response to Panel question No. 29, para. 68.

ascertain whether it is applied in a way that affords protection to domestic products. Although it is true that the aim of a measure may not be easily ascertained, nevertheless its protective application can most often be discerned from the design, the architecture, and the revealing structure of a measure."²⁸⁰

8.86 The design and operation of the soft drink tax and the distribution tax indicate that they afford protection to Mexican production of cane sugar. These taxes apply to the importation and internal transfers of all soft drinks and syrups, except for internal transfers of soft drinks and syrups sweetened with cane sugar. As the Panel has already determined, this means that the challenged measures mostly affect imported sweeteners as opposed to domestic like products.²⁸¹ Mexican production of sweeteners for soft drinks and syrups is concentrated on cane sugar, whereas imports of sweeteners were overwhelmingly concentrated on HFCS (until this trade ceased, coinciding with the imposition of the taxes).

8.87 The magnitude of the tax differential between imported and domestic products, resulting from the application of the soft drink tax and the distribution tax, is additional evidence of the protective effect of the measure on Mexican domestic production of sugar. As has been already noted, the 20 per cent tax rate on the finished soft drinks and syrups constitutes a tax on HFCS as an input that is considerably more than 20 per cent.²⁸²

8.88 The finding that the tax measures have a protective effect is in line with the general character of the measures taken by Mexico in recent years in the sugar sector.²⁸³ Mexico has been able to maintain a relatively protected market for sugar.²⁸⁴ This has allowed Mexico to maintain relatively high domestic prices for sugar, compared to international prices. According to the available data, most sugar consumed in Mexico is domestically produced, since Mexico imports very small quantities of sugar. Indeed, annual Mexican imports of sugar in the period 1995-2003, never exceeded 2.65 per cent of its domestic consumption and, in seven out of the nine years that comprise this period, they were below 1 per cent of domestic consumption.²⁸⁵

8.89 Mexico does not deny the importance it attributes to the protection of its cane sugar industry. Although Mexico states that its tax measures were "not intended to afford protection to domestic production within the meaning of Article III of the GATT 1994"²⁸⁶, it acknowledges that the IEPS was one of a number of measures adopted by the Mexican authorities to alleviate the adverse economic situation experienced by its domestic sugar industry. Indeed, it has expressed its agreement with the United States' observation that the challenged measures were imposed to "stop the displacement of domestic cane sugar by imported HFCS and soft drinks and syrups sweetened with HFCS".²⁸⁷ Mexico claims, however, that its tax measures are not intended to afford protection to domestic production within the meaning of Article III of the GATT 1994, but were rather adopted as a response to the impairment of Mexico's rights under the NAFTA regarding market access opportunities for its sugar exports to the United States' market.²⁸⁸

²⁸⁰ Appellate Body Report on *Japan – Alcoholic Beverages II*, p. 29, DSR 1996:I, p. 97, at p. 120.

²⁸¹ See para.8.56, above.

²⁸² See para. 8.82 above.

²⁸³ See, for example, Mexico's first written submission, para. 52. See also, United States' first written submission, footnote 30. United States' comments to Mexico's response to Panel question No. 90, para. 48. Exhibits US-59, US-61, US-62, US-63, US-64 and US-65.

²⁸⁴ Cf. Appellate Body Report on *Japan – Alcoholic Beverages II*, p. 31, DSR 1996:I, p. 97, at p. 122. See also, Panel Report on *Japan – Alcoholic Beverages II*, para. 6.35.

²⁸⁵ United States' first written submission, para. 20. Exhibit US-42.

²⁸⁶ Mexico's first written submission, section III.D. Written version of Mexico's oral statement during second substantive meeting of the Panel with the parties, para. 18.

²⁸⁷ Mexico's first written submission, para. 111. United States' first written submission, para. 3.

²⁸⁸ Mexico's response to Panel question No. 83.

8.90 In its various submissions in this case, Mexico describes at length the economic and social importance of its sugar sector. For example, it says that "in Mexico the cultivation of sugarcane is widespread and crucial to the rural economy. It is a vital cash crop for many relatively poor farmers in 15 of Mexico's 32 states. There are some 155,000 cane growers in Mexico and it is estimated that nearly 3 million people in rural Mexico depend on the sugarcane crop."²⁸⁹ Mexico adds that: "Sugarcane is the leading and most important crop in Mexico. The cultivated field area is twice that of tomatoes, corn, carrots, and potatoes."²⁹⁰ According to its figures, 1.5 per cent of the Mexican workforce depends directly on its sugar industry.²⁹¹ Sugar cane generates higher returns to the farmers than any other crop, in terms of production value per harvested hectare.²⁹²

8.91 The protective effect of the measure on Mexican domestic production of sugar does not seem to be an unintended effect, but rather an intentional objective. The Appellate Body has cautioned against ascribing too much importance to the subjective legislative intent of legislators and regulators in the drafting of a particular measure, to determine whether the measure is applied so as to afford protection to domestic production, particularly when that declared intent is that protectionism was not an objective.²⁹³ However, the declared intention of legislators and regulators of the Member adopting the measure should not be totally disregarded, particularly when the explicit objective of the measure is that of affording protection to domestic production. Indeed, the Appellate Body has confirmed that statements made by government representatives of a Member, admitting to the protective intent of a measure, may be relevant as part of a number of considerations in reaching the conclusion that a measure is applied so as to afford protection to domestic production.²⁹⁴

8.92 In this respect, the United States has presented a copy of the written record of the debate that took place in December 2001 in the Mexican Congress on the bill that proposed the amendments to the LIEPS that would put in place the measures at issue. During that debate, a member of the Mexican Congress presented the bill on behalf of the committee that had drafted it (the Committee of Treasury and Public Credit of the Chamber of Deputies (*Comisión de Hacienda y Crédito Público*)). During his presentation, the representative of the committee declared, after explaining to the chamber the taxes that would be imposed on soft drinks and syrups, "[w]e legislators, however, have the commitment to protect the national sugar industry, because a great number of Mexicans' subsistence depends on it. To that effect, it is proposed that the tax on soft drinks be applied only to those [soft drinks] that for their production utilize fructose instead of cane sugar".²⁹⁵

8.93 In March 2002, the Mexican Executive exempted, *inter alia*, all imports and transfers of soft drinks and syrups (and not only those of soft drinks and syrups sweetened with cane sugar) from payment of the soft drink tax. The Mexican Supreme Court of Justice was asked by the Chamber of Deputies of the Mexican Congress to annul that exemption on the grounds that the exemption was unconstitutional. When considering the case, the Supreme Court of Justice stated that:

"[i]n order to resolve the alleged unconstitutionality of the challenged decree, that is, whether the law approved by the Congress of the Union is being duly executed, it is necessary to turn to the motives that prompted the ordinary legislator to reform the Law on the Tax on Production and Services, in order to extend the scope of subjects to that tax to those who use sweeteners different than cane sugar."²⁹⁶

²⁸⁹ Mexico's first written submission, para. 4.

²⁹⁰ *Ibid.*, para. 16.

²⁹¹ *Ibid.*, para. 17.

²⁹² *Ibid.*, para. 20.

²⁹³ Appellate Body Report on *Japan – Alcoholic Beverages II*, pp. 27-28, DSR 1996:I, p. 97, at pp. 119.

²⁹⁴ Appellate Body Report on *Canada – Periodicals*, pp. 30-32, DSR 1997:1, p. 449, at pp. 475-476.

²⁹⁵ Exhibit US-28, US-29 (original in Spanish) and US-34(a), page 90 (original in Spanish).

²⁹⁶ Exhibit US-31 (original in Spanish).

8.94 The Mexican Supreme Court of Justice looked at the report of the Committee of Treasury and Public Credit of the Mexican Chamber of Deputies and at the statement made to the chamber by the representative of that committee to which we have referred. From those documents, the Court concluded that "the legislator's intent when extending the aforementioned tax to gasified waters, soft drinks, hydrating drinks and other taxed goods and activities, when they use fructose in their production rather than cane sugar, was that of protecting the sugar industry". The Court concluded that the Executive had violated, not only the fiscal objective of the measure, but "also its extra-fiscal objective that was expressed in the legislative procedure, that is the protection of the domestic sugar industry".²⁹⁷ The exemption granted by the Mexican Executive was thus annulled.

8.95 Having considered all these factors, the Panel concludes that the soft drink tax and the distribution tax are being applied so as to afford protection to Mexican domestic production of cane sugar.

5. Conclusion

8.96 For the reasons given above, the Panel concludes that the dissimilar taxation imposed on directly competitive or substitutable imports (HFCS) and domestic products (cane sugar) is applied in a way that affords protection to domestic production, and that the tax measures are therefore inconsistent with Article III:2, second sentence, of the GATT 1994.

E. THE UNITED STATES' CLAIMS REGARDING SWEETENERS UNDER ARTICLE III:4 OF GATT 1994

1. The United States' claims

8.97 The United States requests the Panel to find that the challenged tax measures (the soft drink tax, the distribution tax and the bookkeeping requirements) are inconsistent with Article III:4 of the GATT 1994, because they are internal measures that affect the internal use and sale of imported non-cane sugar sweeteners and accord those non-cane sugar sweeteners treatment that is less favourable than that accorded to like products of national origin, i.e. cane sugar.

8.98 The United States claims that beet sugar, HFCS and cane sugar, as sweeteners for soft drinks and syrups, are "like products"; that the three challenged tax measures (the soft drink tax, the distribution tax and the bookkeeping requirements) affect the use of beet sugar and HFCS, by conditioning access to an advantage (the exemption from the tax) on use of a domestic sweetener (cane sugar); that producers of soft drinks and syrups who use imported beet sugar or HFCS to sweeten their products do not enjoy the same advantage; and that the three measures therefore accord less favourable treatment to imports than to like Mexican domestic products. The United States concludes that the soft drink tax, the distribution tax and the bookkeeping requirements are therefore inconsistent with Article III:4 of the GATT 1994.²⁹⁸

2. Mexico's response

8.99 Mexico does not respond to the United States' claims in this regard.²⁹⁹

3. Article III:4 of GATT 1994

8.100 Under Article III:4 of the GATT 1994:

²⁹⁷ Ibid.

²⁹⁸ United States' first written submission, paras. 155-162. United States' second written submission, paras. 34-36.

²⁹⁹ Mexico's first written submission, para. 114. Mexico's response to Panel question No. 9.

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

8.101 The Appellate Body has said that "[f]or a violation of Article III:4 to be established, three elements must be satisfied: that the imported and domestic products at issue are 'like products'; that the measure at issue is a 'law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution, or use'; and that the imported products are accorded 'less favourable' treatment than that accorded to like domestic products".³⁰⁰

4. Panel's analysis

8.102 The Panel has already determined that the soft drink tax and the distribution tax, as applied on beet sugar and HFCS, are internal taxes inconsistent with Article III:2 of the GATT 1994. Consequently, the Panel need not proceed any further in respect of these two measures. Nevertheless, the Panel will analyse the United States' claims against the soft drink tax and the distribution tax under Article III:4, in the event that either or both of the two measures should be considered more properly as measures affecting the internal use of sweeteners, rather than as internal taxes on sweeteners.

(a) Likeness of products

8.103 The United States argues that, as sweeteners for the production of soft drinks and syrups, beet sugar, HFCS and cane sugar are "like products" within the meaning of Article III:4. In its opinion, cane and beet sugar are not only "like", but are almost identical. HFCS and cane sugar, on the other hand, are near perfect substitutes as sweeteners in soft drinks and syrups.³⁰¹

³⁰⁰ Appellate Body Report on *Korea – Various Measures on Beef*, para. 133.

³⁰¹ United States' first written submission, paras. 155-162. United States' second written submission, paras. 34 and 36.

8.104 The analysis of the likeness between imported and domestic products for the purpose of Article III:4 covers the characteristics of the relevant products and the extent of the competitive relationship between them. The Appellate Body has said that:

"As products that are in a competitive relationship in the marketplace could be affected through treatment of *imports* 'less favourable' than the treatment accorded to *domestic* products, it follows that the word 'like' in Article III:4 is to be interpreted to apply to products that are in such a competitive relationship. Thus, a determination of 'likeness' under Article III:4 is, fundamentally, a determination about the nature and extent of a competitive relationship between and among products."³⁰²

8.105 Beet sugar and cane sugar have already been found to be like products within the meaning of the first sentence of Article III:2 of the GATT 1994, as sweeteners in the production of soft drinks and syrups.³⁰³ Since the Appellate Body has clarified that "that the scope of 'like' in Article III:4 is broader than the scope of 'like' in Article III:2, first sentence"³⁰⁴, it follows that beet sugar and cane sugar are like products within the meaning of Article III:4.

8.106 As regards the likeness of cane sugar and HFCS, the factors to be taken into account – the products' properties, nature and quality; their end-uses in a given market; consumers' tastes and habits; and the tariff classification of the products – are the same as those examined by the panel when considering whether the two products were "directly competitive or substitutable" under Article III:2, second sentence.³⁰⁵ It is not necessary for the Panel to repeat its factual conclusions regarding those factors. All that is necessary is that the Panel should consider, in the light of those factual conclusions, whether, and to what extent, the products involved are, or could be, in a competitive relationship in the marketplace and satisfy the "like products" criterion in Article III:4. The Panel is satisfied that the facts amply demonstrate that, as sweeteners for soft drinks and syrups, cane sugar and HFCS are in a close competitive relationship and that they undoubtedly can be considered as "like products" under Article III:4.

(b) Measures affecting the internal use of sweeteners

8.107 The United States claims that the LIEPS "affects" the use of beet sugar and HFCS, because they grant producers of soft drinks and syrups an advantage (an exemption from the three challenged tax measures: the soft drink tax, the distribution tax and the bookkeeping requirements) that is conditional on the use of a domestic sweetener, cane sugar. The added burdens imposed on the use of beet sugar and HFCS would influence the producers' choice of sweeteners. In the United States' opinion, the best evidence of this effect is the fact that, after imposition of the tax measures, all Mexican bottlers of soft drinks and syrups that were using HFCS, reverted to use of cane sugar. The United States thus concludes that the LIEPS is a law "affecting" the "internal use" of beet sugar and HFCS.³⁰⁶

8.108 The term "affecting" in the expression "laws, regulations and requirements affecting [the] internal sale, offering for sale, purchase, transportation, distribution or use" in Article III:4 of the GATT 1994 has a broad scope. As articulated in WTO and GATT jurisprudence, it "cover[s] not only laws and regulations which directly govern the conditions of sale or purchase but also any laws or

³⁰² Appellate Body Report on *EC – Asbestos*, para. 99.

³⁰³ See para. 8.36 above.

³⁰⁴ Appellate Body Report on *EC – Asbestos*, para. 99. Cf. Appellate Body Report on *Japan – Alcoholic Beverages II*, p. 19-21, DSR 1996:I, p. 97, at pp. 112-114.

³⁰⁵ See paras. 8.69 to 8.77 above.

³⁰⁶ United States' first written submission, para. 160. United States' second written submission, para. 34. United States response to Panel question No. 11, para. 26; question No. 21, para. 44; and question No. 55, para. 14.

regulations which might adversely modify the conditions of competition between domestic and imported products³⁰⁷ "308

8.109 The Panel has already concluded that two of the measures challenged by the United States under Article III:4 of the GATT 1994 (the soft drink tax and the distribution tax) are imposed on imported sweeteners in a manner inconsistent with Article III:2.³⁰⁹ The facts that were analysed by the Panel and led it to consider that the two taxes "apply" to imported sweeteners,³¹⁰ also support the conclusion that these taxes "affect" imported sweeteners.

8.110 The LIEPS exempts producers of soft drinks and syrups from payment of the soft drink tax, contingent on the use of cane sugar as a sweetener. On the other hand, producers of soft drinks and syrups that use any other sweetener to sweeten their products, including beet sugar or HFCS, do not enjoy the same exemption. Similarly, the LIEPS imposes a distribution tax on the provision of certain services, when these services are provided for the purpose of transferring soft drinks and syrups sweetened with non-cane sugar sweeteners. Providers of the same services, when the soft drinks and syrups are sweetened with cane sugar, are exempted from the distribution tax.³¹¹

8.111 The LIEPS also imposes a number of requirements (referred to in this case as the "bookkeeping requirements") on taxpayers who are subject to the soft drink tax and the distribution tax.³¹² The bookkeeping requirements include the following obligations:

- (a) Provide the tax authorities, in March of each year, in respect of the goods produced, transferred or imported in the immediately preceding year, with information regarding consumption of the goods by state and the corresponding tax, and the services provided by establishment in each state³¹³;
- (b) Provide the Tax Administration Service with quarterly information, in the months of April, July, October and January of the relevant year, on their 50 main customers and suppliers in the quarter immediately preceding that in which they filed their statement, in respect of such goods³¹⁴;
- (c) Maintain physical volumetric controls of the goods manufactured, produced or bottled, as appropriate, and report quarterly, in the months of April, July, October and January of the relevant year, on the monthly readings registered by each of the devices used for such controls, in the quarter immediately preceding that in which they filed their statement³¹⁵;
- (d) In the case of importers or exporters of soft drinks or syrups, register in the sectoral register of importers and exporters, as appropriate, kept by the Ministry of Finance and Public Credit³¹⁶; and,

³⁰⁷ (footnote original) Panel Report on *Italy – Agricultural Machinery*, para. 12.

³⁰⁸ See, for example, Panel Report on *Canada – Autos*, para. 10.80.

³⁰⁹ See paras. 8.59 and 8.96 above.

³¹⁰ See paras. 8.42 to 8.45 and 8.46 to 8.50 above. See also, para. 8.80 above.

³¹¹ United States' first written submission, paras. 159-160. United States' second written submission, paras. 34-36. United States response to Panel question No. 74, paras. 72-75.

³¹² Mexico's response to Panel questions Nos. 22 and 50. United States response to Panel question No. 74, para. 76.

³¹³ LIEPS, article 19(VI).

³¹⁴ LIEPS, article 19(VIII).

³¹⁵ LIEPS, article 19(X).

³¹⁶ LIEPS, article 19(XI).

- (e) Provide the Tax Administration Service with quarterly information, in the months of April, July, October and January of the relevant year, on the price, value and volume of each product transferred in the immediately preceding quarter.³¹⁷

8.112 These bookkeeping requirements impose a burden on producers of soft drinks and syrups in addition to the payment of the soft drink tax and the distribution tax. However, this burden does not extend to producers who use cane sugar rather than beet sugar or HFCS as a sweetener. In light of the previous considerations and the broad scope of the expression "affect the internal sale, offering for sale, purchase, transportation, distribution, or use of imported products", the Panel considers that these bookkeeping requirements affect the "use" of imported beet sugar and HFCS by the soft drinks industry.

8.113 For the reasons indicated above, the Panel concludes that the soft drink tax, the distribution tax and the bookkeeping requirements may be considered as measures that affect the internal use in Mexico of non-cane sugar sweeteners, such as beet sugar and HFCS, within the meaning of Article III:4 of the GATT 1994.

- (c) Less favourable treatment

8.114 The United States argues that the IEPS accords less favourable treatment to imports than that accorded to like products of national origin. In the United States' opinion, this is because in relation to their use in the production of soft drinks and syrups, the challenged measures bestow a substantive advantage on cane sugar that is not extended to non-cane sugar sweeteners, such as beet sugar or HFCS. The United States does not contend that the challenged measures overtly discriminate between imported and domestic products, but that they result in the latter being treated less favourably *in practice*. Since in Mexico cane sugar is almost exclusively a domestically produced sweetener, while HFCS is mostly an imported product and beet sugar is exclusively an imported product, this advantage in fact implies that the measures afford imported HFCS and beet sugar less favourable treatment than that accorded to the like product of national origin, cane sugar.³¹⁸

8.115 The United States contends that almost all imported products are being accorded less favourable treatment as a result of the application of the challenged measures, since almost all imported products are comprised of non-cane sugar sweeteners and the only sweetener exempted from the measures (cane sugar) is almost exclusively a domestic product. As the following paragraphs explain, the Panel finds that the facts of the case support this contention. However, the Panel refrains from ruling on whether such a finding is necessary in order for the United States to establish its claim under Article III:4 of the GATT 1994.

8.116 The LIEPS establishes a different regime for two groups of soft drinks and syrups. One group of soft drinks and syrups is subject to the payment of a soft drink tax and a distribution tax and to the fulfilment of certain bookkeeping requirements, while the other group is exempted from these taxes and requirements. The criterion established by the Mexican legislation for the division of soft drinks and syrups into these two groups is whether the soft drinks and syrups are sweetened with cane sugar or with non-cane sugar sweeteners, such as beet sugar or HFCS. These measures have the effect of penalizing the consumption of non-cane sugar sweeteners by industrial producers of soft drinks and syrups. Producers who opt for the use of non-cane sugar sweeteners, such as beet sugar or HFCS, in the preparation of their soft drinks and syrups are subject to the payment of taxes and to the completion of requirements that are not demanded of those producers who use cane sugar instead.

³¹⁷ LIEPS, article 19(XIII).

³¹⁸ United States' first written submission, paras. 161-162. United States' second written submission, paras. 34 and 36.

8.117 The challenged measures create an economic incentive for producers to use cane sugar as a sweetener in the production of soft drinks and syrups, instead of other non-cane sugar sweeteners such as beet sugar or HFCS. This incentive is created by conferring an advantage (the exemption from the soft drink tax, the distribution tax and the bookkeeping requirements) on those producers that use cane sugar instead of non-cane sugar sweeteners, such as beet sugar or HFCS. These measures do not legally impede producers from using non-cane sugar sweeteners, such as beet sugar or HFCS. However, they significantly modify the conditions of competition between cane sugar, on the one hand, and non-cane sugar sweeteners, such as beet sugar or HFCS, on the other. Indeed, there is evidence that the imposition of these measures reverted the trend that was seemingly under way in the Mexican market towards the replacement of cane sugar as an industrial sweetener in the production of soft drinks and syrups, for non-cane sugar sweeteners, such as HFCS.³¹⁹

8.118 The description of the soft drink tax, the distribution tax, and the bookkeeping requirements, and the fact that they are imposed only on soft drinks and syrups that contain non-cane sugar sweeteners, leaves no doubt that the soft drinks and syrups sweetened with beet sugar and HFCS are less favourably treated. The measures therefore alter the conditions of competition in the Mexican market in favour of cane sugar and to the detriment of non-cane sugar sweeteners, such as beet sugar or HFCS, according a less favourable treatment to the latter than that accorded to cane sugar.

8.119 The evidence demonstrates that, although on their face the challenged measures do not distinguish between imported and domestic sweeteners, the distinction they make between the use of cane sugar and non-cane sugar sweeteners is, in fact, one that distinguishes between imported and domestic sweeteners. Domestically produced sweeteners in Mexico consist overwhelmingly of cane sugar. In the years prior to the imposition of the challenged measures, production of HFCS started to develop in Mexico, mainly to satisfy the demand for sweeteners by the domestic soft drinks and syrups industry. However, even in 2001, when HFCS reached its highest share of the Mexican sweetener market, it still represented less than 10 per cent, with cane sugar accounting for almost all the rest. Coinciding with the imposition of the challenged measures, Mexican production of HFCS started to decline.³²⁰

8.120 In turn, before the challenged measures were instituted, as a group imported sweeteners in Mexico were overwhelmingly constituted by non-cane sugar sweeteners. In the five years from 1997 to 2001, non-cane sugar sweeteners, consisting almost entirely of HFCS, represented almost 100 per cent of total Mexican imports of sweeteners. Imports of cane sugar during that period represented less than 1 per cent of total Mexican imports of sweeteners in each year.³²¹

8.121 In conclusion, it is evident that in practice the challenged measures detrimentally affect the competitive situation of the imported sweeteners that the producers of soft drinks and syrups could have chosen (mostly HFCS), when compared to that of the most widely available domestic sweetener (i.e., cane sugar).

8.122 Consequently, the Panel finds that the challenged measures accord less favourable treatment to imported non-cane sugar sweeteners, such as beet sugar and HFCS, than that accorded to like products of national origin.

³¹⁹ United States' first written submission, paras. 25-26. United States response to Panel question No. 72, para. 59.

³²⁰ United States' first written submission, paras. 16 and 23-25. See also, Exhibits US-11(b), US-11(c), US-11(d) and US-11(e).

³²¹ United States' first written submission, para. 25. See also Exhibit US-42.

5. Conclusions

8.123 For the reasons indicated (and subject to the qualification made above³²², regarding the Panel's findings that the soft drink tax and the distribution tax are inconsistent with Article III:2 as regards imported beet sugar and imported HFCS), the Panel concludes that, through the soft drink tax, the distribution tax and the bookkeeping requirements, Mexico accords less favourable treatment to imported non-cane sugar sweeteners, such as beet sugar and HFCS, than that accorded to like products of national origin, i.e., cane sugar. These measures are therefore inconsistent with Article III:4 of the GATT 1994.

F. THE UNITED STATES' CLAIMS REGARDING SOFT DRINKS AND SYRUPS UNDER THE FIRST SENTENCE OF ARTICLE III:2 OF GATT 1994

1. The United States' claims

8.124 The United States requests the Panel to find that two of the challenged tax measures, specifically the soft drink tax and the distribution tax, are inconsistent with the first sentence of Article III:2, because they are internal taxes imposed on imported soft drinks and syrups sweetened with HFCS and beet sugar in excess of the taxes applied to the like domestic product, i.e., soft drinks and syrups sweetened with cane sugar.³²³

8.125 With regard to the soft drink tax, the United States argues that the measure is imposed at the time of importation into Mexico of all soft drinks and syrups, regardless of the type of sweetener used.³²⁴ The tax is also imposed on internal transfers of soft drinks and syrups, except for those exclusively sweetened with cane sugar (and with the exception of public sales). The distribution tax is imposed on the provision of certain services (agency, representation, brokerage, consignment and distribution) for soft drinks and syrups, except for those exclusively sweetened with cane sugar.³²⁵

8.126 The United States observes that the vast majority of soft drinks and syrups produced in Mexico are sweetened with cane sugar, while in the United States the sweetener of choice for soft drink and syrup production is HFCS.³²⁶ Since soft drinks and syrups sweetened with non-cane sugar sweeteners, such as HFCS and beet sugar, and Mexican domestic soft drinks and syrups sweetened with cane sugar are "like" products, the United States submits that the imposition of the soft drink tax and the distribution tax subjects imported products to taxes higher than those applied to the like domestic product, in a manner inconsistent with the first sentence of Article III:2 of the GATT 1994.

2. Mexico's response

8.127 Mexico does not respond to these United States' claims.³²⁷

3. Panel's analysis

8.128 As was done with respect to the treatment accorded to beet sugar, the Panel will analyse the consistency of the challenged measures with Article III:2, first sentence, by considering two

³²² See para. 8.102 above.

³²³ United States' first written submission, paras. 57 and 62-90. United States' second written submission, paras. 23 and 25-31.

³²⁴ United States response to Panel question No. 13, para. 29 and question No. 14, paras. 30-32.

³²⁵ United States' first written submission, paras. 59, 60, 85 and 89. United States' second written submission, para. 9.

³²⁶ United States' first written submission, para. 56.

³²⁷ Mexico's first written submission, para. 114. Mexico's response to Panel question No. 9.

questions. First, whether the imported and domestic products are like products. Second, whether the imported products are subject to taxes in excess of those applied to the like domestic products.³²⁸

(a) Likeness of products

8.129 The United States contends that imported soft drinks and syrups and domestic soft drinks and syrups are alike, because soft drinks and syrups sweetened with non-cane sugar sweeteners including HFCS and beet sugar (which are mostly imported), are like those sweetened with cane sugar (which are mostly domestic).³²⁹ According to the United States, soft drinks sweetened with non-cane sugar sweeteners, in particular, with HFCS and beet sugar, and those sweetened with cane sugar, have "virtually identical" characteristics in terms of physical properties, end-uses, consumer tastes and habits, and tariff classification.³³⁰

8.130 Under the principles established by previous GATT and WTO dispute settlement bodies, the Panel will determine the "likeness" of the products by examining the products' properties, nature and quality; their end-uses in the given market; consumers' perceptions and behaviour; and the products' tariff classification.³³¹

(i) *Products' properties, nature and quality*

8.131 Regarding the physical characteristics of the soft drinks, both types of products (soft drinks and syrups sweetened with non-cane sugar sweeteners and soft drinks and syrups sweetened with cane sugar) are virtually identical. They have identical physical appearances. They are virtually indistinguishable by the human body, since they contain similar amounts of calories and are digested and absorbed in the same manner. Since caloric non-cane sugar sweeteners (HFCS and beet sugar) and cane sugar have a very similar chemical composition, it follows that soft drinks and syrups sweetened with non-cane sugar sweeteners and soft drinks and syrups sweetened with cane sugar have nearly the same chemical composition. In countries such as Mexico and the United States, both types of soft drinks and syrups are usually indistinguishable on the basis of their ingredient labels, since both generally bear the same ingredient inscription on the label.³³²

(ii) *Products' end-uses*

8.132 As the United States has contended, it is evident that soft drinks and syrups, regardless of the caloric sweetener used, share identical end-uses. Both types of products may be drunk for quenching thirst, providing energy or nourishment, or for socialization; they may be drunk straight or mixed with other beverages; they may be consumed before, after or during meals; and they may be consumed at home or in public places alike, regardless of whether they are sweetened with HFCS or beet sugar or with cane sugar.³³³

8.133 The evidence also indicates that, regardless of the caloric sweetener used, soft drinks and syrups use similar distribution channels. The United States has quoted major producers of soft drinks (*Coca-Cola* and the *Pepsi Bottling Group*) to the effect that there are no differences in the distribution channels used for these products. Retail seems to be the primary distribution channel in both Mexico (where most soft drinks are sweetened with cane sugar) and the United States (where most soft drinks

³²⁸ Appellate Body Report on *Canada – Periodicals*, p. 24, DSR 1997:I, p. 449, at p. 465-466.

³²⁹ United States second written submission, para. 23.

³³⁰ United States first written submission, paras. 66-83. United States second written submission, paras. 23 and 26-29. United States responses to Panel question No. 18, para. 39, and question No. 74, paras. 68 and 69.

³³¹ Appellate Body Report on *Canada – Periodicals*, p. 21, DSR 1997:I, p. 449, at p. 466. See also, Appellate Body Report on *Japan – Alcoholic Beverages II*, pp. 21-22, DSR 1996:I, p. 97, at p. 113.

³³² Exhibits US-22 and US-37(a), table 1 (original in Spanish).

³³³ United States first written submission, para. 72 and footnote 117. Exhibit US-38.

are sweetened with HFCS). Considering the evidence, there is no indication that channels of distribution for major producers of soft drinks in Mexico changed during the 1990s through 2001, even though the producers switched from cane sugar to a blend of HFCS and sugar, and then again to cane sugar during this period.³³⁴

(iii) *Consumers' perceptions and behaviour*

8.134 Regarding consumer tastes and preferences, the United States has indicated that surveys and taste tests conducted by soft drinks bottlers demonstrate that consumers do not show any consistent pattern of preference for soft drinks sweetened with sugar versus soft drinks sweetened with HFCS, nor do they detect any significant difference in taste and sweetness.³³⁵ There is also evidence that in Mexico, under labelling regulations, labels will generally identify "all monosaccharides and disaccharides that are present in a non-alcoholic food or beverage" as "sugars" (*azúcares*), so that consumers may not even be aware of the specific type of caloric sweetener used.³³⁶ Also, marketing strategies in Mexico seem not to have changed when the largest local bottler of soft drinks switched to a blend of sugar and HFCS, instead of pure cane sugar, from 1996 through 2003.³³⁷ All these facts support the conclusion that there is no perceived consumer preference for any of the considered products based exclusively on the type of caloric sweetener that is used. Indeed, the difficulty for consumers to distinguish between soft drinks and syrups sweetened with HFCS and those sweetened with cane sugar is not a matter of chance. HFCS was designed to mimic sugar as much as possible, in order to be an alternative industrial sweetener.³³⁸

(iv) *Tariff classification of the products*

8.135 With respect to their tariff classification, Mexico does not draw any distinction between soft drinks and syrups on the basis of the type of sweetener used (cane sugar, beet sugar or HFCS). Its tariff schedule classifies soft drinks and syrups as follows:

- (a) soft drinks, hydrating and rehydrating beverages: 2202.10 and 2202.90
- (b) syrups (including concentrates, powders, essences and extracts): 2101.11, 2101.12, 2101.20, 2101.30, 2106.90.05, 2106.90.06 and 2106.90.07.³³⁹

(v) *Conclusion*

8.136 In view of these considerations, the Panel concludes that soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are "like products" for the purposes of Article III:2, first sentence of the GATT 1994. HFCS and cane sugar have a slight difference in the exact ratio of their components (i.e. fructose to glucose)³⁴⁰, but the difference between both products is not enough to make soft drinks sweetened with one or the other not "like". Likewise, the Panel finds that soft drinks and syrups sweetened with beet sugar and soft drinks and syrups sweetened with cane sugar are "like products" for the purposes of this provision. In fact, the two are virtually identical.

³³⁴ United States first written submission, paras. 73-76. Exhibits US-16, US-18, US-19, US-20, US-24 and US-39.

³³⁵ United States first written submission, paras. 77, 78 and 99.

³³⁶ United States first written submission, paras. 68-71 and 111. Exhibits US-36 and US-37.

³³⁷ United States first written submission, para. 81.

³³⁸ United States first written submission, para. 107.

³³⁹ United States first written submission, paras. 27 and 82. Exhibit US-43. Mexico's response to Panel question No. 44.

³⁴⁰ See footnote 115 of the United States first written submission.

(b) Taxed in excess

8.137 Having determined that soft drinks and syrups sweetened with beet sugar and HFCS may be regarded as "like products" when compared with soft drinks and syrups sweetened with cane sugar, the Panel will now turn to the issue of whether, through the soft drink tax and the distribution tax, Mexico is subjecting, directly or indirectly, imported products to internal taxes *in excess* of those applied, directly or indirectly, to like domestic products, in a manner inconsistent with the first sentence of Article III:2 of the GATT.

8.138 The challenged tax measures (soft drink tax and the distribution tax) are applied at different points in time. First, at the time of importation, the soft drink tax is applied to all imported soft drinks and syrups, regardless of the sweetener used. Second, once imported soft drinks and syrups clear customs and enter into the Mexican market, the soft drink tax is applied to soft drinks sweetened with non-cane sugar sweeteners upon each internal transfer (with the exception of public sales). Third, the distribution tax is applied to soft drinks and syrups sweetened with non-cane sugar sweeteners on the provision of certain services within Mexico. The Panel will examine the challenged tax measures considering these three points in time to determine whether they are imposed on imported soft drinks and syrups in excess of the taxes imposed on like domestic soft drinks and syrups.³⁴¹

(i) *Soft drink tax at the time of importation*

8.139 At the time when the DSB established this Panel and approved its terms of reference, Mexico was imposing a 20 per cent tax (the soft drink tax) on "all imported soft drinks and syrups" at the point of importation, regardless of the sweetener used.³⁴² The United States argues that this tax discriminated on its face against imports, since it was not applied to domestic products.³⁴³

Amendments to the LIEPS

8.140 In November 2004, the Mexican Congress amended the LIEPS with the effect that, from January 2005, imported soft drinks and syrups qualify for the exemption from payment of the soft drink tax, as long as they are sweetened exclusively with cane sugar.³⁴⁴

8.141 The United States argues that the Panel should not take such amendment into consideration, because it is outside the Panel's terms of reference. It submits that the measures before the Panel are Mexico's tax measures as they stood when this Panel was established, which were embodied in the text of the LIEPS published on 1 January 2002 and its subsequent amendments published on 30 December 2002 and 31 December 2003.³⁴⁵ Mexico responds that the Panel has the power to consider the amendments to the LIEPS in the context of this dispute. In its opinion, the obligation contained in Article 11 of the DSU, under which a Panel must assist the DSB in discharging its responsibilities under the DSU by making an objective assessment of the matter before it, require panels to take into account events which occurred during the proceedings, including amendments to the measures at issue.³⁴⁶

8.142 In respect of these arguments, the Panel first notes that the entry into force of the amendments to the LIEPS occurred after the date of establishment of the Panel (6 July 2004).³⁴⁷ The parties do not

³⁴¹ United States first written submission, paras. 38-44.

³⁴² Mexico's response to Panel question No. 45.

³⁴³ United States second written submission, para. 11.

³⁴⁴ Mexico's response to Panel questions Nos. 45, 50 and 52. Exhibit MEX-46.

³⁴⁵ United States second written submission, para. 32. United States response to Panel question No. 52, paras. 1-6.

³⁴⁶ Mexico's response to Panel question No. 52.

³⁴⁷ "Mexico – Tax Measures on Soft Drinks and other Beverages. Constitution of the Panel Established at the Request of the United States. Note by the Secretariat". Doc. WT/DS308/5/Rev.1 of 25 August 2004.

claim that the amendments are within the Panel's terms of reference. In its request for the establishment of a panel in this case, the United States identified the measures at issue as the "Law on the Special Tax on Production and Services (*Ley del Impuesto Especial sobre Producción y Servicios*) published on 1 January 2002 and its subsequent amendments published on 30 December 2002 and 31 December 2003".³⁴⁸ The specific reference made by the United States to "subsequent amendments published on 30 December 2002 and 31 December 2003" is not broad enough to include further amendments that came after the establishment of the Panel³⁴⁹, and consideration of such amendments does not seem necessary to secure a positive solution to the present dispute for the reasons explained below.

8.143 Several previous panels have refrained from making findings on measures terminated before their establishment.³⁵⁰ In *Argentina – Textiles and Apparel*, the panel declined to rule on a measure that was "revoked before the Panel was established and its term of reference set, i.e. before the Panel started its adjudication process"³⁵¹, even though the measure had been included in its terms of reference. The panel cited in its support the statement of the Appellate Body that the aim of dispute settlement is not:

"[T]o encourage either panels or the Appellate Body to 'make law' by clarifying existing provisions of the *WTO Agreement* outside the context of resolving a particular dispute. A panel need only address those claims which must be addressed in order to resolve the matter in issue in the dispute."³⁵²

8.144 In the present case, however, the amendments to the LIEPS entered into force on 1 January 2005, which was six months after the establishment of the Panel. Furthermore, the effects of the new amendments seem to be limited to only part of the claims against the challenged measures, i.e. the imposition of the soft drink tax to all imported soft drinks and syrups at the point of importation, regardless of the sweetener used. The Panel recalls that the Appellate Body has said that "the demands of due process are such that a complaining party should not have to adjust its pleadings throughout dispute settlement proceedings in order to deal with a disputed measure as a 'moving target'".³⁵³ Given its terms of reference³⁵⁴, in the light of the obligations contained in Article 11 of the Dispute Settlement Understanding, and without an agreement between the parties to terminate the proceedings as regards this aspect of the contested measures, the Panel considers there is no basis for it to abstain from ruling on the complaint made by the United States. Indeed, several panels have reached the same conclusion, when examining measures terminated before or during the panel process.³⁵⁵

³⁴⁸ See, "Mexico – Tax Measures on Soft Drinks and other Beverages. Request for the Establishment of a Panel by the United States". Doc. WT/DS308/4 of 11 June 2004.

³⁴⁹ See, Appellate Body Report on *Chile – Price Band System*, para. 144.

³⁵⁰ See, for example, Panel report on *US – Gasoline*, and Panel Report on *Argentina – Textiles and Apparel*.

³⁵¹ Panel report on *Argentina – Textiles and Apparel*, para. 6.13.

³⁵² Appellate Body Report on *US – Wool Shirts and Blouses*, p. 19, DSR 1997:I, p. 323 at p. 340.

³⁵³ Appellate Body Report on *Chile – Price Band System*, para. 144.

³⁵⁴ See, "Mexico – Tax Measures on Soft Drinks and other Beverages. Constitution of the Panel Established at the Request of the United States. Note by the Secretariat". Doc. WT/DS308/5 of 20 August 2004. See also, "Mexico – Tax Measures on Soft Drinks and other Beverages. Request for the Establishment of a Panel by the United States". Doc. WT/DS308/4 of 11 June 2004.

³⁵⁵ See, for example, Panel Report on *US – Certain EC Products*; Panel Report on *US – Wool Shirts and Blouses*; Panel Report on *Indonesia – Autos*; Panel Report on *Chile – Price Band System*; and, Panel Report on *Canada – Wheat Exports and Grain Imports*.

Soft drink tax at the time of importation

8.145 The Panel will therefore examine the soft drink tax as it stood on 6 July 2004, in respect of its application at the point of importation.³⁵⁶ There is no question that the imported soft drinks and syrups were directly subject to the soft drink tax. The same tax is also directly applied on internal transfers of the product domestically, as long as the soft drinks or syrups are not sweetened with cane sugar.³⁵⁷ According to *Ad Article III* of the GATT 1994:

"Any internal tax or other internal charge, or any law, regulation or requirement of the kind referred to in paragraph 1 which applies to an imported product and to the like domestic product and is collected or enforced in the case of the imported product at the time or point of importation, is nevertheless to be regarded as an internal tax or other internal charge, or a law, regulation or requirement of the kind referred to in paragraph 1, and is accordingly subject to the provisions of Article III."

8.146 The Panel has already discussed the meaning of the term "in excess of".³⁵⁸ This term has been interpreted very strictly, and encompasses even the slightest difference in the level of taxes. The Appellate Body has said that "[e]ven the smallest amount of 'excess' is too much. 'The prohibition of discriminatory taxes in Article III:2, first sentence, is not conditional on a 'trade effects test' nor is it qualified by a *de minimis* standard.'"³⁵⁹ There can be no doubt that a tax difference of 20 per cent can be regarded as "in excess".

Conclusion

8.147 Since at the point of importation all imported soft drinks and syrups, whether sweetened with cane or beet sugar or with HFCS, were subject to a tax in excess of the tax applied to the like domestic products (soft drinks and syrups sweetened with cane sugar), the soft drink tax is in this respect inconsistent with Article III:2, first sentence, of the GATT 1994.

(ii) *Soft drink tax on internal transfers*

8.148 Mexico also imposes a 20 per cent soft drink tax on internal transfers of soft drinks and syrups sweetened with non-cane sugar sweeteners, including HFCS and beet sugar. An exemption from this tax is available only for those soft drinks and syrups that are sweetened with cane sugar.³⁶⁰ The United States claims that this aspect of the tax constitutes *de facto* discrimination and is inconsistent with Article III:2, first sentence, of the GATT 1994.³⁶¹

8.149 The Panel has already concluded that, in regard to internal transfers, as a result of the soft drink tax, beet sugar used as a sweetener in soft drinks and syrups is subject, directly or indirectly, to a tax in excess of that applied to the like domestic product, because of the non-application of that tax when the sweetener used is cane sugar and considering that the burden of the tax can be expected to fall, at least in part, on the products containing the sweetener.³⁶² By the same logic, the Panel finds

³⁵⁶ LIEPS, article 1 (I). United States first written submission, paras. 85-86. United States second written submission, paras. 11, 23, 30-31. United States response to Panel question No. 14, para. 30; question No. 27, paras. 59-60; and question No. 74, para. 73.

³⁵⁷ Domestic soft drinks and syrups sweetened with cane sugar are exempted from the soft drink tax on their internal transfers under Article 8 of the LIEPS.

³⁵⁸ See para. 8.52 above.

³⁵⁹ Appellate Body Report on *Japan – Alcoholic Beverages*, p. 23, DSR 1996:I, p. 97, at p. 115.

³⁶⁰ United States response to Panel questions Nos. 14, 27 and 74.

³⁶¹ United States first written submission, para. 87. United States second written submission, paras. 11, 23, 30-31 and 33. United States response to Panel question No. 14, paras. 30-31; question No. 27, paras. 59 and 61; and question No. 74, paras. 71-74.

³⁶² See para. 8.59 above.

that the soft drinks and syrups sweetened with beet sugar or HFCS are subject, directly or indirectly, to the soft drink tax. Furthermore, as concluded above³⁶³, a difference of 20 per cent tax undoubtedly meets the "in excess of" criterion. Finally, the Panel notes that soft drinks and syrups imported into Mexico are sweetened primarily with non-cane sugar sweeteners (HFCS or beet sugar), whereas Mexican domestic soft drinks and syrups are sweetened primarily with cane sugar.³⁶⁴ Since the latter are the main beneficiaries of the exemption from the tax, and using the logic that it applied to the discrimination regarding sweeteners³⁶⁵, the Panel concludes that, although the soft drink tax does not on its face distinguish between imported and domestic products, it has this result in practice.

(iii) *Distribution tax*

8.150 The United States also claims that the distribution tax of 20 per cent, which is charged on representation, brokerage, agency, consignment and distribution provided in relation with soft drinks or syrups sweetened with non-cane sugar sweeteners, is inconsistent with Article III:2, first sentence. This is because no such tax is applied to such services when provided in relation to soft drinks or syrups sweetened with cane sugar. In this instance also the United States argues that the discrimination is *de facto*.³⁶⁶

8.151 The distribution tax is imposed on certain services provided for the purpose of transferring one group of soft drinks and syrups, while the same services related to another group of soft drinks and syrups are exempted from the tax, based only on the consideration of whether those soft drinks and syrups are sweetened with cane sugar or with non-cane sugar sweeteners.

8.152 The Panel has already concluded that the imposition of the distribution tax, based solely on the nature of the sweetener used, and considering that the burden of the tax can be expected to fall, at least in part, on the products containing the sweetener, creates a connection such that the tax can also be regarded as a tax *indirectly* imposed on non-cane sugar sweeteners.³⁶⁷ By the same logic, the Panel finds that, while on its face the distribution tax is a tax on the provision of certain services, in the circumstances of this case, it is also a tax applied *indirectly* on soft drinks and syrups. Furthermore, as concluded above³⁶⁸, assuming that the services provided have some value, the 20 per cent *ad valorem* tax on those services will result in an additional tax on soft drinks and syrups sweetened with non-cane sugar sweeteners. That figure would have to be compared with the tax rate applied to the provision of services related to soft drinks and syrups sweetened with cane sugar, the like domestic product, which is zero per cent. There can be no doubt that the former is "in excess" of the latter. Finally, using the same logic that it applied to the discrimination regarding the soft drink tax³⁶⁹, the Panel concludes that, although the distribution tax does not on its face distinguish between imported and domestic products, it has this result in practice.

(iv) *Taxes imposed in excess*

8.153 Considering the respective groups of products that are subject to the soft drink tax and the distribution tax, domestic soft drinks and syrups are the main beneficiaries of the tax exemption under the LIEPS. Indeed, most domestic soft drinks and syrups in Mexico are sweetened with cane sugar,

³⁶³ See para. 8.146 above.

³⁶⁴ United States first written submission, paras. 30, 32 and 35. Exhibits US-8, US-10, US-13 and US-57.

³⁶⁵ See paras. 8.55 to 8.58 above.

³⁶⁶ United States first written submission, paras. 89-90. United States second written submission, paras. 11, 23, 30-31. United States response to Panel question No. 14, para. 32; question No. 27, paras. 59 and 61; question No. 74, paras. 71-74.

³⁶⁷ See para. 8.48 above.

³⁶⁸ See para. 8.51 above.

³⁶⁹ See para. 8.149 above.

while most imported soft drinks and syrups are sweetened with non-cane sugar sweeteners, such as HFCS.

8.154 In light of the above, a soft drink tax and a distribution tax imposed only on soft drinks and syrups with non-cane sugar sweeteners, most of which are imported, and not applied to soft drinks and syrups sweetened with cane sugar, most of which are domestic, may be regarded as a tax imposed on imports "in excess of" that imposed on like domestic products.

4. Conclusion

8.155 For the reasons given above, the Panel concludes that, at the time of establishment of this Panel, the soft drink tax, as applied by Mexico at the point of importation, subjected soft drinks and syrups imported into Mexico to internal taxes in excess of those directly applied to like domestic products, in a manner inconsistent with Article III:2, first sentence, of the GATT 1994.

8.156 The Panel also finds that the soft drink tax, as applied on internal transfers in Mexico, subjects imported soft drinks and syrups to internal taxes in excess of those directly applied to like domestic products, in a manner inconsistent with Article III:2, first sentence, of the GATT 1994.

8.157 Finally, the Panel finds that the distribution tax, as applied on the provision of certain services, when those services are provided for the purpose of transferring soft drinks and syrups sweetened with non-cane sugar sweeteners, subjects imported soft drinks and syrups to internal taxes in excess of those indirectly applied to like domestic products, in a manner inconsistent with Article III:2, first sentence, of the GATT 1994.

G. THE UNITED STATES' CLAIMS REGARDING SOFT DRINKS AND SYRUPS UNDER THE SECOND SENTENCE OF ARTICLE III:2 OF GATT 1994

1. The United States' claims

8.158 The United States also argues that two of the challenged tax measures, specifically the soft drink tax and the distribution tax, are inconsistent with the second sentence of Article III:2 of GATT 1994, because soft drinks and syrups sweetened with HFCS and beet sugar and the directly competitive or substitutable products, i.e., soft drinks and syrups sweetened with cane sugar, are dissimilarly taxed, so as to afford protection to domestic production.³⁷⁰

8.159 The United States presents this claim only as an alternative should the Panel not consider that soft drinks and syrups sweetened with HFCS and those sweetened with cane sugar are like products, and that the soft drink tax and the distribution tax are in this respect inconsistent with Article III:2, first sentence, of the GATT 1994.³⁷¹

2. Mexico's response

8.160 Mexico's only response to this claim is that its measures are not intended to afford protection to its domestic production within the meaning of Article III of the GATT.³⁷²

³⁷⁰ United States first written submission, paras. 141-152.

³⁷¹ United States responses to Panel questions, question No. 18, para. 39. United States second written submission, paras. 23-24.

³⁷² Mexico's first written submission, section III.D. Mexico's responses to Panel questions, question No. 83. Written version of Mexico's oral statement during second substantive meeting of the Panel with the parties, para. 18.

3. Panel's analysis

8.161 The panel has already determined that the soft drink tax and the distribution tax, as applied by Mexico on soft drinks and syrups, are inconsistent with Article III:2, first sentence, of the GATT 1994.³⁷³ Since the condition set by the United States has therefore not been fulfilled, the Panel will not address this claim.

H. MEXICO'S DEFENCE UNDER PARAGRAPH (D) OF ARTICLE XX OF GATT 1994

1. Mexico's defence

8.162 As described above, for the most part Mexico has not presented rebuttal arguments regarding the United States' claims under Article III of GATT 1994. Mexico argues, however, that if the IEPS taxes are found by the Panel to violate Article III, the measures are nevertheless justifiable under Article XX(d) of GATT 1994.³⁷⁴ In its opinion, the measures are "necessary to secure compliance" by the United States with the United States' obligations under the NAFTA, an international agreement that is a law not inconsistent with the provisions of the GATT 1994.³⁷⁵ Mexico does not claim any justification for its measures other than that provided through Article XX(d). Furthermore, although Mexico has characterized its actions as an exercise of countermeasures, as recognized under international law³⁷⁶, it does not seem to be suggesting that the international law rules governing such actions should affect the interpretation of Article XX(d).

2. The United States' response

8.163 The United States responds that, although Article XX(d) of GATT 1994 permits a WTO Member to maintain measures that are "necessary to secure compliance with laws or regulations which are not inconsistent" with the provisions of the GATT 1994, the NAFTA is not a "law or regulation," and Mexico's taxes are not "necessary to secure compliance." In its opinion, nothing in Article XX(d) supports the contention that a WTO Member may violate its WTO obligations in order to punish another Member because the former thinks that the latter has not complied with its obligations under another international agreement.³⁷⁷ The United States adds that Mexico's measures are also incompatible with the requirements of the *chapeau* to Article XX.³⁷⁸

3. Article XX(d) of GATT 1994

8.164 According to the *chapeau* and paragraph (d) of Article XX of the GATT:

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

(d) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including those relating to customs enforcement, the enforcement of

³⁷³ See paras. 8.155 to 8.157 above.

³⁷⁴ Mexico's first written submission, paras. 115-138.

³⁷⁵ Mexico's first written submission, paras. 117-118 and 125.

³⁷⁶ See, for example, written version of Mexico's oral statement during second substantive meeting of the Panel with the parties, para. 3.

³⁷⁷ Written version of United States' oral statement during first substantive meeting of the Panel with the parties, paras. 7-8. United States second written submission, paras. 41-67.

³⁷⁸ United States second written submission, paras. 68-73.

monopolies operated under paragraph 4 of Article II and Article XVII, the protection of patents, trade marks and copyrights, and the prevention of deceptive practices;"

4. Panel's analysis

(a) Order of analysis

8.165 The Panel will follow the well-established two-tiered process of analysis elaborated by the Appellate Body in *US – Gasoline*:

"In order that the justifying protection of Article XX may be extended to it, the measure at issue must not only come under one or another of the particular exceptions - paragraphs (a) to (j) - listed under Article XX; it must also satisfy the requirements imposed by the opening clauses of Article XX."³⁷⁹

8.166 The burden lies on Mexico, as the party invoking the affirmative defence provided by Article XX(d), to demonstrate that the measures which the Panel has found to be inconsistent with Article III, satisfy the requirements of the invoked defence.³⁸⁰

8.167 Regarding the first stage in the application of Article XX, the Panel will follow the order of analysis set out by the Appellate Body:

"For a measure, otherwise inconsistent with GATT 1994, to be justified provisionally under paragraph (d) of Article XX, two elements must be shown. First, the measure must be one designed to 'secure compliance' with laws or regulations that are not themselves inconsistent with some provision of the GATT 1994. Second, the measure must be 'necessary' to secure such compliance. A Member who invokes Article XX(d) as a justification has the burden of demonstrating that these two requirements are met."^{381,382}

(b) Designed to secure compliance with laws or regulations

8.168 Mexico argues that the challenged tax measures are "designed to secure compliance" by the United States with the NAFTA, a law that is not inconsistent with the provisions of the GATT 1994.³⁸³

8.169 In order to determine whether a measure may be considered to be "designed to secure compliance", the Panel will look at the meaning of the expression "to secure compliance". It will then examine the issue of the design of the measures. Finally, it will address the issue of whether the NAFTA may be considered to be part of the laws and regulations covered by paragraph (d).

³⁷⁹ Appellate Body Report on *US – Gasoline*, p. 22, DSR 1996:I, p. 3, at p. 20.

³⁸⁰ Appellate Body Report on *Korea – Various Measures on Beef*, para. 157. See also, Appellate Body Report on *US – Gambling*, para. 309.

³⁸¹ (footnote original) Appellate Body Report, *United States – Gasoline*, *supra*, footnote 98, pp. 22-23; Appellate Body Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R, adopted 23 May 1997, pp. 14-16; Panel report, *United States – Section 337*, *supra*, footnote 69, para. 5.27.

³⁸² Appellate Body Report on *Korea – Various Measures on Beef*, para. 157. See also, Appellate Body Report on *US – Gambling*, para. 295.

³⁸³ Mexico's first written submission, para. 118.

(i) *To secure compliance*

8.170 Mexico argues that the tax measures at issue are justifiable under Article XX(d) as "necessary to secure compliance" by the United States with the United States' obligations under the NAFTA. In Mexico's opinion, this provision allows WTO Members to adopt measures that are necessary to secure compliance by another Member with the latter's international obligations arising from a treaty that is not one of the WTO "covered agreements". Mexico refers to its IEPS taxes on soft drinks and syrups as "temporary and proportionate measures" intended to induce the United States to comply with what Mexico says are its NAFTA obligations regarding market access conditions for Mexican sugar or to submit to dispute settlement procedures under the NAFTA regarding these obligations.³⁸⁴ Mexico also speaks of the measures as intended to rebalancing its market so that Mexican surplus sugar that could have been exported to the United States can be sold locally.³⁸⁵ While acknowledging that there are no WTO or GATT precedents to support an interpretation that Article XX(d) would justify such measures, Mexico argues that there are none that deny it.³⁸⁶

8.171 The United States responds that Article XX(d) does not provide an exception for measures to secure compliance with obligations of a WTO Member under another international agreement. In the first place, the United States argues that obligations under an international agreement are not covered by the expression "laws or regulations".³⁸⁷ According to the United States, the ordinary meaning of the terms "laws or regulations" encompasses only the domestic laws or regulations of a government; it does not include obligations under an international agreement, which have a different meaning.³⁸⁸ The United States submits that such interpretation of the ordinary meaning of "laws or regulations" is supported by the context in which the terms appear – namely, Article XX of the GATT and more broadly the GATT and the WTO Agreement as a whole.³⁸⁹ In its opinion, Mexico's interpretation would allow any WTO Member to invoke Article XX(d) as a justification for actions depriving other Members of their rights under the GATT to the extent needed to "secure compliance" with any other international agreement.³⁹⁰

8.172 The United States further argues that, even if "laws or regulations" could be read to include obligations owed by one WTO Member to another under an international agreement, Mexico's tax measures are not designed to "secure compliance" within the meaning of Article XX(d) of the GATT 1994. In this regard, Mexico's position presupposes that the United States is not in compliance with its NAFTA obligations, a matter that has not been proved by Mexico, that is currently being disputed in the NAFTA forum and that would anyhow be outside the Panel's terms of reference. The United States adds that Mexico has not explained how its tax measures are designed to secure compliance by the United States, considering that the measures apply to soft drinks and syrups and non-cane sugar sweeteners imported from *any* WTO Member, and not just those from the United States. Rather, in its opinion, those taxes protect Mexico's own cane sugar industry.³⁹¹

³⁸⁴ Written version of Mexico's oral statement during first substantive meeting of the Panel with the parties, para. 45. Written version of Mexico's oral statement during second substantive meeting of the Panel with the parties, para. 36. Mexico's response to Panel question No. 87.

³⁸⁵ Mexico's first written submission, para. 84.

³⁸⁶ Mexico's response to Panel question No. 25.

³⁸⁷ United States second written submission, paras. 2 and 37.

³⁸⁸ United States second written submission, para. 43. United States response to Panel question No. 30, para. 71.

³⁸⁹ United States second written submission, paras. 44-46. United States response to Panel question No. 30, paras. 72-74.

³⁹⁰ United States second written submission, para. 48.

³⁹¹ United States second written submission, paras. 56-59.

8.173 The Panel commences its analysis of the issue by recalling that, in order to be justified by Article XX(d), a measure must be "necessary to secure compliance with laws or regulations that are not inconsistent with the provisions of the GATT 1994".³⁹²

8.174 The word "compliance" may be defined as "the action of complying with a request, command, etc.", while in that sense to "comply" with is to "act in accordance with".³⁹³ In turn, to "secure" may be defined as to "make (something) certain or dependable. Now [especially] ensure (a situation, outcome, result, etc.)".³⁹⁴

8.175 The context in which the expression is used makes clear that "to secure compliance" is to be read as meaning to enforce compliance. Firstly, the provision is addressing compliance with "laws or regulations", and these characteristically concern obligations rather than requests, and compliance is secured by enforcement through the use of force by the authorities, if necessary. Secondly, the examples of measures that are given in the latter part of paragraph (d) all concern that concept (the terms used in these examples are "enforcement" (twice), "protection", and "prevention").³⁹⁵

8.176 This interpretation is confirmed by consideration of the *travaux préparatoires* of GATT 1947. The strong language used in the phrase "to secure compliance" differs from that contained in early drafts of the Charter for an International Trade Organization (ITO), a weaker "to induce compliance".³⁹⁶ There is also evidence that negotiators were aware of the issue of countermeasures. During the negotiations on the ITO Charter, India proposed the inclusion (in the provision that would be the basis for Article XX of the GATT) of a paragraph that would allow a country "temporarily to discriminate against the trade of another Member when this is the only effective measure open to it to retaliate against discrimination practised by that Member in matters outside the purview of the [International Trade] Organization, pending a settlement of the issue through the United Nations".³⁹⁷ The proposal was not accepted.³⁹⁸

8.177 The interpretation is also confirmed by the Appellate Body's use of the expression "enforcement instrument" when referring to measures covered by paragraph (d).³⁹⁹ Indeed, Mexico has also referred to measures "designed as an enforcement instrument", when referring to the measures that would be covered by paragraph (d).⁴⁰⁰

8.178 The identification of the phrase "to secure compliance" with the notion of enforcement has important implications for the arguments presented by Mexico. The context of Mexico's action is essentially international. Countermeasures have an intrinsic inter-state character, and there is no concept of private action against a state being justifiable on this basis. On the other hand, the notion

³⁹² See, for example, GATT Panel Report on *EEC – Parts and Components*, para. 5.14.

³⁹³ *The New Shorter Oxford English Dictionary* (Clarendon Press, 1993), Vol. I, p. 461.

³⁹⁴ *Ibid.*, Vol. II, p. 2754.

³⁹⁵ Paragraph (d) illustrates the measures that may be covered by the provision by citing measures such as those "relating to customs enforcement, the enforcement of monopolies operated under paragraph 4 of Article II and Article XVII, the protection of patents, trade marks and copyrights, and the prevention of deceptive practices".

³⁹⁶ "Preparatory Committee of the International Conference on Trade and Employment, Committee II, Report of the Technical Sub-Committee", Doc. E/PC/T/C.II/54/rev.1 (28 November 1946), p. 37. See also, Panel Report on *EEC – Parts and Components*, para. 5.16. *Suggested Charter for an International Trade Organization of the United Nations* (United States Department of State, September 1946), Article 32, p. 24.

³⁹⁷ Doc. E/PC/T/180 (19 August 1947), p. 97.

³⁹⁸ See, "Havana Charter for an International Trade Organization", United Nations Conference on Trade and Employment, Final Act and Related Documents (Lake Success, New York, April 1948), pp. 33-34.

³⁹⁹ Appellate Body Report on *Korea – Various Measures on Beef*, paras. 162-163. See also, Panel Report on *US – Gasoline*, para. 6.33. See also, GATT Panel Report on *EEC – Parts and Components*, paras. 5.17-5.18.

⁴⁰⁰ Mexico's response to Panel question No. 24.

of enforcement contains a concept of action within a hierarchical structure that is associated with the relation between the state and its subjects, and which is almost entirely absent from international law (action under Chapter VII of the United Nations Charter is arguably an exception, but it has no relevance in the present dispute⁴⁰¹). The possibility for states to take countermeasures, that is to try by their own actions to persuade other states to respect their obligations, is itself an acknowledgement of the absence of any international body with enforcement powers. In contrast to this, the capacity to enforce laws and regulations through the use of coercion, if necessary, is perhaps the most important of the features that distinguish states from other kinds of bodies.

8.179 The examples provided in Article XX(d) serve to reinforce the conclusion that this provision is concerned with action at a domestic rather than international level. Customs, monopolies, patents, trade marks and copyrights, and deceptive practices are in essence matters that are regulated under domestic law. It can be argued that the topics covered by these examples are all capable of being the subjects of international agreements.⁴⁰² However, the same point could be made of almost any aspect of national law, and the argument does not detract from the basic point that these examples essentially concern aspects of domestic law which make use of systems of enforcement. Thus, there could be domestic customs laws without international agreements, but international agreements on customs without domestic law would be meaningless. Of course, these topics are listed in Article XX(d) merely as examples, so they cannot of themselves be taken as providing conclusive support for the Panel's conclusions. Nevertheless, they provide a significant indicator of the intended interpretation.

8.180 The Panel will return to the notion of enforcement in its discussion of "laws or regulations"⁴⁰³, but before leaving the current topic it is worth noting that the Draft Articles on *Responsibility of States for internationally wrongful acts* adopted by the International Law Commission⁴⁰⁴ do not speak of enforcement when addressing the use of countermeasures. Rather, paragraph 1 of Article 49 states that "[a]n injured State may only take countermeasures against a State which is responsible for an internationally wrongful act in order to induce that State to comply with its obligations under Part Two." Nor is the notion of enforcement used in the Commentary on the articles, except in regard to procedures within the European Union, which because of its unique structures and procedures is obviously a special case.⁴⁰⁵

8.181 For these reasons the Panel concludes that the phrase "to secure compliance" in Article XX(d) does not apply to measures taken by a Member in order to induce another Member to comply with obligations owed to it under a non-WTO treaty.

(ii) *Whether Mexico's tax measures are designed to secure compliance*

8.182 In *Korea – Various Measures on Beef*, the Appellate Body said that:

"For a measure, otherwise inconsistent with GATT 1994, to be justified provisionally under paragraph (d) of Article XX, two elements must be shown. First, the measure must be one designed to 'secure compliance' with laws or regulations that are not

⁴⁰¹ A special exception for action of this kind is created by Article XXI(c) of GATT 1994.

⁴⁰² Written version of Mexico's oral statement during first substantive meeting of the Panel with the parties, para. 42. See also, Mexico's response to Panel question No. 67.

⁴⁰³ See para. 8.199 below.

⁴⁰⁴ "Draft Articles on Responsibility of States for internationally wrongful acts" adopted by the International Law Commission at its fifty-third session (2001).

⁴⁰⁵ "Commentaries to the draft Articles on Responsibility of States for internationally wrongful acts" adopted by the International Law Commission at its fifty-third session (2001), p. 337.

themselves inconsistent with some provision of the GATT 1994. Second, the measure must be 'necessary' to secure such compliance."⁴⁰⁶

8.183 In that case, the Appellate Body was confirming the decision of the panel which said that:

"... the dual retail system was put in place, at least in part, in order to secure compliance with the Korean legislation against deceptive practices to the extent that it serves to prevent acts inconsistent with the *Unfair Competition Act*. First, the system was established at the time when, as stated by Korea and not refuted by the Complaining parties, acts of misrepresentation were widespread in the beef sector. Second, it must be conceded that the dual retail system does appear to reduce the opportunities and thus the temptations for butchers to misrepresent foreign beef for domestic beef, when compared with the situation where all domestic and imported beef could officially be supplied to the same shop."⁴⁰⁷

8.184 The question of whether the measure identified by Mexico is *designed* to secure compliance is therefore one that must be addressed by the Panel. The considerations that influenced the Panel in reaching a conclusion regarding the phrase "to secure compliance"⁴⁰⁸ are also relevant to answering this question.

8.185 The panel additionally notes that, when enforcement action is taken within a Member's legal system there will normally be no doubt, provided the action is pointed at the right target, that it will achieve that target. At least, there is no systemic problem in arriving at that conclusion, because the State by its very nature is usually in a position to achieve that enforcement, through the use of coercion, if necessary. However, the situation is quite different when one considers international relations. Mexico argues that its tax measures are designed to secure compliance by the United States with obligations Mexico considers the United States to have under the NAFTA. Regardless of the issue of Mexico's actual intentions regarding its measures, the effectiveness of those measures in achieving their stated goal – that of bringing about a change in the behaviour of the United States – seems to the Panel to be inescapably uncertain.

8.186 In this regard, Mexico has not explained how its measures will make any significant contribution to securing compliance on the part of the United States, and much less how they will perforce bring about such a change of conduct. Mexico has claimed only that the measures have had the effect of "attracting the attention" of the United States.⁴⁰⁹ Attracting the attention of a Member is not equivalent to securing compliance of that Member with a law or regulation. Even conceding that the measures may have "attracted the attention of the United States", at most this would imply the beginning of a process between the parties with uncertain results. The Panel mentions these considerations principally in order to reinforce its conclusion that the outcome of international countermeasures, such as those adopted by Mexico, is inherently unpredictable, and that they are therefore not eligible to be considered as measures "to secure compliance" within the meaning of Article XX(d). However, even if the assumption were to be made in the abstract that international countermeasures are potentially capable of qualifying as measures designed to secure compliance, the Panel's conclusion would be that Mexico has not established that its measures contribute to securing compliance in the circumstances of this case.

8.187 Confirmation of the view that the uncertain outcome of international countermeasures is a reason for disqualifying them as measures eligible for consideration under Article XX(d) is to be

⁴⁰⁶ Appellate Body Report on *Korea – Various Measures on Beef*, para. 157. See also, Appellate Body Report on *Dominican Republic – Import and Sales of Cigarettes*, para. 65.

⁴⁰⁷ Panel Report on *Korea – Various Measures on Beef*, para. 658.

⁴⁰⁸ See para. 8.175 above.

⁴⁰⁹ Mexico's second written submission, para. 83.

found in the Appellate Body Report in the *US – Gambling* case. When considering whether a measure could be considered to be "necessary", the Appellate Body dismissed the idea that consultations between the Members concerned could constitute a reasonably available alternative:

"Engaging in consultations with Antigua, with a view to arriving at a negotiated settlement that achieves the same objectives as the challenged United States' measures, was not an appropriate alternative for the Panel to consider because consultations are by definition a process, the results of which are uncertain and therefore not capable of comparison with the measures at issue in this case."⁴¹⁰

8.188 As indicated by the Appellate Body, measures that are of uncertain outcome do not qualify as reasonably available alternatives when considering whether a measure is necessary to secure compliance with a law or regulation. Following a similar rationale, in order to qualify as a measure "to secure compliance", it would seem that there should be a degree of certainty in the results that may be achieved through the measure. Such certainty is inherently absent in the case of international countermeasures.

8.189 Finally, it should be noted that, as regards the design of the measures, the Panel has already determined that, by their design and operation, the challenged tax measures afford protection to Mexican domestic production.⁴¹¹ The measures apply to imported soft drinks and syrups, and particularly to those produced with non-cane sugar sweeteners, from all origins. Even Mexico acknowledges that its measures are intended to rebalance its sugar market, so that surplus sugar that could otherwise have been exported to the United States could be sold in the Mexican domestic market.⁴¹² These considerations serve to further undermine Mexico's claim that, in the circumstances of this case, its measures are designed to secure compliance with laws or regulations.

8.190 For these reasons, the Panel is not convinced by Mexico's argument that the challenged tax measures are *designed* to secure compliance by the United States with laws or regulations.

(iii) *Laws and regulations covered by paragraph (d) of Article XX*

8.191 As noted above, the United States argues that the phrase "laws or regulations" in paragraph (d) covers only internal or domestic laws and regulations, and does not extend to international obligations owed to Mexico by other countries under the NAFTA, and other international agreements. It contends that both the ordinary meaning of the terms "laws or regulations", as well as the context in which the terms appear – namely, Article XX of the GATT and more broadly the GATT and the WTO Agreements – support its interpretation that they are limited to domestic laws or regulations.⁴¹³ In the view of the United States, Mexico has not established that the phrase "laws or regulations" as used in Article XX(d) means or includes "international law" or obligations owed to Mexico under an international agreement such as the NAFTA.⁴¹⁴

8.192 Mexico responds that international agreements that are incorporated into domestic law, and the legal obligations arising from those agreements, would be covered by the phrase "laws or regulations". It argues that "international law is no less law than domestic law". In its opinion, "[t]he

⁴¹⁰ Appellate Body Report on *US – Gambling*, para. 317.

⁴¹¹ See para. 8.86 above.

⁴¹² Mexico's first written submission, para. 84.

⁴¹³ Written version of United States' oral statement during first substantive meeting of the Panel with the parties, para. 9. United States second written submission, paras. 37 and 41-55. United States response to Panel question No. 30, paras. 72-78.

⁴¹⁴ United States second written submission, paras. 42-55. Written version of United States' oral statement during second substantive meeting of the Panel with the parties, paras. 4-12.

mere characterization of a rule as an obligation under an international agreement does not mean that such a rule is not also a 'law' within the meaning of Article XX(d)."⁴¹⁵

8.193 The Panel commences its examination of the phrase "laws or regulations" by noting that "law" can be defined as a "rule of conduct imposed by secular authority" or as "[a]ny of the body of individual rules in force in a State or community"⁴¹⁶, while "regulation" can be defined as a "rule prescribed for controlling some matter, or for the regulating of conduct".⁴¹⁷ However, these definitions are too general to resolve the question of the meaning of these terms in Article XX(d),⁴¹⁸ and in particular whether, as argued by Mexico, they include the rules of international agreements, such as those of the NAFTA. Nor does the Panel find guidance in this regard from the use of the plural form of the word "laws" in paragraph (d); nor from the different use of the word in the Spanish and French text of the GATT 1994 and the DSU.⁴¹⁹ For the answer to this question it is necessary to look at the context in which the words occur. This context includes the other terms of paragraph (d) as well as the other provisions of GATT 1994, and indeed of the WTO covered agreements.

8.194 The phrase "laws or regulations" is most closely linked with the opening words of the paragraph: "to secure compliance with". Furthermore, in looking for the meaning of these words, the Panel found it necessary to look at the whole expression "to secure compliance with laws or regulations". It therefore follows logically that the conclusions reached in that analysis must also apply in the present context. Consequently, the conclusion that these words refer to enforcement action within a particular domestic legal system, and that they do not extend to international action of the type taken by Mexico, necessarily applies to both parts of this expression.

8.195 Both parties have sought to invoke the use of the terms "laws" and "regulations" elsewhere in the GATT 1994 and in other WTO agreements in support of their respective suggested interpretations.⁴²⁰ The use of these terms in the text of the GATT 1994⁴²¹ and the WTO Agreement⁴²²

⁴¹⁵ Mexico's first written submission, para.118. Written version of Mexico's oral statement during first substantive meeting of the Panel with the parties, paras. 41-44. Mexico's second written submission, paras. 66-73.

⁴¹⁶ *The New Shorter Oxford English Dictionary* (Clarendon Press, 1993), Vol. I, pp. 1544-1545.

⁴¹⁷ *Ibid.*, Vol. II, p. 2530.

⁴¹⁸ See also United States response to Panel question No. 30, para. 71.

⁴¹⁹ The United States argues that there is a textual difference between "laws or regulations" and "international law". In support for its argument, it refers to the fact that one expression uses the singular "law" while the other uses the plural "laws". In its view, while it is possible to speak of international "law" in the same sense as to speak about "common law" or the "law of the sea", international law is not ordinarily used in the plural. It also argues that the word "law", as used in the expressions "public international law" (in Article 3.2 of the DSU) and "laws or regulations" (in Article XX(d) of the GATT 1994) has been translated differently in the Spanish and French texts of the agreements. See, United States second written submission, para. 51 and footnote 72. Written version of United States' oral statement during second substantive meeting of the Panel with the parties, para. 9. The Panel notes that the singular form of the word "law" can also be used in reference to any particular body of rules in force in a community, such as "criminal law", "commercial law" or "administrative law", without regard to whether it is domestic or international.

⁴²⁰ United States response to Panel question No. 30, paras. 72-74. United States second written submission, paras. 37 and 44-46. Written version of United States' oral statement during second substantive meeting of the Panel with the parties, paras. 6 and 9. Written version of Mexico's oral statement during second substantive meeting of the Panel with the parties, para. 77. Mexico's response to Panel question No. 84.

⁴²¹ See, for example, Article II:5 ("tariff laws of such contracting party"); Article III:1 ("internal taxes and other internal charges, and laws, regulations and requirements"); Articles III:4 and III:8 ("laws, regulations and requirements"); Article V:3 ("applicable customs laws and regulations"); Article VII:1 (contracting party's "laws or regulations relating to value for customs purposes"); Article VIII:2 (contracting party's "laws and regulations"); Article IX:2 ("laws and regulations relating to marks of origin"); Article IX:4 ("laws and regulations of contracting parties relating to the marking of imported products"); Article X:1 ("Laws, regulations, judicial decisions and administrative rulings of general application, made effective by any contracting party"); and Article X:3(a) (contracting party's "laws, regulations, decisions and rulings").

suggests that such terms relate principally to domestic rules issued by the authorities of Members (or of GATT contracting parties) and not to obligations under international agreements. At the same time, it should be noted that in a limited number of instances, the WTO Agreement refers to "regulations" adopted by the WTO Ministerial Conference⁴²³, and to "financial regulations" adopted by the General Council⁴²⁴, suggesting that the term "regulation" may also be associated to acts adopted by international bodies. The Panel does not find that this last consideration gives any decisive indication of the meaning of "laws or regulations" in Article XX(d), and in particular does not detract from the conclusion it has reached by considering the immediate context of the phrase.

8.196 The Panel does not see that the issue of the possible direct effect of an international agreement in domestic law is relevant in the present context. Whether or not an agreement has that effect, it retains its *international* character, and it is that character and the international character of the obligations that arise from it which lead to the possible use of countermeasures to encourage respect for those obligations. Thus, even if some of the rules of the agreement become part of national law as a result of a doctrine of direct effect, it remains the case that it is the international dimension of the agreement's rules that needs to be considered when interpreting the phrase "laws or regulations".

8.197 Finally, the Panel observes that, even if it were to assume that the expression "laws or regulations" in Article XX(d) could include international agreements such as the NAFTA, it would in any event conclude that, on the facts of the case, because of the uncertainty of their consequences, the challenged measures are not designed "to secure compliance with laws or regulations which are not inconsistent with the provisions" of GATT 1994.

(iv) *Conclusion*

8.198 For the reasons indicated above, the Panel concludes that Mexico has not demonstrated that the challenged measures are designed "to secure compliance with laws or regulations", within the meaning of Article XX(d) of the GATT 1994.

(c) Necessary to secure compliance with laws or regulations

8.199 Mexico argues that the challenged tax measures are "necessary" to secure compliance by the United States with its own obligations under the NAFTA, a law that is not inconsistent with the provisions of the GATT 1994.⁴²⁵

8.200 Mexico argues that the measures at issue have "to a large extent" contributed to the end pursued, that is, securing the United States' compliance with the NAFTA. In its opinion, the evidence reveals that the adoption of the IEPS tax created a "desired dynamic to secure the United States' compliance or otherwise arrive at a mutually satisfactory resolution of the dispute". Mexico adds that the measures have had the effect of "attracting the attention" of the United States.⁴²⁶ As evidence to support its assertion, Mexico has presented a newspaper article on the effect of the IEPS tax in the bilateral sweeteners dispute between Mexico and the United States under the NAFTA. In the article, the president of the Mexican National Chamber of the Sugar and Alcohol Industries is quoted as saying: "Thanks to the tax, they [American sugar and corn growers, sugar refiners, and HFCS

⁴²² See Article XVI:4 of the WTO Agreement (Member's "laws, regulations and administrative procedures").

⁴²³ See, for example, Articles VI:2 and VI:3 of the WTO Agreement.

⁴²⁴ Ibid., Articles VII:2, VII:3 and VII:4.

⁴²⁵ Mexico's first written submission, paras. 117 and 123-126.

⁴²⁶ Mexico's second written submission, para. 83.

producers] are sitting at the negotiating table...Without the tax, they would not even answer the telephone."⁴²⁷

8.201 The United States responds that, even assuming *arguendo* that Mexico's tax measures contributed to NAFTA compliance, they are not "necessary" to secure such compliance as required by Article XX(d).⁴²⁸

8.202 Having found that Mexico, as the responding party invoking the affirmative defence, has not established that the challenged measures are designed to secure compliance with laws or regulations, under the terms of Article XX(d) of the GATT 1994, the Panel concludes that it does not need to determine whether such measures are "necessary" to secure such compliance by the United States. In some disputes, where a party fails to establish one of the elements of its case, the panel, with a view to assisting the Appellate Body may nevertheless proceed to rule on the remaining elements. However, such an approach is not possible in the present case because the question of whether a measure is "necessary" cannot be examined without taking into account the particular nature of that measure, especially the way in which it secures compliance with laws or regulations. In other words, the elements that Mexico must establish are so closely related that the Panel, having found that the measures do not meet the criterion that they are *designed* "to secure compliance", cannot meaningfully provide any additional analysis about whether the measures are *necessary* "to secure compliance".

(d) *Chapeau* of Article XX

8.203 As Mexico has failed to justify provisionally the challenged measures, it is not necessary for the Panel to consider whether the measures are consistent with the *chapeau* of Article XX.

5. Conclusion

8.204 For the reasons given above, the Panel concludes that Mexico has not established that the challenged measures are justified under Article XX of the GATT 1994.

I. ADDITIONAL REQUESTS BY MEXICO

1. Mexico's additional requests

8.205 Mexico requests that, if the Panel exercises its jurisdiction, it should refrain from making certain findings that could jeopardize Mexico's ability to mount a proper defence in international proceedings that are taking place in other *fora*. More specifically, Mexico requests that the Panel recommend that the parties (Mexico and the United States) take steps to resolve their sweeteners trade dispute within the NAFTA framework. Mexico also asks the Panel to employ particular care in terms of how it formulates its findings and recommendations, making clear that its findings apply solely to the parties' respective rights and obligations under the WTO agreements and cannot be taken to pre-judge legal rights under other rules of international law.⁴²⁹ In response to questions from the Panel, Mexico has clarified that the international proceedings that it is referring to, are three investor – State disputes under Chapter Eleven of the NAFTA, in which claims for monetary damages have been presented against Mexico.⁴³⁰

8.206 After being informed of the Panel's preliminary ruling regarding its decision to exercise jurisdiction, Mexico has reiterated its view that the present dispute is one more properly dealt with

⁴²⁷ Mexico's second written submission, para. 83. Exhibit MEX-8.

⁴²⁸ United States second written submission, paras. 60-67.

⁴²⁹ Mexico's first written submission, paras. 14, 104 and 110.

⁴³⁰ Mexico's response to Panel question No. 36.

under the NAFTA and has repeated its argument that the Panel has broad powers of discretion under the GATT and the DSU to decide whether or not to issue findings in a matter that has been brought before it. In Mexico's opinion, this Panel does not have a legal obligation to issue findings on the claims raised by the United States. The relevant provisions in GATT and the DSU do not say that a panel must issue findings of breach on the merits of a claim.⁴³¹

8.207 Mexico states that neither Article XXII nor Article XXIII of GATT establish an obligation for panels to issue findings. In particular, Article XXIII:2 only provides that a matter (including an alleged failure of a Member to carry out its obligations or a Member's application of a measure which conflicts with the agreements) may be referred to the CONTRACTING PARTIES. Upon such referral, the CONTRACTING PARTIES shall promptly investigate the matter and shall make appropriate recommendations to the contracting parties which they consider to be concerned, or give a ruling on the matter, as appropriate. When dealing with a dispute, CONTRACTING PARTIES would thus have two options, "as appropriate": (i) to make recommendations to the contracting parties concerned; or, (ii) to issue a ruling in the matter. Articles XXII and XXIII of the GATT would confer this discretion upon the CONTRACTING PARTIES (and upon panels acting at their behest). Panels would have the power to determine what is appropriate in the circumstances of each particular case, even in situations where a breach of the agreements was alleged.

8.208 Mexico argues further that, when the WTO was created, this flexibility was preserved. The drafters of the WTO's dispute settlement system did not amend GATT Articles XXII and XXIII when GATT 1947 became GATT 1994. Moreover, in Article 3 of the DSU, the Members stated that they affirmed their adherence to the principles for the management of disputes heretofore applied under Articles XXII and XXIII of GATT 1947, and the rules and procedures as further elaborated and modified herein. This flexibility is further illustrated by Article 3.7 of the DSU: "... The aim of the dispute settlement mechanism is to secure a positive solution to a dispute. A solution mutually acceptable to the parties to a dispute and consistent with the covered agreements is clearly to be preferred". The flexibility is further preserved in the same paragraph: "In the absence of a mutually agreed solution, the first objective of the dispute settlement mechanism is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements..." The inclusion of the qualifying word "usually" was intentional, in case of unusual circumstances in which the withdrawal of the measures concerned would not result in a positive solution to a dispute. It is thus open to panels to make other findings in order to secure a positive solution to a dispute. Article 11 of the DSU clarifies that it is within the Panel's discretion, based on an objective assessment of the matter before it, to recommend what steps the parties should take to "secure a positive solution to the dispute". This flexibility is confirmed by the terms of reference of this Panel: "To examine, in the light of the relevant provisions of the covered agreements cited by the United States in document WT/DS308/4, the matter referred to the DSB by the United States in that document, and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements".

8.209 Mexico argues that, in this case, issuing findings would not secure a positive solution to the dispute. Findings would not lead to a mutually acceptable solution to the parties if Mexico continues to be blocked in having its grievance under the NAFTA resolved. The Panel should aim to treat both parties fairly.

8.210 Mexico requests that the Panel take particular care in formulating its findings and recommendations so as not to suggest that it is interpreting the two parties' rights and obligations under the NAFTA.⁴³²

⁴³¹ Mexico's second written submission, paras. 48-64. Written version of Mexico's oral statement during second substantive meeting of the Panel with the parties, paras. 43-52.

⁴³² Mexico's second written submission, para. 86.

8.211 Mexico additionally requests the Panel to make the following determinations of fact, whatever its resolution on the merits of this dispute may be. First, that Mexico and the United States have negotiated a bilateral preferential trade regime for sweeteners, which includes HFCS and sugar, products that compete in certain market segments. Second, that a legitimate broader dispute exists between Mexico and the United States regarding access of Mexican sugar to the US market. Third, that Mexico has exhausted all efforts to resolve that dispute through diplomatic channels, bilateral consultations and negotiations, and through NAFTA's Chapter Twenty dispute settlement mechanism. Fourth, that, notwithstanding the fact that Mexico requested the establishment of a NAFTA arbitral panel in 2000, to date the United States has not appointed panellists and has thus frustrated Mexico's attempt to resolve its grievances under the NAFTA. Fifth, that the tax measures at issue are a response to the United States' refusal to submit to NAFTA's dispute settlement; a response that seeks to induce the United States to do so, as well as to rebalance Mexico's market which has been affected by the sugar production surplus resulting in part from United States' HFCS imports and HFCS production from corn imported from the United States. Sixth, that the United States has stated that under international law it can validly adopt counter-measures when another State refuses to submit to dispute settlement mechanisms.⁴³³

8.212 Finally, Mexico requests the Panel, in the course of its deliberations, to give the fullest weight to Mexico's status as a developing country and to the fact that agrarian reform entails a lengthy process of adjustment.⁴³⁴

2. The United States response

8.213 The United States responds to Mexico's arguments in this regard, by stating that they are not relevant to the resolution of this dispute. In the United States' opinion, Mexico's assertions that this is a NAFTA dispute and that a finding of WTO-inconsistency could prejudice Mexico's interests in on-going or future NAFTA proceedings, do not bear on whether Mexico's tax measures are consistent with Article III of the GATT 1994 or justified under Article XX(d). They are, therefore, not issues that this Panel needs to consider further. The United States adds that Mexico is incorrect in arguing that the Panel need not limit its recommendations in this dispute to a request that Mexico bring its WTO-inconsistent tax measures into compliance. Panel recommendations are limited to recommendations that WTO-inconsistent measures be brought into conformity with the covered agreements. This limitation is explicitly provided for in Article 19.1 of the DSU.⁴³⁵

8.214 Regarding Mexico's request that the Panel make certain determinations of fact, the United States responds that most of the facts identified by Mexico involve determinations of contested legal issues. The United States also disputes many of the facts identified by Mexico. It additionally argues that these determinations do not concern facts that this Panel needs to determine in order to fulfil its mandate in this dispute, which concerns the consistency of Mexico's tax measures with Mexico's WTO obligations and not the United States' actions under the NAFTA. The United States concludes that the Panel should not agree to make the determinations of fact requested by Mexico.⁴³⁶

⁴³³ Written version of Mexico's oral statement during second substantive meeting of the Panel with the parties, para. 36.

⁴³⁴ Mexico's first written submission, paras. 105-109, 137 and 139.

⁴³⁵ Written version of United States oral statement during second substantive meeting of the Panel with the parties, paras. 19 and 26.

⁴³⁶ United States response to Panel question No. 73, paras. 61-67.

3. Panel's analysis

(a) The Panel's "discretion"

8.215 Mexico has made a variety of requests regarding the findings and recommendations that the Panel might make. Most of these requests rest on the premise that the Panel has discretion as to what it may do in this regard, in support of which Mexico has made a number of arguments. The Panel will commence its analysis by examining these. In essence, Mexico argues that the Panel has discretion to depart from the procedure stated in Article 19.1 of the DSU:

"Where a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement. In addition to its recommendations, the panel or Appellate Body may suggest ways in which the Member concerned could implement the recommendations." (Footnotes omitted.)

8.216 In support of its arguments, Mexico has referred to Article 3.1 of the DSU⁴³⁷, which states that:

"Members affirm their adherence to the principles for the management of disputes heretofore applied under Articles XXII and XXIII of GATT 1947, and the rules and procedures as further elaborated and modified herein."

8.217 Mexico seems to invoke Article 3.1 of the DSU merely in order to address the text of Articles XXII and XXIII of the GATT. Since the latter provisions are explicitly included in WTO law as part of the GATT 1994, there is no need to invoke Article 3.1 of the DSU for this purpose. Mexico has not referred to any other matters that would require the invocation of Article 3.1.

8.218 Despite Mexico's argument⁴³⁸, the Panel does not find anything in Article XXII of the GATT which suggests that panels have the discretion not to issue rulings and recommendations in disputes where they have found measures to be inconsistent with WTO obligations.

8.219 As to Article XXIII of the GATT, Mexico points to several features in Article XXIII:2 in support of its contentions. This paragraph states in its relevant parts that:

"If no satisfactory adjustment is effected between the contracting parties concerned within a reasonable time, or if the difficulty is of the type described in paragraph 1 (c) of this Article, the matter may be referred to the CONTRACTING PARTIES. The CONTRACTING PARTIES shall promptly investigate any matter so referred to them and shall make appropriate recommendations to the contracting parties which they consider to be concerned, or give a ruling on the matter, as appropriate..."⁴³⁹

8.220 Mexico claims that the use of the phrase "as appropriate" gives discretion to panels whether or not to issue rulings. In the first place, it is clear that, even if such discretion exists, it is given to CONTRACTING PARTIES (and their equivalent under the WTO, the DSB), and not to panels. More generally, it must be borne in mind that the use of panels in dispute settlement was not specifically envisaged in the text of the GATT adopted in 1947, but was developed in the following years. The topic was the subject of a number of decisions of the CONTRACTING PARTIES during this

⁴³⁷ Mexico's second written submission, para. 59.

⁴³⁸ Mexico's second written submission, para. 55.

⁴³⁹ Under the system of the GATT 1947, the expression "CONTRACTING PARTIES" in capital letters, meant the Contracting Parties "acting jointly". GATT, Article XXV:1.

period.⁴⁴⁰ Many of the elements of these decisions have now been absorbed into the DSU. Terms in Article XXIII:2 should therefore not be read in isolation. In particular, the Panel regards it as significant that none of the DSU provisions touching on the powers of panels in regard to making recommendations qualifies those powers with the phrase "as appropriate". The relevant DSU provisions are considered below.

8.221 Mexico also claims support for its arguments from the use of the word "or" that connects the two options open to the CONTRACTING PARTIES: to make recommendations, and to give a ruling.⁴⁴¹ The Panel is not aware of any authoritative interpretation of the term "ruling". However, it does not find that in this context the word "or" indicates that the two options are mutually exclusive. The term most likely includes a panel's conclusion that the respondent Member's measures are inconsistent with particular WTO obligations. Such a conclusion would invariably be accompanied by a recommendation. Consequently, whether in relation to the Panel in making proposals to the DSB, or to the DSB itself, this use of the word merely serves to present a list of the actions that may be taken. It does not indicate that the Panel has the flexibility that is claimed by Mexico.

8.222 Apart from these specific points, Mexico argues that Articles XXII and XXIII of the GATT confer "discretion upon the Contracting Parties (and panels acting at their behest)".⁴⁴² The Panel does not see how these provisions can in general be read as giving discretion to either the CONTRACTING PARTIES or panels.

8.223 Mexico seeks support for its position from several provisions of the DSU. The Panel will examine these in turn in order to determine the present legal situation.

8.224 Mexico claims that Article 3.7 of the DSU confirms the flexibility accorded to panels.⁴⁴³ This provision states that:

"Before bringing a case, a Member shall exercise its judgement as to whether action under these procedures would be fruitful. The aim of the dispute settlement mechanism is to secure a positive solution to a dispute. A solution mutually acceptable to the parties to a dispute and consistent with the covered agreements is clearly to be preferred. In the absence of a mutually agreed solution, the first objective of the dispute settlement mechanism is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements. 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 measure which is inconsistent with a covered agreement. The last resort which this Understanding provides to the Member invoking the dispute settlement procedures is the possibility of suspending the application of concessions or other obligations under the covered agreements on a discriminatory basis vis-à-vis the other Member, subject to authorization by the DSB of such measures...."

8.225 Mexico refers in particular to the second and fourth sentences. Regarding the former, the Panel's view is that the statement that "[t]he aim of the dispute settlement mechanism is to secure a positive solution to the dispute" is too general to be set against the precise rules that define the role of

⁴⁴⁰ See, for example, Understanding Regarding Notification, Consultation, Dispute Settlement and Surveillance (1979), BISD 26S/210. Doc. L/4907. See also, Decision on Improvements to the GATT Dispute Settlement Rules and Procedures (1989), Doc. L/6489.

⁴⁴¹ Mexico's second written submission, para. 57.

⁴⁴² Mexico's second written submission, para. 58. Written version of Mexico's oral statement during second substantive meeting of the Panel with the parties, para. 48.

⁴⁴³ Mexico's second written submission, para. 60.

panels. Regarding the fourth sentence ("[i]n the absence of a mutually agreed solution, the first objective of the dispute settlement mechanism is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements"), the Panel notes that it simply describes the desired outcome of dispute settlement proceedings, when a finding of inconsistency has already been made by the DSB and no other mutually acceptable solution has been reached between the parties. The word "usually" in the phrase "is usually to secure the withdrawal of the measures concerned" does not have the implications given to it by Mexico. This phrase must be read in conjunction with the remainder of the paragraph, which addresses the fall-back solutions to be adopted when immediate withdrawal of the measure is not achieved. These in effect state what should happen in other-than-usual cases. Consequently, Article 3.7 of the DSU does not confer a general discretion on panels to make any kind of recommendations they might think appropriate in a particular case.

8.226 Mexico has also invoked Article 11 of the DSU in support of its contentions.⁴⁴⁴ That provision reads:

"The function of panels is to assist the DSB in discharging its responsibilities under this Understanding and the covered agreements. Accordingly, a panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements. Panels should consult regularly with the parties to the dispute and give them adequate opportunity to develop a mutually satisfactory solution."

8.227 Mexico points to the use of the word "should" rather than "shall" as an indication that panels have a discretion in these matters.⁴⁴⁵ It acknowledges that "should" can mean "shall"⁴⁴⁶, but says that this interpretation cannot be assumed. In fact, the obligatory nature of the panels' duties under Article 11 has been repeatedly emphasized by the Appellate Body.⁴⁴⁷ Indeed, the importance of the topics covered by this provision would not allow for any other interpretation.

8.228 Mexico has also argued that the terms of reference of this Panel confirm the notion that the Panel has flexibility to decide whether to issue findings on the claims. Mexico has recalled the terms of reference of this Panel: "[t]o examine... the matter referred to the DSB by the United States... and to make such findings as will assist the DSB in making the recommendations *or* in giving the rulings provided for in those agreements" (emphasis added by Mexico).⁴⁴⁸ The Panel notes that this formulation follows the standard terms of reference stated in Article 7.1 of the DSU, and that in its mention of recommendations and rulings it directly reflects the terms of Article XXIII:2 of the GATT, which also refers to the making of recommendations "or" the giving of a ruling.⁴⁴⁹ Consequently, the explanation that the Panel gave above in order to show that Article XXIII:2 provides no basis for Mexico's argument is also applicable in regard to the terms of reference.

8.229 Finally, the Panel returns to Article 19.1 of the DSU:

⁴⁴⁴ Mexico's second written submission, para. 50.

⁴⁴⁵ Ibid.

⁴⁴⁶ Mexico cites in its support the Appellate Body Report on *Canada – Aircraft*, para. 187. See Mexico's second written submission, para. 50.

⁴⁴⁷ See, for example, Appellate Body Report on *EC – Hormones*, para. 133. See also, Appellate Body Report on *Korea – Dairy*, para. 137.

⁴⁴⁸ Mexico's second written submission, para. 63.

⁴⁴⁹ See paras. 8.219 to 8.222 above.

"Where a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned⁴⁵⁰ bring the measure into conformity with that agreement.⁴⁵¹ In addition to its recommendations, the panel or Appellate Body may suggest ways in which the Member concerned could implement the recommendations."

8.230 While Article 19.1 allows panels (and the Appellate Body) to suggest ways in which the Member concerned can implement the appropriate recommendations, this provision also confirms the Panel's earlier conclusion⁴⁵² that it is a legal obligation for panels (and for the Appellate Body), once they have concluded that a measure is inconsistent with a covered agreement, to recommend that the Member concerned bring the measure into conformity with that agreement. Since the Panel has concluded that it does not have discretion to depart from the procedure stated in Article 19.1, there is no occasion for it to consider the various ways in which Mexico requested that such discretion should be exercised. Mexico does not request the Panel to make suggestions of the kind described in the second sentence of Article 19.1. In any event, since Mexico's interest lies in having the Panel issue recommendations directed at what the United States should do, such a step would serve no purpose.

(b) Determinations of fact requested by Mexico

8.231 As for the factual determinations requested by Mexico, the Panel notes that some of the facts included in its request have been taken into account and noted in the findings, to the extent that those facts are relevant for the resolution of the matter put before this Panel.

8.232 Both parties acknowledge that there is a dispute between them concerning the United States' commitments under the NAFTA regarding the access of Mexican sugar to the United States market.⁴⁵³ However, that is a separate dispute from the one that has been brought before this Panel. First, it is a dispute regarding obligations under a different international agreement, the NAFTA. Second, the DSU and the terms of reference approved by the DSB define the limits of the matter that is before of this Panel. Article 3.10 of the DSU states that WTO Members understand that "complaints and counter-complaints in regard to distinct matters should not be linked". Consequently, even if, *arguendo*, the dispute between Mexico and the United States regarding access of Mexican sugar in the United States market were a matter under the WTO covered agreements, a Panel could not link the complaints and counter-complaints related to distinct matters in one single case.

(c) Mexico's status as a developing country

8.233 Mexico requests the Panel, in the course of its deliberations, to give the fullest weight to Mexico's status as a developing country and to the fact that agrarian reform entails a lengthy process of adjustment.⁴⁵⁴

8.234 The Panel is aware of the crucial importance of the provisions on special and differential treatment in the WTO agreements in general, and of Article 12.11 of the DSU in particular. During the Panel proceedings, the Panel has taken into account Mexico's status as a developing country, *inter alia*, when establishing the timetable for the panel process, and has accorded flexibility within that timetable for the receipt of Mexico's submissions and responses. In the course of these proceedings,

⁴⁵⁰ (*footnote original*) The "Member concerned" is the party to the dispute to which the panel or Appellate Body recommendations are directed.

⁴⁵¹ (*footnote original*) With respect to recommendations in cases not involving a violation of GATT 1994 or any other covered agreement, see Article 26.

⁴⁵² See para. 8.225 above.

⁴⁵³ Mexico's first written submission, paras. 1-8, 12, and 27-77. United States' response to Panel question No. 73, paras. 62-64.

⁴⁵⁴ Mexico's first written submission, paras. 105-109, 137 and 139. Mexico's response to Panel question No. 24.

however, Mexico has raised no specific provisions on differential and more-favourable treatment for developing country Members that require additional consideration.⁴⁵⁵

4. Conclusion

8.235 In light of the above considerations, the Panel will follow Article 19.1 of the DSU as regards the recommendations that it makes.

IX. CONCLUSIONS AND RECOMMENDATION

9.1 For the reasons indicated in this report, the Panel has determined that, under the DSU, it has no discretion to decline to exercise its jurisdiction in the case that has been brought before it.

9.2 With respect to the United States' claims, the Panel concludes as follows:

(a) With respect to Mexico's soft drink tax and distribution tax:

- (i) As imposed on sweeteners, imported beet sugar is subject to internal taxes in excess of those applied to like domestic sweeteners, in a manner inconsistent with Article III:2, first sentence, of the GATT 1994;
- (ii) As imposed on sweeteners, imported HFCS is being taxed dissimilarly compared with the directly competitive or substitutable products, so as to afford protection to the Mexican domestic production of cane sugar, in a manner inconsistent with Article III:2, second sentence, of the GATT 1994;
- (iii) As imposed on sweeteners, imported beet sugar and HFCS are accorded less favourable treatment than that accorded to like products of national origin, in a manner inconsistent with Article III:4 of the GATT 1994;
- (iv) As imposed on soft drinks and syrups, imported soft drinks and syrups sweetened with non-cane sugar sweeteners (including HFCS and beet sugar) are subject to internal taxes in excess of those applied to like domestic products, in a manner inconsistent with Article III:2, first sentence, of the GATT 1994.

(b) With respect to Mexico's bookkeeping requirements: As imposed on sweeteners, imported beet sugar and HFCS are accorded less favourable treatment than that accorded to like products of national origin, in a manner inconsistent with Article III:4 of the GATT 1994.

9.3 With respect to Mexico's invocation of Article XX(d) of the GATT 1994, the Panel concludes that the challenged tax measures are not justified as measures that are necessary to secure compliance by the United States with laws or regulations which are not inconsistent with the provisions of the GATT 1994.

9.4 Under Article 3.8 of the DSU, in cases where there is an infringement of the obligations assumed under a covered agreement, the action is considered prima facie to constitute a case of nullification or impairment. The Panel concludes that, to the extent that the measures listed above are inconsistent with the GATT 1994, they have nullified or impaired benefits accruing to the United States under that agreement.

⁴⁵⁵ Mexico's response to Panel question No. 39.

9.5 Having concluded that it has no discretion to depart from the procedure stated in Article 19.1 of the DSU, the Panel recommends that the Dispute Settlement Body request Mexico to bring the inconsistent measures as listed above into conformity with its obligations under the GATT 1994.
