

10.15 The European Communities and Japan claim that this import duty exemption is inconsistent with Article I:1 of the GATT, which provides in relevant part:

"With respect to customs duties and charges of any kind imposed on or in connection with importation ..., any advantage, favour, privilege or immunity granted by any contracting party to any product originating in ... any other country shall be accorded immediately and unconditionally to the like product originating in ... the territories of all other contracting parties."

10.16 The parties do not dispute that the import duty exemption is an "advantage" within the meaning of Article I:1 with respect to "customs duties and charges of any kind on or in connection with importation". It is also not in dispute that there are imported products which do not benefit from this exemption which are like imported products which benefit from the exemption.

10.17 Two main arguments have been advanced with respect to the alleged inconsistency of this import duty exemption with Article I:1. Firstly, Japan argues that the import duty exemption is inconsistent with Article I:1 because, by conditioning the exemption on criteria which are unrelated to the imported product itself, Canada fails to accord the exemption immediately and unconditionally to like products originating in the territories of all WTO Members. Secondly, both the European Communities and Japan argue that the limitation of the eligibility for the import duty exemption to certain motor vehicle manufacturers is inconsistent with Article I:1 on the grounds that it entails *de facto* discrimination in favour of products of certain countries.

(b) Whether the import duty exemption is awarded "immediately and unconditionally"

10.18 We first consider the argument of Japan that, by making the import duty exemption conditional upon criteria which are unrelated to the imported product itself, Canada fails to accord the import duty exemption immediately and unconditionally to like products originating in all WTO Members. By "criteria unrelated to the imported products themselves," Japan means the various conditions which confine the eligibility for the exemption to certain motor vehicle manufacturers in Canada.

10.19 We note that in developing this argument, Japan refers to the Concise Oxford Dictionary definition of the word "unconditional" as meaning "not subject to conditions", and cites *Indonesia Autos*⁸⁰⁸ and *Belgian Family Allowances*⁸⁰⁹, as well as the *Working Party Report on the Accession of Hungary*⁸¹⁰, as authority for the proposition that the subjecting of an advantage to *any* condition *unrelated to the product* is inconsistent with Article I:1.

10.20 We also recall Canada's response that Japan misinterprets the "immediately and unconditionally" clause in Article I:1 and that Article I:1 contains no prohibition of origin-neutral terms and conditions on importation that apply to the *importers* as opposed to the *products* being imported. According to Canada, Article I:1 prohibits only conditions related to the national origin of the imported product. Canada thus argues that it is entitled to treat like products differently so long as the distinction in treatment is based on criteria other than national origin. Canada argues that in the instant case the conditions under which the import duty exemption is accorded are consistent with Article I:1 in that they are based on the activities of importing manufacturers and not on the origin of the products. Canada further argues that to hold otherwise would be to "read Article II out of the

⁸⁰⁸ Panel Report on *Indonesia – Autos*, *supra* note 270.

⁸⁰⁹ Panel Report on *Belgian Family Allowances*, *supra* note 276.

⁸¹⁰ Report of the *Working Party on the Accession of Hungary*, *supra* note 276.

GATT", given that Article II specifically contemplates tariff bindings being subject to "terms, conditions or qualifications"⁸¹¹.

10.21 We note that the argument of Japan that the import duty exemption is inconsistent with Article I:1 because it is conditioned upon criteria that are unrelated to the imported products is distinct from Japan's argument that the import duty exemption violates Article I:1 because it discriminates in practice in favour of products of certain countries. Thus, Japan advances an interpretation of Article I:1 which distinguishes between, on the one hand, the issue of whether the advantage arising out of the import duty exemption is accorded "unconditionally" as required by Article I:1, and, on the other, the issue of whether that advantage is accorded without discrimination as to the origin of products.

10.22 As explained below, we believe that this interpretation of Japan does not accord with the ordinary meaning of the term "unconditionally" in Article I:1 in its context and in light of the object and purpose of Article I:1. In our view, whether an advantage within the meaning of Article I:1 is accorded "unconditionally" cannot be determined independently of an examination of whether it involves discrimination between like products of different countries.

10.23 Article I:1 requires that, if a Member grants any advantage to any product originating in the territory of any other country, such advantage must be accorded "immediately and unconditionally" to the like product originating in the territories of all other Members. We agree with Japan that the ordinary meaning of "unconditionally" is "not subject to conditions". However, in our view Japan misinterprets the meaning of the word "unconditionally" in the context in which it appears in Article I:1. The word "unconditionally" in Article I:1 does not pertain to the granting of an advantage *per se*, but to the obligation to accord to the like products of all Members an advantage which has been granted to any product originating in any country. The purpose of Article I:1 is to ensure unconditional MFN treatment. In this context, we consider that the obligation to accord "unconditionally" to third countries which are WTO Members an advantage which has been granted to any other country means that the extension of that advantage may not be made subject to conditions with respect to the situation or conduct of those countries. This means that an advantage granted to the product of any country must be accorded to the like product of all WTO Members without discrimination as to origin.

10.24 In this respect, it appears to us that there is an important distinction to be made between, on the one hand, the issue of whether an advantage within the meaning of Article I:1 is subject to conditions, and, on the other, whether an advantage, once it has been granted to the product of any country, is accorded "unconditionally" to the like product of all other Members. An advantage can be granted subject to conditions without necessarily implying that it is not accorded "unconditionally" to the like product of other Members. More specifically, the fact that conditions attached to such an advantage are not related to the imported product itself does not necessarily imply that such conditions are discriminatory with respect to the origin of imported products. We therefore do not believe that, as argued by Japan, the word "unconditionally" in Article I:1 must be interpreted to mean that making an advantage conditional on criteria not related to the imported product itself is *per se* inconsistent with Article I:1, irrespective of whether and how such criteria relate to the origin of the imported products.

10.25 We thus find that Japan's argument is unsupported by the text of Article I:1. We also consider that there is no support for this argument in the GATT and WTO reports cited by Japan. A review of these reports shows that they were concerned with measures that were found to be inconsistent with Article I:1 not because they involved the application of conditions that were not related to the imported product but because they involved conditions that entailed different treatment of imported products depending upon their origin.

⁸¹¹ *Supra* para. 7.97.

10.26 Thus, the measure at issue in *Belgian Family Allowances* was "the application of the Belgian law on the levy of a charge on foreign goods purchased by public bodies when these goods originated in a country whose system of family allowances did not meet specific requirements."⁸¹² The panel determined that this levy was an internal charge within the meaning of Article III:2 of the GATT and found that it was inconsistent with Article I:1:

"According to the provisions of paragraph 1 of Article I of the General Agreement, any advantage, favour, privilege or immunity granted by Belgium to any product originating in the territory of any country with respect all matters referred to in paragraph 2 of Article III shall be granted immediately and unconditionally to the like product originating in the territories of all contracting parties. Belgium has granted exemption from the levy under consideration to products purchased by public bodies when they originate in Luxemburg and the Netherlands, as well as in France, Italy, Sweden and the United Kingdom. If the General Agreement were definitively in force in accordance with Article XXVI, it is clear that the exemption would have to be granted unconditionally to all other contracting parties (including Denmark and Norway). *The consistency or otherwise of the system of family allowances in force in the territory of a given contracting party with the requirements of the Belgian law would be irrelevant in this respect, and the Belgian legislation would have to be amended insofar as it introduced a discrimination between countries having a given system of family allowances and those which had a different system or no system at all, and made the granting of the exemption dependant on certain conditions.*"⁸¹³ (emphasis added)

10.27 Similarly, the reference made by Japan to the *Working Party Report on the Accession of Hungary* concerns tariff exemptions and reductions granted in the framework of co-operation contracts. The GATT Secretariat, in response to a request for a legal opinion, commented that "the prerequisite of having a co-operation contract in order to benefit from certain tariff treatment appeared to imply conditional most-favoured-nation treatment and would, therefore, not appear to be compatible with the General Agreement".⁸¹⁴

10.28 With respect to the Panel Report on *Indonesia – Autos*, we note that the panel determined that certain customs duty and tax benefits provided by Indonesia to imports of "National Cars" and parts and components thereof from Korea were advantages within the meaning of Article I, and that these "National Cars" and their parts and components imported from Korea were like other similar motor vehicles and parts and components from other Members. The panel then proceeded to

"...examine whether the advantages accorded to national cars and parts and components thereof from Korea are unconditionally accorded to the products of other Members, as required by Article I. The GATT case law is clear to the effect that any such advantage (here tax and customs duty benefits) cannot be made conditional on any criteria that is not related to the imported product itself."⁸¹⁵

Significantly, in support of the statement that "the GATT case law is clear to the effect that any such advantage (...) cannot be made conditional on any criteria that is not related to the imported product itself", the panel referred to the Panel Report on *Belgian Family Allowances*.⁸¹⁶ As discussed above, that Panel Report dealt with a measure which distinguished between countries of origin depending upon the system of family allowances in force in their territories. We further note that, following this

⁸¹² Panel Report on *Belgian Family Allowances*, *supra* note 276, para. 1.

⁸¹³ *Ibid.*, para. 3.

⁸¹⁴ Report of the *Working Party on the Accession of Hungary*, *supra* note 276, para. 12.

⁸¹⁵ Panel Report on *Indonesia – Autos*, *supra* note 270, para. 14.143.

⁸¹⁶ *Ibid.*, para. 14.144.

statement, the panel on *Indonesia – Autos* identified certain conditions which entailed discrimination between imports of the subject products from Korea and like products from other Members, and found that these measures were thus inconsistent with Article I of the GATT.⁸¹⁷ The statement in the Panel Report that an advantage within the meaning of Article I "cannot be made conditional on any criteria that is not related to the imported product itself" must therefore in our view be seen in relation to conditions which entailed different treatment of like products depending upon their origin.

10.29 In sum, we believe that the panel decisions and other sources referred to by Japan do not support the interpretation of Article I:1 advocated by Japan in the present case according to which the word "unconditionally" in Article I:1 must be interpreted to mean that subjecting an advantage granted in connection with the importation of a product to conditions not related to the imported product itself is *per se* inconsistent with Article I:1, regardless of whether such conditions are discriminatory with respect to the origin of products. Rather, they accord with the conclusion from our analysis of the text of Article I:1 that whether conditions attached to an advantage granted in connection with the importation of a product offend Article I:1 depends upon whether or not such conditions discriminate with respect to the origin of products.

10.30 In light of the foregoing considerations, we reject Japan's argument that, by making the import duty exemption on motor vehicles conditional on criteria that are not related to the imported products themselves, Canada fails to accord the exemption immediately and unconditionally to the like product originating in the territories of all WTO Members. In our view, Canada's import duty exemption cannot be held to be inconsistent with Article I:1 simply on the grounds that it is granted on conditions that are not related to the imported products themselves. Rather, we must determine whether these conditions amount to discrimination between like products of different origins.

(c) Whether the import duty exemption discriminates in favour of motor vehicles of certain countries

10.31 We thus turn to the issues raised by the complainants to support their view that the import duty exemption involves discrimination in favour of motor vehicles of certain countries. We begin by recapitulating the main arguments of the parties.

10.32 Japan argues that, by virtue of the eligibility restriction, the import duty exemption accorded by Canada on motor vehicles discriminates in practice by according an advantage to motor vehicles from certain countries while effectively denying the same advantage to like motor vehicles originating in the territories of other WTO Members. Japan submits that, although the beneficiaries of the import duty exemption are ostensibly permitted to import motor vehicles of any national origin, in practice they have chosen and will continue to choose to import the products of particular companies from particular countries, in consideration of their previous history of transactions, capital relationships, and the nationality of companies investing in the beneficiaries. In the view of Japan, this means that the eligibility restriction and other conditions attached to the exemption effectively limit access to the advantage to certain Members having the companies with which the beneficiaries have certain commercial relationships. Japan further argues that the discriminatory nature of the exemption was strengthened due to the fact that the list of eligible importers has been frozen since 1 January 1989. As evidence of the discriminatory character of the import duty exemption, Japan adduces statistics which show that in 1997, 96% of Sweden's imports into Canada, and 94% of Belgium's were duty-free (in both cases these were imports of Volvos and of Saabs, the latter partly owned by GM, with Volvo Canada and GM Canada both being eligible manufacturer beneficiaries). Japan compares this with just under 30% of duty-free imports for the whole of the European Communities, and of just under 5% for Korea and just under 3% for Japan.⁸¹⁸ Japan also points to the fact that Volvos and Saabs are imported under the import duty exemption from Belgium or Sweden while like vehicles produced by

⁸¹⁷ Ibid., paras. 14.145-148.

⁸¹⁸ *Supra* Japan's Table 6.

Japanese manufacturers are imported subject to the MFN rate.⁸¹⁹ We note that at the initial stage of this proceeding Japan's argument concentrated on the discrimination in favour of imports from Belgium and Sweden as compared with imports from Japan; subsequently Japan has also contended that there is discrimination in favour of imports from the United States and Mexico.

10.33 The European Communities argues that, although the import duty exemption on its face is non-discriminatory in that it applies equally with respect to all imports of automobiles by the beneficiaries, irrespective of their country of origin, in reality the main beneficiaries are subsidiaries of US companies with large manufacturing facilities in the United States and Mexico, and the benefit of the exemption therefore accrues almost exclusively to imports from these two countries. In support of this, the European Communities states that in 1997, imports of automobiles from the United States and Mexico accounted for 97% of all duty-free imports into Canada, when in contrast imports from these two countries accounted for only 80% of all imports of automobiles into Canada.⁸²⁰ According to the European Communities, this "disproportionate" share is not a result of commercial factors but is the result of the import duty exemption. Moreover, whereas in 1997 the vast majority of imports from Mexico and the United States benefited from the import duty exemption, most imports from other sources were subject to customs duties.⁸²¹

10.34 Both Japan and the European Communities argue that their claim that the import duty exemption gives rise to *de facto* discrimination is supported by relevant GATT and WTO Panel Reports.

10.35 Canada argues that the claim of the complainants that the import duty exemption involves *de facto* discrimination in favour of products of certain countries is without foundation in law or in fact. According to Canada, GATT and WTO dispute settlement cases demonstrate that to prove a *de facto* violation of Article I:1 it must be shown that a criterion that is neutral on its face is in fact able to be met only by products of a particular origin or origins such that national origin determines the tariff treatment the product receives. In the case at hand, there are no such criteria that determine the origin of the products which may be imported under the import duty exemption. In the view of Canada, the mere limitation of the number of eligible importers is not inconsistent with Article I:1 given that there are no conditions restricting the origin of products imported by the beneficiaries. In this connection, Canada submits that there is no basis in GATT and WTO case law for the view that a *de facto* violation of Article I:1 can be established on the basis of the commercial decisions of importers with respect to their sources of supply.

10.36 Canada further submits that the complainants have failed to adduce evidence supporting their claim of discrimination. The lack of factual support for this claim is illustrated by the fact that the complainants differ on which third countries benefit from the allegedly more favourable treatment. In addition, the statistics adduced by the complainants to demonstrate that the products of some countries receive a disproportionate share of the duty-free benefit do not provide evidence of discrimination. With respect to the data presented by Japan, Canada argues that these data are inaccurate, incomplete and irrelevant to the establishment of a violation of Article I:1. In any event, even Japan's data show that in 1996 there were 1,776 duty-free import sales of vehicles from Sweden, compared with 4,502 duty-free import sales from Japan. Canada also submits data⁸²² showing that during the years 1991-98 Japanese-origin vehicles have benefitted from the import duty exemption to a much greater extent than have vehicles of Belgium, Sweden and several other WTO Members. Canada rejects as irrelevant Japan's comparison between luxury models imported from Belgium and Sweden and luxury models imported from Japan. With respect to the statistics adduced by the European Communities, Canada argues that the European Communities fails to explain how these statistics constitute evidence of

⁸¹⁹ *Supra* Japan's Tables 9 and 10.

⁸²⁰ *Supra* EC's Table 1.

⁸²¹ *Supra* EC's Table 2.

⁸²² *Supra* Canada's Figure 4.

discrimination within the meaning of Article I:1, and that, even if it were true that an advantage is granted *de facto* to products of the United States and of Mexico, such advantage would be exempted from Article I:1 by virtue of Article XXIV.

10.37 In respect of this disagreement between the parties on whether or not the import duty exemption accorded by Canada under the MVTO 1998 and SROs involves discrimination in favour of products of certain countries, we note first that Japan and the European Communities do not contest the fact that this exemption applies to imports from any country entitled to Canada's MFN rate. We therefore consider that the fundamental legal question before us is how the MFN requirement in Article I:1 must be applied to a measure which, on the one hand, involves a limitation to certain importers of an advantage granted in connection with the importation of a product but which, on the other hand, does not impose conditions regarding the origin of the products which can benefit from such advantage. More specifically, the question arises whether such a measure can be considered to give rise to *de facto* discrimination between like products originating in the territories of different Members.

10.38 In this regard, we note that GATT/WTO jurisprudence has established that Article I:1 encompasses both *de jure* and *de facto* forms of discrimination.⁸²³ The instant case differs from situations addressed in some of the Panel Reports referred to by the parties with respect to the issue of *de facto* discrimination under Article I:1 in that in the present case such discrimination is alleged to arise from conditions with regard to the importers eligible for the import duty exemption rather than from conditions applied with respect to the products imported by such importers: the complainants essentially argue that there is *de facto* discrimination as a result of the fact that only certain importers in Canada qualify for the import duty exemption. In their view, this effectively limits the benefit of that exemption to the products of certain Members in whose territories are located companies related to those importers.

10.39 By contrast, Canada submits that Article I:1 does not prohibit the imposition of origin-neutral terms and conditions on importation that apply to importers as opposed to the products being imported. As we understand this argument, Canada takes the view that terms and conditions that apply to importers are "origin-neutral" if they do not provide for limitations with respect to the origin of products which may be imported by the importers.

10.40 Though we do not contest the validity of the proposition that Article I:1 does not prohibit the imposition of origin-neutral terms and conditions on importation that apply to importers, we believe that the interpretation advocated by Canada of what "origin-neutral" means in this context is unduly narrow. We see no basis in the text of Article I:1 to hold that, where a measure reserves an import duty exemption to certain importers, the consistency of that measure with Article I:1 depends solely on whether or not there are restrictions on the origin of products imported by such importers. Rather, we believe that account should also be taken of the possibility that the limitation of the exemption to certain importers may by itself have a discriminatory impact on the treatment of like products of different origins.

10.41 As described above in the introductory section of these findings, the category of importers eligible for the import duty exemption accorded by Canada under the MVTO 1998 and the SROs is confined to manufacturers who were present in Canada in a particular base year and who meet certain performance requirements. In addition, since 1989 no new motor vehicle manufacturers have been able to qualify for the exemption. We note in this regard that among the manufacturers who currently benefit from the exemption are companies which have links of ownership or control with motor vehicle producers based in certain countries. Thus, with respect to automobiles, the current

⁸²³ See Appellate Body Report on *EC – Bananas III*, *supra* note 49, para. 232. See also Panel Report on *EEC – Beef from Canada*, *supra* note 282; Panel Report on *Spain – Unroasted Coffee*, *supra* note 282; and Panel Report on *Japan – SPF Lumber*, *supra* note 282.

beneficiaries of the MVTO 1998 are fully-owned subsidiaries of General Motors, Ford, Chrysler and Volvo.⁸²⁴ On the other hand, there are automobile manufacturers in Canada which are subsidiaries of companies based in other countries and which do not enjoy the import duty exemption.

10.42 We consider that, for the purpose of determining whether the limitation of eligible importers has an impact on the origin of products imported under the import duty exemption, the foreign affiliation of automobile manufacturers in Canada which benefit from the import duty exemption, as compared with the foreign affiliation of automobile manufacturers who are not entitled to the exemption, is of particular significance when viewed in conjunction with the evidence before us regarding the predominantly, if not exclusively, "intra-firm" character of trade in automotive products.

10.43 In this regard, we note the arguments and evidence presented by the complainants that the global automotive industry is highly integrated and characterized by a high degree of intra-firm trade. In particular, evidence adduced in this proceeding shows that the import patterns of the major automotive corporations in Canada are such that they import only their own make of motor vehicles and those of related companies.⁸²⁵ Thus, General Motors in Canada imports only GM motor vehicles and those of its affiliates; Ford in Canada imports only Ford motor vehicles and those of its affiliates; the same is true of Chrysler and of Volvo. These four companies all have qualified as beneficiaries of the import duty exemption. In contrast, other motor vehicle companies in Canada, such as Toyota, Nissan, Honda, Mazda, Subaru, Hyundai, Volkswagen and BMW, all of which also import motor vehicles only from related companies, do not benefit from the import duty exemption. The evidence also shows that General Motors has imported Saabs and Suzukis duty free into Canada and that General Motors has an ownership in the foreign producers of these vehicles. Similarly, between 1971-1993 when Mitsubishi and Chrysler ran a joint venture, Chrysler imported motor vehicles from Mitsubishi into Canada duty-free, but these imports ceased after the termination of the joint-venture affiliation.

10.44 We further note the statement by Canada that it is characteristic of the globalized automotive industry that there be some sort of capital, manufacturing or similar relationship between the automobile manufacturers and companies from which they import.⁸²⁶ We also note that, as part of its defence to the claims raised under Article II of the GATS, Canada stresses the vertical integration between distributors and manufacturers of motor vehicles and the fact that distributors will not import and distribute motor vehicles produced by other manufacturers unless there is that capital, manufacturing or similar relationship.

10.45 We conclude from this analysis that the limitation of the eligibility for the import duty exemption to certain importers in Canada who are affiliated with manufacturers in certain countries affects the geographic distribution of the imports of motor vehicles under the import duty exemption. While these eligible importers are not in law or in fact prevented from importing vehicles under the exemption from any third country, in view of their foreign affiliation and the predominantly, if not exclusively, "intra-firm" character of trade in this sector, imports will tend to originate from countries in which the parent companies of these manufacturers, or companies related to these parent companies, own production facilities. Whether or not a like product of a WTO Member in practice benefits from the import duty exemption depends upon whether producers in the territory of that Member are related to any of the eligible Canadian motor vehicle manufacturers. Thus, in reality the conditions on which Canada accords the import duty exemption on motor vehicles entail a distinction between exporting countries depending upon whether or not producers in such countries are related to the eligible manufacturers. We therefore consider that, in a context of intra-firm trade, the limitation

⁸²⁴ We note the recent changes that have occurred in the ownership of Chrysler and Volvo, as described in the factual arguments section of this report, and, in the case of Volvo, the implications of these changes for its status as a beneficiary of the import duty exemption.

⁸²⁵ See Exhibit JPN-10.

⁸²⁶ *Supra* para.7.119.

of the availability of the import duty exemption to certain manufacturers, including fully-owned subsidiaries of firms based in a very limited number of third countries, discriminates as to the origin of products which will benefit from the import duty exemption.

10.46 We note Canada's argument that the origin of products imported under the import duty exemption is determined by commercial decisions of the importers and that such decisions cannot be the basis for finding a violation of Article I:1. In this regard, we wish to stress that, in finding that the conditions attached to the import duty exemption discriminate as to the origin of products imported under this exemption, we are not denying that the decisions taken by individual importers as to the sourcing of their supplies are commercial decisions in which the Government of Canada is not involved. In our view, however, the issue is not whether the Government of Canada is somehow directing importers to import from particular sources; it clearly is not. While there is no involvement of the Government of Canada in decisions by individual importers, what is attributable to the Government of Canada is that, as a result of the limitation of the number of eligible importers, the geographic distribution of imports benefitting from the import duty exemption is determined by the commercial decisions of a closed category of importers mainly consisting of subsidiaries of firms based in certain countries, rather than by the commercial decisions of a broader, open-ended group of importers.

10.47 We have carefully considered the evidence provided by the parties with respect to the origin of imports under the import duty exemption. In this respect, we note in particular the argument of Canada that the available evidence, such as the data contained in Canada's Figure 4, shows that imports under the import duty exemption originate from a number of countries, including Japan, Belgium and Sweden, and that in recent years imports from Japan have accounted for a greater percentage of imports under the import duty exemption than imports from some other countries, such as Sweden, Belgium and the United Kingdom.

10.48 We consider that the evidence presented by Canada shows that the conditions attached to the import duty exemption do not prevent imports of motor vehicles from a range of countries, including the complainants, from benefitting from the exemption. This evidence also confirms the point made by Canada that the eligible manufacturers have affiliations with companies in a range of countries. At the same time, we do not believe that these data are in contradiction with our view that the import duty exemption favours products of certain countries depending upon the affiliation of producers located in those countries to the importers in Canada who are eligible for the import duty exemption. We note in this connection that other data before us, presented by the European Communities and Japan, reveal very significant differences between the percentages of imports of automobiles from individual countries that have benefitted from the import duty exemption. The difference between the United States, Mexico, Sweden and Belgium, on the one hand, and other European countries and Japan on the other - not to mention other major motor vehicle producers such as Korea - is particularly striking.⁸²⁷ We also consider significant the data presented by the European Communities and Japan regarding imports of automobiles from different sources as percentages of total imports under the import duty exemption.⁸²⁸ We therefore believe that the fact that imports under the import duty exemption have originated from a number of countries, as a consequence of the capital relationship between eligible importers and producers in those countries, does not warrant a conclusion that the import duty exemption is accorded on equal terms to like products of different origin.

10.49 As explained above, our view of the discriminatory character of the import duty exemption is based on an analysis of the consequences, in the context of an industry characterized by intra-firm trade, of the limitation of the number of eligible importers to manufacturers with particular foreign affiliations. We believe that, while not of decisive importance, the historical context of the import

⁸²⁷ *Infra* EC's Table 2, Japan's Table 6.

⁸²⁸ *Infra* EC's Table 1, Japan's "New" Figure 4.

duty exemption provides further support for this view. We recall that this measure stems from a bilateral agreement between Canada and the United States designed to resolve a long-standing trade dispute between Canada and the United States over trade in automotive products. This agreement was designed *inter alia* to achieve rationalization of production in the North-American market. From the perspective of Canada this involved the granting of import duty exemptions as an encouragement to US owned motor vehicle manufacturers to expand their production operations in Canada. We therefore consider that at the outset the import duty exemption was expected to benefit mainly imports from particular sources.

10.50 In light of the foregoing considerations, we **find** that, by reserving the import duty exemption provided for in the MVTO 1998 and the SROs to certain importers, Canada accords an advantage to products originating in certain countries which advantage is not accorded immediately and unconditionally to like products originating in the territories of all other WTO Members. Accordingly, we find the application of this measure to be inconsistent with Canada's obligations under Article I:1 of the GATT.

(d) Applicability of Article XXIV of the GATT

10.51 Having found that the import duty exemption is inconsistent with Article I:1 of the GATT, we now turn to the arguments of the parties with respect to the applicability of Article XXIV to the exemption.

10.52 We note that Canada raises Article XXIV in response to the complaint of the European Communities that Canada has accorded duty-free treatment on a basis inconsistent with Article I of the GATT, because most of the vehicles that receive duty-free treatment originate in the United States or Mexico. Canada notes that it had formed a free-trade area with the United States and Mexico and, therefore, granting duty-free treatment to products of its free-trade partners is exempt from Article I:1 by reason of Article XXIV.

10.53 The European Communities submits that there is currently no free-trade area between Mexico and Canada; that the import duty exemption is neither part of nor required by NAFTA; that, to the extent the import duty exemption is based on an international agreement, that agreement – the Auto Pact – lacks the necessary coverage to bring it within the ambit of Article XXIV; and that the import duty exemption is not a measure necessary for the formation of a free-trade area.

10.54 Canada contests the arguments of the European Communities, indicating that there is no doubt about the existence of a free-trade area between Canada, the United States and Mexico; that Article XXIV status does not require the total elimination of all duties among the members of a free-trade area; that the European Communities is in error in arguing that the measures in dispute are not part of NAFTA because the NAFTA specifically provides for the continuation of duty-free treatment pursuant to the Auto Pact; that in any event nothing in Articles I or XXIV states that preferential duty-free treatment is exempt from Article I only to the extent that it is "part of" or "required by" the principal agreement establishing the free-trade area, and that the objective of a free-trade area is, if nothing else, duty-free treatment among its Members.

10.55 We recall that in our analysis of the impact of the conditions under which the import duty exemption is accorded, we have found that these conditions entail a distinction between countries depending upon whether there are capital relationships of producers in those countries with eligible importers in Canada. Thus, the measure not only grants duty-free treatment in respect of products imported from the United States and Mexico by manufacturer-beneficiaries; it also grants duty-free treatment in respect of products imported from third countries not parties to a customs union or free-trade area with Canada. The notion that the import duty exemption involves the granting of duty-free treatment of imports from the United States and Mexico does not capture this aspect of the measure. In our view, Article XXIV clearly cannot justify a measure which grants WTO-inconsistent duty-free