

INTERNATIONAL BUSINESS TRANSACTION

“END-USE” AS A CRITERION IN THE DETERMINATION OF “LIKE” AND “DIRECTLY COMPETITIVE OR SUBSTITUTABLE” PRODUCTS UNDER ARTICLE III: 2 OF GATT 1994.

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Abstract: End-Use within the context of “Like” and “Directly Competitive or Substitutable” Products under Article III: 2 of GATT 1994 presents some questions when latent competition is introduced. Will products targeting two different end-uses find that the “accordion” of “likeness” squeezes a little too tight? The Michiu or rice wine debate in Taiwan provides a good and timely context on which to conclude the analysis.

List of Abbreviations

GATT	General Agreements on Tariffs and Trade
WTO	World Trade Organisation

1. INTRODUCTION

Article III:2 of the General Agreement on Tariffs and Trade 1994 (“GATT 1994”) provides for the national treatment of “like” and “directly competitive or substitutable” products regarding internal taxation or other charges. A number of key decisions from the Panels and Appellate Body have interpreted the scope of these product classifications within the context of Article III:2.¹

End-use represents a determinative criterion in the assessing of a violation of Article III: 2. There has been clear direction in recent decisions that this covers not only consideration of extant competition but latent competition as well.² The decisions, however, have been set within the context of a broad end-use and addressed differing manifestations of that main end-use.

The context of the decisions and the statement on latent competition give rise to consideration of the scope of commonality of end-use within Article III:2. One needs to consider the situation where two products do not share the same targeted end-use but rather primarily serve to meet different end-uses. Within this context, latent competition has possible broad applications and implications for tax policy.

The paper will consider the scope of end-use in Article III:2. This will be achieved first, through a brief examination of the background and development of “like” and “directly competitive or substitutable” products in Article III:2. The paper will then proceed with an examination and analysis of determining end-use. Finally, the paper will consider the Michiu debate in Taiwan within the scope of Article III:2. The paper will show that products targeting different end-uses may be “like” or “directly

¹ *Japan – Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages: Report of the Panel, (“Japan I”)* BISD 34S/83, General Agreement on Tariffs and Trade 1947, adopted 10 November 1987; *Japan – Taxes on Alcoholic Beverages: Report of the Panel, (“Japan II”)* WT/DS8/R, WT/DS10/R, WT/DS11/R, World Trade Organization, adopted as modified by the Appellate Body Report 1 November 1996. *Japan – Alcoholic Beverages: Report of the Appellate Body, (“Japan II”)* WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, World Trade Organization, adopted 1 November 1996; *Korea – Taxes on Alcoholic Beverages: Report of the Panel, WT/DS75/R, WT/DS84/R, World Trade Organization, adopted as modified by the Appellate Body Report 17 February 1999; Korea – Alcoholic Beverages: Report of the Appellate Body, WT/DS75/AB/R, WT/DS84/AB/R, World Trade Organization, adopted 17 February 1999; Chile – Taxes on Alcoholic Beverages: Report of the Panel, WT/DS87/R, WT/DS110/R, World Trade Organization, adopted as modified by the Appellate Body Report 12 January 2000.*

² *Korea – Alcoholic Beverages: Report of the Appellate Body* at 124.

competitive or substitutable” products if the physical characteristics and market so dictate.

2. “LIKE PRODUCTS” AND DIRECTLY COMPETITIVE OR SUITABLE PRODUCTS”

2.1 BACKGROUND

The term “like” product appears in a number of articles within GATT 1994 as well as in other multilateral trade agreements within the World Trade Organization (“WTO”). No standard definition has been provided for throughout, rather the term has been considered akin to an accordion. The definition of what constitutes a “like” product shall stretch and squeeze contingent upon the context of the article in which it appears.³ Guidance in determining what constitutes “like or similar products”, however, has been found in the Report of the Working Party on *Border Tax Adjustments*.⁴

The Working Party considered the interpretation to be given to “like or similar products” with GATT 1947, but did not reach a consensus. It did agree that the term should be interpreted on a case-by-case basis with consideration given to “the product's end-uses in a given market; consumers' tastes and habits, which change from country to country; the products' properties, nature and quality.”⁵ These criteria, however, do not represent an exhaustive list and found reference only as suggestions on how to approach the assessment.

2.2 “LIKE PRODUCTS” AND ARTICLE III:2

“Like products” find a rather unique distinction within Article III:2, as not just “like products” appear but also “directly competitive or substitutable products.” This may be considered within the context of concentric circles. The outer most circles would represent indirectly competitive and substitutable products. This would be very broad and could potentially include all products. The next circle would represent “directly

³ *Japan II – Report of the Appellate Body* at p. 21.

⁴ *Border Tax Adjustments: Report of the Working Party*, L/3464, General Agreement on Tariffs and Trade 1947, adopted 2 December 1970.

competitive and substitutable products.” And the third, “like products.” That is to say, “like products” represent a narrower subset of “directly competitive and substitutable products.”⁶ Only products falling within the inner-most two circles would be within the scope of Article III:2.⁷

“Like products” would require a narrow assessment while “directly competitive or substitutable products” would rely on a broader approach.⁸ This paper shall follow the approach of the Panel in *Korea – Taxes on Alcoholic Beverages* and set the discussion and analysis of products that primarily serve to meet different end-uses within the broader context of “directly competitive or substitutable products.”⁹

2.3 “DIRECTLY COMPETITIVE OR SUBSTITUTABLE PRODUCTS”

“Directly competitive or substitutable products” may be defined as those that “consumers consider or could consider . . . as alternative ways of satisfying a particular need or taste.”¹⁰ This must be considered in the context of a domestic product and an imported product. These need not represent a “complete overlap of substitutability”¹¹ – that would fit within the narrower “like product” classification. This relationship may be established through the application of the Working Party’s criteria as developed and expanded over the years.

A directly competitive or substitutable relationship between two products may be shown through an examination of the products’ physical characteristics and their end-

⁵ *Id.*, at 18

⁶ *Japan II: Report of the Panel Board* at 6.22; *Korea – Taxes on Alcoholic Beverages: Report of the Panel* at 10.39 – 10.40.

⁷ The unique nature of Article III:2 through the inclusion of “directly competitive or substitutable products” limits the general application of any definition of “like products” to this Article. The criteria and approach, however, may give rise to consideration within the context of other WTO agreements. For example, see *Australia: “Like Products” Within the Meaning of the WTO Anti-Dumping Agreement*, Submission to the Negotiating Group on Rules, TN/RL/91, WTO, 1 May 2003.

⁸ *Japan II: Report of the Panel Board* at 6.28 “Like products” will share greater common physical properties than “directly competitive or substitutable products”.

⁹ In *Korea – Taxes on Alcoholic Beverages* the Panel explained at 10.36 that where “directly competitive or substitutable products” represented a broader product category than “like products” and where “like products” would by their nature also be “directly competitive or substitutable products” that the appropriate starting point would be to first consider “directly competitive or substitutable products”.

¹⁰ *Id.*, at 10.40.

¹¹ *Id.*, at 10.97 and *Chile – Taxes on Alcoholic Beverages: Report of the Panel* at 7.84.

uses. Evidence of commonality of end-use will be the determinative factor.¹² The examination of the end-use will be within the marketplace and may take into account, but is not limited to, any number of the following considerations:

- i.) Consumer surveys¹³;
- ii.) Market surveys evidencing trends and changes in consumption patterns¹⁴;
- iii.) Product advertising and marketing strategies¹⁵;
- iv.) Price and cross-price elasticity¹⁶;
- v.) Channels of distribution and points of sale¹⁷; and
- vi.) Outside markets¹⁸.

Tariff classifications and bindings as a third consideration have also been considered in the past, however they may be of little probative value given their arbitrary nature. The examination of “directly competitive or substitutable products” requires flexibility and consideration of all relevant factors and must be determined on a case-by-case basis.¹⁹

3. THE DETERMINATION END-USE

3.1 COMMONALITY OF END-USE

The situation where two products do not share the same targeted end-use but rather primarily serve to meet different end-uses may arise within many different contexts.

¹² Trebilcock, Michael J. and Giri, Shiva K., *The National Treatment Principle in International Trade Law*, 2003 at p.22 commenting on the Panel’s decision in *Japan II*. A “like product” within Article III:2 requires not only commonality of end-use but also strong corresponding physical properties.

¹³ *Japan II: Report of the Panel Board* at 6.32; *Korea – Taxes on Alcoholic Beverages: Report of the Panel* at 10.82; *Chile – Taxes on Alcoholic Beverages: Report of the Panel* at 7.87.

¹⁴ *Japan II: Report of the Panel Board* at 6.32; *Korea – Taxes on Alcoholic Beverages: Report of the Panel* at 10.82; *Chile – Taxes on Alcoholic Beverages: Report of the Panel* at 7.24.

¹⁵ *Japan II: Report of the Panel Board* at 6.28; *Korea – Taxes on Alcoholic Beverages: Report of the Panel* at 10.95; *Chile – Taxes on Alcoholic Beverages: Report of the Panel* at 7.45.

¹⁶ *Japan II: Report of the Panel Board* at 6.32; *Korea – Taxes on Alcoholic Beverages: Report of the Panel* at 10.94; *Chile – Taxes on Alcoholic Beverages: Report of the Panel* at 7.60.

¹⁷ *Korea – Taxes on Alcoholic Beverages: Report of the Panel* at 10.86; *Chile – Taxes on Alcoholic Beverages: Report of the Panel* at 7.55.

¹⁸ *Korea – Taxes on Alcoholic Beverages: Report of the Panel* at 10.45.

¹⁹ *Japan II: Report of the Appellate Body* at pp. 26-27.

In the WTO alcohol taxation decisions to date, end-use and the scope of the market have been contentious issues. Disagreement centred on how narrow a scope to place upon the market and end-use. A broad scope was applied covering the beverage spirit market rather than focus on particularly narrow end-uses of spirits within it. That is to say, the beverage spirits shared end-use as beverage spirits and that sector within the market. The evidence from the markets supported that the beverages shared sufficient commonality of end-use to be “directly competitive or substitutable products”.

End-use and the market will define one another. Identifying a degree of overlap of end-uses within a market sector proved sufficient to support the possibility of commonality of end-uses. In reaching an appropriate balance, a number of factors have been considered.

3.1.1 Latent Competition

Latent competition may be anticipated through physical properties, outside markets, or supporting information from the domestic market including consumer surveys, market trends, channels of distribution and points of sale, and any other relevant data - any means by which competition may be demonstrated. It will form part of the overall analysis.

The recognition of latent competition reflects the fact that competition is not static. Evidence of latent competition assists in establishing that products are “directly competitive or substitutable products”. One means by which to establish latent competition is the presence of some degree of extant competition.²⁰ Latent competition represents one piece in the puzzle and not the puzzle itself.

3.1.2 Physical Properties

Physical properties may be assistive in determining end-use or in eliminating commonality of end-use.

²⁰ *Korea – Alcoholic Beverages: Report of the Appellate Body* at 112-124.

The fact that the products in the alcohol disputes all shared the characteristics of being “potable distilled spirits” or “distilled alcoholic beverages” proved supportive in finding that they were “directly competitive or substitutable products”.²¹ Physical characteristics also serve as an indication of potential competition.²² The general physical properties associated with being distilled spirits served to assist in defining the end-use and appropriate market though this definition will still be made on a case-by-case basis.

In *Canada – Periodicals*, the Appellate Body noted that the magazines forming the subject matter of the dispute could be distinguished with respect to their end-use from other magazines by differing content.²³

In *Korea – Taxes on Alcoholic Beverages* the complainants noted that while alcohol and soda served the similar end-uses the physical presence of alcohol or lack thereof distinguished the overlap.²⁴ A physical property distinguished the products sufficiently with respect to particular end-uses so as to set them apart from other products.

Three points need to be noted on physical characteristics. First, physical characteristics need to be considered broadly on a case-by-case basis regarding “directly competitive or substitutable products” and the decisions reflect identifying common general characteristics suitable for the end-use. Second, physical characteristics may be both inclusive and exclusive. Third, physical characteristics alone will not be determinative. Fourth, physical characteristics can serve as indicators of latent competition.

3.1.3 Overlapping End-Uses

Actual analysis and consideration of the market and the products’ end-uses serve as the most effective means by which to gauge commonality of end-uses. This requires identifying overlapping end-uses or a lack thereof.

²¹ *Chile – Taxes on Alcoholic Beverages: Report of the Panel* at 7.53 and also see 7.82; *Korea – Taxes on Alcoholic Beverages: Report of the Panel* at 10.67

²² *Korea – Taxes on Alcoholic Beverages: Report of the Panel* at 10.67.

²³ *Canada – Periodicals: Report of the Appellate Body*, WT/DS31/AB/R, World Trade Organization, adopted 30 July 1997 at 25 and 28.

²⁴ *Korea – Taxes on Alcoholic Beverages: Report of the Panel* at 10.69.

Panels in the alcohol cases relied on evidence from the market in the form of consumer surveys, market surveys evidencing trends and changes in consumption patterns, outside markets and advertising for the local products to identify an overlap. Once an overlap or, in theory the potential of one, had been identified, the market analysis continued so as to reach a determination on whether sufficient evidence existed for a finding. The scope of this second stage included examining channels of distribution and points of sale, price and cross-price elasticity, and other market information.

The weight afforded to evidence from the domestic market has been subject to a caveat. There has been a recognition that market information will be supportive in determining whether overlap of end-use exists generally as well as sufficiently to support findings of commonality of end-use and thus “directly competitive or substitutable products”. Market information may not be useful though, in refuting overlap or a finding of “directly competitive or substitutable products”.²⁵ The decisions adopt a legacy effect presumption.

The measures in dispute may very well distort the market and the information from it. For example, consumer and business behaviour as well as market trends may not reflect competition either extant or latent if the market has not been open to sufficient competition. Evidence from the market that does not support commonality of end-use needs to be weighed considering that the evidence may be reflecting the measure in dispute rather than competition within the market. This has supported looking at outside markets.

The examination of a similar outside market may well give insight as to competition in domestic market but for the measure in dispute. Physical characteristics, as noted, also may give indications of potential competition within a market and may offer an additional means by which to balance any possible legacy effects.

²⁵ This finds reference in the four noted WTO decisions. For an explanation of the problem, see the Panel Report in *Japan I* at 5.9.

This leaves the question as to what standard and scope of overlap of end-uses and competition will constitute commonality of end-use sufficient for a finding of “directly competitive or substitutable products”.

The scope of overlap need not be in respect of all economic uses that the products may be used for.²⁶ A pattern indicating that the products “may be for some purposes at some times by some consumers” will be sufficient to be considered competitive.²⁷ “Direct” simply requires a degree of “proximity.”²⁸ Article III does not support a type of “trade effects” test but rather “protects the expectations not of any particular trade volume but rather of equal competition.”²⁹ That is to say, the quality of trade and not the quantity will be the issue.

There must be an overlap of end-uses giving rise to direct competition. Differing targeted end-uses may not matter if a degree of overlap can be established and nothing can be found to distinguish the products from the common end-use.

4. MICHIU

4.1 “DIRECTLY COMPETITIVE OR SUBSTITUTABLE PRODUCTS”?

? ? (“Michiu”)³⁰ or rice wine is a distilled spirit used primarily by Taiwanese for cooking.

As part of Taiwan’s admission to the WTO, it agreed to tax Michiu at the same rate as other distilled spirits though the full rate would be implemented over a number years. This was the result of concerns raised by members on national treatment issues. Michiu is also used as an ingredient in traditional Chinese medicinal and herbal

²⁶ *Id.*, at 5.7.

²⁷ *Chile – Taxes on Alcoholic Beverages: Report of the Panel* at 7.43.

²⁸ *Korea – Alcoholic Beverages: Report of the Appellate Body* at 116.

²⁹ *Japan II: Report of the Appellate Body* at p.16; cited in *Korea – Alcoholic Beverages: Report of the Appellate Body* at 119.

³⁰ Information on Michiu and the issue in this chapter is from professional knowledge gained through working on the issue in Taiwan. For additional background information on Michiu see, for example, Louie, Johnson, *Taiwan and Rice Wine*, TED Case Studies No. 669, April 2002, available at <http://www.american.edu/TED/ricewine.htm>

tonics. There is also some degree of use as a beverage on its own. Taiwanese primarily view and use the product as a traditional cooking wine.

The post-WTO taxation of Michiu has been a serious domestic issue. The government had to implement measures in the lead up to the tax increases to ration Michiu and prevent it being hoarded. On admission to the WTO, the price of Michiu increased by 500% with more tax increases required before it was WTO compliant. Wholesale counterfeiting occurred and a number of deaths resulted in 2002 from contaminated products. The government came under increasing pressure and began looking at amending the tax for Michiu.

The Michiu debate represents a timely example for consideration and one that may be done without any market statistics or detailed data:

- i.) Michiu is a potable distilled spirit that would share the same general characteristics of the potable distilled spirits examined in the WTO alcohol cases; and
- ii.) Market information will indicate that a percentage of individuals consume Michiu as a beverage.

An overlapping end-use in the beverage could be established either through the market, physical properties, or both. In the alternative, one could also consider the issue within the context of an overlapping end-use with western spirits and cooking. The presence of strong market data to contradict either overlapping end-use could be balanced out by the legacy effect presumption. The shared general physical properties of Michiu and traditional western spirits – with nothing to distinguish them - and a degree of overlapping end-use would likely be sufficient for the products to be “directly competitive or substitutable products”.

A “salted” version of Michiu, taxed at a lower rate than traditional Michiu and beverage spirits, entered the market around WTO accession. The inclusion of a minimum level of salt was seen as sufficient to distinguish it from the beverage alcohol market. No objections have been raised by members regarding national treatment and salted Michiu.

5. CONCLUSIONS

The accordion has been stretched to include latent competition in an Article III:2 dispute. It has not stretched far enough though to create “like” and “directly competitive or substitutable” products where none exist.

“Like” and “directly competitive or substitutable” products represent a multitude of concentric circles within the marketplace. Products targeting different end-uses will fall within these circles. There will be many times where an overlap of end-uses occurs.

An overlap may be established or disproved by considering physical properties and evidence from the market. These factors will define the scope of the end-use in dispute. Latent competition serves to qualify these factors. The recognition of the legacy effect presumption for market data will place a greater weight on the physical properties to refute a finding in favour of the complainant.

Each case will be decided on its own merits. Products targeting different end-uses may be “like” or “directly competitive or substitutable” products if the physical characteristics and market so dictate.

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