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Can GATT Article III Recover From Its Head-On Collision With *United States—Taxes on Automobiles*?

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Like the Dormant Commerce Clause of the U.S. Constitution,¹ the General Agreement on Tariffs and Trade (GATT)² seeks to limit the ability of each individual government to insulate its constituent industries from outside competition. In theory GATT Article III prohibits internal taxes and other regulations that enhance the competitive position of domestic producers relative to that of foreign producers.³ In practice, however, GATT tribunals have not yet resolved the issue of where Article III's limits begin.

The GATT dispute settlement proceeding titled *United States: Taxes on Automobiles* provides a recent and controversial installment in the evolution of Article III. In 1993, the Euro-

1. The Commerce Clause provides that "The Congress shall have the Power . . . To regulate Commerce . . . among the several States." U.S. CONST. art. I, § 8, cl. 3. The Dormant Commerce Clause (DCC) doctrine established that this text operates not only as a positive grant of regulatory power to Congress, but also as a limitation upon the power of state governments to regulate interstate commerce. For example, in 1951 the U.S. Supreme Court struck down as violative of the DCC a municipal ordinance requiring milk sold locally to be pasteurized within five miles of town. *Dean Milk Co. v. City of Madison*, 340 U.S. 349 (1951). The ordinance unreasonably discriminated against non-local producers. *Id.* at 354. For a review of DCC jurisprudence, see Daniel A. Farber & Robert E. Hudec, *Free Trade and the Regulatory State: A GATT's-Eye View of the Dormant Commerce Clause*, 47 VAND. L. REV. 1401, 1411-18 (1994).

2. General Agreement on Tariffs and Trade, *opened for signature* Apr. 15, 1994, in GATT SECRETARIAT, THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 21, GATT Sales No. 1994-4 (1994) [hereinafter GATT].

3. GATT, *supra* note 2, art. III, para. 1. The first paragraph of Article III states the broad purpose of the entire Article:

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.

Id.

pean Community (EC) asserted that three U.S. laws—the Corporate Average Fuel Economy (CAFE) law and the luxury and gas-guzzler taxes—discriminated against imported cars and were thus inconsistent with Article III.⁴ Just in time for the congressional debate on U.S. membership in the World Trade Organization (WTO),⁵ the *United States: Taxes on Automobiles* Panel concluded that Article III should not excessively curtail the legislative freedom of member nations. Rejecting traditional analysis of Article III claims,⁶ the Panel reasoned that only those taxes enacted with the “aim and effect” of protecting domestic industry fail Article III’s national treatment requirements. Because Congress enacted the luxury and gas-guzzler taxes to effect “legitimate” policy objectives, the Panel found no Article III violation.⁷

Congress designed the challenged measures to ease the effects of economic recessions and achieve greater independence from foreign oil producers.⁸ The powerful U.S. automobile industry—reeling from fuel crises, import competition, and unanticipated changes in demand during the 1970s and 1980s—was an important factor for the government to consider in responding to both these problems.⁹ Although the luxury and gas-guzzler taxes do not explicitly favor domestic producers over foreign

4. GATT Dispute Resolution Panel, *United States: Taxes on Automobiles*, GATT Doc. DS31/R, (panel report not adopted), reprinted in 33 I.L.M. 1397, para. 1.1 (1994).

5. On December 8, 1994, President Clinton signed the Uruguay Round Agreements Act, which approved the agreement establishing the WTO. Pub. L. No. 103-465, 108 Stat. 480, 4809 (1994). Congress passed the Act on December 1, 1994. *Id.* During the congressional debate on the Act, Utah Senator Orrin Hatch hailed the *United States: Taxes on Automobiles* Panel report as an indication that U.S. membership in the WTO would not infringe upon Congress’ legislative freedom. 140 CONG. REC. S15,112-13 (daily ed. Nov. 30, 1994).

6. See *infra* notes 74-80 and accompanying text.

7. See *infra* notes 92-115 and accompanying text. In a separate analysis, the Panel found that certain provisions of the CAFE law were inconsistent with Article III:4, which proscribes non-tax protectionist regulations. The Panel also considered whether GATT Article XX excepted the CAFE law from the provisions of Article III. *United States: Taxes on Automobiles*, *supra* note 4, at paras. 5.56-5.67.

This Comment will focus on the Panel’s detailed analysis of the challenged luxury and gas-guzzler taxes under Article III:2 and allude to those issues that are pertinent as well to other provisions of Article III. This edition includes a thorough review of various panels’ analyses of Article XX. See Cynthia M. Maas, *Should the WTO Expand GATT Article XX: An Analysis of United States-Standards for Reformulated and Conventional Gasoline*, 5 MINN. J. GLOBAL TRADE 415 (1996).

8. See *infra* notes 47-72 and accompanying text.

9. See *infra* notes 11-46 and accompanying text.

producers, European auto makers bear a disproportionately large share of the resultant regulatory burdens.¹⁰

This Comment analyzes Article III's limitation on facially neutral internal legislation and recommends an interpretation that preserves legislative freedom without sacrificing restraints on regulatory protectionism. Part I summarizes the dynamics of the U.S. auto market since the 1970s and describes previous GATT analysis of Article III claims. Part II outlines the Panel's reasoning in *United States: Taxes on Automobiles*. Part III examines the shortcomings of the Panel's analysis and the virtues of alternative approaches. Part IV concludes that the Panel conceded too much to new nationalist dogma and that GATT's future might be better served by an Article III that regulates incidental as well as intentional protectionism.

I. BACKGROUND

A. THE U.S. AUTOMOBILE MARKET IN THE 1970s, 1980s AND 1990s

In 1973 domestic automobile manufacturers sold a historic 9.7 million new cars¹¹ in the United States for a total price of \$40.4 billion,¹² more than \$130 billion in current dollars.¹³ The Big Three U.S. auto companies,¹⁴ which controlled 80% of the U.S. new car market, reported record earnings as a result.¹⁵ A variety of factors, however, conspired to confound these compa-

10. Similarly, the municipal ordinance in *Dean Milk* was neutral on its face. The ordinance required all producers, whether located in Madison or Chicago or Minneapolis, to pasteurize their milk within five miles of town. 340 U.S. at 350. The ordinance's burdens, however, fell more harshly on non-local producers. *Id.* at 354.

11. MOTOR VEHICLE MANUFACTURERS ASSOCIATION, MOTOR VEHICLE FACTS & FIGURES '76 15 (1976).

12. See 1985 *Market Data Book*, AUTOMOTIVE NEWS, Apr. 24, 1985, at 53 (reporting that the average transaction price per new domestic car in 1973 was \$4,180).

13. See U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 1995 492 (1995) (reporting Consumer Price Indexes for all urban consumers of 44.4 and 148.2, respectively, for 1973 and 1994).

14. General Motors, Ford, and Chrysler are referred to collectively as the Big Three.

15. 1985 *Market Data Book*, *supra* note 12, at 25. The Big Three reported net income of approximately \$3.56 billion on sales of approximately \$70.6 billion, including worldwide auto and truck sales and financing revenue, in 1973. Two years later, the same companies reported net income of only \$1.2 billion, a 67% decline. By 1980, the Big Three were in dire financial straits, combining for a net loss of \$4 billion. ROBERT SOBEL, CAR WARS 262 (1984).

nies soon after their banner year, and in 1975 American producers sold only 7 million new cars domestically.¹⁶

1. The Fuel Crises

During 1973 the Organization of Petroleum Exporting Countries (OPEC) began to raise the price of oil dramatically.¹⁷ In little more than a year the price of OPEC crude oil quadrupled, but U.S. price controls¹⁸ prevented this increase from being fully reflected at American gas stations.¹⁹ A panic ensued, however, when OPEC responded to American support of Israel in the Arab-Israeli war by announcing an embargo against the United States in October 1973.²⁰ The resulting gas shortage sparked domestic concern for automobile fuel economy.

The fuel shortage and price controls ended in 1974, and gasoline became readily available again, albeit at a price nearly 50% higher than that observed one year earlier.²¹ Various U.S. government measures stabilized the pump price of gasoline at 50 to 60 cents per gallon for the next several years.²² In the spring of 1979, the Iranian revolution led to another oil

16. 1985 Market Data Book, *supra* note 12, at 22.

17. SOBEL, *supra* note 15, at 222-25. America's oil consumption doubled during the 1950's and again in the 1960's. Robert D. Hershey, Jr., *10 Years After Oil Crisis: Lessons Still Uncertain*, N.Y. TIMES, Sept. 25, 1983, at A1. In 1970 domestic oil production reached its limit, but demand continued to grow. *Id.* Foreign oil filled the void. *Id.* In the mid-1970's, after decades of submission to the major oil companies, the oil-rich nations of the Middle East recognized their oligopoly power over oil prices and collaborated to keep prices high. DAVID HALBERSTAM, *THE RECKONING* 451-59 (1986).

18. In response to concerns regarding rising inflation, Congress in 1970 granted the president authority to freeze wages, salaries, prices, and rents. A. JAMES REICHLEY, *CONSERVATIVES IN AN AGE OF CHANGE* 215-16 (1981). Continuing inflation and unemployment in 1971 led the Nixon administration to institute a new economic program, which included temporary wage and price freezes, a 10% surcharge on imports, repeal of the 7% excise tax on automobiles, suspension of dollar convertibility into gold, and acceleration of an increase in the personal tax exemption. *Id.* at 225. In 1972, an election year, the administration sought to stimulate the economy by increasing federal spending and the money supply. *Id.* at 226. When the controls were lifted late in 1973, prices for consumer goods (including automobiles) skyrocketed. *Id.* at 228.

19. SOBEL, *supra* note 15, at 222-25.

20. *Id.* at 223; JOHN B. RAE, *THE AMERICAN AUTOMOBILE INDUSTRY* 140 (1984).

21. SOBEL, *supra* note 15, at 224.

22. *Id.* at 224, 234. The Energy Policy and Conservation Act of 1975 included a complex system of supply allocations that insulated American consumers from rising crude oil prices. RAE, *supra* note 20, at 141. The stable price of gas during this period led to continuing consumer demand for large, fuel-inefficient cars, which the Big Three were ready and willing to produce. *Id.* at 142.

shortage. By late 1979 gas was selling above the once inconceivable price of one dollar per gallon.²³ The high price of gasoline, in conjunction with the 55 mile per hour speed limit²⁴ and other government actions, convinced many American car buyers that "miles-per-gallon was far more important than miles-per-hour."²⁵

2. Imported Automobiles

As President Nixon announced wage and price freezes in 1971, the United States also imposed a 10% surtax on all imports and ended dollar convertability into gold.²⁶ The government took these steps to stem the flow of imports into the United States, a flow that precipitated the first trade deficit since the 1800s.²⁷

Automobile imports accounted for a healthy portion of the American trade deficit in the 1970s. From 1971 through 1975, the United States imported \$32.4 billion worth of new automobiles, but exported only \$9.4 billion.²⁸ In 1970, Americans bought 1.3 million imported new cars, roughly 15% of the domestic new car market.²⁹ By 1980 that figure rose to 2.4 million imported new cars, a market share of more than 25%.³⁰ In the early 1970s, European and Japanese auto manufacturers each accounted for roughly half of U.S. import sales.³¹ Since the

23. SOBEL, *supra* note 15, at 259-60.

24. The U.S. government imposed the 55 mile per hour national speed limit as part of its response to the 1973 fuel crisis. RAE, *supra* note 20, at 140.

25. SOBEL, *supra* note 15, at 224.

26. *Id.* at 220.

27. *Id.*; U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 1976 825 (1976).

28. U.S. DEP'T OF COMMERCE, *supra* note 27, at 847, 851.

29. 1985 *Market Data Book*, *supra* note 12, at 22, 25.

30. *Id.*

31. GRAEME P. MAXTON & JOHN WORMALD, DRIVING OVER A CLIFF? BUSINESS LESSONS FROM THE WORLD'S CAR INDUSTRY 84-88 (1995). Four manufacturers have dominated West European car production since the 1970's: Volkswagen (including Audi and Seat), Peugeot (including Citroën), Fiat (including Lancia and Alfa Romeo), and Renault. JAMES M. LAUX, THE EUROPEAN AUTOMOBILE INDUSTRY 220-41. Of the major European car manufacturers, only Volkswagen sells a significant number of cars in the United States (Renault has not sold cars in the United States since 1986, Peugeot abandoned the American market in 1992, and Fiat's annual U.S. sales are limited to a few hundred Alfa Romeos). *Id.* at 237; 1990 *Market Data Book*, AUTOMOTIVE NEWS, May 30, 1990, at 27.

late 1970s, however, Japanese manufacturers have controlled more than 70% of the U.S. market for imported cars.³²

3. The Modern U.S. Automobile Market

The U.S. auto market today comprises six basic segments: budget and small cars, mid-range, upper mid-range, luxury, sporty cars, and specialty cars.³³ Many of these cars now compete directly with the market for light trucks, nearly half of which are minivans and sport-utility vehicles.³⁴ The Big Three dominate the U.S. light truck market, which expanded from 4.6 million vehicles in 1990 to 6.1 million in 1994—a 33% increase.³⁵ During the same period, the U.S. car market enjoyed only a 6% volume increase, from 6.8 million cars in 1990 to 7.2 million in 1994.³⁶ The Big Three produced more than 85% of the light trucks sold in the United States in 1994, while European manufacturers produced less than 1%.³⁷ Commentators have reported that consumers are purchasing light trucks to replace passenger cars, noting the light truck segment's growing share of the total U.S. motor vehicle market.³⁸

American and Japanese manufacturers are well represented in each segment of the U.S. car market, while European producers—with the single exception of Volkswagen—compete in only the upper mid-range, luxury, and specialty car seg-

32. See 1985 *Market Data Book*, *supra* note 12, at 24; 1990 *Market Data Book*, *supra* note 31, at 27; 1995 *Market Data Book*, AUTOMOTIVE NEWS, May 24, 1995, at 28. At the behest of the U.S. government in 1981, Japan instituted voluntary controls on the number of cars exported to the United States. Greg Johnson, *Free Market Again? Export Flood Unlikely, Despite End of VRA*, INDUSTRY WK., Apr. 1, 1985, at 17. Without such controls, the Japanese share of the total U.S. import market likely would have been even larger.

33. 1995 *Market Data Book*, *supra* note 32, at 30. Different commentators may use different terminology or subdivide the market into a different number of segments, but the basic idea remains the same. See, e.g., MAXTON & WORMALD, *supra* note 31, at 61-65 (dividing the market into subcompact, compact, mid-size, full-size luxury, small-specialty, and mid-specialty segments).

34. 1995 *Market Data Book*, *supra* note 32, at 30; Phil Katcher, *Where is the Market Going?*, AUTOMOTIVE MARKETING, June 1, 1993, at 47.

35. 1995 *Market Data Book*, *supra* note 32, at 28.

36. *Id.*

37. *Id.*

38. See, e.g., Katcher, *supra* note 34, at 47.

ments.³⁹ These segments accounted for sales of 2 million cars in 1994, 23% of the total U.S. car market.⁴⁰

The Big Three sold 5.7 million cars⁴¹ and 5.2 million light trucks⁴² in the United States in 1994, and reported record earnings of \$13.7 billion on total revenues of \$335.6 billion.⁴³ The domestic motor vehicle industry used nearly 20 million tons of steel (20% of domestic steel production),⁴⁴ employed over 800,000 American workers (5% of the domestic manufacturing labor force),⁴⁵ and sold more than \$400 billion in retail goods (20% of total domestic retail sales).⁴⁶

B. U.S. AUTOMOBILE FUEL ECONOMY REGULATIONS AND EXCISE TAXES

1. Fuel Economy Legislation

The U.S. government recognized long ago that the domestic automobile industry is among the most important political constituencies in the country.⁴⁷ The successes and failures of the

39. See *1995 Market Data Book*, *supra* note 32, at 25, 30. Volkswagen, which sold slightly more than 90,000 cars in the United States in 1994, competes in only the budget, mid-range, and sporty car segments. *Id.* The other European car manufacturers, such as BMW, Mercedes, Porsche, Volvo, Rolls-Royce, Ferrari, and Lamborghini, offer cars that compete in only the more expensive segments. *Id.*

In 1994, European imports accounted for 12% of the upper mid-range segment, 19% of the luxury segment, and 18% of the specialty segment. *See id.* at 30. Domestic manufacturers dominated the upper mid-range and luxury segments, and Japanese manufacturers accounted for close to half of the specialty segment in 1994. *See id.* at 30.

40. *Id.* at 25, 30.

41. *Id.* at 28. Domestic manufacturing facilities operated by Japanese auto makers accounted for sales of an additional 1.4 million new cars. *Id.*

42. *Id.*

43. *Big Three Bask in Big Bucks*, *WARD'S AUTO WORLD*, Mar. 1995, at 31.

44. Matthew J. Doherty, *Curtains Drop on Steel Boom*, *CINCINNATI ENQUIRER*, July 2, 1995, at G1.

45. U.S. DEP'T OF COMMERCE, *STATISTICAL ABSTRACT OF THE UNITED STATES* 1995 417 (1995).

46. *Id.* at 782.

47. Examples of this recognition include the Nixon Administration's action to repeal the 7% automobile excise tax in 1971 and the Reagan Administration's negotiation of the Voluntary Restraint Agreement with Japan in 1981. *See supra* notes 18 and 32. The bailout of Chrysler Corp. in 1980, however, is perhaps the most telling event in this regard. After years of requesting relief from federal fuel economy and emissions regulations, Chrysler's financial position finally became precarious enough to elicit \$1.2 billion in federal loan guarantees. *See HALBERSTAM, supra* note 17, at 557-59. These loan guarantees, combined with extensions of credit from trade creditors and the company's liquidation of its tank division and European manufacturing facilities, enabled

Big Three affect employment, the balance of trade, air pollution, national dependence on foreign oil, and a variety of other public issues. The U.S. government's frustration with OPEC, however, sometimes overshadowed even its concern for the short-term profitability of the Big Three. At the height of the fuel crises of the 1970s Congress enacted laws designed primarily to diminish the American appetite for gasoline. Rather than impose taxes to increase the pump price of gasoline and thus decrease the quantity demanded by consumers, Congress chose to impose fuel economy regulations on automobile manufacturers to decrease the quantity of fuel-inefficient cars available in the market.⁴⁸

a. *The CAFE Law*

In 1975, the United States enacted the CAFE law as part of the Energy Policy and Conservation Act.⁴⁹ The CAFE law imposes a penalty on any automobile manufacturer that fails to meet the fuel economy standard⁵⁰ for either its domestic fleet or its imported fleet. Each fleet's average fuel economy is calculated and, if below CAFE standards, penalized separately.⁵¹ Congress included this separate foreign fleet accounting requirement after intense lobbying by the United Automobile Workers

Chrysler to narrowly avert bankruptcy in the early 1980's. *Id.* Chrysler ultimately reaped huge financial rewards as a result of its successful front-wheel drive K-cars and minivans. *Id.* at 565-66.

48. Many commentators have opined that excise taxes on gasoline would be a more efficient mechanism to decrease domestic fuel consumption. *See, e.g.*, Pietro S. Nivola & Robert W. Crandall, *The Extra Mile: Rethinking Energy Policy for Automotive Transportation*, BROOKINGS REV., Jan. 1995, at 30; Gary Fauth, *Regulating the Automobile: Learning From Cost-Effective Analysis*, BUS. ECON., Oct. 1994, at 23. Although the CAFE law is the end-result of Congress' original fuel conservation objective, the regulation only indirectly affects total automobile fuel consumption, which is the product of miles driven and fuel economy. Fuel taxes or fuel rationing would directly affect total fuel consumption and would thus be the most efficient and effective methods of furthering fuel conservation goals. Such methods were evidently too unattractive from a political perspective, however, for Congress to consider them seriously.

Experts also contend that the popular technique of decreasing vehicle weight in order to meet fuel economy regulations has led to a decrease in vehicle safety. Robert W. Crandall & John D. Graham, *The Effect of Fuel Economy Standards on Automobile Safety*, 32 J.L. & ECON. 97, 100 (1989).

49. Pub. L. No. 94-163, 89 Stat. 871, 901-10 (current version at 49 U.S.C.A. §§ 32901-19 (West Supp. 1995)).

50. CAFE came into effect in 1978, and required fuel economy of at least 18 miles per gallon to avoid penalties. *Id.* at 902. The legislation called for fuel economy improvement over time until 1985, when the standard reached 27.5 miles per gallon. *Id.* This standard remains in effect today. 49 U.S.C.A. § 32902 (West Supp. 1995).

51. 49 U.S.C.A. § 32904(b) (West Supp. 1995).

to address the concern that the Big Three would rely on foreign manufacturing facilities to produce the massive amount of small, fuel-efficient cars that would be necessary to comply with the new law.⁵²

The U.S. government continues to look to the law as a means of inciting the Big Three to develop new fuel efficiency technologies.⁵³ As a practical matter, however, CAFE's mechanics have allowed domestic manufacturers to avoid penalties.⁵⁴ For example, light trucks are subject to a much lower CAFE standard than that imposed on automobiles.⁵⁵ Of the \$263 million in CAFE penalties assessed from 1980 to 1992, European manufacturers paid more than 99% of the total.⁵⁶

52. *Back to the Sad CAFE*, WALL ST. J., May 8, 1985, at 30; *UAW Backs CAFE Goals*, FOUNDRY MGMT. & TECH., Nov. 1989, at 8. In 1981, the Chairman of Ford Motor Co. described these requirements as protectionist, because they effectively prevented manufacturers from moving small car production offshore. *The Automobile Crisis and Public Policy*, HARV. BUS. REV., Jan.-Feb. 1981, at 73, 80. This view is supported by CAFE's legislative history:

[The] committee did not want the auto efficiency tax to provide a stimulus to increased imports of autos in view of the depressed state of the U.S. auto industry. The auto efficiency tax in the bill is designed to provide a significant amount of gasoline conservation without having an adverse effect on American jobs. . . . Furthermore, since a U.S. manufacturer who is also an importer must meet the standards on both his U.S. fleet and his imports separately in order to avoid tax, there is incentive to build fuel-efficient cars in the United States.

H.R. REP. NO. 221, 94th Cong., 1st Sess., at 15 (1975) (considering an early version of CAFE as part of the Energy Conservation and Conversion Act of 1975).

53. Max Gates, *Environmentalists Seek 60% Hike in CAFE: Clinton Panel Targets Emissions*, AUTOMOTIVE NEWS, Sept. 26, 1994, at 8. In 1990, Congress debated a bill that would increase the CAFE requirement from 27.5 miles per gallon to 40 miles per gallon over several years. *Id.* Although Congress has yet to take any action in this regard, many continue to advocate raising CAFE standards. *Id.*; Jayne O'Donnell, *Auto Future Hits a Roadblock: Washington Meetings Devolve into Car Not Talks*, AUTOWEEK, Oct. 2, 1995, at 4.

54. CAFE's weighted-average calculation operates to the benefit of full-line manufacturers like the Big Three, which have the ability to offset low-mileage models with the high-mileage models that they sell in great quantity. The law also allows manufacturers to earn credits for exceeding the CAFE standard in any given year and apply the credits against poor performance in any subsequent year. 49 U.S.C.A. § 32903 (West Supp. 1995).

55. *1995 Market Data Book*, *supra* note 32, at 58. The 1994 CAFE standard for trucks was 20.6 miles per gallon, roughly 25% lower than the 27.5 miles per gallon requirement for cars. *See id.* The Big Three produce the overwhelming majority of light trucks sold in the United States. *See supra* text accompanying note 35. For purposes of CAFE, minivans and sport-utility vehicles are light trucks. *See* 49 U.S.C.A. § 32901 (West Supp. 1995); 49 C.F.R. §§ 523.4, 523.5 (1995).

56. *United States: Taxes on Automobiles*, *supra* note 4, at para. 3.220.

b. *The Gas-Guzzler Tax*

In 1978, as part of the Energy Tax Act,⁵⁷ the United States enacted an excise tax (Gas-Guzzler Tax) on sales of domestic and imported automobile models that fail to meet certain fuel efficiency standards. For Gas-Guzzler Tax purposes, manufacturers determine the fuel efficiency of each model, and the tax applies to the sale of an automobile if that automobile model's fuel efficiency falls below federal standards.⁵⁸ The Gas-Guzzler Tax applies to each automobile produced by a manufacturer, as opposed to CAFE which applies to a manufacturer's fleet as a whole.

Congress doubled the Gas-Guzzler Tax in 1990,⁵⁹ when 44 of the 47 model types subject to the tax were of European manufacture.⁶⁰ Like the CAFE law, the Gas-Guzzler Tax allows domestic manufacturers to avoid much of the burden.⁶¹ Light trucks again receive favored treatment, as they are not subject to the Gas-Guzzler Tax at all.⁶² In 1992, European cars accounted for 85% of total Gas-Guzzler Taxes.⁶³

57. Pub. L. 95-618, 92 Stat. 3174, 3180-84 (1978) (current version at 26 U.S.C.A. § 4064 (West Supp. 1995)).

58. 26 U.S.C.A. § 4064 (West Supp. 1995). The law came into effect in 1980, at which point gas-guzzler taxes applied to automobile models with fuel economy below 15 miles per gallon. *Id.* The threshold increased annually until 1986, when the tax applied to automobile models with fuel economy below 22.5 miles per gallon. *Id.* This threshold remains in effect today. *Id.*

59. Pub. L. 101-508, § 11216, 104 Stat. 1388-437 (1990). Congress debated doubling the Gas-Guzzler Tax in 1988 as well, at which time New York Senator Alfonse D'Amato supported the proposed tax increase by observing that "[t]here are absolutely no domestic-made cars that are impacted by this tax." 134 CONG. REC. 1, 650-51 (1988).

60. *United States: Taxes on Automobiles, supra* note 4, at para. 3.110.

61. The Gas-Guzzler Tax allows manufacturers to average the mileage of different model configurations within a specific model type. 26 U.S.C.A. § 4064(b)(3), (c)(1) (West Supp. 1995). Although the average is weighted by sales of each model configuration, manufacturers who, like the Big Three, offer multiple configurations of each model type clearly benefit from the averaging mechanism. Further, the Tax requires manufacturers to include only the highest selling configurations in the model type average; additional configurations can be factored in at the manufacturer's discretion. *United States: Taxes on Automobiles, supra* note 4, at paras. 2.12-.13. In some cases, this averaging mechanism allows manufacturers to avoid Gas-Guzzler Taxes on cars that actually perform below the threshold, if other configurations of the same model perform above the threshold.

62. For purposes of the Gas-Guzzler Tax, minivans and sport-utility vehicles are light trucks. See 26 U.S.C.A. § 4064(b)(1)(B) (West Supp. 1995); 49 U.S.C.A. § 32901 (West Supp. 1995); 49 C.F.R. §§ 523.4, 523.5 (1995).

63. *United States: Taxes on Automobiles, supra* note 4, at para. 3.111.

2. Luxury Tax

In 1990, as part of the Omnibus Budget Reconciliation Act,⁶⁴ the United States enacted an additional excise tax (Luxury Tax) on retail sales of certain expensive goods. The Luxury Tax applied to sales of cars over \$30,000, boats over \$100,000, aircraft over \$250,000, jewelry over \$10,000, and furs over \$10,000.⁶⁵

Various parties influenced the Luxury Tax price threshold amounts. The threshold for cars vacillated between \$20,000 and \$30,000 in different pre-enactment versions of the Luxury Tax.⁶⁶ Within this range, a higher threshold is preferable for domestic manufacturers and a lower threshold is preferable for EC manufacturers.⁶⁷ Assuming that Congress was determined to levy a luxury tax on cars selling above some price between \$20,000 and \$30,000, domestic auto makers got the best threshold possible.⁶⁸

64. Pub. L. 101-508, 104 Stat. 1388, 1388-438 to -444 (1990) (current version at 26 U.S.C.A. §§ 4001-04 (West Supp. 1995)).

65. *Id.* The law included exemptions for cars, boats, and aircraft used primarily for business purposes (e.g., taxicabs, commercial fishing boats, and company jets). *Id.*

66. When first introduced in Congress, the Luxury Tax bill specified that it would apply to car sales over \$25,000; domestic automobile industry representatives lobbied for the increase to \$30,000. Robert M. McElwaine, *The War Between the Imports; the Import Automobile Business in the United States*, AUTO AGE, Aug. 1991, at 10. See also Bill Montague, *Congress Weighs Tax on Trappings of Rich*, USA TODAY, Sept. 12, 1990, at B1 (noting that a \$25,000 threshold would affect only 10% of all cars sold in the United States). In 1987 Congress considered an automobile luxury tax with a price threshold as low as \$20,000. First Submission of the United States to the Panel on United States - Taxes on Automobiles at para. 211 (Oct. 22, 1993). GATT Dispute Resolution Panel, *United States: Taxes on Automobiles*, GATT Doc. DS31/R, (panel report not adopted), reprinted in 33 I.L.M. 1397, para. 1.1 (1994).

67. In the *United States: Taxes on Automobiles* proceeding, U.S. representatives asserted (using EC estimates) that a \$20,000 threshold would affect 9.7% of U.S. car production and 71.6% of European imports. *United States: Taxes on Automobiles*, *supra* note 4, at para. 3.97. The \$30,000 threshold, in contrast, affects 2% of domestic production and 38.5% of European imports. *Id.* at paras. 3.90, 3.97. The lower threshold thus increases the number of American cars subject to the tax by a factor of nearly five but doesn't even double the number of European cars subject to the tax.

Most Americans spend less than \$20,000 when buying a new car; when the Luxury Tax came into effect in 1991, the average new car cost around \$16,500 in the United States. *Id.* at para. 3.93; see also 1993 *Market Data Book*, AUTOMOTIVE NEWS, May 26, 1993, at 61 (reporting that 1991 new car transaction prices averaged \$16,150 for domestic cars and \$18,200 for imported cars).

68. Although imported car dealers lobbied against the Luxury Tax from the beginning, the Big Three mounted no serious opposition to the tax until recently. See *infra* note 69. See also Lornet Turnbull, *Luxury Levy Less Taxing for Big 3*, CHI. TRIB., Aug. 29, 1993, § 17, at 7 (asserting that General Motors

Soon after Congress enacted the Luxury Tax, debate began regarding its repeal.⁶⁹ In 1993, Congress eliminated the Luxury Tax on boats, aircraft, jewelry, and furs, but retained the tax on automobiles, raising the threshold sale price to \$32,000.⁷⁰ The U.S. government collected \$226 million and \$311 million in automobile Luxury Taxes in 1991 and 1992, respectively.⁷¹ Unfortunately, neither the U.S. government nor any other entity has compiled comprehensive independent data with regard to the make of cars subject to the Luxury Tax.⁷²

supported the Luxury Tax because it provides a competitive advantage); Ameet Sachdev, *Full Assault on Luxury Tax on Cars*, CHI. TRIB., June 18, 1995, § 17, at 2 (quoting a National Automobile Dealers Association representative's statement that the Big Three avoided opposition to the Luxury Tax because it afforded a competitive advantage).

69. See, e.g., *Hearing to Examine the Impact of the 10 Percent Luxury Tax on Small Businesses: Hearing Before the Senate Committee on Small Business*, 102d Cong., 1st Sess. (1991). The overwhelming majority of the testimony presented at congressional hearings on the Luxury Tax concerned its devastating effects on the domestic boat manufacturing industry. See *id.* Of the ten industry representatives who presented statements to the Senate Committee on Small Business, only one represented a constituency associated with automobile manufacturing: Gary Olin of the American International Automobile Dealers Association testified regarding the negative impact of the Luxury Tax on sales of imported cars. See *id.* at 58-63. In contrast, six boat industry representatives from manufacturing and retailing associations, the Union of Shipbuilding Workers, and private businesses presented testimony at the hearings. See *id.*; see also *Miscellaneous Tax Bills—1991: Hearings on S. 90, S. 150, S. 267, S. 284, S. 649, and S. 913 Before the Subcommittee on Taxation of the Senate Committee on Finance*, 102d Cong., 1st Sess. (1991).

70. Pub. L. 103-66 § 13161(a), 107 Stat. 449 (1993) (amending 26 U.S.C. § 4001).

71. Response of the United States to the Panel's Questions Regarding the Luxury Tax at Attachment A-4, *United States: Taxes on Automobiles*.

72. Many commentators and industry analysts believe that European cars account for the bulk of Luxury Tax collections. See, e.g., Turnbull, *supra* note 68, at 7 (noting the statement of Susan Jacobs, president of a luxury car market analyst group, that "[t]here is no question that the impact of the tax has fallen almost exclusively on foreign brands"); Jim Henry, *Europeans See Luxury Tax as Slap*, AUTOMOTIVE NEWS, Aug. 23, 1993, at 3 (noting that in 1993, 52 series of European cars had models with base prices above the \$32,000 threshold, as opposed to only 11 series of American cars and 9 series of Japanese cars).

In connection with the *United States: Taxes on Automobiles* dispute resolution proceeding, the European Community commissioned an expert report for the purposes of estimating the Luxury Tax burden borne by European and American manufacturers. The expert found that 70% of the total Luxury Tax assessed in 1992 was associated with sales of European cars. The United States used a different methodology to estimate the comparative burden borne by each group of manufacturers, and concluded that the burden was shared more equitably. The United States methodology, however, resulted in an estimated total Luxury Tax amount that exceeded by more than 20% the total amount actually assessed by the U.S. Internal Revenue Service. The EC report

C. GATT'S LIMITATIONS ON INTERNAL TRADE RESTRICTING MEASURES

The GATT operates essentially as an international dormant commerce clause, ensuring that individual governments refrain from unreasonably interfering with the flow of goods across international borders. GATT Article III addresses "internal" taxes and regulations.⁷³ This includes taxes and regulations that, unlike tariffs and quotas, are imposed *after* products clear customs. Under Article III, imported goods are to receive "national treatment" for purposes of internal taxation and regulation.⁷⁴

reconciled to IRS information within three per cent. *United States: Taxes on Automobiles, supra* note 4, at paras. 3.8-3.21.

To determine the relative burdens of the luxury tax on domestic and EC producers, each party estimated the actual transaction prices at which dealers sold their cars. Both parties started with the manufacturer's suggested retail price ("MSRP"), which is readily available for any car sold in the United States. The parties diverged, however, in their approaches to adjusting MSRP to account for options and discounts. Essentially, the EC asserted that the average car sells at a price 10% below MSRP and the United States asserted that the discount should be 4%. *Id.*

73. GATT, *supra* note 2, art. III, para. 1. The Luxury Tax, for instance, is assessed at the point of sale to the consumer and is thus an internal tax for purposes of Article III. The full text of Article III:2 provides that:

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

Id. at para. 2. Paragraph four of Article III prescribes similar limitations on protectionist internal regulations other than taxes. The full text of Article III:4 provides that:

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.

Id. at para. 4.

74. Imported goods are to be treated no worse than domestically produced, or "national," goods. *See supra* note 3. The second sentence of Article III:2 explicitly invokes the national treatment provisions set forth in Article III:1 with regard to application of taxes and internal charges. *See supra* note 73. The national treatment concept differs from the most favored nation obligation of Article I, which seeks to ensure that all goods imported from parties to the GATT are treated similarly regardless of country of origin. *See GATT, supra* note 2, art. I, para. 1.

Article III:2 provides that imported goods will not be subject to taxes or other charges in excess of those applied to "like domestic products."⁷⁵ The text of Article III suggests a two-part examination: 1) whether the imported and domestic products concerned are "like," and 2) whether the internal taxation or other regulation discriminates against the like imported product.⁷⁶

Until recently, GATT panels in Article III cases employed a rather mechanical "like products" analysis that focused on the physical characteristics and end-uses of the products involved. In 1987, for example, a panel found that certain Japanese liquor taxes violated Article III after such an analysis.⁷⁷ The Panel summed up the relevant considerations to include "not only objective criteria (such as composition and manufacturing processes of products) but also the more subjective consumers' viewpoint (such as consumption and use by consumers)."⁷⁸ The Panel found that Japanese shochu and imported vodka "could be considered as 'like' products in terms of Article III:2 because they were both white/clean spirits, made of similar raw materials, and their end-uses were virtually identical (either as straight 'schnaps' [sic] type of drinks or in various mixtures)."⁷⁹ The Panel noted that "the aim of Article III:2 of ensuring neutrality of internal taxation as regards competition between imported and domestic like products could not be achieved if differential taxes could be used to crystallize consumer preferences for traditional domestic products."⁸⁰

75. See *supra* note 73.

76. GATT Dispute Resolution Panel, *Japan: Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34th Supp. 83, para. 5.5(d) (1987) (panel report adopted Nov. 10, 1987) [hereinafter *Japan: Alcoholic Beverages*] (citing GATT Dispute Resolution Panel, *EEC: Measures on Animal Feed Proteins*, BISD 25th Supp. 49 (1978) (panel report adopted Mar. 14, 1978)).

77. *Id.* at para. 5.6.

78. *Id.* at para. 5.7.

79. *Id.*

80. *Id.* The Panel also concluded that Article III prohibits protectionist tax treatment of imported products relative to "directly competitive or substitutable" domestic products. *Id.* at para. 5.7. The Panel found that shochu, vodka, and all other distilled liquors were directly competitive or substitutable, because "the flexibility in the use of alcoholic drinks and their common characteristics often offered an alternative choice for consumers leading to a competitive relationship." *Id.*

GATT Ad Article III provides the following insight relevant to the interpretation of Article III:2:

A tax conforming to the requirements of paragraph 2 would be considered to be inconsistent with the provisions of the second sentence only

Although independent from the GATT dispute resolution system, the European Court of Justice has employed a similar analysis in cases arising under Article 95 of the European Economic Community Treaty.⁸¹ In *Humblot v. Directeur Des Services Fiscaux*,⁸² the court considered a French tax on automobiles based on horsepower rating. Under the French law, all automobiles were subject to an annual tax that was progressive up to a certain horsepower rating, above which a special, much higher tax applied.⁸³ The court found that only foreign manufacturers produced cars above the special tax power threshold and thus concluded that the special tax was inconsistent with Article 95:

The . . . additional taxation is liable to cancel out the advantages which certain cars imported from other Member States might have in consumers' eyes over comparable cars of domestic manufacture In that respect the special tax reduces the amount of competition to which cars of domestic manufacture are subject and hence is contrary to the principle of neutrality with which domestic taxation must comply.⁸⁴

The court's holding depended upon its finding that cars above and below the special tax threshold competed against one an-

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.

GATT, *supra* note 2, Ad art. III, para. 2. The text of Article III:2 and Ad Article III thus leads to two separate determinations: first, whether imported products are taxed more than like domestic products; and second, whether imported products are taxed differently than directly competitive or substitutable domestic products so as to afford protection to domestic production. The line between like products on one hand and directly competitive and substitutable products on the other appears to be quite fine. Ad Article III would be meaningless, however, if its language were not more expansive than that of Article III:2, first sentence. This interpretation is implicit in *Japan: Alcoholic Beverages*; shochu and vodka were like products, but shochu, vodka, and all other distilled liquors were directly competitive or substitutable products.

81. The text of Article 95, practically identical to that of GATT Article III:2, provides that:

No Member State shall impose, directly or indirectly, on the products of other Member States any internal taxation of any kind in excess of that imposed directly or indirectly on similar domestic products. Furthermore, no Member State shall impose on the products of other Member States any internal taxation of such a nature as to afford indirect protection to other products.

TREATY ESTABLISHING THE EUROPEAN ECONOMIC COMMUNITY, [EEC TREATY] art. 95 (as amended 1987).

82. Case 112/84, 1985 E.C.R. 1367.

83. *Id.* at 1376. At the time of the complaint, the special tax was FF 5,000 and the highest rate of the progressive tax was FF 1,100. *Id.*

84. *Id.* at 1379.

other in the market.⁸⁵ In GATT Article III terms, the two groups of cars were “directly competitive or substitutable products,” if not “like products.”

In 1992, a GATT panel considering a variety of U.S. state and federal measures affecting alcoholic beverages established the modern Article III like products analysis.⁸⁶ The *United States: Alcoholic Beverages* panel found that “the limited purpose of Article III has to be taken into account in interpreting the term ‘like products’ in this Article.”⁸⁷ Under this interpretation, the imported and domestic goods at issue are like products only if the tax distinction is applied “so as to afford protection to domestic production.”⁸⁸

One of the many regulations at issue in *United States: Alcoholic Beverages* was a Mississippi state tax on wine that afforded special treatment to wine produced from a grape that grows only in the southeastern United States and the Mediterranean region.⁸⁹ After noting that this was a “rather exceptional basis for a tax distinction” and that the tax treatment implied “a geographical distinction which affords protection to local production of wine to the disadvantage of wine produced where this type of grape cannot be grown,” the Panel concluded that the Missis-

85. *Id.* The court observed that French consumers “would naturally choose from among cars above and below the critical power rating laid down by French law.” *Id.* It is important to note that the court found only the special tax offensive; the plaintiff did not allege that the progressive tax violated Article 95. The court suggested that the progressive tax was in keeping with the provisions of Article 95: “[M]ember States are at liberty to subject products such as cars to a system of road tax which increases progressively in amount depending on an objective criterion, such as the power rating” *Id.* at 1378. The court continued, however, to provide an important limitation, stating that a progressive tax is “compatible with Article 95 only in so far as it is free from any discriminatory or protective effect.” *Id.*

86. GATT Dispute Resolution Panel, *United States: Measures Affecting Alcoholic and Malt Beverages*, BISD 39th Supp. 206 (1992) (panel report adopted June 19, 1992) [hereinafter *United States: Alcoholic Beverages*]. Support remains, however, for the mechanical Article III like products analysis. A WTO dispute settlement panel recently followed the *Japan: Alcoholic Beverages* approach in its like products examination under Article III:4. WTO Dispute Settlement Panel, *United States: Standards for Reformulated and Conventional Gasoline*, WTO Doc. WT/DS2/R, para. 6.8 (1996).

87. *United States: Alcoholic Beverages*, *supra* note 86, at para. 5.25. According to the Panel, this limited purpose did not include infringing upon national and state fiscal and regulatory powers, except to the extent that such powers were used to afford protection to domestic production. *Id.*

88. *Id.* (quoting GATT, *supra* note 2, art. III, para. 1).

89. *Id.* at para. 5.26.

sippi wine tax was inconsistent with Article III:2.⁹⁰ The Panel applied this like products analysis to each of the facially neutral measures challenged under Article III.⁹¹

By considering the purpose of a challenged measure as well as the physical characteristics of the products involved, the modern approach to Article III allows governments more freedom to employ regulations with genuinely inadvertent and insignificant disproportionate burdens upon foreign producers. The *United States: Alcoholic Beverages* panel, however, may have opened the door to an interpretation of Article III that significantly expands GATT's tolerance of regulatory protectionism.

II. UNITED STATES: TAXES ON AUTOMOBILES SLAMS THE BRAKES ON ARTICLE III:2

The *United States: Taxes on Automobiles* Panel began its like products analysis by noting that two products could never be exactly the same in all respects.⁹² Following the lead of *United States: Alcoholic Beverages*, the Panel abandoned strict textual interpretation⁹³ and considered Article III's policy objec-

90. *Id.* The Panel made clear that it considered the second sentence of Article III:2 distinct from the first sentence:

[E]ven if the wine produced from the special variety of grape were considered unlike other wine, the two kinds of wine would nevertheless have to be regarded as 'directly competitive' products in terms of the Interpretive Note to Article III:2, second sentence, and the imposition of a higher tax on directly competing imported wine so as to afford protection to domestic production would be inconsistent with that provision.

Id.

91. *Id.* at paras. 5.73-77. Like product issues arise in Article III:4 claims as well as Article III:2 claims. For instance, the *United States: Alcoholic Beverages* panel determined that 3.2% beer and beer with higher alcoholic content were not like products for purposes of Article III:4. *Id.* In its determination, the Panel noted that the regulatory distinction was facially neutral, that both domestic and foreign manufacturers produced both types of beer, that "consumers who purchase low alcohol content beer may be unlikely to purchase beer with a higher alcohol content and vice versa," that "manufacturers target these different market segments in their advertising and marketing," and that non-protectionist policy goals explained the distinction. *Id.* at paras. 5.73-74.

Unlike Article III:2, Article III:4 includes no direct reference to the national treatment provisions of Article III:1. As a result, Article III:4 does not explicitly require determination of a regulation's protectionist effect or purpose, as does the second sentence of Article III:2. *See supra* note 73. Nevertheless, the *United States: Alcoholic Beverages* panel indicated that Article III requires the same like product analysis for purposes of both paragraph two and paragraph four. *United States: Alcoholic Beverages, supra* note 86, at para. 5.71.

92. *United States: Taxes on Automobiles, supra* note 4, at para. 5.6.

93. *Id.* The Panel rejected the mechanical like products analysis, because legitimate (*i.e.*, non-protectionist) government purposes might be served by reg-

tive to "prohibit regulatory distinctions between products applied so as to afford protection to domestic production."⁹⁴ To carry out this objective, the Panel reasoned that Article III:2 need only invalidate taxes with the "aim and effect" of protecting domestic production.⁹⁵ Tax distinctions fail this new test if: 1) protectionism was a "desired outcome and not merely an incidental consequence of the pursuit of a legitimate policy goal," and 2) the distinctions accord "greater competitive opportunities to domestic products than to imported products."⁹⁶

A. THE LUXURY TAX

The Panel discounted legislative history as a source of enlightenment regarding the desired outcome of the Luxury Tax.⁹⁷ The Panel relied instead on the "wording of the legislation as a

ulatory distinctions between products that were not based on the products' end-uses, physical characteristics, or other criteria enumerated in prior panel reports. *Id.* at para. 5.8. Article III:2 should not prohibit "government policy options, based on products, that were not taken so as to afford protection to domestic production." *Id.*

94. *Id.* at para. 5.7. The Panel derived this objective from paragraph one of Article III, which states essentially that internal regulations "*should* not be applied . . . so as to afford protection to domestic production." *Id.* (emphasis added). Paragraphs two, four, and five of Article III are stated in mandatory, rather than hortatory, language and provide specific prohibitions with regard to internal taxes, regulations, and quantitative restrictions. See *supra* notes 3, 73 for the complete text of Article III:1 and 2.

95. *United States: Taxes on Automobiles*, *supra* note 4, at para. 5.10. In other words, the products between which a tax distinguishes are "like products" only if the aim and effect of the distinction is to afford protection to domestic suppliers. The Panel found that the phrase "so as to" in Article III:1 suggested both aim and effect. *Id.* (citing WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY OF THE ENGLISH LANGUAGE (UNABRIDGED)).

96. *Id.* The Panel stated that the desired outcome of a particular tax should be demonstrated by "the instruments available to the contracting party to achieve the declared domestic policy goal." *Id.* The Panel recognized that its like products analysis rendered the second sentence of Article III:2 impotent: "Having found in its examination under Article III:2, first sentence, . . . that the measure was not applied so as to afford protection, the Panel concluded that the measure at issue was consistent also with the Article III:2, second sentence." *Id.* at para. 5.16.

97. *Id.* at para. 5.12. The Panel suggested that legislative history may be relevant to the determination of legislative intent but ignored such information in this case. *Id.* The Panel noted that the EC had presented statements of legislators indicating that the Luxury Tax threshold targeted foreign producers; the Panel's report, however, did not include examples of the statements. *Id.* The EC's submissions to the Panel are not publicly available. See *supra* notes 66-69 and accompanying text for available information regarding the purpose of the Luxury Tax.

whole.⁹⁸ The apparent policy objective of the Luxury Tax was to generate federal revenue from sales of luxury goods.⁹⁹

Determining the effect of the Luxury Tax was not so easy. After considering conflicting quantitative evidence presented by the EC and the United States, the Panel remained uncertain about the actual effect of the Luxury Tax on competitive conditions.¹⁰⁰ Qualitative factors proved more useful, however. After noting that “a selling price above \$30,000 did not appear . . . to be inherent to EC or other foreign automobiles” and that “the threshold did not appear arbitrary or contrived in the context of the policies pursued,” the Panel concluded that the effect of the Luxury Tax was not protectionist.¹⁰¹

Because the Panel found neither protective aim nor protective effect, automobiles above and below the Luxury Tax price threshold were not like products for purposes of Article III:2.¹⁰² The distinction between cars above and below the threshold price was thus consistent with GATT.¹⁰³

B. THE GAS-GUZZLER TAX

The Gas-Guzzler Tax presented a more complicated set of facts for the Panel. The Luxury Tax distinguished only between cars above and below the price threshold. The Gas-Guzzler Tax, however, distinguished between: 1) cars above and below the fuel economy standard, 2) cars below the standard and lacking access to model-type averaging and cars below the standard but benefitting from model-type averaging, and 3) cars below the standard and light trucks.¹⁰⁴ The Panel evaluated the three dis-

98. *United States: Taxes on Automobiles, supra* note 4, at para. 5.12.

99. *Id.* The Panel did not point to specific language in the legislation relevant to its conclusion regarding the aim of the Luxury Tax.

100. *Id.* at para. 5.13. The EC submitted data indicating that 85% of cars sold in 1991 at prices just under the Luxury Tax threshold were of domestic manufacture, while only 40% of cars sold above the threshold were domestic. *Id.* The United States estimated that only 42% of cars sold below the threshold were domestic, and that 90% of cars sold above the threshold were domestic. *Id.* See *supra* note 72 for a description of the analytical bases underlying each party's estimates.

101. *United States: Taxes on Automobiles, supra* note 4, at para. 5.14. The Panel observed further that “many Japanese and other foreign models were in fact exported to the United States and sold for below \$30,000.” *Id.* In addition, the Panel observed that “there was no sudden transition to a higher tax at the threshold.” *Id.* Cf. Humblot 1985 E.C.R. 1367 (finding that the special tax affected only foreign producers).

102. *United States: Taxes on Automobiles, supra* note 4, at para. 5.15.

103. *Id.*

104. *Id.* at para. 5.23.

inctions separately to determine whether Congress made each distinction with the aim and effect of protecting domestic production.

The Panel made quick work of the distinction between cars above and below the fuel economy threshold. The U.S. assertion that Congress designed the Gas-Guzzler Tax to conserve fossil fuels carried the day, despite arguments that the U.S. government had other more effective and less trade-distorting methods of furthering this policy goal.¹⁰⁵ Similarly, the effect of the Gas-Guzzler Tax was not protectionist. The Panel disregarded quantitative evidence that European automobiles bore the brunt of the tax, because "the technology to manufacture high fuel economy automobiles . . . was not inherent to the United States, nor were low fuel economy automobiles inherently of foreign origin."¹⁰⁶ The distinction was thus not protectionist in effect.

With regard to the second distinction, based on model-type averaging, the Panel found that the United States had articulated policy reasons that justified the distinction.¹⁰⁷ The government's need to obtain fuel economy information quickly required tests on a limited sample of cars and averaging based on sales estimates.¹⁰⁸ The aim of the distinction was thus consistent with the overall fuel conservation goal and not protectionist.¹⁰⁹ Although the model-type averaging mechanism might ultimately tax similar cars differently, the Panel concluded that the effect of the distinction was not to protect domestic production.¹¹⁰ Because foreign manufacturers were not "inherently" limited to offering a smaller number of model variations than domestic manufacturers, the distinction's effect was not to alter the conditions of competition in favor of domestic production.¹¹¹

The Panel also accepted the offered policy reasons for the tax distinction between cars and light trucks. The United States argued that the government desired to avoid Gas-Guzzler Taxes on vehicles "which for technical reasons owing to their commer-

105. *Id.* at para. 5.24.

106. *Id.* at para. 5.25.

107. *United States: Taxes on Automobiles*, *supra* note 4, at para. 5.29.

108. *Id.* To administer the Gas-Guzzler Tax, the government needs fuel economy information *before* the manufacturers sell the cars. Assuming that the manufacturers are ignorant of each model's fuel economy characteristics until they perform the post-production tests, the gas-guzzler tests must be performed during the limited time-frame between production and sale.

109. *Id.*

110. *Id.* at 5.31.

111. *Id.*

cial or utilitarian use had relatively lower fuel economy.”¹¹² Although more efficient means might be available to encourage higher fuel economy, the Panel found the aim of the distinction consistent with the fuel conservation objective.¹¹³ In a familiar refrain, the Panel also concluded that, because light trucks were not inherently of domestic manufacture, the effect of the distinction was not to afford protection to domestic production.¹¹⁴ The Gas-Guzzler Tax was thus consistent with Article III.¹¹⁵

III. FREE TRADE: CAN WE GET THERE FROM HERE?

The Panel stressed that its approach to solving the mysteries of Article III was nothing new,¹¹⁶ but a thorough review of the report reveals that a funny thing happened between the liquor store and the car lot. Article III's ban on regulatory protectionism had lost much of its punch since the Japanese and U.S. alcoholic beverages cases. Although the Panel's report—which the GATT never adopted—fell into the twilight zone between GATT dispute resolution procedures and the new WTO regime, the Panel's reasoning may affect future Article III disputes.¹¹⁷ Commentators have speculated that the Panel may have manufactured a rationale to appease congressional opponents to U.S. membership in the WTO.¹¹⁸ In any case, the Panel's reasoning was neither consistent with that of prior panels nor in the long term best interests of free international trade.

112. *United States: Taxes on Automobiles*, *supra* note 4, at para. 5.33.

113. *Id.* The Panel noted that many consumers used light trucks and cars for the same purposes, but concluded that “the efficiency of the measure was not by itself relevant in assessing its conformity under Article III.” *Id.*

114. *Id.* at para. 5.34.

115. *Id.* at para. 5.36.

116. *Id.* at para. 5.9 (“The Panel concluded that its interpretation was consistent with previous ones.”).

117. U.S. Trade Representative Mickey Kantor stated that he “would expect the panel's report to help steer the debate when GATT countries take up trade and environment issues under the new World Trade Organization.” *GATT Panel Rejects Key EU Challenges to U.S. Fuel Conservation Measures*, Int'l Trade Daily (BNA) (Oct. 4, 1994).

118. *See supra* note 5; *see also U.S. Stalling GATT Panel 'Gas Guzzler' Ruling, Sources Say*, Int'l Trade Daily (BNA) d5 (June 29, 1994) (“To head off congressional criticism while the Uruguay Round accord is before Congress, the United States is trying to delay or water down the pending panel report, according to EU and GATT sources.”); *Dismayed European Car Makers May Contest U.S. Car Tax Ruling*, Eur. Info. Service, Dec. 3, 1994, available in LEXIS, News Library (speculating that the European Union might file a new complaint under the new WTO system).

A. NATIONALISM IN THE DRIVER'S SEAT

The Panel based its interpretation of Article III:2 on that of the panels in *Japan: Alcoholic Beverages*¹¹⁹ and *United States: Alcoholic Beverages*.¹²⁰ Ironically, the liquor cases laid the foundation for GATT tolerance of facially neutral taxes, even as they found Mississippi wine and Japanese liquor taxes inconsistent with Article III:2.¹²¹ These taxes were offensive because the tax distinctions were unsupported by any objective basis. In the parlance of the *United States: Taxes on Automobiles* panel, no aim other than protectionism explained the tax distinctions. The European Court of Justice provided further conceptual support in *Humblot*, indicating that a progressive tax based on horsepower was not protectionist.¹²² Like a progressive tax based on alcohol content,¹²³ such a tax boasts the objective basis that generally legitimizes the purpose of the tax distinction.¹²⁴ The taxes at issue in *United States: Taxes on Automobiles*, however, were not so obviously offensive as the Mississippi wine tax or the extreme French horsepower tax. The Panel was thus compelled to develop a new mechanism for evaluating facially neutral regulations under Article III.

119. See *supra* notes 77-80 and accompanying text (describing the *Japan: Alcoholic Beverages* Panel decision).

120. See *supra* notes 86-91 and accompanying text (describing the *United States: Alcoholic Beverages* Panel decision).

121. *Japan: Alcoholic Beverages*, *supra* note 76, at para. 5.5 (c) ("Article III:2 was designed with 'the intention that internal taxes on goods should not be used as a means of protection.'") (quoting UN Conference on Trade and Employment, Reports of Committees, at 61 (1948)); *United States: Alcoholic Beverages*, *supra* note 86, at para. 5.25 ("[T]he purpose of Article III is not to prevent contracting parties from differentiating between different product categories for policy purposes unrelated to the protection of domestic production.").

122. 1985 E.C.R. at 1378. The court noted, however, that the progressive tax was valid "only in so far as it is free from any discriminatory or protective effect." *Id.* (emphasis added).

123. Prior panels have indicated that taxes based on alcohol content are generally consistent with Article III. See *United States: Alcoholic Beverages*, *supra* note 86, at paras. 5.73-5.77 (finding regulatory distinction between low alcohol and high alcohol beer consistent with Article III); *Japan: Alcoholic Beverages*, *supra* note 76, at para. 5.9(b) (suggesting that tax distinction based on alcohol content could be objective and thus consistent with Article III).

124. Objectivity is a common thread through various tribunals' conclusions regarding allegedly protectionist internal trade measures. See, e.g., *Japan: Alcoholic Beverages*, *supra* note 76, at para. 5.9(b); 1985 E.C.R. at 1378 ("Member States are at liberty to subject products such as cars to a system of road tax which increases progressively in amount depending on an objective criterion."). In this context, however, objectivity is a rather indefinite concept.

1. New in 1995 Models: The Aim and Effect Test

The Panel made some significant leaps to arrive at the “aim and effect” test. In particular, prior panels had not required such a clear showing of both protectionist purpose and protectionist result.¹²⁵ The text of the GATT suggests that Article III analysis should focus primarily on the protectionist effects of trade measures.¹²⁶ The GATT explicitly provides for consideration of a measure’s purpose under Article XX, which provides guidance as to which aims the contracting parties agree are legitimate.¹²⁷

125. The *United States: Alcoholic Beverages* panel was not so unequivocal that Article III prohibited only those measures implemented with protectionist intent and effect. With regard to the Mississippi wine tax, the Panel stated:

the particular distinction in the Mississippi law in favour of still wine of a local variety must be presumed, on the basis of the evidence submitted to the Panel, to afford protection to Mississippi vintners. Accordingly, the Panel found that the lower rate of excise tax applied by Mississippi to wine produced from the specified variety of grape, which lower rate is not available to the imported like product from Canada, is inconsistent with Article III:2, first sentence.

United States: Alcoholic Beverages, *supra* note 86, at para. 5.26. Although the Panel noted that the only asserted purpose of the distinction was to subsidize local producers, the report included no explicit conclusion that the purpose of the distinction was to afford protection to domestic production. Rather, the apparent purpose of the tax distinction was only one of many considerations relevant to determining whether the tax was applied so as to protect domestic production.

Similarly, with regard to the regulatory distinction between high alcohol and low alcohol beer, the Panel performed a detailed examination of the intent and effect of the distinction and ultimately concluded that “there was no evidence . . . that the choice of the particular level has the purpose or effect of affording protection to domestic production.” *Id.* at para. 5.74 (emphasis added).

Further, the Panel made clear that the second sentence of Article III:2 and the Ad Note to Article III required an independent determination of whether the imported and domestic products were directly competitive or substitutable. *See supra* note 90.

126. The text of Article III:2 is phrased in terms of effect only. *See supra* note 73. Such phrasing makes sense in the context of GATT Article XX. Article XX allows for exceptions to the obligations created by other articles in the GATT, including Article III, when such exceptions are related to or necessary to further certain enumerated policy goals. GATT, *supra* note 2, art. XX. The Panel’s analysis of a tax distinction’s purpose in the context of Article III renders Article XX impotent. Under the Panel’s approach, Article III prohibits only those measures that are implemented clearly for the purpose of protecting domestic production. Article XX will obviously not provide exceptions for any such measures and thus becomes irrelevant.

127. The Panel’s approach assumes that protectionism is an acceptable side effect of any internal measure that is at least arguably aimed at furthering a non-protectionist goal. Such an assumption is at odds with the GATT in general, which attempts to channel protection through tariffs and domestic subsidies.

2. Politicians Aim To Please

Even accepting the "aim and effect" test, the Panel endorsed the proffered U.S. "aims" of the Luxury and Gas-Guzzler Tax distinctions without much real examination.¹²⁸ What legislative history exists indicates that domestic industry interests influenced the Luxury Tax price threshold.¹²⁹ The circumstances surrounding the Energy Policy and Conservation Act and the Energy Tax Act suggest that the U.S. auto industry negotiated relatively favorable terms for implementing the fuel economy legislation as well.¹³⁰

That is not to say that GATT does not allow for protection in any other forms. Article XX provides for exceptions from GATT obligations when necessary, for example, to protect public morals; to protect human, animal or plant life or health; to protect national treasures; and to secure compliance with laws or regulations not inconsistent with other provisions of the GATT. GATT, *supra* note 2, art. XX (a), (b), (f), (d). Article XX also excepts measures relating to the conservation of exhaustible natural resources and to the products of prison labor, among others. GATT, *supra* note 2, art. XX (g), (e). Article XX's exceptions to GATT obligations are based on policy goals ostensibly shared by the contracting parties. The goals of measures satisfying the Panel's interpretation of Article III may or may not be shared throughout the GATT membership.

128. With regard to the Luxury Tax, the Panel proclaimed that the price threshold was consistent with "the policy objective apparent in the legislation, to raise revenue from sales of perceived 'luxury' products." *United States: Taxes on Automobiles*, *supra* note 4, at para. 5.12. The Panel alluded to no specific language in the act or the legislative history to support the notion that Congress established the price threshold upon finding that the \$30,000 price divided the luxury and non-luxury segments of the car market. *See supra* notes 66-72, 97 and accompanying text.

The Panel found that the Gas-Guzzler Tax distinctions would indirectly lead to conservation of fossil fuels and were necessary to obtain accuracy and efficiency. *United States: Taxes on Automobiles*, *supra* note 4, at paras. 5.24, 5.29. These observations provided a basis for endorsing the U.S. argument that the purpose of the distinctions was to conserve fuel. Further, the Panel found that Congress' legitimate aim in distinguishing between cars and light trucks for the Gas-Guzzler Tax was to avoid taxing "vehicles which for technical reasons owing to their commercial or utilitarian use had relatively lower fuel economy." *Id.* at para. 5.33. The Panel neglected to explain why commuting in a Range Rover should be considered utilitarian while doing so in a Testarossa should not. Indeed, the Panel's reasoning begs for evidence that drivers use sport-utility vehicles predominantly for utilitarian or commercial purposes. *See supra* text accompanying note 38.

The Panel discounted the argument that fuel conservation is only incidentally addressed by fuel economy regulation. *United States: Taxes on Automobiles*, *supra* note 4, at para. 5.24. The Gas-Guzzler Tax, as opposed to a fuel tax, for instance, may or may not effect total fuel consumption. *See supra* note 48.

129. *See supra* notes 66-72 and accompanying text.

130. The general economic conditions in the United States, as well as the influx of imports, in the years preceding CAFE, led to congressional sensitivity

This might seem like a lot of heavy lifting to find a protectionist aim, but without a comprehensive review of a measure's real goal, the Panel's approach will allow national governments to get away with the free trade equivalent of murder. The U.S. Supreme Court concluded long ago that a superficial examination of regulatory purpose was insufficient for DCC purposes: "[The view] that the ordinance is valid *simply because it professes to be a health measure*, would mean that the Commerce Clause of itself imposes no limitations on state action . . . save for the rare instance where a state artlessly discloses an avowed purpose to discriminate against interstate goods."¹³¹

The history of the fuel economy regulations can be framed in a manner that illustrates how protectionism might creep into otherwise non-protectionist legislation. First, Congress recognizes the problems associated with the oil crises. Debate ensues regarding various measures—including fuel taxes, gasoline rationing, and fuel economy taxes and penalties—to reduce the immense, and growing, amount of gasoline Americans consume driving their cars. The oil and gas industry lobbies successfully against the fuel tax, voters indicate that gasoline rationing is politically unacceptable, and automobile fuel economy regulation emerges as the best option. Domestic automobile industry interests give up on derailing CAFE and the Gas-Guzzler Tax in their entirety and lobby instead for legislation that allows domestic producers to suffer less than foreign producers.

to the United Automobile Workers' support for CAFE's separate foreign fleet accounting requirements. See *supra* note 52 and accompanying text. Congress also enacted the Gas-Guzzler Tax during this era of paranoia regarding the growing number of imported automobiles. Congress acknowledged and endorsed the protectionism furthered by the Gas-Guzzler Tax in 1988, when considering an increase in the tax, and again in 1990, when Congress doubled the tax. See *supra* note 59 and accompanying text.

The Panel also ignored the possibility that the aims of fuel economy legislation have changed during the twenty years since Congress passed the laws. Although fuel conservation may have been the primary goal furthered by CAFE and the Gas-Guzzler Tax in the 1970's, current circumstances indicate that these measures have been ineffective in that regard for some time. See *supra* notes 48-63 and accompanying text.

131. *Dean Milk Co. v. City of Madison*, 340 U.S. 349, 354 (1951) (emphasis added). Unlike the DCC, however, the GATT provides an additional remedy in certain circumstances even when the challenged regulations are not violative. GATT Article XXIII allows contracting parties to extract concessions in cases of "nonviolation" nullification or impairment of GATT benefits. GATT, *supra* note 2, art. XXIII. Practically speaking, the nonviolation remedy is available only when a new regulation effectively negates a recent tariff concession.

3. The Role of "Inherence" in Assessing Protective Effects

The Panel expressed concern for the "inherent characteristics" of domestic and foreign automobile manufacturers when evaluating the effects of the challenged measures.¹³² Unfortunately, the Panel offered little insight into the analytical link between inherence and protective effects. Apparently, in the Panel's view, a tax distinction is protective in effect only if inherent characteristics prevent foreign producers from avoiding excessive regulatory burdens in the long term.

A simple hypothetical illustrates this point. The farmland of Country A yields apples but no other fruit. Country B's fruit producers cultivate only bananas, and their harvest always exceeds domestic consumption. Country B thus exports bananas to Country A. Ostensibly to reduce the large amount of banana peels inundating national landfills (and after extensive lobbying by apple industry representatives citing the rapid biodegradability of apple cores), Country A imposes a 10% excise tax on all fruit with skin not normally eaten with the fruit itself. Assuming versatile soil and climate conditions in Country B, the Panel's analysis would suggest that such a tax has no protective effect, because Country B's banana producers could shift their production to apples (or pears, plums, strawberries, etc.). Of course, such a shift would require several years and a lot of money, but they could do it. This tax would not result in a protective effect under the Panel's test.

The Panel's view of inherence disregards economic reality. Particularly in a capital intensive industry, such as automobile manufacturing, the costs to a producer of changing market specialization in foreign markets are astronomical.¹³³ A foreign producer who, in response to new taxes or domestic regulations,

132. The Panel noted repeatedly that the Luxury and Gas-Guzzler Taxes took advantage of no "inherent" characteristics of foreign automobile producers. See *supra* text accompanying notes 101, 106, 111, 114.

133. Significant economic barriers block new entrants to certain automobile market segments. The costs associated with new designs, new or reengineered manufacturing facilities, advertising, and new dealer relationships, among many other factors required to compete in a new market segment, would be staggering for any manufacturer. In light of such costs, the limited-line producers that import the bulk of European cars into the United States are practically powerless to shift their production to the high volume budget or mid-size car segments. Foreign full-line manufacturers, such as Renault and Peugeot, could possibly absorb such costs, which would be lower for them as they already compete abroad in most segments. These manufacturers, however, abandoned the U.S. market several years ago. See *supra* notes 33-40 and accompanying text.

“chooses” to change or expand its market specialization provides a significant competitive advantage to “lucky” domestic producers whose market specializations are unaffected by the new measures.¹³⁴

Further, the Panel justified its conclusion that the Luxury Tax exploited no inherently foreign characteristics by observing that Japanese auto manufacturers compete strongly in the lower-price segments of the U.S. market.¹³⁵ Such reasoning, however, effectively tolerates discrimination against one group of foreign competitors, so long as some other foreign competitors are not unduly burdened. The Panel would apparently find a protective effect only when a regulation imposes a disproportionate burden on *all* foreign producers. The existence of a group of unaffected foreign competitors does not independently show that a domestic regulation is non-discriminatory with regard to a different group of foreign competitors.

When assessing a measure's protective effect, inherent characteristics should be considered in the context of examining the costs associated with avoiding excess regulatory burdens. Unless the cost of shifting from the overburdened foreign producer's market position to the relatively favored domestic producer's market position are insignificant, the regulation creating the burden is protective, regardless of inherent characteristics.¹³⁶ When the costs of such a shift are extreme, the existing market positions may effectively be inherent, at least for purposes of the Panel's analysis.

134. For example, a tax that is implemented such that full-line manufacturers can substantially avoid the tax presents a quandary to the foreign limited-line manufacturer competing in only the tax-burdened segments of the market. On one hand, the foreign manufacturer can absorb the enormous costs and risks associated with attempting to become a full-line competitor in the domestic market. On the other hand, it can incur the significant, but not so enormous, costs associated with paying the tax and providing a competitive advantage in their market segments to domestic full-line producers, who pay little or none of the new tax. Regardless of the strategy chosen by the foreign manufacturer, the tax affords protection to domestic production, at least in the short term.

135. See *supra* note 101.

136. An exception may be regulations that correct prior distortions of trade. Instead of protecting domestic industry from foreign competition, such regulations negate protective or otherwise distortive measures undertaken by foreign governments.

B. GETTING BACK ON THE ROAD TO FREE TRADE

The Panel's approach could negate the purpose of Article III, at least in the area of internal taxes.¹³⁷ Several alternative approaches to Article III could preserve its purpose, each satisfying nationalist and free trade objectives to varying degrees.

1. Old Textualist Approach

The *Japan: Alcoholic Beverages* panel strayed little from the text of Article III. The panel determined whether the imported and domestic products were alike by focusing on the effects of the challenged tax distinctions.¹³⁸ If the taxed imported product shared certain characteristics (e.g., material content, end-use) with the untaxed domestic product, the tax distinction violated Article III. The regulating party could then avail itself of Article XX to justify a violation.¹³⁹

This approach boasts a clean mechanical precision, as well as predictability. It is vulnerable to criticism, however, particularly in cases involving facially-neutral measures that only incidentally burden imports. Article XX's exceptions are neither broad nor flexible enough to mollify its critics, who oppose the least restrictive alternative requirement implied in several provisions,¹⁴⁰

137. The *United States: Taxes on Automobiles* Panel clearly restricted the power of Article III:2; its evaluation of Article III:4 was much less conclusive. Perhaps because CAFE required classification of foreign and domestic products, the Panel had an easier time finding the law inconsistent with Article III. The Panel did not, however, state explicitly that it based its opinion on facial discrimination. See *United States: Taxes on Automobiles*, *supra* note 4, at paras. 5.44-5.55. A key issue in both provisions of Article III is that regarding like products. As stated by previous panels, like products analysis should be the same for both Article III:2 and Article III:4. See *supra* note 91.

138. See *supra* notes 78-79 and accompanying text. The *United States: Alcoholic Beverages* Panel considered these factors, as well as the apparent purpose of the regulatory distinction. See *supra* notes 87-91 and accompanying text.

139. See *supra* notes 126-27.

140. Certain provisions under Article XX except only those measures that are "necessary" to further the approved policy goal. Panels have interpreted this language to provide exceptions only for measures for which there is no less trade restrictive alternative means of furthering the policy goal. See, e.g., *Thailand: Restrictions on Importation of and Internal Taxes on Cigarettes*, BISD 37th Supp. 200, paras. 73-75 (1990) (panel report adopted Nov. 7, 1990).

In the case of CAFE and the Gas-Guzzler Tax, for instance, Congress had available to it a variety of less trade-restrictive means of achieving fuel conservation. Of the available alternatives, many experts favored fuel taxes, which would have addressed the consumption problem directly and less expensively. See *supra* note 48. Also, Congress could have formulated the Gas-Guzzler Tax without the model-type averaging requirement, and CAFE without separate foreign fleet accounting. Further, if the U.S. government had simply

as well as the harsh burden of proof on the regulating party.¹⁴¹

As a practical matter, Article XX would require substantial reworking before nationalists and environmentalists would subscribe to the textual interpretation of Article III. Considering the near-Herculean efforts required to implement changes to the GATT, widespread acceptance of the textual approach is not likely.¹⁴²

2. Modified *United States: Taxes on Automobiles* Approach

As described above, the textual approach is quite rigid. At the other end of the spectrum, the Panel's approach in *United States: Taxes on Automobiles* condones a great deal of incidental protectionism. Slight adjustments to elements of the Panel's test, however, yield an approach that falls somewhere between the two extremes.

As shown in Figure 1, the Panel would find an internal tax inconsistent with Article III only if: a) its clear purpose was to protect domestic production; b) it did, in effect, protect domestic production; and c) the protective effect was the result of characteristics inherent to foreign producers. A tax lacking one of these requirements would be consistent with GATT.

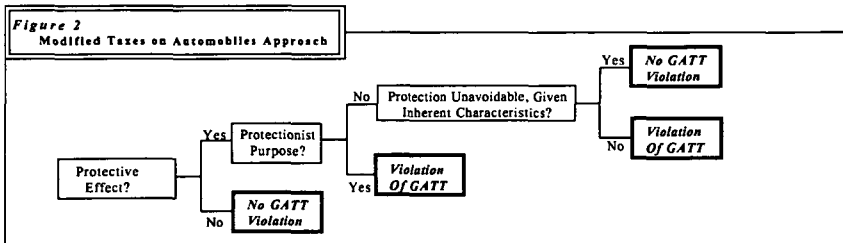
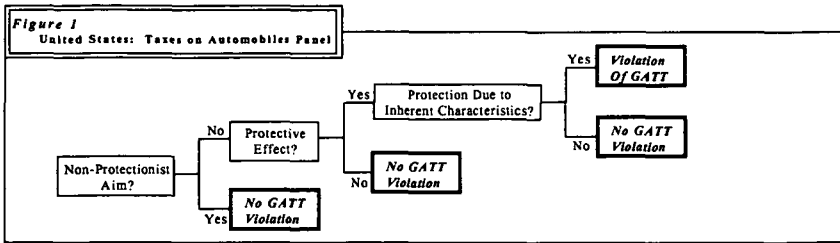
The modified *United States: Taxes on Automobiles* approach, illustrated in Figure 2, moves away from the nationalist extreme by tweaking the Panel's considerations. Of course, a tax that produces no protective effect is consistent with Article

allowed the market to determine the price of gasoline in the first place, the fuel economy regulations would likely have been unnecessary. See *supra* notes 17-25 and accompanying text. High gas prices would have stimulated consumer demand for fuel-efficient cars in the early 1970's and incited the Big Three to alter their designs without government action. See *supra* notes 17-25 and accompanying text. Similarly, higher progressive income tax rates (among other alternatives) would serve the same goals as the Luxury Tax without its trade-restrictive effects.

The least restrictive alternative requirement, coupled with the limited number of approved policy goals and other aspects of Article XX, restrict each nation's legislative freedom to a certain extent. For some, notably environmentalists, this restriction is excessive. See, e.g., Alberto Bernabe-Riefkohl, "To Dream the Impossible Dream": *Globalization and Harmonization of Environmental Laws*, 20 N.C. J. INT'L L. & COM. REG. 205, 218-20 (1995).

141. Once a claimant has shown that the challenged measure is inconsistent with the GATT, the burden of showing that the inconsistency is justified under Article XX shifts to the regulating nation. *United States: Alcoholic Beverages*, *supra* note 86, at para. 5.41.

142. A WTO panel recently employed the textual approach to like products analysis in a case under Article III:4, however. See *supra* note 86.



III. The Panel's manipulation of the other two factors, however, is puzzling. By requiring an avowed protectionist purpose, the Panel endorses all incidental protection. Panels could avoid the resulting *Dean Milk* problem¹⁴³ by considering an avowed protectionist purpose an Article III violation without further inquiry.

Further, a tax with a protective effect but lacking a protectionist purpose should be valid only if the protective effect is unavoidable, given the tax's non-protectionist objective and the inherent characteristics of foreign and domestic producers. This least restrictive alternative requirement provides legislative freedom to regulate in such a way that burdens international trade, but only if such burdens are necessary to achieve non-protectionist objectives.

This approach fails to consider, however, that a regulation's incidental protective effects could conceivably be quite extreme relative to its non-protectionist objectives. This failure can be remedied by adding another factor to the analysis.

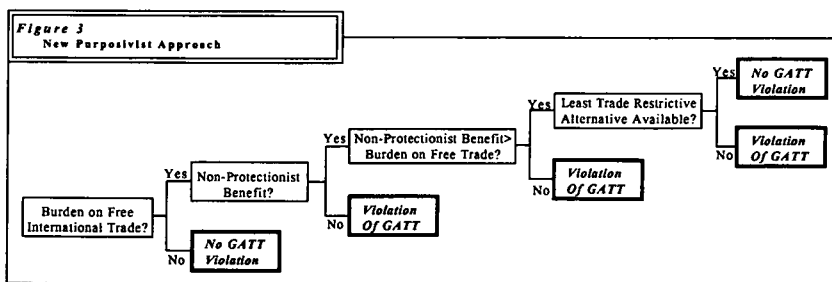
143. See *supra* text accompanying note 131.

3. New Purposivist Approach

Future panels will have to find and exploit the common ground between the free trade and nationalist interpretations of Article III if the WTO is to realize its full potential. This common ground might lie in an approach that balances the burden on free trade imposed by the challenged measures against the benefit realized as a result of the measures.

This approach is based upon the underlying purpose of Article III, much like the panels' interpretations in *United States: Alcoholic Beverages* and *United States: Taxes on Automobiles*.¹⁴⁴ The measures at issue in *United States: Measures Affecting Alcoholic and Malt Beverages* were too black-and-white to flush out much in the way of balancing benefits and burdens.¹⁴⁵ The essence of the *United States: Taxes on Automobiles* approach, however, can be stated in terms of a benefit-burden test: If no benefit (or "goal" or "aim") other than protectionism can be attributed to the measure, then no burden on free trade is tolerable, but if any benefit other than protectionism can be attributed to the measure, then any burden on free trade is tolerable. This test avoids the harshness of the textual approach but swings too far back into nationalism to achieve anything approaching free trade.

Under a more neutral purposivist approach, illustrated in Figure 3, panels would first assess the burden of an internal



measure on free trade by comparing the imported and domestic products involved to determine whether the products compete

144. See *supra* notes 87-88, 94 and accompanying text (describing the panels' statements of the purpose of Article III).

145. The Mississippi wine tax presented a substantial burden on free trade and no non-protectionist benefit, while the 3.2 beer regulation presented an insignificant burden on free trade and substantial non-protectionist benefits. See *supra* notes 89-91 and accompanying text.

against one another and then evaluating the measure's effect on the conditions of competition between the products. Second, panels would examine the benefits of the measure, in terms of its apparent goals and results. Like the *United States: Taxes on Automobiles* test, if no benefits other than protection of domestic production are attributed to the measure, then no burden on free trade would be tolerated. Unlike the *United States: Taxes on Automobiles* test, however, non-protectionist benefits would not grant legislatures *carte blanche* to incidentally protect domestic industries. Only those measures that result in non-protectionist benefits exceeding the burden on free trade¹⁴⁶ and that represent the least trade restrictive means available to obtain the same non-protectionist benefits without incurring substantial additional cost¹⁴⁷ would be consistent with Article III.¹⁴⁸

The approach described above is obviously more rooted in policy than in the specific text of Article III.¹⁴⁹ Other GATT text, however, provides support for such a balancing test in similar contexts.

146. A panel estimating benefits and burdens in this context would obviously be painting with an extremely broad brush. Although comparisons of this type may sometimes yield inconclusive results, in certain circumstances the result might be quite clear. In response to Justice Scalia's criticism that balancing in this context is akin to determining "whether a particular line is longer than a particular rock is heavy," Professors Farber and Hudec note the following:

The case in which such a judgment can most comfortably be made . . . is when one of the quantities is zero. It may also be other than nonsensical to assert that the Earth is heavier than a pin is long: after all, the Earth is very heavy, where a pin is very short.

Farber & Hudec, *supra* note 1, at 1409 n.19 (quoting *CTS Corp. v. Dynamics Corp.*, 481 U.S. 69, 95-96 (1987) (Scalia, J., concurring)).

147. This least restrictive means consideration is less stringent than that found in certain provisions of Article XX. See *supra* note 140. These provisions "allow contracting parties to impose trade restrictive measures inconsistent with the General Agreement to pursue overriding public policy goals to the extent that such inconsistencies [are] unavoidable." *Thailand: Restrictions on Importation of and Internal Taxes on Cigarettes*, *supra* note 140, at para. 74.

148. Panels could then consider whether Article XX excepts any measures found inconsistent with Article III. Article XX remains effective under this approach, excepting those measures that create burdens in excess of non-protectionist benefits associated with enumerated policy goals. Regardless of the extent of the regulatory burden, Article XX would except measures necessary to further enumerated goals.

149. The *United States: Taxes on Automobiles* Panel may have correctly concluded that the strict textual approach to Article III had to be forsaken in order to preserve the GATT as a whole. The Panel's approach, however, went so far that it sacrificed the ultimate goal of free trade.

The Agreement on Technical Barriers to Trade,¹⁵⁰ an annex to the Agreement Establishing the WTO, limits the use of protective technical regulations.¹⁵¹ Article 2.2 of the Standards Code provides that:

Members shall ensure that technical regulations are not prepared, adopted or applied with a view to or with the effect of creating unnecessary obstacles to international trade. For this purpose, technical regulations shall not be more trade-restrictive than necessary to fulfil a legitimate objective, taking account of the risks non-fulfilment would create.¹⁵²

As illustrated in Figure 4, this text suggests an analysis substantially the same as the balancing test described above. Risks associated with non-fulfilment of the regulation's objective weigh against the resulting obstacle to international trade. Further, the Standards Code explicitly requires that the regulation be the least trade-restrictive alternative available to achieve the objective.

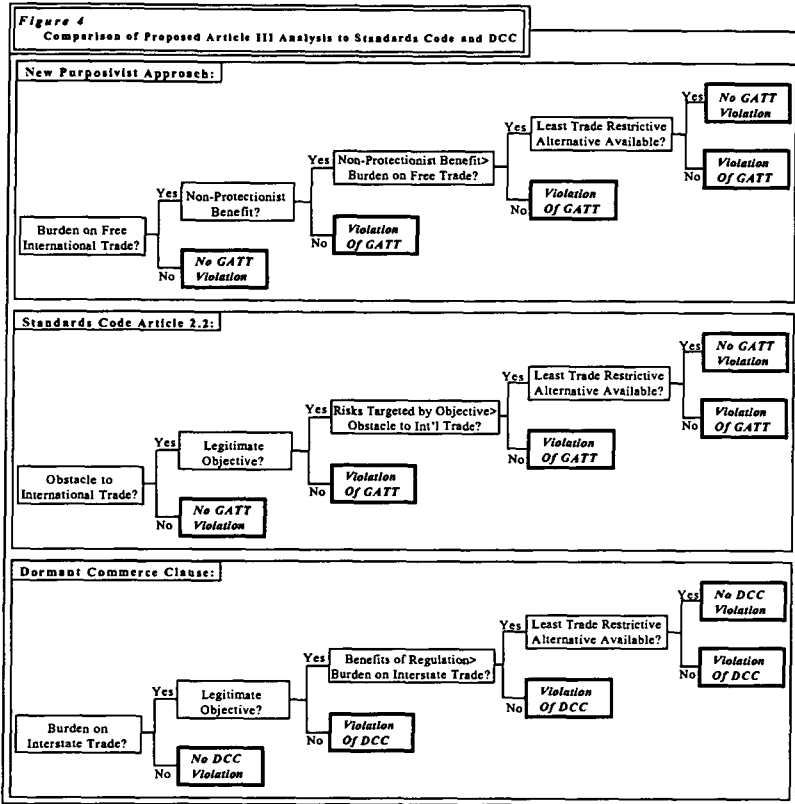
The purposivist approach thus results in an Article III analysis that is more closely tied to the text of the Standards Code than to that of Article III.¹⁵³ The alternative, however, is to allow protectionism via taxation that is prohibited via technical regulations. Governments can use either mechanism to achieve

150. Agreement on Technical Barriers to Trade, in GATT SECRETARIAT, THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS, GATT Sales No. 1994-4 (1994) [hereinafter Standards Code].

151. The Standards Code applies to internal regulations that are also subject to Article III:4; in these circumstances, the Standards Code preempts Article III:4. See Farber & Hudec, *supra* note 1, at 1429-30.

152. Standards Code, *supra* note 150, art. 2.2. The phrase "taking account of the risks non-fulfilment would create" implies a balancing of the risks targeted by the regulation against the resulting obstacle to international trade (i.e., are the risks worth burdening free trade?). An alternative reading, however, might not suggest such a balancing. The phrase could refer merely to the likelihood that objectives will go unfulfilled, rather than the adverse consequences of nonfulfilment. Panels have yet to interpret this language.

153. The parties to the GATT adopted the Standards Code in 1979 in response to widespread concern regarding the growing array of conflicting technical regulations promulgated by individual member nations. R.W. Middleton, *The GATT Standards Code*, 14 J. WORLD TRADE L. 201 (1980). The Standards Code provided for a system of notification and articulated a commitment to develop international regulations where possible. *Id.* at 204-08. Although the Standards Code applies only to technical regulations, as opposed to all internal measures covered by Article III, nothing in the text suggests that internal taxes were purposefully excluded from the Code's limitations. Rather, the Standards Code test merely reflects a more recent understanding of the appropriate approach to evaluating an allegedly protectionist measure.



similar protectionist (or non-protectionist) ends,¹⁵⁴ and GATT should therefore apply the same limits to both.¹⁵⁵

U.S. Supreme Court DCC cases provide further support for the purposivist approach. In *Pike v. Bruce Church*, the U.S. Supreme Court provided the following approach for evaluating

154. Taxes and regulations often yield the same results. Although most consider taxes a means of generating revenue and regulations a means of restricting activities, legislators frequently use taxes as a prod to modify behavior and regulations to obviate the need for public expenditures.

155. One difference between the two trade-distorting measures is that the taxing government collects most of the monopoly rents that result from a protectionist tax, while domestic producers collect most of the monopoly rents that result from a protectionist regulation. Obviously, governments need no encouragement from GATT to choose a tax over a regulation as a means of protection. Incidentally, consumers pay the monopoly rents that result from either measure.

the constitutionality of facially neutral state statutes under the Commerce Clause:

Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.¹⁵⁶

As illustrated in Figure 4, the Court's analysis employs a balancing of burdens against benefits and requires that the regulation be the least restrictive alternative available, much like the Standards Code and the purposivist approach.

Conceptually, the purposivist approach attempts to strike a middle ground between the harshly anti-protectionist strict textual interpretation of Article III and the weak nationalist interpretation employed by the panel in *United States: Taxes on Automobiles*. Both extremes afford different advantages and disadvantages. An interpretation of Article III that blends the two might enable both the GATT and hopes for free international trade to survive in the long term.

IV. CONCLUSION

Experienced legislators have discovered that the GATT does not suffer outright protectionism lightly. The temptation to satisfy powerful domestic industry groups can still influence lawmakers to tip the regulatory scales against foreign interests. When the events of the 1970's led Congress to attempt to contain American dependence on foreign oil, domestic automobile industry representatives helped shape the legislation to minimize the losses to their constituents. The Gas-Guzzler Tax and CAFE law may have achieved significant fuel conservation, but they may also negatively affect the conditions of competition for European products in certain segments of the automobile market. Similarly, although the Luxury Tax on cars has provided a sorely needed source of federal revenue, Congress may have directed its burdens primarily at foreign producers.

The *United States: Taxes on Automobiles* panel concluded in 1994 that the incidental protectionism resulting from the Gas-Guzzler and Luxury Taxes was consistent with GATT Article

156. *Pike v. Bruce Church*, 397 U.S. 137, 142 (1970) (citations omitted).

III. To the delight of isolationists and environmentalists, the Panel introduced a new reading of Article III that prohibits only those measures with both the aim and the effect of protecting domestic production. The Panel's approach clearly preserves legislative freedom, but consumers ultimately pay the price of all protectionism, whether incidental or intentional. Future panels faced with similar challenges to facially-neutral internal measures should consider an interpretation of Article III that preserves the benefits of free trade as well as those associated with national sovereignty.