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THE ROLE OF DISPUTE SETTLEMENT IN WORLD TRADE LAW: SOME LESSONS FROM THE KODAK-FUJI DISPUTE

JOHN LINARELLI*

I. INTRODUCTION

Over the course of several decades, Japan and the United States have engaged in acrimonious conflict over the issue of whether Japan has truly opened its economy in accordance with the disciplines of the General Agreement on Tariffs and Trade (GATT) and, now, the World Trade Organization (WTO) trade agreements regime.¹ These two countries have perhaps the most adversarial of relationships in the international trade arena, despite their close connections as strategic allies and their numerous other ties. The U.S. government has persistently tried to use a very hard stick to pound open Japanese markets that it alleges are closed. In most cases, the Japanese government seems to succumb to this pounding, and to enter into bilateral agreements with the U.S. government, although it is questionable whether these side agreements really result in trade liberalization.²

One can trace cycles of such behavior over the course of many years. Japan and the United States have engaged in bilateral trade negotiations, or perhaps more accurately, "re-negotiation" between official WTO rounds. The behavior of these two trading nations presents an intriguing study of the nature of the global trading system and its limitations.

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1. See Kristin Leigh Case, *An Overview of Fifteen Years of United States—Japanese Economic Relations*, 16 ARIZ. J. INT'L & COMP. L. 11 (1999); Jean Heilman Grier, *The Use of Section 301 to Open Japanese Markets to Foreign Firms*, 17 N.C. J. INT'L L. & COM. REC. 1, 3 (1992); Junji Nakagawa & Thomas J. Schoenbaum, *Introduction: the Course of Japanese-American Economic Relations*, 16 ARIZ. J. INT'L & COMP. L. 1 (1999). The World Trade Organization will hereinafter be referred to as the "WTO." Either "GATT" or "WTO" terminology will be used in this Article, depending on the context.

2. It is more likely that Japan would have engaged in the same behavior even in the absence of a bilateral agreement with the United States. For the proposition that treaties may only reflect a coincidence of interest and insignificant departures from what a country would do anyway, see George W. Downs et al., *Is the Good News About Compliance Good News About Cooperation?*, 50 INT'L ORG. 379, 380 (1996); Jack L. Goldsmith & Eric A. Posner, *A Theory of Customary International Law*, 66 U. CHI. L. REV. 1113, 1171–72 (1999); Joseph M. Grieco, *Anarchy and the Limits of Cooperation: A Realist Critique of the Newest Liberal Institutionalism*, 42 INT'L ORG. 485, 497–98 (1988).

More recently, Japan and the United States have disputed measures affecting photographic film and paper. The dispute centered on the question of whether Japanese markets for camera film and paper for photographs were open to Eastman Kodak Company, a company headquartered in Rochester, New York.³ The United States contended that, for over thirty years, the Japanese government engaged in systematic and non-transparent measures designed to protect the two principal Japanese producers of film and paper, Fuji Photo Film Ltd. and Konica Corporation,⁴ from international competition to keep Kodak out of the Japanese market and to counteract the tariff concessions that Japan made in several GATT rounds of multilateral negotiations.

On December 5, 1997, the WTO Panel on *Japan—Measures Affecting Consumer Photographic Film and Paper* issued an Interim Report deciding in favor of Japan. It was the first case that the United States lost before a WTO panel. The Panel Report was finalized in January 1998, circulated to WTO members on March 31, 1998, and adopted by the WTO Dispute Settlement Body (DSB) on April 22, 1998.⁵

In the WTO proceeding, the United States argued that, over the course of several decades, Japan engaged in a broad range of protectionist activities intended to circumvent tariff concessions that Japan agreed to in various GATT negotiating rounds. The activities can be classified into three categories: distribution countermeasures, restrictions on large retail stores, and promotion countermeasures. The United States first argued that Japan engaged in distribution countermeasures to encourage and facilitate the creation of market structures for the distribution of film and photographic paper that caused the exclusion of imports from distribution channels in Japan. Second, a Large Stores Law, the United States argued, restricted the development of large retail stores in Japan. The United States argued that these large stores, if permitted to grow in accordance with market forces, would diminish the monopoly power of wholesalers and provide increased opportunities for the import of foreign film and paper into Japan. Finally, the United States argued that Japan implemented restrictions on the offering of advertising promotions in a manner that impeded interna-

3. Hereinafter Kodak.

4. Hereinafter Fuji and Konica, respectively.

5. WTO Panel Report, *Japan—Measures Affecting Consumer Photographic Film and Paper*, WT/DS44/R, (Mar. 31, 1998) [hereinafter *Japan—Film Panel Report* or *Kodak-Fuji*]. The WTO Dispute Settlement Body shall hereinafter be referred to as the DSB. The WTO Dispute Settlement Understanding shall hereinafter be called the DSU.

tional competition by prohibiting financially strong international competitors from engaging in marketing strategies designed to penetrate the Japanese market.

The United States classified the three categories of countermeasures as "liberalization countermeasures," meaning that Japan promulgated and implemented these measures to counteract and circumvent the concessions that Japan agreed to during the GATT negotiations. The United States argued that these measures, by themselves and in combination, contravened the WTO agreements. The United States argued that the measures violated Articles III, X, and XXIII:1 (b) of the GATT.⁶

Article III sets forth the national treatment obligations of the GATT. Article X sets forth requirements for the transparent publication and administration of regulations affecting international trade by WTO member countries. Article XXIII:1 (b) prohibits nullification or impairment of WTO obligations by WTO members by methods that do not expressly violate the WTO Agreement, but which "nullify or impair" the WTO obligations. Among other things, Article XXIII:1 (b) prohibits nullification or impairment of WTO obligations by methods that do not expressly violate the WTO Agreement, but that evade basic WTO obligations. A claim before the DSB under Article XXIII:1 (b) is called a "non-violation claim" because it asserts that a WTO member has nullified or impaired its concessions. It does not assert, however, any explicit violations of substantive WTO obligations.⁷ The DSB found that Japan had not violated these provisions and that the United States failed to prove its case.

The *Kodak-Fuji* case was the first post-Uruguay Round WTO dispute settlement panel case to consider a non-violation complaint under GATT Article XXIII:1 (b). It remains the only post-Uruguay Round case to date that is decided on the basis of the non-violation provisions of Article XXIII:1 (b). Article XXIII has the potential to play a significant part in the WTO dispute settlement regime. It has been on the books since the initial GATT came into existence in 1947, but there have been very few cases in which the GATT has considered the non-violation provision on its merits.⁸ Indeed, there have been only three successful

6. General Agreement on Trade and Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194 [hereinafter GATT]. Unless otherwise specified, references to GATT Articles are to the GATT agreement that came into existence in 1947 and is still in force today.

7. Of course, a complaining party may allege both a violation claim and a non-violation claim in the same dispute. This would seem to be a matter of good pleading practice for counsel, so long as there is a colorable argument of a violation of an explicit GATT obligation.

8. See *Japan—Film Panel Report*, *supra* note 5, ¶ 10.36.

cases based on the provision.⁹ The new dispute settlement regime, however, has the potential to expand substantially the operation of the provision.

Article XXIII, particularly the non-violation provision, has the potential to be an important piece of the WTO agreement architecture. It provides WTO members with the twin incentives of providing concessions to one another during successive rounds of multilateral negotiations and of avoiding circumvention of agreed-upon concessions after the conclusion of the negotiating rounds. The impracticalities related to the ability of WTO members to obtain adequate information about barriers to trade in the economies of other members, to reach agreement on concessions, and to monitor compliance makes Article XXIII necessary to encourage liberalization and to deter evasion of agreed-upon concessions.

Despite its significant potential as a monitoring mechanism in the WTO system, many scholars have dismissed Article XXIII as setting forth dangerously broad language that should be construed narrowly.¹⁰ The cases in which non-violation nullification or impairment was found to exist all date prior to 1960 and were decided when the GATT was in its infancy. Moreover, for the most part, they deal with some fairly standard and straightforward questions of nullification or impairment, such as where a GATT contracting party has nullified or impaired the benefits of a tariff through a subsidy.¹¹

In *Kodak-Fuji*, the United States asked the DSB to consider very novel claims. These claims, however, related to core issues relating to the structure of the institutions of the economy of Japan, a major trading nation. The U.S. claims were of the kind typically addressed in domestic law and policy regulating restrictive business practices. The United States asked the DSB for a great deal, given that the WTO does not yet regulate competition policy and restrictive business practices.

The *Kodak-Fuji* case appears to have been a test case for the United States and, to some extent, for other WTO members. The European Community and Mexico expressed their interest in the case as third parties.¹² The United States apparently sought to determine whether

9. See Frieder Roessler, *Should Principles of Competition Policy Be Incorporated into WTO Law Through Non-Violation Complaints?*, 2 J. INT'L ECON. LAW. 413, 418 (1999).

10. See *id.*; *infra* notes 275–76 and accompanying text.

11. See Roessler, *supra* note 9, at 418–19. The use of subsidies to counteract tariff concessions is now expressly prohibited under Article 5 of the WTO Subsidies and Countervailing Measures Agreement. The practice has thus become a “violation” claim.

12. Unlike the United States, it would seem that the European Union has not had sufficient reason to engage in a strident approach towards the Japanese. The EU (and other WTO members) can free ride on the American effort to open allegedly closed Japanese markets. It is,

the existing WTO agreements would sufficiently regulate anti-competitive behavior in the absence of an explicit agreement within the WTO framework that deals with competition policy.¹³ The case is consistent with the United States' cautious approach to the question of whether the WTO should have an agreement dealing with competition policy. The great deal of discussion as to whether the WTO framework should include an international agreement that deals with competition questions has failed to generate any consensus. As a result of the Singapore Ministerial Conference, a Working Group on Trade and Competition Policy has been established to look at this question, but with no concrete results as yet.

Part II of this Article sets forth the main findings of the *Kodak-Fuji* panel report. It also examines the decision in the context of remedial activity that the United States attempted pursuant to its municipal law—the well-known Section 301 of the Trade Act of 1974, as amended by the Omnibus Trade and Competitiveness Act of 1988.¹⁴ The Article is based on the contention that detailed “case study” analysis of DSB panel reports assists substantially in understanding how the WTO DSU operates. This is particularly true for the first panel report to apply the non-violation provisions of Article XXIII:1(b).

Part III provides an analytical framework for thinking about *Kodak-Fuji*, specifically, and about non-violation claims under Article XXIII:1(b), generally. A substantial number of WTO scholars have argued that the non-violation provisions should be interpreted narrowly, particularly as the coverage of WTO agreements expands into new areas and covers old areas in greater depth. Part III examines the implications of the *Kodak-Fuji* decision and extends the analysis of the non-violation provision of Article XXIII:1(b). Part III first provides an analytical introduction to Article XXIII. It explores the meaning of Article XXIII and its role in the WTO system. It looks at six kinds of complaints that may be brought under XXIII in WTO dispute proceedings. Then it explores in detail “non-violation, nullification or impairment” claims that formed the basis of the U.S. claim in *Kodak-Fuji* and

thus, generally in the interests of the EU for the United States to engage Japan in inter-round negotiations, so long as the benefits of such negotiations accrue multilaterally, which they must under WTO most favored nation requirements. See GATT, *supra* note 6, art. I, 4 B.I.S.D. at 2–3.

13. One commentator has argued that the United States strategically crafted its litigation position in the *Japan—Film Panel Report* so as to in essence “win” major concessions by settlement with Japan, while letting issues of questionable merit reach the WTO panel. See Sara Dillon, *Fuji-Kodak, the WTO, and the Death of Domestic Political Constituencies*, 8 MINN. J. GLOBAL TRADE 197 (1999).

14. 19 U.S.C. § 2411 (1994).

that seem to hold out the most promise for future DSB panel jurisprudence. Although the mainstream view would seem to be that Article XXIII:1 (b) should be used in rare circumstances, this Article proposes a policy oriented jurisprudence for Article XXIII:1 (b), infusing it with the ability to cover the fundamental problem of "domestic policy externalities" among WTO members. Although a controversial approach, the non-violation provision can address the regulation of domestic policy when domestic policy autonomy has a substantial adverse effect on obligations set forth in WTO agreements. Finally, Part III examines the WTO dispute settlement system as part of a policy evolution game. It uses positive political theory to show that WTO institutions will likely constrain the DSB to issue non-violation decisions that essentially conform with WTO member preferences. Indeed, policy development based on a common law jurisprudence may be helpful to the WTO in making policy in successive negotiating rounds.

This Article reaches the opposite conclusion of those reached by other scholars, who argue that Article XXIII should be interpreted narrowly. Although a panel report in favor of the United States in *Kodak-Fuji*, assuming it would have withstood an appeal to the WTO Appellate Body, would have provided the United States with a major victory and significant leverage in bilateral negotiations with Japan, this is not a reason to support the U.S. claim. Rather, a win for the United States would have been an important first move in a policy evolution game concerning the development of competition policy and dealing with the issue of transparency in the Japanese economy and in the economies of WTO members generally.

II. THE *KODAK-FUJI* PROCEEDINGS

A. *The Section 301 Proceeding*

Under U.S. law, private parties may request that the U.S. government, through the U.S. Trade Representative (USTR), its principal organ in WTO matters, impose unilateral sanctions on a country that maintains measures that block free trade. Parties may seek such unilateral remedies when a country has violated or evaded a WTO obligation. Parties may also seek unilateral remedies to open markets in which a country maintains protectionist measures even though the measure does not constitute a violation or evasion of WTO obligations.

Section 301 of the Trade Act of 1974, as amended, provides the

principal unilateral remedy.¹⁵ Section 301 is controversial. Some govern-

15. Section 301 of the U.S. Trade Act of 1974 provides, in pertinent part, that upon the initiation of proceedings by an interested person,

If the United States Trade Representative determines . . . that—

- (A) the rights of the United States under any trade agreement are being denied; or
- (B) an act, policy, or practice of a foreign country—
 - (i) violates, or is inconsistent with, the provisions of, or otherwise denies benefits to the United States under, any trade agreement, or
 - (ii) is unjustifiable and burdens or restricts United States commerce;

the Trade Representative shall take action authorized in subsection (c) of this section, subject to the specific direction, if any, of the President regarding any such action, and shall take all other appropriate and feasible action within the power of the President that the President may direct the Trade Representative to take under this subsection, to enforce such rights or to obtain the elimination of such act, policy, or practice.

19 U.S.C. § 2411.

Subsection (c) of Section 301 provides the U.S. Trade Representative with a number of powers in the event of a finding of a violation, including the power to suspend or withdraw concessions granted in trade agreements, and to impose retaliatory duties, fees, and restrictions on the goods and services of the offending country for so long as the Trade Representative deems appropriate.

If the Trade Representative makes the requisite findings as set forth above, the statute provides that she “shall take action” in accordance with subsection (c). The law provides, however, that the Trade Representative is not required to take action if, among other things, the WTO Dispute Settlement Body

has adopted a report, or a ruling issued under the formal dispute settlement proceeding provided under any other trade agreement finds, that—

- (i) the rights of the United States under a trade agreement are not being denied, or
- (ii) the act, policy, or practice—
 - (I) is not a violation of, or inconsistent with, the rights of the United States, or
 - (II) does not deny, nullify, or impair benefits to the United States under any trade agreement.

Id.

In addition, the U.S. Trade Representative need not take action if she finds, among other things, that:

- (i) the foreign country is taking satisfactory measures to grant the rights of the United States under a trade agreement, [or]
- (ii) the foreign country has—
 - (I) agreed to eliminate or phase out the act, policy, or practice, or
 - (II) agreed to an imminent solution to the burden or restriction on United States commerce that is satisfactory to the Trade Representative, [or]
- (iii) it is impossible for the foreign country to achieve the results described in clause (i) or (ii), as appropriate, but the foreign country agrees to provide to the United States compensatory benefits that are satisfactory to the Trade Representative.

Id.

ments and commentators contend that it takes an overly aggressive approach that is ill-suited to the rule-based multilateral framework that has emerged from the Uruguay Round of multilateral trade negotiations.¹⁶

Kodak filed a petition under Section 301 with the USTR on May 18, 1995.¹⁷ Kodak's petition alleged that prior to 1976, Japan violated the bilateral U.S.-Japan Friendship Commerce and Navigation Treaty and the Organization for Economic Co-operation and Development Code of Liberalization of Capital Movements with restrictions on inward foreign investment. Kodak's petition further alleged that Japan instituted liberalization countermeasures designed to maintain restrictions after they were removed under the WTO regime.¹⁸ The acting USTR initiated an investigation under Section 301 as of July 5, 1995.¹⁹

On June 13, 1996, the acting USTR found the following:

[C]ertain acts, policies, and practices of the Government of Japan with respect to the sale and distribution of consumer photographic materials in Japan are unreasonable and burden or restrict U.S. commerce. Specifically, the USTR found that the Government of Japan established and tolerated a market structure that impedes U.S. exports of consumer photographic materials to Japan, and in which practices occur that also impede U.S. exports of these products to Japan, thereby denying fair and equitable market opportunities. The USTR also concluded that there is reason to believe based on strong evidence that certain Japanese Government liberalization countermeasures, including *inter alia*, distribution guidelines and related measures, the Law Pertaining to Adjustment of Business Activities of the Retail Industry for Large Scale Retail Stores (LSRS Law) and the Law Against Unjustifiable Premiums and

16. See United States—Sections 301–310 of the Trade Act of 1974, WT/DS152R, Dec. 22, 1999 (WTO Panel Report ruling that U.S. statute not inconsistent with U.S. obligations under the WTO); see also WTO Dispute Settlement Proceeding Regarding Sections 301–310 of the Trade Act of 1974, as Amended, 64 Fed. Reg. 14,037 (1999). The European Community Trade Barriers Regulation, enacted primarily as a response to the U.S. law, provides less discretion to European Community administrators than does the U.S. law to its administrators. It, among other things, does not permit unilateral action to attempt to open markets that are not covered by the WTO agreements. See Council Regulation 3286/94, 1994 O.J. (L 349) 71.

17. See Initiation of Investigation Pursuant to Section 302 Concerning Barriers to Access to the Japanese Market for Consumer Photographic Film and Paper; Request for Public Comment, 60 Fed. Reg. 35,447 (1995).

18. See *id.*

19. See *id.*

Misleading Representations (Premiums Law) contravene Japan's obligations under the Multilateral Trade Agreements annexed to the Marrakesh Agreement Establishing the World Trade Organization (WTO), and nullify or impair benefits accruing to the United States under the WTO agreements.²⁰

Further details from the summary of the 301 proceeding are as follows:

The USTR found that when the Japanese Government gradually withdrew its formal restrictions on imports and inward investment following international pressure beginning in the late 1960s, it simultaneously implemented liberalization countermeasures designed to restrict access of foreign capital and goods to the Japanese market. The capital and import liberalization countermeasures implemented beginning in the 1960s, included measures to block or limit foreign direct investment in both new and established enterprises with the intent and effect, *inter alia*, of limiting market access for imported products. Because of the perceived need to protect the Japanese photographic materials industry from foreign products, the consumer photographic materials sector was among the last to be liberalized. Restrictions on foreign investment in existing enterprises remained in effect until the early 1980s. During the period of capital and import liberalization countermeasures, the Government of Japan, in particular the Ministry of International Trade and Industry (MITI), took steps to restructure the distribution sector to prevent foreign products from making inroads into the Japanese market. For example, MITI promulgated distribution guidelines for photographic film, and the market structure and practices established under and promoted by these guidelines fostered a dependent and exclusionary relationship among Japan's major photographic materials manufacturer, the primary wholesalers (*tokuyakuten*), secondary wholesalers, and retailers. The distribution structure, retail sales environment, and business relationships in this sector that were established as a result of MITI's protection of the sector remain in place today.

The USTR also uncovered significant evidence of anti-

20. Section 304 Determinations: Barriers to Access to the Japanese Market for Consumer Photographic Film and Paper, 61 Fed. Reg. 30,929, 30,929 (1996) [hereinafter *Japanese Film*].

competitive activities that warrants full and thorough examination.²¹

The Japanese government refused to participate in the 301 proceeding, although Fuji did participate. The following finding from the 301 proceeding encapsulates the U.S. position on the Japanese refusal:

At an October 3, 1995 meeting in Tokyo, U.S. Government officials were prepared to discuss the substance of the issues involved in the investigation, and they solicited the views of and information from Japanese officials concerning those issues. However, at that meeting and throughout the course of the investigation, the Government of Japan unreasonably refused to consult on the substance of the matters under investigation, despite repeated U.S. attempts to engage in consultations.²²

The Japanese government took the position that the issues were inappropriate for resolution in a 301 proceeding and that Kodak should have brought its complaint to the Japan Fair Trade Commission because its complaint was essentially that Japan failed to enforce its Antimonopoly Law. The Japanese government argued that the dispute involved questions of competition law and not international economic law. Given that Kodak argued that the Japanese government was involved significantly in erecting trade barriers, and that the industrial policy of the country was designed to stop foreign firms from entering the Japanese market even after the Japanese government conceded to tariff reductions in various rounds of GATT multilateral trade negotiations, Kodak apparently was reluctant to seek a domestic remedy in Japan from the Japanese government.²³

The acting USTR stated in the 301 proceeding that the United States:

immediately will seek recourse to the dispute settlement procedures of the WTO to challenge these measures and their application, as provided by the Trade Act and in accordance with Article 23 of the WTO Dispute Settlement Understanding (DSU). If, at the conclusion of dispute settlement proceedings,

21. *Id.*

22. *Id.*

23. See Mark R. Joelson, *The Kodak-Fuji Trade Dispute: A U.S. View*, 4 INT'L TRADE L. & REG. 34, 34 (1998).

the WTO Dispute Settlement Body finds that Japanese government acts, policies or practices violate, or are inconsistent with, the provisions of, or otherwise deny benefits accruing to the United States under, any of the WTO agreements, and, unless Japan is taking satisfactory measures to grant the rights of the United States under the WTO agreements, has agreed to eliminate or phase out the affected act, policy or practice, or agreed to an imminent satisfactory solution to the burden or restriction on U.S. commerce, or provided satisfactory compensatory trade benefits, the United States shall take action under section 301 in accordance with the DSU. . . . The United States will request consultations immediately with the Government of Japan pursuant to arrangements for consultations on restrictive business practices adopted by the GATT Contracting Parties in 1960 and carried forward into the WTO.²⁴

B. *The WTO Proceeding*

Contemporaneously with its decision under Section 301, the USTR, on June 13, 1996, requested consultations with the Japanese government under Article 4.4 of the WTO Dispute Settlement Understanding and Article XXIII:1 of the GATT.²⁵ Japan and the United States held consultations on July 11, 1996. The consultations failed to result in a resolution of the dispute.²⁶

The United States alleged that a large number of Japanese government proclamations and activities fell within the three categories of liberalization countermeasures described above. The parties vigorously advocated their respective positions and devoted significant legal resources to dealing with the various issues in the dispute.²⁷ The clearest and most succinct way to deal with the issues is to start with the law. The

24. *Japanese Film*, *supra* note 20, 30,929–30.

25. *See Japan—Film Panel Report*, *supra* note 5, ¶ 1.1.

26. *See* Sara Dillon, *Fuji-Kodak, the WTO, and the Death of Domestic Political Constituencies*, 8 MINN. J. GLOBAL TRADE 197, 199 (1999). Dillon explains that the United States and Japan actually did reach agreement on some issues, in particular on the repeal of the Japanese Large Stores Law. Dillon concludes that “the U.S. did not entirely lose *Fuji-Kodak*, because the US secured from Japan a long-sought concession—a ‘sell-out’ of small business interests in Japan by the Japanese bureaucracy that completely revised national laws protecting the small and medium retail sector.” *Id.* at 200. A contrary hypothesis would conclude that Japan really did not change its laws any more than it was prepared to do even without U.S. pressure. *See supra* note 2.

27. Assistance likely came from the affected private parties. *See* Jeffrey L. Dunoff, *The Misguided Debate over NGO Participation at the WTO*, 1 J. INT’L ECON. L. 433, 436 (1998) (stating that “[t]he work of private parties can also serve as a ‘resource enhancer’”).

measures that the United States challenged and how the law applies to them will then be examined. The case is analyzed in this fashion because the facts are so complex and dynamic, spanning over thirty years, and it is easier to deal with them once.

1. Procedural Issues

One of the principal issues in the *Kodak-Fuji* case was the level of detail the parties should be required to provide in the “pleading” or initial presentation of their claim before the Dispute Settlement Body. This has been a significant issue in a number of municipal jurisdictions, with the trend toward more relaxed “notice”-type pleading and the avoidance of forfeiture on the basis of technical pleading rules. It has also been the subject of several WTO panel reports.

Article 6.2 of the WTO Understanding on Rules and Procedures Governing the Settlement of Disputes provides in pertinent part that “[t]he request for the establishment of a panel shall be made in writing. It shall indicate whether consultations were held, identify the specific measures at issue, and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly. . . .”²⁸

In this case, the United States admitted that its request for a panel did not contain eight measures. The initial submission of the United States to the panel and to Japan disclosed and discussed these measures. The issue thus was “whether the ordinary meaning of the terms of Article 6.2, i.e., that ‘the specific measures at issue’ be identified in the panel request can be met if a ‘measure’ is not explicitly described in the request.”²⁹ The panel provided the following guidance:

To fall within the terms of Article 6.2, it seems clear that a “measure” not explicitly described in a panel request must have a clear relationship to a “measure” that is specifically described therein, so that it can be said to be “included” in the specified “measure.” In our view, the requirements of Article 6.2 would be met in the case of a “measure” that is subsidiary or so closely related to a “measure” specifically identified, that the responding party can reasonably be found to have received

28. Understanding on Rules and Procedures Governing the Settlement of Disputes, Apr. 15, 1994, art. 6.2, Marrakesh Agreement Establishing the World Trade Organization [hereinafter WTO Agreement], Annex 2, in RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 1 (1994) [hereinafter RESULTS OF THE URUGUAY ROUND] 404, 410 (1994), 33 I.L.M. 1226, 1230 [hereinafter DSU].

29. See *Japan—Film Panel Report*, *supra* note 5, ¶ 10.8.

adequate notice of the scope of the claims asserted by the complaining party. The two key elements—close relationship and notice—are interrelated: only if a “measure” is subsidiary or closely related to a specifically identified “measure” will notice be adequate.³⁰

Article 6.2 provides a general pleading requirement. Article 26 of the Rules and Procedures is a special provision for non-violation complaints. It states that, for non-violation complaints of the type described in Article XXIII:1 (b), the complainant “shall present a detailed justification in support of any complaint relating to a measure that does not conflict with the relevant covered agreement.”³¹ In other words, if the complainant alleges that the measure taken by the respondent nullified or impaired a WTO obligation without explicitly violating a WTO agreement, the complainant must proffer a detailed justification for its complaint. The panel report states that Article 26.1 and WTO jurisprudence “confirm that this is an exceptional remedy for which the complaining party bears the burden of providing a *detailed justification* to back its allegations.”³² According to the panel, this detailed justification will establish a presumption that what is claimed is true, and that it would be for Japan to rebut any such presumption.³³

2. Substantive Issues: The Non-Violation Claim

a. General Considerations

Article XXIII:1 (b) provides that a WTO member may seek dispute settlement in the following circumstances: “If any [WTO Member] should consider that any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired . . . as the result of . . . the application by another [WTO Member] of any measure, whether or not it conflicts with the provisions of this Agreement.” This is known as a non-violation claim because the measures alleged to violate WTO obligations under this provision do not have to be an explicit breach of any provision in a WTO agreement or of any concessions made by the other WTO member.³⁴

30. *Id.*

31. DSU, *supra* note 28, art. 26 (1) (a), at 427, 33 I.L.M. at 1243.

32. *Japan—Film Panel Report*, *supra* note 5, ¶ 10.30; see GATT Dispute Panel Report on Uruguay Recourse to Article XXIII, L/1923 (Nov. 15, 1962) [hereinafter *Uruguay—Recourse*].

33. *Japan—Film Panel Report*, *supra* note 5, ¶ 10.32 (seconded ellipsis added).

34. See *Uruguay Recourse*, *supra* note 32.

A prior panel report, in the *EEC—Oilseeds* case, explained the purpose for the provision as follows:

The idea underlying [... Article XXIII:1(b)] is that the improved competitive opportunities that can legitimately be expected from a tariff concession can be frustrated not only by measures proscribed by the General Agreement but also by measures consistent with that Agreement. In order to encourage contracting parties to make tariff concessions they must therefore be given a right of redress when a reciprocal concession is impaired by another contracting party as a result of the application of any measure, whether or not it conflicts with the General Agreement.

The panel considered that the main value of a tariff concession is that it provides an assurance of better market access through improved price competition. Contracting parties negotiate tariff concessions primarily to obtain that advantage. They must therefore be assumed to base their tariff negotiations on the expectation that the price effect of the tariff concessions will not be systematically offset. If no right of redress were given to them in such a case they would be reluctant to make tariff concessions and the General Agreement would no longer be useful as a legal framework for incorporating the results of trade negotiations.³⁵

The rationale for Article XXIII:1(b) thus provides countries with an incentive to make tariff concessions. The impracticalities for the parties to obtain adequate information about barriers to trade that exist in the economies of other parties, to reach agreement on tariff concessions, and to monitor compliance with concessions, makes the clause a needed incentive device to encourage negotiations in the WTO multi-lateral negotiations process.

As explained in the panel report, this provision has been on the books of the GATT for almost fifty years, yet there have been very few cases in which a GATT panel or working party has considered the provision on its merits.³⁶ On this basis, the panel report stated that the remedy should be approached with caution and as an exceptional

35. *Japan—Film Panel Report*, *supra* note 5, ¶ 10.35 (quoting GATT Dispute Panel Report on European Economic Community-Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins, L/6627 (Dec. 14, 1989) (hereinafter *EEC—Oilseeds*)).

36. *Japan—Film Panel Report*, *supra* note 5, ¶ 10.36.

remedy. As explained in the panel report, “[t]he reason for this caution is straightforward. Members negotiate the rules that they agree to follow and only exceptionally would expect to be challenged for actions not in contravention of those rules.”³⁷

The panel said that each case brought under Article XXIII:1(b)

should be examined on its own merits, bearing in mind the above-mentioned need to safeguard the process of negotiating reciprocal tariff concessions. Our role as a panel charged with examining claims under Article XXIII:1(b) is, therefore, to make an objective assessment of whether, in light of all the relevant facts and circumstances in the matter before us, particular measures taken by Japan have nullified or impaired benefits accruing to the United States within the meaning of Article XXIII:1(b).³⁸

All but one of the cases prior to *Kodak-Fuji* concerned allegations that a subsidy to a firm that was consistent with the GATT, but that was provided subsequent to a tariff concession, nullified or impaired the tariff concession.³⁹ There is no reason to limit Article XXIII:1(b) to such situations. As the panel report found,

[W]e wish to make clear that we do not *a priori* consider it inappropriate to apply the Article XXIII:1(b) remedy to other governmental actions, such as those designed to strengthen the competitiveness of certain distribution or industrial sectors through non-financial assistance. Whether assistance is financial or non-financial, direct or indirect, does not determine whether its effect may offset the expected result of tariff negotiations. Thus, a Member's industrial policy, pursuing the goal of increasing efficiency in a sector, could in some circumstances upset the competitive relationship in the market place between

37. *Id.*

38. *Id.* ¶ 10.37.

39. In only one case did a panel uphold a non-violation claim based on the nullification or impairment of a GATT benefit other than a tariff concession. See GATT Dispute Panel Report on European Community—Tariff Treatment on Imports of from Certain Countries in the Mediterranean Region, L/5776 (Feb. 7, 1985) (hereinafter *EC—Citrus Products*); see Frieder Roessler, *The Concept of Nullification and Impairment in the Legal System of the World Trade Organization*, in *INTERNATIONAL TRADE LAW AND THE GATT/WTO DISPUTE SETTLEMENT SYSTEM* 123, 132 (Ernst-Ulrich Petersmann ed. 1997). See *supra* note 11 for a discussion of the use of subsidies to counteract tariffs.

domestic and imported products in a way that could give rise to a cause of action under Article XXIII:1(b). In the context of a Member's distribution system, for example, it is conceivable that measures that do not infringe GATT rules could be implemented in a manner that effectively results in a disproportionate impact on market conditions for imported products. In this regard, however, we must also bear in mind that tariff concessions have never been viewed as creating a guarantee of trade volumes, but rather, as explained below, as creating expectations as to competitive relationships.⁴⁰

b. *The Elements of a Non-Violation Claim*

The panel report sets forth the following three elements of a claim under Article XXIII:1(b): (i) application of a measure by a WTO Member, (ii) a benefit accruing under a WTO agreement, and (iii) nullification or impairment of the benefit as a result of the application of the measure.

(i) *What is a "Measure?"*

The parties to the dispute vigorously litigated the question of what constitutes a "measure." In Japan, a great deal of government direction of private sector activity is accomplished through administrative guidance that, in formal legal terms, is non-binding, but that may be a very persuasive tool of the Japanese government. The panel report stated

The ordinary meaning of *measure* as it is used in Article XXIII:1(b) certainly encompasses a law or regulation enacted by a government. But in our view, it is broader than that and includes other governmental actions short of legally enforceable enactments. At the same time, it is also true that not every utterance by a government official or study prepared by a non-governmental body at the request of the government or with some degree of government support can be viewed as a measure of a Member government.⁴¹

The panel was mindful of the role of formally non-binding adminis-

40. *Japan—Film Panel Report*, *supra* note 5, ¶ 10.38.

41. *Id.* ¶ 10.43.

trative guidance in Japan and found the following with respect to such guidance:

In Japan, it is accepted that the government sometimes acts through what is referred to as administrative guidance. In such a case, the company receiving guidance from the Government of Japan may not be legally bound to act in accordance with it, but compliance may be expected in light of the power of the government and a system of government incentives and disincentives arising from the wide array of government activities and involvement in the Japanese economy.⁴²

The panel concluded that “where administrative guidance creates incentives or disincentives largely dependent upon governmental action for private parties to act in a particular manner, it may be considered a governmental measure.”⁴³ The panel explained, however, that the examination of alleged measures must be performed in context and that the incentives/disincentives test is not the exclusive test of whether a government activity is a measure under Article XXIII:1(b).⁴⁴ The panel found that it should be open to a “broad definition of the term *measure* for purposes of Article XXIII:1(b), which considers whether or not a non-binding government action has an effect similar to a binding one.”⁴⁵

An action must be taken by the government of a WTO member to be a measure. As explained by the panel,

As the WTO Agreement is an international agreement, in respect of which only national governments and separate customs territories are directly subject to obligations, it follows by implication that the term *measure* in Article XXIII:1(b) and Article 26.1 of the DSU, as elsewhere in the WTO Agreement, refers only to policies or actions of governments, not those of private parties. But while this “truth” may not be open to question, there have been a number of trade disputes in relation to which panels have been faced with making sometimes difficult judgements as to the extent to which what appear on their face to be private actions may nonetheless be attribut-

42. *Id.* ¶ 10.44.

43. *Id.* ¶ 10.45.

44. *See id.* ¶ 10.44.

45. *Id.* ¶ 10.49.

able to a government because of some governmental connection to or endorsement of those actions.⁴⁶

The panel concluded

that an action is taken by private parties does not rule out the possibility that it may be deemed to be governmental if there is sufficient government involvement with it. It is difficult to establish bright-line rules in this regard, however. Thus, that possibility will need to be examined on a case-by-case basis.⁴⁷

Finally, an action must be currently applied to be a measure. Only an action that continues in operation, and not the market structure that resulted from past actions, constitutes a measure under Article XXIII:1(b). This is based on the plain meaning of Article XXIII:1(b) and its use of the present tense, “[i]f any Member should consider that any benefit *accruing* to it . . . is being nullified or impaired . . . as a result of . . . (b) the application by another Member of any measure, whether or not it *conflicts* with the provisions of the Agreement.”⁴⁸

(ii) *What is a Benefit Accruing under the WTO Agreements?*

Article XXIII:1(b) provides that, to prove a non-violation claim, the complainant must show that a benefit accruing under a relevant WTO agreement is being nullified or impaired. The panel ruled that the concept of benefit in WTO precedent has been that of “legitimate expectations of improved market-access opportunities arising out of relevant tariff concessions.”⁴⁹ The panel also said that “for expectations to be legitimate, they must take into account all measures of the party making the concession that could have been reasonably anticipated at the time of the concession.”⁵⁰

Japan argued that only the tariff concessions granted in the Uruguay Round, the latest round of multilateral negotiations, should be considered by the panel. Japan’s argument was based on Article 30 of the Vienna Convention on the Law of Treaties, to the effect that in the event of a conflict, the provision that is later in time prevails.⁵¹ The

46. *Id.* ¶ 10.52.

47. *Id.* ¶ 10.56.

48. *Id.* ¶ 10.57 (first ellipsis added).

49. *Id.* ¶ 10.61.

50. *Id.*

51. *See id.* ¶ 10.65.

panel disagreed, asserting that it could consider concessions going back to the 1967 Kennedy Round. The panel's decision was based on Paragraph 1 of the GATT 1994, negotiated as part of the Uruguay Round. Paragraph 1 provides that GATT 1994 incorporates "protocols and certifications relating to tariff concessions."⁵² The panel found that Article 30 did not apply

because there is nothing inherently incompatible—in conflict—between the earlier and later agreed tariff concessions. Such a conflict would only seem to exist if the subsequent concessions were less favorable than prior concessions, which is not the situation in this case. Where tariff concessions have been progressively improved, the benefits—expectations of improved market access—accruing directly or indirectly under different tariff concession protocols incorporated in GATT 1994 can be read in harmony.⁵³

The panel explained, however, that the United States might have a very difficult case because it was based on expectations from rounds concluded eighteen and thirty years ago.⁵⁴

A WTO member must "legitimately expect" to obtain a benefit as a result of tariff negotiations. One of the principal issues in making such a determination was what to do with measures that existed prior to a round. The panel report sets forth the following guidelines:

First, in the case of measures shown by the United States to have been introduced subsequent to the conclusion of the tariff negotiations at issue, it is our view that the United States has raised a presumption that it should not be held to have anticipated these measures and it is then for Japan to rebut that presumption. Such a rebuttal might be made, for example, by establishing that the measure at issue is so clearly contemplated in an earlier measure that the United States should be held to have anticipated it. However, there must be a clear connection shown. In our view, it is not sufficient to claim that a *specific* measure should have been anticipated because it is consistent with or a continuation of a past *general* government policy.

Second, in the case of measures shown by Japan to have been

52. *Id.* ¶ 10.64.

53. *Id.* ¶ 10.65.

54. *See id.* ¶ 10.70.

introduced prior to the conclusion of the tariff negotiations at issue, it is our view that Japan has raised a presumption that the United States should be held to have anticipated those measures and it is for the United States to rebut that presumption. In this connection, it is our view that the United States is charged with knowledge of Japanese government measures as of the date of their publication. We realize that knowledge of a measure's existence is not equivalent to understanding the impact of the measure on a specific product market. For example, a vague measure could be given substance through enforcement policies that are initially unexpected or later changed significantly. However, where the United States claims that it did not know of a measure's relevance to market access conditions in respect of film or paper, we would expect the United States to clearly demonstrate why initially it could not have reasonably anticipated the effect of an existing measure on the film or paper market and when it did realize the effect. Such a showing will need to be tied to the relevant points in time (i.e., the conclusions of the Kennedy, Tokyo and Uruguay Rounds) in order to assess the extent of the United States' legitimate expectations of benefits from these three Rounds. A simple statement that a Member's measures were so opaque and informal that their impact could not be assessed is not sufficient. . . .

Third, for our purposes, we consider the conclusion of the tariff negotiations in the three Rounds to be as follows: In the case of the Kennedy Round, it appears that tariff negotiations continued until the very end of the Round and thus we will consider the date of the conclusion of the Round, i.e., 30 June 1967, as the relevant date. In the case of the Tokyo Round, the conclusion of the Round was 12 April 1979, although the relevant Protocol was formally dated 30 June 1979. We will address where appropriate the U.S. argument that the negotiations on film tariff reductions ended earlier. In the case of the Uruguay Round, tariff negotiations were substantially completed as of 15 December 1993, although the formal end of the Round occurred on the signing of the WTO Agreement in Marrakech on 15 April 1994. Accordingly, we will use the date of 15 December 1993 as the conclusion of the Uruguay Round tariff negotiations.⁵⁵

55. *Id.* ¶¶ 10.79–10.81.

(iii) *Nullification or Impairment of Benefits: The Causation Requirement*

Article XXIII:1(b) provides that, for a WTO member to establish a non-violation claim, it must prove that a benefit under the WTO agreements is being “nullified or impaired as the result of” measures by another WTO member. The panel ruled that this means that “it must be demonstrated that the competitive position of the imported products subject to and benefiting from a relevant market access (tariff) concession is being *upset by* . . . the application of a measure not reasonably anticipated.”⁵⁶

Finding causation when both the government and the private sector are engaged in the activities in question presents one potential problem. The panel ruled that “the issue is whether . . . a measure has made more than a *de minimus* contribution to nullification or impairment.”⁵⁷

The proclamations of the Japanese government that were under scrutiny in this case were all facially neutral—they did not say anything about the origin of the goods. Japan argued that this was sufficient to find that there was no causal connection between the alleged measures and competitive conditions for film and photographic paper.⁵⁸ The U.S. position was that the panel should examine disparate impact. The panel stated:

In our view, even in the absence of *de jure* discrimination (measures which on their face discriminate as to origin), it may be possible for the United States to show *de facto* discrimination (measures which have a disparate impact on imports). However, in such circumstances, the complaining party is called upon to make a detailed showing of any claimed disproportionate impact on imports resulting from the origin-neutral measure. And, the burden of demonstrating such impact may be significantly more difficult where the relationship between the measure and the product is questionable.⁵⁹

The parties disagreed in many cases about whether a specific measure was intended to restrict imports or to promote other policies. The Japanese government may have had a multitude of reasons for its activities.⁶⁰ The panel found a potential connection between intent

56. *Id.* ¶ 10.82.

57. *Id.* ¶ 10.84.

58. *See id.* ¶ 10.85.

59. *Id.*

60. *See id.* ¶ 10.87.

and causation. Although Article XXIII:1 (b) does not require a proof of intent of nullification or impairment of benefits,

What matters for purposes of establishing causality is the impact of a measure, i.e. whether it upsets competitive relationships. Nonetheless, intent may not be irrelevant. In our view, if a measure that appears on its face to be origin-neutral in its effect on domestic and imported products is nevertheless shown to have been intended to restrict imports, we may be more inclined to find a causal relationship in specific cases, bearing in mind that intent is not determinative where it in fact exists. It remains for the complaining party to show that the specific measure it challenges does in fact nullify or impair benefits within the meaning of Article XXIII:1 (b).⁶¹

Finally, the panel agreed with the United States that it should examine the impact of the measures in combination as well as individually. The panel said that “[n]otwithstanding the logic of this theoretical argument, however, we are sensitive to the fact that the technique of engaging in a combined assessment of measures so as to determine causation is subject to potential abuse and therefore must be approached with caution and circumscribed as necessary.”⁶²

3. The WTO Rulings on the Non-Violation Claim

In applying the law to the facts, the panel looked at all three factors, regardless of whether the case could be disposed of on the basis of a single factor. The panel thus did not apply established principles of judicial economy.⁶³ Article XXIII:1 (b) factors are cumulative, and all must be met in order for a claim to succeed.

a. *Distribution Countermeasures*

(i) *The Claim in Context*

In the two most recent rounds of trade negotiations, the Tokyo and the Uruguay Rounds, Japan committed to substantial reductions in its

61. *Id.*

62. *Id.* ¶ 10.88.

63. This is common practice, particularly in international tribunals, whose authority is determined by treaty and may not be as longstanding or certain as the authority of domestic judiciaries.

tariffs and applied rates for photographic film and paper. Tariffs were eliminated completely in the Uruguay Round. The United States took the position that these tariff concessions were nullified or impaired by "the Japanese government's array of opaque, informal measures" designed to exclude foreign products and to support "single-brand distribution" for Japanese products only.⁶⁴

The United States advanced as a "general theme" of their entire case that there is a "unique relationship" in Japan between government and industry.⁶⁵ The U.S. argument was that Japanese industrial policy relied substantially on "quasi-governmental entities, including, *inter alia*, fair trade councils, advisory committees, study groups, research institutes, and chambers of commerce."⁶⁶ The United States argued that these entities engaged in a "concerted adjustment" process to restrict entry into the market by foreign competitors.⁶⁷ As the panel report explained,

The United States argues that when the liberalization of international trading conditions became imminent, MITI and Japanese industry recognized the superiority of foreign firms which could create serious competition for Japanese manufacturers and their products. MITI and Japanese manufacturers, it is argued, consequently devised a plan to streamline Japan's distribution system in order to bring it under the control of domestic producers. The basic US position is that MITI sought to strengthen vertical distribution channels that would handle the products of a particular domestic manufacturer exclusively.⁶⁸

Japan countered that the United States engaged in distorted characterization. Japan argued that the panel should examine each "measure" on its own merit without any "preconceived prejudice" against an alleged "unique" Japanese system.⁶⁹

The panel considered the following distribution countermeasures on the merits:

64. *Japan—Film Panel Report*, *supra* note 5, ¶¶ 10.151, 10.158.

65. *Id.* ¶ 10.90.

66. *Id.*

67. *Id.*

68. *Id.* ¶ 10.92.

69. *Id.* ¶ 10.91.

- (1) 1967 Cabinet Decision;
- (2) 1967 JFTC Notification 17 on premiums to businesses;
- (3) 1968 Sixth Interim Report on Distribution Modernization Outlook and Issues;
- (4) 1969 Seventh Interim Report on Systemization of Distribution Activities;
- (5) 1969 Survey Report regarding Transaction Terms;
- (6) 1970 Guidelines for Rationalizing Terms of Trade for Photographic Film;
- (7) 1971 Basic Plan for the Systemization of Distribution; and
- (8) 1975 Manual for Systemization of Distribution by Industry: Camera and Film.⁷⁰

The panel rejected the U.S. distribution countermeasures claim. The panel concluded:

[T]he United States has not been able to show that the various “measures” it cites have upset competitive relationships between domestic and US film and paper in Japan, principally because single-brand distribution appears to have occurred before and independently of those “measures”, but also because the United States has not demonstrated that these “measures” are directed at promoting vertical integration or single-brand distribution. In answering the timing problem, the United States has provided no convincing evidence or arguments that the cited “measures” in fact had the effect of reinforcing single-brand distribution. Equally, the United States has not explained why the vertically integrated, single-brand distribution structure of the film sector in Japan—a state of affairs that the evidence suggests is similar to that occurring elsewhere in the world (including in the United States)—would have broken down in the absence of continuing government intervention.⁷¹

In addition, the panel ruled that the United States failed to show that a number of measures important to its case continued in effect.⁷² Indeed, the panel held that some “may be dated or have been formally revoked.”⁷³ With respect to such measures, the United States failed to

70. *Id.* ¶ 10.93.

71. *Id.* ¶ 10.204.

72. *See id.* ¶ 10.205.

73. *Id.*

prove that they “are today upsetting competitive relationships between domestic and U.S. film and paper in Japan.”⁷⁴ As to some measures, the panel was not persuaded that their major purpose was to block entry of foreign firms.⁷⁵

(ii) *The Specific Alleged Distribution Countermeasures*

(a) *The 1967 Cabinet Decision on Liberalization of Inward Direct Investment*

In the WTO proceeding, the United States characterized a 1967 Cabinet Decision Concerning Liberalization of Inward Direct Investment of June 1967 (hereinafter 1967 Cabinet Decision) as a “watershed” in Japan’s protection of film and photographic paper markets liberalized under the GATT/WTO framework.⁷⁶ The avowed purpose of the 1967 Cabinet Decision was to determine what steps the Japanese government and Japanese industry should take to prepare for capital liberalization and for the introduction of foreign enterprises into Japan. The Decision states the following three points as the basic justification of its “countermeasures” to deal with the presence of foreign investment in Japan:

- (1) prevent disorder that may arise from the advancement of foreign capital; (2) create the foundation to enable our enterprises to compete with foreign enterprises on equal terms; and (3) actively strengthen the quality of [domestic] enterprises and reorganize the industrial system so that they can fully compete with foreign capital.⁷⁷

In reading the portions of the 1967 Cabinet Decision set forth in the panel report, one is struck by what would seem to be policy conclusions that fly in the face of neo-classical economic theory and that seek “orderly” competition.⁷⁸ For example, the 1967 Cabinet Decision states:

74. *Id.*

75. See *id.* ¶ 10.206. The Panel ruled that the U.S. claim may succeed with respect to black and white film, which is a very small part of the contemporary film market. See *id.* ¶ 10.207.

76. See *id.* ¶¶ 5.156, 5.87–5.88.

77. *Id.* ¶ 10.95.

78. For a discussion of the concepts of orderly markets in Japanese policy making, see Douglas E. Rosenthal & Mitsuo Matsushita, *Competition in Japan and the West: Can the Approaches Be Reconciled?*, in *GLOBAL COMPETITION POLICY* 313, 313 (Edward M. Graham & J. David Richardson eds., 1997) (“Some Western policy analysts . . . are convinced that Japanese culture is fundamentally incompatible with the Western ideological commitment to economic competition.”). See also

[I]t would be necessary to restrain foreign enterprises coming into Japan after liberalization from disturbing order in domestic industries, by resorting to the strength of their superior power, and from advancing into the non-liberalised sectors by evading control. The establishment of these “(counter)measures” for strengthening the capacity of our enterprises for international competition and for preventing foreign enterprises from disturbing order in our industries and market would be a basic necessity if the liberalization is to be promoted and if our people are to enjoy its economic benefits.⁷⁹

The 1967 Cabinet Decision asserted that the distribution sector required substantial improvement:

Modernization lags behind most in the distribution sector. Here, the power of resistance against the inroad of foreign capital is weak, and the impact of foreign capital advancing into this sector will also pose significant impact on the production sector. It is necessary, therefore, to implement countermeasures in support of the efforts of industry with the objectives of modernizing the distribution structure, fundamentally strengthening the enterprises in this sector, and establishing a mass sales system.⁸⁰

The United States argued that the 1967 Cabinet Decision set a clear national priority in Japan to protect domestic industry from international competition. The United States also argued that, while Japan agreed on the international level to liberalization, it began a process of restructuring Japanese industry through various countermeasures to offset the effects of international liberalization. Japan responded that the 1967 Cabinet Decision was concerned with modernization and efficiency in the Japanese distribution sector to prepare it for international competition.⁸¹

The panel report is vague on whether the 1967 Cabinet Decision is a measure. The panel found that the 1967 Cabinet Decision as a whole constitutes a measure, but it also found that the part of the Decision

Mitsuo Matsushita, *The Intersection of Industrial Policy and Competition: The Japanese Experience*, 72 CHI.-KENT L. REV. 477 (1996).

79. *Japan—Film Panel Report*, *supra* note 5, ¶ 2.9.

80. *Id.*

81. *See id.* ¶ 10.97.

dealing with modernization of the distribution sector "is more in the nature of a general policy statement than either a decision on particular government actions or a mandate to private industry to follow governmental policy by taking specific actions."⁸² The panel report is also vague on whether the Decision continued in force after December 1980, when the Cabinet Decision of December 26, 1980 expressly states that the 1967 Cabinet Decision was no longer in effect. The 1980 Decision, according to the panel, does not clearly abolish the 1967 Cabinet Decision.⁸³

The panel found that the United States could not claim any benefits accruing from the 1967 Cabinet Decision under the Tokyo and Uruguay Rounds. The 1967 Cabinet Decision was published in *Kampo*, Japan's official gazette, on June 21, 1967. The Kennedy Round concluded on June 30, 1967, but the Tokyo and Uruguay Rounds were far into the future at the time. Applying the principles set forth above, the panel ruled that the United States could not claim legitimate expectations of improved market access based on the Tokyo and Uruguay Rounds.⁸⁴

The United States also failed to demonstrate that the 1967 Cabinet Decision nullified or impaired its Kennedy Round benefits. The portions of the 1967 Cabinet Decision dealing with the Japanese distribution sector set forth general policy statements that do not provide for clear directions to the public or the private sector to undertake specific activities.⁸⁵

(b) 1967 Japan Fair Trade Commission Notification 17 on Premiums to Business

Notification 17, issued on May 10, 1967 by the Japan Fair Trade Commission (JFTC),⁸⁶ prohibited manufacturers of certain goods, including film and photographic paper, to offer cash and other premiums in excess of 100,000 yen (\$278 in 1967) annually as inducements to wholesalers and retailers to distribute and sell the products of the manufacturers or to agree to certain contract terms. The JFTC repealed Notification 17 in April 1996. The United States alleged that Notification 17 was both a distribution and a premium countermeasure.⁸⁷

82. *Id.* ¶ 10.98.

83. *See id.* ¶ 10.100.

84. *See id.* ¶ 10.103.

85. *See id.* ¶ 10.105.

86. *See id.* ¶ 2.42.

87. *See id.* ¶ 10.107.

The panel found that Notification 17 was a measure under Article XXIII:1(b), but only between 1967 and 1996. The United States argued that the repeal was ineffective because manufacturers were still required to comply with Designation 9 of JFTC Notification 15 of 1982, which banned “unjust inducements” in excess of “normal business practice.”⁸⁸ The panel concluded that Notification 17 was no longer in effect for two reasons. First, consideration by the panel of Designation 9 was inappropriate for the same reason that other measures were excluded from the panel’s terms of reference: an insufficient relationship existed between Designation 9 and measures specified in the U.S. complaint. Second, the panel concluded that the United States failed to prove that “the policy underlying JFTC Notification 17 has been continued through ongoing administrative guidance.”⁸⁹

The panel found that Notification 17 was not a benefit under the GATT/WTO framework. Notification 17 existed prior to the Kennedy Round. The panel ruled that “[a]lthough we can conceive of circumstances where the exporting WTO Member may not reasonably be aware of the significance of a measure for or its potential disparate impact on imported products until some time after its publication, the United States has not demonstrated the existence of any such circumstance here.”⁹⁰

Notification 17 applied to both foreign and domestic firms and did not contain any explicit discrimination against foreign firms. The United States argued that Notification 17 was nevertheless discriminatory. Because of restrictions on foreign investment in Japan until the 1970s, foreign firms could not set up their own distribution networks. They thus had to compete with domestic firms for existing wholesalers and distributors. The domestic firms were already entrenched in the distribution system. Notification 17, argued the United States, restricted the ability of foreign firms to compete with domestic firms on crucial terms such as price.⁹¹ The panel found that, although a JFTC press summary stated that “counteract[ing] the influence of U.S. capital” was a purpose of Notification 17, the JFTC justified Notification 17 as necessary to deal with distortions in the domestic market and “cut-throat sales practices promoted by huge capital power.”⁹² The panel ruled that, on balance, the evidence on the adoption of Notifica-

88. *Id.* ¶ 10.108.

89. *Id.* ¶ 10.109.

90. *Id.* ¶ 10.111.

91. *See id.* ¶ 10.112.

92. *Id.* ¶ 10.114.

tion 17 suggested that it “was directed against potential excesses of promotional activities in the distribution sector in general.”⁹³ The panel found that the United States failed to identify a single instance in which implementation of Notification 17 led to the upsetting of the competitive relationship between Japanese and U.S. film and photographic paper.⁹⁴

(c) 1968 Sixth Interim Report on Distribution Modernization Outlook and Issues

The Sixth Interim Report of the MITI Industrial Structure Council Distribution Committee, entitled, “Distribution Modernization Outlook and Issues,” stated the following concerns about the potential for foreign enterprises to take control of Japan’s distribution system:

1. There is a risk that growth sectors will fall under the monopolistic control of foreign capital, resulting from the difference in capital resources and the like.
2. There is a risk that the process of sales expansion by foreign capital affiliated distribution enterprises will aggravate excessive competition and hinder the smooth implementation of distribution modernization plans, and the [established] order of trade will be disrupted.
3. There is a risk that the manufacturing sector will be dominated by controlling the sales routes, bringing about the international subcontracting of Japanese industry.⁹⁵

The Sixth Interim Report was issued on August 5, 1968.⁹⁶

The United States was concerned that the Sixth Interim Report would promote horizontal integration and make entry into the Japanese distribution system difficult for foreign firms.⁹⁷ Japan responded that the Sixth Interim Report addressed modernization of the distribution sector as a whole and was intended to deal with the concern that domestic firms would be restricted in using distribution channels that were subject to regulation, while foreign firms, in the wake of capital liberalization, would be free to build modern and potentially exclusive distribution systems.⁹⁸

93. *Id.* ¶ 10.115.

94. *See id.* ¶ 10.116.

95. *Id.* ¶ 10.118.

96. *See id.*

97. *See id.* ¶ 10.119.

98. *See id.* ¶ 10.120.

The panel ruled that the Sixth Interim Report was not a measure. It found that the Distribution Committee was established by the MITI Industrial Structure Council, which was an advisory council that was not comprised of government officials. The panel ruled that the Sixth Interim Report was not binding law or regulation, nor did it provide “incentives or disincentives to the private sector to take any particular action.” It was essentially a “study report” to government, an examination of the status of the distribution sector that makes general recommendations to government. It does not tell the private sector to take any action.⁹⁹

The panel ruled that the Sixth Interim Report did not frustrate the legitimate expectations of the United States of a benefit accruing under GATT/WTO. Any such expectations could only exist with respect to Kennedy Round negotiations because the Sixth Interim Report was issued in 1968. The Tokyo Round concluded in 1979, and the Uruguay Round in 1994.¹⁰⁰

The panel ruled that the United States failed to demonstrate causation and that the United States failed to prove that the Sixth Interim Report nullified or impaired benefits accruing to the United States under Article XXIII:1 (b). The panel found the following to be influential in its ruling on lack of causation:

[F]irst, the report is an advisory report directed to the government, setting out non-binding policy options for the government; second, these policy options are directed to modernizing and improving the overall efficiency of the distribution sector in Japan; third, they are not at all product-specific; and fourth, the United States has not been able to point to any specific government actions resulting from this policy options report, except perhaps for the 1970 Guidelines discussed below.¹⁰¹

The panel found “timing problems” with the U.S. argument because, by 1968, a good deal of the distribution sector for film in Japan was already single brand. The panel noted that the Sixth Interim Report was origin-neutral and listed advantages that would result from liberalization and discussed potential disadvantages of cooperation among firms in the distribution sector. The panel also found that the United States failed to point to a single instance where the Sixth

99. *Id.* ¶ 10.122.

100. *See id.* ¶ 10.125–10.126.

101. *Id.* ¶ 10.129.

Interim Report upset the competitive relationship between foreign and domestic firms.¹⁰²

(d) *1969 Seventh Interim Report on Systemization of Distribution Activities*

The Seventh Interim Report of the MITI Industrial Structure Council Distribution Committee, entitled "Systemization of Distribution Activities," proposed the following four ideas to "systematize" the distribution system: "(i) establishing a Distribution Systemization Council; (ii) presenting guide posts and promoting standardization; (iii) establishing a system for providing distribution-related information; and (iv) providing incentives in areas such as financing and taxation."¹⁰³ The Seventh Interim Report was issued in July 1969.¹⁰⁴

The United States argued that the Seventh Interim Report was one of the "key foundation stones" of Japan's alleged plan to "systematize" the distribution sector in order to make it resistant to foreign involvement. The United States argued that the purpose of the Seventh Interim Report was to direct stronger vertical and horizontal ties within Japanese industry to exclude foreigners.¹⁰⁵ Japan provided the familiar refrain that the Seventh Interim Report would facilitate the modernization of the backward distribution system so that Japanese firms could compete with foreign firms.¹⁰⁶

The panel ruled that the Seventh Interim Report was not a measure, that it did not relate to benefits accruing under GATT/WTO, and that the United States failed to show nullification or impairment, for reasons similar to those provided concerning the Sixth Interim Report.¹⁰⁷

(e) *1969 Survey on Transaction Terms*

In 1968, MITI asked the Institute for Distribution Research, an "apparently private organization," to survey transaction terms in several industries, including the film industry.¹⁰⁸ The purpose of the

102. See *id.* ¶ 10.130.

103. *Id.* ¶ 10.133.

104. See *id.*

105. *Id.* ¶ 10.134.

106. See *id.* ¶¶ 10.134–10.135.

107. See *id.* ¶¶ 10.136–10.145.

108. *Id.* ¶ 10.146.

survey included the dissemination of “rational trade practices.”¹⁰⁹ In March 1969, the Institute submitted its survey report on the film industry.¹¹⁰ MITI thereafter published drafts and republications of this 1969 Survey Report. The 1969 Survey Report examined the terms and conditions of contracts, including terms dealing with discounts and rebates, delivery, returns, settlement of accounts, and promotional practices.¹¹¹ The Report included the following findings:

[T]here is a view and an impression that the industry of general use photographic film, based on an oligopoly of two domestic manufacturers [Fuji and Konica], is superficially in a stable and normal state in which contract formation and documentation of transactions are progressing. Consider, however, one postulate:

- (1) If the oligopoly of the two domestic manufacturers is broken up by a foreign company; and
- (2) If a new [distribution] route emerges to compete against the route of photographic material dealers, which is the core existing route in the distribution market.

There may be very few observers who have a sense of crisis regarding (1) and (2) as realistic issues; however, they should now be considered as the most concrete and realistic problems.¹¹²

The 1969 Survey Report recommended the following:

Given this situation, it is necessary to formulate measures before hand in order to minimize the anticipated disorder in the distribution market. This is why it is significant to rationalize and standardize transaction terms and to create an [established] order of distribution.¹¹³

The panel concluded that the 1969 Survey Report was not a measure for reasons similar to those provided for reaching the same conclusion about the Sixth Interim Report. The panel found that it was “in the

109. *Id.* ¶ 2.16.

110. *See id.* ¶ 2.16 & n.29.

111. *See id.* ¶ 10.146.

112. *Id.* ¶ 2.16.

113. *Id.*

nature of a factual survey conducted by an apparently private organization at the request of the Government” and that, “[w]hile it is true that the report contains a few introductory pages (and concluding paragraphs) on the subject of what are irrational contract terms, the vast bulk of the 1969 Survey Report simply provides a description of existing practices.”¹¹⁴ The panel found the 1969 Survey Report to be a “background report providing current factual information of the basis on which the government might later decide to act.”¹¹⁵

The panel concluded that the 1969 Survey Report did not upset any legitimate expectations by the United States of a benefit accruing under GATT/WTO, for reasons similar to the reasons provided for the Sixth Interim Report, discussed above.¹¹⁶ The panel ruled that the United States failed to prove any nullification or impairment. The panel found that neither party to the dispute “submitted any evidence or argument regarding the impact of the 1969 Survey Report on U.S. market-access expectations . . . beyond the type of arguments made in relation to the Sixth and Seventh Interim Reports.”¹¹⁷

(f) 1970 Guidelines for Rationalizing Terms of Trade for Photographic Film

MITI established a Transaction Terms Standardization Committee to examine the issue of standardization of contract terms in industry. It focused on industry generally rather than solely on the film industry.¹¹⁸ In 1970, the Committee published “Guidelines for Rationalizing Terms of Trade for Photographic Film.”¹¹⁹ The United States argued that the 1970 Guidelines promoted vertical integration through terms and conditions in transactions within the film distribution sector, and that this vertical integration was designed to make wholesalers more dependent on Japanese manufacturers. Japan countered that it issued essentially the same guidelines to fifteen different industries in 1970.¹²⁰ The panel reiterated that “MITI has been consistently concerned with rationalization of trading terms in the distribution sector since the 1960s. What had hitherto existed, Japan maintains, were irrational

114. *Id.* ¶ 10.148.

115. *Id.*

116. *See id.* ¶ 10.155.

117. *Id.* ¶ 10.154.

118. *See id.* ¶ 2.17.

119. *See id.*

120. *See id.* ¶ 10.158.

business practices that were economically inefficient.”¹²¹ Japan also argued that single brand distribution was the norm prior to the issuance of the guidelines and is common world wide.¹²²

The panel ruled that the 1970 Guidelines constituted a measure under Article XXIII:1(b). In the publication of the 1970 Guidelines, MITI said “that it intends to see to it that improvement of terms of trade will be implemented in accordance with this guideline” and that “we expect that the parties involved in transactions understand the need for trade rationalization, and will make voluntary efforts to achieve this purpose.”¹²³ MITI also asked industry associations to formulate more specific trade terms based on the 1970 Guidelines, and, shortly after the publication of the 1970 Guidelines, the wholesalers’ association for film and photographic paper published a “Transaction Outline” to implement its own guidelines that were promulgated in response to the 1970 Guidelines and reported these activities back to MITI. Subsequently, MITI and industry together published a “Model Contract” for the film industry. The panel concluded that “there is sufficient likelihood that the administrative guidance given by MITI in the 1970 Guidelines provides sufficient incentives for private parties to act in a particular manner such that it would have a similar effect on business activity in Japan as a legally binding measure.”¹²⁴ The panel concluded that the 1970 Guidelines “may still be in effect” because the Japanese government had not expressly revoked them, although it issued new guidelines in 1990.¹²⁵

As for benefits accruing under GATT/WTO, based on the standards set forth above, the panel found that the United States could have a legitimate expectation with respect only to the Kennedy Round and not for the Tokyo and Uruguay Rounds.¹²⁶

The panel found no nullification and impairment of GATT/WTO benefits. According to the panel, the United States argued the following:

The standardization of transaction terms chilled the ability of foreign manufacturers to offer competitive terms to Japanese wholesalers: first, by setting uniform transaction terms, limiting

121. *Id.*

122. *See id.*

123. *Id.* ¶ 10.160.

124. *Id.* ¶ 10.161.

125. *Id.* ¶ 10.163.

126. *See id.* ¶ 10.164.

the ability of foreign enterprises to outbid their Japanese competitors; second, by establishing shortened payment terms that enhanced the financial strength of Japanese manufacturers at the expense of wholesalers, and positioned domestic manufacturers to better withstand foreign penetration; and third, by establishing standardized terms, in particular volume rebates, that were by their very nature more beneficial to Japanese manufacturers with large market share.¹²⁷

Japan responded that the 1970 Guidelines did not require uniform transaction terms or identify specific transaction terms to be followed. Rather, the 1970 Guidelines simply suggested the adoption of "rational" transaction terms. According to Japan, it was up to industry participants to come up with their own terms. Japan argued that, in fact, the terms of the transactions of the manufacturers did vary, and that single-brand distribution is the common form of distribution in the film industry world-wide, including in the United States.¹²⁸

The panel found the following with respect to causation:

In considering the purpose of the guidelines, we note that the introduction to the 1970 Guidelines states:

It goes without saying that rationalization of terms of trade is essential to improving market conditions, assuring effective competition, creating efficient distribution activities, developing a large scale distribution system, systematizing distribution activities, and facilitating the response to foreign capital.

However, beyond this general introductory reference to facilitating the response to foreign capital, the recommendations set out in the 1970 Guidelines appear to be origin neutral, i.e., they do not formally differentiate as to the treatment of domestic and imported film and paper. We are not persuaded, therefore, that the 1970 Guidelines are directed at promoting vertical integration in the photographic materials distribution sector with a view to impeding market access for foreign products. Rather, as argued by Japan, they appear to be directed at generally improving transaction efficiency in this sector, a result that is not inherently unfavorable to imports. As noted above, the 1967 Cabinet Decision, the Sixth Interim Report, the

127. *Id.* ¶ 10.167.

128. *See id.* ¶ 10.169.

Seventh Interim Report and the 1969 Survey Report provide context for the interpretation of the 1970 Guidelines. Our examination of those documents supports our view of the 1970 Guidelines. While the documents occasionally make reference to the imminent entry of foreign capital into Japan, in our reading of them, their main focus is clearly on improving the various inefficiencies and deficiencies in Japan's distribution system, as a means to address broader problems, such as the need to cope with inflationary pressures and labor shortages.¹²⁹

The panel did not rule out discrimination, even in measures that appear neutral on their face, but found that the United States did not provide a single instance of discrimination based on the 1970 Guidelines.¹³⁰

The panel also found serious timing problems in the U.S. argument. Most of film wholesale activities were single-brand before 1970. Furthermore, Fuji started to tighten payment terms in 1966, prior to the issuance of the Guidelines. The panel also noted

that single-brand wholesale distribution is the common market structure—indeed the norm—in most major national film markets, including the U.S. market. While the United States responds that the U.S. market structure was the result of private and not governmental actions, it is unclear why the same economic forces acting in the United States would not also exist in Japan.¹³¹

(g) *1971 Basic Plan of the Distribution Systemization Promotion Council*

On July 28, 1971, the Japanese government published the Basic Plan for the Systemization of Distribution (hereinafter 1971 Basic Plan).¹³² MITI's Distribution Systemization Promotion Council, which was formed in 1970 on the basis of a recommendation contained in the Seventh Interim Report, prepared the 1971 Basic Plan. The 1971 Basic Plan promoted the "systematization and rationalization" of the distribution sector. It was not limited to film and photographic paper.¹³³

129. *Id.* ¶ 10.171.

130. *See id.* ¶ 10.172.

131. *Id.* ¶ 10.173.

132. *See id.* ¶ 5.103 & n.173.

133. *See id.* ¶¶ 10.176–10.182.

The panel ruled that the 1971 Basic Plan was a measure under Article XXIII:1(b). The panel said:

Although the 1971 Basic Plan was authored and published by a quasi-governmental advisory body composed of academics, industry representatives and government officials, it nonetheless bears some hallmarks of a governmental measure in that the Distribution Systemization Promotion Council was created by MITI and commissioned by MITI to prepare the plan. Moreover, as noted above, upon its publication senior MITI officials endorsed the plan and stated that MITI would work with the private sector to ensure implementation of the plan's recommendations. In light of these statements and actions by MITI, we consider that there is sufficient likelihood that the administrative guidance given by MITI in connection with the 1971 Basic Plan provides sufficient incentives for private parties to act in a particular manner such that it would have a similar effect on business activity in Japan to a legally binding measure.¹³⁴

The panel found no evidence of abandonment of the 1971 Basic Plan by the Japanese government, although one may question whether the 1971 Basic Plan has relevance to the current market twenty-six years after its publication.¹³⁵

The panel found a benefit accruing only under the Kennedy Round of the GATT, on grounds substantially similar as those set forth for the above measures.¹³⁶ The panel found no impairment or nullification of a GATT/WTO benefit under Article XXIII:1(b). The United States argued that the 1971 Basic Plan, along with the Seventh Interim Report, exemplified "Japan's intent to promote vertical *keiretsu* in its systemization policy."¹³⁷ The panel disagreed and found both that the 1971 Basic Plan was facially neutral and that the United States failed to carry its burden of proving that Japan applied the plan in a discriminatory fashion. Again, the timing problem plagued the U.S. case because single-brand distribution started well before 1971.¹³⁸

134. *Id.* ¶ 10.180.

135. *See id.* ¶ 10.187.

136. *See id.* ¶ 10.183.

137. *Id.* ¶ 10.185.

138. *See id.* ¶ 10.184.

(h) *1971 Japan Fair Trade Commission International Contract Notification Requirement*

Article 6 of Japan's Antimonopoly Law of 1947 provides:

(1) No entrepreneur shall enter into an international agreement or an international contract which contains such matters as constitute unreasonable restraint of trade or unfair trade practices.

(2) An entrepreneur who has entered into an international agreement or an international contract (limited to only such an agreement or contract that belongs to the types which are prescribed by the rules of the [JFTC] as tending to contain such matters as constitute unreasonable restraint of trade or unfair trade practices) shall, in accordance with the Rules of the [JFTC], file a notification thereof with the [JFTC], accompanied by a copy of the said agreement or contract (in the case of an oral agreement or contract, a document describing the contents thereof), within thirty days as from the conclusion of such agreement or contract.¹³⁹

The JFTC promulgated Rule 1 to implement the above Article 6.2. Japan contended that the Diet repealed the international contract notification requirement in June 1997 by amending Article 6(2) of the Antimonopoly Law and abolishing Rule 1.¹⁴⁰

The panel did not consider the merits of the U.S. arguments on Rule 1 because the U.S. panel request had not identified it. The panel request referred to the Antimonopoly Law in connection with other measures and, therefore, did not put Japan on notice that Rule 1 would be under consideration.¹⁴¹

(i) *1975 Manual for Systemization of Distribution by Industry: Camera and Film*

In March 1975, the Distribution Systematization Center published the "Manual for Systemization of Distribution by Industry: Camera and Film," accompanied by actions taken to implement the recommendations. In accordance with the 1971 Basic Plan, the Distribution Systemization Development Center was formed in 1972 and had support from

139. *Id.* ¶ 2.32.

140. *See id.* ¶ 2.33.

141. *See id.* ¶¶ 10.8–10.21.

MITI. Its purpose was to facilitate the work of the Distribution Systemization Promotion Council, and it was assigned to work with industry to produce industry-specific "Systemization Manuals." The 1975 Manual was prepared by the Center in collaboration with industry and with a MITI official in observer status.¹⁴²

The panel found that the 1975 Manual was not the application of a measure under Article XXIII:1(b). The panel found the evidence "somewhat conflicting," but "[o]n balance, in contrast to our conclusions on this issue in respect of the 1970 Guidelines and the 1971 Basic Plan, we consider that the evidence on this issue suggests that the 1975 Manual does not have sufficient government imprimatur to be considered a governmental measure in this case."¹⁴³

As for the issue of whether it nullified a benefit under the GATT, the panel ruled in the negative. As for the prior alleged measures, given the timing of the 1975 Manual, it could be a measure only with respect to the Kennedy Round.¹⁴⁴

The panel found no causation. The 1975 Manual stated as an "urgent need" the improvement of the "structure" of Japanese manufacturers "to a capacity that will resist foreign capital affiliated firms."¹⁴⁵ The panel concluded, however, that its

assessment of the impact of this 1975 Manual is similar to that of the 1971 Basic Plan: the policy recommendations for systemization and modernization in the Japanese distribution sector are without regard to the source of the products involved. Also, even if one of the concerns expressed in the manual was to address 'foreign capital affiliated firms,' this concern does not appear to be reflected in the actual analysis or recommendations advanced in the manual [and] the United States has not been able to point to any specific instances where such systemization of the distribution sector in the Japanese film industry has undermined market-access conditions for U.S. film or paper."¹⁴⁶

Moreover, timing problems continued to plague the U.S. case in that Fuji and Konica had nearly finished single-brand vertical integration of their wholesalers well before the publication of the 1975 Manual.¹⁴⁷

142. *See id.* ¶ 10.190.

143. *Id.* ¶ 10.194.

144. *See id.* ¶ 10.197.

145. *Id.* ¶ 10.199.

146. *Id.* ¶ 10.200.

147. *See id.* ¶ 10.201.

(j) *1976 Japan Development Bank Financing to Konica for Joint Distribution Facilities*

The Japan Development Bank, a “quasi-governmental financial institution,” provided funding in the form of subsidies to Konica so that Konica could establish joint distribution facilities with independent wholesalers.¹⁴⁸ The panel did not consider the merits of U.S. claims with respect to such subsidies. The United States argued that Japan had adequate notice of the potential for the Konica subsidies to be raised because the subsidies related to the 1971 Basic Plan, which the United States raised in its panel request as well as in consultations. The 1971 Basic Plan refers to “positive support and guidance from the government.” The panel concluded that there was an insufficient relationship between the 1971 Basic Plan and the Konica subsidization and that the statement from the 1971 Basic Plan by the United States was too vague and general to provide adequate notice to Japan that the Konica subsidies could be raised in the proceeding.¹⁴⁹

(k) *1967–77 Small and Medium-Sized Enterprises Act Financing*

The Small and Medium-Sized Enterprise Agency (SMEA) is part of MITI.¹⁵⁰ The United States made some relatively minor arguments that SMEA provided subsidies to various companies in the film and photographic paper industry. The United States used the same arguments for inclusion of assertions concerning SMEA financing in the proceeding as they did for the Konica financing, set forth above. The panel findings for refusal to consider the merits of the issues on SMEA financing were the same as for the Konica financing. The panel rejected discussion of SMEA financing on procedural grounds, finding inadequate notice to Japan.¹⁵¹

b. *Restrictions on Large Retail Stores: Japan’s 1974 Large Stores Law as Amended*

The Japanese Diet passed a Large Stores Law on October 1, 1973. By its terms, it became effective on March 1, 1974. The law set forth a mixture of notification and regulatory requirements that stores proposed in excess of a certain size were required to follow. The original

148. *Id.* ¶ 2.30.

149. *See id.* ¶ 10.18.

150. *See id.* ¶ 2.30.

151. *See id.* ¶ 10.18.

law regulated stores in excess of 1500 square meters. A 1979 amendment lowered the threshold for application of the law to 500 square meters. The 1979 amendment also classified stores into two classes for regulation by different government entities. Class I stores, which were 1500 square meters and larger, were regulated by MITI; and Class II stores, which were between 500 and 1500 square meters, were regulated at the local level. The size for Class I stores was subsequently raised twice.¹⁵²

The law required advance notification of the building or opening of a store. The relevant government authority could recommend a reduction in size of the store, a delay in its opening and dictate opening times and store holidays.¹⁵³

The purpose of the law, according to Japan in the WTO proceeding, was to preserve diversity and a balance of various sizes of retail outlets in the same area.¹⁵⁴ The United States argued that the law imposed burdensome regulatory requirements that restricted the growth of alternative distribution channels for imported film. The panel explained the U.S. position as follows:

The United States claims that large retail stores remain one potentially significant alternative distribution channel in Japan for foreign film manufacturers despite the Japanese Government's alleged reorganization of wholesale operations in the photographic materials sector. According to the United States, large retailers offered foreign manufacturers, foreclosed from the primary distribution network, a partial alternative to wholesalers. The United States also argues that large stores have carried imported products, including film, more frequently than small stores and have been less susceptible to pressure by domestic manufacturers. If such stores were permitted to proliferate across Japan, the United States argues, wholesalers would become less significant and foreign manufacturers could circumvent the bottle-necked distribution system. It was in response to this threat, the United States submits, that in 1967 and 1968 Japan began to impose controls on the expansion of large stores and finally enacted the Large Stores Law in 1973.¹⁵⁵

152. *See id.* ¶ 10.210.

153. *See id.* ¶ 10.211.

154. *See id.* ¶ 10.213.

155. *Id.* ¶ 10.212.

Both parties agreed that the Large Store Law is a measure.¹⁵⁶

The panel refused to find, however, that the United States could claim a benefit under GATT/WTO with respect to any round of negotiations other than the Kennedy Round, which applies only to black and white film. Japan argued that the United States could not even argue that it could not have anticipated the law prior to the 1967 Kennedy Round. Japan based its argument on the existence of the predecessor law of the Large Stores Law, the Department Store Law, which was promulgated in 1956. Japan alleged that the Large Stores Law simply extended the policy of the prior law to new types of stores, such as supermarkets and large discount stores, and was enacted to stop stores from circumventing long-standing policy. Moreover, according to Japan, the Large Stores Law was less stringent than the prior Department Store Law. The prior law required permission to open a store; the successor law only required notification. Other aspects of the successor law were less restrictive than the predecessor law. Japan argued that "even if one accepts, for argument's sake, that restrictions on large stores are unfavorable to imported products, there is nothing unfavorable to imports that the United States could not have anticipated at the time of the Kennedy Round tariff concessions."¹⁵⁷

The panel concluded, however, that because the Large Stores Law was introduced prior to the conclusion of the Kennedy Round in 1967, Japan had the burden of proving that the United States could have anticipated the passage of the Large Stores Law in 1979. The panel ruled that

a broad notion of reasonable anticipation, as espoused by Japan, could have the effect of depriving this element of a non-violation case of its meaning. In our view, it is not sufficient to claim that a *specific* measure should have been anticipated because it is a continuation of a past *general* government policy.¹⁵⁸

The panel thus ruled that the United States could not have reasonably anticipated the Large Stores Law and its subsequent amendments as of the conclusion of the Kennedy Round. As for the Tokyo Round, the United States conceded its awareness of the law, but argued that it could not have known or appreciated its significance, particularly in

156. *See id.* ¶ 10.214.

157. *Id.* ¶ 10.216.

158. *Id.* ¶ 10.217.

combination with other countermeasures. The panel disagreed and found that the United States should have anticipated both the law and its 1979 amendment, based on the timing of the legislative processes, the Tokyo Round, and bilateral negotiations between the United States and Japan. As for the Uruguay Round, the United States had a particularly weak argument because the law was the subject of the U.S. government report "National Trade Estimate Report on Foreign Trade Barriers" and bilateral discussions and joint reports between the parties.¹⁵⁹

Finally, the panel found no nullification or impairment. The panel summarized the U.S. argument on causation as follows:

The United States contends that the suppression of large stores under the Large Stores Law affects the distribution of foreign film in Japan in two respects. First, restricting large stores indirectly supports manufacturer domination of oligopolistic distribution structures. This structure depends on manufacturer dominance of wholesalers, and wholesaler dominance over retailers. Retailers with greater purchasing power and business sophistication could effectively play the various wholesalers and manufacturers off of each other to gain more favorable terms, and to resist attempts to hold the retailers under the control of a single manufacturer-wholesaler chain. Second, large stores provide an alternative channel to market film for foreign manufacturers excluded from the wholesale distribution system. With a sufficiently developed network of large stores, a manufacturer could reach a large portion of the Japanese market with a limited number of accounts. Consequently, the United States claims that Japan upset the competitive relationship between imported and domestic photographic film and paper by inhibiting the development of a viable alternative channel for the distribution and sale of imported film and paper.¹⁶⁰

The panel examined two issues and found no nullification or impairment. First, it looked at the relationship of large stores and imported film and photographic paper. The panel found that the law was "clearly neutral as to products and the origin of products."¹⁶¹ The panel also

159. *See id.* ¶ 10.220.

160. *Id.* ¶ 10.222.

161. *Id.* ¶ 10.225.

found a lack of any evidence of a discriminatory implementation of the law. According to the panel, the real

motivating force behind opposition to the expansion of large stores in Japan, and in many other countries as well, is from small- and medium-sized stores concerned with the impact that such stores may have on them, and not because of a desire to hinder imports of foreign film and paper.¹⁶²

As for the issue of discriminatory application of a facially neutral measure, the panel found conflicting evidence. The United States presented survey data showing that large stores are likely to carry imported film. Japan countered that the issue was whether or not a store carries a high volume of film, not the size of the store. The United States, however, contended that size controlled for this situation. The panel said:

It seems to us that even if there is a greater tendency for large stores to carry imported film, access to large stores is less important for film than for other imported products since film takes up very little shelf space even taking account that a full display of all film types is comprised of many rolls of film. This would seem to be confirmed by the Japanese evidence that high-volume sellers of film, whether large or small stores, are more likely to carry imported film. However, on balance we are left with conflicting evidence and no sure way to resolve the conflict.¹⁶³

The panel concluded that it was not necessary to resolve this issue, in light of its findings that the regulation of large retail stores had lessened over the years and that the trend was towards less regulation, with the result that the law was now more favorable to large stores than it was during the three rounds of multilateral negotiations.¹⁶⁴

The panel noted the United States argument with "unease,"¹⁶⁵ finding it similar to the unsuccessful argument in Case C-145/88, *Torfaen Borough Council v. B&Q PLC*,¹⁶⁶ that Sunday closing laws in the

162. *Id.*

163. *Id.* ¶ 10.226.

164. *See id.* ¶ 10.228.

165. *Id.* ¶ 10.227.

166. Case C-145/88, *Torfaen Borough Council v. B & Q PLC*, 10 E.C.R. 3851 (1989).

European Community were discriminatory and violated the EC Treaty. In that case, it was argued unsuccessfully that, because home improvement stores sell imported products and sell more products on Sunday, limitations on Sunday trading amount to import restrictions.¹⁶⁷

Finally, the panel noted that there were more large stores in Japan today than in 1982, the first year in which data was compiled. If the position of the United States was correct concerning the import friendliness of large stores, then U.S. products should have been in a better position. The U.S. argument seemed to imply that the market for imported film would be even better had the Japanese government not restricted large store growth. The panel explained:

In these circumstances, the argument would seem to be that the situation would be even better if Japan had not interfered with this favorable market evolution by slowing it. This raises the question of whether the United States can claim legitimate expectations related to expected market evolution, as opposed to expectations that the market situation at the time of a tariff concession will not be upset, e.g., by a grant of subsidies or implementation of measures that change existing competitive relationships or by restricting the use of previously permitted sales techniques. Normally, for competitive relationships to be upset, we would expect an adverse change in the situation existing at the time of the tariff concessions. In the case of subsidies, for example, a Member reasonably expects that subsidies will not be increased, not that they will be decreased. To the extent that the United States claim is viewed as being based on expectations about market evolution, the question becomes to what extent it must establish it had reasons to expect in 1967 (or 1979 or 1993) that there would be a relative expansion of the large-store segment of Japan's economy, taking into account the existing regulation under the Department Stores Law or Large Stores Law. Even assuming that such expectations would be protected by Article XXIII:1(b), the United States has not established that it had any such expectation in 1967, 1979 or 1993.¹⁶⁸

167. See *Japan—Film Panel Report*, *supra* note 5, ¶ 10.227.

168. *Id.* ¶ 10.232.

c. *Promotion Countermeasures*(i) *The Claim in Context*

The United States argued that the following eight promotion countermeasures nullified or impaired imports by restricting sales promotions by foreign firms in Japan:

- (1) 1967 Cabinet Decision on Liberalization of Inward Direct Investment;
- (2) 1967 JFTC Notification 17 on premiums to businesses;
- (3) 1977 JFTC Notification 5 on premium offers to consumers;
- (4) 1981 JFTC Guidance on Dispatched Employees;
- (5) 1982 Self-Regulating Rules Concerning Fairness In Trade With Business;
- (6) 1982 Establishment of Fair Trade Promotion Council;
- (7) 1982 Self-Regulating Standards Concerning Display of Processing Fees; and
- (8) 1987 JFTC approval of the Retailers Fair Competition Code and the Retailers Fair Trade Council.¹⁶⁹

The United States argued that these promotion countermeasures reinforced the distribution countermeasures. Essentially, the United States argued that Japanese promotion countermeasures restricted the ability of new market entrants to use their capitalization and competitiveness in combination with innovative marketing programs in order to capture market share in Japan. The United States argued that Japan used these promotion countermeasures to nullify or impair trade liberalization benefits that Japan agreed to in GATT/WTO negotiating rounds. Japan responded that the measures were typical consumer protection laws that encouraged firms to compete on the basis of price and quality and not on the basis of inducements or deceptive advertising. The promotion countermeasures were facially neutral because they applied to domestic and foreign firms alike.

As set forth below, the panel ruled in Japan's favor and found no nullification or impairment of GATT/WTO obligations.

169. *Id.* ¶ 10.234.

(ii) *The Specific Countermeasures*

(a) *The 1967 Cabinet Decision*

The United States argued that the 1967 Cabinet Decision was a promotion countermeasure as well as a distribution countermeasure. In June 1967, the Foreign Investment Council (FIC) Expert Committee, an advisory committee of the Japan Ministry of Finance, produced a report that the Japanese government had requested. The Report stated the following concerning the regulation of foreign capital:

(1) When foreign capital is brought into Japan, it is possible for a parent company to use vast amounts of capital to engage in dumping, offer premiums, and conduct large-scale publicity and advertising, etc. In the future, as liberalization of direct investment in the domestic market progresses, such risk may conceivably be reinforced. Therefore, in such a situation, it is necessary to fully study whether these actions qualify as unfair trade practices as defined in Article 2 of the Antimonopoly Law and can be regulated pursuant to provisions under Article 19 of the said Antimonopoly Law or the Law Against Unjustifiable Premiums and Misleading Representations.

(2) For the application of the Antimonopoly Law, while one may not specifically select foreign capital affiliated firms for differential treatment, foreign capital affiliated firms nevertheless have the strong capital and technological background of the parent company and are usually in an economically strong position. Consequently, it is believed that they will often become the object of regulation of the Antimonopoly Law. On this point, we must be able to apply standards to deal with any disorderly activities by foreign capital because existing standards of regulation of unfair trade practices are not necessarily clear and we may, for example, clarify them by making use of a special designation or some other method.¹⁷⁰

Concerning the use of “fair” competition codes, the report stated that, “[f]or the provision of large-scale premiums, it is believed that establishing fair competition codes pursuant to the [Premiums Law] with assistance from the industry that might be affected, would be an

170. *Id.* ¶ 10.240.

effective countermeasure.”¹⁷¹ The United States argued that the Japanese government adopted the recommendations of the Expert Committee to the effect that the Premiums Law should be the basis of premium countermeasures in the nature of fair competition codes. Article 10 of the Premium Law provides for the establishment of such codes by industry.¹⁷²

The panel found that the 1967 Cabinet Decision was a measure in the context of U.S. arguments about promotion countermeasures for the same reasons that it found it to be a measure in the context of U.S. arguments about distribution countermeasures.¹⁷³ Moreover, for reasons similar to those set forth when the 1967 Cabinet Decision was considered in the context of the U.S. argument that it was a distribution countermeasure, the panel found that the United States could claim legitimate expectations of a benefit accruing under GATT only for the Kennedy Round.¹⁷⁴

Again, the panel found no impairment or nullification to be caused by the 1967 Cabinet Decision, for reasons substantially similar to the reasons cited in its examination of the 1967 Cabinet Decision as a distribution countermeasure. The 1967 Cabinet Decision set forth “very general policy statements,” and the United States failed to identify specific actions from the 1967 Cabinet Decision that discriminated against imports. The panel said that “[a]t most, in our view, the 1967 Cabinet Decision is part of the context for later actions taken by Japan.”¹⁷⁵

(b) *1967 JFTC Notification 17 on Premiums to Business*

The United States alleged that JFTC Notification 17 was a promotion countermeasure as well as a distribution countermeasure. The panel, however, found that Notification 17 was not a measure after 1996 for the same reasons that it cited in considering Notification 17 as a potential distribution countermeasure.¹⁷⁶ The panel found that Notification 17 did not impair any benefit accruing under GATT. The publication of Notification 17 by the Japanese government occurred prior in time to the conclusion of the Kennedy Round. The United States, moreover, failed to demonstrate any situation in which it could

171. *Id.*

172. *See id.* ¶ 10.242.

173. *See id.* ¶ 10.244.

174. *See id.* ¶ 10.247.

175. *Id.* ¶ 10.250.

176. *See id.* ¶ 10.256.

not have known of the effect of Notification 17 until some time after its publication. The panel noted that

[t]his is particularly true given that, as of 1967, the current structure of the Japanese film market was largely in place, i.e., there were only a few primary film wholesalers and single-brand distribution of film was typical, it would seem that the United States should have been able to assess the impact of this measure, if any, on the Japanese market for film at the time it was introduced.¹⁷⁷

The panel also found no impairment or nullification for reasons substantially similar to those that caused it to find no impairment or nullification when it considered Notification 17 as a potential distribution countermeasure.¹⁷⁸

(c) 1971 JFTC Notification No. 34 on Open Lotteries

On procedural grounds, the panel excluded from consideration Notification 34 on Unfair Trade Practices Offering Economic Benefits by Means of Advertising Lotteries, etc., promulgated by the JFTC on July 2, 1971. Notification 34 declared that lotteries held by sellers of film and other products that offered “excessive economic benefits” were unfair and unlawful. Guidelines promulgated by the JFTC set yen limitations on what was an excessive economic benefit.¹⁷⁹ The United States argued that Notification 34 restricted the ability of importing firms to introduce and market their products.¹⁸⁰

The panel excluded Notification 34 from consideration because the U.S. panel request failed to identify it as a measure and because it was not adequately related to other alleged measures identified in the request. Japan, therefore, would not have adequate notice. Notification 34 was promulgated pursuant to Article 2(7) of the Japanese Antimonopoly Law, which the United States did not identify as a measure in their panel request. According to the panel, the identification of other articles of the Antimonopoly Law in the panel request was insufficient to charge Japan with notice because the law was broad and covered a multitude of issues unrelated to lotteries.¹⁸¹

177. *Id.* ¶ 10.258.

178. *See id.* ¶ 10.263.

179. *See id.* ¶ 10.234.

180. *See id.* ¶¶ 5.476–5.477.

181. *See id.* ¶ 10.16.

(d) 1977 JFTC Notification 5 on Premiums to Consumers

On March 1, 1977, the JFTC issued Notification 5 on "Restriction on Premium Offers to Consumers." Notification 5 provided in pertinent part:

The value of a premium offered to general consumers, excluding those by lotteries or prize competition, shall be within 10 percent of the transaction value involved in the premium offer (provided that if the amount is less than 100 yen, the limit shall be 100 yen), and which is found reasonable in the light of normal business practices.¹⁸²

The United States argued that Notification 5 unduly restricts the offering of premiums on photographic film and paper to consumers, particularly given the low price of film and paper. Premiums would have to be a token amount to remain lawful under Notification 5.¹⁸³

The panel found that Notification 5 was a measure still in effect.¹⁸⁴ The panel also found, however, that Notification 5 related to a benefit accruing under the GATT only with respect to the Kennedy Round, if at all.¹⁸⁵

Finally, the panel found no nullification or impairment. Notification 5, on its face, does not discriminate against foreign products or firms. Notification 5 appears to limit only one form of promotional activity—the value of premiums offered by manufacturers as a percentage of the value of the purchase. The panel found it "significant" that Notification 5 and other measures alleged by the United States "[did] not limit general advertising expenditures or price competition in general."¹⁸⁶

The United States argued that it was essential that foreign firms have the ability to offer premiums directly to customers because Japanese wholesalers and retailers refuse to pass discounts on to customers. The panel found this to be a weak argument, based on one example of Kodak's advertising, which increased market share during the Nagano Olympic Games. The panel accepted Japan's argument that the ability to give premiums is not essential to succeeding in the Japanese retail market for film. The United States, moreover, did not argue that the Japanese government was involved in any cartel-like behavior to refuse

182. *Id.* ¶ 10.265.

183. *See id.* ¶ 10.266.

184. *See id.* ¶ 10.267.

185. *See id.* ¶¶ 10.270–10.271.

186. *Id.* ¶ 10.275.

to pass on price reductions to consumers. The United States also failed, according to the panel, to identify instances in which Notification 5 was applied in a discriminatory fashion.¹⁸⁷

(e) *1981 JFTC Guidance on Dispatched Employees*

The Distribution Sector Office is part of the JFTC. It was established in October 1979 with the approval of the Japanese Cabinet. Its purpose is to “administer duties pertaining to unfair trade practice designations related to distribution.”¹⁸⁸ In December 1981, this Office made findings and recommendations to “camera, photographic materials, color photo laboratories and related industries” in an article entitled “The Status of Distribution of Cameras.” In this article, the Office advised the industry to deal with “problems” that resulted from the dispatching of employees by manufacturers to large retail stores. The article stated:

The JFTC is issuing guidance to the camera, photographic accessories, color photo lab and related industries to examine the use of self-regulating measures with respect to the permanent dispatch of sales people so as not to go too far as manufacturers’ sales promotion methods or as acts based on the buying power of volume sales stores.¹⁸⁹

The United States asserted that the dispatch of manufacturers’ employees to retailers and wholesalers constituted a “unique form of economic inducement” that “reduce costs for wholesalers and retailers and thereby allow for increased sales based upon cost or price reductions passed down the line of distribution.”¹⁹⁰ Japan replied that the photographic industry worked on self-regulating measures even before the JFTC published the above article.¹⁹¹

The panel found that the article constituted a measure. It was classic Japanese administrative guidance. The panel explained:

[T]he relevant statement of the JFTC official makes explicit reference to “guidance” and advises the photographic materials industry (or a substantial part of it) “to examine the use of

187. See *id.* ¶ 10.277.

188. *Id.* ¶ 10.279.

189. *Id.*

190. *Id.* ¶ 10.280.

191. See *id.* ¶ 10.291.

self-regulating measures with respect to the permanent dispatch of sales people". Given this explicit statement of guidance to the photographic materials industry from the government body charged with implementation of the Antimonopoly Law and the Premiums Law, we think it reasonable to assume, in the absence of substantial argument to the contrary, that this JFTC Guidance on Dispatched Employees meets the standard for governmental measures that we laid out in our general discussion of Article XXIII:1 (b). This result is supported by the fact that the guidance was acted upon.¹⁹²

The guidance led to the Self-Regulating Measures discussed in the succeeding section.¹⁹³

There was also no indication from Japan that the measure had been withdrawn. The panel found the measure to still be in effect, although its significance may have been minimal given the existence of the Self Regulating Measures.¹⁹⁴

The panel found that the 1981 Guidance could relate to benefits accruing under the Kennedy and Tokyo Rounds, given that it was promulgated subsequent to the conclusion of those rounds. The United States, however, failed to demonstrate any circumstance that would make it unaware of the guidance for the Uruguay Round, which concluded in 1994.¹⁹⁵

The panel found no nullification or impairment. First, it was unclear whether the guidance was directed at film and paper, because it refers only to "camera, photographic accessories, color photo lab and related industries." Second, the guidance applied to only one type of activity involving promotion. Third, the United States failed to demonstrate how the measure restricted the sale of imported film in Japan. Fourth, the measure was facially neutral and the United States presented no evidence of discriminatory application.¹⁹⁶

(f) 1982 Self-Regulating Rules Concerning Fairness in Trade with Business and 1982 Establishment of Fair Trade Promotion Council

The panel considered the U.S. arguments concerning "Self-Regulating Measures concerning Fairness in Trade with Business,"

192. *Id.* ¶ 10.282.

193. *See id.*

194. *See id.*

195. *See id.* ¶ 10.286.

196. *See id.* ¶¶ 10.288–10.290.

issued in June 1982, and the establishment of the Fair Trade Promotion Council on December 23, 1982 together because they were closely related. The Self-Regulating Measures regulated the dispatch of employees for sales promotion and other marketing activities and provided financial standards for promotions. The Fair Trade Promotion Council, established by the industry on December 23, 1982, policed the “fairness” of transactions in the photographic industry and implementation of the Self-Regulating Measures.¹⁹⁷

The panel found that the Self-Regulating Measures and the establishment of the Fair Trade Promotion Council were measures. Although the documentation on the Self-Regulating Measures and on the Fair Trade Promotion Council indicated that they were “largely the product of decisions by private industry associations,” there were several references in various laws and documents that indicate a “substantial connection” among the JFTC, the Self Regulating Measures, and the Fair Trade Promotion Council.¹⁹⁸

With respect to benefits accruing under the GATT/WTO, the panel applied its standard approach and looked at the dates of the negotiating rounds and the alleged measures to determine whether the alleged measures would relate to benefits accruing under the Kennedy and Tokyo Rounds but not under the Uruguay Rounds.¹⁹⁹

The panel found no nullification or impairment. The United States argued that the Fair Trade Promotion Council held a wide range of enforcement powers over competition for film. The United States provided an example, the Kodak VR Trial-Pack campaign, that it contended was seriously hindered by actions of the Council. The United States contended that the Council, at the request of the retailers association and with the prompting of the JFTC, determined that Kodak had engaged in misrepresentation in its advertisements, and the campaign was thus “cut back” and “muted.” In addition, the United States asserted that, in July 1996, the Council issued a “directive” to Kodak stating that the Council “decided in July 1995 to request [Kodak’s] co-operation in continuing to reduce dispatched employees” and that Kodak is to “immediately report the status of your company to this Council.”²⁰⁰

Japan replied that the actions of the Council, and the Self-Regulating Measures themselves, were private actions and did not involve the

197. *See id.* ¶ 10.295.

198. *Id.* ¶ 10.298.

199. *See id.* ¶¶ 10.302–10.303.

200. *Id.* ¶ 10.304.

Japanese government. Moreover, Japan argued that the dispatch of employees is not of major concern in the marketing of film or paper: for film, consumers decide which brand to buy on their own, and the consumers of paper are adequately informed professionals. Finally, Japan argued that Kodak's VR campaign had nothing to do with dispatch of employees and disagreed with the characterization of events by the United States concerning the sales campaign.²⁰¹

The panel agreed with Japan that the VR campaign had nothing to do with dispatch of employees or promotion money, the two key areas controlled by the Self-Regulating Measures. The panel also agreed that the dispatch of employees was a minor issue in the film and paper market. The panel disagreed with the Japanese characterization of the Self Regulating Measures and the operations of the Council and the retailers association as purely private actions. The panel explained:

The evidence advanced by the two parties shows that the action against the VR trial pack had its origins with Zenren, the photo retailers' association, putting pressure on Kodak's distributor (Nagase) to limit promotion, in particular its pricing discounts on this new type of film. Indeed, the evidence suggests that Zenren succeeded in persuading Kodak to reduce the scope and duration of this promotional discount scheme. In addition to this private initiative by Zenren, however, the evidence also suggests that JFTC officials, at the urging of the Fair Trade Promotion Council, issued guidance to Kodak concerning potential issues under the Antimonopoly Law in relation to operation of the VR campaign.²⁰²

The panel found, however, that "[i]t is not clear to us that compliance with most of these terms would seriously hinder the VR campaign."²⁰³ The panel concluded:

Considering all the evidence taken together, it appears that the pressure put on Kodak's subsidiary by Zenren was by far the major factor impacting the VR campaign. The pressure from Zenren has not been shown to have emanated in any way from the JFTC. Thus, we find that the United States has not come forward with a sufficient demonstration of how statements

201. *See id.* ¶ 10.305.

202. *Id.* ¶ 10.308.

203. *Id.*

made to Kodak representatives by JFTC and council officials in relation to the VR campaign could be said to have impaired competitive market-access conditions accruing to the United States. According to the evidence of record, it appears that Kodak did carry out a successful if somewhat abbreviated VR campaign.²⁰⁴

Finally, the panel found that the VR campaign was a “14 year-old incident” and was the only one proffered by the United States.²⁰⁵

(g) Self-Regulating Standards Concerning Display of Processing Fees for Color Negative Film

In May 1984, the Fair Trade Promotion Council promulgated “Self-Regulating Standards Concerning Display of Processing Fees for Color Negative Film.” The 1984 Self-Regulating Standards regulate representations to consumers of price and price information relating to film developing and printing of pictures.²⁰⁶ Japan argued that the 1984 Self-Regulating Standards were intended to protect consumers from misleading representations by firms who offer inexpensive printing charges but, in fact, charge customers expensive fees for developing pictures. The 1984 Self-Regulating Standards, according to Japan, addressed an asymmetric information problem.²⁰⁷ The United States argued the Fair Trade Promotion Council used the 1984 Self-Regulating Standards to impose and enforce a broad range of restrictions on price competition to the detriment of foreign firms in Japan.²⁰⁸

The panel ruled that the 1984 Self-Regulating Standards constituted a measure under Article XXIII:1 (b), noting that the Fair Trade Promotion Council “has elaborate links to the JFTC.”²⁰⁹ The panel found that the 1984 Self-Regulating Standards were based in part on instructions from the JFTC:

Even though the 1984 Self-Regulating Standards were apparently not formally approved by the JFTC, in view of these express references to the dependence of the Fair Trade Promo-

204. *Id.*

205. *Id.*

206. *See id.* ¶ 10.311.

207. *See id.* ¶ 10.312.

208. *See id.* ¶ 10.318.

209. *Id.* ¶ 10.314.

tion Council on liaison with the JFTC for the establishment of these standards, we consider that there is a sufficient likelihood that private parties will act in conformity with the 1984 Self-Regulating Standards to consider them administrative guidance attributable to the Japanese Government. Thus, the 1984 Self-Regulating Standards, as such, have sufficient connection to the Japanese Government to warrant a finding that they are a measure within the ambit of Article XXIII:1 (b).²¹⁰

Although the Standards stated that they were temporary until the establishment of a Fair Competition Code, the panel, due to the lack of evidence on withdrawal of the standards, assumed that the 1984 Self-Regulating Standards were still in effect.²¹¹

The panel ruled that the 1984 Self-Regulating Standards related to a benefit accruing only under the Tokyo Round. The 1984 Self-Regulating Standards applied only to color film; the Kennedy Round was thus irrelevant because it set forth tariff concessions only for black and white film. Further, the 1984 Self-Regulating Standards were promulgated prior to the conclusion of the Uruguay Round, and the United States presented no evidence, according to the panel, to indicate that it should not have known of the significance of the 1984 Self-Regulating Standards prior to the Uruguay Round.²¹²

Finally, the panel found that the 1984 Self-Regulating Standards caused no nullification or impairment. The panel stated that "[I]n essence, this measure appears directed at consumer protection, in particular, preventing misleading price representations in the film-processing industry."²¹³ The panel also found that the United States did not show how the 1984 Self-Regulating Standards, which are neutral on their face, were applied in a manner that discriminates against foreign firms.²¹⁴

(h) 1983 JFTC Guidance on Establishment of Rules on Loss-Leader Advertising and Dumping

The United States challenged what it contended was the JFTC's administrative guidance in recommending that industry promulgate rules on dumping and loss-leader advertising. The United States re-

210. *Id.*

211. *See id.*

212. *See id.* ¶ 10.317.

213. *Id.* ¶ 10.319.

214. *See id.*

ferred to an article in Zenren Tsuho in May 1983, quoting a speech by Yamada Akio, the Director of the Premiums and Representations Guidance Division of the JFTC. The United States alleged that Mr. Akio said:

In any case, it goes without saying that rule abiding sales practices and fair competition must be established. Fortunately, the photo industry has its "self-regulating standards for normalizing trade". Nevertheless, it is of critical importance to develop rules one by one against dumping and loss-leader advertising. With the regard to loss-leader advertising, if the photo industry will clarify what the problems are, how we should apply the law will become clear.²¹⁵

The panel excluded this guidance from consideration on procedural grounds. The United States identified the guidance in response to a question asked by the panel, subsequent to the United States' initial submission in the proceeding. Japan objected to consideration of the merits of the guidance. The panel ruled that the guidance, "which is difficult to comprehend in any event and is in part subject to a translation dispute, probably is not a measure" and is apparently unrelated to any measure alleged by the United States in its panel request.²¹⁶

(i) 1987 JFTC Approval of Retailers' Fair Competition Code and the Retailers Fair Trade Council

On March 31, 1987, the JFTC approved a Fair Competition Code and its enforcement body, the Retailers Council. The Fair Competition Code states that its purpose is "to protect the general consumers' appropriate product selection, prevent the unfair inducement of customers, and thereby to secure fair competition."²¹⁷ The Code contains rules on marketing representations made by retailers. The United States argued that the Fair Competition Code and its enforcement vehicle, the Retailers Council, operated in a manner that led to discriminatory treatment of foreign firms attempting to import film into the Japanese market.

The panel found that the Fair Competition Code and actions of the Retailers Council were measures of the Japanese government. The

215. *Id.* ¶ 2.47.

216. *Id.* ¶ 10.19.

217. *Id.* ¶ 10.321.

panel examined "the status these actions are given in the eyes of the Japanese Government and the photographic industry." Article 10(1) of the Premiums Law states that trade associations may obtain JFTC approval to establish fair competition codes. Article 10(3) states that the JFTC has supervisory powers over the codes and the councils. Article 10(5) states that the firms and trade associations operating under the codes are exempt from the Antimonopoly Law. According to the panel, these provisions made it "difficult to conclude" that the Retailers Council conducts "purely private actions of a private trade association" under the Fair Competition Code. The text of the Code itself, which references the role of the Premium Law and the JFTC, confirms this finding.²¹⁸

The panel found that the Fair Competition Code and the Retailers Council could impair benefits accruing under the Kennedy and Tokyo Rounds, because they did not predate those rounds, but could not do so for the Uruguay Round, because they did predate that round. The United States identified no extenuating circumstances for the Uruguay Round.²¹⁹

The panel found no nullification or impairment caused by the Fair Competition Code or the Retailers Council. In reaching this conclusion, the panel examined three issues. First, it was unclear whether the Code and Council covered film. The Code, by its terms, applied to the "camera category" according to the Japanese translation, and to "cameras and related products" according to the U.S. translation.²²⁰ Second, the panel analyzed whether the origin marking requirements discriminated against imports. The panel ruled:

[W]hile being sensitive to the possibility that a discriminatory country-of-origin designation requirement could result in impairment of competitive relationships, we initially note that GATT Article IX specifically allow[s] origin-marking requirements. Thus, we hesitate to condemn automatically the requirements in the code, although they go beyond marking. Moreover, we note that the code requires indications of origin in respect of certain domestic, as well as imported products, and that Japan has provided an explanation for treating domestic and imported products differently with respect to country-of-origin designations. More significantly, the United States has

218. *Id.* ¶ 10.327.

219. *See id.* ¶¶ 10.330–10.331.

220. *See id.* ¶ 10.333.

failed to demonstrate how such a designation requirement in the code has upset competitive relationships between domestic and imported film or paper.²²¹

Japan explained that the country of origin identification simply provided information to consumers.²²²

The third issue that the panel considered was whether Japan applied the Code in a discriminatory fashion to imported goods. The panel found that the United States failed to offer examples with a “clear connection” to the JFTC approval of the Code nor to the activities of the Council. The United States argued that the “overlapping enforcement mechanisms” of the JFTC, the Fair Trade Promotion Council, the Retailers Council, and other “fair trade councils” and trade associations, considered along with the myriad rules restricting promotions, have imposed a “chilling effect” on importers. The panel found that this argument was too general.²²³

d. *The Combined Effects Analysis*

The panel rejected the U.S. argument that all of the above alleged countermeasures in combination i.e., as a whole resulted in a violation of Article XXIII:1(b). The panel summarized Japan’s counter-argument as “nothing combined with nothing is still nothing.”²²⁴ The panel articulated the following standard for assessing the U.S. claim:

[I]t is not implausible that individual measures which do not impair benefits when considered in isolation, could nonetheless have an adverse impact on conditions of competition when considered collectively. However, for such a legal theory to be shown to have factual relevance in the present case, the United States must adduce relevant specific evidence and provide a detailed justification showing how this evidence supports the theory. In considering the U.S. allegations in relation to “combined effects”, we recall our discussion of the facts that (i) the various “measures” cited by the United States—distribution and promotion “measures” and restrictions on large stores—were introduced over a period of several decades, and (ii) a

221. *Id.* ¶ 10.338.

222. *See id.* ¶ 10.337.

223. *Id.* ¶ 10.346.

224. *Id.* ¶ 10.352.

number of these “measures” are no longer in effect. We also recall our discussion of the timing problems as between the issuance of the “measures” and the emergence of standard transaction terms and single-brand distribution in the Japanese market. Against this background, to the extent that the United States claims that various “measures” in the areas of distribution, promotion and large stores set in motion policies which are said to have a complementary and cumulative effect on imported film and paper, we consider that it is for the United States to provide this panel with a detailed showing of how these alleged “measures” interact with one another in their implementation so as to cause effects different from, and additional to, those effects which are alleged to be caused by each “measure” acting individually.²²⁵

The panel found that the United States failed to meet this standard. It addressed each type of countermeasure alleged by the United States and found no proof of combined effect.

As explained above, the panel found that none of the distribution countermeasures alleged by the United States individually upset the competitive conditions for importing film and paper. The panel also noted a “timing problem” for each of the alleged distribution countermeasures because the vertical integration of the market into single-brand distribution occurred before the adoption of the measures asserted by the United States. The panel found that this timing problem applied to the distribution measures as a set of measures. The panel ruled that the United States failed to present additional arguments and evidence to prove that the alleged measures operated in combination to impair competitive market access for imported film and paper.²²⁶

As for the Large Stores Law, the United States relied on a MITI survey on transaction terms. The United States asserted that the MITI survey demonstrated that MITI was concerned that large stores threatened the oligopoly of Fuji and Konica in Japan.²²⁷ Japan countered that the survey actually expressed fear that new retail stores would introduce “irrational business practices” into the distribution sector, and that the United States failed to interpret the survey in the proper

225. *Id.* ¶ 10.353.

226. *Id.* ¶ 10.354.

227. *Id.* ¶ 10.355.

context.²²⁸ The panel found that the United States failed to present the requisite detailed justification and convincing evidence:

On the basis of the evidence and arguments presented by the two parties, and taking into account the additional portion of the MITI Survey Report mentioned by Japan, we consider that the MITI survey report cited by the United States, when correctly translated and read in context, does not sufficiently support the U.S. proposition in relation to the alleged role of the Large Stores Law (and related "measures") in supporting what the United States claims is an oligopolistic distribution system for film and paper in Japan. Rather, the evidence would seem to suggest that MITI was mostly concerned with avoiding the reintroduction of what MITI viewed as irrational business terms. To the extent that the U.S. claim is that the Large Stores Law "created" manufacturer-dominated, vertically integrated distribution in Japan, it suffers from the timing problem referred to above, i.e., such a distribution structure existed prior to the adoption of the Large Stores Law in 1973. The United States offers insufficient evidence as to how the Large Stores Law played a role in keeping this already-existing vertically integrated structure in place.²²⁹

The panel also ruled that the United States failed to demonstrate that the Large Stores Law, in addition to maintaining the oligopoly of Fuji and Konica, also restricted an alternate route for the marketing of imported products.²³⁰

The panel next rejected the U.S. claim that promotion countermeasures worked in combination to restrict the market for imported film and paper. The United States failed to prove that the alleged countermeasures had any effect individually, provided only a few examples, over many years, in which Kodak was restricted in promotional activities, and failed to provide additional evidence or arguments as to how the alleged promotion countermeasures in combination restricted competitive market access.²³¹

Finally, the panel rejected the U.S. claim that all three of the countermeasures worked together to restrict market access of im-

228. *Id.* ¶ 10.356.

229. *Id.* ¶ 10.337.

230. *See id.*

231. *See id.* ¶ 10.366.

ported film and paper. The panel found that none of the alleged countermeasures individually restricted market access, and the United States presented no additional evidence or argument that the combination of measures restricted market access.²³²

4. The Violation Claims

a. *The National Treatment Claim*

Article III:4 of the GATT sets forth the basic national treatment requirement found in the WTO system. It provides in pertinent part as follows:

The products of the territory of a Member imported into the territory of any other Member shall be accorded treatment no less favorable 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.²³³

The panel set forth the following requirements that the United States would have to meet to prove a violation of the national treatment obligation by Japan:

We consider that in line with GATT/WTO precedent, under this provision the United States is required to demonstrate the existence of: (a) a law, regulation or requirement affecting the internal sale, offering for sale or distribution of imported film or paper; and (b) treatment accorded in respect of the law, regulation or requirement that is less favorable to the imported film or paper than to like products of national origin.²³⁴

The panel also found that Article III:1 was relevant to the proceeding. It provides:

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

232. *See id.* ¶ 10.363.

233. GATT, *supra* note 6, art. III:4, 4 B.I.S.D. at 18.

234. *Japan—Film Panel Report*, *supra* note 5, ¶ 10.369.

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.²³⁵

The panel cited the WTO Appellate Body in *Japan—Alcoholic Beverages*, where it said that “Article III obliges Members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products.”²³⁶ Moreover, under *Bananas III*, the WTO Appellate Body explained that a determination of whether there has been a violation of Article III:4 does not require a determination of whether a measure “afford[s] protection to domestic production.”²³⁷

The United States argued that distribution countermeasures that Japan allegedly had undertaken violated the WTO national treatment obligation. As for the first issue, whether the alleged countermeasures are “laws, regulations or requirements,” the panel stated:

A literal reading of the words *all laws, regulations and requirements* in Article III:4 could suggest that they may have a narrower scope than the word *measure* in Article XXIII:1(b). However, whether or not these words should be given as broad a construction as the word *measure*, in view of the broad interpretation assigned to them in [WTO jurisprudence], we shall assume for the purposes of our present analysis that they should be interpreted as encompassing a similarly broad range of government action and action by private parties that may be assimilated to government action.²³⁸

For purposes of analysis, the panel decided to treat all of the distribution countermeasures cited by the United States as laws, regulations, or requirements, even though it only found four of them to be measures in the prior analysis, and only three of them to be in effect.²³⁹

235. GATT, *supra* note 6, art. III, 4 B.I.S.D. at 18; *see also Japan—Film Panel Report, supra* note 5, ¶ 10.369.

236. *Japan—Film Panel Report, supra* note 5, ¶ 10.370 (quoting WTO Appellate Body Report, *Japan—Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, at 16 (Oct. 4, 1996), 1996 WL 738800, *10.

237. *Japan—Film Panel Report, supra* note 5, ¶ 10.371; *see also* WTO Appellate Body Report, *EC—Regime for Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, ¶ 36 (Sept. 9, 1997).

238. *Japan—Film Panel Report, supra* note 5, ¶ 10.376.

239. *See id.* ¶ 10.377.

The next issue for the panel to consider was whether these laws, regulations, or requirements accorded less favorable treatment to imported film and paper than to domestic film and paper. The panel applied the “effective equality of competitive opportunities” test set forth in U.S.—*Section 337* as follows:

the “no less favourable” treatment requirement set out in Article III:4, is unqualified. These words are to be found throughout the General Agreement and later agreements negotiated in the GATT framework as *an expression of the underlying principle of equality of treatment* of imported products as compared to the treatment given either to other foreign products, under the most favoured nation standard, or to domestic products, under the national treatment standard of Article III. The words “treatment no less favourable” in paragraph 4 call for *effective equality of opportunities* for imported products in respect of the application of laws, regulations and requirements affecting the internal sale, offering for sale, purchase transportation, distribution or use of products. This clearly sets a minimum permissible standard as a basis.²⁴⁰

The panel found no “significant distinction” between the “upsetting the competitive relationship” standard of Article XXIII:1(b) and the “upsetting effective equality of competitive opportunities” standard of Article III:4, except that the latter “calls for no less favorable treatment for imported products in general” and the former “calls for a comparison of the competitive relationship between foreign and domestic products at two specific points in time, i.e., when the concession was granted and currently.”²⁴¹

The panel’s findings on the national treatment claim were similar to its findings on the non-violation claim. The eight distribution countermeasures alleged by the United States did not discriminate on a *de jure* or a *de facto* basis—they did not discriminate on their face or by their terms, nor were they applied on a discriminatory basis. The panel reiterated that the distribution countermeasures alleged by the United States did not promote vertical integration to impede market access of foreign firms, and that the U.S. argument suffered from serious timing

240. *Id.* ¶ 10.379 (emphasis added) (quoting United States—Section 337 of the Tariff Act of 1930, Nov. 7, 1989, B.I.S.D. (36th Supp.) at 345 (1990).

241. *Japan—Film Panel Report*, *supra* note 5, ¶ 10.380.

problems.²⁴² Finally, the panel reiterated that single brand distribution is now the “common market structure” and “indeed the norm” in national film markets, including the U.S. market.²⁴³ “It is unclear why the same economic forces acting to promote single brand wholesale distribution in the United States would not also exist in Japan.”²⁴⁴

b. *The Transparency Claim*

GATT 1994 Article X:1 provides:

Laws, regulations, judicial decisions and administrative rulings of general application, made effective by any contracting party, pertaining to the classification or the valuation of products for customs purposes, or to rates of duty, taxes or other charges, or to requirements, restrictions or prohibitions on imports or exports or on the transfer of payments therefor, or affecting their sale, distribution, transportation, insurance, warehousing, inspection, exhibition, processing, mixing or other use shall be published promptly in such a manner as to enable governments and traders to become acquainted with them.²⁴⁵

The issue presented by the United States was whether administrative rulings of the Japanese government are “administrative rulings of general application.” The United States argued that Japan breached Article X:1 in the following two situations: (1) the failure to publish decisions that relate to the enforcement of the Premiums Law and fair competition codes when those decisions set or amend rules that apply to future cases; and (2) the failure to publish guidance in which applicants for a new or expanded store under the Large Stores Law are required to coordinate their plans with competitors and that require prior explanation prior to the filing of a notification under the Large Stores Law.²⁴⁶

The panel found that the meaning of “general application” was addressed in the WTO panel report in *United States—Restrictions on Imports of Cotton and Man-Made Fibre Underwear*,²⁴⁷ in which the panel

242. See *id.* ¶ 10.381.

243. *Id.*

244. *Id.*

245. *Id.* ¶ 10.384.

246. See *Japan—Film Panel Report*, *supra* note 5, ¶ 10.383.

247. WTO Panel Report, *United States—Restrictions on Imports of Cotton and Man-Made Fibre Underwear*, WT/DS24/R (Nov. 8, 1996).

stated that “[i]f, for instance, the restraint was addressed to a specific company or applied to a specific shipment, it would not have qualified as a measure of general application.”²⁴⁸ The panel also found that there were no WTO precedents directly on point. The panel explained:

In our view, it stands to reason that inasmuch as the Article X:1 requirement applies to all administrative rulings of general application, it also should extend to administrative rulings in individual cases where such rulings establish or revise principles or criteria applicable in future cases. At the same time, we consider that it is incumbent upon the United States in this case to clearly demonstrate the existence of such unpublished administrative rulings in individual matters which establish or revise principles applicable in future cases.²⁴⁹

The panel summarized the United States arguments concerning the alleged non-transparent enforcement of the Premiums Law by Japan as follows:

The United States argues that Japan’s enforcement of its premium and representation provisions is “shrouded in secrecy” resulting from the use of informal, unpublished enforcement actions. According to the United States, the problem is exacerbated due to the multi-tiered nature of Japan’s enforcement system, with the JFTC, the prefectural governments and deputized private sector councils all having authority to enforce the Premiums Law. The confusion for companies attempting to do business in Japan primarily arises from Japan’s failure to publish a large percentage of administrative rulings and enforcement actions and the difficulty in obtaining what information may be available. The United States submits that since the Premiums Law was enacted in 1962, the JFTC has initiated relatively few formal enforcement actions but has issued many “administrative guidances” or warnings, the overwhelming majority of which are unpublished. The lack of transparency is compounded, the United States maintains, by the fact that Japan’s 47 prefectural governments take thousands of informal actions.²⁵⁰

248. *Id.* ¶ 7.65.

249. *Japan—Film Panel Report*, *supra* note 5, ¶ 10.388.

250. *Id.* ¶ 10.390.

The panel found that “the primary difference between the parties is on whether or not such enforcement actions—i.e., unpublished enforcement actions that establish or modify criteria applicable in future cases—exist.”²⁵¹ The panel rejected the U.S. claim, explaining as follows:

We agree with the United States that the vast majority of individual enforcement actions are unpublished. However, we note that there is a pronounced lack of evidence as to the nature of any alleged unpublished enforcement actions effecting changes to JFTC enforcement criteria. We agree with Japan that the record is devoid of any specific allegation by the United States as to any JFTC enforcement action that is at odds with already published policies. We acknowledge that the nature of the U.S. claim makes it difficult to cite examples—if a ruling is unpublished how can the United States know that it effects such changes? The United States maintains it has made repeated requests for information on enforcement activities from the Japanese Government, the respective enforcement councils and relevant photographic trade associations, but that, almost without exception, these requests have been denied. Nonetheless, it would seem that the United States should be able to cite examples of changed policies that it believes were in fact implemented first in unpublished decisions. Otherwise, we have no basis for finding that there are such decisions. Even if the rate of published-to-unpublished actions is low, we have nothing before us that suggests what it should be. We cannot find that Japan should publish “more” decisions in the absence of specific examples of the types of decisions that should be published, i.e., administrative rulings establishing or modifying criteria applicable in future cases.²⁵²

According to the U.S. allegations, four bodies in the Japanese private sector engage in enforcement based on delegations from the JFTC: (1) the Retailers Fair Trade Council, (2) the Promotion Council, (3) the Manufacturers Fair Trade Council, and (4) the Wholesalers Fair Trade Council. The United States complained that none of these enforcement bodies publishes its enforcement actions. Because these private bodies and the fair competition codes they maintain are created

251. *Id.* ¶ 10.392.

252. *Id.* ¶ 10.393.

pursuant to Section 10 of the Premiums Law, and they are supervised by the JFTC, the United States argued that they engage in governmental action and that Article X:1 requires publication of enforcement actions that have ramifications for future cases.²⁵³

Again, the panel ruled against the United States, maintaining that the United States failed to present evidence

as to the nature of any alleged unpublished enforcement actions effecting changes to JFTC or code enforcement criteria. The record is devoid of any specific allegation by the United States as to any action taken by any of the councils that is at odds with the basic principles set forth in the codes. In these circumstances, we find that the United States has failed demonstrate the existence of any such administrative rulings by any of the councils, establishing or modifying criteria applicable in future cases, the non-publication of which could be viewed as a violation of Article X:1.²⁵⁴

As for measures taken under the Large Stores Law, the panel found that there was “conflicting argument and evidence on whether or not there is unpublished administrative guidance promoting continuation through informal means of the formally abolished government policy requiring “prior explanation” by large stores.”²⁵⁵ The panel framed the issue under consideration, however, as “whether or not such administrative rulings are rulings of general application.”²⁵⁶ On this limited issue, the panel concluded:

(i) the Japanese Government at the national level has published a directive formally eliminating the “prior explanation” requirement under the Large Stores Law, but (ii) there is anecdotal evidence of certain continued guidance at the sub-national level in Japan urging large stores owners to continue the practice of prior explanation and adjustment.²⁵⁷

The United States failed to convince the panel that the continued guidance establishes or modifies criteria applicable in future cases, or

253. *See id.* ¶¶ 10.393–10.394.

254. *Id.* ¶ 10.396.

255. *Id.* ¶ 10.399.

256. *Id.*

257. *Id.* ¶ 10.401.

otherwise constitutes administrative rulings of “general application.”²⁵⁸

C. *The U.S. Response: Litigation Strategy and Japanese “Commitments”*

The U.S. response to the panel report was predictable. The USTR issued a press statement saying that

we are obviously extremely disappointed in the WTO panel decision. . . . It is impossible to reconcile the realities of the marketplace with that decision. It is our intention to outline steps in the very near future to ensure that the Japanese market in this sector is indeed open and competitive.²⁵⁹

The United States did not appeal the decision, however. Apparently, the United States decided as a matter of litigation strategy not to appeal to the WTO Appellate Body, which has competence only over matters of law.²⁶⁰ Rather, the U.S. approach was to characterize the representations that Japan made during the proceeding as “commitments”—something like a party admission in domestic U.S. litigation.²⁶¹ The USTR explained that, “[b]y making these statements to a WTO panel, Japan has committed itself before an international tribunal to implement its wholesale and retail distribution measures and enforce its competition laws in a manner consistent with its own representations and findings.”²⁶² The United States thus treated the panel report and

258. *Id.*

259. Press Release by the Office of the U.S. Trade Representative, Executive Office of the President, Press Release No. 98–08, *Statement by U.S. Trade Representative Charlene Barshefsky Concerning WTO Film Panel Decision*, ¶ 1 (Jan. 30, 1998) <<http://www.ustr.gov/releases/1998/01/98-08.pdf>>; see also Press Release by the Office of the U.S. Trade Representative, Executive Office of the President, Press Release No. 97–102, *Statement by Ambassador Charlene Barshefsky Regarding the WTO Dispute on Photographic Film and Paper*, ¶ 6 (Dec. 5, 1997) <<http://www.ustr.gov/releases/1997/12/97-102.pdf>>.

260. As a result of the DSU, there is now a permanent seven-member Appellate Body to hear appeals from panel reports by parties to the dispute on matters of law. See DSU, *supra* note 28, arts. 16.4, 17, at 417–19, 33 I.L.M. at 1235–37. The Appellate Body has no authority to review facts, even under a deferential review standard typically found in the domestic laws of some of the WTO members. An opinion of the Appellate Body is binding unless the DSB decides by consensus not to adopt it. See *id.* art. 17.14, at 418, 33 I.L.M. at 1237.

261. See FED. R. EVID. 801(d)(2).

262. Press Release by the Office of the U.S. Trade Representative, Executive Office of the President, Press Release No. 98–10, *USTR and Department of Commerce Announce Next Steps on Improving Access to the Japanese Market for Film*, ¶ 4 (Feb. 3, 1998) <<http://www.ustr.gov/releases/1998/02/98-10.pdf>>. The United States and Japan, during and prior to the Kodak Fuji proceed-

Japan's representations in the case as part of bilateral negotiations between the countries concerning so-called structural impediments in the Japanese economy. Some have asserted that the panel proceeding was simply the part of the dispute between the countries that was not settled, and that the United States did not have a significant interest in winning or losing the case.²⁶³

MITI responded that the U.S. characterization of Japan's representations in the dispute were unreasonable and that the United States has tried to "unilaterally create new future obligations."²⁶⁴ MITI said:

The U.S. position is untenable. Like all submissions to the WTO dispute settlement panels, Japan's submissions in the film dispute were representation of historic factual circumstances and legal principles at issue in the particular case. The U.S. characterization of these factual representations about the past as future "commitments" attempts to unilaterally create new future obligations. Such an approach is unreasonable, may be thought of as having the application of Section 301 in mind, and Japan should not accept such an approach.²⁶⁵

III. ANALYSIS

A. Introduction

The *Kodak-Fuji* decision is the first Dispute Settlement Panel Report in the post Uruguay Round period to decide a non-violation claim under Article XXIII. It, along with the *Australian Subsidy*²⁶⁶ and *EEC*—

ing, engaged in discussions under what the United States has called the Enhanced Initiative on Deregulation and Competition Policy. In fact, the Large Stores Law has been repealed. See Press Release by Office of the Press Secretary (Birmingham, England), The White House, *U.S.-Japan Initiative Delivers Progress on Deregulation*, ¶ 1 (May 15, 1998) <<http://www.ustr.gov/releases/1998/05/us-japan.pdf>>. These negotiations are reciprocal in that the Japanese have used the negotiations to raise a number of complaints about the United States, as well.

263. See Dillon, *supra* note 13, at 197-99.

264. Subcommittee on Unfair Trade Policies and Measures under the World Trade Organization Committee of the Industrial Structure Council, Ministry of International Trade and Industry of Japan, *1998 Report on the WTO Consistency of Trade Policies by Major Trading Partners, Executive Summary* (visited Jan. 25, 2000) <<http://www.miti.go.jp/report-e/g401001e.html>>.

265. Ministry of International Trade and Industry of Japan, *1998 Report on the WTO Consistency of Trade Policies by Major Trading Partners, Chapter 13 Unilateral Measures* (visited Jan. 25, 2000) <<http://www.miti.go.jp/report-e/g400113e.html>>.

266. GATT Dispute Panel Report on Australian Subsidy on Ammonium Sulfate, Apr. 3, 1950, 2 B.I.S.D. at 188 (1952) [hereinafter *Australian Subsidy*].

Oilseeds cases,²⁶⁷ is perhaps one of the more significant Article XXIII cases. There have indeed been very few non-violation cases in the history of the GATT, with only 14 of the 250 claims under Article XXIII brought as non-violation claims and the rest as violation claims.²⁶⁸ Of the fourteen non-violation cases that GATT working parties have considered on the merits, only three have resulted in a finding of nullification or impairment.²⁶⁹ Only one of these three decisions was not based on the nullification or impairment of tariff concessions made under GATT Article II.²⁷⁰

The *Kodak-Fuji* panel report has prompted significant response from both the academic and practitioner legal communities.²⁷¹ A good deal of the commentary has either criticized the U.S. position in the dispute or has argued for a narrow approach to Article XXIII:1(b) interpretation. One commentator has criticized the U.S. position as an attack on local constituency preferences in Japan and as an attack on Japanese culture.²⁷² A common critical theme is that the United States attempted to bootstrap competition policy into the WTO agreements, when, in fact, the WTO members have not reached an agreement on whether competition policy should be regulated in the WTO regime.²⁷³ Others criticize the U.S. contention regarding vertical re-

267. *EEC—Oilseeds*, *supra* note 35.

268. *See Roessler*, *supra* note 39, at 130–02.

269. *See id.* at 130.

270. *See id.* at 132; *see also EC—Citrus Products*, *supra* note 39. There have been no successful “situation” claims in the GATT/WTO regime. Roessler, *supra* note 39, at 139–40; *see infra* notes 297–99 and accompanying text on situation claims.

271. *See* William H. Barringer, *Competition Policy and Cross Border Dispute Resolution: Lessons Learned from the U.S.-Japan Film Dispute*, 6 GEO. MASON L. REV. 459 (1998); ERNST-ULRICH PETERSMANN, *THE GATT/WTO DISPUTE SETTLEMENT SYSTEM: INTERNATIONAL LAW, INTERNATIONAL ORGANIZATIONS AND DISPUTE SETTLEMENT* 175–76, 221–22 (1997); Mitsuo Matsushita, *Restrictive Business Practices and the WTO/GATT Dispute Settlement Process*, in *INTERNATIONAL TRADE LAW AND THE GATT/WTO DISPUTE SETTLEMENT SYSTEM*, *supra* note 39, at 359, 362–63; Sung-joon Cho, *GATT Non-Violation Issues in the WTO Framework: Are They the Achilles’ Heel of the Dispute Settlement Process?*, 39 HARV. INT’L L.J. 311, 311–13 (1998); Dillon, *supra* note 13; Dunoff, *supra* note 27; Joelson, *supra* note 23; William H. Barringer & James P. Durling, *Out of Focus: The Use of Section 301 to Address Anticompetitive Practices in Foreign Markets*, 1 UCLA J. INT’L L. & FOREIGN AFF. 99, 99–101 (1996); Charles D. Lake II & Jennifer Danner Riccardi, *Market Access Barriers in the Japanese Consumer Photographic Film and Paper Sector: Can Section 301 Address the Problem?*, 1 UCLA J. INT’L L. & FOREIGN AFF. 143 (1996).

272. *See* Dillon, *supra* note 13, at 202–03.

273. This argument ignores that the WTO members have agreed to the broadly worded Article XXIII to monitor actions that are not explicit violations of WTO agreements, but which nullify or impair WTO obligations. In the negotiation of the DSU, one of the most significant instruments negotiated in the Uruguay Round, making a radical change in dispute settlement in

straints in the Japanese economy because vertical restraints, in some circumstances, may be efficient and because ambiguity exists as to whether vertical restraints should be unlawful under competition law.²⁷⁴

Augmenting the literature on the *Kodak-Fuji* case, a significant amount of writing addresses Article XXIII. Most commentators argue for a narrow interpretation of Article XXIII, contending that a broad interpretation would result in "wrong cases" and would contravene the bargains that WTO members make in multilateral trade negotiations.²⁷⁵ Another common theme is that Article XXIII has diminished in importance because the WTO agreements increasingly restrict non-tariff barriers, regulate government measures that occur inside the borders of countries, and constrain the domestic policy autonomy of governments when domestic policy affects international trade.²⁷⁶

This Article takes a different approach than the mainstream literature on the *Kodak-Fuji* case specifically, and on Article XXIII generally. The DSB should adopt a "common law" approach to interpreting Article XXIII in WTO dispute settlement cases, which would be best suited to policy evolution and trade liberalisation in the world trading system. This Article makes the case that fears of "opening the flood-gates" and the parade of horrors that those seeking narrow interpretations of definitive texts typically assert may be unfounded, given the constraints imposed on the DSB by the rules and institutions of the world trading system. These conclusions are an institutionalist analysis of treaties as well as a doctrinally oriented approach to understanding the meaning of Article XXIII:1(b).

As John Jackson and others have asserted, the WTO is a constitutional regime.²⁷⁷ The WTO sets forth a constitutional order for international trade relations between countries. There are many ways to theorize about constitutions, but a set of tools that assist in the

the multilateral trading system, the WTO members had the opportunity to amend Article XXIII or delete it from the WTO framework. Instead, they left it intact.

274. See Edward Iacobucci, *The Interdependence of Trade & Comp. Policies*, WORLD COMPETITION: L. & ECON. REV., Dec. 1997, at 5, 20.

275. Cho, *supra* note 271, at 313; Robert E. Hudec, *GATT Dispute Settlement After the Tokyo Round: An Unfinished Business*, 13 CORNELL INT'L L.J. 145, 167 (1980).

276. See Roessler, *supra* note 39, at 134 ("[G]iven the broad extension of the multilateral trade order into the area of domestic policies, the field of potential application of [Article XXIII: 1(b)] has diminished significantly.").

277. This has been an important theme that runs throughout Professor Jackson's work. See, e.g., JOHN H. JACKSON, *WORLD TRADE AND THE LAW OF THE GATT* 35 (1969) (Part 1 is called "Constitutional Law of GATT.").

understanding of WTO dispute settlement and Article XXIII can be found in new institutional economics, political economics, and positive political theory.²⁷⁸ An institutionalist analysis of treaties focuses on the function of treaty rules and institutions in reducing and affecting transaction costs to facilitate agreement among treaty parties.²⁷⁹ In this analysis, institutions matter because they "alter the relative costs of transactions."²⁸⁰ WTO dispute settlement makes it "cheaper for governments to get together to negotiate agreements."²⁸¹ WTO dispute settlement is a coordination mechanism for international trade regulation, which facilitates WTO member bargaining under the shadow of the law and legal institutions.²⁸²

All constitutional regimes rely, to some extent, on conflicts of interests among institutions to accomplish monitoring functions. This is a dominant theme in all regulatory regimes. The DSU, in conjunction with Article XXIII, has the potential to provide a significant component of such monitoring in the multilateral trading system. Article XXIII has fallen into desuetude in some major respects and has been

278. See THRAINN EGGERTSSON, *ECONOMIC BEHAVIOR AND INSTITUTIONS* 59 (1990); DOUGLASS C. NORTH, *INSTITUTIONS, INSTITUTIONAL CHANGE, AND ECONOMIC PERFORMANCE* 107-40 (1990).

279. Douglass North defines institutions as: "[T]he humanly devised constraints that structure human interaction. They are made up of formal constraints (e.g. rules, laws, constitutions), informal constraints (e.g. norms of behavior, conventions, self-imposed codes-of-conduct), and their enforcement characteristics. Together, they define the incentive structure of societies and specifically economies." Douglass C. North, *Economic Performance Through Time*, 84 *AMER. ECON. REV.* 359, 360 (1994); see also NORTH, *supra* note 278, at 27 & n.1.

280. ROBERT O. KEOHANE, *AFTER HEGEMONY: COOPERATION AND DISCORD IN THE WORLD POLITICAL ECONOMY* 89 (1984). One can examine international institutions using the economic framework of the working concept of transaction costs. Transaction costs are the "comparative costs of planning, adapting, and monitoring task completion under alternative governance structures." AVINASH K. DIXIT, *THE MAKING OF ECONOMIC POLICY: A TRANSACTION-COST POLITICS PERSPECTIVE* 31 (1996) (quoting Oliver Williamson, *Transaction Cost Economics*, in *HANDBOOK OF INDUSTRIAL ORGANISATION* 142 (1989)). Alternatively, they are "the costs of measuring the valuable attributes of what is being exchanged and the costs of protecting rights and policing and enforcing agreements." *Id.* (quoting NORTH, *supra* note 278, at 27). Another definition is "search and information costs, bargaining and decision costs, policing and enforcement costs." Carl J. Dahlman, *The Problem of Externality*, 22 *J.L. & ECON.* 141, 148 (1979). In the absence of transaction costs, parties to international trade agreements could draft perfect trade agreements that could be costlessly enforced. There would be no concern about compliance with promises, because parties would know instantaneously about breaches. Violations of trade agreements would be perfectly observable, and parties could take action to obtain compliance at no cost. It is obvious that such a frictionless world is a theoretical abstraction, and not very useful for understanding the behavior of treaty parties.

281. KEOHANE, *supra* note 280, at 90.

282. See KENNETH A. SHEPSLE & MARK S. BONCHEK, *ANALYZING POLITICS: RATIONALITY, BEHAVIOR, AND INSTITUTIONS* 407 (1997).

rarely relied upon in GATT/WTO dispute settlement. It has the potential, however, to serve as a significant principal-agent monitoring device if applied with constraints that provide the DSB with incentives to make decisions that maximize WTO member preferences and enhance global economic welfare.

Institutionalist theories of treaties explain a number of features of international trade agreements. We can analyze treaty formation and implementation using these theories. Because the drafting of a perfect trade agreement is impossible, parties must take into account a number of contingencies in the agreement. Trade agreements tend to be relatively long-term deals. They are characterized by open-ended language and procedures that vest substantial discretion in both the WTO members and in the WTO itself. The style of their drafting is around substantive standards (rather than discrete rules) and procedural mechanisms that provide for monitoring and enforcement.

The transaction costs associated with international trade agreements cause difficulties in the implementation and enforcement of the provisions of the agreements. Effective dispute settlement is necessary to accommodate the institutional weaknesses in any treaty regime in which transaction costs are present. Substantial transaction costs will likely be present in any treaty regime that requires performance of treaty obligations dynamically over time, as do the WTO agreements.

B. *The Legal and Policy Analytical Framework*

1. Article XXIII Principles in the Post-Uruguay Round Period

The concept of nullification or impairment found in Article XXIII:1(b) has been said to originate in the bilateral trade agreements entered into between the United States and other countries in the 1930s and 1940s.²⁸³ Article XXIII has the potential to operate in a manner roughly analogous to judicial review in domestic legal orders. The *Australian Subsidy* decision has been called the *Marbury v. Madison* of the pre-Uruguay Round GATT period.²⁸⁴ The *Australian Subsidy* case developed a reasonable anticipation or legitimate expectations test to

283. See Roessler, *supra* note 39, at 126; see also PETERSMANN, *supra* note 271, at 143 (explaining that "A 1931 League of Nations survey of dispute settlement procedures showed that in bilateral commercial treaties between European States, not one distinguished between disputes on legal obligations and those on other claims involving an impairment of reciprocal commitments").

284. JOHN H. JACKSON, *THE WORLD TRADING SYSTEM: LAW AND POLICY OF INTERNATIONAL ECONOMIC RELATIONS* 373 n.29 (2d ed. 1997).

assess non-violation claims.²⁸⁵ Certainly, *Kodak-Fuji* confirms that similar standards of review under Article XXIII will continue to incorporate themselves into the WTO adjudicatory infrastructure. *Kodak-Fuji* extends the *Australian Subsidy* analysis by providing concrete guidance on how to assess complex Article XXIII disputes that rely on facts going back into several rounds of multilateral trade negotiations.

As explained above, some have argued that Article XXIII may be of lesser importance in the WTO regime.²⁸⁶ Actually, the opposite seems to be true. Article XXIII seems to be enjoying a revival in the WTO regime. The Uruguay Round resulted in the inclusion of provisions similar to Article XXIII in several WTO agreements and, despite a modicum of protest, Article XXIII has remained intact even though the GATT framework underwent a major overhaul in the Uruguay Round.²⁸⁷ With the substantial shift in power from the WTO members to the WTO DSB, however, comes substantially increased power for the DSB in Article XXIII cases.²⁸⁸

WTO members can make six different kinds of complaint under Article XXIII:1.²⁸⁹ Two of these complaints are "violation" complaints requiring that a WTO member violate a provision of an applicable WTO agreement to trigger a violation of Article XXIII. Two complaints are "non-violation" complaints, which do not require a separate violation of other WTO agreements. Finally, two complaints are "situation" complaints, which are very broad complaints that WTO members can raise when "any other situation" leads to a circumvention of WTO obligations.

The language of Article XXIII is the best place to start in analyzing these causes of action. Article XXIII:1(a) sets forth the violation complaints. The first violation complaint is as follows:

If any contracting party should consider that any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired . . . as the result of . . . the failure of another contracting party to carry out its obligations under this Agreement. . . . the contracting party may, with a view to the

285. See Adrian T.L. Chua, *Reasonable Expectations and Non-Violation Complaints in Gatt/Wto Jurisprudence*, 32 J. WORLD TRADE 27, 30 (1998); *Australian Subsidy*, *supra* note 266.

286. See *supra* note 276 and accompanying text.

287. See Roessler, *supra* note 39, at 134-38 (discussing similar provisions in GATS and eventual application of Article XXIII to TRIPS).

288. See *infra* notes 290-95 and accompanying text; John Linarelli, *The Institutional Economics of World Trade Organization Dispute Settlement* (unpublished, on file with the author).

289. See PETERSMANN, *supra* note 271, at 72-74.

satisfactory adjustment of the matter, make written representations or proposals to the other contracting party or parties which it considers to be concerned.²⁹⁰

The second violation complaint is as follows: "If any contracting party should consider . . . that the attainment of any objective of the Agreement is being impeded as the result of . . . the failure of another contracting party to carry out its obligations under this Agreement."²⁹¹

There are two kinds of non-violation complaints, both found in Article XXIII:1 (b). The first one is as follows:

If any contracting party should consider that any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired . . . as the result of . . . the application by another contracting party of any measure, whether or not it conflicts with the provisions of this Agreement.²⁹²

The second one is as follows: "If any contracting party should consider . . . that the attainment of any objective of the Agreement is being impeded as the result of . . . the application by another contracting party of any measure, whether or not it conflicts with the provisions of this Agreement."²⁹³

Finally, there are two kinds of "situation" complaints, which have their basis in Article XXIII:1 (c). The first one provides: "If any contracting party should consider that any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired . . . as the result of . . . the existence of any other situation."²⁹⁴ The second one provides: "If any contracting party should consider . . . that the attainment of any objective of the Agreement is being impeded as the result of . . . the existence of any other situation."²⁹⁵

The above provisions show the broad wording of the Article XXIII treaty language. The provision has the potential to give the DSB

290. GATT, *supra* note 6, art. XXIII:1 (a), 4 B.I.S.D. at 51. Consultation is always the first step in WTO dispute settlement. Article XXIII:2 deals with what happens when no satisfactory adjustment occurs. Article XXII explicitly deals with consultation.

291. *Id.* The last phrase ("the contracting party may, with a view to the satisfactory adjustment of the matter, make written representations or proposals to the other contracting party or parties which it considers to be concerned") is omitted in succeeding quotes.

292. *Id.*

293. *Id.*

294. *Id.*

295. *Id.*

significant power. When coupled with the need for consensus in the WTO to render a panel report ineffective,²⁹⁶ and appeal possibilities to the WTO Appellate Body only on points of law,²⁹⁷ it makes the putative powers of the DSB under Article XXIII formidable.

The United States argued *Kodak-Fuji* case under the first non-violation complaint identified above—nullification or impairment of tariff concessions made to the United States by Japan in the film and photographic market as a result of the application of measures by the Japanese government. The case could have been argued and decided as a situation complaint. Situation claims, however, are extremely rare. There have been no successful situation claims under the GATT/WTO regime, and some argue that they should fall into disuse.²⁹⁸

2. Alternative Interpretations of Article XXIII:1(b)

Given the breadth and ambiguity of Article XXIII, what standards should the DSB apply when deciding Article XXIII claims? We are concerned here primarily with non-violation claims and perhaps secondarily with situation claims. *Kodak-Fuji* involved a non-violation claim. We are also concerned here with the third part of the non-violation standard identified in *Kodak-Fuji*—nullification or impairment of a GATT/WTO benefit. This is the core non-violation complaint.

There are at least six ways to interpret the nullification or impairment provision. They are discussed below.

296. Key to the effectiveness of the WTO dispute settlement process and its transformation in the Uruguay Round is the following found in DSU Article 16:4:

Within 60 days after the date of circulation of a panel report to the Members, the report shall be adopted at a DSB meeting unless a party to the dispute formally notifies the DSB of its decision to appeal or the DSB decides by consensus not to adopt the report. If a party has notified its decision to appeal, the report by the panel shall not be considered for adoption by the DSB until after completion of the appeal.

DSU, *supra* note 28, art. 16:4, at 417, 33 I.L.M. at 1235 (emphasis added). This paragraph provides one of the more significant distinctions between pre- and the post-Uruguay Round dispute settlement. It effectuates the new consensus rule in WTO dispute settlement, in that a panel report is deemed adopted by the WTO unless the DSB unanimously rejects the report. Article 16.4 also provides that the adoption procedure “is without prejudice to the right of Members to express their views on a panel report.” *Id.*

297. See *supra* note 260.

298. See PETERSMANN, *supra* note 271, at 74.

a. An “Expectations” Test

One test for non-violation claims is a legitimate expectations test. It is the test used in *Kodak-Fuji*, although *Kodak-Fuji* seems to confuse “legitimate expectations” with “reasonable expectations.” The WTO Appellate Body’s position on appropriate standards, moreover, is unclear at present. The U.S. decision not to appeal *Kodak-Fuji* suggests that there may have been strategic reasons for a settlement with Japan.²⁹⁹

The *Kodak-Fuji* panel relied on past GATT non-violation cases and found:

In all but one of the past GATT cases dealing with Article XXIII:1(b) claims, the claimed benefit has been that of *legitimate expectations* of improved market-access opportunities arising out of relevant tariff concessions. This same set of GATT precedents suggests that *for expectations to be legitimate*, they must take into account all measures of the party making the concession that could have been *reasonably anticipated* at the time of the concession.³⁰⁰

The *Kodak-Fuji* panel thus merged the concept of “legitimate expectations” with that of “reasonable expectations.”³⁰¹ Elsewhere, the panel explained that it would examine the “reasonable expectations” of the parties.³⁰² Based on its review of prior GATT panel reports deciding non-violation claims, the *Kodak-Fuji* panel concluded that,

under Article XXIII:1(b), the United States may only claim impairment of benefits related to improved market access conditions flowing from relevant tariff concessions by Japan to the extent that the United States could not have *reasonably anticipated* that such benefits would be offset by the subsequent application of a measure by the Government of Japan.³⁰³

299. See Dillon, *supra* note 13, at 198–200.

300. *Japan—Film Panel Report*, *supra* note 5, ¶ 10.61.

301. Another question that arises from the decision is whether the legitimate expectations test applies to nullification or impairment of WTO benefits other than tariff concessions. It was unnecessary to decide this issue in *Kodak-Fuji* because the United States argued that Japan had nullified or impaired tariff concessions.

302. See *id.* ¶¶ 10.66, 10.67, 10.70, 10.71, 10.74, 10.217, 10.301, 10.315, 10.329.

303. *Id.* ¶ 10.77.

The standard GATT practice in prior cases was to not make a stark distinction between these two tests. The *Kodak-Fuji* panel report relied on *EEC—Oilseeds*, a pre-Uruguay Round GATT panel report issued in January 1990, for the legitimate or reasonable expectations concept.³⁰⁴ The *EEC—Oilseeds* Panel stated that the rationale for non-violation claims under Article XXIII:1(b) “is that the improved competitive opportunities *that can be legitimately expected* from a tariff concession can be frustrated not only by measures proscribed by the General Agreement but also by measures consistent with that Agreement.”³⁰⁵ It also stated in several places that the non-violation provisions protected “reasonable expectations.”³⁰⁶ The *EEC—Oilseeds* Panel characterized the main issue for determination to be “whether it was *reasonable* for the United States to *expect*” that the European Community would forego subsidy programs “systematically counteracting” the benefits of tariff concessions.³⁰⁷ Other GATT non-violation cases state substantially similar tests. The *Australian Subsidy on Ammonium Sulfate* and *Germany—Sardines* cases both set forth a reasonable expectations test based on the reasonable anticipations of the claimant at the time it negotiated concessions that it alleged the respondent had nullified or impaired.³⁰⁸

It is unclear how the WTO Appellate Body would have dealt with the *Kodak-Fuji* panel report had the United States appealed. The rulings and *obiter dicta* in two Appellate Body decisions, *EC—Customs Classification of Certain Computer Equipment*³⁰⁹ and *India—Patent Protection for Pharmaceutical and Agricultural Chemical Products*,³¹⁰ are relevant on the issue of the appropriate legal standards for non-violation claims.

One day after the *Kodak-Fuji* panel issued its interim panel report, the Appellate Body issued its opinion in the *India—Patent Protection* case.³¹¹ In that case, the panel found that India had not complied with

304. See *supra* note 35 and accompanying text.

305. *EEC—Oilseeds*, *supra* note 35, ¶ 144.

306. *Id.* ¶ 80–88.

307. *Id.* ¶ 147.

308. See *Australian Subsidy*, *supra* note 266, at 193; GATT Dispute Panel Report on Treatment by Germany of Imports of Sardines, Oct. 30, 1952, B.I.S.D. (1st Supp.) at 53 (1953).

309. See WTO Appellate Body Report, European Communities—Customs Classification of Certain Computer Equipment, WT/DS62/AB/R, WT/DS67/AB/R, WT/DS68/AB/R (June 5, 1998) [hereinafter *EC—Computer Equipment Appellate Body Report*].

310. See WTO Appellate Body Report, India—Patent Protection for Pharmaceutical and Agricultural Chemical Products, WT/DS50/AB/R, (Dec. 19, 1997) [hereinafter *India—Patent Appellate Body Report*].

311. See *id.*, title page & signature page (The formal date of the Appellate Body opinion is Dec. 19, 1997, but the opinion was signed by the relevant Appellate Body members on Dec. 4, 1997).

obligations in the TRIPS Agreement to provide adequate patent protection for pharmaceutical and agricultural chemical products. The Appellate Body upheld most of the findings of the panel but criticized the panel's interpretation of TRIPS obligations based on the "legitimate expectations" of the parties. The panel's use of the legitimate expectations concept to interpret WTO obligations generally was found to be improper. The Appellate Body found:

Although the panel states that it is merely applying a "well established GATT principle," the panel's reasoning does not accurately reflect GATT/WTO practice. In developing its interpretative principle, the panel merges, and thereby confuses, two different concepts from previous GATT practice. One is the concept of protecting the expectations of contracting parties as to the competitive relationship between their products and the products of other contracting parties. This is a concept that was developed in the context of *violation* complaints . . . brought under Article XXIII:1 (a) of the GATT. The other is the concept of the protection of the reasonable expectations of contracting parties relating to market access concessions. This is a concept that was developed in the context of *non-violation* complaints brought under Article XXIII:1 (b) of the GATT.³¹²

The Appellate Body further found that "the panel's invocation of the 'legitimate expectations' of Members relating to conditions of competition melds the legally distinct bases for 'violation' and 'non-violation' complaints."³¹³

The Appellate Body issued the *EC—Computer Equipment* panel report on June 5, 1998, after the WTO adopted the *Kodak-Fuji* panel report, on April 22, 1998. In *EC—Computer Equipment*, the Appellate Body reversed a panel's finding that tariff schedules are to be interpreted in light of the "legitimate expectations" of the parties.³¹⁴ The Appellate Body criticized the panel for confusing the concept of "legitimate expectations" with "reasonable expectations" and for conflating the two distinct causes of action of violation and non-violation complaints into one cause of action.³¹⁵ Moreover, the Appellate Body disagreed with

312. *Id.* ¶ 36.

313. *Id.* ¶ 42.

314. See *EC—Computer Equipment Appellate Body Report*, *supra* note 309, ¶ 111.

315. See *id.* ¶¶ 80–111.

the panel's finding that the "maintenance of the security and predictability of tariff concessions" permits the interpretation of concessions basis on the "legitimate expectations" of the exporting party.³¹⁶ Reliance on legitimate expectations, according to the Appellate Body, leads to an inappropriate examination of the subjective views of WTO members in delimiting the terms of a concession.³¹⁷

The Appellate Body appears to be struggling to restrict the application of the non-violation provisions to a narrow range of cases. It also seems to prefer to avoid a common law approach in WTO dispute settlement cases in which panel members would have substantial discretion to formulate standards for interpreting the WTO agreements. The Appellate Body has engaged in a highly formal style of reasoning in the above recent cases. It is possibly reacting to criticism of the DSB by various domestic and international constituencies.³¹⁸

The lack of clarity in the law on non-violation claims occurs on at least four levels. First, from a positive standpoint, it is unclear whether there is a distinction between "legitimate expectations" and "reasonable expectations." Second, from a normative standpoint, it is unclear whether there *should* be a distinction between the two verbalizations. The Appellate Body seems to prefer the "reasonable expectations" language for assessment of non-violation claims because the "legitimate expectations" language would permit subjective and unreasonable expectations.³¹⁹ Third, it is unclear whether the Appellate Body sees any role at all for a legitimate expectations approach, preferring instead to apply a reasonable expectations test to non-violation claims and no expectations test at all to violation claims. Fourth, one could

316. See *id.* ¶ 82.

317. See *id.* ¶ 84. Moreover, in both the *India—Patent Appellate Body Report* and the *EC—Computer Equipment Appellate Body Report* decisions, the Appellate Body ruled that the legitimate expectations test is inconsistent with the principle of good faith interpretation of treaties under Article 31 of the Vienna Convention on the Law of Treaties. The decisions would appear to be based on an unduly narrow reading of the Vienna Convention Article 31. See Thomas Cottier & Krista Nadakavukaren Schefer, *Non-Violation Complaints in WTO/GATT Dispute Settlement: Past, Present and Future*, in *INTERNATIONAL TRADE LAW AND THE GATT/WTO DISPUTE SETTLEMENT SYSTEM*, *supra* note 39, at 145, 180.

318. See *infra* note 339. For a recent discussion, see John H. Jackson, *Dispute Settlement and the WTO: Background Note for a Conference on Developing Countries and the New Round of Multilateral Trade Negotiations*, 1 J. INT'L ECON. L. 329, 341-42 (1999); Public Citizen, Global Trade Watch (last modified Feb. 23, 2000) <<http://www.publiccitizen.org/pctrade/trade/aboutgtw.htm>>.

319. See, e.g., *EC—Computer Equipment Appellate Body Report*, *supra* note 309, ¶ 80 ("The concept of 'reasonable expectations,' which the Panel refers to as 'legitimate expectations,' is a concept that was developed in the context of *non-violation* complaints.").

argue that such open-ended standards should perhaps be abandoned altogether, given their indeterminacy.

Some commentators have argued that Article XXIII:1(b) is analogous to the frustration of purpose doctrine in English contract law or to the principle of *clausula rebus sic stantibus*, which has been codified in Article 62 of the Vienna Convention of the Law of Treaties.³²⁰ Although there are similarities in the three legal concepts, perhaps most notably in that they do not require a violation of contract or treaty, the differences are substantial. Most importantly, a successful non-violation claim does not excuse or discharge a WTO member from performance of its WTO obligations. To the contrary, the relevant WTO provision continues in force, and the obligations of the offended WTO member are either adjusted or the offending WTO member pays compensation to the offended member.

The concept of legitimate expectations as expressed in both English contract law and English administrative law provides a better analogy. As explained above, a contract or institutionalist theory of treaty relationships can explain WTO rules and institutions. The WTO agreements are essentially long-term bargains subject to re-negotiation by members in successive negotiating rounds. In addition, WTO law is regulatory or public in nature. It is different in character from transactional law or private international law, which applies directly to transactions between private persons.³²¹

320. See, e.g., Cottier & Schefer, *supra* note 317, at 173. Article 62 of the Vienna Convention on the Law of Treaties, entitled "*Fundamental Change of Circumstances*," reads:

1. A fundamental change of circumstances which has occurred with regard to those existing at the time of the conclusion of a treaty, and which was not foreseen by the parties, may not be invoked as a ground for terminating or withdrawing from the treaty unless: (a) the existence of those circumstances constituted an essential basis of the consent of the parties to be bound by the treaty; and (b) the effect of the change is radically to transform the extent of obligations still to be performed under the treaty.
2. A fundamental change of circumstances may not be invoked as a ground for terminating or withdrawing from a treaty: (a) if the treaty establishes a boundary; or (b) if the fundamental change is the result of a breach by the party invoking it either of an obligation under the treaty or of any other international obligation owed to any other party to the treaty.
3. If, under the foregoing paragraphs, a party may invoke a fundamental change of circumstances as a ground for terminating or withdrawing from a treaty it may also invoke the change as a ground for suspending the operation of the treaty.

321. Although the public-private distinction may be somewhat artificial, it is nevertheless useful here.

Some legal theorists, notably P.S. Atiyah, maintain that legitimate expectations are the foundation for much of contract law. In contract law, legitimate expectations form the basis for reliance-based theories of contract law.³²² Reliance-based contract doctrine focuses analysis on a person's reaction to a promise; the promise itself is important, but it is not the source of the obligation. Alternatively stated, reliance-based theory focuses on the interaction of contract parties to find contractual obligation. The test for legitimate expectations in reliance based contract theory is whether justifiable or reasonable reliance exists.³²³ In administrative law, particularly the English version, the concept of legitimate expectations comes into play when a party justifiably relies on the promise or action of a public official. Legitimate expectation in administrative law is tied intrinsically to concepts of fairness and justice.³²⁴

Once the fundamental role of legitimate expectations is exposed, the use of a legitimate expectations standard by DSB panel members to determine WTO member obligations seems straightforward. The concept could be said to be a legal foundation for most agreements, private (contractual) or public (administrative and constitutional).

The standard tests for legitimate expectations, moreover, typically conflate "legitimate" and "reasonable." In contract law, reliance must be reasonable for it to have legal effect. In administrative law, reliance depends on the credibility of the representations and conduct of public officials. Thus, there is no meaningful distinction to be made between the formulation of "legitimate" and "reasonable" expectations.

b. *A Reciprocity Test*

Given the inevitable imprecision of language in Article XXIII and in "judicial" standards for interpreting WTO provisions, an alternative approach to interpreting Article XXIII:1(b) would be an even more explicit focus on the contract or bargain relationships between the parties. Such an approach is based on the concept of reciprocity, "a system of continuous 'trades' or 'swaps' of measures to liberalize (or restrict) trade."³²⁵

The reasoning for a reciprocity test would proceed as follows. The real focus of Article XXIII:1(b) analysis should not be on unduly

322. See P.S. Atiyah, *Contracts, Promises and the Law of Obligations*, 94 L.Q. REV 193 (1978).

323. See JOHN N. ADAMS & ROGER BROWNSWORD, *KEY ISSUES IN CONTRACT*, 153-54 (1995).

324. See P.P. CRAIG, *ADMINISTRATIVE LAW*, 288-89, 294, 434 (3d ed. 1994); P.P. Craig, *Legitimate Expectations: A Conceptual Analysis*, 108 L.Q. REV. 79 (1992).

325. JACKSON, *supra* note 284, at 345.

indeterminate language. Any reasonably open-ended formulation will vest substantial discretion in panel members. Non-violation claims should focus on whether measures have upset the competitive relations or balance of concessions among WTO members. Violation claims, on the other hand, should focus on whether there has been an actual violation of a provision in a WTO agreement.

The above Appellate Body decisions, as well as *Kodak-Fuji*, seem to at least hint at such distinctions, although they do not clearly articulate them. The Appellate Body in *India—Patent Protection* explained that a WTO member can bring a non-violation complaint

when the negotiated balance of concessions between Members is upset by the application of a measure, whether or not this measure is inconsistent with the provisions of the covered agreement. The ultimate goal is not the withdrawal of the measure concerned, but rather achieving a mutually satisfactory adjustment, usually by means of compensation.³²⁶

The reciprocity approach seems to reflect the way that WTO members actually interact in the world trading system. There are three possible states of affairs for the world trading system. The first state of affairs is one of totally open free trade. This is, of course, a theoretical possibility but not much else. In a world of free trade, “unilateral disarmament” would be the preferred option—removal of all trade restrictions regardless of whether countries have agreed to remove them. There would be no need for institutions such as the WTO or its DSB because governments, through their politicians and bureaucrats, would perceive free trade as the optimal solution. The neo-classical economic theory of comparative advantage reflects this approach. As explained by Paul Krugman, “the economist’s case for free trade is essentially a unilateral case: a country serves its own interests by pursuing free trade regardless of what other countries may do.”³²⁷

326. The Appellate Body in *EC—Computer Equipment Appellate Body Report*, *supra* note 309, explained that Article II:5 of the GATT 1994, dealing with tariff concessions, “recognizes the possibility that the treatment contemplated in a concession, provided for in a member’s schedule, on a particular product, may differ from the treatment accorded to that product and provides for a compensatory mechanism to rebalance the concessions between two members concerned in such a situation. However, nothing in Article II:5 suggests that the expectations of only the exporting member can provide the basis for interpreting a concession in a member’s schedule for the purposes of determining whether that member has acted consistently with its obligations under Article II:1.”

327. Krugman cites Bastiat for the proposition that “it makes no more sense to be protection-

Governments in this state of affairs are interested only in economic efficiency and in maximizing the welfare of their populace as a whole. In other words, the sole focus is on the size of the pie, with no consideration of the distribution of the pie.³²⁸ It is clear that the first state of affairs ignores or assumes away the transaction costs of institutions.

The second state of affairs is an intermediate position and one that, from an economic point of view, is second best.³²⁹ In this second state, the WTO agreements function as a set of incomplete contracts. The focus of the WTO regime is on *pacta sunt servanda*, not on welfare maximization. The second state of affairs represents a Pareto improvement in comparison to the third state of affairs outlined below, but it permits WTO members to take into account the distributional interests of producers to the potential detriment of consumers.

The third state of affairs is one of an economy completely closed off from international trade. In terms of strategic interaction, it is a state of affairs that could arise in the event that countries engage in a trade war involving retaliation. This third closed state of affairs is unrealistic for at least two reasons. First, government officials in industrialized countries may receive poor payoffs for substantial across the board restrictions in international trade. The disastrous consequences of the Smoot-Hawley Tariff Act may still loom on the time horizons of many politicians, which make such payoffs foreseeable. Second, economists have more-or-less clearly demonstrated that import substitution leads to substantial welfare losses.³³⁰

The world trading regime falls within the second state of affairs. The WTO regime, by its very nature and existence, represents a divergence from the neo-classical economic approach. Either the WTO shows that governments are unable to stop intervening and have to negotiate away concessions that they should give anyway, or economics fails to account for the very real consequences of institutions.

ist because other countries have tariffs than it would to block up our harbours because other countries have rocky coasts." Paul Krugman, *What Should Trade Negotiators Negotiate About?*, 35 J. ECON. LITERATURE 113, 113 (1997).

328. See RICHARD A. MUSGRAVE & PEGGY B. MUSGRAVE, *PUBLIC FINANCE IN THEORY AND PRACTICE* 11 (5th ed. 1989).

329. For a discussion of second best approaches in the context of the normative economics of international trade, see W. M. CORDEN, *TRADE POLICY AND ECONOMIC WELFARE* (2d ed. 1997).

330. There is a vast literature on the disadvantages of import substitution. See, e.g. ROBERT GILPIN, *THE POLITICAL ECONOMY OF INTERNATIONAL ECONOMIC RELATIONS* 184-87 (1987); Alan O. Sykes, *Comparative Advantage and the Normative Economics of International Trade Policy*, 1 J. INT'L ECON. L. 49 (1998).

The second state of affairs is also reflected in the structure of the DSU and in the DSB's Article XXIII:1(b) interpretations. The DSB enforces the WTO bargain of tariff concessions and agreements on non-tariff barriers without regard to economic efficiency. The DSB exists in the nation state system of reciprocity, and it is bound to adhere to an approach resembling the legal doctrine of freedom of contract even when this approach is inconsistent with the maximization of consumer welfare or economic efficiency. In a reciprocity based system, the DSB focuses on the balance of concessions, the competitive relationships between the WTO members, and similar conceptualizations to either preserve or restate the WTO bargain struck by the WTO members.

c. *An Inefficiency Test*

A radical alternative test for non-violation claims that would depart significantly from the language of Article XXIII and from the reciprocity orientation inherent in the WTO agreements would be an inefficiency test. Using an inefficiency test, a panel could interpret reasonable expectations, with economic efficiency as the primary consideration. Claimants would have to demonstrate that the measures of the respondent unambiguously reduce economic welfare below a certain level, agreed to by the WTO members. There are many possible formulations, from a very broad test that makes measures actionable under Article XXIII:1(b) if they substantially decrease the economic welfare of any WTO member or global welfare generally, to a narrow test that resembles the expectations test, which would require claimants to show that the measures in question reduce, stop, or block welfare improvements that were anticipated by the parties in the relevant rounds of trade negotiations. The test could include a Pareto or Kaldor-Hicks efficiency standard. Such a test would accommodate the widely accepted notion that trade liberalization increases economic welfare. It explicitly recognizes at least the avowed purpose for international trade agreements.

An inefficiency test could accommodate the notion that a trade agreement would be subject to efficient breach doctrine in few, if any, instances.³³¹ Countries are rarely in a position to argue that more trade barriers are more efficient than fewer trade barriers because trade

331. See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 131-40 (5th ed. 1988) for a basic discussion of efficient breach. Coasean bargaining approaches should be applied cautiously when the bargaining parties are governments. When the Coase Theorem is applied to legal rules directed toward the behavior of governments, the measurement of gain and loss may not truly

barriers imposed by governments block Pareto efficient exchanges by persons in different countries.³³²

The position of Uruguay in *Uruguay Recourse to Article XXIII* is helpful in understanding how an inefficiency test would (or would not) work.³³³ In 1961, Uruguay complained to the GATT that GATT benefits accruing to it had been nullified or impaired by 562 trade restrictions imposed by fifteen industrialized countries.³³⁴ According to the GATT Panel that considered Uruguay's claim, Uruguay drew to GATT's attention "the trade problems concerning temperate primary producers such as Uruguay, both as regards the limited marketing opportunities available to them and the failure of the prices of their products to be maintained at a satisfactory level."³³⁵ Uruguay essentially made a situation claim. Uruguay did not provide a detailed demonstration of how each trade restriction impaired or nullified a particular GATT benefit. According to the panel, Uruguay:

repeatedly referred to the general difficulties created for Uruguay by the prevalence of restrictive measures affecting its exports and to the resulting inequality in the terms on which temperate zone primary producers participate in world trade. The panel noted that it was not charged with the examination of broader issues falling outside the purview of Article XXIII. It also noted that those broader issues are being actively discussed by the Contracting Parties.³³⁶

In the *Uruguay Recourse* case, the GATT panel avoided the issue of whether Uruguay's claim was justiciable and instead relied on procedure to decide the case. In this case, GATT established standards for the burdens of proof in nullification or impairment claims. The panel stated:

In implementing the compensation provision of Article XXIII:2, the Contracting Parties would . . . need to know what benefits

reflect the gain or loss to private parties, but instead may reflect the gains and losses of government officials whose interests may be skewed towards particular producer lobbies or by vote trading and logrolling. Cf. Kenneth W. Dam, *THE GATT: LAW AND INTERNATIONAL ECONOMIC ORGANIZATION* 370 (1970).

332. See GILPIN, *SUPRA* NOTE 330.

333. *Uruguay—Recourse*, *supra* note 32.

334. Ernst-Ulrich Petersmann, *Violation Complaints and Non-Violation Complaints in Public International Trade Law*, 34 GERMAN Y.B. INT'L L. 175, 206–07 (1991).

335. *Uruguay Recourse*, *supra* note 32, ¶ 2.

336. *Id.* ¶ 22.

accruing under the Agreement, in the view of the country invoking the provisions, had been nullified or impaired, and the reasons for this view. In cases where there is a clear infringement of the provisions of the General Agreement, or in other words, where measures are applied in conflict with the provisions of the GATT and are not permitted under the terms of the relevant protocol under which the GATT is applied by the contracting party, the action would, *prima facie*, constitute a case of nullification or impairment and would *ipso facto* require consideration of whether the circumstances are serious enough to justify the authorization of suspension of concessions or obligations. While it is not precluded that a *prima facie* case of nullification or impairment could arise even if there is no infringement of GATT provisions, it would be in such cases incumbent on the country invoking Article XXIII to demonstrate the grounds and reasons of its invocation. Detailed submissions on the part of that contracting party on these points were therefore essential for a judgment to be made under this Article.³³⁷

The inefficiency test is subject to at least six objections. First, it conflates a situation complaint with the non-violation complaint. Second, it is not supported by the text of Article XXIII. These objections should not prove fatal to its existence, however, because the tests that panels already use are not explicit in the text of Article XXIII.

Third, the inefficiency test could be formulated in a way that is not much different than the expectations test. The major difference in the tests, however, could be on the focus on the source of the claim. The inefficiency test would focus on a very important avowed economic function of trade agreements—economic welfare enhancement. With very few exceptions, economists support trade liberalization to bring about gains from trade and specialization, and to increase global welfare through enhanced international trade.³³⁸ Politicians, however, may have other goals in mind, and are often concerned about distribution, although they may use free trade rhetoric to support their

337. *Id.* ¶ 15, *see generally* Petersmann, *supra* note 334.

338. This is the efficiency case for freetime. The theory of comparative advantage does not account for distributional concerns and some may question the normative sufficiency of conditions of economic efficiency. There are winners and losers in the theory of comparative advantage, but society as a whole is better off. *See* JACKSON, *supra* note 284, at 349; Sykes, *supra* note 330, at 49.

positions.³³⁹ A potential advantage of an inefficiency test is that it has the potential to channel political incentives toward the normative policy preference of free or liberalized trade.

Fourth, the test may be viewed as impinging on sovereignty, in that it may prescribe or attack the domestic policy autonomy of municipal institutions of WTO members. It could lead panels to declare, as impermissible under WTO agreements, policy or behavior that WTO members did not consider to be affected by the WTO regime. Worse, it could provide panels with incentives to be too active and intrusive and to add new substantive obligations to the WTO regime on a case-by-case or judicialized basis in dispute settlement rather than on a codified or legislative basis in WTO negotiating rounds.³⁴⁰ An overly broad inefficiency test could also lead to violations of DSU Article 3.2, which provides that "[r]ecommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements."³⁴¹ The result of an evolutionary legal regime brought

339. One of the basic insights in public choice theory that is relevant to examining the nature of sovereignty is the concept of rent seeking. See GORDON TULLOCK, *RENT SEEKING* (1993); Anne O. Krueger, *The Political Economy of the Rent-Seeking Society*, 64 AM. ECON. REV. 291 (1974). Interest groups take advantage of the rational ignorance of the general population of voters to obtain policy outcomes in the political process that are beneficial to their own special interests, yet harmful to the public at large. See CHARLES K. ROWLEY, ET AL., *TRADE PROTECTION IN THE UNITED STATES* 91 (1995). Efforts at seeking such restrictions in the law are a negative sum game. The consequences of such rent seeking by interest groups is dead-weight loss, a transfer of wealth from many voters or consumers to a few special interests or producers, and socially wasteful expenditure on lobbying. As explained by Rowley, et al.:

Special interests may be viewed as rent-seekers or as rent-protectors, whose principal objective is that of creating or of maintaining rents through the political process and of securing such rents in the form of transfers from the general interest to their own constituencies. Such rents, by definition, are returns in excess of opportunity cost, and special interest groups do not engage primarily in productive activity. Indeed, rent-seeking by special interest groups typically occurs in institutional settings where the pursuit of private gain generates social waste rather than social surplus . . . and in which the competition between scarce resources focuses on the redistribution rather than the enhancement of a nation's wealth.

Id. at 92.

340. A rigorous application of Article XXIII may deter rent-seeking and other activities that result in social waste, but it may also drive such activities further underground. Lax competition policy, for example, could have the effect of shifting rents from foreign to domestic firms. See Iacobucci, *supra* note 274, at 8-9.

341. DSU, *supra* note 28, art. 3.2, at 405, 33 I.L.M. at 1227. A covered agreement is one subject to the DSU. These arguments are listed in DSU Appendix I. See *id.* art. 1.1, at 404, 33 I.L.M. at 1226.

about by an inefficiency test could be asymmetrical policy and differing obligations amongst WTO members. On the other hand, it may be more efficient for members that lose dispute panel cases to apply such policies across the board to all WTO members than to have different policies for different members. This could lead to substantial augmentation of WTO obligations via dispute settlement “case law.” As demonstrated below, these concerns may be unfounded to the extent that WTO rules and institutions are effective in constraining DSB preferences in a manner that align with the preferences of WTO members.³⁴²

Fifth, and related to the fourth objection, an inefficiency test vests substantial discretion in members of dispute settlement panels and the Appellate Body. But are these decision makers any worse at making decisions than other WTO decision makers? DSB decision-makers are insulated, to a significant extent, from conflicts-of-interest and, as shown below, they are constrained by decisions made by other WTO institutions.³⁴³ This fifth objection is really part of the fourth objection—it is an objection to the sovereignty impinging nature of the shift of power to the DSB. The objection reflects a recognition that decisions about the nature of multilateral trading obligations are *political* in nature and that DSB panelists should not make political decisions.

Finally, the inefficiency test presents the DSB with difficult information problems. This, however, could be said about non-violation claims generally, and also about a host of other claims that the DSB is bound to decide. Having said this, an inefficiency test will likely lead to more onerous information problems than the contract-related standards that the DSB currently employs.

d. *A National Treatment Test*

A final test to be considered for assessing non-violation claims is the national treatment requirement found in Article II of GATT 1947³⁴⁴. This is an approach that has been developed by Trebilcock and Howse in posing alternatives to harmonization across countries in order to maintain domestic policy autonomy and to obtain the benefits of the

342. See *infra* notes 359–80 and accompanying text.

343. See *id.*

344. General Agreement on Tariffs and Trade, Oct. 30, 1947, art. II, 61 Stat A-11, T.I.A.S. 1700, 55 U.N.T.S. 194,

existence of competitive governments.³⁴⁵ As explained by Trebilcock and Howse:

[T]he focus of attention on domestic policies that may constitute non-tariff barriers to trade should relate principally to two objectives: first, elaborating on the principles of negative integration that have historically characterized the approach of the GATT to these issues, i.e. the application of the National Treatment principle in Article III of the GATT to domestic policy measures of member states (requiring that produces of foreign countries receive no less favourable treatment than that accorded to like produces of national origin), and elaborating the criteria presently contained in Article XX of the GATT that justify exceptions to this basic obligation of non-discrimination and the constraints thereon, in particular constraints on disguised or unjustified forms of discrimination (the sham principle and the least trade-restrictive means or proportionality principle); and second, to structure the ground rules pursuant to which mutually beneficial agreement between member states can be reached over policy harmonization or convergence that are both non-coercive and non-discriminatory vis-a-vis other trading partners (i.e. respect the Most-Favoured Nation principle).³⁴⁶

A subsidiary argument of the United States in *Kodak-Fuji* was that Japanese distribution countermeasures violated the national treatment obligation set forth in Article II of GATT 1947. The *Kodak-Fuji* panel found that the Japanese measures did not discriminate, *de jure* or *de facto*, against foreign firms. In addition, the panel found that the activities in question—single brand distribution in particular—were becoming standard industry practices without government intervention, even in the United States.³⁴⁷

As explained above, the *Kodak-Fuji* panel found few significant distinctions between national treatment and non-violation standards. The main difference between the two provisions was that the non-violation provision requires a comparison of competitive relationships

345. See Michael Trebilcock & Robert Howse, *Trade Liberalization and Regulatory Diversity: Reconciling Competitive Markets with Competitive Politics*, 6 EUR. J.L. & ECON. 5 (1998); see also Michael Trebilcock, *Competition Policy and Trade Policy: Mediating the Interface*, 30 J. WORLD TRADE 71 (1996).

346. See *id.* at 10.

347. See *Japan—Film Panel Report*, *supra* note 5, at ¶ 10.381.

between products both currently and at the time of the relevant concession, while the national treatment provision requires a consideration generally of whether foreign goods are treated no less favorable than domestic goods, with no references to the timing of concessions.³⁴⁸

The main drawback of using a national treatment test under Article XXIII is that it could render the non-violation language in Article XXIII ineffective or meaningless. The non-violation claim is designed to deal with situations that do *not* result in a violation of any WTO obligation, including Article III. A national treatment test, in essence, would turn every non-violation claim into a violation claim. These drawbacks, however, do not refute the proposition that Article III and its substantial jurisprudence provides useful guidance in understanding how to decide non-violation claims and to properly delimit Article XXIII:1 (b) coverage.³⁴⁹

3. Summary Critique: Regulating Domestic Policy Externalities

The fundamental problem that Article XXIII has the potential to contend with are “domestic policy externalities.” The term “externalities” is used loosely here and not necessarily in the strict economic sense of the term; the term may have more precise meanings in mainstream economic theory.³⁵⁰ The term is used here to refer to situations in which the laws or policies of one WTO member have a negative effect on the benefits that another WTO member enjoys under a WTO agreement that is subject to Article XXIII:1 (b). Moreover, the relevant interest here is negative effects rather than positive effects, because negative effects are more likely to result in nullification or impairment that is actionable under Article XXIII:1 (b).³⁵¹

Scholars have described the problem of domestic policy externalities in different ways. In promoting the idea of harmonization of competition policy, Ostry describes the problem as one of “system frictions”:

348. See *supra* notes 233–44 and accompanying text.

349. See JACKSON, *supra* note 284, at 216–24 (discussing national treatment jurisprudence).

350. See Jeffrey L. Dunoff & Joel P. Trachtman, *Economic Analysis of International Law*, 24 YALE J. INT'L L. 1, 13–16 (1999) (“externalities are notoriously difficult to define”). For a similar substantive treatment, see David W. Leebron, *Lying Down with Procrustes: An Analysis of Harmonization Claims*, in 1 FAIR TRADE AND HARMONIZATION: PREREQUISITES FOR FREE TRADE? 41 (Jagdish Bhagwati & Robert E. Hudec eds., 1996).

351. See *id.*

[C]ompetition among firms is also competition among systems and the slow “natural” process of convergence will produce serious discord—system friction—along the way. A globalizing world has a low tolerance for system divergence. Continuing instability and growing pressure for new forms of managed trade are the likely outcomes. But a new approach to mitigating system friction is, in fact, to undertake an international policy process to promote the convergence of those government policies which are most relevant to the process of innovation. Most of these policies are domestic: the new international arena beyond the border.³⁵²

Jackson, on the other hand, has distinguished between harmonization, reciprocity, and “interface.”³⁵³ Interface “recognizes that different economic systems will always exist in the world and tries to create the institutional means to ameliorate international tensions caused by those differences, perhaps through buffering or escape-clause mechanisms.”³⁵⁴ Hard-to-define language such as “globalization” and “interdependence” are used frequently to describe these sorts of problems.³⁵⁵

The incentives for states to externalize the costs of their domestic policies are numerous and varied. Competition policy is one of the primary areas of public policy that presents significant opportunities for policy makers to devise domestic legal and political institutions that result in a disguised protectionism.³⁵⁶ The disguise in competition policy is a very good one because the government in question can hide behind the argument that it is the structure of the economy and the actions of the private sector, not official measures undertaken by the government, that close or restrict markets. Competition policy can form an integral part of a strategic trade policy by changing the

352. Sylvia Ostry, *Beyond the Border: The New International Policy Arena in COMPETITION POLICY IN AN INTERDEPENDENT WORLD ECONOMY* 265 (E. Kantzenback, et al. eds., 1991).

353. JACKSON, *supra* note 284, at 345.

354. *Id.*

355. See, e.g., GLOBALIZATION IN WORLD POLITICS (John Baylis & Steve Smith eds. 1997); THE GLOBALIZATION READER (Frank J. Lechner & John Boli eds., 1999); Marsha A. Echols, *Food Safety Regulation in the European Union and the United States: Different Cultures, Different Laws*, 4 COLUM. J. EUR. L. 525 (1998) (stating that the globalization and interdependence affect regulation of food safety); Julie Mertus, *From Legal Transplants to Transformative Justice: Human Rights and the Promise of Transnational Civil Society*, 14 AM. U. INT'L L. REV. 1335 (1999); Alex Y. Seita, *Globalization and the Convergence of Values*, 30 CORNELL INT'L L.J. 429 (1997).

356. See generally Iocabucci, *supra* note 274.

strategic interaction of firms to facilitate the shift of wealth (or, in economic terms, surplus) from foreign firms to domestic firms.³⁵⁷

The methods by which domestic policy externalities are dealt with in international relations fall into three categories: methods based on bilateral persuasion, methods based on institutionalization, and unilateral techniques such as extraterritorial application of laws.³⁵⁸ In the early days of the GATT, when conciliation was the prevalent policy conception underlying GATT dispute settlement, Article XXIII served an important role as a "bilateral persuader." Countries could use Article XXIII to conciliate potential disputes about the respective benefits that they anticipated under the GATT. This was the power-based system that pervaded GATT diplomacy. In the post-Uruguay Round period, there is the institutionalization of a judicialized based dispute settlement. Countries can now use Article XXIII to litigate disputes that cannot be resolved through conciliation. This is the rule-based system that exists in the WTO system.

Finally, Article XXIII can be posed as an alternative to harmonization and to extraterritorial application of domestic laws. The relevant question is: should competition policy be the subject of regulation in a WTO code framework, or should the DSB be left alone, at least for the time being, to produce "case law" that would serve the purpose of revealing the preferences of WTO member positions on competition policy? Article XXIII can serve as a "grant of common law jurisdiction"³⁵⁹ to deal with domestic policy externalities as they arise.

C. *The Positive Political Framework: Conceptualizing the Constraints in the WTO System*

1. The WTO Policy Evolution Game

As explained above, a substantial amount of literature on Article XXIII argues that Article XXIII should be interpreted narrowly to avoid "wrong cases" and to avoid the typical parade of horrors or opening of the floodgates.³⁶⁰ These arguments are made when there is disagreement as to interpretation of a text or when a judicialized decision-maker is viewed as being too active in its approach to adjudication. Positive political theory can be used to understand institutional

357. *See id.* at 8-9.

358. *See* Dunoff & Trachtman, *supra* note 349, at 14.

359. HUDEC, *supra* note 275, at 480; *see supra* notes 283-88 and accompanying text.

360. *See supra* note 275 and accompanying text.

interaction and to show that these concerns may be unfounded and may result in unneeded limits on the authority of the DSB.

For this analysis, attribute the worst motivations to DSB panel members: assume that they act as any WTO member would with the power to write an obligation into a WTO agreement that maximizes their own preferences.³⁶¹ No judicialized system of decision making can operate without some degree of discretion vested in the decision-maker.³⁶² The issue, however, is how that discretion is constrained by rules and institutions, in this context WTO rules and institutions.

In the WTO legal system, members of dispute settlement panels and the Appellate Body can be viewed as players in a policy evolution game. Although the WTO constitutional structure does not closely resemble the structure of typical domestic constitutional structures, with legislative, executive, and judicial functions more or less plainly carved out in the domestic constitution, there is a separation of powers within the WTO system. There are also conflicts of interest among institutions within the WTO system that facilitate principal-agent monitoring. Policy is formulated in negotiating rounds, in the Ministerial Conference, in the four Councils, and, to a more limited extent, in Committees.³⁶³ There is no discrete executive as in a domestic legal order, but the WTO Secretariat serves a coordinating and administrative role. The DSB serves a judicial or judicialized role.

If a "decisive coalition" of WTO members disagrees with a panel report or Appellate Body report, they may overrule it in any number of ways.³⁶⁴ There are at least seven constraints on the DSB:

First, panel reports have no precedential value. As Jackson explains:

The . . . DSU does not contain anything that would lead to a view that the legal effect . . . of a panel report is different from that of the practice under GATT. This suggests that . . . neither a *stare decisis* effect, nor any "definitive interpretation" effect (particularly given that there is an alternative procedure for a definitive interpretation) of a panel report exists. Nevertheless, the panel report remains persuasive, and presumably is part of the "practice" of the parties under the agreement.³⁶⁵

361. This is a well-established assumption in the rational choice literature. See Posner, *supra* note 331, at 581–84; see also SHEPSLE & BONCHEK, *supra* note 282, at 422 (stating that judges are "legislators with robes").

362. See John Linarelli, *Anglo-American Jurisprudence and Latin America*, 20 FORDHAM INT'L L.J. 50, 65 (1996).

363. See JACKSON, *supra* note 284, at 62–67.

364. See SHEPSLE & BONCHEK, *supra* note 282, at 422.

365. JACKSON, *supra* note 284, at 126.

Second, a Ministerial Conference and a General Council have exclusive authority to issue interpretations of the basic WTO treaties and the multilateral trade in goods agreements found in Annex 1 of the Uruguay Round Final Act. These constitute the bulk of the WTO texts. An interpretation requires a three-fourths vote by WTO members.³⁶⁶

Third, GATT 1994 provides that the WTO may issue "decisions" on the basis of a majority vote if the WTO members cannot reach a consensus.³⁶⁷

Fourth, the Ministerial Conference may grant waivers of WTO obligations on the basis of a three-fourths favorable vote of WTO members.³⁶⁸

Fifth, WTO members may affect DSB panel reports by negotiating new obligations or by changing obligations in successive negotiating rounds of multilateral trade negotiations.

Sixth, WTO agreements may be amended. There are complex voting rules for amending a WTO agreement. They range from consensus requirements to actions by a Ministerial Conference without any vote. A two-thirds vote is required to amend most WTO obligations.³⁶⁹ It has been the GATT/WTO practice, however, to avoid amendments and to instead revise obligations through bargaining, in successive negotiating rounds.³⁷⁰

Seventh, the Appellate Body serves as an additional constraint on dispute settlement panels. The Appellate Body, a permanent group comprised of a roster of seven experts, has issued very conservative appeals, possibly to preserve their credibility in the early years of the post-Uruguay Round period.³⁷¹ Appellate Body members serve for four years, subject to one renewal for another four years.³⁷²

The DSB is constrained by these WTO institutions—any widely expansive opinion is likely to have limited effect, and indeed could be limited to the particular proceeding—even though the consensus rule has been reversed.³⁷³ Procedures exist to "reverse" decisions prospectively, despite the powers given to the DSB in the Uruguay Round. Judicialized dispute settlement and the institutional constraints in the

366. See Marrakesh Agreement Establishing the World Trade Organization, Apr. 15, 1994, art. IX(2), WTO Agreement, in *RESULTS OF THE URUGUAY ROUND* 5, 11 (1994), 33 I.L.M. 1125, 1148.

367. See *id.*, art. IX(1), at 11, 33 I.L.M. at 1148.

368. *Id.*, art. IX(3), at 11–12, 33 I.L.M. at 1148.

369. See JACKSON, *supra* note 284, at 71–73.

370. See *Id.*

371. See, e.g., *supra* note 318 and accompanying text.

372. See DSU, *supra* note 28, art. 17(2), at 417, 33 I.L.M. at 1236.

373. See *supra* note 296 and accompanying text.

WTO give WTO members the opportunity to engage in an iterative policy evolution game, which allows for the screening of issues for consideration under future rounds.

A spatial choice model initially conceived by Harold Hotelling³⁷⁴ and developed by Marks and others³⁷⁵ can be used to understand the constraints on WTO panels. Assume that policy choices in the WTO system can be represented on a one-dimensional interval, $[0, x]$. We can define x to be 10 or 1000; it does not matter to the analysis. This one-dimensional interval can be used to derive a policy evolution game applicable to the WTO.³⁷⁶ Assume that all of the actors in this policy evolution game have single peaked preferences. This means that each player in the game prefers policies that are closer to their ideal policy, as those policies are mapped out spatially on the one-dimensional interval.³⁷⁷ Three dispute settlement panel members have ideal points on this interval labeled x_{p1} , x_{p2} , and x_{p3} . The ideal points of the approximate 135 WTO members³⁷⁸ are given by x_{m1}, \dots, x_{m135} , and the ideal points of the seven members of the Appellate Body are x_{a1}, \dots, x_{a7} . Only three members of the Appellate Body may sit on any given appeal, and in this analysis the decision of the Appellate Body is represented by the median Appellate Body member.

Assume at the beginning of the play of the game that a *status quo* WTO agreement choice, x_w , is in place. This may be the result of actions taken during previous plays of the policy evolution game, such as a rule resulting from a ministerial round, an interpretation, or any other decision-making process in the WTO.³⁷⁹ A typical policy evolution game in an Article XXIII context would occur as follows. A WTO member decides to take action possibly nullifying or impairing the benefits of another WTO member, depending on the Article XXIII

374. See generally Harold Hotelling, *Stability in Competition*, 39 ECON. J. 41 (1929).

375. SHEPSLE & BONCHECK, *supra* note 282, at 423.

376. The following analysis is based on SHEPSLE & BONCHECK, *supra* note 282, at 422–29. See generally MELVIN J. HINICK & MICHAEL C. MUNGER, *ANALYTICAL POLITICS* (1997); John A. Ferejohn & Barry R. Weingast, *A Positive Theory of Statutory Interpretation*, 12 INT'L REV. L. & ECON. 263 (1992); John Ferejohn & Barry Weingast, *Limitation of Statutes: Strategic Statutory Interpretation*, 80 GEO. L.J. 565 (1992); Thomas W. Gilligan & Keith Krehbiel, *The Gains from Exchange Hypothesis of Legislative Organization*, 19 LEGIS. STUD. Q. 181 (1994); Keith Krehbiel, *Spatial Models of Legislative Choice*, 13 LEGIS. STUD. Q. 259 (1988).

377. See HINICK & MUNGER, *supra* note 375, at 27.

378. See World Trade Organization, *About the WTO* (visited Jan 15, 2000) <<http://www.wto.org/wto/about/about.htm>> (stating that, as of November 13, 1999, there were 135 members); JACKSON, *supra* note 284, at 2 (projecting 160 WTO members).

379. See *supra* note 365–71 and accompanying text.

interpretation to apply to the given situation. The offended WTO member decides to bring a dispute, and the dispute panel decides whether or not to find nullification or impairment. The losing party may appeal if it has a colorable argument for disagreeing with the panel's interpretation of the proper legal standard under Article XXIII, i.e., if it believes that the preferences of the Appellate Body are closer to its own rather than to those of the panel.³⁸⁰ The Appellate Body then issues its decision. The Appellate Body can only hear appeals on matters of law, not fact. The distinction between "fact" and "law," however, is widely acknowledged to be tenuous, and it is particularly unhelpful in an Article XXIII context because the choice of legal standard—the interpretation of Article XXIII—will, in effect, determine whether there is a new WTO obligation for the WTO member that is a respondent in the proceeding. If WTO members are dissatisfied with the Appellate Body's decision, or with the panel outcome, then they can nullify it or stop it from becoming WTO practice through the various WTO decision-making modes outlined above. This last action by the members sets the stage for another round of the game. On the next occasion of the game, a panel may have to make a decision under Article XXIII constrained by the new action or code provided by the members. With numerous iterations along these lines, the long-term "common law" evolution of policy can be studied. WTO members can use this policy evolution to understand, for example, the effects of the lack of a WTO competition policy on international trade.

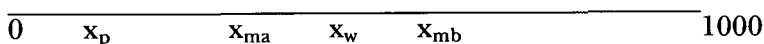
For purposes of simplicity, it can be assumed that the point x_w in Figure 1 represents the preferences of median members of the particular group in question. This may be a troublesome assumption because, clearly, not all decisions are made by majority rule and the preferences of WTO members are heterogeneous. This simplifying assumption is made to keep the model tractable and to avoid the cluttered exposition of mapping every preference of all the WTO members. The model could be made more realistic and incorporate a consensus rule approach, but this would add much more detail with no increase in the usefulness or predictability of the model.

The fundamental issue for consideration is what actions by a dispute settlement panel will trigger a response by either the WTO members or by the Appellate Body. Consider Figure 1, in which there is no Appellate Body; panel members must only be concerned with the preferences of the WTO members. This resembles the situation existing prior

380. As explained above, Appellate Body only reviews questions of law. See *supra* note 260.

to the Uruguay Round. We will assume that the interval $[x_{ma}, x_{mb}]$ is an interval of indifference or deadlock for WTO members. It is the interval in which WTO members cannot reach agreement to change policy through the modes of policy change that are available to them.³⁸¹ Assume, for purposes of conceptualization, that as one moves to the left along the entire one-dimensional interval, policy preferences tend to favor an expansive Article XXIII, and as one moves to the right, policy preferences tend to favor a restrictive Article XXIII. If a panel's ideal preference lies to the left of this interval, and there is no Appellate Body, then the best that a panel could do is x_{ma} . Thus, the panel report would be at $X = x_{ma}$. This is the policy closest to the panel's ideal that would not trigger a response from the WTO members.

Figure 1



Now, add the Appellate Body into the game. Suppose that the Appellate Body's ideal preferences lie to the left of x_p . This Appellate Body would prefer an expansive Article XXIII. The best that the Appellate Body could do would be x_{ma} . Thus, if the panel report is at $X = x_{ma}$, then the Appellate Body would uphold the decision at x_{ma} . This is the best it could do, given its preferences and the preferences of the WTO members.

Suppose that x_a were inside the interval $[x_{ma}, x_{mb}]$. The Appellate Body could overrule the panel, whose preferences are outside the interval, and choose any interpretation of Article XXIII within the interval.

Finally, what if x_a is to the right of x_{mb} ? This Appellate Body would prefer a restrictive Article XXIII. Any panel report at $X = x_p$ would be overruled unless it was at x_{mb} , which is the best that the Appellate Body could get, given the preferences of the WTO members.

This analysis provides a method for determining whether Article XXIII decisions by dispute settlement panels are constrained by the rational responses of other actors in the WTO system. Notably, it shows that if effective constraints on DSB decision making exist, concerns about overly broad Article XXIII decisions by the DSB could be misguided.

381. See *supra* notes 259–63 and accompanying text.

2. Unilateral Remedies: An Opting Out of the Policy Evolution Game?

One of the more contentious disagreements in the world trading system is whether states may impose unilateral remedies against other states. Can a domestic institution in state A (perhaps a political body such as a legislature or some body within the executive of state A) determine, on its own, that state B has violated its WTO obligations or some other international obligation relating to international trade liberalization, or has acted unfairly in protecting markets located in state B? With the promulgation of the Uruguay Round agreements, the question has been transformed from a normative one to a positive one—*can* states still undertake unilateral action despite the establishment of the Uruguay Round DSU?

The question is relevant to the policy evolution game described in the preceding section because WTO members that use unilateral remedies (most notably the United States) may have an “out” from the policy evolution game, or may be playing a different game. With the possibility of unilaterally imposed sanctions, the strategies and players of the game would be fundamentally altered. There would be at least one additional player (a domestic decision maker) and additional strategies (the choice of unilateral sanctions outside of the multilateral legal framework). The addition of players and strategies could be detrimental to policy evolution. Parties could play a different game and the development of Article XXIII as a tool for developing WTO jurisprudence could be thwarted. In *Kodak-Fuji*, the United States used Section 301 to set the agenda for its dispute with Japan and then moved the case into the WTO. U.S. reliance on Section 301 in the initial stages of *Kodak-Fuji* did not seem to result in the abandonment of the multilateral system to resolve the dispute. In future cases, however, the payoffs may provide the United States with the incentives to take unilateral action outside of the multilateral dispute settlement system.

One of the fundamental problems with the DSU in its current state is that it may not effectively constrain parties from relying on unilateral approaches. Many commentators and government officials quickly conclude that the DSU prohibits all forms of unilateral action.³⁸² Such a flat prohibition would appear to be an oversimplification. It cannot be stated unequivocally that a unilateral regime is inconsistent with the DSU. DSU Article 23.3(a) states that WTO members “shall not make a determination to the effect that a violation has occurred, that benefits

382. See, e.g., J.G. MERRILLS, *INTERNATIONAL DISPUTE SETTLEMENT* (3d ed. 1998).

have been nullified or impaired or that attainment of any objective of the covered agreements has been impeded, except through recourse to dispute settlement" under the DSU.³⁸³ Moreover, DSU Article 23.2(c) requires WTO members to

follow the procedures set forth in [the DSU] to determine the level of suspension of concessions or other obligations and obtain [DSB] authorization in accordance with those procedures before suspending concessions or other obligations under the covered agreements in response to the failure of the Member concerned to implement [DSB] recommendations and rulings within [a] reasonable period of time.³⁸⁴

These provisions seem to mandate that WTO members resort to the DSU for disputes concerning WTO agreements. They do not explicitly forbid unilateral action, and the provisions could reasonably be interpreted to permit unilateral action to attack measures that are not covered by WTO agreements.³⁸⁵ The fundamental question is whether the DSU should be interpreted or amended to forbid WTO members from undertaking any unilateral action whatsoever in international trade matters.³⁸⁶ Such an approach would be necessary to bring about the policy evolution game set forth in the preceding section.³⁸⁷

383. DSU, *supra* note 28, art. 23.2(a), at 426, 33 I.L.M. at 1241.

384. *Id.* art 23.2(c) at 426, 33 I.L.M. at 1242.

385. There may be great difficulty, moreover, in determining whether the a WTO agreement covers or does not cover a particular area of economic activity. WTO agreement coverage may be a matter of degree rather than kind, particularly as the scope of WTO agreement coverage increases with each successive round of multilateral negotiations.

386. The issue of whether remedies provided for by treaty preclude resort to customary international law remedies will be left for another article.

387. A counter-argument is that when a unilateral regime provides persons with the ability to bring complaints to their government for adjudication, the regime may be characterized as a procedural mechanism for citizens to access international law remedies. Unilateral regimes have the potential to facilitate monitoring by WTO members of other members and to open markets. They may also serve to open markets and increase global welfare even where the restrictive measures are not subject to WTO liberalization. See Alan O. Sykes, *Constructive Unilateral Threats in International Commercial Relations: The Limited Case for Section 301*, 23 LAW & POL'Y INT'L BUS. 263, 265 (1992) (stating that U.S. Section 301 "is sharply distinguishable from other U.S. trade statutes. . . . The other statutes "are intrinsically protectionist and are ordinarily detrimental to the national economic interest. By contrast, *successful* actions under Section 301 almost invariably benefit the U.S. economy, other things being equal."). Exporters will have an incentive to report instances of market access problems when these problems impede their ability to export. Unilateral remedies thus may be simply a formalized, institutionalized and more transparent form

D. Kodak-Fuji in Context

The above analytical framework can be applied to understand the *Kodak-Fuji* dispute.³⁸⁸ Much of the discussion to date on *Kodak-Fuji* and related policy issues has focused on Japanese “structural” barriers to trade, and on whether the WTO should regulate competition policy or restrictive business practices.³⁸⁹ These are good questions, but they do not address the core of the problem. Further, these questions do not explain *why* the economic institutions of two large trading nations such as Japan and the United States are so different.

The Panel Report is evidence of the different approaches of Japan and the United States to the role of law and regulation in the market-oriented economy. These differences have been well documented, prior to and independent of the dispute between the two countries on the openness of markets for film and photographic paper. Much of this literature explains Japanese and American differences on the basis of culture, and asserts that Westphalian conceptions of nation-state sovereignty should protect culture from external intrusions.³⁹⁰ In addition

of diplomatic protection, in which persons petition their governments to take action against other governments.

Another potential disadvantage of unilateral approaches, however, is that an implicit market for protection or in the allocation of rights to access the system may be created. There is a substantial argument that 301 and other unilateral remedies are subject to capture by special interest groups. *See supra* note 339 on rent seeking. This criticism, however, is not unique to unilateral remedies and could be leveled at virtually all areas of public regulation.

388. Indeed, they can be applied to a host of issues that have historically been in contention in Japan-U.S. relations, including the Structural Impediments Initiative of the late 1980s and early 1990s, and the Enhanced Initiative on Deregulation and Competition Policy under the U.S.-Japan Framework Agreement, which Japan and the United States entered into in June 1997. *See* U.S. DEP'T OF STATE, 1998 COUNTRY REPORTS ON ECONOMIC POLICY AND TRADE PRACTICES: JAPAN (Jan. 31, 1999) <http://www.state.gov/www/issues/economic/trade_reports/eastasia98/japan98.html>; U.S. TRADE REPRESENTATIVE, SUBMISSION BY THE GOVERNMENT OF THE U.S. TO THE GOVERNMENT OF JAPAN REGARDING DEREGULATION, COMPETITION POLICY, AND TRANSPARENCY AND OTHER GOVERNMENT PRACTICES IN JAPAN (Oct. 7, 1998) <<http://www.ustr.gov/reports/index.html>>; MINISTRY OF FOREIGN AFFAIRS OF JAPAN, SUBMISSION BY THE GOVERNMENT OF JAPAN TO THE GOVERNMENT OF THE U.S. REGARDING DEREGULATION, COMPETITION POLICY AND OTHER GOVERNMENT PRACTICES (Oct. 6, 1999) <<http://www.mofa.go.jp/region/n-america/us/dereg9910.html>>; *see also* Case, *supra* note 1, at 15–27.

389. *See supra* notes 1, 264, 387.

390. Sovereignty is an ambiguous concept. It is perhaps trite to say that the WTO agreements, as do all treaties, “abrogate” sovereignty. *See* JACKSON, *supra* note 284, at 293–300 (discussing the context of actionable subsidies); John Linarelli, *The Economics of Sovereignty*, in RENEGOTIATING WESTPHALIA: ESSAYS AND COMMENTARY ON THE EUROPEAN AND CONCEPTUAL FOUNDATIONS OF MODERN INTERNATIONAL LAW 351, 353 (Christopher Harding & C.L. Lim eds. 1999).

to the culture arguments, a host of explanations for Japanese and American differences are based on differing conceptions of the role of industrial policy or trade policy in an economy. Japan, it is argued, has well-established approaches to industrial policy and strategic trade policy that originated in the Meiji era, when Japan rapidly industrialized.³⁹¹

Kodak-Fuji suggests an alternative explanation to the culture explanation. It illustrates the existence of significant domestic policy externalities that cross Japanese and U.S. borders. The case shows how property (or contract) rights exist in different forms in the United States and Japan, and how the differences affect international trade liberalization. As explained by one Japanese social scientist, Takeo Kikkawa:

The problem of the 'closed' Japanese market lies in the existence of a large gray zone within which two—in theory mutually contradictory—principles, the market principle and the organization principle, are mixed together. This gray zone is known as the 'organized market.' The market, in essence, is a place which members can enter and leave freely and where they can freely make exchanges, with price as the most important signal and with maximization of profits or benefits as the most important motive. The organization, on the other hand, is a place where a fixed set of members carry out transactions, their behavior steered ultimately by orders backed up by authority. According to conventional, two-dimensional theory the market and the organization are incompatible. The problem is that in every sphere of economic activity in Japan we find organized markets which conventional theory has great difficulty in explaining.³⁹²

Conceptualizing a market-oriented order is a Hayekian notion of the

391. See Kozo Yamamura, *Caveat Emptor: The Industrial Policy of Japan*, in STRATEGIC TRADE POLICY AND THE NEW INTERNATIONAL ECONOMICS 169 (Paul R. Krugman ed., 1986); Mitsuo Matsushita, *The Intersection of Industrial Policy and Competition: The Japanese Experience*, 72 CHI-KENT L. REV. 477, 479 (1996); Frank K. Upham, *The Legal Framework of Japan's Declining Industries Policy: The Problem of Transparency in the Administrative Process*, 27 HARV. INT'L L.J. 425, 425–36 (1986); Takashi Wakiyama, *The Nature and Tools of Japan's Industrial Policy*, 27 HARV. INT'L L.J. 467, 471–98 (1986).

392. Takeo Kikkawa, *Organized Markets in Japan: An Attempted Assessment and Typology*, 1 SOC. SCI. JAPAN ¶ 1 (1994) <<http://www.iss.u-tokyo.ac.jp/Newsletter/SSJ1/kikkawa.html>>; see also Ronald J. Gilson & Mark J. Roe, *Understanding the Japanese Kieretsu: Overlaps Between Corporate Governance and Industrial Organization*, 102 YALE L.J. 871 (1993); Douglas E. Rosenthal & Mitsuo Matsushita, *Competition in Japan and the West—Can the Approaches Be Reconciled?*, WORLD COMPETITION: L. & ECON. REV., Mar. 1996, at 5.

market as spontaneous order.³⁹³ Its apparent roots are in the neoclassical notion of freedom of contract. The Japanese approach, on the other hand, is a combination of Oliver Williamson and James Buchanan—transaction cost economics, captured in the political process.³⁹⁴ This is what Kikkawa refers to as “organized markets”—the Japanese government involves itself in establishing property rights at the transactional level. The Western approach is based on freedom of contract, where contract rules are designed principally as default terms or ground rules, and it is up to participants in the market to make transaction decisions. In the United States and the West generally, government involvement in transaction structuring is considered a questionable form of government interference, to be used exceptionally to implement public policy designed to deal with market failures, such as information problems in securities offers and monopoly problems in mergers and acquisitions. In Japan, government involvement in transaction structuring is a routine and vital part of government activity. In both systems, the state is involved in the creation of property rights, albeit in different ways.

Why do these differences exist? Though it would be easy to look to the cultural differences for explanations, there is perhaps a rational choice explanation, found in the costs of implementing a legal and regulatory regime, and in the concept of path dependence.³⁹⁵ Although it is beyond the scope of this Article to explore these questions in detail, some tentative generalizations will be provided.³⁹⁶ Two events

393. Hayek's works in this connection include FRIEDRICH A. HAYEK, 1 *LAW, LEGISLATION AND LIBERTY: RULES AND ORDER* (1973); F. A. Hayek, *The Use of Knowledge in Society*, 35 *AM. ECON. REV.* 519 (1945).

394. See, e.g., Oliver E. Williamson, *Transaction Cost Economics*, in 1 *HANDBOOK OF INDUSTRIAL ORGANIZATION* 135 (R. Schmalensee & R.D. Willig eds., 1989). Oliver Williamson is one of the founders of transaction cost economics. James Buchanan is one of the founders of public choice theory, which is the economic analysis of the political process and non-market allocative decision-making. See *supra* note 339 for a discussion of public choice theory on capture of the political process and rent seeking.

395. See Steven N. Kaplan & J. Mark Ramseyer, *Those Japanese Firms with Their Disdain for Shareholders: Another Fable for the Academy*, 74 *WASH. U. L.Q.* 403 (1996), for a critical view of path dependence as an explanation of Japanese corporate behavior. The findings of this article do not depart from Kaplan and Ramseyer's thesis, in that rational choice explanations do indeed seem to exist to explain Japanese law. This article perhaps adopts a milder form of path dependence, arguing that path dependence indeed can influence institutions because people act rationally in response to transaction costs resulting from historically contingent circumstances. This is not a departure from rational choice theory, but its application to situations where transaction costs are positive.

396. It is plainly beyond the scope of this article to provide empirical analysis to support these generalizations.

designed to facilitate Japan's "catch up" with the West—comprehensive transplantations of Western law and the implementation of assertive industrial policy—affected the costs of Japanese government involvement in the "organized market."³⁹⁷ In the nineteenth century, the Japanese undertook a substantial reform and "modernization" of the Japanese legal system, focused on transplanting civilian code-based approaches into the country. This process occurred relatively recently, with purposeful transplantation of Western law and institutions starting in the Meiji era. Japanese government officials were of the view that common law or evolutionary systems of governance were inefficient and would take too long to develop.³⁹⁸ The development of the legal system was complemented by industrial policies that sought rapid industrialization. The two-fold focus on transplanted Western law and assertive industrial policy made it less costly for the Japanese government to be involved at the transactional level in the economy. It is, therefore, less costly for Japan to depart from neoclassical contract-firm paradigms that are entrenched in the West.³⁹⁹

This explanation seems to be confirmed by the *Kodak-Fuji* panel report. Examples from the panel report are set forth here.

The 1967 Cabinet Decision on Liberalization of Inward Direct Investment states the following three policies to direct measures on the regulation of foreign investment in Japan: "(1) *prevent disorder* that may arise from the advancement of foreign capital; (2) create the foundation to enable our enterprises to compete with foreign enterprises on equal terms; and (3) *actively strengthen* the quality of [domestic] enterprises and *reorganize the industrial system* so that they can fully compete with foreign capital."⁴⁰⁰ The 1967 Cabinet Decision also identified the Japanese distribution sector as in need of substantial improvement:

397. See Feinerman, *supra* note 390.

398. *Id.*

399. This is not to say that the Japanese economy does not suffer from significant inefficiencies as a result of government intervention. There is at present significant skepticism that the Japanese system of governance has a long term advantage. Casual observation suggests that government intervention in the Japanese economy is in some cases socially wasteful rent seeking and rent shifting. The more limited point made in the text is that government involvement in using transaction terms to establish property rights is less costly in Japan than it is in the West, and thus the Japanese government can more easily use transaction structuring to allocate (or misallocate) rights.

400. See *Japan—Film Panel Report*, *supra* note 5, ¶ 2.9

Modernization lags behind most in the distribution sector. Here, the power of resistance against the inroad of foreign capital is weak, and the impact of foreign capital advancing into this sector will also pose significant impact on the production sector. It is necessary, therefore, to implement countermeasures in support of the efforts of industry with the objectives of modernizing the distribution structure, fundamentally strengthening the enterprises in this sector, and establishing a mass sales system.⁴⁰¹

The Sixth Interim Report of the MITI Industrial Structure Council Distribution Committee, entitled "Distribution Modernization Outlook and Issues," warned of "a risk that the process of sales expansion by foreign capital affiliated distribution enterprises will *aggravate excessive competition* and *hinder the smooth implementation of distribution modernization plans*, and the [established] *order of trade will be disrupted*."⁴⁰² The Report also identified "a risk that the manufacturing sector will be dominated by controlling the sales routes, *bringing about the international subcontracting of Japanese industry*."⁴⁰³

The Seventh Interim Report of the MITI Industrial Structure Council Distribution Committee, entitled "Systemization of Distribution Activities," proposed the following four ideas to "systematize" the distribution system: "(i) establishing a Distribution Systemization Council; (ii) presenting guide posts and promoting standardization; (iii) establishing a system for providing distribution-related information; and (iv) providing incentives in areas such as financing and taxation."⁴⁰⁴

In 1968, MITI asked the Institute for Distribution Research to survey transaction terms in several industries.⁴⁰⁵ The purpose of the survey included the dissemination of "rational trade practices."⁴⁰⁶ In March 1969, the Institute submitted its report on the film industry,⁴⁰⁷ which examined the terms and conditions of contracts.⁴⁰⁸ The Report included the following findings:

401. See *id.* ¶ 5.88.

402. See *id.* ¶ 5.92. The Panel found that "MITI has been consistently concerned with *rationalization of trading terms* in the distribution sector since the 1960s. What had existed previously, Japan argued, were *irrational business practices that were economically inefficient*." *Id.*

403. See *id.*

404. See *id.* ¶ 10.134.

405. See *id.* ¶ 2.16.

406. See *id.*

407. See *id.*

408. See *id.*

[T]here is a view and an impression that the industry of general use photographic film, based on an oligopoly of two domestic manufacturers [Fuji and Konica], is superficially in a *stable and normal state* in which contract formation and *documentation of transactions are progressing*. Consider, however, one postulate:

- (1) If the oligopoly of the two domestic manufacturers is broken up by a foreign company; and
- (2) If a new [distribution] route emerges to compete against the route of photographic material dealers, which is the core existing route in the distribution market.

There may be very few observers who have a sense of crisis regarding (1) and (2) as realistic issues; however, they should now be considered as the most concrete and realistic problems.⁴⁰⁹

The Report recommended the following: "Given this situation, it is necessary to formulate measures before hand in order to *minimize the anticipated disorder* in the distribution market. This is why it is *significant to rationalize and standardize transaction terms* and to *create an . . . order of distribution*."⁴¹⁰

In 1968, MITI also established a Transaction Terms Standardization Committee, to examine the issue of standardization of contract terms in industry. In 1970, the Committee published "Guidelines for Rationalizing Terms of Trade for Photographic Film."⁴¹¹

On July 28, 1971, MITI's Distribution Systemization Council published a "Basic Plan for the Systemization of Distribution."⁴¹² The plan essentially promoted the "systematization" and "rationalization" of the distribution sector.

In accordance with the above 1971 Basic Plan, the Distribution Systemization Development Center was formed in 1972, the purpose of which was to facilitate the work of the Distribution Systemization Council. The Center was tasked with working with industry to produce industry-specific "Systemization Manuals." In March 1975, the Distribution Systematization Center published the "Manual for Systemization of Distribution by Industry: Camera and Film." The 1975 Manual was prepared by the Center in collaboration with industry and with a MITI official as an observer.⁴¹³

409. See *id.*

410. See *id.*

411. See *id.* ¶ 2.17.

412. See *id.* ¶ 2.20.

413. See *id.* ¶ 2.24.

The Japanese Diet passed a Large Stores Law on October 1, 1973, which became effective on March 1, 1974. The law as amended set forth a mixture of notification and regulatory requirements that stores in excess of a certain size were required to follow. The law required advance notification prior to a store's building or opening. The relevant government authority could recommend a reduction in size of the store, a delay in its opening, and could direct opening times and store holidays.⁴¹⁴

The Large Stores Law has been repealed. It has been argued that its appeal was part of a set of concessions that Japan gave to the United States as part of structural impediment negotiations.⁴¹⁵ Despite its repeal, the law, and its continued existence and evolution over the course of many years, illustrates the limited point being made here, that legal rights are structured differently in Japan than in the United States.

The Japanese Fair Trade Commission established a Distribution Sector Office with the approval of the Japanese Cabinet. Its purpose is to "administer duties pertaining to unfair trade practice designations related to distribution."⁴¹⁶ In December 1981, the Office made findings and recommendations to "camera, photographic materials, color photo laboratories and related industries" in an article entitled "The Status of Distribution of Cameras." In this article, the Office advised the industry to deal with "problems" that were the result of the dispatching of employees by manufacturers to large retail stores.

Further examples from the panel report that seem to show government sanctioned transaction structuring include the establishment of the Japanese Fair Trade Promotion Council and the issuance of Self-Regulating Rules Concerning Fairness in Trade with Business in 1982. The Self-Regulating Measures regulate, among other things, the dispatch of employees for sales promotion and other marketing activities and financial standards for promotions. The Fair Trade Promotion Council, established by industry, is involved in the policing of "fairness" in transactions and the implementation of the Self-Regulating Measures.⁴¹⁷

The panel report refused to find many of the above items to be "measures" under Article XXIII:1 (b), but they are nevertheless illustrative of the differing ways of establishing rights in Japan and the United

414. *See id.* ¶ 5.220.

415. *See* Dillon, *supra* note 13.

416. *See id.* ¶ 5.492.

417. *See id.* ¶ 6.493.

States. There was some government involvement in establishing all of these policies. The focus here is not so much on what Article XXIII:1(b) actually means (or on what a panel report says it means), but on what it *should* mean. It is now well understood that Japan promulgates norms through non-binding administrative guidance; the *Kodak-Fuji* panel ruled that such guidance could indeed constitute measures under Article XXIII:1(b). One of the principal issues examined here is whether Article XXIII:1(b) standards may require reinterpretation or modification.

The issue confronted in the WTO is how to deal with domestic policy externalities when they have international trade implications—when they negatively affect WTO obligations among WTO members. It is highly unlikely that any WTO agreement in the foreseeable future will explicitly deal with the problems addressed in this Article. Various future WTO agreements may touch upon specific areas that WTO members can agree upon as part of progressive liberalization, such as a competition policy. In some instances, these new agreements will deal with symptoms rather than causes. What the WTO members can develop to promote deeper liberalization is a norm-based system that relies on the DSB as an active player in a policy evolution game. WTO members can thus develop norms that can be amended in future negotiating rounds and in the WTO policy evolution process generally.⁴¹⁸

IV. CONCLUSION

This Article has attempted a comprehensive examination of the non-violation provision of Article XXIII:1(b). It has examined the provision in the context of a major decision interpreting its terms. There are no easy answers to the question of what the proper scope of Article XXIII:1(b) or the role of WTO dispute settlement should be. An interdisciplinary approach that focuses on the analytical social sciences, including political economics and positive political theory, can provide tentative answers. The social sciences can serve in a complementary role to a traditional legal or policy analysis. This Article is an attempt to synthesize teachings from various disciplines into a coherent whole to understand the role that WTO dispute settlement might take in the future.

418. See *id.* ¶ 6.37 n.567. For a discussion of Jagdish Bhagwati's norms on a competition policy that the WTO dispute settlement system could develop, see Roessler, *supra* note 9, at 414. The proposals set forth in this article are more general than Bhagwati's proposal.

This Article was being completed as the Seattle Ministerial Conference was coming to a close. That Conference furnishes a stark reminder: politics matter. WTO policy will be shaped in response to politics, perhaps more than any other factor. The analysis set forth in this Article, and the recommendations it makes, may be impracticable from a political or practical point of view. The politicians and public officials of the WTO members may not be in a position to provide additional power to the DSB for a long time and, indeed, in response to widespread popular misunderstandings and distrust of the role of the WTO, they may be required to promote a conservative agenda for the WTO. The purpose of this Article is not to engage the populist politics that currently surround the WTO in controversy, but to examine the potential of the WTO in the evolution of norms that promote global welfare.

When this Article was in the final stages of completion, the WTO issued the panel report, *United States—Sections 301–310 of the Trade Act of 1974*,⁴¹⁹ The panel ruled that sections of the trade Act of 1974 were not inconsistent with DSU Article 23.2 or any relevant GATT 1994 provisions. The DSB adopted the panel report on January 27, 2000. It is unknown whether the complainant will appeal. The findings of the panel report may have important implications for those parts of the Article dealing with the effect of unilateral remedial regimes on the functioning of the DSU.

419. WTO Panel Report, *United States—Sections 301–310 of the Trade Act of 1974*, WT/DS152/R (Dec. 22, 1999).