WORLD TRADE ORGANIZATION

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CANADA - CERTAIN MEASURES CONCERNING PERIODICALS

Report of the Panel

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I. INTRODUCTION

1.1 On 11 March 1996, the United States requested Canada to hold consultations pursuant to Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) and Article XXIII of the General Agreement on Tariffs and Trade 1994 (GATT 1994) on certain measures maintained by Canada, namely, measures prohibiting or restricting the importation into Canada of certain periodicals; tax treatment of so-called "split-run" periodicals; and the application of favourable postage rates to certain Canadian periodicals (WT/DS31/1). These consultations were held on 10 April 1996. As they did not result in a satisfactory adjustment of the matter, the United States, in a communication dated 24 May 1996, requested the Dispute Settlement Body (DSB) to establish a panel to examine the matter (WT/DS31/2).

1.2 The DSB, at its meeting on 19 June 1996, established a panel on the matter in accordance with Article 6 of the DSU. In document WT/DS31/3, the Secretariat reported that the Panel would have the following standard terms of reference and composition:

> "To examine, in the light of the relevant provisions of the covered agreements cited by the United States in document WT/DS31/2, the matter referred to the DSB by the United States in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements".

1.3 On 25 July 1996, the Panel was constituted with the following composition:

Chairman: Mr. Lars Anell

Panelists: Mr. Victor Luiz do Prado
Mr. Michael Reiterer

1.4 No Members reserved their rights to participate in the Panel proceedings as a third party.

1.5 The Panel met with the parties to the dispute on 11 October 1996 and 14-15 November 1996. The Panel submitted its report to the parties on 21 February 1997.

II. FACTUAL ASPECTS

2.1 This Panel concerns three Canadian measures: Tariff Code 9958 which prohibits the importation into Canada of certain periodicals; Part V.I of the Excise Tax Act, as enacted by Bill C-103 of 15 December 1995, which imposes an excise tax on certain "split-run" periodicals; and the application of certain postal rates to certain Canadian periodicals including through actions of Canada Post Corporation and the Department of Canadian Heritage.

A. Tariff Code 9958 - Import Prohibition

2.2 In 1965, the Canadian Government enacted Tariff Code 9958, in Schedule VII of the Customs Tariff. It is put into effect by Article 114 of the Customs Tariff which provides that "the importation into Canada of any goods enumerated or referred to in Schedule VII is prohibited".[1] Tariff Code 9958 applies if an issue of a periodical imported into Canada is a special edition, including a split-run or regional edition, that contains an advertisement that is primarily directed to a market in Canada and

[1]R.S.C. 1985, c. 41 (3rd Suppl.) as amended to 30 April 1996, s.114, Sch. VII, Item 9958, (1996 Customs Tariff: Departmental Consolidation) Ottawa: Minister of Supply & Services Canada, 1996.

that does not appear in identical form in all editions of that issue of the periodical that were distributed in the periodical's country of origin. The Code defines an "issue" to include a special annual issue, and a "periodical" to mean a periodical, the issues of which other than the special annual issue, are published at regular intervals of more than six days and less than fifteen weeks and are distributed as issues of a distinct publication or as a supplement to more than one newspaper, but does not include a catalogue, a newspaper, or a periodical, the principal function of which is the encouragement, promotion or development of the fine arts, letters, scholarship or religion.

2.3 For the purposes of determining whether or not an advertisement is primarily directed at the Canadian market, a number of factors are taken into consideration such as whether there are enticements to the Canadian market, references to the goods and services tax, listing of Canadian addresses as opposed to foreign addresses, and specific invitations to Canadian consumers only.

2.4 The Code also applies where an issue of a periodical imported into Canada is an edition in which more than five per cent of the advertising content consists of advertisements directed to the Canadian market. Advertisements directed to the Canadian market include those that indicate specific sources of product or service availability in Canada or which include specific terms or conditions relating to the sale of goods or services in Canada.[2] The publisher of a periodical is notified by the Department of National Revenue for Customs and Excise when a periodical is found to be in contravention of Tariff Code 9958.[3]

2.5 In 1988, the Canadian Parliament enacted an exception to Tariff Code 9958 which allows Canadian publishers to have their periodicals, which must otherwise be Canadian issues of Canadian periodicals, typeset or printed wholly or partially in the United States.

B. Part V.I of the Excise Tax Act

2.6 In 1995, Bill C-103, which added Part V.I - Tax on Split-run Periodicals to the Excise Tax Act, became law.[4] The amendment calls for the imposition, levy and collection, in respect of each split-run edition of a periodical, a tax equal to 80 per cent of the value of all the advertisements contained in the split-run edition. The tax is levied on a per issue basis. The value of all advertisements in a split-run edition of a periodical is the total of all the gross fees for all the advertisements contained in the edition.[5] The term "periodical" means printed material that is published in a series of issues that appear not less than twice a year and not more than once a week. Where an issue of a periodical is published in several versions, each version is an edition of the issue. Each edition of the issue must be considered separately when determining whether an edition is a split-run edition. The definition of "periodical" explicitly excludes a catalogue which is substantially made up of advertisements.[6]

2.7 The amendment defines a split-run edition as an edition of an issue of a periodical that:

(i) is distributed in Canada;

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[2]The Department of National Revenue for Customs and Excise has adopted and published guidelines providing details relating to the application and administration of Code 9958 of the Customs Tariff (Revenue Canada Memorandum D9-1-10, 21 May 1993).

[3]The Importation of Periodicals Regulations (C.R.C., c. 533 as amended on 30 April 1996) describe the review process as carried out by an officer or the Deputy Minister of the Department of National Revenue for Customs and Excise.

[4]An Act to amend the Excise Tax Act and the Income Tax Act, S.C. 1995, c. 46.

[5]*Ibid.*, s. 38.

[6]*Ibid.*, ss.35(1) and 35(5).

(ii) in which more than 20 per cent of the editorial material is the same or substantially the same as editorial material that appears in one or more excluded editions of one or more issues of one or more periodicals; and

(iii) contains an advertisement that does not appear in identical form in all the excluded editions.

There are two exclusionary provisions. Under the first, the particular edition is not a split-run edition if it is an edition that is primarily circulated outside Canada. In effect, this is an exemption for editions that are distributed in Canada, but are mainly distributed outside Canada. Under the second, a particular edition of an issue of a periodical that would otherwise be a split-run edition is not a split-run edition if all the advertisements in the particular edition appear in identical form in one or more editions of that issue that are primarily distributed outside Canada and that have a combined circulation outside Canada that is greater than the circulation in Canada of the particular edition. The purpose is to prevent a publisher from qualifying for this exemption by having all the advertisements in its Canadian split-run edition also appear in one of its excluded editions that has a very small circulation.[7]

2.8 Further, a grandfathering provision provides limited "grandfathering" treatment to certain existing periodicals that distributed Canadian split-run editions prior to 26 March 1993. A particular periodical is eligible for "grandfathering" treatment and therefore not subject to the tax on split-runs if the number of split-run editions per year does not exceed the number of split-run editions that were distributed during the 12-month period ending on 26 March 1993, provided that the periodicals continue to be similar in editorial content and direction to the split-run editions distributed before that date. If the number of split-run editions per year is increased, the tax applies to the additional split-run editions.[8]

2.9 Depending on the circumstances, the person responsible for paying the tax is the publisher, a person connected with the publisher, the distributor, the printer or the wholesaler of the split-run edition. (The Excise Tax Act stipulates that a person is considered to be connected to another person if one of them is controlled by the other or if both of them are controlled by the same person.[9] A corporation is controlled by a particular person if 50 per cent or more of its share of capital with voting rights belongs to that person or to persons with whom that person does not deal at arm's length. A partnership is controlled by a particular person if the person or persons with whom that person does not deal at arm's length is or are entitled to 50 per cent or more of the partnership's income.[10]) The responsible person is the first of these persons who resides in Canada.[11] The responsible person can be domestic- or foreign-owned or controlled. In order to ensure enforcement and collection of the tax, the tax is imposed on a person who resides in Canada. The persons connected with the responsible person are jointly and severally liable for payment of the tax.[12] As well, where the responsible person is a distributor, a printer or a wholesaler (and if there is more than one), they are jointly and severally liable for payment of the tax.[13] Where a person other than the publisher pays the excise tax in respect of a split-run edition, the person is deemed to have paid the tax on behalf of the publisher of the periodical. The legislation authorizes the person to recover the amount of the tax from the publisher

[7] *Ibid.*, ss.35(5).

[8] *Ibid.*, s. 39.

[9] *Ibid.*, ss.35(2).

[10] *Ibid.*, ss.35(3).

[11] *Ibid.*, ss.35(1).

[12] *Ibid.*, s. 41.1.

[13] *Ibid.*, s. 41.2.

in a court of competent jurisdiction or to deduct or withhold the amount from any amount payable by the person to the publisher or distributor of the periodical.[14]

C. Funded and Commercial Postal Rates

2.10 In 1981, the Canada Post Corporation (hereafter called Canada Post) was established by the Parliament of Canada as a Crown corporation pursuant to the Canada Post Corporation Act (CPC Act).[15] Crown corporations are created by one of three methods: an Act of Parliament; letters patent under the Canada Business Corporations Act; or Articles of Incorporation under the Canada Business Corporations Act. According to a treatise on Crown law cited by Canada, Crown corporations are created to separate the management of an activity from continuous partisan intervention and to provide independence from the close financial controls within the government departmental structure.[16] The Government of Canada gains control over, and accountability from, Crown corporations primarily through the Financial Administration Act (FA Act) and its Regulations. The FA Act endeavours to strike a balance between the desires for public accountability and for private industry independence. Parliament is required to approve the creation, mandate, and financing of new parent Crown corporations. Government approval is required for annual corporate plans operating and capital budgets, and major corporate acquisitions. The FA Act and the CPC Act define the responsibilities for the direction and daily operation of the corporations.

2.11 The Canada Post publication entitled *Publications Mail Postal Rates*, (effective 4 March 1996), describes the three categories of publications mail postal rates which are the subject of this dispute: the "funded" publications rates and the commercial "Canadian" and commercial "International" publications rates. The first two categories apply to periodicals published and printed in Canada. "Funded" rates are rates that are subsidized by the Canadian Government and commercial rates are for publications ineligible for "funded" rates. "Canadian" rates are commercial rates available to Canadian publications and "International" commercial rates apply to all foreign publications mailed in Canada.

(i) "Funded" rates

2.12 Since its incorporation, the Government of Canada has provided funding to Canada Post to support special rates of postage for eligible publications through the Publications Distribution Assistance Program (hereafter called the Program). The Program, which was developed to promote Canadian culture, provided funding through Canada Post to eligible Canadian publications, including periodicals, mailed in Canada for delivery in Canada. "Funded" postal rates are available to Canadian-owned and -controlled paid circulation publications that are published and printed in Canada and meet certain editorial and advertising requirements. In January 1990, the Government announced plans to gradually phase out the Program and replace it with a system of direct funding to eligible publications. Since the announcement, funding available for the Program has been gradually reduced. On 30 April 1996, the current policy and funding agreement concerning the Program between Canada Post and the Department of Canadian Heritage (hereafter called Canadian Heritage) was set to expire. At that time, available funding would have been directed to eligible publishers through a replacement program.[17]

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[14]*Ibid.*, ss.41.3(2).

[15]R.S.C. 1985, c. C-10.

[16]P. Lordon, Crown Law (Toronto: Butterworths 1991) at 49, 57 and 58. The next five sentences are also from this source.

[17]*Canada Gazette*, Part II, Vol 130, No. 10, Newspapers and Periodicals Regulations, repeal, SOR/96-209, 23 April 1996, Regulatory Impact Analysis Statement.

2.13 The Program and its funding structure was extended for three years through a Memorandum of Agreement (MOA), signed in March 1996 and effective 1 May 1996, between the Department of Communications (now the Department of Canadian Heritage) and Canada Post.[18] This new agreement provides for payments of funds in quarterly instalments by Canadian Heritage to Canada Post "in exchange for providing prescribed postage rates for publications deemed eligible to the Publications Assistance Program", and the transfer of the program administration from Canada Post to Canadian Heritage.[19] Canadian Heritage had requested within the new agreement that Canada Post initiate the complete removal of funded publications mail from the regulations associated with the CPC Act, effective April 1996.[20] On 23 April 1996, Canada Gazette published a repeal of the Newspapers and Periodicals Regulations pursuant to Subsection 19(1) of the CPC Act. The revocation was intended to facilitate the transfer of eligibility assessment from Canada Post to Canadian Heritage, to reduce the Program's administrative costs while expediting and simplifying modifications to its policies[21], and to allow Canada Post and Canadian Heritage to respond more appropriately and more rapidly to Program and customer needs.

2.14 The amounts authorized by the MOA are CD$58 million for the period commencing 1 May 1996 and ending 31 March 1997; CD$57.9 million for the period 1 April 1997 to 31 March 1998; and CD$47.3 million for the period 1 April 1998 to 31 March 1999.

2.15 Canadian Heritage administers the eligibility requirements for the Program based on the criteria specified in Schedule A to the MOA. Canadian Heritage is responsible for the administration of the eligibility requirements for the Program, and Canada Post must accept for distribution all publications that are eligible under the Program once the publication is approved by Canadian Heritage. For eligible publications to receive funded rates, the publisher must first enter into a sales agreement with Canada Post prior to posting under the Program. Rates of postage for publications eligible under the Program are set out in Schedule C of the MOA and are as follows:

a) First 10,000 copies of an issue addressed to *Bona Fide* Subscribers and newsdealers in Canada:

per kg or fraction thereof:
Year 1: $0.390
Year 2: $0.395
Year 3: $0.405

or, per individually addressed copy whichever is the greater:
Year 1: $0.078
Year 2: $0.079
Year 3: $0.081

b) Copies exceeding the first 10,000 copies of an issue addressed to *Bona Fide* Subscribers and newsdealers in Canada:

per kg or fraction thereof:
Year 1: $0.430
Year 2: $0.435
Year 3: $0.445

or, per individually addressed copy, whichever is the greater:
Year 1: $0.086
Year 2: $0.087

[18]Memorandum of Agreement (MOA) Concerning the Publications Assistance Program Between the Department of Communications and Canada Post Corporation.

[19]*Canada Gazette*, Part II, Vol 130, No. 10.

[20]*Ibid.*

[21]*Ibid*.

Year 3: $0.089

(Year 1: 1 May 1996 to 31 March 1997; Year 2: 1 April 1997 to 31 March 1998; Year 3: 1 April 1998 to 31 March 1999.)

2.16 In order to be eligible for funded rates, Canadian publications must generally meet the following criteria: (i) produced by a person or company whose primary business is publishing[22]; (ii) Canadian ownership and control; (iii) published, printed and mailed in Canada; (iv) edited in Canada[23]; (v) eligible editorial categories[24]; (vi) minimum paid circulation requirement[25]; (vii) maximum advertising allowance[26]; (viii) frequency[27]; and (ix) minimum price.[28]

(ii) Commercial "Canadian" and commercial "International" rates

2.17 Canada Post has authority to set its commercial rates outside of regulation, pursuant to subsections 16(1) and 21(a) of the CPC Act, for any person who has entered into an agreement with Canada Post for (a) the variation of rates of postage on the mailable matter of that person in consideration of his mailing in bulk, preparing the mailable matter in a manner that facilitates the processing thereof or receiving additional services in relation thereto;…".[29] In order to take advantage of this provision and receive commercial postal rates and service, a publisher must enter into an agreement with Canada Post. For a Canadian publication, this agreement is the "Publications Mail Product Service Agreement"[30], and for a foreign publication mailed in Canada, this agreement is the "International Publications Mail Product (Canadian Distribution) Sales Agreement".[31] These arrangements are intended to benefit Canadian and foreign publications and their subscribers by reducing mailing costs and improving delivery standards. Appendix A of each "Agreement" contains the commercial "Canadian" and commercial "International" rates. These rates are identical to those found in the *Publications Mail Postal Rates* (referred to in paragraph 2.11) which divides commercial rates into those that apply for (i) mail service for Canadian publications that are ineligible for "funded" rates (Rate Code 5); and (ii) mail service for international publications (Rate Code 6 or what are called "International" rates in this dispute). Further, special agreements may be entered into for both Canadian and non-Canadian publications whereby terms and conditions (including rates of postage) may be established on a case-by-case basis.

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[22]Funded rates cannot be used to promote a specific business, service, fraternal, trade or professional organizations (MOA).

[23]An eligible publication must be edited by persons residing in Canada (editing encompasses the commissioning of editorial material and artwork, supervising writers, illustrators and photographers regarding the final format of the material, as well as laying out, copy editing and proofreading, and otherwise preparing the contents for printing) (MOA).

[24]Eligible publications must be published for the dissemination to the public consisting of either news, comment and analysis of news and articles on topics of current public interest; or articles on religion, the sciences, agriculture, forestry, the fisheries, social or literary criticism, reviews of literature or the arts, or be an academic or scholarly journal; or articles promoting public health and published by a non-profit organization administered on a national or provincial basis (MOA).

[25]No less than 50 per cent of an eligible publication's total circulation must be paid circulation (MOA).

[26]No more than 70 per cent of the space, including advertising inserts, in an eligible publication may be devoted to advertising (MOA).

[27]It must be published not less than twice a year and not more than 56 times a year (MOA).

[28]It must have a stated subscription price of $0.50 or more per copy and $6.00 or more per year.

[29]R.S.C. 1985, c.C-10, s. 21(a).

[30]Canadian Publications Mail Products Sales Agreement, 1 March 1995.

[31]International Publications Mail Product (Canadian Distribution) Sales Agreement, 1 March 1994.

2.18 Publications must meet the six criteria enumerated below in order for their publishers to enter into either a "Publications Mail Products Sales Agreement" or an "International Publications Mail Product Sales Agreement". Additionally for the former, the publication "must be a newspaper, newsletter or periodical, published, printed and mailed in Canada".[32] Additionally for the latter, the publications "must be a newspaper, newsletter or periodical printed outside of Canada or registered under Rate Code 5 prior to 1 March 1992".[33]

Six criteria:

(i) published for the purposes of disseminating to the public news, articles containing comments on or analysis of the news, and articles with respect to other topics currently of interest to the general public;
(ii) devoted primarily to one or more of religion, the sciences, agriculture, forestry, the fisheries, social or literary criticism or reviews of literature or the arts, or academic or scholarly writings;
(iii) published at a frequency of not less than four times a year;
(iv) addressed to a subscriber, non-subscriber, company or to a newsdealer in Canada;
(v) containing not more than 70 per cent of the space devoted to advertising in more than 50 per cent of the issues published during any twelve month period; and
(vi) published by or at the direction of a person whose principal business is publishing.

2.19 The rates for the commercial "Canadian" and commercial "International" publications mail service are summarized as follows:

Commercial "Canadian" rates:

Minimum postage per addressed copy (100g or less)	Price per copy
Local rural rates	$0.103
Local urban rates	$0.231
Regional rates	$0.184
National rates	$0.378

Commercial "International" rates:

Minimum postage per addressed copy (100g or less)	Price per copy
Rates for foreign magazines, newspapers or newsletters mailed in Canada (inbound)	$0.436

Two sub-categories include discounts for palletization and by-pass. Non-subsidized Canadian publications can receive discounts of $0.01 to $0.02 per copy if palletized, and discounts ranging from $150.00 to $200.00 per truck load for a by-pass or downstream entry. These discounts are not available generally to foreign publications mailed in Canada. Further, the commercial "Canadian" and commercial "International" categories have not been subject to regulation since 1994 and 1992, respectively.[34]

[32]Canadian Publications Mail Products Sales Agreement, para. 5.1.

[33]International Publications Mail Product (Canadian Distribution) Sales Agreement, para. 4.1.

[34]SOR/94-210, 24 February 1994 and SOR/91-641, 7 November 1991.

III. MAIN ARGUMENTS

3.1 The **United States** asked the Panel to find that:

(a) Tariff Code 9958 is inconsistent with Article XI of GATT 1994;

(b) Part V.I of the Excise Tax Act is inconsistent with Article III:2 of GATT 1994, or in the alternative, Article III:4 of GATT 1994; and

(c) The application by Canada Post of lower postal rates to domestically-produced periodicals under the "funded" and "commercial" rate systems is inconsistent with Article III:4 of GATT 1994, and is not a domestic subsidy within the meaning of Article III:8 of GATT 1994.

3.2 **Canada** asked the Panel to find that:

(a) Tariff Code 9958 is justifiable under Article XX(d) of the GATT 1994;

(b) Article III of GATT 1994 does not apply to Part V.I of the Excise Tax Act, and if the Panel decides that it does apply, Part V.I is consistent with Article III of GATT 1994;

(c) Article III:4 of GATT 1994 does not apply to the commercial rates charged by Canada Post, and the funds paid by the Department of Canadian Heritage to Canada Post for the "funded" rates are allowable subsidies pursuant to Article III:8(b) of GATT 1994.

A. Tariff Code 9958 - Import Prohibition

(i) Article XI:1

3.3 The **United States** argued that the Canadian import prohibition on the products listed in Tariff Code 9958 is a violation of Article XI:1 of GATT 1994, which prohibits quantitative restrictions on imports. By its terms, Tariff Code 9958 applies both to special Canadian editions of magazines that are also published in versions targeted at readers in other countries (i.e. split-runs) and to magazines produced solely for the Canadian market. In either case, the import ban applies if the periodical contains even a small amount of advertising directed primarily at Canadian readers - single advertisement in the case of split-runs and five per cent or more of the advertising space in the case of magazines generally. The ban eliminates these magazines from the Canadian magazine market, and ensures that only Canadian magazines can compete for domestically-oriented advertising. Canada did so for the specific purpose of ensuring that Canadian magazines can enjoy a monopoly on the sale of magazines containing such advertisements. Advertising is an important source of revenue for magazine publishers. Thus, granting domestic magazines a monopoly on local advertising provides them a competitive advantage over foreign-produced magazines that are denied the right to carry such advertisements.

3.4 **Canada** argued that the United States claim that the Canadian legislation creates a "monopoly" for Canadian publishers of advertisements directed at the Canadian market is inconceivable in the North American environment. The existence of "spillover" advertising, whereby advertisements for generally-available products in wide-circulation US magazines automatically reach the Canadian public, with very significant consequences for the competitiveness of the Canadian industry, is sufficient by itself to prevent the creation of any true monopoly. The "monopoly" effect complained of by the United States has nothing to do with the first part of the Code, dealing with split-runs, or with the Excise Tax Act. It is true that the second part of the Tariff Code prevents the entry of foreign magazines

with substantial amounts of advertising directed specifically at Canadian, as a means of preventing an easy way to get around the split-run prohibition. However, the 5 per cent rule applies only to a limited type of advertising with Canadian addresses and phone numbers, and this aspect of the policy has not been carried forward to the excise tax provisions, which are strictly limited to the split-run phenomenon.

(ii) Article XX(d)

3.5 Canada added that Tariff Code 9958 is a measure intended to secure the attainment of the objectives of Section 19 of the Income Tax Act. The issue is whether Tariff Code 9958 can be justified as a necessary measure within the meaning of Article XX(d). Because it forms an integral part of a package of measures with a single objective, it can be so justified on a natural and reasonable reading of the treaty language. Canadian public policy for the magazine industry is designed to provide Canadians with a distinctive vehicle for the expression of their own ideas and interests. Such a vehicle faces enormous competition from foreign magazines for both advertising and readership. Public policy measures aim to balance the need to establish and maintain a place for Canadian periodicals in their own domestic market while at the same time ensuring that Canadians have unrestricted access to foreign periodicals. To achieve this long-standing policy objective, government policy has focused on two areas: advertising and distribution. The Government of Canada has introduced a series of measures to ensure that magazines with editorial content developed for the Canadian market can compete for the limited advertising revenues. These measures include Tariff Code 9958, Sections 35-41 of the Excise Tax Act and Section 19 of the Income Tax Act. Section 19 of the Income Tax Act allows a deduction for advertising directed at the Canadian market. Tariff Code 9958 restricts the importation into Canada of periodicals whose advertising has been purchased especially to reach a Canadian audience. The general objective of these measures is to help the Canadian periodical industry raise advertising revenues. Tariff Code 9958 ensures the achievement of this goal, with Section 19 of the Income Tax Act.

"Secure compliance"

3.6 The **United States** referred to the panel on *United States - Standards for Reformulated and Conventional Gasoline ("US - Standards for Gasoline")* which states that a party invoking an exception under Article XX(d) has to demonstrate the following elements:

> "(1) that the measures for which the exception are being invoked - that is, the particular trade measures inconsistent with the General Agreement - *secure compliance* with laws or regulations themselves not inconsistent with the General Agreement;
>
> (2) that the inconsistent measures for which the exception is being invoked are *necessary* to secure compliance with those laws or regulations; and
>
> (3) that the measures are applied in conformity with the requirements of the *introductory clause* of Article XX.

In order to justify the application of Article XX(d), all the above elements have to be satisfied".[35]

[35]Panel Report on *United States - Standards for Reformulated and Conventional Gasoline*, adopted on 20 May 1996, WT/DS2/R, para. 6.31 (emphasis in original).

3.7 Canada's import prohibition fails to meet *any* of these requirements. With respect to the first requirement, Canada has failed to demonstrate that its import ban secures compliance with Section 19 of the Income Tax Act. Canada has not claimed that the import ban is meant to enforce the income tax provisions, only that the import ban and the income tax measures advance the same objective (through different means), which is to channel all domestic advertising to domestic magazines.

3.8 **Canada** noted that the conformity of the Income Tax Act with GATT 1994 is not being challenged. Tariff Code 9958 and Section 19 of the Income Tax Act are conceived to deal with the problem of split-runs with inserted Canadian advertising. The idea is that the income tax provision would cover magazines printed in Canada and the border measure would cover magazines printed outside the country. The effectiveness of the non-deductibility provision standing by itself would obviously be very limited. The problem is that of foreign companies that sold into the Canadian market but are not subject to Canadian income tax. This would be more than a loophole, given the open nature of the Canadian economy and the degree of import penetration. It would largely destroy the effectiveness of the income tax measures.

3.9 Canada drew the Panel's attention to the panel report on *EEC - Regulations on Parts and Components*[36] ("*EEC - Parts and Components*") which introduces a very stringent test for the application of Article XX(d), under which the non-conforming measures have to be necessary for the enforcement of another law, and not merely in order to ensure that the objectives of that law be fulfilled. This test is entirely appropriate where the issue is the enforcement of regulatory statutes and ordinary fiscal measures designed to raise revenue, where compliance with the statute is virtually synonymous with the attainment of its objectives. If, for example, an environmental measure is complied with, its objective is *ipso facto* attained.

3.10 The *EEC - Parts and Components* panel interpreted Article XX(d) in terms of enforceability as opposed to measures designed to ensure that the objectives of another measure are not undermined. Canada is not challenging that decision or its reasoning. It makes sense in the context of regulatory statutes with prohibitions or even tax statutes that are designed to raise revenue and prevent tax evasion. It is doubtful, on the other hand, that an enforceability test is meaningful in the case of a fiscal or other economic incentive where formal compliance is not the real object, and *substantial* compliance can not be separated from the underlying social and economic objectives the measure is designed to secure. In the case of a fiscal incentive whose sole purpose is to influence business decisions in a certain direction, compliance has to be judged in terms of effectiveness. Canada suggests, therefore, that the application of the exception in Article XX(d) should take account of the nature of the measures under consideration, and that the test in the *EEC - Parts and Components* panel decision should not be rigidly applied without taking account of these circumstances.

3.11 Further, the US consideration that compliance is always a matter of enforceability, no more no less, may be a valid proposition, as held in *EEC - Parts and Components*, for mandatory legislation based on prohibitions or exactions. Compliance and effectiveness are synonymous in the case of the vast majority of legislative measures. But Section 19 is not an ordinary tax measure, designed to raise revenue for the public purse or prevent tax evasion. In the case of a fiscal or other economic incentive whose sole purpose is to influence business decisions in a certain direction, compliance has to be judged in terms of effectiveness as well as enforceability. The distinction is between formal compliance and real or substantial compliance, which in this case has nothing to do with whether deductions are properly claimed but with the policy behind this entire set of measures.

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[36]Panel Report on *European Economic Community - Regulations on Parts and Components*, adopted on 16 May 1990, BISD 37S/132.

3.12 The **United States** argued that the panel on *EEC - Parts and Components* dismisses the argument that Article XX(d) permits governments to maintain GATT-inconsistent measures to "ensure the attainment of the *objectives* of [GATT-consistent] laws and regulations" rather than to prevent violations of the GATT-consistent laws or regulations.[37] That panel stated that the interpretation it rejects would make the function of Article XX(d) "substantially broader" and would not be consistent with the fact that Article XX(d) applies only in the specific circumstances set out in that paragraph - namely, to secure compliance with GATT-consistent laws or regulations.

3.13 Canada's claim that the import ban does not seek "formal compliance" with Section 19 of the Income Tax Act, but rather "real or substantial compliance", which Canada admits "has nothing to do with whether deductions are properly claimed", is simply another way of stating that the import ban helps advance the same overall (protectionist) aim as Section 19. However, the import ban does not "secure compliance" with Section 19, and thus does not fall within the purview of Article XX(d). If accepted, Canada's view of Article XX(d) would allow WTO Members to adopt all manner of GATT-inconsistent measures on the ground that they further the same objectives as other protectionist legislation. As the *EEC - Parts and Components* panel makes clear, the phrase "secure compliance" does not reach measures that merely help ensure that domestic policy goals are realized.

"Necessary"

3.14 The **United States** noted that the panel report on *United States - Section 337 of the Tariff Act of 1930* ("*US - Section 337*") observed that :

> "[A] contracting party cannot justify a measure inconsistent with another GATT provision as 'necessary' in terms of Article XX(d) if an alternative measure which it could reasonably be expected to employ and which is not inconsistent with other GATT provisions is available to it".[38]

The normal way for tax authorities to enforce income tax provisions is to audit the relevant tax returns, and to make adjustments to those returns where necessary to secure compliance. Tax, civil, or criminal penalties may be imposed where warranted in individual cases. Such measures would normally be entirely consistent with GATT and in any event would be applied to particular taxpayers, not to imports. It is extraordinary for income tax enforcement measures to take the form of restrictions on trade in goods. Canada has demonstrated no basis for why, of all possible measures, it is necessary to impose a blatantly GATT-inconsistent *import ban* to secure compliance with Section 19 of the Income Tax Act nor why normal tax enforcement procedures were insufficient.

3.15 **Canada** stated that the panel in *US – Section 337*[39] held that the term "necessary" required the use of the least trade-restrictive measure available. Canada submits that there are no other measures, less restrictive or otherwise, that would accomplish the objective. If split-runs could be imported, with Canadian advertisements often placed by businesses for which Canadian tax liability is irrelevant, the program would simply no longer work.

3.16 Canada therefore reiterates its suggestion that the application of the exception in Article XX(d) should take account of the nature of the measures under consideration, and that the test in the *EEC - Parts and Components* and the *US - Section 337* panel decisions should not be rigidly applied without

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[37]Ibid., para. 5.17 (emphasis added).

[38]Panel Report on *United States - Section 337 of the Tariff Act of 1930*, adopted on 7 November 1989, BISD 36S/345, para. 5.26.

[39]*Ibid.*, at 392, paras. 5.25-5.27.

taking account of these circumstances. The Panel should recall that Code 9958 and the income tax provision have always been considered part of a single, indivisible package of complementary, indivisible measures and should be treated as such for the purposes of Article XX(d).

3.17 The **United States** stated that even if one were to credit Canada's argument that Article XX(d) covers measures necessary to secure the attainment of the domestic policy goals embedded in other laws, the import ban would still not be "necessary" for such a purpose. The objective of Section 19 is to support Canada's magazine industry. Canada has not shown why GATT-consistent measures (such as subsidies paid directly to producers) would not reasonably be available to it for advancing this objective.

(iii) Chapeau to Article XX

3.18 **Canada** noted that each term of Article XX(d), including its Preamble, should be given consideration when examining whether Tariff Code 9958 could be justified as a necessary measure within the meaning of the treaty. Since Tariff Code 9958 is a "measure" directed against imports from all foreign countries and not only the United States, it is "not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail", as stated in the preamble to Article XX. Similarly, having regard to the application of Tariff Code 9958 since its adoption, it could not be claimed that it has been "applied in a manner which would constitute … a disguised restriction on international trade". Tariff Code 9958 is not applied in such a way as to constitute a restriction on international trade, as the evidence so strongly demonstrates, nor does it prohibit the importation of foreign periodicals into Canada or threaten their dominant position in the English-Canadian market place.

3.19 The **United States** considered that because the import ban does not satisfy the terms of paragraph (d) of Article XX, the Panel does not need to ascertain whether or not it is in conformity with the introductory clause of Article XX. However, were the Panel to reach this issue, it should find that Canada's import ban does not meet the requirements of the introductory clause, because the import ban constitutes "a means of arbitrary and unjustifiable discrimination between countries where the same conditions prevail," and is also "a disguised restriction on international trade." In the *US - Standards for Gasoline* case, the Appellate Body states that whatever else the term "disguised restriction on international trade" means, it could be read to encompass any " . . . restrictions amounting to arbitrary or unjustifiable discrimination in international trade taken under the guise of a measure formally within the terms of an exception listed in Article XX".[40] The import ban's "arbitrary" and "unjustifiable" nature is apparent from the very structure of Tariff Code 9958. Application of the import ban depends on advertising content and on sales in more than one country - factors that are relevant only for purposes of distinguishing between those categories of foreign-produced magazines that compete with Canadian magazines for Canadian advertising revenues and those that do not. The import ban therefore constitutes a "disguised restriction on international trade".

3.20 Moreover, the expression "between countries" in the chapeau to Article XX includes a comparison between Canada and other countries as well as between countries other than Canada. The import prohibition bars only magazines produced outside Canada, thus discriminating in favour of magazines produced in Canada. There are no relevant conditions prevailing in Canada or elsewhere that would justify the discrimination imposed on foreign-produced split-runs. Thus, for the reasons discussed above, the import ban constitutes "arbitrary or unjustifiable discrimination between countries where the same conditions prevail".

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[40]Appellate Body Report on *United States - Standards for Reformulated and Conventional Gasoline*, adopted on 20 May 1996, WT/DS2/AB/R at 25.

3.21 Canada considered that the United States argued that the prohibition on arbitrary or unjustifiable discrimination requires a comparison between other countries and Canada, and not just between countries other than Canada. This, in effect turns this Article into a national treatment proviso. An import prohibition or restriction could never meet this test. The effect would be to remove Article XI almost completely from the range of measures that can potentially be subject to Article XX derogations. The interpretation suggested here is novel. It does not correspond to the way the chapeau to Article XX has been interpreted in the past, as shown by the 1982 decision on *United States - Prohibition on Imports of Tuna and Tuna Products from Canada*[41], and the 1983 decision on *United States - Imports of Certain Automotive Spring Assemblies*.[42] In both those decisions, a US import prohibition was held not to be discriminatory within the meaning of the chapeau to Article XX, because it applied equally to all foreign countries exporting to the United States.

B. Part V.I of the Excise Tax Act

3.22 The **United States** argued that the excise tax was designed specifically to shore up Canada's GATT-inconsistent import prohibition. Canada did not deny that this is so, or that the tax was designed to eliminate the competition between split-run magazines and domestically produced magazines. The purpose of the tax is protectionist - namely, to ensure that only Canadian magazine producers capture all of the revenues associated with advertisements directed specifically at Canadian readers. The Canadian magazine tax is designed to ensure that foreign-based publishers forego the commercially attractive option of publishing a split-run edition of an existing magazine for the Canadian market. Any such edition will be hit with a prohibitive 80 per cent excise tax. This means that foreign magazine producers contemplating sales in the Canadian market can not make use of the economies of scale that split-run editions provide. Split-run editions drive down per unit production costs by spreading the expense of producing articles and photographs over a greater number of magazines. The Canadian tax ensures that no foreign-based publisher can take advantage of those lower costs to compete in the Canadian market against wholly Canadian-produced magazines.

3.23 Canada's policy of protecting its domestic publishing industry from import competition is long-standing. Since the early 1900s, Canada has provided subsidized, lower postal rates exclusively to Canadian-produced magazines.[43] More recently, Canada sought to protect its industry by targeting imported periodicals sold into Canada as "split-run" or "regional" editions. A publisher produces a "split-run" edition of a single issue of a magazine by separating ("splitting") the editorial content (articles, photographs, artwork, etc.) and the advertising content of the magazine. The publisher then produces two or more separate regional editions of the issue of the magazine. Each edition shares some or all of the editorial content, but the advertising content in each edition may differ, because each edition is distributed in a different geographic market and the advertising is directed at that specific market.

3.24 Concerned that imported split-run editions of magazines would divert advertising revenues from domestic competitors, Canada enacted Tariff Code 9958 in 1965 specifically to prohibit the importation of split-run editions as well as any other magazine containing a more than a *de minimis* amount of advertising directed at the Canadian public, and in 1976 prohibited income tax deductions for advertisements placed in foreign-owned publications. Within a matter of a few decades, however, technological advances made it practical for foreign-based publishers to transmit editorial material electronically across the border into Canada and to publish split-run editions in Canada, thus avoiding

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[41]Panel Report on *United States - Prohibition on Imports of Tuna and Tuna Products from Canada*, adopted on 22 February 1982, BISD 29S/91 .

[42]Panel Report on *United States - Imports of Certain Automotive Spring Assemblies*, adopted 26 May 1993, BISD 30S/107.

[43]*A Question of Balance, Report of the Task Force on the Canadian Magazine Industry*, 1994 ("*Task Force Report*") at 72.

the application of Tariff Code 9958. To plug this perceived loophole - and ensure that split-run editions could not compete in the domestic marketplace - Canada enacted a punitive excise tax on split-run editions in December 1995.

3.25 In an opinion dated 15 August 1990, Investment Canada advised Time Canada Ltd., a company controlled by Time Warner, Inc. of New York, N.Y., that its proposal to publish a Canadian edition of *Sports Illustrated* was not inconsistent with Section 15 of the Investment Canada Act. Based on that opinion, on 11 January 1993, Time-Warner announced plans to publish in Canada a special Canadian edition of *Sports Illustrated* magazine. Recognizing that Tariff Code 9958 could not be relied upon to keep a Canadian-produced version of *Sports Illustrated* or other foreign-based magazines out of the Canadian market, the Canadian Government responded to Time's announcement on 26 March 1993, by establishing a Task Force on the Canadian Magazine Industry whose mandate was "to recommend ways in which the current measures [supporting the Canadian magazine industry] could be brought up-to-date".[44]

3.26 The Task Force concluded that it in the absence of additional legislation it was highly likely that a significant number of US split-runs would be sold in Canada. The Task Force estimated that there were 53 potential US consumer magazine entrants into the Canadian market, and 70 potential US business and trade magazine entrants, and that the majority of these would actually enter the Canadian market.[45] In December 1994, the Canadian Government announced its intention to implement the Task Force's recommendation to implement a new excise tax on all split-run magazines that contain ads directed at Canadians.[46] On 25 September 1995, the Government formally introduced Bill C-103, the excise tax bill, in the Canadian House of Commons. In introducing Bill C-103, Minister of Canadian Heritage Dupuy stated: "*Sports Illustrated Canada* managed to get around custom tariff 9958, because most of its content was sent electronically from the United States. It was simply a loophole in the tariff laws since electronic transmission made it possible to avoid tariff regulations. . . . Task Force members explored several avenues and finally concluded that the proposed excise tax was the best solution. It could be designed and implemented in order to avoid split-run editions".[47] In the Parliamentary debate, one Member described the bill in the following terms:

> "[I]t is important to be very clear about the nature of the bill. In essence it is designed to kill international competition between magazines, more specifically magazines which come into Canada. The killing of that competition kills a lot of good things which flow from competition".[48]

3.27 **Canada** argued that the excise tax measure is designed to prevent the diversion of advertising to low-cost publications reproducing recycled editorial content, at the expense of publications created for Canadians. The Excise Tax Act is carefully designed to deal with a particular combination of circumstances. What it targets is the combination of recycled editorial content plus Canadian advertisements. Magazines derive their revenues predominantly from the sale of advertising space and from the circulation of the magazine. Advertising revenue is by far the most important revenue stream for Canadian magazines, accounting for 60 per cent of total revenue. Circulation revenue accounts for 33 per cent of total revenue, or $287 million. Advertising revenue is crucial for the Canadian

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[44]Task Force Report at iii.

[45]Task Force Report at 50-52.

[46]News Release, Canadian Heritage, December 22, 1994 at 1.

[47]*Commons Debates* at 14790-1 (Sept. 25, 1995).

[48]*Commons Debates* at 14795 (statement of Mr. Monte Solberg).

magazine industry, allowing the publisher to provide the magazine at an affordable cost or, in some cases, free of charge.

3.28 Canada explained that there is a direct correlation between circulation, advertising revenue and editorial content. The larger the circulation, the more advertising a magazine can attract. With greater advertising revenue, a publisher can afford more to spend on editorial content. The more a publisher spends, the more attractive the magazine is likely to be to its readers, resulting in circulation growth. Similarly, a loss of advertising revenue will produce a "downward spiral". Less advertising entails less editorial, a reduction in readership and circulation and a diminished ability to attract advertising. Magazines can be sold on newsstands, or through subscriptions, or distributed at no cost to selected consumers. The Canadian market is not large, particularly when compared to the US market. It is also highly fragmented from a language perspective. There are two official languages in Canada as well as a number of other languages. Canadian English-language publications face tough competition on newsstands; they account for only 18.5 per cent of English-language periodicals distributed on newsstands, where space is dominated by foreign publications. Subscriptions are the main source of circulation revenue for most Canadian magazines.

3.29 The constraints imposed by the demographics of the Canadian market have a significant impact on the ability of a magazine primarily addressed to Canadian interests to obtain the broad base of circulation that is necessary to achieve economic viability. Canadian magazine publishers compete with other media for the same limited amount of advertising dollars in the Canadian market. Magazines have been losing market share to other media forms such as direct mail and television. It is unlikely that the share held by magazines will increase. The amount of money spent by advertisers to reach Canadian consumers is also not likely to grow. In addition, "spillover" advertising (the ability of advertisers of internationally distributed products to reach Canadian consumers through US magazines) is a further limitation on the competitive position of the Canadian industry. Canadian periodical publishers face a major competitive challenge in their business environment that is not common to their counterparts in countries with a larger population to serve. The pivotal fact is the penetration of the Canadian market by foreign magazines. Canadian readers have unrestricted access to imported magazines. At the same time, Canadian readers have demonstrated that they value magazines that address their distinct interests and perspectives. However, foreign magazines dominate the Canadian market. They account for 81.4 per cent of all newsstand circulation and slightly more than half (50.4 per cent) of the entire circulation of English-language magazines destined for the general public in Canada.

3.30 Magazines are a particularly good medium for advertisers wishing to reach a specific market defined by regional location. Both Canadian and foreign magazines currently have regional editions in their respective home markets. Publishers and advertisers recognize the importance of regional editions as an advertising vehicle. The marketing strategy behind regional editions is that they allow publishers to offer very specific advertising vehicles for advertisers interested in targeting a particular audience, hence they maximize advertising revenues. Some foreign publishers view Canada as a separate "region" within their own national market. The "Canadian" regional edition produced by such publishers generally contains the same editorial content as the other editions but different advertising content, reflecting the addition of advertisements from Canadian advertisers. The term "split-run" is used in Canada to refer to such a Canadian regional edition. For a foreign publisher, the incentive to produce a Canadian regional edition of its magazine containing advertising directed at Canadians is, of course, profit. A profit for the foreign publisher only requires that the incremental revenue from advertising in the regional edition exceeds the costs of producing the split-run. Since its fixed costs have already been recovered in the larger home market, this offers an inviting prospect for a foreign magazine.

3.31 The Task Force on the Canadian Magazine Industry was established as a result of the anticipated publication of *Sports Illustrated Canada*. *Sports Illustrated Canada* was a split-run edition that was

printed in Canada using text that was electronically transmitted from the United States. The editorial content of *Sports Illustrated Canada* was largely the same as the content in the American editions of *Sports Illustrated* but it contained advertisements that had been specifically purchased to reach a Canadian audience. Tariff Code 9958 was not applicable to *Sports Illustrated Canada* because it was printed in Canada rather than being imported. The emergence of *Sports Illustrated Canada* as a new split-run edition revealed the limitations of Canada's existing policy instruments. Accordingly, the Task Force was created to recommend ways to bring these policy instruments up to date. The Task Force's main recommendation was that an excise tax be imposed on advertising contained in split-run editions of periodicals that are distributed in Canada. The object of the excise tax is not to discourage readership of foreign magazines, but to maintain an environment in which Canadian magazines can exist in Canada alongside with imported magazines. It is also intended to foster conditions in which indigenous magazines can be published, distributed and sold in Canada on a commercial basis. The tax is consistent with the broad principles of the cultural and media policies of successive federal governments.

(i) Article III:2 versus coverage under the General Agreement on Trade in Services (GATS)

Applicability of Article III of GATT 1994

3.32 The **United States** argued that Canada's 80 per cent excise tax on split-run editions is inconsistent with Article III:2, first sentence, of GATT 1994 because it creates an artificial distinction between "split-run" magazines and all other types of magazines and applies the 80 per cent tax solely to split-runs. It therefore applies a higher tax to certain types of imported magazines than to "like" domestic magazines.

3.33 **Canada** argued that this dispute concerns the provision of advertising services to Canadian advertisers and that Part V.I of the Excise Tax Act was a measure pertaining to advertising services. A magazine publisher derives revenue from both the sale of the magazine to consumers and from the sale of advertising space to advertisers. The sale of the right to advertise to a magazine's audience is an advertising service. As the tax imposed by the Excise Tax Act is imposed on the revenues earned through the provision of advertising services by a magazine publisher, it is a tax in respect of the provision of an advertising service. Multilateral trade disciplines on advertising services fall within GATS and not GATT 1994; Article III of GATT 1994 does not apply to Part V.I of the Excise Tax Act. However, the terms of reference direct the Panel to examine only trade matters within the purview of GATT 1994. Thus, the examination of Part V.I of the Excise Tax Act in light of GATS is not covered by the terms of reference. The first distinctive aspect of a magazine is its character as a public good which is largely defined by its content. The second distinctive feature is the magazine's dual nature in that it is both a consumer good and an advertising service with two distinct revenue streams. The two separate revenue streams are circulation revenue, which is derived from the sale of a good, and advertising revenue, which is derived from the sale of a service. The two consumers are readers and advertisers. All magazines exhibit this essential duality, which represents two distinct economic outputs.

3.34 GATT 1994 establishes the standards that govern international trade in goods. The central obligations of GATT 1994 are the tariff concessions by which WTO Members commit themselves (in Article II and the Schedules) to limit the level of tariffs they will impose on imports from other Members. A second obligation is that of the most-favoured-nation ("MFN") obligation in Article I. Articles III through XVII comprise most of the other substantive obligations of GATT 1994. These obligations apply to goods only. Article III of GATT 1994 sets out the national treatment obligation pertaining to treatment of imported goods. The Uruguay Round has produced a similar framework for trade in services. Specific commitments are recorded in national schedules that are attached to, and form an integral part of, the GATS. Every undertaking contained in a schedule to GATS is a binding commitment to allow the supply of the service in question on the terms and conditions specified and to not impose

any new measures that would restrict entry into the market or the operation of the service. In the absence of any scheduled commitments, there are no disciplines on the introduction or the maintenance of measures of any type, even those that may be inconsistent with market access or national treatment commitments. Advertising services appear on the Services Sectoral Classification List of the Secretariat under the business sector.[49] The provision of advertising services is consequently a GATS matter, not a GATT matter.[50] Canada has not undertaken any commitments in respect of the provision of advertising services in its Schedule of Specific Commitments. In the absence of any scheduled commitments, there are *no* restrictions on Canada in respect of the introduction of measures concerning the provision of advertising services. In particular, Canada is not bound, nor in any way obliged, to provide national treatment to Members of the WTO in respect of the provision of advertising services in the Canadian market.

3.35 This challenge in respect of the Excise Tax Act measures is an indirect attempt by the United States to obtain trading benefits that it has been unable to obtain directly. In the guise of a GATT goods argument, the United States now attempts to persuade the Panel to allow it to have access to a service sector to which, in full accordance with the terms of international trade law, it is presently not entitled. Should the Panel agree that a Member can obtain benefits under a covered agreement that have been expressly precluded under another covered agreement, the Panel risks introducing uncertainty into the relationship between GATS and GATT disciplines.

3.36 The **United States** argued that the Canadian argument was baseless because: (1) nothing in GATS purports to reduce or eliminate the obligations that GATT has imposed since 1947; (2) GATS does not have primacy over GATT with respect to measures affecting trade in goods; and (3) Canada can observe its obligations under GATT Article III consistently with the provisions of GATS. There is no indication in the Agreement Establishing the WTO, GATT, or GATS, that adoption of GATS was intended as a limitation on the scope of GATT 1994. Had the negotiators intended to adopt a principle as fundamental as the one Canada now puts forward, they certainly would have provided for it in the text of GATT, GATS or WTO Agreement. In the absence of such an indication, or an irreconcilable conflict - neither of which Canada can point to here - GATT and GATS must be applied according to their terms. (It is theoretically possible that the same measure may be covered by, and may even violate, both agreements. Indeed, a measure may violate more than one goods agreement as well, provided the measure is within the scope of each agreement and is inconsistent with the provisions of each.) By contrast, the negotiators of the WTO did establish a rule for addressing conflicts between GATT 1994 and the multilateral agreements on trade in goods in Annex 1A to the WTO Agreement.[51] By their terms, GATT Article III:2 covers taxes applied to products "directly or indirectly", and GATT Article III:4 applies even to measures affecting *services* connected to goods, such as "distribution" and "transportation".

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[49]Canada notes that there are three Articles in Part III of the GATS on Specific Commitments, entitled Market Access, National Treatment, and Additional Commitments (Articles XVI, XVII and XVIII respectively). In general, the classification of sectors in national schedules is based on the Secretariat's Services Sectoral Classification List. This reference list of the Secretariat is based on the Central Product Classification (CPC) of the United Nations. See *Services Sectoral Classification List: Note by the Secretariat,* MTN.GNS/W/120 (10 July 1991). See also *Scheduling of Initial Commitments in Trade in Services: Explanatory Note,* MTN.GNS/W/164 (3 September 1993).

[50]Canada cites United Nations, Dept. of International Economic and Social Affairs, Statistical Office of the United Nations, *Provisional Central Product Classification*, Statistical Papers, Series M No. 77, U.N. Doc. ST/ESA/STAT/SER.M/77 (New York: United Nations, 1991) at 147-148, 173. Item 8711 states: sale or leasing services of advertising space or time. Services provided in soliciting advertising space or time for newspapers, other periodicals, and television stations. Item 8712 states: planning, creating and placement services of advertising. Planning, creating and placement services of advertisements to be displayed through the advertising media. Item 8719 states: other advertising services. Other advertising services not elsewhere classified, including outdoor and aerial advertising services and delivery services of samples and other advertising material.

[51]See General interpretive note to Annex 1A.

3.37 Canada's decision not to inscribe relevant commitments on advertising services in its GATS schedule of specific commitments means that Canada is not assuming certain GATS obligations as to those services. Canada does not thereby insulate all measures having any connection to advertising from review under any other WTO agreement. Such a result would improperly exalt GATS over GATT and other WTO agreements. Canada's view would open a huge hole in GATT because there is no shortage of "service-related" measures that could be used to discriminate against imported goods. Under Canada's interpretation, a Member could, consistently with GATT: tax the rental of foreign cars, place a prohibitive surcharge on telecommunication services that are carried out using imported equipment, or impose a room tax on persons staying at hotels that were built using imported construction materials. Although each of these measures relates to the provision or consumption of a service, each also obviously imposes a competitive disadvantage on imported products and provides protection to domestic production, and each would be within the scope of GATT Article III. It is irrelevant whether or not the excise tax could be a measure affecting trade in advertising services. The excise tax is a direct or indirect tax on a product, split-run magazine editions, within the meaning of Article III:2.

3.38 **Canada** noted that it does not claim that there is a conflict between GATT 1994 and GATS in this case. The two treaties may very well apply in their own respective jurisdiction. GATS does not have as its object, and does not result in, the carving out of part of the jurisdiction of GATT 1994. The negotiators of GATS have merely developed new rules for a sector of international trade to which the existing rules did not apply. They have not, in doing so, redefined the scope of Article III of GATT 1994. The interpretation suggested by Canada of the area of application of Article III with respect to the provisions relating to services would have been the same in 1993 before the GATS treaty came into force. The interpretation is autonomous and based on specific terms of Article III:2 as well as on its intent and its original scope. The issue of overlapping obligations or conflicts arises because of the existence of two treaties, GATT 1994 and GATS, which contain different sanctions with respect to the provisions relating to services. Because of the existence of these two treaties which may apply to a given measure, it is necessary to interpret the scope of application of each such as to avoid any overlap. Such overlaps between the areas of GATT 1994 and GATS could lead to conflicts in the application of the treaties which should be resolved on the basis of the rules of interpretation of public international law.

3.39 The Canadian interpretation of the scope of Article III:2 of GATT 1994 and Article I:1 of GATS avoids such overlaps, respects the autonomy of each treaty and ensures the harmonious application thereof. It is not necessary in the instant case to determine the primacy of one treaty over the other. The Panel does not have to decide this question since there is no conflict. What must be decided is the individual scope of Article III:2 of GATT 1994 and Article I:1 of GATS. Part V.1 of the Excise Tax Act is a measure regarding the provision of services which is dealt with by Article I:1 of GATS. It is on the basis of an interpretation of the specific terms of Article III:2 of GATT 1994 and of Article I:1 of GATS, made in accordance with Article 31 of the Vienna Convention on the Law of Treaties, that the scope of application of each of the two treaties must be determined. The analysis of the measure which is the subject of the dispute leads to the determination of which of the two treaties apply. Canada does not rely on the rules of conflict to resolve the question of the applicability of Article III:2 of GATT to Part V.I of the Act. It is the interpretation of the word "indirectly" in Article III:2 which enables Canada to conclude that the Article does not apply to this measure.

3.40 To determine which disciplines apply to a given measure, one must examine not only the object of the tax and the fiscal mechanism used, but most of all one must examine the effects of the tax, by distinguishing between principal and incidental effects. Some relevant factors for such a determination are: the nature of the economic activity covered by the measure, the structure and effects of the measure and the intention of the measure. A measure may have different aspects and may, as a result, attract different disciplines under different agreements, but no single aspect of a measure should be subject to both disciplines at the same time. In any case at the margins of the two disciplines, Canada suggests

that the dominant or essential characteristics of the economic activity at issue should control the determination of whether GATT or GATS is applicable. In the case of the excise tax on split-run periodicals, the principal effect is to restrict the access of foreign publishers to the Canadian advertising market since, in principle the periodical could very well be sold on the Canadian market with advertising not specifically addressed to Canada. This is evidenced by the fact that plans for prospective split-runs for the Canadian market are based on actual sales in Canada of the original version of the magazine which does not contain specific advertising for that market.

3.41 The tax is intended to prevent the penetration of the Canadian advertising market by publishers who sell their advertising services in association with split-run magazines. It is clear that the measure pertains to the supply of a service and as such is a measure that WTO Members intended to be disciplined under GATS. This was recognized by the United States Trade Representative, in the *1995 National Trade Estimate Report on Foreign Trade Barriers* (NTE), where Canada's practices with respect to split-run advertising were listed and described under the heading Services Barriers.[52]

3.42 The **United States** responded that Canada's suggestion that GATT or GATS should apply based on the "dominant or essential characteristics of the economic activity at issue" was simply a test Canada had invented. Like Canada's other assertions relating to the GATS, it found no support in any of the WTO Agreements or their negotiating history. Adoption of such a test would alter the rights and obligations of WTO Members, in violation of Article 3.2 of the DSU. The United States submitted that whereas Canada referred to the need to avoid conflicts between GATT and GATS, it had failed to identify exactly what those conflicts were. A true "conflict" between two agreements arose only where compliance with one agreement necessarily resulted in non-compliance with the other. This simply was not the case with respect to the excise tax. Applying taxes to imported split-run magazines in a GATT-consistent manner (i.e., at a rate no higher for split-run than for non-split-run magazines) in no way requires Canada to breach its GATS obligations with regard to advertising services or any other service sector. Moreover, there is nothing that is even "inconsistent" about the obligations that the two agreements impose on Canada. The United States also asserted that, although USTR's *1995 NTE Report* listed the excise tax and other similar Canadian barriers under the heading of "services barriers", the report noted that these practices "restrict US access to the Canadian market for *publications and* media advertising" (emphasis added). In the *1996 NTE* report, the United States discussed Canadian restriction on US publications under the heading "Import Policies", not "Services Barriers".

"Taxes applied directly or indirectly to products"

3.43 The **United State**s further argued that the tax is covered by Article III because it is imposed on the split-run edition which, like all magazines, are "products" for purposes of GATT. Magazines are physical goods that are manufactured, traded, and in the absence of a ban such as Canada's, imported. While the amount of the tax is *measured* in terms of "the value of all advertising in the edition," the tax is *applied* to each split-run edition. By its terms the tax is applied "in respect of each split-run edition of a periodical". Moreover, the tax is applied on a "per issue" basis. In addition, the obligation to pay the tax is imposed on those who produce or trade in the magazine as a final product, such as the publisher, distributor, printer or wholesaler, *as opposed to those who design or purchase advertising*. Finally, even the method of calculating the tax is based on revenues derived from an integral element of the physical magazine itself - the printed advertisements. Thus, the excise tax is applied directly on split run editions themselves, not on a service offered in connection with such editions.

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[52]See *1995 National Trade Estimate Report on Foreign Trade Barriers* (Washington, D.C.: United States Trade Representative, 1995) at 38.

3.44 **Canada** argued that the tax is not applied directly to a split-run magazine and in particular it is not based on, or applied to, the price of a split-run magazine. The tax is applied to the value of advertising carried by each issue of a split-run magazine and is assessed against the publisher of the split-run magazine, as the seller of the advertising service. The expression "in respect of each edition" serves as a basis for determining and calculating liability that relates to advertising revenue as the subject matter of the tax. The significant point, which decisively identifies the subject matter of the tax, is that the tax is measured not in terms of the price of the magazine but in terms of the advertising revenues it generates.

3.45 The tax is imposed on the publisher in the publisher's capacity as a provider of advertising services. The tax is tied to the service provided rather than the good. The publisher is the person responsible for the payment of the tax. The distributor, the printer and the wholesaler have been identified as potentially liable where it would be impossible to collect the tax in Canada from the publisher. In such cases, the Act grants those persons a right of recovery against the publisher.[53] Accordingly, there is no doubt that the ultimate liability falls on the publisher, and because the *ad valorem* basis of the tax is advertising, this liability arises directly out of the services dimension of the publisher's business. The collection mechanism is designed to ensure that there is always a person in Canada from whom the tax can be collected. It is doubtful whether collection machinery should ever be used as a basis for characterizing the nature of a tax, and in the particular circumstances of this case it would be entirely inappropriate.

3.46 The **United States** responded that Canada's allegation that the excise tax is collected from the publisher in connection with its provision of advertising services ignored that the publisher was the producer of the magazine as a product. With regard to imported magazines, Canada admitted that it is the *distributor* "who has to pay the tax". A magazine's distributor had absolutely no connection to the provision of any "advertising services". Moreover, if the foreign publisher of the imported magazine did not have a sufficient business presence in Canada, the magazine's distributor who paid the tax would be unlikely to obtain indemnification from the publisher at all. Indeed, the excise tax on split-run magazines was collected in a fashion similar to other excise taxes on products, such as the excise taxes in the *Japan - Alcoholic Beverages* case, and the federal excise taxes in the *US - Malt Beverages* case. Like the split-run tax, in those cases the excise taxes with respect to domestic products were collected from the producer, and the excise taxes with respect to imported products were collected from the importer, who was essentially a type of distributor.

3.47 Article III:2, first sentence, governs taxes applied directly or indirectly to products. Canada's argument that the tax is actually on advertising services confuses how the tax is *measured* (i.e., in terms of advertising fees) with what the tax *applies* to (i.e., split-run editions). There is ample additional evidence that the excise tax is a tax applied to split-run magazines as a product:

- The Task Force's recommendation - which the Canadian Government adopted and which the Canadian Parliament enacted - describes the tax as a tax "*imposed on a magazine or periodical*".[54]

- In introducing the bill to enact the excise tax, Minister of Canadian Heritage Dupuy stated that the excise tax "would *apply to all periodicals* distributed in Canada and containing more than 20 per cent of reused editorial material as well as one or more advertisements aimed at Canadians", and that "[t]he publisher, the distributor, the printer

[53]*Excise Tax Act*, R.S.C. 1985, c. E-15 as amended by S.C. 1995, c. 46, s. 41.3(2).

[54]*Task Force Report* at vi, 64 .

> or the wholesaler of *any magazine subject to the tax* would be responsible for paying the tax".[55]

- Following House of Commons passage of the excise tax bill, Canadian Heritage issued a press release describing the tax as follows: "The amendment to the Excise Tax Act will *place an excise tax on split-run magazines* distributed in Canada that contain more than 20 per cent recycled material . . . and one or more advertisements aimed at Canadians".[56]

Thus, during the time the excise tax was being formulated and enacted, Canadian officials had considered the tax to be a tax imposed on split-run magazines. It is only in the context of this panel proceeding, and in the light of US claims that the tax is inconsistent with Article III of GATT 1994, that Canada has advanced the argument that the tax is really a tax on advertising services and not a tax on split-run magazines. Indeed, given the statements of Canadian Government officials that the excise tax was designed to eliminate split-runs from its market, Canada's argument that split-run magazines are neither directly nor indirectly subject to the excise tax is not credible.

3.48 Even if the tax is not applied *directly* to split-runs, it is at a minimum applied *indirectly* to them because it is based on one of the two key uses to which magazines are put - in this case, the placement of advertisements. Moreover, it is impossible to separate the advertising that goes into a magazine from the magazine itself. Advertising is a significant component of commercial magazines, typically accounting for half or more of total pages. A magazine's advertisements can significantly affect its appeal and usefulness to readers. In addition to virtually eliminating their use as advertising vehicles - thus drastically reducing the revenues available to market such magazines - the tax reduces the appeal of such magazines to Canadian readers by effectively eliminating advertisements of interest to them.

3.49 **Canada** argued that the excise tax does not apply "indirectly" to a good within the meaning of Article III:2. In discussions at the London session of the Preparatory Committee, it was suggested that the word "indirectly" covers a tax not on a product as such but on the processing of the product".[57] The panel report in *Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*[58] gave an interpretation of the term "indirectly" that was consistent with this reading:

> "The Panel…found that the wording "directly or indirectly" and "internal taxes… of any kind" implied that, in assessing whether there is tax discrimination, account is to be taken not only of the rate of the applicable internal tax but also of the taxation methods (e.g. different kinds of internal taxes, direct taxation of the finished product or indirect taxation by taxing the raw materials used in the product during the various stages of its production) and of the rules for the tax collection (e.g. basis of assessment)".

The concept of "indirectly" in Article III:2 does not capture measures that are disciplined under GATS. It is intended to capture taxes that apply to "inputs" that contribute to the production of a good – raw materials, service inputs, intermediate inputs, etc. The question of whether the excise tax is covered

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[55]*Commons Debates* at 14790, Sept. 25, 1995 (emphasis added).

[56]*House of Commons Passes Bill C-103, News Release*, Department of Canadian Heritage, Nov. 3, 1995 at 2 (emphasis added).

[57]EPCT/A/PV/9 at 19; and EPCT/W/181 at 3.

[58]Panel Report on *Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, adopted on 10 November 1987, BISD 34S/83 at 118, para. 5.8.

by Article III:2 of GATT 1994 by reason of the expression "indirectly" must be examined in light of the relationship between GATS and GATT 1994.

3.50 Article III:2, to the extent that it allows a challenge of measures relating to services that "indirectly" impact on trade in goods, covers only measures concerning inputs such as raw material or services inputs that are directly involved in the production of a good. Taxes on such production inputs are properly subject to Article III:2 because they affect the costs and prices, and therefore the competitive position of goods that are subject to Article III:2. It is important, however, for the Panel to distinguish service inputs that are directly involved in the production of a good and services that are "end-products" in their own right. The publishers' advertising services, although closely associated with the magazines, are separate products. They are not involved in the production process of the magazines. The advertising services of the publisher are not, like labour in the production of a car, an input in the production of a good.

3.51 In order for a measure with respect to services to fall "indirectly" under Article III:2 of the GATT 1994, it has to affect the competitive situation of the importer on the market. In other words, the provision of the service has to be ancillary to the provision of the good in that market. The situation is reversed where the good produced by the exporter is used to gain access to a service market. In such an instance, the provision of the good becomes ancillary to the provision of the service which has the effect of transferring jurisdiction from GATT 1994 to GATS. Consequently, the argument on Article III:2 (and Article III:4) does not hold. Otherwise, such a restrictive interpretation could considerably diminish the scope of GATS and could lead to absurd situations such as those provided as examples by the United States. For example, irrespective of a Member's right not to make commitments with respect to foreign legal services, it would be impossible to maintain measures that restrict access when provided in a printed format. If allowed, the US interpretation of the expression "indirectly" would force Canada to accord national treatment to foreign publishers with respect to advertising services when it did not make any commitments in that respect in GATS. Such an interpretation would create an imbalance in carefully negotiated concessions on services sectors made by WTO Members during the last round of Multilateral Trade Negotiations. It would also void GATS of its effectiveness as it concerns Canada's right not to make commitments on advertising services.

3.52 If the United States is successful in persuading the WTO to condemn Canada's measures as inconsistent with GATT, the United States will be able to obtain direct access to a market from which it is otherwise properly precluded under international law. The measures in question are designed to protect access to Canada's advertising services market and they are effective in doing so. If the measures are struck down under the guise of GATT inconsistency, the WTO will have facilitated an unnegotiated concession on the part of Canada. The consequences of such an effect are far reaching. If the WTO is in any doubt about the nature of the dispute, it must simply look at what the United States will gain if successful. The United States will not gain greater access for its magazines. These magazines in exactly the same form as they are distributed in the United States already enter unimpeded. It will gain access to Canada's advertising market and the revenues to be had in that market.

3.53 The periodical publication industry is one which combines two commercial activities which are economically linked, the production of periodicals and the sale of advertising services. It cannot be denied that the autonomous economic activity which is the sale of advertising services significantly contributes to the financial viability of the publishing industry. However, this has nothing to do with the designation of two separate activities of an industry for the purposes of the application of GATT 1994 and GATS. The fact that an integrated industry uses some of its commercial activities and revenues so generated in order to facilitate the marketing of some of its other activities should not influence the characterization of the activities for the purposes of determining which sections of the WTO apply to them. The key element in the application of Article III:2, when considering whether a tax applies indirectly to a good, is whether this tax affects indirectly the global income generated by the industry

under consideration. Hence the distinction made by Canada between a service as an input in the production of a good, which is within the scope of Article III:2, and a service which is a product of an independent activity such as the advertising services of a publisher, which are within the scope of Article I:1 of GATS. Canada also raised the further distinction which must be made between the services that are within the scope of GATT 1994 and GATS on the basis of the accessory or principal nature of the service. A service, as an input in the production of a good, is an accessory in the production of a good. However, the advertising services of a publisher are the principal product for which a periodical is the accessory.

3.54 A large number of services result in the production of a good. The fact that the result of the provision of the service is physically incorporated in the production of a good is not in itself a key factor in the characterization of the measure which relates to such a service. It is because of the economic integration of the two activities which form the periodical publication industry that advertising, in its physical form, is incorporated into periodicals. It is because a periodical is the accessory of the advertising service, its vehicle, that advertising in its physical form is incorporated into a periodical. It is not because advertising is physically "necessary" to the material production of a periodical as an editorial vehicle. Unlike printing services (the work of the printers), the advertising services of the publisher have nothing to do with the physical production of periodicals. Those services only relate to the financial viability of the integrated activities of the periodical publishing industry. This has nothing to do with the protection found in Article III:2 of GATT 1994. To extend the scope of Article III:2 and of the phrase "indirectly" would result in en extension beyond natural and reasonable meaning in the circumstances. The level of integration of an industry cannot be a factor in the characterization of a measure which relates to one of its activities for the purposes of determining which WTO treaties applies thereto. The only factors applicable are the nature of the measure and the scope of application of each of the two treaties.

3.55 There are no contradictions in the Canadian approach. Canada provided a general description of the periodical publishing industry and pointed out the integration of advertising and publishing activities. This explains the close relationship of these activities as far as overall income for the industry is concerned as well as the accessory nature of periodicals for the advertising services of publishers. Canada's main position is very clear. There is no doubt that the advertising services of publishers are services that are not accessory services or inputs in the production of periodicals. The fact that these services are part of the integrated activities of a publisher and that the income which results from them contributes to the overall financial viability of the industry does not affect the characterization of the activity for the purposes of the applicability of Article III:2. The latter does not apply to measures relating to the ability of a publisher to market its advertising services. Part V.1 of the Excise Tax Act is beyond the scope of Article III:2 of GATT 1994.

3.56 The **United States** asserted that neither the plain meaning of the term "indirectly" in Article III:2, nor the limited negotiating history concerning it, supports a restrictive meaning of that term. Rather, the negotiating history reveals that a tax with respect to the processing of a product was one example, but not necessarily the only example, of an "indirect" tax on a product. Advertisements are a substantial feature or component of a magazine as a product, accounting for half or more of the pages of a typical magazine sold in Canada. It is not logical to say, as Canada does, that a tax with respect to inputs - that is to say, things that are consumed in making a product - is a tax directly or indirectly on a product, but a tax that concerns a major feature or component of that actual product is not. If anything, the latter is more directly a tax applied to the product itself. Advertisements affect a magazine's price, cost, and competitive position as much as any input consumed in the production of a product. The carrying of advertisements is, moreover, a major use to which magazines are put. A tax with respect to a substantial use of a product can be viewed as a tax, directly or indirectly, applied to the product.

(ii) Conformity of Part V.I with Article III of GATT 1994

3.57 **Canada** observed that there is an artificial quality to any attempt to assess how Article III applies to a tax that has never been applied to a foreign product. It has been assumed that the tax does not apply to imported products in view of the maintenance of Tariff Code 9958. Article III:2 requires a comparison of an imported and a domestic product, a comparison that has to remain purely hypothetical in this case. Subject to this observation, Canada provides an alternative argument to be considered in the event the Panel is of the view that Part V.I is a taxation measure that applies to magazines as "goods" and that an examination of the application of Article III of GATT 1994 has to be conducted.

3.58 The **United States** remarked that, by Canada's own admission, the excise tax applies to imported (as well as domestically produced) magazines. To the extent that the tax had not actually been *levied* on imported split-runs, it is because those imports had been completely banned by Canada. It is entirely possible that even if there were no import ban the excise tax would still not be levied because the tax is set at such a high level that it would likely discourage producers from marketing imported split-runs in the first place. It is well-settled in GATT that the level of actual imports is not the basis for assessing whether a violation of GATT Article III exists. The 1949 Working Party on *Brazilian Internal Taxes* stated that the obligations of Article III "were equally applicable whether imports from other contracting parties were substantial, small or non-existent".[59] This is because the purpose of Article III is not to protect expectations on trade volumes, but rather "expectations on the competitive relationship between imported and domestic products".[60]

3.59 Thus, the plain fact that the excise tax is mandatory legislation that applies by its terms to imported magazines brings it within the purview of Article III. The principle that actual imports are not required is especially appropriate in this case because Canada has banned the relevant imports to which the tax would otherwise apply. A WTO Member cannot use a GATT-inconsistent import prohibition to shield its discriminatory domestic regulations from scrutiny. In the absence of the import prohibition, the excise tax would immediately affect imported split-run magazines. By making imported split-runs prohibitively expensive to sell in Canada, the tax would accomplish what the import ban now does: the absence of imported split-runs in the Canadian market. The effect of this scheme is that dozens of US split-runs would be sold in Canada but for barriers Canada has erected to their sale. This case is not based on Canada's treatment of US publishers' split-run magazines produced *in Canada*. Such magazines are not imported products within the scope of GATT Article III.

(a) Article III:2, first sentence

Like product issue

3.60 The **United States** argued that the Canadian excise tax created an artificial distinction between otherwise entirely like products - split run and non-split run magazine editions - based on the extent to which the same or a similar version of the product was sold abroad. The excise tax defines a split-run magazine entirely in terms of its relationship to another magazine sold outside Canada. It is, therefore, impossible to determine whether a magazine is a split-run based simply upon an examination of its physical form, its editorial content, or its advertising content. The fact that a similar edition of a magazine is sold in a country other than Canada does not differentiate the magazine from another magazine in terms of physical characteristics, end-uses, content, advertising, or any other attribute. In fact, the defining characteristic of a split-run magazine under the excise tax - the existence of another

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[59]The 1949 Working Party on *Brazilian Internal Taxes*, adopted on 31 June 1949, BISD II/181, 185, para. 16 .

[60]Panel Report on *United States - Taxes on Petroleum and Certain Imported Substances*, adopted on 17 June 1987, BISD 34S/136, 158, para. 5.1.9.

magazine sold outside Canada - is an extraneous factor having nothing to do with the character of the split-run itself.

3.61 **Canada** argued that periodicals with editorial content developed for the Canadian market and split-runs substantially reproducing foreign editorial content are not "like products" within the meaning of Article III:2 and are distinguishable on the basis of their content, the essential characteristic of any magazine. Magazines are distinct from ordinary articles of trade. Magazines are intended, by their very nature, for intellectual consumption as opposed to physical use (like a bicycle) or physical consumption (like food). It follows that the intellectual content of a cultural good such as a magazine must be considered its prime characteristic. Consequently, the "like product" analysis of whether imported split-run magazines share the same characteristics as domestic magazines with editorial content developed for the Canadian market must be approached in terms of intellectual content as opposed to the traditional approach of examining material or physical characteristics. The periodical industry is keenly aware of the importance of editorial content. It is editorial content and its ability to attract readers that determine the ability of a periodical to attract advertising revenues to securing its financial viability.

3.62 Periodicals with editorial content developed for the Canadian market and split-run periodicals envisaged by the legislation are distinct products on the basis of their editorial content. The definition of "split-run edition" reflects this distinction. Editorial material developed for the Canadian market reflects a Canadian perspective and contains specific information of interest to Canadians. The content is qualitatively different from editorial material copied from foreign publications.

3.63 What has been said of the essential properties of magazines is equally applicable to their end-use. The end-use of a magazine is not simply reading; it is the transmission and acquisition of specific information. The information in, for example, a sports magazine, cannot be considered essentially the same as that in a philosophical journal. Any attempt to characterize the "end-use" of products so broadly that they all end up in the same category would deprive this consideration of any real meaning and would run afoul of the principle that the expression "like" in this context is to be narrowly construed.[61]

3.64 The **United States** argued that a distinction of the type Canada had drawn in its excise tax should be inherently suspect under Article III because it is founded on distinctions other than differences between the products being sold in the importing country. In *US - Standards for Gasoline,* the panel rejected an argument that the US "Gasoline Rule" did not provide less favourable treatment to imported products as compared to like domestic products because it treated similarly situated parties similarly noting that

> "in the *Malt Beverages* case, a tax regulation according less favourable treatment to beer on the basis of the size of the producer was rejected".

and observing that, under the US argument in that case

> *"imported goods would be exposed to a highly subjective and variable treatment according to extraneous factors. This would thereby create great instability and*

[61]Appellate Body Report on *Japan - Taxes on Alcoholic Beverages*, adopted 11 July 1996, WT/DS8/R, WT/DS10/R and WT/DS11/R .

> *uncertainty in the conditions of competition as between domestic and imported goods in a manner fundamentally inconsistent with the object and purpose of Article III".* [62]

3.65 The same concerns about "highly subjective and variable treatment according to extraneous factors" that the panel identified also apply in this case. The "extraneous factors" on which application of Canada's excise tax depends are the existence or non-existence of a product sold in a country other than Canada, and the extent of that product's similarities to, and differences from, the product sold in Canada. The United States described examples that it considered showed how Canada's distinction between split-runs and other magazines produced odd and arbitrary results based on sales of products outside Canada.

3.66 **Canada** argued that the point is not whether originality could be perceived as such, but whether there was a difference between the two products at issue - the split-run replicating a foreign magazine, on the one hand, and the domestic magazine with original content, on the other. This had nothing to do with "subjective and variable treatment according to extraneous factors" as identified in the panel on *US - Standards for Gasoline*. It made no difference in terms of product characteristics whether the gasoline was handled by refiners, blenders, or producers. Gasoline was gasoline, but any careful examination would show that content differences between split-runs and original Canadian magazines were characteristics of the products themselves. A recurring theme of the United States argument is that the Canadian legislation is not based upon objective product differences; that it is based on a distinction unrelated to product characteristics. This is said to be the result of a definition that depends entirely on the existence of a foreign companion edition with sales outside Canada. In the words of the United States, this is an extraneous factor that has nothing to do with the character of the split run itself. On the contrary, it has everything to do with the character of the split-run itself. The legislation does not focus on the existence of a so-called companion edition as a factor unrelated to the characteristics of a split-run marketed in Canada. It focuses on the fact that the split-run marketed in Canada is to a substantial degree no more than a reproduction of a foreign edition, with the content characteristics invariably associated with such material. It is not the existence of a foreign companion edition, or sales of that edition outside Canada, that counts. It is the reproduction in the Canadian split-run of content that originated in that foreign edition. Contrary to the United States argument, this is a product characteristic of the split-run magazine. The replication of foreign content is not only an attribute of the split-run – a defining attribute, in fact – it is readily discernible from an examination of the product itself.

3.67 Canada further considered that the United States' approach to like products is *necessarily* over-broad because it ignores the only basis on which one magazine can be distinguished from another - the content. If magazines are treated as ordinary articles of manufacture, defined only by the fact that they are physically made up of printed paper and staples, then it would obviously have to follow that all magazines are exactly the same. The United States submission even implies when it refers to Canada's tariff item 49.02, that newspapers, journals and periodicals are like goods. This leads to the second basic principle Canada referred to in this connection: that "like product" determinations under Article III.2 are to be made on a case-by-case basis. The reason for proceeding case-by-case is obvious: to avoid over-generalization and a mechanical or automatic transfer of criteria that are suitable in one context to another context where they no longer properly apply. A case-by-case approach is one that

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[62] *United States - Standards for Reformulated and Conventional Gasoline, op. cit.*, paras. 6.11-6.12 (emphasis added). The United States added that in *United States - Taxes on Automobiles*, DS31/R (29 Sept. 1994, unadopted), the panel (para. 5.55) found that "Article III:4 does not permit treatment of an imported product less favourable than that accorded to a like domestic product, based on factors *not directly relating to the product as such.* The Panel found therefore that, to the extent that treatment under the CAFE measure was based on factors relating to the control or ownership of producers/importers, it could not in accordance with Article III:4 be applied in a manner that also accorded less favourable treatment to products of foreign origin" (emphasis added).

takes account of the particular circumstances. It cannot be denied that cultural products are different, that they have their own distinguishing characteristics. By treating them as if they were ordinary items of merchandise trade, the United States has ignored the entire rationale of the case-by-case approach.

3.68 The chief and for all practical purposes the *only* distinguishing characteristic of a magazine is its content. Content plays a role in the case of cultural products that is analogous to physical properties in the case of ordinary items of trade. Content is what the reader is looking for – the message and not the medium. The end-use of a magazine is the transmission of specific information. A magazine has a utilitarian function – it may be to keep up on current events; to acquire information about specific topics like computers or investments; in some cases, to provide entertainment – but in every case, the function and value of the magazine to the reader is inseparably linked to its specific content or subject matter. The United States' emphasis on physical properties leads inevitably to a lumping together of all magazines as indistinguishable commodities, contrary to the principle of narrow construction and the case-by-case approach. The approach that Canada advocates, giving content the decisive role, does not lead to the opposite extreme. Magazines can easily be classified by type, either broadly or narrowly, on the basis of content. Exactly where the lines are to be drawn can be a matter of judgment, but no more so than in the case of any other like product determination.

3.69 The legislation uses the concept of original material as the defining element – material that is not, to quote the statute, "the same or materially the same as editorial material" in editions that circulate primarily in foreign markets. This criterion of original versus replicated material might seem abstract at first, but in its practical effect it refers to a dividing line that is very easily recognized. Original material means content developed for and aimed at the Canadian market – this means Canadian content in terms of subject matter as opposed to authorship or production. The idea that Canadian content is the same as foreign content is simply not tenable. The events, topics and people covered will be Canadian. They may not be exclusively Canadian, but the balance will be recognizably and even dramatically different than in a replicated foreign publication, where articles on Canada are close to non-existent. Foreign magazines are almost devoid of content dealing with Canada, and what little there is quite logically fails to reflect a Canadian perspective. Even where the topics covered are the same, the perspective will be different. Some of these qualities like "perspective" are admittedly somewhat intangible; but where cultural products are at issue, these assessments cannot be avoided. And they fall well within the legitimate range of the kind of "discretionary judgment" the Appellate Body has identified as inherent in like products determinations for the purposes of Article III – discretionary but not arbitrary. It is the prevailing characteristics of each category that we should look at in determining whether or not publications created for Canada are the same as publications replicated from foreign editions. There may be individual articles that might conceivably have appeared in either type of magazine. Some issues might be more different or less different than others. But the prevailing pattern is what counts. Canadian content and foreign content are significantly different. Local publications deal with local topics. People are preoccupied with their own affairs and communities. Periodicals are the mirror image of those communities. The content of a periodical created for one community will necessarily differ from what is created for another community.

3.70 Further, the only actual magazines the United States has chosen to exhibit in this case are *Pulp & Paper*,[63] which is not a split-run and has no relevance to the Excise Tax Act, *Paris Match* and *The Economist*. *Paris Match* is an imported non-split-run and *The Economist* is an imported split-run that is exempt from the tax as a North American edition without advertising specifically directed at the Canadian market. *None* of these magazines is relevant to the comparison between domestic and imported products that has to be made under Article III:2, first sentence. But the evidence is readily available, because there are grand-fathered split-runs in Canada that can be compared with other domestic Canadian

[63]Referred to in paragraph 3.91.

magazines. This evidence has been filed by Canada, although Canada does not bear the burden of proof. The evidence consists of *Time US*, *Time Canada* and *Maclean's* – what the United States would call a foreign companion magazine, a split-run that would be taxable without the grandfathering provision, and an original domestic magazine. And the issue, in a nutshell, is whether the last two – *Time Canada* and Maclean's – are "like" products, having regard to the narrow construction and the case-by-case approach mandated by the *Japan - Alcoholic Beverage* Appellate ruling.

3.71 Canada's evidence in the form of actual magazines provides typical examples of a split-run in the form of *Time Canada*, the parent edition in the form of *Time US*, and a domestic magazine in the form of *Maclean's*. The proper basis of comparison is of course *Maclean's* and *Time Canada*. Almost every article in *Maclean's* deals with Canada. This is true of the editorial, the letters, the business news, the entertainment coverage, the arts, crime, people, the law, much of the news – everything in fact but the lead international stories covering about 8 out of 88 pages. Next, a comparative look at *Time Canada* shows that it has practically *no* reference to Canada or Canadian subject. There are two out of 21 letters from Canadian sources. There is a travel advisory on Montreal, but it turns out to be about an exhibit dedicated to an American landscape architect. The difference between *Time Canada* and *Maclean's* is striking. It would escape no reader and no consumer. This is about as typical an example as one could find. These are mainstream, mass circulation magazines. Canada suggests that there is a significant, objective, discernible difference between a split-run and a magazine created with original content for the Canadian market.

3.72 The **United States** contested Canada's argument that imported split-runs were not like or directly competitive or substitutable with non-split runs because non-split-runs contain original content that is from a Canadian perspective. An examination of the structure of the tax showed this to be false. Moreover, even if this assertion were true it would not form a legitimate basis for distinguishing between otherwise like products. First, by its terms the tax applied or did not apply, to particular magazines irrespective of their editorial "perspective". For example, a magazine published solely for the Canadian market, or that contained no advertising specifically directed at Canadians, automatically avoided the tax regardless of how "foreign" its contents might be. However, the very same magazine became subject to the tax if it had a somewhat different foreign companion edition. Second, the editorial content need not be "original" at all. Rather, a magazine could avoid the tax, but still be identical to what is sold abroad, as long as the publisher did not advertise to Canadians. This suggested that the real basis for the distinction is simply whether the magazine might compete for advertising revenues with purely domestically produced Canadian magazines. That, indeed, is a purpose that Canada did not hide. Finally, even if one could somehow credit Canada's argument that it is seeking through the excise tax to ensure "original content" in magazines sold in Canada this purpose would be equally illegitimate. If GATT permitted governments to require that imported goods be designed exclusively or primarily for their markets, they could easily insulate their markets from the comparative economic advantages of other WTO Members. Such a result would undermine the foundations of international trade.

3.73 The recent Appellate Body report in *Japan - Alcoholic Beverages* shares the focus of the *US - Standards for Gasoline* panel report on objective *product* differences in judging product likeness. There the Appellate Body observed:

> "The Report of the Working Party on *Border Tax Adjustments*, adopted by the CONTRACTING PARTIES in 1970, set out the basic approach for interpreting 'like or similar products' generally in the various provisions of GATT 1947:
>
> > …The interpretation of the term should be examined on a case-by-case basis. This would allow a fair assessment in each case of the different elements that constitute a "similar" product. Some criteria were suggested for determining, on a case-by-case basis, whether a product is "similar"; the product's end-uses in a given market;

> consumers' tastes and habits, which change from country-to-country; the product properties, nature and quality.
>
> This approach was followed in almost all adopted panel reports after *Border Tax Adjustments*". [64]

The Appellate Body found that the term "like product" in Article III:2, first sentence must be "construed narrowly" in light of the existence of the second sentence of Article III:2 which covered "directly competitive or substitutable" products, and that distinguishing between "like products" and "directly competitive or substitutable" products "is a discretionary decision that must be made [by panels] in considering the various characteristics of the *products* in individual cases".[65]

3.74 Thus the Appellate Body in *Japan - Alcoholic Beverages*, like the *US - Standards for Gasoline* decision, endorsed a case-by-case approach that focused on differences in *products,* rather than on distinctions based on extraneous factors such as the production method. The illustrative list of like-product factors cited by the Appellate Body - end-uses, the product's properties, and so forth - are identical for a magazine sold only in Canada and a magazine for which a companion edition is sold abroad. While "like product" in Article III:2, first sentence, must be interpreted narrowly, it cannot be interpreted so narrowly as to permit less favourable treatment based on distinctions between literally identical products depending on whether a companion product is sold in another market. This interpretation would be so narrow as to eliminate "like product" altogether from Article III:2, first sentence.

3.75 **Canada** considered that the US arguments on the like product issue failed to present any positive evidence that an imported split-run had enough in common with original-content Canadian magazines to allow them to be considered like products. The absence of such evidence is fatal because the United States had the burden of proof. Canada was not suggesting that a magazine had only one attribute. Nor did it back away from the proposition that the assessment had to take into account all the relevant circumstances. But the circumstances had to be weighed and balanced according to their importance, and editorial content was the most important distinguishing feature and was the chief and for all practical purposes the *only* distinguishing characteristic of a magazine. A magazine is nothing without its content which was what defined the end-use and the value of a magazine to its readers. Treating content as "one attribute among many" as the United States would say, would tend to sweep all or at least very broad classes of magazines into the same category. This would disregard the narrow characterization of like products required by the Appellate Body in *Japan - Alcoholic Beverages*.

3.76 As the complainant, the United States bears the burden of proving that Canada acted inconsistently with its obligations under Article III:2, first sentence. This is a principle of long standing in GATT jurisprudence. To date the United States has made no effort to discharge this burden. Instead, it has relied upon general allegations and assertions such as the following: "there is no identifiable difference between split-run magazines, on the one hand, and magazines without a companion edition, on the other hand, in terms of their physical characteristics, appearance, uses, tariff classifications, or even editorial content". Such statements do not constitute the empirical evidence required to both substantiate the claim made by the United States that all magazines are the same or that magazines based on local content are the same as magazines replicating foreign content; and to fulfil the burden of proof borne by the United States.

3.77 While Canada also recognized the definition of what constitutes a "like product" by the Working Party on Border Tax Adjustments, it considered that the "like products" test requires a much more

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[64]Appellate Body Report on *Japan - Taxes on Alcoholic Beverages, op. cit.*,at 20.

[65]*Ibid.*, at 21 (emphasis added).

sophisticated analysis than that suggested by the United States. The Working Party had concluded that the determination of what constitutes "like products" must be made on a case-by-case basis in order to allow for the consideration of the specific circumstances of each case. In that context the Working Party suggested some criteria: "… the product's end-uses in a given market; consumers' tastes and habits, which change from country to country; the product's properties, nature and quality".[66] This line of thinking evolved into an established GATT practice and was recently reaffirmed by the panel in *US - Standards for Gasoline*.

3.78 The **United States** considered that with Canada's argument - that the US like product analysis is incomplete because it relies solely on the physical characteristics of magazines, and ignores their editorial content - Canada appears to concede that there is no other basis to consider split-run magazines and other magazines to be "unlike" based on the specific criteria established by the Appellate Body in *Japan - Alcoholic Beverages*. By focusing solely on "editorial content", Canada ignores the Appellate Body's instruction that the analysis of "like product" must take into account "the *various* characteristics of products in individual cases".[67] Editorial content is only one attribute of a magazine, among many. The type, texture, colour, thickness, and even the perfume, of the paper can be important factors to market appeal. The dimensions of the magazine, the manner in which its pages are bound, the typesetting, and the appearance of the ink, can also be significant. The type, appearance, and frequency of advertisements may be a factor in a consumer's purchasing decision as well. Readers may purchase a magazine in part for the information its advertisements contain about where and how to purchase products or services locally. All of these attributes - including editorial content - combine to form an *overall package* that a consumer may or may not be attracted to. For the Canadian and US magazine industries, editorial content generally represents substantially less than 20 per cent of the cost of producing a consumer magazine.

3.79 Even if one were to examine editorial content in isolation, Canada's argument that magazines can be differentiated solely according to the percentage of "original" versus "non-original" editorial content they contain is untenable. There simply is no readily identifiable difference in actual editorial content between what the excise tax deems to be "original" and "non-original" content. That is because the distinction drawn by the excise tax is not based on the specific contents of magazines distributed in Canada but simply on whether those contents are used in magazines distributed abroad. A magazine reader in Canada cannot discern whether a magazine is "original" or not based on an examination of the magazine's contents, and thus could not be expected to consider "non-original" magazines to be any different from "original" magazines. For purposes of consumer use - as well as use by advertisers - magazines are judged by what they themselves offer, not by what a companion edition may contain.

3.80 In fact, Canada's "original content" requirement is not really meant to ensure that magazines sold in Canada have any particular type of content. Rather, it is meant to ensure that one type of production method - regional or split-runs - cannot be employed for magazines sold in the Canadian market. A distinction drawn to favour one type of production method has obvious protectionist implications and is not one that GATT should countenance for distinguishing between otherwise-like products.

3.81 Further, Canada's argument that split-runs usually differ from magazines sold only in Canada with respect to the perspective and orientation of their editorial content is legally irrelevant. A panel must assess the distinction that a measure *actually draws*, not a distinction a measure might have drawn but does not. In this case, to the extent the excise tax concerns content, it differentiates between magazines whose content is contained in a product sold in another country and magazines whose content

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[66] *Border Tax Adjustments* (Report of the Working Party adopted on 2 December 1970), BISD 18S/97.

[67] Appellate Body Report on *Japan - Taxes on Alcoholic Beverages, op. cit.*, at 21 (emphasis added).

is sold only in Canada. Thus, the excise tax simply does not differentiate between content based on its Canadian focus or perspective. Application of the excise tax does not turn merely on a magazine's "originality". A magazine distributed both inside and outside Canada becomes subject to the tax based solely on the inclusion of a single advertisement that is not identical in both editions. The very same magazine whose several editions do *not* differ in advertising is not taxed. Canada has advanced no basis for distinguishing between magazines based on the type of advertisements they contain.

3.82 For example, a science magazine escapes from the tax even if it contains absolutely no articles about Canadian scientists or Canadian scientific research so long as it is not sold outside Canada. The very same magazine would be subject to the tax if it is sold both in Canada and abroad and contained an advertisement that differed between the version sold in Canada and the version sold abroad. Yet the same magazine would not be subject to the tax if it is sold both inside and outside Canada but did not contain such an advertisement. Thus, the excise tax does not, in fact, distinguish between magazines based on their editorial content, let alone based on the orientation of the content. Rather, it applies based on factors related to whether a magazine was produced for more than one market, and advertising content. Article III:2 does not permit governments to distinguish between otherwise like products based on such business and trade factors.

3.83 With regard to the Canadian assertion that the US analysis of like product with respect to the excise tax is unacceptably general and would necessarily lead to the conclusion that *all* magazines are the same like product, regardless of content, the Appellate Body made clear in *Japan - Alcoholic Beverages* that product likeness for purposes of Article III must be addressed on a case-by-case basis and in the light of all relevant circumstances. Thus, no sweeping once-and-for-all product likeness determinations are appropriate for magazines or other products. The distinction between "original" and "non-original" content was not based on objective content differences, or any differences at all, based on a comparison of products sold in Canada. Whether or not distinctions may ever properly be drawn between magazines based on their editorial content is not an issue that is before this Panel. The excise tax distinguishes between products based on whether a similar product is sold abroad, not on objective content differences between products being sold in Canada.

3.84 Canada argues that because magazines contain intellectual or cultural content, they should receive unique treatment under GATT. Many products, as diverse as works of art, designer clothing, phonograph records and cinematographic films contain intellectual or cultural content. Like magazines, these products were in widespread use prior to the adoption of GATT 1947. But of these products, only cinematographic films were accorded special treatment in GATT 1947. Had the drafters of GATT 1947 sought to treat other intellectual or cultural products differently from products in general, they would have done so.

3.85 **Canada** argued that the United States insists that it is impossible to determine whether a magazine is a split-run simply upon an examination of its physical form, its editorial content, or its advertising. This simply misses the point. A casual reader might not in fact know whether a magazine is a split-run or simply an imported foreign magazine. There might be practically no difference between the two. *Time US* and *Time Canada* are very close. But that basis of comparison is irrelevant, because the comparison is not between imported magazines and imported magazines. The comparison is between imported split-run with the domestic magazine –*Time Canada* and *MacLean's*. And here the reader would have no difficulty in seeing that the two are very different products, offering completely different benefits to the prospective reader. The point, in sum, is not whether a split-run can be identified as such by the consumer. It is whether it can be identified as a significantly different product when compared to a domestic magazine that is not a split-run.

3.86 The United States makes the same point when it says a magazine reader in Canada cannot discern whether a magazine is original or not, based on an examination of the magazine's contents, and thus

could not be expected to consider non-original magazines to be any different from original magazines. This is based on the same misperception. The point is not whether originality can be perceived as such, but whether there is a difference between the two products at issue – the split-run replicating a foreign magazine, on the one hand, and the domestic magazine with original content, on the other. And nothing the United States has said casts any doubt on the proposition that difference would be obvious to any reader. This has nothing to do with subjective and variable treatment according to extraneous factors, as identified in the panel report on *US - Standards for Gasoline*. That situation obviously had nothing to do with objective product differences. It makes no difference in terms of product characteristics whether the gasoline is handled by refiners, blenders, or producers, or what data these various companies are likely to hold. Gasoline is gasoline, but any careful examination will show that content differences between split-runs and original Canadian magazines are characteristics of the products themselves.

3.87 At some points the United States refers to split-runs as a production method. In fact it is not a production method, it is a specific type of magazine. The United States says that a distinction drawn to favour one production method over another has protectionist implications that GATT should not countenance. This reflects a passage of the *United States - Measures Affecting Alcoholic and Malt Beverages* ("*US - Malt Beverages*") decision that was specifically overruled in *Japan - Alcoholic Beverages*.[68] In any event, it mischaracterizes the legislation, which distinguishes not on the basis of production method but of product content. The United States argument on like products is based on a highly abstract reading of the Canadian legislation taken out of its real-world context. It is based in fact on a refusal to take account of the effect of the distinction between original and reproduced content on which the legislation is based. But it is only on the basis of the effect of the distinction that one can determine whether in fact the legislation has the effect of taxing imported products in excess of like domestic products.

3.88 Canada noted the United States' contention that Canadian content or Canadian perspective are legally irrelevant, and that a panel must assess the distinction a measure actually draws, not a distinction it might have drawn but does not. In fact, the point is to assess what the legislation actually does – not simply what it says but what it does. It is obvious that the basis of the legislation – content reproduced from foreign sources – has concrete effects. These are effects that any reader can see – from the stories, the people, the subjects and – indeed – the perspective. They determine the character and the subject matter of the publication. The suggestion that these are not objective, visible product differences makes no sense. When the United States says that the nature of the content is irrelevant because that is not the distinction the legislation actually draws, they are asking the Panel simply to close its eyes to the actual operation and effect of the legislation in a real-world context. The implication is that one should look at the form, not the substance; that the assessment should be in the abstract and that the concrete effect should be ignored. None of this makes sense in the context of Article III:2, first sentence, which requires a finding of excess taxation in fact. One of the reasons why Canadian magazines do not sell well in the US market is precisely that they have a different content, content designed for Canadians. The American public is not attracted to this content. If American consumers can recognize the difference between an American and a Canadian magazine, surely Canadians can recognize it just as easily.

3.89 The **United States** asserted that the terms of the excise tax itself define the distinction Canada has drawn and this is what is at issue in this case. An analysis of the way the tax is structured shows the two to be like products. Canada's claim that the United States had failed to produce evidence of imported split-runs ignores the fact that Canada has banned imported split-runs. Canada could not,

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[68]Panel Report on *United States - Measures Affecting Alcoholic and Malt Beverages*, adopted on 19 June 1992, BISD 39S/274, para. 5.25.

on the one hand, ban the relevant imported product, then argue on the other hand that there are no "real-life" examples of how that (banned) product is actually similar to domestic products, or actually competes. In fact, Canada's own example - *Time Canada* and *Maclean's* - does not involve an imported split-run magazine. Moreover, one simply could not say that the concrete effects of the terms of the excise tax are to separate out imported split-runs (of which there are none) that have no Canadian content from domestic non-split-runs that do.

3.90 In the *US - Section 337* panel report, the panel stated that it "had to assess whether or not Section 337 *may* lead to the application to imported products of treatment less favourable than that accorded to products of the United States [i.e. domestic] origin. It noted that this approach is in accordance with previous practice of the Contracting Parties in applying Article III, which has been to base their decisions on *the distinctions made by the laws, regulations or requirements themselves* and on their potential impact, rather than on the actual consequences for specific imported products" (emphasis added). In this case, the excise tax law *itself* did not distinguish between editorial content that is about Canada and editorial content that is not, but is instead based on the existence or non-existence of a similar product in a foreign country, and on advertising.

3.91 The United States questioned the necessity for specific product examples in light of this analysis of the *US - Section 337* panel report and Canada's longstanding import ban. The United States argued that while there were no specific examples of imported split-runs because none exist; should the Panel find specific examples relevant, a useful comparison to demonstrate the "likeness" of imported and Canadian-produced magazines exists between a US (*non*-split-run) magazine, *Pulp & Paper*, and *Pulp & Paper Canada*, a Canadian magazine unconnected to *Pulp & Paper* (US). The two publications have substantially similar editorial content and subject matter - pulp and paper technology, products, processes and marketing. Both contain a number of technical reports on various paper and pulp subjects that have little, if any, connection with particular paper and pulp operations in either Canada or the United States. Both contain information about paper and pulp operations and statistics in both Canada and the United States. Both contain a wide variety of advertisements from suppliers of products and services directly related to the pulp and paper products. Both contain classified advertising sections, and both contain an advertisers' index. Only a handful of pages out of the 78 pages in *Pulp & Paper Canada* were devoted to exclusively Canadian pulp and paper, and the vast majority of the publication consists of advertisements and feature articles that did not focus specifically on Canadian production or issues. Moreover, a Canadian paper industry publication reader study conducted by an independent advertising agency indicated that the two magazines have comparable readership and that readers use these magazines for the same purposes such as product information and mill news. Based on these and other similarities, the United States argued there can be no doubt that *Pulp & Paper Canada* is "like" *Pulp & Paper* (US). The United States further argued that these examples also show the importance of advertisements to the usefulness and appeal of magazines as products. The ads in the pulp and paper magazines are so obviously highly useful to those in the pulp and paper business. Both the Canadian and the US publications go so far as to contain an advertisement directory so that readers can more readily access pertinent advertisements.

3.92 In response to Canada's reliance on the editorial content of the *Time Canada* and *Maclean's*, the United States argued that this editorial content does not show that split-run and non-split-run magazines are not like products. First, one example out of over 1,000 magazines sold in Canada hardly proves the point. The fact is that, under the terms of the excise tax, a non-split-run magazine need not contain any "Canadian" editorial content, as long as the content is not sold outside Canada, or the advertisements in the Canadian and foreign editions are identical. Second, even as to these two magazines, Canada ignores the similarities between the two products, in terms of all factors other than Canadian focus. Indeed, the similarities are so great - including with respect to subject matter - that

the two magazines were recognized to be direct competitors by industry witnesses in testimony before a Canadian Senate committee.[69]

3.93 The United States considered that Canada sought to minimize the significance of the fact that its WTO tariff commitments did not distinguish between split-runs and non-split runs. Canada's relevant tariff binding also includes newspapers, which are obviously not like products. However, the fact that Canada's tariff binding reflects the single Harmonized System (HS) heading for all magazines *does* provide support for a finding that split-runs and non-split-runs are the same like product. The Appellate Body in *Japan - Alcoholic Beverages* stated that, while broad GATT tariff bindings that cut across HS headings may not be useful to determine product likeness, GATT 1947 practice has looked to similar categorization in the *HS itself* in determining like product:

> "Uniform classification in tariff nomenclatures based on the Harmonized System (the 'HS') was recognized in GATT 1947 practice as providing a useful basis for confirming 'likeness' in products. However, there is a major difference between tariff classification nomenclature and tariff bindings or concessions made by Members of the WTO under Article II of GATT 1994. There are risks in using tariff bindings that are too broad as a measure of product 'likeness'.... Many of [the] least-developed countries, as well as other developing countries, have bindings in their schedules which include broad ranges of products that cut across several different HS tariff headings . . .".[70]

3.94 Thus, the Appellate Body distinguished between the situation in which products fell within common HS categories, and the situation in which a Member made broad tariff bindings that cut across multiple HS categories. In this case, all periodicals, whether split-run or not, and whether or not they contain advertising, are included within the same HS category: HS 49.02. The fact that the distinction Canada is drawing in this case is not one reflected in the HS supports our claim that split-runs and non-split-runs are the same like product.

3.95 With regard to the Canadian argument that implementation of its import ban through a provision in its tariff code is proof that there *are* differences in tariff classification between split-runs and non-split-runs, the Appellate Body in *Japan - Alcoholic Beverages* referred to universally-accepted HS nomenclature, not to one Member's protectionist restrictions that happen to find themselves in that Member's "Customs Tariff". The reason why it was practice under GATT 1947 to look to HS nomenclature is because it generally reflects an objective assessment of the intrinsic similarity of products. As far as the United States knew, Canada is unique in drawing lines (in a "tariff-related" provision or elsewhere) based on an artificial distinction such as "split-run" versus "non-split-run". Thus, the Panel should reject Canada's effort to be rewarded for its import ban, and find that the common HS classification of split-runs and non-split-runs provides additional support for a finding that split-runs and non-split-runs are the same like product.

3.96 **Canada** considered that the US reference to the Canadian tariff classification in heading 49.02 had the effect of sweeping not only all periodicals, but newspapers as well into a single very comprehensive classification. The inappropriateness of this kind of result was pointed out by the Appellate Body in its recent decision on *Japan - Alcoholic Beverages*, when it said that "tariff bindings that include a wide range of products are not a reliable criterion for determining or confirming product "likeness" under Article III:2".[71] The use of tariff classifications in this case is especially inappropriate.

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[69]See, e.g. Senate of Canada, Proceedings of the Standing Senate Committee on Banking, Trade and Commerce, Issue no. 49 (30 November 1995) at 57, 64 (testimony of officials of Canadian Magazine Publishers Association).

[70]Appellate Body Report on *Japan - Taxes on Alcoholic Beverages, op. cit.*, at 22.

[71]*Ibid.* at 22.

The categories of products listed under tariff item 49.02 are as diverse as periodicals and newspapers. Where the policy framework relates to periodicals and their intellectual *content*, the argument that the two media are "like" would be difficult to sustain. Tariff Code 9958 has effectively carved split-runs out of the general tariff classification; it has been in effect for over 30 years, through several GATT rounds, including the most recent Uruguay Round. The *de facto* exclusion of split-runs from the general tariff classification means at the very least that the US position can derive no support from tariff classification.

3.97 With respect to the support the United States seeks in the HS category, the fact is that this classification is far too broad to serve as a basis for identifying like products. Surely the fundamental point in the Appellate Body decision is that *any* very broad tariff classification is inappropriate, whether it is based on the HS or on tariff bindings. The short answer to the United States argument based on the common HS classification is that, at least in the case of this category, it is far too broad. It puts all magazines and all newspapers into a single global grouping. It also has the practical effect of making editorial content irrelevant. In the circumstances of this case, the use of tariff classifications is inconsistent with the requirement stipulated by the Appellate Body that "like products" under Article III:2, first sentence, should be narrowly construed.

Discrimination

3.98 **Canada** considered that the first sentence of Article III:2 speaks of products "imported *into the* territory" of a contracting party, and it deals with tax discrimination *against* imported products. There is no such discrimination on the facts of this case. To get around this difficulty, the United States has introduced the notion of "foreign-based" split-runs meaning periodicals produced in Canada but replicating foreign editorial content. This is a concept that simply has no legal meaning in the context of Article III:2. If the product is domestically produced, and is not physically moved across the border, it is not an imported product. And if there is no imported product, then there is nothing to which Article III can apply. But even if there were imported split-runs on the Canadian market, the absence of discrimination would be clear. Some imported magazines might attract the tax, but not to any greater extent than the domestically produced split-runs which were and remain the primary object of the legislation. For this reason, the measure is consistent with Article III:2 on its face and in its operation and practical effect. There is no reason why a measure that is non-discriminatory in both form and effect – *de jure* and *de facto* – should be considered inconsistent with Article III:2.

3.99 As the Appellate Body has observed in *US - Standards for Gasoline* in connection with Article III:4 that where there is "identity of treatment – constituting real, not merely formal, equality of treatment … it is difficult to see how inconsistency would have arisen in the first place". The same conclusion is equally valid here. That the tax is free from any taint of overt discrimination is clear from the terms of the legislation, which make no distinction between domestic and imported products. Canada provided an example of the Canadian-owned magazine, *Harrowsmith Country Life*. Before the adoption of Part V.1, this magazine had two editions - a Canadian edition and a US edition. The Canadian and the US editions had different advertisements and a certain amount of common editorial content. Because more than 20 per cent of the editorial content in the Canadian edition was the same as that in the US edition, the tax would have applied to the Canadian edition (even if the editorial content was entirely produced in Canada). As a result of the excise tax, *Harrowsmith Country Life* stopped publishing its US edition. It could hardly be suggested that the tax is discriminatory in its practical operation, since it was designed to prevent the production in Canada of split-runs.

3.100 The Appellate Body on *Japan - Alcoholic Beverages*[72] held that where imported products are taxed in excess of "like domestic products", the general principle set out in Article III:1 may be assumed to have been violated. There is consequently no need to apply that principle as a "separate test" in order to find an inconsistency with Article III:2, first sentence. The Appellate Body has thus established a balance in the interpretation of Article III:2. The concept of "like products" is to be very narrowly construed, on a case-by-case basis in a way that requires "discretionary judgment"; but once the determination is made, excess taxation of imported products entails a violation without any need to conduct a further inquiry under paragraph 1. The essential elements of the interpretation of this provision have thus been authoritatively identified.

3.101 One question, however, was not addressed in the recent decision: whether taxation of imported products "in excess of" like products is to be determined in terms of classes of products, or whether any single instance of differential taxation creates an automatic *per se* violation even when it results from fiscal classifications that are not themselves discriminatory in form or in fact. The answer is clear both from the wording of Article III:2, first sentence, and from the object and purpose of Article III as a whole, which is the prevention of discrimination against imported products. The use of the plural in referring to "imported products" and "like domestic products" indicates clearly that the concern is with classes of products, not with the isolated instances of differential taxation that necessarily result when product "A" is taxed at a different rate than product "B" because it happens to fall into a different, but non-discriminatory, fiscal classification.

3.102 This interpretation also seems necessary to create a workable rule. Article III:2 is not intended to impose fiscal harmonization in rates, methods or classifications. It therefore remains not only possible but inevitable that domestic fiscal classifications may in certain instances have the effect of subdividing or straddling "like product" categories, or otherwise crossing "like product" category lines. Since fiscal classifications have no other purpose than to allow differences in tax treatment, any such classifications that failed to correspond precisely to "like product" categories under Article III:2, first sentence, would automatically lead to a violation. Quite apart from imposing a degree of harmonization that goes beyond the language or the purpose of this provision, such an interpretation would lead to an intolerable unpredictability so long as "like product" determinations are to be made on a case-by-case basis, as the recent decision has reaffirmed.

3.103 It could also lead, paradoxically, to results that would make nonsense of the Appellate Body's assumption that excess taxation under Article III:2 automatically entails a departure from the general principles in Article III:1; and that would in fact make nonsense of the underlying purpose of Article III. It could lead to situations where fiscal classifications decisively *favouring* imported products would be considered inconsistent with the first sentence of Article III:2, so long as the tax classification attracting the higher rate contained at least *some* imported products. It makes no sense to say that Article III is automatically violated in any case where tax differences result from domestic classifications that are "origin-neutral" in form and that might even favour imported products in effect – as might well be true of the tax at issue here. A particular instance of differential taxation in such circumstances should not create a *per se* violation, absent a discriminatory effect or cause to believe such an effect to be probable.

3.104 The **United States** considered that the Canadian argument that under Article III:2, first sentence, a "single" or "particular" instance of higher taxation of a certain subset of a broader category of imported like products "should not create a *per se* violation, absent a discriminatory effect or cause to believe such an effect to be probable", meritless for a number of reasons. First, the United States is not

[72] *Ibid.*

confronted with a mere "single" or "particular" instance of higher taxation of imported products than domestic like products in this case. Rather, a broad group of imported products - split-run magazines - is taxed at higher, not lower, rates than a broad group of like Canadian products - non-split run magazines. Canada has neither defined nor identified what it considers to be a "single instance" of discriminatory treatment in the context of this case.

3.105 In addition, Canada claims that the Appellate Body in the *Japan - Alcoholic Beverages* decision somehow left the door open to allow for discriminatory higher taxes applied to certain imported products within a category of like products. The Appellate Body left no such opening. It made it clear at page 19 that "[i]f the imported and domestic products are 'like products', and if the taxes applied to the imported products are 'in excess of' those applied to the like domestic products, then the measure is inconsistent with Article III:2, first sentence". No further test of "discriminatory effect" or discriminatory aim, is warranted. Canada's proposed "discriminatory effect" test based on "classes" of products if flatly inconsistent with the recent panel and Appellate Body decision in *Japan - Alcoholic Beverages*. In that case, once the panel found vodka and shochu to be like products, the taxation of imported vodka at a higher rate than domestic shochu (even though the tax was facially neutral) was found to be a violation of Article III:2, first sentence. This finding was affirmed by the Appellate Body.

3.106 The United States considered that Canada's argument that, in the absence of such a "discriminatory effect" test, a scheme that, overall, favoured imports over domestic products, might be found to violate Article III:2, first sentence, suggested that less favourable treatment of certain imported products could be counterbalanced by more favourable treatment of others. The *US - Section 337* panel decisively rejected any such "balancing" of less-favourable and more-favourable treatment, observing that "such an interpretation would lead to great uncertainty about the conditions of competition between imported and domestic products and thus defeat the purpose of Article III".[73] Similarly, in the panel report on *US - Malt Beverages* report, the panel observed that "Article III…requires treatment of imported products no less favourable than that accorded to the most-favoured domestic products".[74] Thus, the fact that imported and domestic split-run magazines receive the same tax treatment is irrelevant. Rather, the fact that imported split run magazines are taxed more heavily than like domestic non-split-run magazines establishes the requisite higher taxation under Article III:2, first sentence.

3.107 According to the United States, the fact that Article III:2 is phrased in terms of "products" does not mean that tax discrimination with respect to *one* product is outside the scope of Article III:2, or that such discrimination would be GATT-consistent as long as it is restricted to *one* product. In this case the drafters clearly intended non difference between the treatment of the plural and the treatment of the singular. This fact is confirmed by the drafting of the Note *Ad* Article III (which refers to the "like domestic product" and the "imported product") and Article III:3, a special case of application of Article III:2 which refers to the "taxed product". The 1970 Working Party report on Border Tax Adjustments, which is often referred to in this connection, uses the singular and plural forms in free variation. It is not necessary to demonstrate that all imported magazines are taxed more heavily than all domestic like magazines, or even that the average tax on all imported magazines is higher than the average tax on all like domestic magazines.

3.108 Finally, Canada's proposed "discriminatory effect" test appears to be based on predictions of the level of future trade flows. It is well-established that Article III is not designed to protect expectations of relative trade flows, but rather to ensure equal competitive conditions for imported products. Moreover, in this case, the type of effects analysis Canada suggests would be impossible. There is no basis for judging future levels of split-run magazine imports because Canada has completely eliminated

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[73]Panel Report on *United States - Section 337 of the Tariff Act of 1930, op. cit.*, at para. 5.14.

[74]Panel Report on *United States - Measures Affecting Alcoholic and Malt Beverages, op. cit.*, para. 5.17.

them from its market for the last 30 years. Given its GATT-inconsistent ban, Canada should not be permitted to defend the excise tax on grounds that a small volume of imports would be subject to it.

3.109 **Canada** responded that its interpretation of discrimination under Article III:2 would not require any overall balancing test as the United States stated. It would not require prediction of trade flows and is not an aim-and-effect test in another guise. It says only that if the fiscal categories of a contracting party are origin-neutral and exhibit no inherent bias against imported products, then the mere existence of such categories, with differential rates of taxation, does not violate Article III:2. A simplified example illustrates this point. Suppose raspberries are taxed higher than strawberries, and that all red berries are determined to be like products. Under the Canadian view, there is no violation if the two categories apply to both imported and domestic products and there is no inherent bias against imported products. The United States would say there is a violation because a box of imported raspberries is taxed higher than a box of domestic strawberries. This is accurate only if a single instance of differential taxation creates a violation. Canada submits that there is no violation because imported products as a class are not being subjected to excess taxation over domestic products. The US interpretation leads to results that are close to absurd and would not reflect the language of Article III:2, first sentence, in particular the use of the plural, nor its object and purpose which is non-discrimination or more specifically to protect expectations of the competitive relationship between imported and domestic products. Further, in the *Japan - Alcoholic Beverages* case, it is clear from paragraph 5.19 of the report that the panel based its findings on the assumption that shochu was largely a domestic product.

3.110 The **United States** responded that Canada's attempt to distinguish this case from the *Japan - Alcoholic Beverages* case based on the fact that most shochu was produced domestically in Japan, while in this case one could not show that split-run magazines have a comparable import focus, is inappropriate. Canada has *banned* the relevant imports. Of course there is no preponderance of imported split-run magazines over domestic split-runs. There is also no basis for judging future levels of split-run magazine imports because Canada has completely eliminated them from its market for the last 30 years. Given its GATT-inconsistent ban, Canada should not be permitted to defend the excise tax on grounds that a small amount of imports would be subject to it, or that a small percentage of split-run magazines would be imported. Moreover, the United States contested Canada's claims that the US argument would prevent differential taxation of strawberries and raspberries, if the two fruits were found to be like products. In fact, the distinction the excise tax draws is not analogous to distinguishing between raspberries and strawberries (which are different fruits), but is instead analogous to distinguishing between raspberries and *raspberries*. Specifically, it is analogous to distinguishing between raspberries produced in fields whose harvest is sold only in one country, and raspberries produced in fields whose harvest is sold in multiple countries.

(b) Article III:2, second sentence

Directly competitive or substitutable

3.111 The **United States** argued that in the event the Panel does not find split-runs and non-split-runs to be "like products" for purposes of Article III:2, first sentence, it should find them to be "directly competitive or substitutable" products within the meaning of Article III:2, second sentence, of GATT 1994. The Appellate Body in *Japan - Alcoholic Beverages* provided that, in assessing an allegation of a violation of Article III:2, second sentence, one must examine whether:

> "(1) the imported products and the domestic products are "directly competitive or substitutable products" which are in competition with each other;
> (2) the directly competitive or substitutable imported and domestic products *are "not similarly taxed";* and

(3) the dissimilar taxation of the directly competitive or substitutable imported [and] domestic products *is* "*applied . . . so as to afford protection to domestic production*".[75]

Canada has not challenged the fact that split-runs and non-split runs are "not similarly taxed". The 80 per cent tax applies solely to split-runs. Split-runs and non-split runs are "directly competitive or substitutable", and the excise tax is "applied so as to afford protection to domestic production". Thus, the excise tax violates Article III:2, second sentence.

3.112 The Appellate Body in *Japan - Alcoholic Beverages* indicated that "directly competitive or substitutable" products was a "broader category" of products than "like products" in Article III:2.[76] The Appellate Body observed that it was appropriate to examine such factors as physical characteristics, common end-uses, tariff classifications, and the "market place", but that the "decisive criterion" in determining whether products were directly competitive or substitutable was "common end-uses".[77] Split-runs and non-split runs compete in the Canadian market and have common end-uses. Magazines covering the same general subject matter - e.g., current events magazines, hobby magazines, technical journals - compete with each other whether or not they are split-runs. Whether a magazine is split-run or not cannot be determined simply by examining the magazine, but is based, instead, on how similar the magazine is to a magazine sold outside Canada in another country. Split-runs, as defined by the excise tax, do not differ from other magazines in any way related to their ability to compete with other magazines. Indeed, the excise tax is applied precisely, and solely, because split-runs compete with wholly domestically produced magazines for readers and advertising. As discussed above with respect to the issue of like product, the distinction between split-runs and other magazines is not based on content. Even if one could somehow credit Canada's assertion that the content of non-split-runs has more of a "Canadian perspective" than split-runs, this distinction could not possibly be considered a different "end-use".

3.113 **Canada** argued that split-run edition periodicals are not "directly competitive with or substitutable for" periodicals with editorial content developed for the Canadian market. Although they may be substitutable *advertising* vehicles, they are not competitive or substitutable information vehicles. Moreover, as mentioned above, the excise tax on advertising contained in split-run editions was not introduced so as to protect the Canadian production of periodicals and it does not have this effect. Rather, it was adopted to prevent an unfair practice in the advertising service sector. Under the second sentence of Article III:2 and the *Ad* Article III, Paragraph 2, the complaining party must demonstrate that a tax is being applied to imported products or domestic products that are "directly competitive or substitutable" and that the tax is being applied "in such a way as to protect domestic production". The complainant bears the burden of proof. The United States must therefore demonstrate that split-run edition periodicals and periodicals with editorial content developed for the Canadian market are competitive or substitutable products, and that the Parliament of Canada imposed the 80 per cent tax on split-run edition periodicals in order to protect Canadian production of periodicals which are not split-run editions.

3.114 The interpretation of this phrase shares many characteristics with the interpretation of "like products". A case-by-case approach is required here as well – in other words, an interpretation that takes account of all the relevant circumstances, and in particular the unique characteristics of cultural products. It's also a multi-factorial analysis, as it is for like products as well – no single test is decisive. To a significant extent, one takes account of all the factors that go into a like products determination,

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[75]Appellate Body Report on *Japan - Taxes on Alcoholic Beverages, op. cit.*, at 24 (emphasis in original).

[76]*Ibid.*, at 25.

[77]*Ibid.* (emphasis added).

including properties and end-uses. Because of this common ground, many of the points Canada has made in the context of like products, and how the concept has to be adapted to reflect the special nature of cultural products, are also relevant here.

3.115 Canada noted the United States' unsubstantiated assertion that split-runs and other magazines clearly compete with each other. They do of course compete for the advertising dollar because a split-run recycling foreign content offers a far cheaper vehicle. But competition for advertising is not the issue and is not subject to GATT 1994 disciplines. The only legitimate focus is competition in the consumer marketplace. And the United States has not demonstrated, as it is required to do, that the products at issue are competitive or substitutable, or that they meet the threshold test implied by the word "directly". Substitution implies interchangeability. Once content is accepted as relevant it seems obvious that magazines created for different markets are not interchangeable. They are not substitutes, and certainly not direct substitutes. They serve different end-uses. Canadian periodical consumers have a demand for periodicals containing information that specifically addresses their interests. Canadian magazines contain information developed for and directed to the interests of Canadian consumers over a broad range of genres. Split-runs and magazines with editorial material developed for the Canadian market cannot be considered direct substitutes as information vehicles; and for the same reason they are not in *direct* competition. Ultimately, of course, there may be some degree of competition for disposable income between all cultural products and all luxury products – for everything beyond the necessities of life – but this is far too remote. It is not *direct* competition and it does not therefore fall within the rule. There would not be 1440 different magazine titles produced in Canada alone if the products were directly substitutable, or directly competitive, in the sense contemplated by the *Ad* Article to Article III:2.

3.116 Without embarking on an exercise in economic analysis, there are important respects in which price and demand comparisons are more complicated in the case of magazines and other cultural products than in the case of ordinary commodities. It is not the same as comparing consumer behaviour in response to price changes on a bottle of shochu and a bottle of vodka. There are too many qualitative differences in the case of magazines. To give one example, if the ratio of editorial content to advertisements decreases this can be the same as a price increase. That is a fairly objective, measurable variation, but other qualitative differences of equal importance can also have an effect tantamount to a price change – the quality of the content, the attractiveness of the graphics, the intrinsic interest of the articles.

3.117 The **United States** considered that the very existence of the tax was itself proof of competition of split-runs and non-split-runs in the market. Canada would not have gone to such extraordinary lengths to keep split-runs out of its market if they did not compete with other magazines in the Canadian market. As Canada itself has acknowledged, split-runs compete with wholly, domestically produced magazines for advertising revenue, which demonstrates that they compete for the same readers. The only reason firms place advertisements in magazines is to reach readers. A firm would consider split-runs to be an acceptable advertising alternative to non-split-runs only if that firm had some reason to believe that the split-run products themselves would be an acceptable alternative to non-split-runs in the eyes of readers. According to the United States, Canada acknowledges that "[r]eaders attract advertisers", and that: "The Canadian publishers are ready to compete with magazines published all over the world in order to keep their readers, but the competition is fierce".

3.118 The Report of the Task Force on the Canadian Magazine Industry provides further acknowledgment of the substitutability of magazines produced for the Canadian market and other magazines:

> "[Canadian publishers'] English-language consumer magazines face significant competition for sales from imported consumer magazines. In large measure, this is because the majority

> of the magazines are from the United States and *are a close substitute.* …It is reasonable to expect that the content of American magazines will be of interest to Canadians…".

This report also observes that "there is considerable price competition" on newsstands between domestic and imported magazines",[78] and that:

> "the initial effect of the entry of Canadian regional editions of foreign magazines into the Canadian advertising market would be a loss of advertising pages in Canadian publications offering advertisers a readership with similar demographics".[79]

Minister of Canadian Heritage the Honourable Michel Dupuy described the situation as follows:

> "Canadians are much more interested in American daily life, be it political or sports life or any other kind, than vice versa. Therefore, the reality of the situation is that we must protect ourselves against split-runs coming from foreign countries and, in particular, from the United States".[80]

Canadian Government officials have repeatedly acknowledged outside this proceeding the close substitutability and competitiveness of split-run and non-split-run magazines. Canada affirmed this fact where it refers to domestic and imported magazines competing for readers. Furthermore, Canada admits that split-run and non-split-run magazines compete for advertising; this itself demonstrates that the two are directly competitive and substitutable, since carrying advertising is a principal to which magazines are put.

3.119 **Canada** argued that the US reference to the Task Force in the preceding paragraph does not look into the supporting evidence. The evidence before the Task Force, on which its conclusions were at least partially based, was a study by the economist Leigh Anderson[81] which states:

> "US magazines can probably provide a reasonable substitute for Canadian magazines in their capacity as an advertising medium, although some advertisers may be better served by a Canadian vehicle. In many instances however, they would provide a very poor substitute as an entertainment and communication medium".

The report went on to characterize the relationship as one of "imperfect substitutability" - far from the direct substitutability required by this provision. The market share of imported and domestic magazines in Canada has remained remarkably constant over the 30-plus years between the O'Leary Report and the Task Force. If competitive forces had been in play to the degree necessary to meet the standard of "directly competitive" goods, one would have expected some variations. All this casts serious doubt on whether the competition or substitutability is sufficiently "direct" to meet the standard of Ad Article III.

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[78] *Task Force Report* at 40 and 42.

[79] *Ibid.*, at 53.

[80] Statement of Minister of Canadian Heritage Michel Dupuy before Canada's Standing Senate Committee on Banking, Trade and Commerce, 5 December 1995, Issue No. 50 at 14.

[81] Anderson, Leigh, An Analysis of Advertising Revenues to the Canadian Magazine Industry: the effect of foreign split-run magazines (19 January 1994). Prepared by Leigh Anderson for the Task Force on the Canadian Magazine Industry.

So as to afford protection to domestic production

3.120 The **United States** argued that the excise tax is applied so as to afford protection to Canadian magazine publishers. In *Japan - Alcoholic Beverages*, the Appellate Body indicated that proof of protective *intent* is not required in order to establish a violation of the second sentence of Article III:2, and that the issue is "how the measure in question is *applied*":

> "Although it is true that the aim of a measure may not be easily discerned, nevertheless its protective application can most often be discerned from the design, the architecture, and the revealing structure of a measure. The very magnitude of the dissimilar taxation in a particular case may be evidence of such a protective application, as the panel rightly concluded in this case. Most often, there will be other factors to be considered as well …".[82]

3.121 The Canadian excise tax clearly affords protection to domestic production of magazines directed at the Canadian market. It applies in a manner that effectively eliminates from the Canadian market split-run magazines, which compete directly with and are close substitutes for magazines produced solely for the Canadian market. The "very magnitude of the dissimilar taxation" - an 80 per cent tax on the former and no tax on the latter - is proof of the protective application of the Canadian excise tax, as it applies *only* to split-runs and is set at a prohibitive level. The structure and design of the excise tax are clear: the tax makes it uneconomical to sell any magazines that advertise to Canadians and that are produced for another market or for both Canada and another market. The measure thereby insulates the domestic Canadian magazine industry from competition from imported split-runs. The terms of the tax were crafted deliberately to target *Sports Illustrated* magazine, to direct advertising revenues solely to domestically-produced magazines, and to eliminate the competitive advantages conferred on split-runs by virtue of their economies of scale. *Sports Illustrated* Canada ceased publication in Canada with the issue dated 12 December 1995. Time Warner continues to sell subscriptions of the US national edition of *Sports Illustrated* in Canada and also sells the US edition of *Sports Illustrated* on the newsstands in Canada. These copies are printed in the United States and exported to Canada.

3.122 **Canada** argued that it is not applying the excise tax to imported periodicals so as to afford protection to the Canadian production of periodicals. Part V.I of the Excise Tax Act has no effect on the ability of foreign periodicals to enter Canada and to hold a very large share of the Canadian market. The Excise Tax Act applies to all split-run periodicals – wherever produced – in the same way. Contrary to the US contention, the purpose of Part V.I of the Excise Tax Act is not to protect the production of periodicals in Canada, but to prevent the diversion of advertising revenues to magazines based on content produced for foreign markets, and thus to ensure the production of editorial content for Canadians.

3.123 The purpose of Article III is to protect the competitive relationship between domestic and imported goods. As stated in the report on *United States - Taxes on Petroleum and Certain Imported Substances*:

> "… The general prohibition of quantitative restrictions under Article XI … and the national treatment obligation of Article III … have essentially the same rationale, namely to protect expectations of the contracting parties as to the competitive relationship between their products and those of the other contracting parties".[83]

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[82]Appellate Body Report on *Japan - Taxes on Alcoholic Beverages, op. cit.*, at 28, 29.

[83]Panel Report on *United States - Taxes on Petroleum and Certain Imported Substances, op. cit.*, at 160, para. 5.2.2.

Therefore, when Article III:1 specifies that a contracting party must not adopt measures "so as to afford protection to domestic production", the object is to prevent the adoption or maintenance of measures that protect domestic products to the disadvantage of products imported from the territory of another party.

3.124 Part V.I of the Excise Tax Act is not a protectionist measure adopted "so as to afford protection to domestic production" for the following reasons:

(a) It does not affect the competitive relationship between imported and domestically-produced periodicals;

(b) it is not based on the physical origin of periodicals, which is what is contemplated by the reference to "domestic production"; and

(c) far from having a protectionist aim, it is a legitimate response to an anti-competitive abuse in the advertising field, with the ultimate object of ensuring the survival of a distinct Canadian culture.

3.125 Because GATT 1994, including Article III, applies to trade in goods, the expression "domestic production" must refer to the physical production of the good. This refers to its manufacturing, cultivation, extraction, etc. Article III of GATT 1994 cannot address the competitive relationship between service-providers such as the authors and artists contributing to the intellectual material contained in periodicals. Nor does it protect the competitive relationship between publishers in their capacity as sellers of advertising space. In terms of physical production, the sole perspective that is relevant to Article III, Part V.I of the Excise Tax Act is entirely neutral. It does not have the effect of protecting the production of periodicals in Canada; indeed its principal target was the production *in Canada* of split-run magazines as defined in the Act.

3.126 The measure has valid policy objectives that fit within what the *US - Malt Beverages* decision called a "public policy purpose" that is consistent with Article III. The immediate objective of Parliament was directed against the aggressive marketing of advertising services in Canada by publishers who were recycling in Canada editorial material whose production costs had already been covered in a larger market. The net result of this practice was to cut into the small share of the advertising market available to Canadian publishers, who were producing editorial content specific to Canadians. Part V.I of the Excise Tax Act was drafted in such a way as to curtail this advertising practice and not so as to prevent the entry into Canada of foreign periodicals or in such a way as to disadvantage foreign periodicals in the Canadian market.

3.127 Canada noted that it had never intended to decrease the level of competition between imported and domestic magazines. On the contrary, the members of the Task Force on the Canadian Magazine Industry wrote: "We are convinced that what is being proposed interferes as little as possible with freedom of expression or choice. Indeed, in the final analysis, we are seeking to expand choice by ensuring the continued availability of magazines with original content".[84] These measures did not prevent and were not intended to prevent foreign periodicals from competing in the Canadian market on an equal footing with Canadian periodicals.

3.128 Further, the United States has completely misrepresented the true trade position. There is an enormous penetration of American magazines in Canada, and nothing in the Canadian tax measure would change this or is designed to change this. Nor are there any significant trade effects to the

[84] *Task Force Report* at 64.

measure. This tax concerns a very narrow segment of the total number of American periodicals streaming across the border daily. This very narrow segment was affected in the same way that a narrow segment of Canadian periodicals was affected. And this narrow segment of both the Canadian and the US industry was affected because the Parliament of Canada believed that a certain practice, a services practice, had to be discouraged.

3.129 Protectionism means protection against imported products. There is no protectionist application to be found in a measure that is not aimed at imported products as such, and that does not in fact have a disproportionate impact on imported products. The excise tax is not aimed at imported split-runs and – more important – it has (or would have) no greater effect on imported split-runs than it does on domestically produced magazines of the same kind. There is no doubt that the tax insulates Canadian magazines from a certain form of competition in the advertising sector. It does not, however, insulate Canadian producers from competition resulting specifically from *imported* split-runs. The United States has fundamentally mischaracterized the situation when it says "the measure…insulates the domestic Canadian magazine industry from competition from imported split-runs". This is not the effect of the tax. It affects split-runs in general, not just imported products. It is wrong to think of split-runs as an inherently or a presumptively imported product. The actual effect of the tax in practice has so far been very clear. It caused *Sports Illustrated* to move its production for the Canadian market *out* of Canada and back to the United States. The effect was to substitute imported products for domestic products. This is exactly the opposite of what is understood by protectionism. Even apart from what happened in the case of *Sports Illustrated*, the local production of a split-run – a regional edition – makes eminent business sense.

3.130 The **United States** considered the protectionist nature of the tax is evident from its confiscatory character, the statements of the Canadian Government regarding the tax both before and after its enactment, and from the manner in which it applies. The effective date of the tax was deliberately set to eliminate the split-run edition of *Sports Illustrated* magazine. The tax applies only to those split-runs that began publication after 26 March 1993, a few weeks before *Sports Illustrated* launched its Canadian split-run edition, but more than *two years* prior to enactment of the tax. The excise tax applies in a manner that inherently favours Canadian-based producers, who are much more likely than foreign producers to publish magazines directed solely at Canadian readers. Foreign-based producers who wish to expand operations by entering the Canadian market must create a new magazine for distribution exclusively in Canada (or sell their foreign editions in identical form in Canada). The Canadian magazine tax is designed to ensure that foreign-based publishers forego the commercially attractive option of publishing a split-run edition of an existing magazine for the Canadian market. In introducing the excise tax bill to the House of Commons, Minister of Canadian Heritage Michel Dupuy asked, "Why is this tax necessary?", and answered: "Canadian publishers would be at a grave disadvantage if they were forced to compete for advertising revenues with magazines that have recovered their editorial costs in markets which are much larger than the Canadian market".

3.131 Mr. Dupuy's reference to "markets which are much larger than the Canadian market" was undoubtedly a reference to the United States, whose production of Canadian-edition split-runs was significant prior to the 1965 import ban, and whose potential for re-establishing split-run editions in the Canadian market was the basis for the imposition of the excise tax in 1995. The 1961 O'Leary Report, which preceded the import ban, noted that there were 76 US magazines offering split run or regional editions in Canada.[85] In 1994 the Government-appointed Task Force on the Canadian Magazine Industry concluded that it in the absence of additional legislation it was highly likely that a significant number of US split-runs would be sold in Canada. The Task Force estimated that there were 53 potential US consumer magazine entrants into the Canadian market, and 70 potential US business and trade

[85]Report, Royal Commission on Publications, May 1961 ("O'Leary Report") at 36.

magazine entrants, and that the majority of these would actually enter the Canadian market.[86] (By contrast, although the Task Force report describes in some detail the structure of the Canadian magazine industry, it makes no mention of the existence of split-run editions of *Canadian* publications.) The effect of the 80 percent excise tax is to keep the potential US entrants out of the Canadian market, whether they choose to transmit their magazines electronically for printing in Canada or - should Canada's GATT-illegal import prohibition be removed - to import them. By its terms, the tax applies to all split-runs, whether imported or domestically-produced. The tax makes it unprofitable for split-runs to be sold in Canada. Indeed, this is the whole - and the stated - purpose of the tax. As Minister Dupuy stated: "[The tax] could be designed and implemented in order to avoid split run editions".[87]

3.132 The Canadian argument that the tax is not applied so as to afford protection because it is reasonable to assume that, in the absence of the import ban, split-runs would be published in Canada as much as in the United States was dubious as a factual matter. More importantly, it is legally irrelevant because the tax protects domestic *non*-split-runs from competition from imported split-runs. The appropriate comparison is between the treatment of imported split-runs and domestic *non*-split-runs, not between domestic and imported split-runs. "Article III…requires treatment of imported products no less favourable than that accorded to the *most*-favoured domestic products"[88], not the *least*-favoured. Further, regardless of what Canada's legislators may have intended, the tax does apply, by its terms, to imported split-run magazines. If the import ban were lifted, it would have an immediate and exclusionary effect on imported split-runs.

3.133 In its argument that its excise tax on split-run magazines is meant to address an "anti-competitive abuse in the advertising field", Canada has completely failed to indicate in what way split-run magazines constitute such an abuse, why it has concluded that all, as opposed to some such magazines represent such an abuse, and why its has chosen to apply a tax measure to address such abuses. It is apparent that the "anti-competitive abuse" Canada is concerned about in connection with split-run magazines is competition itself. Canada's real quarrel with split-runs is that they are produced in a manner that takes advantage of economies of scale, in which costs are spread out over a greater number of units produced. This means simply that split-run producers may have a lower cost structure than other producers, which may put them at a competitive advantage.

3.134 Competitive advantage is not competitive abuse, however. Canada has well-developed competition laws to address any such abuses. If Canada were truly interested in remedying competitive abuses, it would have employed those laws. Those laws do not permit application of remedies in a vacuum, however. They require a detailed analysis of the conduct of particular actors and their position in the market, and do not have as their goal the removal of entire product categories from the market. Indeed, it would be difficult to imagine a less pro-competitive remedy than one that effectively removes competing products from the marketplace.

3.135 Further, Canada's claim that marketing split-runs in Canada is akin to dumping is equally untenable. Dumping is generally understood to mean pricing products in a foreign market below the sales price in the home market, or selling products below cost. Canada has not alleged either such practice in this case. There are well-developed WTO procedures for conducting anti-dumping investigations and for determining dumping margins. These procedures do not allow for imposition of duties in arbitrary amounts (e.g., 80 per cent) across the entire range of imported products on the basis of legislative fiat.

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[86] *Task Force Report* at 50-52.

[87] *Commons Debates* at 14790

[88] Panel Report on *United States - Measures Affecting Alcoholic and Malt Beverages, op. cit.* para. 5.17 (emphasis added).

3.136 **Canada** argued that protection is afforded to domestic production for the purpose of Article III:2, second sentence, if there is a "discriminatory or protective effect against imported products". "Imported products" means products physically transported into the territory of a Member. The United States concedes that the *Sports Illustrated* innovation that led to the legislation involved a domestic product, where the only thing "imported" was the electronically-transmitted foreign content. The United States has thus conceded, in the case of *Sports Illustrated Canada*, that there was no discrimination or protective effect against imported products. It follows that "foreign based" split-runs are not imported products if they are printed and published in Canada.

3.137 The Excise Tax Act thus applies to domestic and imported products without distinction, and it is primarily aimed at a form of domestic product. While the tax secures advertising revenues for Canadian publishers, protection in the sense of Article III:1 as read into III:2 means protection against *imported products*. As the preceding paragraph has shown, split-runs are not intrinsically imported products. Even if there were no import prohibition, given the economies of local production and distribution and the ease of electronic transmission, it is likely that most split-runs would be locally produced. It is highly significant, moreover, that, as the United States noted in response to a question at the hearing, the effect of the tax was to induce *Sports Illustrated* to cease its Canadian production and to resume direct imports from the United States. The substitution of imports for domestic products, as the result of a public policy measure, is the direct opposite of what almost everyone understands by protectionism. It suffices by itself to refute the contention that the Excise Tax Act operates to "afford protection to domestic production".

3.138 The excise tax measure is designed to prevent the diversion of advertising to low-cost publications reproducing recycled editorial content, at the expense of publications created for Canadians. It does not guarantee the survival of Canadian magazines that the public does not want. What it targets, very simply put, is the combination of recycled editorial content plus Canadian advertisements. This combination, because the crucial input of content comes with minimal cost, is destructive of fair competition in the market place and consumer choice. It eliminates any possibility of a "level playing field". It would lead ultimately to a reduction of material dealing with the Canadian scene and in turn to a Canadian public that is less well-informed on Canadian affairs. These are not only legitimate legislative concerns; they are far removed from the idea of protecting domestic production which is referred to in Article III. Ultimately, of course, the concern behind this legislation is with the preservation of Canadian culture in the face of an extraordinary challenge from across the border. It is not Canadian public policy to restrict the importation or circulation of imported magazines. It does, however, reinforce the validity of the distinction Canada makes between original content and domestic production as one that is based upon a public policy purpose that has nothing to do with trade protectionism. Split-run editions of magazines compete unfairly for advertising revenues with regular magazines, since their editorial costs are largely paid for in their original market.

3.139 As to the United States' inquiry why Canada failed to apply the WTO dumping procedures, those procedures, and the Canadian domestic legislation that implements them, have never been applied, and would probably not even be applicable, to advertising as a service sector not covered by GATT. The United States also asks, in effect, why Canada has not used the Canadian Competition Act. There is no reason why specially-tailored measures cannot be adopted for specific sectors of the economy that have their own unique characteristics. Competition issues in Canada have never been reserved exclusively to the Competition Act. They are addressed, in the context of specific sectors, through a variety of regulatory statutes. Split-runs and the magazine advertising market are unique. There is no reason why their problems should not be addressed through special legislation. And there is no reason why that legislation should not take the form of a tax. Fiscal incentives and disincentives that have little or nothing to do with raising revenue – ranging from child tax credits to super-depletion allowances – are familiar techniques in Canadian legislative practice.

3.140 The **United States** asserted that, in addition to characterizations by Canadian officials, Canada's submissions to the Panel themselves confirm that the excise tax was structured to protect domestic production. A statement in Canada's submission is instructive:

> "The object of the excise tax is not to discourage readership of foreign magazines, but to *maintain an environment in which Canadian magazines can exist in Canada alongside with imported magazines. It is also intended to foster conditions in which indigenous magazines can be published, distributed and sold in Canada on a commercial basis…*"(emphasis added).

Although couched in the best possible light, this statement does not disguise the fact that the purpose of the excise tax is to protect Canadian magazines from import competition. It appeared to be Canada's position that because it does not *completely* restrict imports of magazines, it should be free to impose *certain* import barriers to benefit its domestic industry. There is absolutely no basis in GATT for this position. Canada's contractual obligations under GATT Article III are not limited to affording a certain amount of national treatment to imports; Canada must provide full national treatment, comparative trade advantages (i.e. to protect domestic producers from legitimate import competition). Tariffs (within bound rates) and certain types of domestic subsidies are among the permitted measures. Internal taxes imposed at rates higher for imported products than domestic like products are not. Moreover, Canada's submissions consistently imply an import penetration much higher than it actually is. Canada's Task Force Report states that , in reality, "Canadian publications account for 67.6 per cent of the magazines sold in Canada in a year".

3.141 Canada asserts repeatedly that the excise tax is designed to encourage "original content", as though such a purpose would justify imposition of a discriminatory excise tax. In fact, the whole notion of "original content" is protectionist in nature. Permitting a Member to require that a product be sold in its territory be a *different* product than that sold abroad would open up the WTO system to serious abuses. For example, a Member concerned about the ability of a local industry to compete with foreign manufacturers of the same product (automobiles, footwear, jewellery, etc.) could impose a prohibitive tax - on the pretext of ensuring that local consumers can purchase products designed exclusively for them - on "non-original" product designs, in order to keep foreign producers from exporting their best-selling products to the Member's market. In order to sell into such a market, the foreign manufacturer would be required to design products and set up new production lines exclusively for that market. That would erase any scale efficiencies the foreign manufacturer might otherwise have gained from sales in its domestic market and to other countries.

3.142 **Canada** considered that the US reliance on the concept of economies of scale is misplaced. The concept is normally associated with large production runs, typically for an international market. A local production run for a single regional market is by definition a relatively low volume production run that does not fit the definition. What the legislation is against is not economies of scale but the clearly unfair competitive advantage that comes from prepaid costs, providing what amounts to a free ride in the Canadian advertising market. The US industry gets tremendous economies of scale through its ordinary operations of publishing large runs in the United States for the international export market. The US publisher is free to produce and then to promote and sell as many copies of the magazine in Canada as possible. None of this is touched by the legislation. The tax does not insulate the domestic Canadian magazine industry from competition for readers. *Harper's*, *Sports Illustrated*, and *Vanity Fair* can all benefit fully from economies of scale of which a Canadian publisher, and in fact most publishers outside the United States, could never dream.

3.143 The United States submits further that the "whole notion of original content" is protectionist in nature, and that the policy has the same protectionist characteristics as if local product designs were to be required. The argument is revealing, because it amounts to a blanket denial that cultural products have any specificity that distinguishes them from ordinary items of trade. Content distinguishes one

magazine from another. Original content created for a specific national community differentiates magazines in a way that product design seldom if ever does. The United States has raised a spectre that is not only far-fetched; it is based on a false analogy, and a failure to recognize the distinctive characteristics of cultural products, and of magazines above all. "Original content" does not have to be domestically-produced. Canadian content, in terms of subject matter, does not have to be content produced by Canadians or in Canada. Most often it will, but the assertion that "original content" is inherently protectionist is incorrect.

(c) Article III:4

3.144 The **United States** argued that if the Panel decides that the excise tax does not fall within the scope of Article III:2, the tax should then be viewed as a measure affecting the sale or use of split-run magazines within the meaning of GATT Article III:4. The excise tax provides less favourable treatment to imported split-runs than to like domestic non-split-runs and therefore violates Article III:4. The excise tax clearly affects the *sale* of split-run magazines. In fact, it is set at a level so high as to prevent any sales of split-runs in the Canadian market. Indeed, Canadian officials have repeatedly stated that to be the purpose of the tax. An 80 per cent excise tax is obviously not intended to generate tax revenue. The excise tax also affects the *use* of split-run magazines, by applying a prohibitive tax whenever they are used to convey advertising to the Canadian public. Moreover split-run magazines and non-split-run magazines are "like products" for purposes of Article III:2 and should thus be considered "like products" for purposes of Article III:4 as well. The panel in *US - Standards for Gasoline* considered that similar factors were relevant to like product analyses under paragraphs III:2 and III:4.[89]

3.145 Finally, the excise tax accords less favourable treatment to imported split-run magazines than to other domestically-produced magazines. As discussed above, by its terms the tax applies to imported split-runs. The excise tax treats imported split-runs less favourably than other purely domestic magazines because it effectively prevents split-runs from being sold profitably in the Canadian magazine market, and makes it effectively impossible for split-runs to be used to carry domestic advertising. Thus, if the excise tax is not covered by Article III:2, it falls within the scope of, and is inconsistent with, Article III:4.

C. Funded and Commercial Postal Rates

(i) Article III:4

"Regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use"

3.146 The **United States** argued that Canada's postal rates for magazines are openly discriminatory and in contravention of III:4 of GATT 1994. Canada Post is a Canadian Government entity that charges domestic magazines lower rates (either "commercial" or "funded" depending on the magazine) than it charges imported magazines that are mailed in Canada. Canada Post also offers certain discounts (such as for "palletization" and "pre-sort") only to domestic magazines. These measures amount to "regulations" or "requirements" that affect the internal sale, transportation, or distribution of magazines in Canada, and provide less favourable treatment to imported magazines than to like domestic magazines, in violation of GATT Article III:4.

3.147 In the report on *EEC - Parts and Components*, the panel recognized that requirements that an enterprise voluntarily accepts to gain government-provided advantages are nonetheless "requirements":

[89]Panel Report on *United States - Standards for Reformulated and Conventional Gasoline, op.cit.*, para. 6.8.

> "The Panel noted that Article III:4 refers to "all laws, regulations or requirements affecting (the) internal sale, offering for sale, purchase, transportation, distribution or use". The Panel considered that the comprehensive coverage of "*all* laws, regulations or requirements *affecting*" the internal sale, etc. of imported products suggests that not only requirements which an enterprise is legally bound to carry out, . . . but also those which an enterprise voluntarily accepts in order to obtain an advantage from the government constitute "requirements" within the meaning of that provision. . . ."[90]

Magazine publishers that sought to make use of the Canadian mails have to agree to pay the postal fees charged by Canada Post. Those charges are requirements - or regulations - within the meaning of Article III:4.

3.148 Canada Post's postal rates also clearly "affect" the sale, transportation and distribution of imported magazines, because they specify the cost of using the services of Canada Post to transport or distribute magazines to subscribers in Canada. A publisher seeking to have Canada Post transport and distribute its magazines to subscribers in Canada - and virtually all subscription magazines sold in Canada were distributed in this manner - would have to pay the postal fees prescribed by Canada Post. The postal fees directly affected the competitive conditions under which the product is transported, distributed, and sold to subscribers. These rates therefore "affect" the sale, transportation, and distribution of magazines in Canada.[91]

3.149 Canada's discriminatory postal rates have a particular impact on the transportation of magazines in Canada. The drafters of GATT clearly intended to include the rates charged for government-provided transportation services under the disciplines of Article III. Canada Post's divergent postal rates are not based on neutral economic considerations, but explicitly discriminatory criteria - namely, whether the magazine is Canadian or foreign in origin.[92]

3.150 **Canada** underscored the importance of the distinction between the subsidized rates, those rates available as a result of a subsidy granted exclusively to domestic publishers by Canadian Heritage, and commercial publications rates, those rates available to all publishers (Canadian or otherwise) that do not qualify for the subsidy granted by Canadian Heritage. Whereas the subsidized rates are the result of an expressed intention on the part of the Government to assist domestic publishers (as specifically permitted by GATT Article III:8(b)), the commercial publications rates are the result of generally accepted commercial and marketing practices and are not influenced by government policy. Unfortunately, the United States has failed to make this important distinction.

3.151 Canada Post is a corporation in its own right, with a legal personality distinct from that of the Government, and considerable autonomy in the conduct of its operation; far more than would ever be accorded to a government department. Canada Post is a Crown corporation and its objectives are set out in the CPC Act. In addition, under the FA Act, as a Schedule III, Part II Crown Corporation, Canada Post is expected to: operate in a competitive environment; earn a return on equity; not depend on government appropriation; and finally, provide a reasonable expectation that it would pay dividends. Both the CPC Act and the FA Act essentially establish a commercial mandate for Canada Post comparable to a private sector interest.

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[90]Panel Report on *European Economic Community - Regulations on Parts and Components, op.cit.*, at 132, 197, para. 5.21, Italics in original. *See also,* "*Canada - Administration of the Foreign Investment Review Act*", adopted on 7 February 1984, BISD 30S/140, 158 para. 5.4.

[91] Panel Report on *Italian Discrimination Against Agricultural Machinery*, adopted on 23 October 1958, BISD 7S/64 para. 12.

[92]The United States recommended the Panel to see also, *U.S. - Malt Beverages* (panel found that restrictions on private delivery of imported, but not domestic beer, was inconsistent with Article III:4).

3.152 This legislative framework provides Canada Post with the legal and operational flexibility to implement its commercially-oriented mandate. With respect to publications, i.e., newspapers and periodicals, Canada Post is not a government monopoly and does not have the exclusive right of delivery. Canada Post does not have the power of a monopoly when it sets commercial rates for the delivery of publications.[93] It competes in an open competitive market for its share of the publications delivery market. Any publisher, foreign or domestic, is free to arrange for the delivery of his newspaper or periodical via Canada Post or with any other distributor. Section 14(2) of the CPC Act states that "[n]othing in this Act shall be construed as requiring any person to transmit by post any newspaper, magazine, book, catalogue or goods". Pursuant to Section 2 of the Act,"post" means to leave in a post office or with a person authorized by the Corporation to receive mailable matter. Foreign publishers have the additional option of mailing their copies addressed to Canadian addresses with their own postal administration at the applicable international printed matter rates.

3.153 The principle of national treatment of Article III:4 of GATT 1994 does not apply to the commercial postal rates charged by Canada Post. The United States contends that commercial rates set by Canada Post are "regulations" or "requirements" affecting the internal sale of imported publications. The term "regulation" in the context of GATT 1994 means the rules or orders having the force of law that are issued by executive or administrative authorities of government. The rates for the delivery of letters in Canada are set by regulations.[94] However, the commercial rates for publications are set by market forces and fluctuate with commercial imperatives – not to mention that in many cases they are the result of negotiations with both domestic and international large volume customers pursuant to specific agreements. The responsibility for setting those rates rests exclusively with senior management of the Corporation who exercise their discretion based on commercial principles without government intervention.

3.154 The term "requirement" in the context of GATT also implies a demand or direction proclaimed by an authority within government. Again, commercial imperatives and market forces dictate the commercial rates for publications charged by the Corporation to its customers. The government has never issued a directive to the Corporation regarding publications mail. The Corporation's prices are set to meet market demands and opportunities (as in the case of any private sector company), and are clearly not the product of "laws, regulations or requirements" of Canada. It is incorrect to suggest, as does the United States, that the differential between the commercial rate provided to Canadian publishers and the commercial rate provided to non-Canadian publishers is calculated to place non-Canadian publishers at a competitive disadvantage. Canada Post has no policy of giving a competitive advantage to one segment of its customers over another, and has no interest in pursuing any such practice. For their part, customers have access to competing delivery channels and, as in all open markets, have the ability to negotiate rates in a manner reflecting their purchasing power.

3.155 The international commercial rates reflect the reality that suppliers in any competitive market would attempt to obtain the best possible price. Pricing is set to maximize contribution while remaining competitive. Factors such as the availability and cost to customers of competing distribution channels, currency exchange rates, service standards, etc., are all taken into consideration by Canada Post (as would any company in a competitive market) when setting its pricing. As a Crown corporation with a commercial mandate, Canada Post operates on the same basis as a private sector interest. The commercial postage rate applicable to non-Canadian publications is set on the basis of the commercial

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[93]Canada added that Canada Post does have a limited exclusive privilege with respect to the collection, transmission and delivery of "letters" in Canada, including addressed advertising mail. This exclusive privilege represents in aggregate approximately 50 per cent of total corporate revenues. Canada Post has no statutory protection for the remainder of its business and must compete with existing or potential competitors, as the case may be. The Corporation's exclusive privilege is defined in Section 14 and 15 of the *Canada Post Corporation Act*.

[94]*Letter Mail Regulations*, SOR/88-430 as amended to April 30, 1996.

business reality that the next-best option faced by mailers of publications that are printed outside Canada is the much higher international rate charged by the postal administration in the country of publication. In the case of publications from the United States, this means a rate for deposit in Canada with Canada Post that is about half of what they would have to pay the United States Postal Service (USPS) for delivery of the same items to Canada. The commercial mandate given to Canada Post requires it to obtain the best possible rate in order to maximize its returns.

3.156 Almost half the direct-deposit foreign periodicals business Canada Post receives is contracted through specific agreements, negotiated on a case-by-case basis subject to customer- and market-specific needs and opportunities as opposed to generic pricing policies. Canada Post's commercial pricing policies are determined by the demands of the markets in which it operates and not by governmental directives or public policy considerations. In the case of commercial publications, there is no direction, instruction or any other obligation to provide this service or to provide this service at certain rates. This means that the management of Canada Post is free to establish commercial services and rates for publications purely on commercial principles and market realities so as to maximize the financial advantage to Canada Post providing such commercial publication services. The decision to maintain a separate, higher rate for international as opposed to Canadian commercial publications is made purely by Canada Post management for commercial reasons and in no way reflects any explicit or implicit request by government that Canada Post use its rate structure to disadvantage foreign commercial publications relative to Canadian commercial publications. The Canadian Government could express its views on commercial and international rates much in the same way it might choose to comment on pricing of a private sector firm. However, to compel change, the Government would have to instruct Canada Post under the directive power in Section 22 of the CPC Act. Indeed, Canada Post has received no instruction or advice – implicit or explicit – to set international commercial rates in excess of domestic commercial rates for periodicals. This action is of Canada Post's own creation based on its perception of market opportunity.

3.157 The **United States** argued that the Government of Canada is responsible for Canada Post's activities, including its so-called commercial postal rates. Canada's argument implicitly concedes that Canada Post is a governmental entity, and exercises a governmental function, when it applies "funded" (subsidized) postal rates to, and provides for the delivery of, certain domestically produced magazines. Canada seeks to convince the Panel that Canada Post sheds its governmental character when it applies its so-called "commercial" rates and provides for the delivery of magazines subject to those rates.

3.158 Canada Post is a wholly, government-owned, government-created chartered body, subject to the control of a board of directors appointed by the Minister responsible for Canada Post. (The existence of a Government Minister responsible for Canada Post is further proof that Canada Post is an arm of the Canadian Federal Government.) The Chairman of the Board and the President of Canada Post are both appointed by the Governor-in-Council. Section 5(2)(e) of the CPC Act provides explicitly that Canada Post is "an institution of the Government of Canada". The Canadian Parliament created Canada Post and fixed its operating mandate. Moreover, Canada Post's mandate to operate, in part, on a "commercial" basis is itself set by the Government. An important oversight role is played by the Minister responsible for Canada Post. In "The Mandate of Canada Post Corporation and its Development", Canada acknowledged that: "Section 22 of the CPC Act provides that Canada Post is required to comply with directions issued by the Minister responsible for the corporation. This gives the Minister powers analogous to those exercisable by shareholders of other privately held corporations through unanimous shareholders agreements".[95] Thus, Canada Post is entirely a creature of the Canadian Government, subject to its direct supervision and control.

[95]"The Mandate of Canada Post Corporation and its Development".

3.159 Recent events confirm that the Canadian Government considers Canada Post to be a government entity fully subject to Canadian Government direction, and a vehicle for the expression of Government policy - including through Canada Post's "commercial" operations. On 8 October 1996, Diane Marleau, the Minister responsible for Canada Post Corporation, presented the Canadian Government's reaction to a report issued by an independent task force chaired by Mr. George Radwanski (the "Radwanski Report"). The report addressed financial and policy issues related to the future of Canada Post.

3.160 The Radwanski Report was highly critical of Canada Post and, *inter alia,* charged Canada Post with engaging in unfair competition with its private sector competitors in the delivery of commercial services, such as courier and advertising mail services.[96] In her press conference responding to the report, Ms. Marleau stated:

> "I want to emphasize that *the government regards Canada Post as a significant federal institution, and that it sees Canada Post continuing to carry out a public policy role* based on the provision of mail to all Canadians, no matter where they live…The federal government is expected to embody certain values and principles in how it carries out its affairs, in particular: fairness, transparency, openness and accountability. *Canada Post is part of the federal government and must live up to these standards*. As *Minister Responsible for Canada Post,* I expect immediate corrective action wherever these values and principles have been compromised. To this end, I have asked Mr. Ouellet, as Chair of Canada Post Corporation, to develop an action plan for improving the transparency of Canada Post's activities, and addressing these issues…The government will consider the rest of the recommendations of the report of the Mandate Review, recognizing that there are certain basic principles which must guide our deliberations:…
> * *Canada Post is a valuable federal institution.* Canadians have invested in it, and the government must protect this value.
> * Canada Post will remain a Crown corporation and not be privatized, *as long as it continues to fulfil a public policy role.*"…[97]

3.161 With respect to Canada Post's commercial courier service activities, Minister Marleau stated that:

> "[A]s long as Canada Post remains in this line of business, it must compete on a level playing field. As I noted earlier, Canada Post's operations must be conducted under the tenets of fairness, transparency, openness, and accountability".[98]

These excerpts confirm that the Canadian Government considers Canada Post to be a Canadian federal government institution and that the Government is fully responsible for Canada Post's activities - even those carried out in commercial sectors.

3.162 Canada Post's so-called "commercial" (non-subsidized) postage rates reflect an overlay of Canadian government policy having nothing to do with marketplace considerations. Notwithstanding Canada's statement that commercial publications rates "are available to all publishers (Canadian or otherwise) that do not qualify for the subsidy granted by Canadian Heritage", in fact only certain types of publications qualify for commercial mail rates. Among the eligibility criteria are: the content of the publication (e.g., devoted to religion, the sciences, social or literary criticism), the amount of space

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[96]The report did not specifically discuss Canada Post's publications mail activities.

[97]*Speaking Notes for the Honourable Diane Marleau, Minister Responsible for Canada Post Corporation, Release of the Canada Post Mandate Review Report,* 8 October 1996, at 1-3 (emphasis added).

[98]*Ibid.*, at 3.

it devoted to advertising, and whether the publisher is a person whose principal business is publishing. These criteria are all irrelevant as commercial considerations, but are indicative of types of publications which a government might wish to support as a matter of public policy. This suggests that Canada Post continues to operate as an instrument of the Canadian Government in its commercial mail operations and does not operate according to purely commercial considerations.

3.163 Finally, the United States considered that Canada's claim that the disparity in "commercial" rates between imports and domestic magazines reflects the lack of commercially feasible alternative delivery options for imports as compared to domestic magazines is dubious as a factual matter. Also, Canada's explanation that the disparity in rates does not reflect Government policy is suspect in light of the existence of a whole set of Canadian Government policy measures whose explicit goal is to benefit domestic magazines. Even if true, Canada's explanation would not remove this measure from the scope of Article III:4. Article III:4 is precise - a Member must accord "treatment no less favourable" to imports as compared to domestic products - regardless of whether imports have fewer commercial alternatives as compared with domestic magazines. It is in the nature of imported products that they often are in an inferior economic and political bargaining position. Article III was included in the GATT because imports are vulnerable to discrimination.

3.164 **Canada** argued that government ownership is not in itself sufficient to qualify the practices of an enterprise as regulations for the purposes of Article III:4 of GATT 1994. The independent nature of Canada Post's commercial operations for the distribution of publications and the competitive environment within which it operates and sets its rates removes such rates from the provisions of Article III:4. Although at one time the Post Office was an integral part of the Government of Canada and its rates were set by statute and regulation, that relationship was changed in a fundamental way in 1981. Concerned with issues relating to service, management, labour relations and the financial performance of the Post Office Department, the Government decided to turn over the postal administration to a Crown corporation with a commercial orientation and an independent management charged with attaining financial self-sufficiency. The CPC Act gave the Corporation the powers of a natural person, an attribute more typical of a private sector corporation than of traditional Crown corporations. The FA Act later confirmed the Corporation's status as an entity expected to operate in a competitive environment, not to be dependent on appropriations, earn a return on equity and pay dividends to its shareholder.

3.165 At the time of the creation of Canada Post, there were those who suggested that it should remain under the direct control of the Government. It was proposed that its activities be overseen by the Postmaster General assisted by a Secretariat. However, what had happened was that supervision of the Corporation had been entrusted to a board of directors composed of independent outside directors and officers of the Corporation (none of whom are civil servants). The Board, like traditional private sector boards of directors, is empowered to establish the general policy of the Corporation, including the making of decisions concerning finance, personnel management and commercial orientation, without the restrictions inherent in government departments. The Board has, since incorporation, pursued the goal of financial self-sufficiency by allowing management the latitude, in commercial operations, to generate revenues through rate and product management and to manage the Corporation's expenditures in a manner consistent with any competitive enterprise, essentially free of government intervention.

3.166 Crown corporations are distinct legal entities wholly owned by the Crown with boards of directors that oversee the management of the corporation and hold management accountable for the company’s performance. The board of directors, through the chair, is accountable to the responsible minister and the responsible minister functions as the link between the corporation and both the Cabinet and Parliament. It is the duty of the board of directors to oversee the management of their Crown corporation with a view to the best interests of both the corporation and the long-term interests of the shareholder. This concept is similar to that of private sector corporations. Boards of directors of Crown corporations are expected to exercise judgement in the broad areas of: the establishment of a corporation’s strategic

direction; the safeguarding of the corporation's resources; the monitoring of corporate performance; and reporting to the Crown. Each Crown corporation is accountable to Parliament for the conduct of its affairs through a minister who represents the Crown. It is through the minister that the Crown corporation reports on its plans and its performance to the Government and to Parliament.

3.167 Canadian and international commercial categories of rates had been set by Canada Post outside of the regulations since March 1994 and March 1992, respectively. Non-subsidized publications formerly subjected to the rates set out in the *Newspapers and Periodicals Regulations* are now subject to commercial Canadian Publications Mail and International Publications Mail rates, respectively, which are established and approved by Canada Post senior management. They are not established by Canadian Government regulations.

3.168 Canada Post is a corporation with a distinct legal personality. It can contract separately from the Government. It contracts with the Government for the supply of postal and other services. The Corporation is obligated to pay corporate income tax to the Government on its revenues.[99] Contrary to US assertions, employees of the Corporation are not employees of the Government. Indeed, Section 12 of the CPC Act authorizes Canada Post to hire employees, fix the terms and conditions of their employment and pay them their remuneration. The statutory regime[100] applicable to employees of the Government does not apply to employees of Canada Post, whose employment conditions and labour relations are governed by the same provisions of the Canada Labour Code that apply to the federal private sector.[101] Furthermore, if Canada Post employees had government employee status, there would have been no need to include a special "deeming" provision in the Act in order to preserve employees' pension rights at the time of the creation of Canada Post. The above attributes are certainly not those of a corporation over which the Canadian Government maintains a "hands-on level of administrative control" as the United States would like the Panel to believe.

3.169 The degree of control that the Government exercises over Canada Post's commercial operations is one dictated by the Government shareholder's interests. The Government requires sound financial administration of the Corporation's business and a fair return on its equity investments. To achieve this goal, the Corporation must offer satisfactory services to customers at a competitive price that will maximize profits. In a competitive environment, pricing policies of Canada Post must take into account basic economic principles of supply and demand. It must consequently consider the effects that its commercial postal rates will have on current or potential competition.

3.170 Canada Post does not have a monopoly with respect to the delivery of publications (newspapers and periodicals) in Canada. Canada Post, through the CPC Act, does have a limited exclusive privilege with respect to the collection, transmission and delivery of "letters" in Canada including addressed advertising mail, but the Corporation has no statutory protection for the remainder of its business and has to compete with existing or potential competition, as the case may be.

3.171 Almost 50 per cent of foreign publications mailed in Canada are accorded special rates negotiated by major foreign publishers pursuant to long-term agreements with Canada Post. Those rates are substantially less than the commercial International Publications Mail rate and relatively close to the

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[99]*Income Tax Regulations, amendment*, SOR/94-405.

[100]Canada states that employees of the Government are appointed by the Public Service Commission under the unique provisions of the *Public Service Employment Act.* Employment conditions and labour relations are governed by the *Public Service Staff Relations Act and the Public Service Employment Act.*

[101]Canada notes that the federal private sector includes such industries as banks, interprovincial trucking, radio, television, railways, ports and the aeronautics industry.

commercial Canadian Publications Mail rate[102]. The willingness of the Corporation to enter into such special-rate agreements reflects the reality that large foreign publishers have the resources and purchasing power to credibly threaten full or partial delivery in Canada via current and potential private distributors. Smaller foreign publishers have neither the volume nor the density of mailings to warrant their effort to access private distribution (often organised on a city by city basis) in Canada. Canadian commercial publishers have credibly threatened to move to private distribution in the past[103]. This motivated the Corporation to develop commercial Publications Mail rates that are financially attractive when compared to that of current or potential private distributors.

3.172 Canada Post currently faces competition for delivery of addressed publications.[104] The principal form of competition for the delivery of addressed subscriber copies of daily and weekly newspapers (those not eligible for subsidized postal rates) is delivery by the publishers themselves. In general, almost all such newspapers choose to deliver their own publications wherever volume densities warrant, with the residual volumes being mailed to subscribers via Canada Post's commercial Publications Mail rates. There is somewhat less competition for the delivery of addressed periodicals, where competition exists mainly in the dense urban areas. Competition for the delivery of addressed periodicals is limited because commercial publications rates are designed to attract the delivery of addressed periodicals not eligible for subsidized rates. It is also limited due to Canada Post's successful bid to Canadian Heritage for the delivery of publications eligible for funded rates. Canada Post's competitors cannot enter into the same arrangement with Canadian Heritage because all available program dollars have been committed to the arrangement signed with Canada Post.

3.173 Canadian Heritage agreed to a fixed price contract with Canada Post, taking into account the fact that this would be an exclusive contract for the delivery of eligible publishers' publications at subsidized rates, and therefore committing all of its funding available for distribution assistance of these publications. Obviously, this precludes any alternative supplier of delivery services from signing a similar agreement with Canadian Heritage during the three-year term of the current agreement. However, Canada Post won the exclusive three-year arrangement in the context of a real possibility of a direct-to-publishers funding program without exclusive suppliers. Such an option or an option of awarding an exclusive supply contract to a supplier or suppliers other than Canada Post is again a possibility at the expiry of the current three-year contract. It should be noted that Canada Post is obliged under the current agreement to provide service without limitation at the agreed funded rates to all existing and new publications that are deemed by Canadian Heritage to meet the agreed eligibility conditions. If the publisher of an eligible publication chooses to deliver the publication via another carrier, the publisher would not have access to special rates given that Canadian Heritage has chosen to negotiate an exclusive supplier contract with Canada Post for the term of the contract.

3.174 With respect to the use of the Radwanski Report by the United States, the mandate review was partially a review of the appropriateness of the monopoly that the Government has granted to Canada Post on letter delivery. The Report recommends, among other things: (1) that providing universality of service and uniformity of price for lettermail be regarded as integral elements of the mandate of Canada Post; and (2) that the exclusive privilege of Canada Post with regard to lettermail be maintained in its current form. Secondly, the mandate review was a review by the shareholder of the validity

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[102]Canada asserts that contrary to what the United States contends, several large foreign publishers enjoy discounts, pursuant to long-term agreements, similar to the mail preparation discounts offered to Canadian publishers.

[103]Canada notes that those threats are substantiated by certain factors such as the proximity of the Canadian publications to their markets, generally greater density of those markets (typically commercial trade publications oriented towards businesses in urban areas) and concentration of ownership in the industry.

[104]Examples of such competitors are Globe and Mail Distribution Services Ltd., A1Tours Ltd. (bundle distribution of magazines to business/professional offices), C.D. Woods Ltd., (Vancouver B.C.), Roltek Ltd., Insurance Courier Services Ltd. and an emerging co-operative delivery venture of Canadian trade publications.

of the strategic, operational and financial direction of Canada Post and in this regard the mandate review is similar in nature to periodic reviews conducted in the private sector by shareholders of both publicly and privately held corporations. The recommendations contained in the Report, in whole or in part, are not government policy but rather recommendations to the government for consideration. The government has rejected certain of the recommendations, adopted others and taken the balance under advisement. The Radwanski Report did not address Canada Post's distribution services for publications.

3.175 The **United States** asserted that the fact that the Government has to date not intervened to put a stop to Canada Post's discriminatory postal rates does not mean that it is not responsible for them. A WTO Member cannot create a government institution, allow it to take actions inconsistent with the Member's WTO obligations, and then claim it has no responsibility for the actions of the institution. The market access concessions that WTO Members have negotiated over the years would not be secure if governments could escape their obligation to provide national treatment to imported products by creating government corporations and then claiming that they are not responsible for the discrimination imposed by the entities they themselves created. Intervention by the Government to ensure that Canada Post complies with Canada's international obligations under the GATT is within the power of the Canadian Government. It is especially important that the Canadian Government take remedial action because publishers of imported magazines have only limited alternatives to using Canada Post's services for delivery and transportation of magazines to Canadian subscribers. Indeed, Canada Post itself boasts that, "*We are the only national distribution service that reaches every single address in Canada*. No one does this - no other competitor comes close".[105] Canada acknowledges that Canada Post faces only limited competition for the delivery of addressed magazines. Magazines seeking to reach destinations other than business addresses in major cities have no practical alternative to using the delivery services of Canada Post.

3.176 Because of Canada Post's status as a Canadian Government institution that delivers and transports magazines and other mail, its actions - including the rates it applies - in respect of these activities are necessarily regulations or requirements affecting the internal sale, distribution or transportation of magazines within the meaning of Article III:4. If the Canadian Government told private Canadian delivery services to charge more for delivering imported goods than for delivering domestic goods, it would be in clear violation of Article III:4. If the Canadian Government accomplishes this same result through rate discrimination in its own delivery services, Article III:4 should apply with equal force. With respect to Canada's arguments concerning the Radwanski report, the United States responded that although that report did not refer to publications mail, it was primarily concerned with advertising mail and courier services, which are both commercial services. Thus, the statements made by Minister Marleau with respect to these services as commercial services are equally applicable to publications mail.

Like product issue

3.177 The **United States** argued that imported magazines are "like" domestic magazines for the purposes of Article III:4. Canada Post's rates distinguish between magazines based on whether they are imported or produced in Canada. In particular, Canada established two rate classes for magazines that are printed and published in Canada (the "commercial" and "funded" rates) and a third rate class for imported magazines (the "international" rate). Magazines eligible for "funded" rates are not only printed and published in Canada, but have to meet other requirements, namely: (a) the periodical must be typeset and edited in Canada; (b) the exclusive right to produce and publish the periodical must be held by a Canadian citizen, or a corporation controlled by Canadian citizens; and (c) the issue can

[105]Canada Post, Publications Mail, Product Guide at B-1 (bold in original).

not be published under license from a foreign publisher, or contain editorial content substantially the same as an issue printed outside Canada that was not first edited in Canada.[106]

3.178 However, all of these categories of magazines are "like products" for purposes of Article III:4 and the distinction that Canada has drawn between them is solely, indeed openly, intended to favour domestic production. Domestic and imported magazines share the same physical characteristics and commercial uses. Neither the location of production, nor the ownership of the right to publish, nor whether editorial content appeared in an issue printed outside Canada, make imported magazines unlike domestically-produced magazines in terms of physical characteristics or end uses. The rates established by Canada Post for imported and domestically-produced magazines draw an impermissible distinction based on the origin of the magazine, a distinction that, on its face, is applied "so as to afford protection to domestic production".

Treatment of imported and domestic magazines

3.179 The **United States** stated that the rates established by Canada Post discriminate against imported magazines. Canada Post charges rates for domestically-produced magazines that are either 10 or 80 per cent lower on average than the rates applicable to imported magazines. These rates accord manifestly less favourable treatment to imported magazines by comparison to their domestically-produced counterparts. Moreover, Canada Post routinely makes discounts (such as "palletization" and "bypass" options) available to domestic magazines but not to imported magazines that increase the degree of discrimination still further. The higher postal rates for imported magazines are calculated to place them at a competitive disadvantage by comparison to competing domestically-produced magazines by creating a disparity between the distribution and transportation costs for imported and domestic magazines. Article III:4, second sentence, confirms that discrimination with respect to transportation based on the "nationality of a product" is not consistent with Article III:4. Canada has made no secret of the fact that the explicit purpose for its varying postal rates is to protect the Canadian publishing industry from import competition. Canada's discriminatory magazine postal rates represent precisely the kind of protectionist regulatory measure that GATT Article III:4 condemns.

3.180 It is no answer for Canada to assert that Canada Post enters into special lower-rate arrangements with certain larger foreign magazines. Canada Post's standard commercial rates for imported magazines are higher than for domestic magazines. Smaller foreign publishers, who cannot enter into special arrangements, are subject to the standard discriminatory rates. Moreover, negotiations for special rates between Canada Post and larger publishers (both foreign and domestic) presumably use the standard discriminatory commercial rates as the starting point. Thus, the resulting negotiated rates are in all likelihood discriminatory as well. Indeed, Canada states that the negotiated rates offered to large foreign publishers are only "relatively" close to the *standard* commercial rates are offered to Canadian publishers.

3.181 **Canada** argued that the economic factors applicable to foreign and domestic periodicals are not the same which is why their respective rates are different. Those rates are a reflection of competitive situations, not the result of discriminatory practices as was argued by the United States. Canada Post has no policy of giving a competitive advantage to one segment of its customers over another, and would have no interest in pursuing any such practice. Given appropriate competitive factors, it might very well be that certain foreign periodicals would enjoy better rates than non-subsidized Canadian magazines. This is exactly the type of scenario that Article III of GATT 1994 is intended to preserve. If foreign magazines are in better competitive situations, they should be able to take advantage of it. If on the contrary, they are not in such a position, Article III should not be there to grant them advantages

[106]*Regulations Respecting Newspapers and Periodicals*, Section 3(2) (definition of "Canadian Periodical"), S.O.R./91-179, 28 February, 1991.

that market forces do not provide. In the commercial and competitive environment in which Canada Post operates, it is under no obligation by virtue of Article III:4 to subsidize US publications by setting a better postal rate then what their specific market conditions require.

(ii) Article III:8(b)

3.182 The **United States** argued that Canada Post's discriminatory postal rates do not constitute the payment of subsidies exclusively to domestic producers within the meaning of Article III:8(b), because domestic producers receive no subsidy payments. Under their 1 May 1996 Agreement, Canadian Heritage provides Canada Post with fixed annual payments to support Canada Post's below-cost "funded" postal rates for certain magazines produced in Canada. Those payments are not distributed to domestic magazine producers; instead Canada Post uses the funds to underwrite the lower postage rates it charges domestically-produced magazines. Thus, Canada's discriminatory postal rates are not direct payments to Canadian producers; rather, they modify the conditions of competition between domestic and imported products in contravention of Article III:4.

3.183 A series of GATT 1947 panel reports had interpreted Article III:8(b) very narrowly to hold that the only subsidies subject to exclusion from the national treatment provisions of Article III are those subsidies that are paid *directly* to domestic producers. So, for example, credit facilities provided to purchasers, and not producers,[107] and payments whose benefits could be partially retained by processors,[108] have been found not to qualify under Article III:8(b). Nor does the annual payment that Canadian Heritage makes to Canada Post constitute a subsidy to domestic producers under Article III:8(b). Canadian Heritage does not provide its funds to domestic producers. The low-priced "funded" postal rate that Canada applies to certain favoured periodicals produced in Canada do not fall within the terms of Article III:8(b). Rather, these rates, together with the "commercial" rate and various discounts applicable only to Canadian-produced magazines, are part of an overtly discriminatory postal rate scheme designed to create further protection for Canada's domestic magazine industry.

3.184 **Canada** argued that the funds paid by Canadian Heritage to Canada Post to enable it to grant Canadian publishers of publications reduced postal rates are allowable subsidies under GATT Article III:8(b), which explicitly recognizes that subsidies to domestic producers are not subject to the national treatment rules of Article III. Paragraph 8(b) applies with respect to all provisions of Article III, including Article III:4. Public policy has been developed to ensure that Canadians, regardless of where they live, have access on a reasonable basis to periodicals. Subsidized postal rates are provided to maximize the opportunity for distribution, particularly in light of Canada's relatively small and widely dispersed population. This measure is critical, since Canadian magazines have only limited access to newsstands and rely mainly on paid subscriptions for circulation. Subsidized postal rates have enabled Canadian magazines to reach a widely dispersed readership. The provision of reduced postal rates is a way of paying subsidies that is compatible with GATT 1994. These payments are made to Canada Post four times a year in return for its undertaking to deliver eligible publications at the agreed reduced rates. The benefit of the subsidies flows directly to eligible Canadian magazine publishers. The Canadian publication industry is the exclusive beneficiary of these subsidies and has to qualify for these subsidized rates in accordance with criteria set by Canadian Heritage before being found to be eligible.

3.185 The decision of the panel in *US - Malt Beverages* lends no support to the US position. This panel held that the expression "payment of subsidies" applies only to direct subsidies and not to other

[107]Panel Report on *Italian Discrimination Against Agricultural Machinery, op. cit.*, at 60, 64, para. 14.

[108]Panel Report on *European Economic Community - Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins*, adopted on 25 January 1990, 37S/86, 124, para 137.

kinds of subsidies such as tax credits or tax abatements.[109] The panel was concerned solely with the distinction between subsidies, tax remissions and differential taxation rates, because a failure to make that distinction would destroy the effect of Article III:2. The formal distinction between taxation measures – benefits not involving direct expenditures by government – and subsidies is vital to the operation of the Article as a whole. Canada's postal subsidy meets the requirement of directness, in the sense in which that concept is used in the *US - Malt Beverages* decision, because a payment by government for the exclusive benefit of the producers is being made. It is only the mechanics of payment that were indirect.

3.186 The position held by the United States is therefore based on a difference of form, not substance. The specific form in which the subsidy is paid is irrelevant to the operation of Article III:8(b), provided that a payment is made by the government for the exclusive benefit of domestic producers.[110] Before being granted the privilege of posting using funded postal rates, a publisher has to sign a service agreement with Canada Post. This simple fact is evidence that publishers are direct beneficiaries. Canada Post is an intermediary, not the beneficiary. Whether the subsidy is paid to Canada Post or paid directly to the publishers, the economic effect is the same, namely that the eligible publishers are the beneficiaries of the subsidy.

3.187 In practical terms, payments to individual publishers would be a cumbersome and ineffective method of delivering this subsidy. The administrative and financial burden of such a process would erode the benefits of the program. If an eligible Canadian publisher of a monthly magazine were to receive the payment, the advantages this publisher enjoys relative to foreign competition would be essentially unchanged. Canadian publishers would find themselves in the same position as they are in now, namely with an advantage over their foreign competitors. Therefore, Canadian Heritage provides Canada Post with an agreed-upon payment on a quarterly basis. The current process is far more efficient in minimizing the administrative overhead related to the program.

3.188 Based on the panel report on the *EEC – Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-feed Proteins*[111] ("*EEC - Oilseeds*"), the United States argued that subsidies not paid directly to producers are not paid to them "exclusively" within the meaning of Article III:8(b). The word "exclusively" as used in this provision is concerned with the distinction between "domestic" as opposed to "non-domestic" producers, not whether third parties benefit from the subsidies. Whether an incidental benefit might be conferred upon Canada Post from the subsidy payment is irrelevant. Under the interpretation of this clause suggested by the United States, virtually any subsidy payment that would confer a third party benefit, however minimal, would be non-compliant. This is surely not the intended application of the exemption. Subsidies have an economic impact on third parties in almost all circumstances. The definition of the term "exclusive" proposed by the United States would lead, in practical terms, to the nullification of the Article III:8(b) exemption.

3.189 The **United States** argued that were Canada to provide payments directly (and exclusively) to domestic producers of magazines, the United States agreed that such payments would be protected by Article III:8(b). Under Canada's postal rate scheme for periodicals, however, domestic magazine producers receive *no* government payments. The only "payments" are made from one government

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[109]Panel Report on *United States - Measures Affecting Alcoholic and Malt Beverages, op. cit.*

[110]Canada noted that the *US-Malt Beverages* panel read subparagraph 8(b) having regard to the context of the whole of Article III but, except in the context of taxation measures, it was never stated that for every subsidy to qualify, the payment must be made directly to domestic producers. The panel simply said that the words "payment of subsidies" refer only to direct subsidies involving a payment, not to other subsidies such as tax credits or tax reductions (*ibid.* at 271, para. 5.8).

[111]Panel Report on *European Economic Community - Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins, op. cit.*, at 124-125, paras. 137-141.

entity (Canadian Heritage) to another (Canada Post).[112] Thus Canada's postal scheme simply does not comply with the requirement of Article III:8(b) that there be "payment . . . to domestic producers".

3.190 With regard to Canada's argument that its funded-rates system satisfied Article III:8(b) because it includes "payments" (to Canada Post), and because the resulting lower postal rates on domestic magazines have the same "economic effect" on domestic producers as payments made directly to them, the United States stated that the mere existence of "payments" (from one government entity to another, in this case) is not enough. The payments have to go to domestic producers. Under Canada's postal rate scheme, domestic *periodicals* are provided lower postal rates than imported magazines; domestic periodical *producers* receive no payments. Instead, so-called "funded publications" are charged lower postal rates. Because imported magazines do not qualify for these rates, they are placed at a commercial disadvantage in terms of the transportation and delivery of their magazines in Canada. This is precisely the type of discrimination that Article III:4 is meant to prohibit. Canada Post's discriminatory postal rates clearly confer an economic benefit on domestic *products*, but a benefit of that sort is not within the scope of Article III:8(b). That Article applies only to "the payment of subsidies exclusively to domestic *producers*" (emphasis added).

3.191 GATT panels have consistently applied Article III:8(b) strictly according to its terms. They have rejected appeals to ignore its actual language in favour of what Canada claims to be "an economic perspective". They have uniformly denied the protection of Article III:8(b) to measures that provided no direct payments to domestic producers, including measures that may have conferred economic benefits indirectly on domestic producers by favouring the purchase or use of domestic products. Indeed, the "economic benefits" argument was explicitly rejected by the panel on *United States - Measures Affecting the Importation, Internal Sale and Use of Tobacco* ("*US - Tobacco*").[113]

3.192 If Canada's view - that Article III:8(b) encompasses the indirect provision of economic benefits to domestic producers through government advantages conferred on their goods - is accepted, it would dramatically expand the types of measures exempted from discipline under Article III. That is because virtually *any* form of more-favourable treatment accorded by a government to domestic products could be characterized as providing economic benefits similar to the payment of subsidies to domestic producers. Past panels have uniformly interpreted Article III:8(b) to require actual payments to domestic producers. In the panel on *Italian Discrimination Against Agricultural Machinery*, that panel

> "agreed with the contention of the United Kingdom delegation that in any case the provisions of paragraph 8(b) would not be applicable to this particular case since the credit facilities provided under the Law were granted to the purchasers or agricultural machinery and could not be considered as subsidies accorded to the producers of agricultural machinery".[114]

3.193 In that case it could have been argued that even though a subsidy was granted to purchasers of agricultural machinery, economic benefits also flowed directly or indirectly to the domestic producer of the machinery, since the availability of inexpensive credit limited to the purchase of domestic goods would stimulate the sales of such goods. However, the panel had correctly interpreted the words "exclusively to domestic producers" according to their plain meaning and found that the Italian credit scheme did not qualify for the Article III:8(b) exemption.

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[112]Memorandum of Agreement.

[113]Panel report on *United States - Measures Affecting the Importation, Internal Sale and Use of Tobacco*, adopted 4 October 1994, DS44/R.

[114]Panel Report on *Italian Discrimination Against Agricultural Machinery, op. cit.* para. 14.

3.194 The panel report on *US - Malt Beverages,* cited by Canada in its submissions, does not deal with the issue of payments to third parties. The panel rejected a US argument that tax credits for small domestic producers of beer and wine constituted a domestic subsidy permitted under Article III:8(b), and holding that

> "Article III:8(b) . . . clarifies that the product-related rules in paragraphs 1 through 7 of Article III 'shall not prevent the payment of subsidies exclusively to domestic producers' (emphasis added [in original text]). The words 'payment of subsidies' refer only to direct subsidies involving a payment. . ."[115]

The panel thus continued the practice of past panels of invoking a narrow and literal interpretation of that provision. In this case, the only "payment" goes from Canadian Heritage to Canada Post, not to magazine producers. In fact, this "payment" is more akin to an internal transfer of government funds than a true economic "payment" to an unrelated entity.

3.195 In *US - Tobacco,*[116] the panel found that price support payments made to domestic tobacco farmers out of the proceeds of the No Net Cost Assessment ("NNCA") were within the scope of Article III:8(b). The panel rejected an interpretation of Article III:8(b) based on a measure's economic impact:

> "The Panel was cognizant of the fact that a remission of a tax on a product and the payment of a producer subsidy out of the proceeds of such a tax could have the *same economic effects. However, the panel noted that the distinction in Article III:8(b) is a formal one, not related to the economic impact of a measure.* Thus, in view of the explicit language of Article III:8(b), which recognizes that the product-related rules of Article III "shall not prevent the payment of subsidies exclusively to domestic producers," the Panel did not consider, as argued by the complainants, that the payment of a subsidy to tobacco producers out of the proceeds of the NNCA resulted in a form of tax remission inconsistent with Article III:2".[117]

3.196 Finally, the *EEC - Oilseeds*[118] panel examined EEC legislation that, like the payments by the Department of Canadian Heritage to Canada Post, included government payments to a middleman rather than to the domestic producer itself, on the theory that the payments would induce the middleman to provide preferential treatment to the domestic producer. The EEC legislation provided for the payment of subsidies to processors of oilseeds whenever they established by documentary evidence that they had transformed oilseeds of Community origin. In that decision:

> "The Panel noted that Article III:8(b) applies only to payments made *exclusively* to domestic producers and considered that *it can reasonably be assumed that a payment not made directly to producers is not made "exclusively" to them.* It noted moreover that if the economic benefits generated by the payments granted by the Community can at least partly be retained by the processors of Community oilseeds, the payments generate a benefit conditional upon the purchase of oilseeds of domestic origin inconsistently with Article III:4. Under these circumstances Article III:8(b) would not be applicable because in that case *the payments would not be made exclusively to domestic producers but to processors as well*".[119]

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[115]Panel Report on *United States - Measures Affecting Alcoholic and Malt Beverages, op. cit.*

[116]Panel Report on *United States - Measures Affecting the Importation, Internal Sale and Use of Tobacco, op. cit.*

[117]*Ibid.,* para. 109 (emphasis added).

[118]Panel Report on *European Economic Community - Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins, op. cit.,*, para. 137.

[119]*Ibid.,* para. 137 (emphasis added).

3.197 Canada mischaracterizes the *EEC - Oilseeds* decision as standing for the proposition that the phrase "exclusively to domestic producer," as used in Article III:8(b), is intended only to distinguish between "domestic" as opposed to "non-domestic" producers. The emphasized language makes it clear that the distinction is between "direct payments to producers" and "payments to … processors" (who might in turn provide an indirect benefit to producers). So, too, in this case, the only "payments" are to an entity other than the domestic producers (and this "payment" is an internal transfer of government funds).

3.198 **Canada** considered it paradoxical if not contradictory for the United States to challenge Canada Post's international commercial rates on the grounds that Canada Post and the Government are one and the same, and to object to subsidized rates on the grounds that the same Corporation is obtaining, as a third party, a share of the benefits which the postal subsidy extends to Canadian periodical publishers. The argument that the Corporation is obtaining a benefit presupposes that it is an entirely separate entity from the Government: were it an organ of the Government, it would make little difference if it benefitted in any way from the payments, for in this case it would not be a government subsidy but simply a transfer of funds. The United States cannot maintain that the commercial rates and subsidized rates are discriminatory because Canada Post is part of the Government in the first case but not part of the Government in the second case. This is a clear contradiction.

3.199 The United States concedes that the protection provided by Article III:8(b) would extend to direct payments made exclusively to domestic periodical producers. At the same time, the United States takes a highly formalistic approach based on a very narrow interpretation of Article III:8(b). However, the formalism which the United States is asking the Panel to enshrine is supported neither by the text of Article III:8(b) nor by GATT practice. The method of subsidy payment is not in and of itself conclusive in determining whether Article III:8(b) applies. The essential factor is that the payment be made by the government for the benefit of domestic producers.

3.200 The panel reports quoted by the United States do not support the conclusion that the subsidy must always be paid directly and exclusively to domestic producers. For example, it cannot seriously be argued that the panel on *Italian Discrimination against Agricultural Machinery* determined that the subsidy had to be paid to domestic producers through actual payments. The panel found that Article III:8(b) did not apply in that case because the credit facilities provided by the legislation were extended to the purchasers of agricultural machinery and could not be considered to be subsidies paid to the producers of agricultural machinery. In the case of the Italian legislation, government support in the form of credit facilities for the purchase of Italian agricultural machinery was granted to the purchasers of agricultural machinery, and in the view of the panel the provisions of Article III:8(b) do not apply in these circumstances. The postal subsidy program involves no similar circumstances, since the Canadian Government's assistance in the form of reduced postal rates does not go to Canada Post Corporation.

3.201 It would appear that the formalism advocated by the United States stems from the report of the *US – Malt Beverages* panel, which dealt with a lower excise tax levied on domestic beer than on imported beer. The United States argued that the clear purpose of the lower tax was to subsidize small producers, and that reducing the excise tax was a way of granting such a subsidy which was compatible with the GATT. The panel concluded that "the words 'payment of subsidies' refer only to direct subsidies involving a payment, not to other subsidies such as tax credits or tax reductions". In the opinion of the panel, the prohibition on discriminatory internal taxes in Article III:2 would be rendered inoperative were it possible to offer a general justification for such taxes on imported goods on the grounds that these were subsidies paid to competing domestic producers in accordance with Article III:8(b).

3.202 The *US – Malt Beverages* report must be read and understood within the full context of Article III:2 and with consideration to tax credits and reductions. In that specific case, the tax reductions and exemptions could not be deemed equivalent to the subsidies provided for by Article III:8(b). The panel did not make a determination on all other forms of subsidies. The Canadian postal subsidy, which has nothing in common with a tax abatement, exemption, credit or reduction, is consistent with the provisions of Article III:8(b) and is in no way incompatible with the *US - Malt Beverages* decision. In the present case, payments are made four times a year for the exclusive benefit of periodical producers. Only the mechanics of payment are indirect.

3.203 This interpretation is supported by the *US – Tobacco* report, which the United States quotes and to which it attributes an unwarranted scope in light of Article III:8(b). Without entering into the details, the issue in this case was whether the net self-financing levy on imported tobacco was higher than the self-financing levy on domestic tobacco, since the latter received a *de facto* tax remission by virtue of the operation of the tobacco price support program. The panel did not consider that the payment of a subsidy to tobacco producers out of the proceeds of the self-financing levy resulted in a form of tax remission inconsistent with Article III:2. The panel noted the formal distinction between a tax remission on the one hand and the payment of a subsidy on the other, even if they could have the same economic effect. The economic impact in the case of tax remission is irrelevant to the application of Article III:8(b). The formal distinction between taxation measures and subsidies is vital to the operation of Article III:2. It cannot be concluded from this panel report, as the United States did, that in the case of a producer subsidy, the examination of the measure's economic impact is irrelevant to determine whether the measure is consistent with the provisions of Article III:8(b).

3.204 Lastly, the United States suggests that Article III:8(b) is inapplicable in light of the *EEC – Oilseeds* report, in which the panel provides an unusual interpretation of the word "exclusively". Contrary to the US contention, Canada has not misinterpreted this report. It simply supports a more common interpretation of the word "exclusively". The general thrust of Article III is against discrimination between imported and domestic products. In this context, granting a government subsidy "exclusively" to domestic producers can only mean granting a subsidy only to the producers of domestic products, in the sense that it is paid to them alone and not to foreign producers.

3.205 In the case under study, the payments to processors were an incentive for them to buy oilseeds of EEC origin instead of imported oilseeds. The incentive derived from the fact that the payments made to processors could be greater than the difference between the price processors actually paid to EEC producers and the price that processors would have had to pay for imported oilseeds. This excess compensation created an incentive to buy products of EEC origin instead of imports. It is for this reason that Article III:8(b) was not applicable, for in this case the payments were not made to domestic EEC producers exclusively, but to processors as well.

3.206 The panel demonstrated that the payments could constitute benefits granted to EEC processors if the latter purchased EEC products. There is no parallel between the postal subsidy and the flaws in the EEC system. The United States has failed to demonstrate such a parallel. Moreover, the United States claim that the panel developed a general principle of interpretation by which Article III:8(b) does not apply if there is an intermediary between the government and the beneficiary is groundless. The panel would not have taken the trouble to perform such a complex analysis of the various prices (in paragraphs 136 through 141) were it only a matter of putting forward a general principle. The United States has not presented any analysis comparable to the one performed by the panel.

3.207 Moreover, there is no parallel with the postal subsidy because Canada Post does not receive "bonus payments" for handling and distributing periodicals from Canadian publishers rather than from foreign publishers. The Corporation receives an amount that is stipulated in a memorandum of understanding or contract in exchange for the provision of reduced postal rates. This amount is based

on estimates of expected eligible Canadian periodical volumes at the negotiated reduced rates, which estimates are developed independently by each of Canada Post and Canadian Heritage in the course of negotiating the contract. There is no incentive to handle the periodicals of Canadian publishers rather than those of foreign publishers, since delivering a larger number of Canadian magazines than that originally estimated by Canada Post would not increase the Corporation's net income. The postal subsidy does not grant the Corporation any particular benefit. The EEC system provided incentives favouring EEC processors whereas there are no such measures favouring Canada Post in the memorandum of understanding with Canadian Heritage.

3.208 The agreement between Canadian Heritage and Canada Post expressly stipulates the rates paid by eligible Canadian periodical publishers. The terms of the agreement ensure that the payments to the Corporation secure the price it must charge publishers who mail their periodicals at subsidized rates. The contract for the provision of delivery services for eligible publications is at a fixed rate. Canada Post receives a lump sum in exchange for providing delivery services at the reduced rate. It should be noted that the predetermined annual payment to Canada Post from Canadian Heritage is a negotiated value for service in the spirit of any fixed price contract; that is, Canada Post must provide delivery at the agreed reduced rates to all eligible publications in return for the fixed amount. Both parties are aware that variances up or down in a given year relative to each's view of expected volume are to be expected. However, it is each party's studied view that in spite of these risks, it has an equal chance to gain or lose relative to those expectations of volumes. In view of the fixed price nature of the agreement, there is no relevance to arguments of payments in excess of value of service provided. The value provided is by definition exactly what was contracted to be provided in return for the pre-determined fixed payment.

3.209 The United States has conceded that were the payments made directly and exclusively to Canadian periodical publishers, these payments would qualify for protection under Article III:8(b). The question the Panel must consider is whether such a change in the method of subsidy payment would place foreign periodical publishers in a more favourable competitive position in relation to Canadian publishers in respect of the postal subsidy. There is no reason to believe that this would be the case. The method of payment is merely the subsidy's technical, administrative aspect. It does not reveal who benefits from the subsidy. If payments were made directly to publishers, Canada Post would increase its rates for the delivery and distribution of the magazines that had previously enjoyed reduced rates, in accordance with its practice for commercial services and its profit maximization objectives. Eligible Canadian publishers would continue to buy periodical delivery services from the Corporation at a cost "lower" than the commercial rate, in view of the compensatory payments they would receive. As for foreign publishers, they would continue to buy periodical delivery and distribution services from Canada Post at the same rates as before.

3.210 If the subsidy were paid directly to publishers rather than to Canada Post, the effects would be the same. Eligible publishers would be the beneficiaries of the subsidy. Only administrative costs would increase substantially. There is no valid reason in this case, such as for example a concern that provisions of the 1994 GATT would be rendered inoperative, which demand that the Panel uphold an interpretation which would have the effect of replacing the relatively simple and economical existing system with a costly and complicated system. Lastly, there are no grounds for claiming, as the United States has done, that our interpretation of Article III:8(b) would have the effect of encouraging the governments of member states to introduce a host of discriminatory measures in favour of domestic goods for the sole reason that these would economically benefit domestic producers. Canada is not proposing the abolition of the disciplines in the 1994 GATT but only a reading of Article III:8(b) that respects its terms.

3.211 The **United States** concluded that over the years GATT panels had been very careful to apply the precise language of Article III:8(b) and to avoid expanding the scope of that Article to encompass

measures other than the direct payment of subsidies that convey economic benefits on the domestic producers. This caution was completely justified because the liberal reading Canada suggests for Article III:8(b) would permit governments to employ a wide variety of discriminatory measures in favour of domestic products that could be justified on the ground of conferring economic benefits on domestic producers. Such a result could dramatically alter the competitive environment in the markets of Members around the world. Canada's "funded" postage rate scheme for domestically-produced periodicals was a very good example of a product transportation and distribution regime that may well confer economic benefits on domestic producers but that plainly altered the competitive relationship between imported and domestic products.[120]

IV. INTERIM REVIEW

4.1 On 23 January 1997, the United States requested the Panel to review, in accordance with Article 15.2 of the DSU, precise aspects of the interim report that had been issued to the parties on 16 January 1997. Canada did not request a review, but wished to reserve its right to respond to the US comments. The Panel ruled that, given the circumstances in this particular case, Canada could submit its response by 31 January 1997. Canada submitted its response to the US comments on 31 January 1997, urging the Panel to disregard a large part of the US comments. Neither the United States nor Canada requested the Panel to hold a meeting. The Panel reviewed the entire range of arguments presented by the parties in their written submissions, and finalized its findings as in Section V below, taking into account the specific aspects it considered to be relevant.

4.2 Regarding Tariff Code 9958, the interim report had focused on the "split-run" rule, which the Panel found to be the principal issue, and had not mentioned the second part of the Code, namely the five-per-cent rule. The United States requested the inclusion of this part in the findings. Canada did not object to this request. The Panel agreed to the inclusion and introduced some drafting modifications in the final report at paragraphs 5.1 and 5.4.

4.3 The interim report had, in a part corresponding to paragraph 5.24 of the final report, stated that the definition of a "split-run" edition relied *solely* on factors external to the Canadian market. The United States suggested that the Panel change this word to *decisively*. Canada objected to this change. However, the Panel considered the US suggestion to be a useful one to improve the accuracy of the findings, and accordingly modified the expression in the way it now appears in paragraph 5.24.

4.4 Regarding paragraph 5.25 of the final report, the United States suggested that the Panel add that "(1) any number of additional hypothetical examples could be devised that would further show that split-run and non-split-run periodicals need not be any different, and that (2) this is to be expected because the definition of split-run periodicals provides that two virtually identical products can be taxed differently depending on whether or not a similar product is sold outside Canada". While the Panel did not disagree with this observation, it was not persuaded that such an addition would enhance the clarity of the logic in the final report. The Panel therefore decided not to introduce the suggested change.

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[120]The United States argued that even if it were concluded that the payments made by Canadian Heritage to Canada Post to support the "funded" postal rates somehow gave rise to payments to domestic producers within the meaning of Article III:8(b), because domestic producers ultimately received an economic benefit, such a benefit would not be provided "exclusively" to domestic producers. Canada Post itself might well be a beneficiary. This is because Canada Post's pre-determined annual payment from Canadian Heritage might exceed Canada Post's cost of delivering all eligible periodicals in a given year. Moreover, Canada Post could further benefit economically from having a captive set of customers who must use its services in order to obtain the "funded" rates. For these reasons, according to the United States, it cannot be said that the benefits of Canada's Publications Assistance Program are provided "exclusively to domestic producers".

4.5 Regarding the directness of the taxation (paragraphs 5.28 and 5.29 of the final report), the United States argued that this was a case of direct taxation because the excise tax was focused on a particular type of good. The Panel rejected this argument. However, in this connection, the United States pointed out that a certain citation of past cases in the interim report could be somewhat misleading. The Panel accepted this point, and modified the paragraphs accordingly.

4.6 Regarding the differences between "commercial Canadian" and "international" rates applied by Canada Post to periodicals, the United States commented that the interim report failed to mention certain additional discount options which were available only to Canadian periodicals. The Panel accepted this comment and introduced some drafting modifications in the final report at paragraphs 5.1, 5.39 and 6.1. The United States further requested that the final report refer to the long-term discount contracts between Canada Post and large-circulation magazine publishers (see paragraph 3.171). Canada objected to this request on the grounds that these agreements or contracts had "never been one of the objects of this dispute". The Panel considered that this particular issue was not presented by the United States in a coherent manner during the proceedings, and that it was too late for the United States to raise this issue as an additional claim at the interim review stage. Accordingly, the Panel did not accept the US request on this point.

4.7 The United States suggested that the Panel restructure paragraph 5.36 of the final report as an alternative argument because, according to the United States, the fact that Canada Post is an entity of the Canadian Government was a sufficient reason to find a violation of Article III:4 of GATT 1994 in this instance. However, the Panel considered such a change unnecessary. In the Panel's view, it was clear that the *Semi-Conductor* case was cited here as supporting evidence, not as decisive reason for finding the violation.

4.8 The United States questioned the appropriateness of paragraphs 5.37 and 5.38 of the final report, suggesting that the examination of Article III:1 of GATT 1994 was unnecessary in this case. Canada did not object to this comment. However, in the Panel's view, the Appellate Body Report on *Japan - Taxes on Alcoholic Beverages* clearly mandates it to engage in such an examination. The Panel therefore decided to retain these paragraphs unchanged from the way in which they appeared in the interim report.

4.9 Regarding paragraphs 5.42 to 5.44 of the final report, the United States considered that the Panel erroneously concluded that the "funded" rate scheme constituted a payment of subsidies permitted by Article III:8 of GATT 1994. The Panel disagreed for reasons elaborated in its final report. The Panel accordingly did not introduce modifications to the final report in this respect.

4.10 The United States also made other drafting suggestions concerning the descriptive part, some of which the Panel accepted and introduced in its final report.

V. FINDINGS

A. Introduction

5.1 This dispute essentially arises from the following facts: *(a)* Canada prohibits imports of "split-run" periodicals (periodicals with the same or similar editorial content as those published in foreign countries, which contain an advertisement directed to the Canadian market) through Tariff Code 9958. Tariff Code 9958 further prohibits imports of periodicals in which more than five per cent of the advertising content consists of advertisements directed to the Canadian market, whether or not an edition with similar editorial content is sold outside Canada; *(b)* Canada, through Part V.1 of the Excise Tax Act, imposes an excise tax of 80 per cent on the value of advertisements in "split-run" periodicals distributed

in Canada on a per issue basis; and *(c)* Canada Post Corporation ("Canada Post") applies reduced ("funded") postal rates, funded by the Department of Canadian Heritage ("Canadian Heritage"), to certain periodicals published in Canada. Postal rates applied to Canadian periodicals not eligible for the "funded" rates ("commercial Canadian" rates) are lower than those applied to imported periodicals ("international" rates). Certain additional discount options (such as for "palletization" and "pre-sort") are available to Canadian periodicals but are not generally available to imported periodicals.

5.2 The United States claims that *(a)* Tariff Code 9958 is inconsistent with Article XI of the General Agreement on Tariffs and Trade 1994 ("GATT 1994"); *(b)* Part V.1 of the Excise Tax Act is inconsistent with Article III:2 of GATT 1994, or in the alternative, is inconsistent with Article III:4 of GATT 1994; and *(c)* the application by Canada Post of lower postal rates to domestically-produced periodicals than to imported periodicals is inconsistent with Article III:4 of GATT 1994, and the "funded" rate scheme is not a domestic subsidy within the meaning of Article III:8 of GATT 1994. The United States requests that the Panel recommend that Canada bring its measures into conformity with its obligations under GATT 1994.

5.3 Canada requests the Panel to dismiss the US claims on the grounds that *(a)* Tariff Code 9958 is justifiable under Article XX(d) of GATT 1994; *(b)* Article III of GATT 1994 does not apply to Part V.1 of the Excise Tax Act; even if the Panel decides that Article III of GATT 1994 applies to these provisions, they do not violate Article III of the GATT 1994; and *(c)* Article III:4 of GATT 1994 does not apply to the "commercial" rates charged by Canada Post because they are the result of a commercial and marketing policy and not influenced by government policy and the "funded" rate scheme is a payment of subsidies allowable under Article III:8(b) of GATT 1994.

B. Tariff Code 9958

5.4 Tariff Code 9958 prohibits the importation into Canada of the following:

> "1. Issues of a periodical, one of the four immediately preceding issues of which has, under regulations that the Governor in Council may make, been found to be an issue of special edition, including a split-run or a regional edition, that contained an advertisement that was primarily directed to a market in Canada, and that did not appear in identical form in all editions of that issue of that periodical that were distributed in the country of origin.
>
> "2. Issues of a periodical, one of the four immediately preceding issues of which has, under regulations that the Governor in Council may make, been found to be an issue of more than five per cent of the advertising space in which consisted of space used for advertisements that indicated specific sources of availability in Canada, or specific terms or conditions relating to the sale of provision in Canada, of any goods or services except where the indication of such sources of availability or such terms or conditions was primarily directed at persons outside Canada".[121]

5.5 Since the importation of certain foreign products into Canada is completely denied under Tariff Code 9958, it appears that this provision by its terms is inconsistent with Article XI:1 of GATT 1994. Article XI:1 reads in relevant part as follows:

> "No prohibitions or restrictions other than duties, taxes or other charges … shall be instituted or maintained by any [Member] on the importation of any product of the territory of any other [Member] …".

[121]Paragraphs 2.2-2.3 *supra*.

5.6 The question presented here is whether the import prohibition under Tariff Code 9958 may be justified under other provisions of the WTO Agreement. Canada claims that the measure is justified under Article XX(d) of GATT 1994. The relevant part of Article XX of GATT 1994 reads as follows:

> "Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any [Member] of measures: … (d) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including those relating to customs enforcement, the enforcement of monopolies operated under paragraph 4 of Article II and Article XVII, the protection of patents, trade marks and copyrights, and the prevention of deceptive practices; …".

5.7 The panel on *United States - Standards for Reformulated and Conventional Gasoline* approached this provision in the following fashion. Having stated that the party invoking an exception under Article XX bore the burden of proving that the inconsistent measures came within its scope, the panel observed that the complainant had to demonstrate the following elements:

> "(1) that the measures for which the exception were being invoked - that is, the particular trade measures inconsistent with the General Agreement - *secure compliance* with laws or regulations themselves not inconsistent with the General Agreement;
>
> "(2) that the inconsistent measures for which the exception was being invoked were *necessary* to secure compliance with those laws or regulations; and
>
> "(3) that the measures were applied in conformity with the requirements of the *introductory clause* of Article XX".[122]

In order to justify the application of Article XX(d), according to the panel, all the above elements had to be satisfied. We will follow the same approach in the present case.[123]

5.8 First, as to whether the import prohibition under Tariff Code 9958 secures compliance with a law or regulation not inconsistent with GATT 1994, Canada argues that Tariff Code 9958 is a measure intended to secure the attainment of the objectives of Section 19 of the Income Tax Act, which allows for the deduction of expenses for advertising directed to the Canadian market on condition that the advertisements appear in Canadian editions of Canadian periodicals. Since the United States is not challenging the GATT consistency of Section 19 of the Income Tax Act in this proceeding, the issue of GATT consistency is not before the Panel. However, the United States claims that Tariff Code 9958 is not a measure to "secure compliance" with the Income Tax Act.

5.9 The interpretative issue here is what is meant by "to secure compliance with laws and regulations" in Article XX(d) of GATT 1994. In this connection, the panel on *European Economic Community - Regulations on Imports of Parts and Components* found this phrase to mean "to enforce obligations

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[122]Panel Report on *United States - Standards for Reformulated and Conventional Gasoline*, adopted on 20 May 1996, WT/DS2/R, para. 6.31 (emphasis in original). The relevant part of the panel report was not modified by the Appellate Body.

[123]We note that the Appellate Body in a recent report stated as follows: "[Adopted panel reports] create legitimate expectations among WTO Members, and, therefore, should be taken into account where they are relevant to any dispute". Appellate Body Report on *Japan - Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R and WT/DS11/AB/R, p. 14.

under laws and obligations", not "to ensure the attainment of the objectives of the laws and regulations".[124] Canada suggests that this precedent should not be rigidly followed in the case of fiscal or economic incentives in general, and particularly in the present case, because Tariff Code 9958 and the income tax provision have always been considered part of a single, indivisible package. We are not persuaded by this argument. Canada's view will inherently lead to a situation where "[w]henever the objective of a law consistent with the General Agreement cannot be attained by enforcing the obligations under that law, the imposition of further obligations inconsistent with the General Agreement could then be justified under Article XX(d) on the grounds that this secures compliance with the objectives of that law", as was pointed out by the aforementioned panel.[125] We fail to see any differences that would obviate this problem in the case of fiscal or economic incentives. It should be noted, however, that we are neither examining nor passing judgment on the policy objectives of the Canadian measure regarding periodicals; we are nevertheless called upon to examine the ***instruments*** chosen by the Canadian Government for the attainment of such policy objectives.

5.10 Tariff Code 9958 cannot be regarded as an enforcement measure for Section 19 of the Income Tax Act. It is true that if a government bans imports of foreign periodicals with advertisements directed at the domestic market, as does Canada in the present case, the possibility of non-compliance with a tax provision granting tax deductions for expenses incurred for advertisements in domestic periodicals will be greatly reduced. It would seem almost impossible for an enterprise to place an advertisement in a foreign periodical because there would be virtually no foreign periodical available in which to place it. Thus, there would be no way for the enterprise legally to claim a tax deduction therefor. However, that is an incidental effect of a separate measure distinct (even though it may share the same policy objective) from the tax provision which is designed to give an incentive for placing advertisements in Canadian, as opposed to foreign, periodicals.[126] We thus find that Tariff Code 9958 does not "secure compliance" with Section 19 of the Income Tax Act.

5.11 In view of the above finding that Tariff Code 9958 does not secure compliance with Section 19 of the Income Tax Act, we need not consider whether the import prohibition under the Code is "necessary" to secure compliance with the tax provision or whether the measure meets the conditions in the introductory clause (or "chapeau") to Article XX. Canada has failed to satisfy at least one of the conditions identified in paragraph 5.7 above. Thus we conclude that Tariff Code 9958 is inconsistent with Article XI:1 of GATT 1994 and cannot be justified under Article XX(d).

C. The Excise Tax Act

5.12 We now turn to the examination of whether the 80 per cent excise tax on advertisements in split-run periodicals under Part V.1 of the Excise Tax Act is compatible with Canada's obligations under Article III of GATT 1994. The United States claims that Part V.1 of the Excise Tax Act is inconsistent with Article III:2 of GATT 1994, or in the alternative, is inconsistent with Article III:4.

(i) Applicability of GATT 1994

5.13 Since Canada challenges the applicability of GATT 1994 to this part of the Excise Tax Act, we address this issue first. Canada claims that Article III of GATT 1994 does not apply to Part V.1

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[124]Panel Report on *European Economic Community - Regulations on Imports of Parts and Components*, adopted on 16 May 1990, BISD 37S/132, paras. 5.14-5.18.

[125]*Ibid.*, para. 5.17.

[126]An import ban under these circumstances is rather likely to be an enforcement measure in respect of a ban on possession or sale of a product. An import ban on alcoholic beverages might share the same objective as a criminal statute against drunk driving, but if alcoholic drinks are not banned or their sale prohibited domestically, the import ban could not be considered as an enforcement measure of the criminal statute.

of the Excise Tax Act because the latter is a measure pertaining to advertising services, which is within the purview of the General Agreement on Trade in Services ("GATS"). Canada further claims that the examination of Part V.1 of the Excise Tax Act in light of GATS is not covered by the terms of reference of this Panel.

5.14 Canada's argument is essentially that since Canada has made no specific commitments for advertising services under GATS, the United States should not be allowed to "obtain benefits under a covered agreement that have been expressly precluded under another covered agreement".[127] Put another way, Canada seems to argue that if a Member has not undertaken market-access commitments in a specific service sector, that non-commitment should preclude all the obligations or commitments undertaken in the goods sector to the extent that there is an overlap between the non-commitment in services and the obligations or commitments in the goods sector. Canada claims that because of the existence of the two instruments - GATT 1994 and GATS - both of which may apply to a given measure, "it is necessary to interpret the scope of application of each such as to avoid any overlap".[128]

5.15 We are not fully convinced by Canada's characterization of the Excise Tax as a measure intended to regulate trade in advertising services, in view of the fact that there is no comparable regulation on advertisements through other media and the fact that the tax is imposed on a "per issue" basis. However, assuming that Canada intended to carve out Part V.1 of the Excise Tax Act from the coverage of its GATS commitments by not inscribing advertising services in its Schedule[129], does that exonerate Canada from the Panel's scrutiny regarding the alleged violation of its obligations and commitments under GATT 1994?

5.16 In order to answer this question, we need to examine the structure of the WTO Agreement including its annexes. Article II:2 of the WTO Agreement is the relevant provision, which reads as follows:

> "The agreements and associated legal instruments included in Annexes 1, 2 and 3 … are integral parts of this Agreement, binding on all Members".[130]

5.17 According to Article 31(1) of the 1969 Vienna Convention on the Law of Treaties ("Vienna Convention"), a treaty must be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose. Furthermore, as the Appellate Body has repeatedly pointed out, "one of the corollaries of the 'general rule of interpretation' in the Vienna Convention is that interpretation must give meaning and effect to all the terms of the treaty. An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility".[131] The ordinary meaning of the texts of GATT 1994 and GATS as well as Article II:2 of the WTO Agreement, taken together, indicates that obligations under GATT 1994 and GATS can co-exist and that one does not override the other. If the consequences suggested by Canada were intended, there would have been provisions similar to Article XVI:3 of the WTO Agreement or the General Interpretative Note to Annex 1A in order to establish hierarchical order between GATT 1994 and GATS. The absence of such provisions between

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[127]Paragraph 3.35 *supra*.

[128]Paragraph 3.38 *supra*.

[129]We note in this connection that Part V.1 of the Excise Tax Act was enacted in 1995, after Canada's acceptance of the WTO Agreement.

[130]GATT 1994 is included in Annex 1A. GATS is included in Annex 1B.

[131]Appellate Body Report on *United States - Standards for Reformulated and Conventional Gasoline*, adopted on 20 May 1996, WT/DS2/AB/R, p. 23. Also cited in the Appellate Body Report on *Japan - Taxes on Alcoholic Beverages*, *op. cit.*, p.12.

the two instruments implies that GATT 1994 and GATS are standing on the same plain in the WTO Agreement, without any hierarchical order between the two.

5.18 In this connection, Canada also argues that overlaps between GATT 1994 and GATS should be avoided.[132] We disagree. Overlaps between the subject matter of disciplines in GATT 1994 and in GATS are inevitable, and will further increase with the progress of technology and the globalization of economic activities. We do not consider that such overlaps will undermine the coherence of the WTO system. In fact, certain types of services such as transportation and distribution are recognized as a subject-matter of disciplines under Article III:4 of GATT 1994. It is also noteworthy in this respect that advertising services have long been associated with the disciplines under GATT Article III. As early as 1970, the Working Party on Border Tax Adjustment made the following observation:

> "The Working Party noted that there was a divergence of views with regard to the eligibility for adjustment of certain categories of tax and that these could be sub-divided into
>
> (a) "Taxes occultes" which the OECD defined as consumption taxes on capital equipment, auxiliary materials and *services* used in the transportation and production of other taxable goods. Taxes on *advertising*, energy, machinery and transport were among the more important taxes which might be involved. … ;
>
> (b) Certain other taxes, …".[133]

We also note that there are several adopted panel reports that examined the issue of services in the context of GATT Article III. For instance, the panel on *Canada - Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies* addressed the issues of access to points of sale and restrictions on private delivery of beer.[134] The panel on *United States - Measures Affecting Alcoholic and Malt Beverages* also dealt with the issues of distribution of wine and beer.[135] More to the point, the panel on *Thailand - Restrictions on Importation of and Internal Taxes on Cigarettes* specifically addressed the question of advertising.[136]

5.19 In any event, since Canada admits that in the present case there is no conflict between its obligations under GATS and under GATT 1994[137], there is no reason why both GATT and GATS obligations should not apply to the Excise Tax Act. Thus, we conclude that Article III of GATT 1994 is applicable to Part V.1 of the Excise Tax Act.

(ii) GATT Article III:2

5.20 The next issue to be examined is whether there is a violation of Article III. The principal claim of the United States is that Part V.1 of the Excise Tax is inconsistent with Article III:2 of GATT 1994. The relevant parts of Article III read as follows:

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[132]Paragraphs 3.38 and 5.14 *supra*.

[133]"Border Tax Adjustments", Report of the Working Party adopted on 2 December 1970 (L/3464), BISD 18S/97, para. 15 (emphasis added).

[134]Panel Report on *Canada - Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies*, adopted on 18 February 1992, BISD 39S/27.

[135]Panel Report on *United States - Measures Affecting Alcoholic and Malt Beverages*, adopted on 19 June 1992, BISD 39S/206.

[136]Panel Report on *Thailand - Restrictions on Importation of and Internal Taxes on Cigarettes*, adopted on 7 November 1990, BISD 37S/200, para. 78.

[137]Paragraph 3.38 *supra*.

> "1. The [Members] 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.
>
> "2. The products of the territory of any [Member] imported into the territory of any other [Member] 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 [Member] 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".
>
> Furthermore, the Interpretative Note *ad* Article III reads in part as follows:
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> "A tax conforming to the requirements of the first sentence of paragraph 2 would be considered to be inconsistent with the provisions of the second sentence only in cases where competition was involved between, on the one hand, the taxed product and, on the other hand, a directly competitive or substitutable product which was not similarly taxed".

5.21 In the present case, the following two questions need to be answered to determine whether there is a violation of Article III:2 of GATT 1994: *(a)* Are imported "split-run" periodicals and domestic non "split-run" periodicals like products?; and *(b)* Are imported "split-run" periodicals subject to an internal tax in excess of that applied to domestic non "split-run" periodicals? If the answers to both questions are affirmative, there is a violation of Article III:2, first sentence.[138] If the answer to the first question is negative, we need to examine further whether there is a violation of Article III:2, second sentence.

(iii) Like product issue

5.22 As the Appellate Body confirmed in its report on *Japan - Taxes on Alcoholic Beverages*, the definition of "like products" in Article III:2, first sentence, should be construed narrowly, on a case-by-case basis, in light of such factors as the product's end uses in a given market, consumer's tastes and habits, and the product's properties, nature and quality.[139] In applying these criteria to the present case, it should be noted that our mandate under the terms of reference of this Panel is not to discuss the likeness of periodicals in general. The question before us, as presented by the United States in its request for the establishment of a panel (WT/DS31/2) and subsequently elaborated[140], is a comparison between imported "split-run" periodicals and domestic non "split-run" periodicals.

5.23 This comparison, at first glance, might seem impossible in view of the fact that there are no imported "split-run" periodicals marketed in Canada due to the import prohibition under Tariff Code 9958. However, as the panel on "United States - Taxes on Petroleum and Certain Imported Substances" observed, the rationale for the national treatment obligation of Article III is to protect expectations

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[138]In this context, we need not examine the applicability of Article III:1 separately, because, as the Appellate Body noted in its recent report, the first sentence of Article III:2 ***is***, in effect, an application of the general principle embodied in Article III:1. Therefore, if the imported and domestic products are "like products", and if the taxes applied to the imported products are "in excess of" those applied to the like domestic products, then the measure is inconsistent with Article III:2, first sentence. Appellate Body Report o*n Japan - Taxes on Alcoholic Bever*ages, *op. cit.*, pp. 18-9.

[139]*Ibid.*, p.20. According to the Appellate Body, the narrow construction of the term was necessary in Article III:2, first sentence, "so as not to condemn measures that its strict terms are not meant to condemn".

[140]See paragraphs 3.104-3.108 *supra*.

of the Members as to the competitive relationship between their products and those of other Members.[141] In so far as imported "split-run" periodicals are subject to the relevant provisions of the Excise Tax Act (as Canada admits to be the case)[142], the comparison can be made on the basis of a hypothetical import.

5.24 We note in this regard that the Excise Tax Act defines a "split-run" edition of a periodical in terms of its editorial content (whether more than 20 per cent of the editorial material is the same or substantially the same as editorial material that appears in editions that are primarily distributed outside Canada) and advertising content (whether it contains an advertisement that does not appear in identical form in other editions distributed outside Canada). Despite the Canadian claim that the purpose of the legislation is to promote publications of original Canadian content, this definition essentially relies on factors external to the Canadian market - whether the same editorial content is included in a foreign edition and whether the periodical carries different advertisements in foreign editions.

5.25 Putting these external factors aside, imported "split-run" periodicals and domestic non "split-run" periodicals can be extremely similar. In the course of the Panel process, Canada made the following statement:

> "*Harrowsmith Country Life* is a Canadian-owned magazine. Before the adoption of Part V.1 of the Excise Tax Act, *Harrowsmith Country Life* had two editions - A Canadian edition and a US edition. The Canadian and the US editions had different advertisements and a certain amount of common editorial content. Because more than 20 per cent of the editorial content in the Canadian edition was the same as that in the US edition, the tax would have applied to the Canadian edition (even if the editorial content was entirely produced in Canada). As a result of the excise tax, *Harrowsmith Country Life* stopped publishing its US edition".[143]

In the case of this particular periodical, if all the volumes of *Harrowsmith Country Life* had been printed in the United States (including its Canadian edition) and the Canadian edition had been exported to Canada because they were somehow exempted from the coverage of Tariff Code 9958, and if the publisher decided to publish the final issue of the US edition after the introduction of the excise tax, the publisher would have been subject to the tax for the imported Canadian edition. If this publisher thereafter discontinued the publication of the US edition, it would no longer be subject to the excise tax. Now, let us compare the two issues of this hypothetical *Harrowsmith Country Life* (Canadian edition) before and after the discontinuation of the US edition. These two editions would have common end uses, very similar physical properties, nature and qualities. It is most likely that the two volumes would have been designed for the same readership with the same tastes and habits. In all respects, these two volumes are "like", and yet one is subject to the Excise Tax, while the other is not.

5.26 Thus, we conclude that imported "split-run" periodicals and domestic non "split-run" periodicals can be like products within the meaning of Article III:2 of GATT 1994. In our view, this provides sufficient grounds to answer in the affirmative the question as to whether the two products at issue are like because, as stated earlier, the purpose of Article III is to protect expectations of the Members as to the competitive relationship between their products and those of other Members, not to protect

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[141]Panel Report on *United States - Taxes on Petroleum and Certain Imported Substances*, adopted on 17 June 1987, BISD 34S/136, para. 5.2.2. See also the Panel Reports on *Italian Discrimination against Imported Agricultural Machinery*, adopted on 23 October 1958, BISD 7S/60, para. 18, and on *United States - Section 337 of the Tariff Act of 1930*, adopted on 7 November 1989, BISD 36S/345, para. 5.13.

[142]Paragraphs 3.58 and 3.98 *supra*.

[143]See paragraph 3.99 *supra*.

actual trade volumes. If Tariff Code 9958 were lifted, a wide variety of "split-run" periodicals ranging from general news magazines to specialty journals dedicated to specific areas of business or profession could be imported into Canada. This situation can hardly be called an "isolated instance of differential taxation" as Canada describes.[144]

5.27 Having found that imported "split-run" periodicals and domestic non "split-run" periodicals are like products, we need not consider the second sentence of Article III:2. The only remaining question is whether imported "split-run" periodicals are subject to an internal tax in excess of that applied to domestic non "split-run" periodicals.

(iv) Taxation in excess: "directly or indirectly"

5.28 In light of the fact that the excise tax is applied only with respect to "split-run" periodicals, it would seem evident that imported "split-run" periodicals are subject to an internal tax in excess of one that is applied to domestic non "split-run" periodicals. However, Canada argues that the excise tax does not apply "indirectly" to a good within the meaning of Article III:2. According to Canada, the drafting history of this paragraph suggests that the expression "indirectly" was intended to capture taxes that apply to inputs that contribute to the production of a good, and not to end products in their own right. Canada also claims that the panel on *Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages* interpreted the term in a manner consistent with Canada's position.[145]

5.29 We note that the excise tax is not "directly" applied to periodicals in that it is levied on the value of advertisements, not on the value of periodicals *per se*. However, it is clear that the tax is applied in respect of each split-run edition of a periodical on a "per issue" basis. Therefore, the tax is applied "indirectly" to periodicals within the ordinary meaning of the terms of Article III:2. Canada's narrow reading of the term "indirectly" is supported only by Canada's own interpretation of the drafting history, which is contested by the United States.[146] Since, according to Article 32 of the Vienna Convention, the preparatory work of a treaty is merely a supplementary means of interpretation to be relied upon in cases where the terms of the treaty, taken in their context and in light of its object and purpose, are ambiguous or obscure, or lead to a manifestly absurd or unreasonable result, we need not take the drafting history into account on this particular point. Furthermore, the panel report cited by Canada in support of its argument referred to taxation on raw materials by way of example. It did not conclude that the scope of the term "indirectly" is limited to taxation on inputs.[147] We thus conclude that imported "split-run" periodicals are subject to an internal tax in excess of that applied to domestic non "split-run" periodicals.

5.30 Having found that Part V.1 of the Excise Tax Act to be in violation of Article III:2, first sentence, we need not examine whether it is inconsistent with Article III:2, second sentence or with Article III:4.

D. Postal Rates

5.31 Now we proceed to examine whether the postal rates scheme applied by Canada Post discriminates against foreign periodicals in contravention of Article III of GATT 1994, as argued by the United States. There are two separate issues involved here: *(a)* whether the fact that Canada Post

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[144]Paragraph 3.101 *supra*.

[145]Paragraph 3.49 *supra*.

[146]Paragraph 3.56 *supra*.

[147]Paragraph 3.49 *supra*.

applies the "commercial Canadian" rates or the "funded" rates to Canadian periodicals, which are lower than the "international" rates applied to imported periodicals, constitute a violation of Article III:4[148]; and *(b)* whether the "funded" rate scheme for certain periodicals is allowed as a subsidy within the meaning of Article III:8(b).

(i) "International" versus "commercial Canadian" and "funded" rates

5.32 The United States claims that Canada Post's practice of charging domestic periodicals lower postal rates than imported periodicals is in violation of Article III:4 of GATT 1994. The relevant part of the Article reads as follows:

> "4. The products of the territory of any [Member] imported into the territory of any other [Member] 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".

In examining the relevance of this provision in the present dispute, we also need take into account the first paragraph of Article III, which reads:

> "1. The [Members] 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".

5.33 There is no disagreement between the parties to the dispute that, in respect of this issue, domestic and imported periodicals are like products. We, too, so find. Nor does Canada contest the fact that Canada Post applies higher postal rates to imported periodicals than to domestic periodicals, which clearly affects the sale, transportation and distribution of imported periodicals. Canada's argument is essentially that since Canada Post is a privatized agency (a Crown corporation) with a legal personality distinct from the Canadian Government, the "commercial Canadian" or "international" rates it charges for the delivery of periodicals are out of the Government's control and do not qualify as "regulations" or "requirements" within the meaning of Article III:4.

5.34 The United States argues that Canada Post is a government entity fully subject to Canadian Government direction because it is a wholly-government-owned, government-created chartered body, managed by a board of directors appointed by the Canadian Government. Canada argues that the different rates charged by Canada Post are a reflection of competitive situations and that the degree of control the Government exercises over Canada Post's commercial operations (including delivery of periodicals) is one dictated by the Government shareholder's interests. In other words, Canada argues here that Canada Post's pricing policy is not a governmental measure subject to Article III:4. The essential question then is whether Canada Post is implementing Canadian Government policy in

[148]We are aware that "international" rates applied to foreign periodicals belong to a subcategory of the "commercial" rate scheme in a broader sense. See paragraphs 2.17-2.19 *supra*. However, in so far as different rates are applied between "international" periodicals and "commercial Canadian" periodicals, it is necessary to draw the distinction. We are also aware, as described in paragraph 5.1, that there are additional discounts for Canadian periodicals which are not generally available to imported periodicals. In our view, these additional discounts constitute part of the "commercial Canadian" rate scheme.

such a manner that its postal rates on periodicals may be viewed as governmental regulations or requirements for the purposes of Article III:4.

5.35 First, it is clear that Canada Post generally operates under governmental instructions. Canada Post has a mandate to operate on a "commercial" basis in this particular sector of periodical delivery: a mandate that was set by the Canadian Government.[149] Second, Canada admits that if the Canadian Government considers Canada Post's pricing policy to be inappropriate, it can instruct Canada Post to change the rates under its directive power based on Section 22 of the Canada Post Corporation Act.[150] Thus, the Canadian Government can effectively regulate the rates charged on the delivery of periodicals.

5.36 This analysis is unaffected by the fact that Canada Post has a legal personality distinct from the Canadian Government. The panel on *Japan - Trade in Semi-Conductors* faced a similar question with respect to the interpretation of the status of "administrative guidance" given to private-sector entities in interpreting the term "measures" in Article XI:1. The panel stated as follows:

> "In order to determine [whether the measures taken in this case would be such as to constitute a contravention of Article XI], the Panel considered that it needed to be satisfied on two essential criteria. First, there were reasonable grounds to believe that sufficient incentives or disincentives existed for non-mandatory measures to take effect. Second, the operation of the measures … was essentially dependent on Government action or intervention. The Panel considered each of these two criteria in turn. The Panel considered that if these two criteria were met, the measures would be operating in a manner equivalent to mandatory requirements such that the difference between the measures and mandatory requirements was only one of form and not of substance, and that there could be therefore no doubt that they fell within the range of measures covered by Article XI:1".[151]

Applying this two-pronged test, *mutatis mutandis*, to the present case, we conclude that the pricing policy of Canada Post is a governmental measure. First, in view of the control exercised by the Canadian Government on "non-commercial" activities of Canada Post, we can reasonably assume that sufficient incentives exist for Canada Post to maintain the existing pricing policy on periodicals. Second, as analyzed in the previous paragraph, Canada Post's operation is generally dependent on Government action. This leads us to the conclusion that Canada Post's pricing policy on periodicals can be regarded as governmental regulations or requirements within the meaning of Article III:4 of GATT 1994.

5.37 Given that imported and domestic periodicals are like products and that Canada Post charges lower rates on domestic periodicals than imported ones, this conclusion might seem sufficient to determine that a less favourable treatment is accorded to imported products in violation of Article III:4. However, before reaching that determination, as the Appellate Body has stated, we need to turn to Article III:1 as a general principle that informs the rest of Article III.[152] Article III:1 constitutes part of the context of Article III:4, which is to be taken into account in our interpretation of the latter, under Article 31(1) of the Vienna Convention.

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[149]From the entirety of Canada's submissions, we take it that the Canadian Government considers Canada Post's pricing policy on periodicals to be driven by "commercial" considerations, although we fail to understand why any document delivery operation aiming at profit maximization would want to make artificial distinctions based on the origin of documents.

[150]Paragraph 3.156 *supra*.

[151]Panel Report on *Japan - Trade in Semi-Conductors*, adopted on 4 May 1988, BISD 35S/116, para. 109.

[152]Appellate Body Report on *Japan - Taxes on Alcoholic Beverages*, *op. cit.*, p. 18. The Report states: "The purpose of Article III:1 is to establish this general principle as a guide to understanding and interpreting the specific obligations contained in Article III:2 and in the other paragraphs of Article III, while respecting, and not diminishing in any way, the meaning of words actually used in the texts of those other paragraphs".

5.38 Article III:1 articulates a general principle that internal measures should not be applied so as to afford protection to domestic production.[153] The protective application of a measure can most often be discerned from the design, the architecture, and the revealing structure of the measure.[154] We find that the design, architecture and structure of Canada Post's different pricing policy on domestic and imported periodicals all point to the effect that the measure is applied so as to afford protection to the domestic production of periodicals. In the case of "funded" rates, the scheme is clearly designed to promote domestic production of periodicals with Canadian content under the supervision of Canadian Heritage. In the case of "commercial Canadian" rates, the very fact that they are lower than "international" rates which are applied to imported products strongly suggests that the scheme is operated so as to afford protection to domestic production.

5.39 In light of the above, we find that Canada Post's application of the "commercial Canadian" and "funded" rates to Canadian periodicals, which are lower than the "international" rates applied to imported periodicals (including the availability of additional discounts only to Canadian periodicals), is inconsistent with Article III:4 of GATT 1994.

(ii) Applicability of Article III:8(b) to the "funded" rate scheme

5.40 Having found that the "funded" rate scheme violates Article III:4 of GATT 1994, we next examine whether this scheme is justified under Article III:8(b) of GATT 1994, as argued by Canada. The relevant part of Article III:8 reads as follows:

> "(b) The provisions of this Article shall not prevent the payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article and subsidies effected through governmental purchases of domestic products".

5.41 The United States claims that this provision is not applicable in the present case because the payment of subsidies by Canadian Heritage is not made directly to Canadian publishers, but rather to Canada Post. The United States argues that past panels have interpreted the term "exclusively" narrowly, to mean only direct payments to domestic producers.[155] To support its argument, the United States quotes the following paragraph from the panel report on *European Economic Community - Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins* (the "*Oilseeds*" case):

> "The Panel noted that Article III:8(b) applies only to payments made *exclusively* to domestic producers and considered that it can reasonably be assumed that a payment not made directly to producers is not made "exclusively" to them. It noted moreover that, if the economic benefits generated by the payments granted by the Community can at least partly be retained by the processors of Community oilseeds, the payments generate a benefit conditional upon the purchase of oilseeds of domestic origin inconsistently with Article III:4. Under these circumstances Article III:8(b) would not be applicable because in that case the payments would not be made exclusively to domestic producers but to processors as well".[156]

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[153]*Ibid.*, p. 18.

[154]*Ibid.*, p. 29.

[155]Paragraphs 3.191-3.197 *supra*.

[156]Panel Report on *European Economic Community - Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins*, adopted on 25 January 1990, BISD 37S/86, para. 137 (emphasis in original).

5.42 We do not disagree with this panel report. However, the United States has failed to show that the factual situation in the present case is similar to that in the *Oilseeds* case. Particularly, the United States has not submitted any evidence to indicate that the economic benefits are partly retained by Canada Post. Furthermore, this argument by the United States is inconsistent with its position regarding Article III:4, where it maintains that Canada Post is a government agency. If Canada Post is a government agency, the payment of funds from Canadian Heritage to Canada Post is merely an internal transfer of resources, and the payment of the subsidy is made directly to Canadian publishers.

5.43 Canada, on the other hand, explains that the payment of the funds from Canadian Heritage to Canada Post is made based on negotiations between the two agencies, taking into account the fact that Canada Post gets an exclusive contract for the delivery of periodicals at subsidized rates.[157] Following the logic of the *Oilseeds* panel cited above, one could argue that there is a reasonable assumption that the "funded" rate scheme is not an exclusive payment of subsidies because the payment is not made directly to the beneficiary. However, in our view, Canada has presented an effective rebuttal to this assumption.

5.44 Thus, we do not find that Canada Post retains any economic benefits from the "funded" rate scheme it applies to certain Canadian periodicals. The payment of the subsidy is made "exclusively" to Canadian publishers that qualify for the scheme. Since Article III:8(b) explicitly recognizes that subsidies exclusively paid to domestic producers are not subject to the national treatment rules of Article III, including those under Article III:4, we find that Canada's "funded" rate scheme on periodicals can be justified under this provision.

E. Concluding Remarks

5.45 Before concluding, in order to avoid any misunderstandings as to the scope and implications of the findings above, we would like to stress that the ability of any Member to take measures to protect its cultural identity was not at issue in the present case. The only task entrusted to this Panel was to examine whether the treatment accorded to imported periodicals under specific measures identified in the complainant's claim is compatible with the rules of GATT 1994.

VI. CONCLUSIONS

6.1 On the basis of the findings set out in paragraphs 5.1 to 5.44 above, the Panel concludes that *(a)* Tariff Code 9958 is inconsistent with Article XI:1 of GATT 1994 and cannot be justified under Article XX(d) of GATT 1994; *(b)* Part V.1 of the Excise Tax Act is inconsistent with Article III:2, first sentence, of GATT 1994; *(c)* the application by Canada Post of lower "commercial Canadian" postal rates to domestically-produced periodicals than to imported periodicals, including additional discount options available only to domestic periodicals, is inconsistent with Article III:4 of GATT 1994; but *(d)* the maintenance of the "funded" rate scheme is justified under Article III:8(b) of GATT 1994.

6.2 The Panel recommends that the Dispute Settlement Body request Canada to bring the measures that are found to be inconsistent with GATT 1994 into conformity with its obligations thereunder.

[157]Paragraph 3.173 *supra*.