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NON-DISCRIMINATION AND THE PILLARS OF INTERNATIONAL ECONOMIC LAW – COMPARATIVE ANALYSIS AND BUILDING COHERENCY

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NON-DISCRIMINATION AND THE PILLARS OF INTERNATIONAL ECONOMIC LAW

Comparative analysis and building coherency

Dr. Nicolas F. Diebold*

Abstract
The principle of non-discrimination constitutes a corner-stone in different fields of international economic law, notably international trade in goods and services as well as intellectual property and investment protection. While its basic rationale appears to be straightforward, the application of the different elements which constitute a non-discrimination obligation has proven to be most complicated. Due to the high fragmentation in international economic law, adjudicating bodies are applying different interpretations and standards with regard to ‘less favourable treatment’, ‘likeness’ and ‘regulatory purpose’. This article shows the different theories for each of these elements on the examples of WTO law, NAFTA, investment protection and EU law and demonstrates how these theories affect the scope and liberalizing effect of the non-discrimination obligation. The article then attempts to develop a coherent factor-based application of non-discrimination rules suitable for all fields of international economic law. The article submits the theory that the elements of non-discrimination should not be applied as strict legal conditions which must be proven by a complainant, but as a range of soft-factors which may be weighed and balanced by the adjudicating bodies.

Key words
non-discrimination, national treatment, like products, like circumstances, less favourable treatment, WTO, GATT, GATS, NAFTA, bilateral investment treaties

JEL Classifications: F13, F15, F21, K33

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I INTRODUCTION

The principle of non-discrimination has a longstanding history in international trade relations and it has turned into a central pillar of postmodern international economic law. Following this principle, the contracting parties shall not treat domestic market participants more favourably than foreign market participants (national treatment, NT) or differentiate between foreign market participants from different origin (most-favoured-nation treatment, MFN). Non-discrimination obligations are found in almost all sub-fields of international economic law, notably trade in goods and services, investment protection or the protection of intellectual property rights. They apply to all types of governmental trade obstacles, such as border measures (e.g. tariffs and quantitative restrictions) and internal regulations (e.g. taxes and product standards). In addition, it is well established that non-discrimination not only prohibits measures which differentiate directly – or de jure – on the basis of origin, but also indirect – or de facto – discriminatory measures.

In spite of these commonalities, it would be wrong to assume that non-discrimination in international economic law has a firmly defined meaning. The applicable standards of non-discrimination are highly fragmented between the different sub-fields of international economic law or even between different treaties within identical sub-fields. The different standards may in some instances be explained by different intentions, objectives and expectations of the contracting parties or by different structures of the specific non-discrimination clause or of the entire treaty; however, since the factual and economic settings underlying a non-discrimination claim are very similar in trade and investment, there is oftentimes no apparent reason other than pure arbitrariness for applying different standards. The rules of treaty interpretation leave considerable discretion to the arbitrator interpreting an obligation of public international law and are not apt to ensure a consistent application of the non-discrimination provisions in different fields. Even though it appears that WTO law has – to a certain degree – assumed a leading role for the general interpretation of international economic law, tribunals applying a specific treaty have no obligation to take into consideration the jurisprudential developments and precedents from other fields of international economic law or even from prior arbitral tribunals applying the exact same provision. Considering that for historical and practical reasons international economic law is split up in innumerable self-contained treaties, it is also not surprising that most scholarly contributions tend to focus on the principle of non-discrimination as it applies in a specific sub-field of international economic law.

Nonetheless, non-discrimination obligations are constantly applied by international arbitral tribunals and, from a pragmatic perspective, the system appears to work. However, the current situation entails a number of shortcomings. Most importantly, contracting parties have no possibility to anticipate the consequences when entering into an international economic treaty. By the same token, private individuals – to the extent the treaty empowers

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them to assert their rights under the agreement – are virtually left in the dark when assessing their rights and risks prior to an investment decision. The scope, substance and standard of a non-discrimination obligation – and *nota bene* many other obligations – depends on the interpretation of the individual arbitrator who happens to be appointed to rule on the specific dispute. Moreover, even once the arbitral tribunal made its ruling by applying a specific treaty, the concerned parties have no guarantee that a second arbitral tribunal will follow the same interpretation. Consequently, the parties to a dispute – whether in state-to-state or investor-state arbitration – have no or very little guidance on how to make their claim, how to present their legal arguments and, most importantly, what evidence will be relevant. Granted, any legal proceeding – whether domestic or international – involves a considerable degree of legal uncertainty, but the risks and uncertainties are exceedingly high in disputes pertaining to international economic law in general and to the non-discrimination obligation in particular.

Against the background of a fragmented standard of non-discrimination, this article attempts to establish a typology of the theoretically possible standards on the basis of previous practice in the law of the World Trade Organization (WTO), the European Union (EU), the North American Free Trade Agreement (NAFTA) and bilateral investment treaties3. Section II outlines the different standards which have been developed by the WTO adjudicating bodies, the ECJ and arbitral tribunals with regard to the non-discrimination elements, namely the ‘comparator clause’, ‘less favourable treatment’ and ‘regulatory purpose’. This overview does not pretend to provide an exhaustive and detailed analysis of the specific most-favoured-nation and national treatment provisions in the different agreements. Rather, section II is designed to present a general overview of the different possible interpretations in order to provide a basis for developing under section III the main factors which determine the outcome of a non-discrimination analysis. The thesis of this article is to propose a new methodology for the legal analysis of non-discrimination which is not based on firm legal elements or conditions, but on soft-factors which need to be weighed and balanced in order to determine whether overall a measure amounts to unlawful discriminatory protection of domestic market participants.

II CURRENT STANDARDS OF NON-DISCRIMINATION

The principle of non-discrimination consists of two main elements which both are comparative in nature. First, the comparator clause calls for a comparison between the *market participants* subject to differential treatment.4 The second element requires a comparison between the *treatments* accorded to the market participants at issue in order to assess whether one is treated less favourably than the other. The comparator clause and the element of ‘less favourable treatment’ constitute two cumulative legal conditions.5 Depending on the structure of a specific non-discrimination provision, additional elements

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may be taken into consideration, such as ‘(non-)protectionist effect’ or ‘(non-)protectionist purpose’. To date, the comparator clause – in particular the GATT ‘like products’ concept – received by far the most attention in dispute settlement and legal scholarship. More recently, however, the focus has also shifted to the element of ‘less favourable treatment’ and its ambiguities. However, scholarly research does not yet sufficiently take into account the relationship and interdependency between the two elements.

Each element may be subject to different interpretations and standards, which considerably affects the reach of the non-discrimination obligation. The spectrum varies from a very lenient form of non-discrimination which only outlaws the most apparent and blatant discriminatory measures, to a very restrictive form which considerably restricts the contracting parties’ regulatory autonomy to pursue domestic policy objectives. The present section illustrates the different standards by referring to examples from GATT 1947, WTO law (GATT 1994 and GATS), EU law, NAFTA and BITs.

A Fragmented standards and terminology for ‘comparator clauses’

The fragmentation of comparator clauses in different international economic treaties becomes already apparent by the differences in terminology. WTO law generally uses the concept of ‘likeness’, such as ‘like products’ in GATT or ‘like service and service suppliers’ in GATS. In addition, one GATT non-discrimination provision also uses the concept of ‘directly competitive or substitutable products’ instead of ‘likeness’. The TFEU refers to ‘similar products’ and ‘other products’ in Article 110. NAFTA and certain BITs apply the concept of ‘like circumstances’, while other BITs use the concept of ‘same circumstances’, ‘like situations’, ‘comparable situations’ or ‘similar situations’. In spite of these different terminologies, all comparator clauses share the identical fundamental problem of identifying the relevant tertium comparationis, i.e. the quality or element which two ‘situations’ or ‘objects’ must have in common in order to conclude that they are ‘alike’ for the purpose of


10 UK-Belize BIT (1982), Art. 3(1).


12 China-Iran BIT (2000), Art. 4(1).

13 Ethiopia-Turkey (2000), Art. 3(1).
the comparison. The practice of international economic law determined different *tertia comparationis* which in turn leads to different standards of non-discrimination.

1. **Objective standard**

Early GATT 1947 jurisprudence pertaining to Articles I (MFN) and III (NT) interpreted the concept of ‘like products’ on the basis of purely formal and objective criteria, mostly ignoring or even denying the relevance of competition. For instance, GATT Panels ruled that ‘likeness’ does not exist between three types of sardines (pilchard, herring and sprat) or between dimension lumber produced from different tree species (SPF and hemlock-fir lumber) for purposes of Article III:2 GATT. Another GATT Panel explicitly refused to consider the competitive relationship between ammonium sulphate fertilizer and nitrate fertilizer and found the two products to be ‘unlike’. Finally, the GATT Panel in *EEC – Animal Feed Proteins* held that different products used for the purpose of adding protein to animal feeds are ‘unlike’ under Articles I and III:4 GATT. All these reports relied heavily on different tariff classifications as well as physical differences between the products as criteria of the ‘likeness’ analysis. In 1970 a Working Party Report developed a test which later came to be known as the *Border Tax Adjustments* framework, identifying also ‘end-uses’ and ‘consumer tastes and habits’ as relevant criteria. While these criteria may have implicitly introduced economic elements into the analysis, most GATT Panels refrained from explicitly recognizing that ‘likeness’ incorporates the economic theory of competitive relationships.

Similar to WTO practice, early ECJ jurisprudence pertaining to the national treatment obligation for internal taxes of Article 110(1) TFEU (ex Art. 90 TEC, ex-ex Art. 95 TEC) also relied on purely formal criteria – such as fiscal, statistical or custom classification – for the assessment of the ‘similar products’ concept.

While all of the above examples from WTO and EU jurisprudence illustrate situations where formal criteria were used to find ‘unlikeliness’ between largely competing products, formal criteria may be used to find ‘likeness’ between non-competing products. In the investor-state dispute *Occidental v. Ecuador*, for instance, the US oil exporter Occidental claimed that the denial of VAT reimbursements to domestic and foreign-invested oil exporters, while granting the reimbursement to domestic and foreign-invested exporters of other goods, constituted a breach of the non-discrimination obligation. The claim was based

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18 See e.g. Case 27/67 *Fink-Frucht* [1968] ECR 223.
mainly on the argument that ‘in like situations’ refers not to companies in the same business sector, but to all companies engaged in exports even across economic sectors. The tribunal distinguished ‘like situations’ from GATT ‘like products’ and upheld the claimant’s argument (paras 168, 173 and 176 ff). In consequence, the Oil exporter Occidental was considered ‘in like situations’ with domestic exporters of flowers, mining and seafood products as well as lumber and bananas (paras 79 and 168).19

In sum, under the objective standard the tertium comparationis may consist of factors such as physical characteristics, tariff classification, end-uses or even the act of exportation. Depending on which criteria are applied, the scope of non-discrimination obligations may be construed very narrowly (e.g. in case of physical characteristics) or extremely broadly (e.g. act of exporting as criterion).

2. Economic standard

Under the economic standard, the tertium comparationis is defined by economic parameters indicating the extent to which the market actors are in a competitive relationship. This standard was first applied by GATT 1947 panels for the ‘directly competitive or substitutable products’ element in Article III:2 GATT and by the ECJ for the concept of ‘other products’ in Article 110(2) TFEU.20 Under WTO jurisprudence, the distinction between ‘like products’ and ‘directly competitive or substitutable products’ in Article III GATT is gradually disappearing.21 The WTO adjudicating bodies are more and more prepared to extend the economic standard to the concept of ‘like products’. The Appellate Body Report on EC – Asbestos nicely illustrates this change in jurisprudence with regard to the assessment of discriminatory regulations (Article III:4 GATT).22 However, even though the WTO adjudicating bodies recognized the relevance of competitive relationships for the analysis of ‘likeness’ under this so called ‘market place approach’, they continue, in principle, to apply the formal criteria from the Border Tax Adjustments framework.

The ECJ jurisprudence pertaining to ‘similar products’ under Article 110(1) TFEU developed in parallel to the WTO jurisprudence on Article III:2 GATT, moving from a formally objective interpretation to a test taking into account also economic considerations.23


20 For the WTO see e.g. GATT Panel Report, EEC – Animal Feed Proteins, above n 16, para 4.3; for the EU see e.g. Case 170/78 Commission v. UK, para 14 (competitive relationship between wine and beer).

21 At least for purposes of Article III:2 GATT it appears that the ‘like products’ concept is interpreted narrower than the ‘directly competitive or substitutable’ standard in that it requires both a competitive relationship and physical similarities between the products.

22 WTO Appellate Body Report, EC – Asbestos, above n 5, para 99: ‘a determination of “likeness” under Article III:4 is, fundamentally, a determination about the nature and extent of a competitive relationship between and among products’.

23 Case 106/84 Commission v. Denmark [1986] ECR 833, para 12: ‘it is necessary first to consider certain objective characteristics …, and secondly to consider whether or not both categories of beverages are capable of meeting the same need from the point of view of consumers’.
Consequently, the difference between the concepts of ‘similar products’ in Article 110(1) TFEU and ‘other products’ in Article 110(2) TFEU is gradually disappearing.

The same economic interpretation of ‘likeness’ will have to prevail for the WTO national treatment obligation pertaining to trade in services, considering that Article XVII:3 GATS explicitly states that it is designed to protect competitive opportunities.24 In comparison, the WTO did not yet have an opportunity to explicitly confirm an economic standard of ‘like products’ for purposes of MFN (Article I GATT),25 but numerous scholars rightfully demand such an approach at least with regard to internal taxes and regulations.26


jurisprudential guidance exists with regard to the standard of ‘likeness’ in Article II GATS on MFN-treatment.  

Finally, most arbitral tribunals applying the NAFTA rules on investment protection largely endorsed an economic interpretation of the ‘like circumstances’ concept, even though the jurisprudence is not entirely consistent. The main criterion generally is whether investors or investments are in the ‘same sector’, including both economic and business sectors. While some tribunals omit to explicitly identify the competitive relationship as the decisive factor to delimit a ‘sector’, others base their analysis more specifically on competition.  

3. Subjective standard

The subjective standard of ‘likeness’ has been developed by different adjudicating bodies of international economic law in order to balance the tension between international obligations designed to liberalize trade and investment on the one hand, and domestic non-economic policy objectives such as environmental and consumer protection. The doctrinal reasoning of the subjective standard is to argue that the tertium comparationis is defined by the regulatory purpose of the measure under scrutiny; for instance, if the measure is designed to protect the environment, then the products are compared on the basis of their environmental impact. GATT 1947 jurisprudence implemented a subjective standard with the so called ‘aim and effects’ test as part of the ‘like products’ analysis. Following this approach a GATT Panel ruled that low and high alcohol content beers are not ‘alike’ for the purpose of Article III:4 GATT because the measures restricting points of sale, distribution and labelling were aimed to encourage the consumption of low alcohol beer. Conversely, wines made from different grapes were found to be ‘like products’ mainly because the respondent was unable to provide any valid public policy purpose in support of its differential tax treatment. However, subsequently the WTO panel and Appellate Body strongly rejected the ‘aim and effects’ test for purposes of both GATT and GATS.

Similar to the ‘aim and effects’ test, most arbitral tribunals ruling on NAFTA non-discrimination provisions in the area of trade in services and investment protection interpret the concept of ‘like circumstances’ as containing a subjective element. Following this rationale, the question is not whether the foreign and domestic suppliers or investors are in ‘like circumstances’, but whether the differential treatment occurs in ‘like circumstances’. In
other words, the policy objective pursued by the measure under scrutiny may be taken into consideration to define the circumstances in which the comparison of the foreign and domestic comparators takes place.\textsuperscript{31} The same result is likely to prevail in certain BIT non-discrimination clauses. For instance, the former Norwegian draft model-BIT specified the applicable subjective standard by means of a footnote to the ‘like circumstances’ concept:

\begin{quote}
‘1. Each Party shall accord to investors of the other Party and to their investments, treatment no less favourable than the treatment it accords in like circumstances\textsuperscript{[fn 2]} to its own investors and their investments, in relation to the establishment, acquisition, expansion, management, conduct, operation and disposal of investments.\textsuperscript{[fn 2]} The Parties agree/ are of the understanding that a measure applied by a government in pursuance of legitimate policy objectives of public interest such as the protection of public health, safety and the environment, although having a different effect on an investment or investor of another Party, is not inconsistent with national treatment and most favoured nation treatment when justified by showing that it bears a reasonable relationship to rational policies not motivated by preference of domestic over foreign owned investment.’\textsuperscript{32}
\end{quote}

The main challenges of this approach are to determine the legitimate policy objectives and the appropriate standard for the reasonable relationship between the measure under scrutiny and the pursued objective (see below, II.C.3).

4. Combination of standards

The objective, economic and subjective standards of ‘likeness’ may be applied individually or in combination. WTO adjudicating bodies combine the economic and objective standard for purposes of certain GATT non-discrimination provisions. For instance, ‘like products’ in terms of Article III:1, first sentence, GATT is interpreted as requiring both physical similarity and a competitive relationship. In comparison, the concept of ‘like circumstances’ in NAFTA non-discrimination rules is usually interpreted as providing both an economic standard and a subjective exception allowing to differentiate between competing investors or service suppliers in order to pursue legitimate domestic policy objectives.

5. Absence of a comparator clause

Finally, the comparator clauses are not only highly fragmented in terms of their terminology and application; some international economic treaties even contain non-discrimination obligations which entirely lack a comparator clause.\textsuperscript{33} The absence of a comparator clause


may be subject to two different interpretations. The first and here supported approach consists of the argument that a comparative element is inherent to the logic and structure of the non-discrimination principle in international economic law. Consequently, the claimant would still have to establish the existence of a competitive relationship between the allegedly discriminated foreign market participant and a domestic market participant who is receiving more favourable treatment. Conversely, under the second theory the absence of a comparator clause entails that competitive relationships or any other form of ‘likeness’ between the domestic and foreign comparators are irrelevant. Consequently, equal treatment would have to be accorded to foreign and domestic market actors across economic sectors.

B Fragmented standards of ‘less favourable treatment’

The term or standard of ‘less favourable treatment’ is usually not defined in the non-discrimination provisions of international economic treaties. As a notable exception, Article XVII:3 GATS states that ‘different treatment shall be considered to be less favourable if it modifies the conditions of competition’.

1. Disproportionate disadvantage test

The disproportionate disadvantage test requires assessing the negative (and potentially neutral or positive) economic effect of a measure on the group – as defined by the

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34 In this sense see e.g. Nykomb Synergetics v. Latvia [on Art. 10(1) of the Energy Charter Treaty], at 34: ‘in evaluating whether there is discrimination in the sense of the Treaty one should only “compare like with like”’; Consortium RFCC v. Morocco [on Italy-Morocco BIT (1990)], para 53; also A. Newcombe and L. Paradell, above n 9, at 160; OECD, The Multilateral Agreement on Investment: Commentary to the Consolidated Text, Negotiating Group on the Multilateral Agreement on Investment, DAFFE/MAI(98)8/REV1 (1998), at 11, available at www1.oecd.org/daf/mai/pdf/98/ng988r1e.pdf.


37 But see, Pope & Talbot v. Canada, para 57.
comparator clause – of domestic and foreign market participants. The non-discrimination obligation is only breached if the group of foreign participants is disproportionately disadvantaged as compared to the domestic one. Even though WTO jurisprudence is not entirely consistent on this issue, it appears that the Appellate Body now explicitly endorsed the disproportionate disadvantage test. In *EC – Asbestos* the Appellate Body reversed the Panel’s ruling primarily on grounds of ‘likeness’, but it also reversed the Panel’s approach in regard to ‘less favourable treatment’ in an *obiter dictum*. The Appellate Body held that ‘a complaining Member must […] establish that the measure accords to the group of “like” imported products less favourable treatment than it accords to the group of domestic products.’ This approach is supported by most commentators of WTO law.

In comparison, the ECJ also adopts the disproportionate disadvantage test in order to demonstrate whether a tax is of protective nature for purposes of Article 110(2) TFEU prohibiting tax discrimination:

‘The protective nature of the tax system […] is clear. A characteristic of that system is in fact that an essential part of domestic production […] come within the most favourable tax category whereas at least two types of product, almost all of which are imported from other Member States, are subject to higher taxation […]. The fact that another domestic product […] is similarly placed at a disadvantage does not rule out the protective nature of the system […].’

Considering the fact that a measure may have negative economic effects on certain competitors and no or even positive effects for other competitors, the disproportionate disadvantage test requires establishing a ratio threshold for ‘disproportionality’. Assume, for instance, a theoretical model situation where 100 domestic products stand vis-à-vis 100 imported ‘like’ products. Presumably no ‘less favourable treatment’ occurs if domestic and foreign products are equally affected (e.g. 10 domestic vs 10 foreign or 70 domestic vs 70 foreign). However, there remains a large range between, for instance, a negative effect on 10 foreign vs 5 domestic or 95 foreign vs 10 domestic products. It remains in the discretion of the arbitral tribunal to define an appropriate ratio for each specific case.

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41 Case 168/78 Commission v. French Republic [1980] ECR 00347, para 41; for an overview and references to ECJ jurisprudence see L. Ehring, above n 6, at 948-49.
2. Obligation to grant the best treatment accorded to any domestic market participant

The non-discrimination principle may also be interpreted as an obligation to grant the best treatment accorded to any domestic market participant. Following this approach the non-discrimination obligation is already breached if one individual foreign market participant receives treatment that is less favourable in comparison to any individual domestic market participant (NT) or to any foreign market participant from different origin (MFN). For instance, less favourable treatment occurs if a measure negatively affects only 1 out of 100 foreign market actors, even if 99 out of 100 domestic market actors are also negatively affected. Consequently, the non-discrimination principle becomes an obligation to treat all foreign market participants equivalent to the best treatment accorded to any ‘comparable’ domestic or other foreign market participant. Under this approach, non-discrimination has a strong liberalizing effect and far reaching consequences for the regulatory autonomy of the contracting parties, in particular if additionally the comparator clause is interpreted widely.

This very liberal and intrusive interpretation is mostly adopted in the area of investment protection. In particular the jurisprudence pertaining to NAFTA chapter 11 shows a clear tendency towards this ‘best treatment’ approach. For instance, the tribunal in Pope & Talbot v. Canada ruled ‘that “no less favorable” means equivalent to, not better or worse than, the best treatment accorded to the comparator.’ The main argument brought forward in support of this far reaching standard is that investment treaties are designed to protect the value of a specific investment. In contrast, international trade law protects a more abstract value of equal conditions of competition, not the actual value of the exported goods and services. This argument has some merit, insofar as the investment in a foreign market is a more substantial and binding commitment to participate in the foreign market than merely exporting goods and services. A new regulation – for instance an environmental standard – may have severe consequences for the foreign investor who, in case he is unable to comply with the standard, may have to disinvest and suffer actual damages. Conversely, a foreign producer unable to meet the new standard may simply cease to export without incurring actual damages, but only loss of potential gains. However, this circumstance is taken care of in that investment treaties accord to the foreign investor an individual right to claim damages, whereas trade agreements are only enforceable by the governments of the contracting parties which can only claim the abolishment of the measure, but not damages. It is however not entirely apparent why these conceptual differences between trade and investment should explain

\[\text{This test is also referred to as ‘diagonal test’}.\]


\[\text{T. J. Grierson-Weiler and I. A. Laird, above n 43, at 293.}\]

\[\text{Pope & Talbot v. Canada}, \text{ para 42, also paras 43-72; see also ADM v. Mexico, para 205: ‘Claimants and their investment are entitled to the best level of treatment available to any other domestic investor or investment operating in like circumstances’; Loewen v. US, para 140: ‘What Article 1102(3) requires is a comparison between the standard of treatment accorded to a claimant and the most favourable standard of treatment accorded to a person in like situation to that claimant’; Methanex v. US, part IV(B), para 21: ‘the investor or investment of another party is entitled to the most favourable treatment accorded to some members of the domestic class’; less clear Thunderbird v. Mexico, para 177, but see Separate Statement by Thomas W. Wälde, Thunderbird v. Mexico, para 105.}\]
different substantive standards of non-discrimination. The circumstances may very well justify a ‘best treatment’ or similar standard in a trade case, whereas the ‘best treatment’ approach may just as well lead to absurd results in investment protection law. On the one hand, most investment treaties go beyond the protection of foreign direct investment by applying also to more mobile forms of investments, such as minority equity investment or debt holdings. These types of investments are not subject to the same sunk costs as foreign direct investment and may even be retracted from the foreign market. On the other hand, measures affecting trade in services under GATS mode 3 (commercial presence) are analysed under a disproportionate impact test in spite of the similarity between commercial presence and investment. Moreover, it is to be expected that NAFTA chapter 12 on trade in services follows the same standards as chapter 11 on investment protection, even though it is more closely related to trade rules. Even within NAFTA chapter 11 the interpretation lacks consistency in that some tribunals seemed to favour the disproportionate disadvantage test. At the same time, some WTO panels applied a standard similar to the ‘best treatment approach’. In view of this inconsistency in the interpretation of the core element of non-discrimination, it would be preferable to either specifically spell out the applicable test in the agreement or to explicitly accord to the arbitral tribunal the competence to determine the applicable standard on a case by case basis.

3. **Subjective standard of ‘less favourable treatment’**

The subjective standard of ‘less favourable treatment’ takes into account the regulatory purpose in order to determine the true basis of the differential treatment. In the case of *de jure* discrimination, the measure differentiates directly on the basis of origin; however, cases of *de facto* discrimination differentiate directly on the basis of a permitted criterion. Under the different approaches discussed above, the link from the permitted to the prohibited criterion is presumed if the quantitative threshold is met. In contrast, the subjective standard requires determining whether the measure truly pursues an objective related to the permitted criterion, or whether the true intent of the measure is to discriminate indirectly on the basis of origin. This subjective theory of ‘less favourable treatment’ has not yet been explicitly recognized by the WTO adjudicating bodies or by arbitral tribunals. Some commentators understood the Appellate Body’s *obiter dictum* in *EC – Asbestos* as a return of ‘aim and effects’ test under the element of ‘less favourable treatment’, however, in this case the

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46 See e.g. *Saluka Investments B.V. v. Czech Republic; Fireman's Fund v. United Mexican States.*

47 See *S.D. Myers v. Canada*, para 252; similarly also *Corn Products v. Canada*, para 138, which looked at both effect and intent of the measure.


Appellate Body only addressed the issue of quantitative effect, but not of purpose.\textsuperscript{50} More pertinently, the Panel in \textit{EC – Approval and Marketing of Biotech Products} seemed to consider a subjective standard of ‘less favourable treatment’; it noted that ‘Argentina is not alleging that the treatment of products has differed depending on their origin. In these circumstances, it is not self-evident that the alleged less favourable treatment of imported biotech products is explained by the foreign origin of these products rather than, for instance, a perceived difference between biotech products and non-biotech products in terms of their safety, etc. In our view, Argentina has not adduced argument and evidence sufficient to raise a presumption that the alleged less favourable treatment is explained by the foreign origin of the relevant biotech products.’\textsuperscript{51}

\textbf{C Fragmented standards and relevance of ‘regulatory purpose’}

The main objective of non-discrimination obligations in international economic law is to outlaw measures which are specifically designed to protect the domestic market from foreign competition. However, even measures which pursue a legitimate policy objective – such as measures setting standards related to health, environment, labour or human rights – may have an indirect protectionist effect. In such cases, most international economic treaties provide that the policy objective of the measure is taken into account for the legal analysis. However, there are two different systemic approaches as to whether the purpose of a regulatory measure is analysed as part of the non-discrimination obligation itself or as a justification.\textsuperscript{52}

1. \textit{Regulatory purpose as part of the non-discrimination standard}

As discussed above, the regulatory purpose may be considered as part of the comparator clause or as part of the ‘less favourable treatment’ element, to the extent that a subjective standard is applied. This solution is very rarely explicitly adopted by international economic treaties, but adjudicating bodies occasionally choose one of these two approaches by applying and interpreting a specific non-discrimination obligation. Alternatively, the regulatory purpose could be considered as a distinct and separate legal element within the non-discrimination obligation. However, international economic treaties do not provide a textual basis for such an approach. The only provision allowing for some flexibility in this regard is Article III:1 GATT, which states that measures ‘should not be applied to imported or domestic products so as to afford protection to domestic production’.\textsuperscript{53} Even though the Appellate Body emphasized that the test for the wording ‘so as to afford protection’ is about

\textsuperscript{50} Also rejecting this interpretation L. Ehring, above n 6, at 945-46.
\textsuperscript{52} G. De Bürca, above n 1, at 191, speaks of ‘definitional stage’ and ‘justificatory stage’.
\textsuperscript{53} According to WTO jurisprudence on GATT Art. III:2, second sentence, the element ‘applied so as to afford protection’ is incorporated in the legal test by reference to paragraph 1 of Article III and must thus be separately analysed, WTO Appellate Body Report, \textit{Japan – Taxes on Alcoholic Beverages (Japan – Alcoholic Beverages II)}, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, at 25 f.
protective *application*, not about protective *intent*, indications of protectionist intent regularly do flow into the analysis.\(^{54}\)

From a practical and pragmatic perspective it seems indifferent whether the regulatory purpose is considered under the comparator clause, the ‘less favourable treatment’ element or as a distinct and separate element. However, from a doctrinal and systemic angle it would be welcomed if the jurisprudence, or preferably the treaties themselves, would clarify whether and under which title the purpose of an allegedly discriminatory measure may be analysed. Such transparency would enhance legal security and facilitate the parties to a dispute to build their legal arguments. For clarity and structural reasons, the regulatory purpose should ideally be considered as its own legal element. However, due to the lack of a textual basis, adjudicating bodies mostly rely on the comparator clause or to a lesser extent on the element of ‘less favourable treatment’.

2. Regulatory purpose as justification

Under the second theory, the regulatory purpose is taken into account only once it has been established that the measure under scrutiny is in breach with the non-discrimination obligation. Such an approach needs to be explicitly incorporated in the structure of an international economic treaty, such as the general exceptions clauses in WTO law (e.g. Articles XX GATT or XIV GATS) or in the NAFTA rules on trade in services (Article 2101[1]). Importantly, however, such justification or exception clauses not only legitimize the violation of a non-discrimination obligation, but also of other substantive obligations set forth in the respective treaty, such as the prohibition of quantitative restrictions.

3. Legal challenges of regulatory purpose

While a proper consideration of a discriminatory measure’s policy objective may provide the ‘most just’ results, it confronts the adjudicating bodies with a number of very difficult problems. First, consideration of the regulatory purpose raises procedural issues of burden of proof, means of proof and standard of review. An unreasonably high bar would be raised by

\(^{54}\) Ibid., at 29: ‘It is irrelevant that protectionism was not an intended objective if the particular tax measure in question is nevertheless, to echo Article III:1, “applied to imported or domestic products so as to afford protection to domestic production”. This is an issue of how the measure in question is applied”; confirmed in WTO Appellate Body Reports, *Chile – Taxes on Alcoholic Beverages (Chile – Alcoholic Beverages)*, WT/DS87/AB/R, WT/DS110/AB/R, adopted 12 January 2000, paras 61 ff, 71; *Korea – Taxes on Alcoholic Beverages (Korea – Alcoholic Beverages)*, WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 February 1999, para 149.

\(^{55}\) WTO Panel Report, *Mexico – Tax Measures on Soft Drinks and Other Beverages (Mexico – Taxes on Soft Drinks)*, WT/DS308/R, adopted 24 March 2006, para 8.91: ‘the declared intention of legislators and regulators of the Member adopting the measure should not be totally disregarded’; WTO Appellate Body Report, *Chile – Alcoholic Beverages*, above n 54, para 71: ‘The conclusion of protective application reached by the Panel becomes very difficult to resist, in the absence of countervailing explanations by Chile’; WTO Panel Report, *Indonesia – Autos*, above n 25, para 14.115: ‘the nature of the discrimination, which is to promote a national industry by giving it advantages vis-à-vis imported products, is clearly designed so as to afford protection to domestic production’, where it is unclear what the real difference between ‘nature’ and ‘purpose’ should be; WTO Appellate Body Report, *Canada – Certain Measures Concerning Periodicals (Canada – Periodicals)*, WT/DS31/AB/R, adopted 30 July 1997, at 30 ff, referring to statements by the Canadian government about the protectionist purpose of the measure.
placing the burden on the complainant to prove a protectionist purpose. Preferably it should be up to the respondent to demonstrate that its measure pursues a non-protectionist and legitimate objective. Either way, direct evidence of protectionist intent will rarely exist, considering that numerous governmental actors and interest groups are usually involved in the decision making process. The parties thus have to rely mostly on circumstantial evidence related to the design, structure, application and effect of a measure. In this context the question arises of how much deference the adjudicating bodies should give to the respondent’s evidence and assertions concerning the purpose of its own measure. This is a very sensitive procedural issue related to the question of the appropriate standard of review.

Second, it must be determined which policy objectives are considered as sufficiently important to justify a measure which – indirectly or directly – discriminates against foreign competitors. General exceptions clauses set forth a list of legitimate objectives agreed upon by the contracting parties during the negotiations. Such lists are usually regarded as exhaustive; however, the ECJ for instance transformed the general exceptions clause of Article 36 TFEU (ex Art. 30 TEC) from an exhaustive to an illustrative list of public interests serving as grounds for justification. Conversely, no such treaty mandated list exists if the regulatory purpose is considered under the comparator clause or the element of ‘less favourable treatment’.

Third, a legitimate objective itself is not sufficient to avoid the breach of a non-discrimination obligation; there must also be a certain nexus between the measure under scrutiny and the legitimate objective pursued. Most treaties which provide a justification or general exceptions clause explicitly state the required nexus. For instance, Articles XX GATT and XIV GATS differentiate between measures which are ‘necessary’ to achieve the pursued policy objective or merely ‘related to’ the policy objective.

To the extent that the treaty is silent on any or all of these issues, it will be up to the adjudicating bodies to develop procedural rules, to determine the legitimate policy objectives and the appropriate threshold for a nexus between the measure and the objective. Considering the far reaching implications such standards may have for the contracting parties’ sovereignty and regulatory autonomy, it is highly questionable whether the adjudicating bodies and other institutions of international economic law are sufficiently legitimized to render these types of decisions.

D Overlap between non-discrimination and non-restriction

Depending on how each element of the non-discrimination obligation is construed, the result may be that non-discrimination overlaps with the more integrative principle of non-restriction (Beschränkungsverbot). The legal concept of non-restriction goes much further in trade liberalization than the principle of non-discrimination. It is fundamental, for instance, to the freedom to provide services under EU law. According to the ECJ, Article 56 TFEU (ex

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Art. 49, ex-ex Art. 59 TEC) requires not only the elimination of all discrimination against a person providing services on the ground of his nationality but also the abolition of any restriction, even if it applies without distinction to national providers of services and to those of other Member States, when it is liable to prohibit or otherwise impede the activities of a provider of services established in another Member State where he lawfully provides similar services. Some commentators suggest that de facto discrimination in WTO law should also be interpreted such that any measure which is more burdensome than necessary for foreign services and suppliers should qualify as discrimination in violation of Articles II or XVII GATS. Under this approach, the elements of ‘less favourable treatment’ and ‘likeness’ would have to be replaced by a test of necessity and proportionality. Yet, another way of assimilating non-discrimination to non-restriction would be to combine the ‘best of the best treatment’ approach for ‘less favourable treatment’ with a broad economic or interpretation of the comparator clause. As it would be almost always possible to determine at least one distant competitor receiving more favourable treatment, the principle of non-discrimination would in essence be transformed into an obligation of non-restriction. The overlap is even more apparent in case broad objective criteria such as ‘the act of exporting’ are applied under the comparator clause, which results in a comparison of different treatments between non-competing products. For instance, the true question in Occidental v. Ecuador was not whether the differential tax treatment between exporters of oil and exporters of flowers is discriminatory, but whether the tax treatment of oil exporters is more burdensome than necessary or whether it violates legitimate expectations.

57 Art. 56 TFEU reads: ‘restrictions on freedom to provide services within the Community shall be prohibited in respect of nationals of Member States who are established in a State of the Community other than that of the person for whom the services are intended’.


60 See e.g. Art. 16 of the EC Services Directive 2006/123/EC, OJ 2006 L 376/36.
III A FLEXIBLE FACTOR-BASED STANDARD OF NON-DISCRIMINATION

Considering that the interpretation of non-discrimination obligations in international economic law lacks coherence, which in turn creates legal uncertainty for the contracting parties, individuals and parties to a dispute, the present section attempts to develop a factor based approach to non-discrimination. Pauwelyn argued that the non-discrimination analysis should treat ‘likeness’ as a mere threshold question and focus more specifically on ‘less favourable treatment’ as the substantive test, taking into account a mix of elements. Section III takes up this theory, suggesting that the entire non-discrimination analysis could be viewed as a threshold question. In other words, ‘less favourable treatment’, ‘likeness’ and other elements such as ‘so as to afford protection’ or ‘regulatory purpose’ should not be incorporated in non-discrimination provisions as strict legal conditions which must be proven by the complainant or the respondent pursuant to the applicable standard of review. Instead, all the relevant elements could be viewed as soft-factors to be weighed and balanced in order to come to an overall conclusion on whether or not a measure is discriminatory and thus illegal. Importantly, this article does not address the question whether specific non-discrimination provisions of the WTO, the EU, NAFTA, BITs and other international economic treaties provide a textual basis for such an approach. The more modest aim is to make adjudicating bodies aware of the significance and mutual relationship of the different legal elements and to propose an alternative approach to non-discrimination for the negotiation of future non-discrimination provisions.

A Formal basis of differential treatment

The first analytical step should be to determine whether the measure differentiates directly on the basis of origin or on the basis of other criteria. All forms of de jure differentiations which affect the competitive opportunities to the detriment of foreign market participants constitute a strong factor pointing towards illegal discrimination. However, the respondent must have the opportunity to justify the measure by proving its legitimate policy objective and a strong nexus between the measure and the objective under scrutiny. In addition, the respondent may show that the measure does not accord a competitive advantage to domestic market participants due to the complete absence of any even remotely competing domestic goods or services.

If a complainant challenges a measure which differentiates on a basis other than origin (de facto discrimination), then the analysis needs to focus strongly on the effect of the measure in a specific market situation.

B Extent of competitive relationship between comparators

The current terminology used in non-discrimination provisions referring to ‘like’ or ‘similar’ products, situations or circumstances does not do justice to the underlying question of whether or not there is a competitive relationship between the foreign and domestic market entities. Oftentimes the wording of the comparator clause invites the adjudicating bodies to take into account the purpose of the regulation. While this subjective approach may be

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appropriate from a pragmatic perspective due to the lack of a general exceptions clause in the respective agreement, it does not live up to the required standards for legal security, consistency and transparency. Conversely, current comparator clauses may allow the adjudicating bodies to find illegal discrimination between market entities which are not in a competitive relationship at all. This approach is not satisfying as it opens the door to an unlimited number of irrelevant *tertia comparationis*, thereby stretching the principle of non-discrimination beyond its original purpose and scope. By comparing, for instance, an export tax on oil with the absence of such a tax on flowers, the true rationale is not whether foreign oil investors are treated less favourably than domestic growers of flowers, but whether the export tax on oil is an unnecessary obstacle to trade or investment. Hence, regulations with no effect between domestic and foreign competitors should not be dealt with under a non-discrimination obligation, but under the more integrative instruments such as non-restriction in trade or legitimate expectations in investment protection.

Currently, the economic concept is best reflected in *Ad* Article III paragraph 2 of the GATT Annex I, which incorporates a standard of ‘directly competitive or substitutable’ products. Another interesting solution had been proposed during the GATS negotiations. An early draft of the GATS national treatment provision contained a specific reference to the marketplace, prohibiting differential treatment of foreign and domestic services and suppliers ‘in the same market’. Future non-discrimination provisions in international economic agreements should follow these examples, prompting the adjudicating bodies to assess the approximate extent of the competitive relationship by focusing on the economic theory of demand substitutability.

**C Effect of the measure on imports**

Once the approximate extent of the competitive relationship between the foreign and domestic market entity has been established, the question becomes whether there is less favourable treatment of the foreign entities. For this purpose, the adjudicating bodies need to assess the effect of the measure, both qualitatively and quantitatively.

1. **Qualitative effect**

The qualitative effect of a measure refers to the parameter of competition which is affected by the measure and the resulting extent of the additional burden placed on the foreign market entities. For instance, measures banning foreign products from the market or regulating the price of certain foreign products are of the highest qualitative burden. In comparison, product regulations, technical regulations or administrative burdens may result in different qualitative effects, depending on which parameter of competition they affect. In such cases, the complainant needs to demonstrate how and to what extent the measure creates additional transaction costs for foreign market entities. Ideally, the additional burden should be assessed in costs, which is relatively easy in the case of taxes. For instance, depending on the cost of the actual product, a tax differential of 1 per cent may be considered to have a low qualitative effect, whereas a differential of 30 per cent would be a high qualitative effect.

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The qualitative effect of the measure may then be placed in relation to the competitive relationship. If the foreign and domestic entities are in a very close competitive relationship, then a very small qualitative effect of the measure – such as a small differential tax or a small administrative burden – may be sufficient to constitute a breach of the non-discrimination obligation. Conversely, if the market players only compete very remotely, then the qualitative effect of the measure needs to be of a higher intensity so as to amount to illegal discrimination. This rationale of placing the qualitative effect of the measure in relation to the competitive relationship is currently reflected in the national treatment provisions of Articles III:2 GATT and 110 TFEU with regard to taxes. For instance, if the products are ‘like’ in terms of Article III:2, first sentence, GATT (i.e. competing and physically similar), every even very small difference in taxation to the detriment of imported products meets the ‘in excess of’ requirement and thus violates national treatment; no de minimis exception is granted.\footnote{In case of de facto discrimination, it could even be argued that the standard of ‘less favourable treatment’ for Art. III:2, first sentence, follows the diagonal test, meaning that the tax violates GATT even if only one imported product is taxed more heavily. This broad interpretation of ‘less favourable treatment’ is counterbalanced with a very narrow interpretation of ‘likeness’.
} In contrast, if the products in question are not ‘like’, but nevertheless in direct competition or substitutable (i.e. competing regardless of physical differences), the requirements on the difference in taxation are more strict. In these cases, a supplemental de minimis tax on imported products is not sufficient to find a breach of Article III:2, second sentence, GATT, and, unlike in the case of the first sentence, the taxation must be construed so as to afford protection.\footnote{WTO Appellate Body Report, Japan – Alcoholic Beverages II, above n 53, at 28.}

2. \textit{Quantitative effect}

An additional aspect that needs to be taken into account for the weighing and balancing test is the quantitative effect of the measure on domestic and foreign market entities. A new regulatory measure may have a positive or a negative competitive effect on a concerned market entity, or it may have no competitive effect at all. The quantitative analysis requires assessing how the positive, negative or neutral effect is distributed among the foreign and domestic market entities. Instead of imposing a fixed standard, such as the ‘disproportionate disadvantage test’ or the ‘best treatment’ approach, the adjudicating bodies should have the flexibility to weigh and balance the quantitative effect in light of the competitive relationship and the relevant market. For instance, a measure is likely to amount to unlawful discrimination if it negatively affects predominantly foreign market entities in a narrowly defined market (i.e. with strong competitive relationship and high demand elasticity). Conversely, on the other side of the spectrum would be a measure which negatively affects only few or one foreign market entity in a broadly defined market (i.e. low competitive relationships with low demand elasticity).

In sum, the higher the competitive relationship between the market entities which are affected by the measure, the fewer foreign entities need to be negatively affected for the measure to amount to unlawful discrimination (‘best treatment’ approach). Conversely, if the entities affected by the measure are only remotely in competition, then discrimination would
only occur if the measure negatively affects predominantly foreign market entities (‘disproportionate impact’ approach).

3. Supply substitutability and temporal considerations

A final aspect that may be taken into consideration when assessing the effect of a measure relates to the issue of supply substitutability and temporal markets. Supply substitutability focuses on the question to what costs and within which time frame a supplier could switch its production from product A to product B. This analysis is particularly pertinent to assess the market position of a company for purposes of antitrust law. In the context of non-discrimination, however, the focus lies not on the market position, but on the ability – in terms of cost and time – of the foreign market entity to escape the negative effect of the measure by, for instance, making its product compliant with the regulation under scrutiny. More specifically, if a foreign producer is banned from importing its product because it fails to meet a new environmental standard, then the discriminatory effect could be mitigated by the fact that the foreign producer could relatively easy (i.e. at low costs and within a short period of time) switch its production from the non-compliant to a compliant product. Consequently, high supply substitutability could be considered as a factor supporting the conclusion that a measure does not amount to unlawful discrimination. Ideally, the costs for the foreign market entity to switch from a non-compliant to a compliant product or service should be viewed in relation to the importance and value of the policy objective pursued by the measure.

D Regulatory purpose

A final element which may be taken into consideration is the regulatory purpose of the measure under scrutiny. Importantly, the regulatory purpose should have its own value and should not be incorporated into the analysis of the previous elements.

1. Protectionist purpose

It is up to the complainant to produce evidence of a protectionist purpose. In the rare cases where direct evidence shows that a measure was adopted with the aim to pursue a protectionist purpose, such evidence should be considered as a very strong – albeit not by itself decisive – indication that the measure amounts to unlawful discrimination. Direct evidence could be obtained from official documents or press coverage related to the legislative history of the measure.

In most cases the complainant is more likely to produce circumstantial evidence pointing towards protectionist intent of the responding government. However, the most important type of circumstantial evidence is the effect of the measure which is already taken into account as its own element. In addition, circumstantial evidence could relate the design, structure and application of a measure.\(^{65}\) Elements to be considered are, for instance, the purpose and

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objective of the government and legislature ‘to the extent that they are given objective expression in the statute itself’\(^{66}\), unexplained changes in drafts during the legislative history\(^{67}\) or the application of differential standards.\(^{68}\) Finally, the absence of a credible non-protectionist purpose could also be considered as circumstantial evidence of a protectionist purpose.

2. Non-protectionist purpose

While the complainant seeks to show protectionism, the respondent may submit evidence demonstrating that the measure was adopted with the objective to protect a public interest, such as health, morals, order, environment, natural resources etc. Such an alleged non-protectionist purpose must not only be balanced with the previous elements, but it must also be analysed under the principle of necessity or, more broadly, the principle of proportionality.

a. Importance of the public interest

The contracting parties have it in their hands to negotiate either an exhaustive or an enumerative list of public interests that may be protected in violation of a non-discrimination obligation. Considering that the need for the protection of unforeseen interests may arise at short notice, an open list of public interests appears to be preferable. In many cases the contracting parties would have great difficulty to find a consensus for amending the exceptions of an existing international economic agreement. However, in order to prevent overreaching justifications, the adjudicating bodies need to have the authority to evaluate the objective value or importance of the allegedly protected public interest. This may be a difficult task as it entails to second guess the national values of sovereign contracting parties with different institutional, political or religious traditions.\(^{69}\) Consequently, the value of the pursued public interest cannot by itself be a decisive element in the analysis, but more a consideration that reinforces the tendencies of the previous elements. For instance, the protection of a minor public interest may reinforce the conclusion that a measure is not discriminatory in cases where the measure differentiates \textit{de facto} between remotely competing market entities and has a low qualitative and quantitative effect on foreign entities. Conversely, a universally very important public interest, such as human life and


\(^{68}\) Ibid., para 176: ‘The Panel merely stated its doubts on whether Australia applies similarly strict sanitary standards on the internal movement of salmon products within Australia as it does on the importation of salmon products and considered that as a factor which can be taken into account in the examination under the third element of Article 5.5’.

\(^{69}\) Such an evaluation of domestic values may also be required under current general exceptions clauses, for instance when the adjudicating bodies are asked to decide whether a protected value falls under the public morals or public order, see N. F. Diebold, ‘The Morals and Order Exceptions in WTO Law: Balancing the Toothless Tiger and the Undermining Mole’, 11 \textit{JIEL} (2008) 43, at 60 ff.
health, may be used to justify measures which differentiate on a formal basis or between strongly competing market entities to the detriment of predominantly foreign entities.

b. Nexus between the public interest and the respondent’s territory

Following the general territoriality principle of public international law, a sovereign country is generally prohibited from adopting extraterritorial measures which infringe with the sovereignty of another country. Consequently, the question whether and to what extent a nexus exists between the policy objectives pursued by the regulatory country and its territory needs to be taken into account under the aspect of regulatory purpose. This nexus is usually existent in cases where a measure concerns a foreign investor or service supplier who is present on the territory of the regulatory country. In the case of trade in goods, no concerns of territoriality arise if the measure sets certain standards in order to pursue a domestic non-economic public interest, such as the protection of domestic health, environment or consumers. In contrast, an importing country may be inhibited from restricting the import of products for reasons of insufficient process or production methods used in the country of production, unless there is a nexus between the ‘extraterritorial’ value and the domestic territory. For instance, in the case US – Shrimp the Appellate Body recognized a sufficiently strong nexus between the United States’ import ban on shrimp caught without a turtle excluder devise and the United States territory due to the fact that sea turtles sought to be protected by may migrate to the waters subject to United States jurisdiction.\textsuperscript{70} The ban was designed to protect exhaustible natural resources under Article XX(g) GATT.

c. Nexus between the measure and the objective

Finally, the most important element that needs to be considered in the analysis of the regulatory purpose is the extent of a nexus or causality between the trade restrictive measure and its objective. Such a nexus is crucial in order to avoid the risk that a measure under scrutiny is overly trade restrictive in view of achieving the pursued objective. For instance, a total import ban of cigarettes may not be necessary to achieve certain objectives related to ensure the quality or to reduce consumption of cigarettes.\textsuperscript{71} This aspect is currently embodied in the general exceptions clauses, which require that a measure must be ‘necessary to protect’ or ‘related to the protection of’ a certain public interest (see e.g. Articles XX GATT and XIV GATS). The here proposed factor-based approach to non-discrimination would not prescribe a fixed threshold, such as ‘necessity’ or ‘related to’, but it would allow the adjudicating bodies to weigh and balance nexus-related factors in light of the analysis of the previous factors. The necessity test, for instance, requires a process of weighing and balancing a series of factors, namely (i) the relative importance of the interest protected by the measure, (ii) the contribution of the measure to the protection of the policy objective and the public interest, (iii) the impact of the measure on trade, (iv) the existence of alternative measures in light of


\textsuperscript{71} See e.g. GATT Panel Report, Thailand – Restrictions on Importation of and Internal Taxes on Cigarettes (Thailand – Cigarettes), DS10/R, adopted 7 November 1990, BISD 37S/200, para 81.
(v) the level of protection chosen by the responding Member (e.g. zero-risk level). Under the factor-based approach, the arbitral tribunals would not be bound by a specific threshold, such as ‘necessary’ or ‘related to’, but they would add the extent to which the measure contributes to the protection of the policy objective as an additional factor to the overall analysis.

IV SUMMARY AND CONCLUSIONS: A FLEXIBLE RANGE OF STANDARDS

This article analysed how each of the legal elements ‘less favourable treatment’, ‘likeness’ and ‘regulatory purpose’ may be subject to different interpretations and how each interpretation affects the scope and intrusiveness of the non-discrimination principle. Depending on how each element is interpreted and combined with the respective interpretation of another element, the non-discrimination obligation turns out to be extremely intrusive or very permissive. The following interpretations are possible:

Comparator clause

- Under the objective standard the tertium comparationis may consist of factors such as physical characteristics, tariff classification, end-uses, environmental impact or even the act of exportation;
- Under the economic standard, the tertium comparationis is defined by economic parameters indicating the extent to which the market actors are in a competitive relationship;
- Under the subjective standard the tertium comparationis is defined by the regulatory purpose of the measure under scrutiny;
- The objective, economic and subjective standards of ‘likeness’ may be applied individually or in combination.

Less favourable treatment

- The disproportionate disadvantage test analyses whether the group (as defined by the comparator clause) of foreign market participants is disproportionately disadvantaged as compared to the domestic one. Different thresholds of disproportionality are theoretically possible;
- The ‘best treatment’ approach leads to an obligation to grant the best treatment accorded to any domestic market participant to all foreign ‘comparable’ (as defined by the comparator clause) market participants;

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73 For a different categorization see e.g. H. Horn and J. H. Weiler, above n 7, at 131 ff; F. Ortino, above n 6, at 14; N. F. Diebold, above n 24, at 94 ff.
The subjective standard of ‘less favourable treatment’ takes into account the regulatory purpose in order to determine the true basis of the differential treatment.

Regulatory purpose

− The regulatory purpose may be considered as part of the non-discrimination obligation itself (definitional stage), either (i) within the comparator clause (aims [and effects] test), (ii) within the ‘less favourable treatment’ element, or (iii) as its own substantive element;

− Alternatively, the regulatory purpose may be considered as part of a general exceptions clause (justificational stage).

Considering this wide variety of different possible interpretations and the lack of any guidance in most treaties of international economic law, it would be preferable that the treaties explicitly empower the adjudicating bodies to construe the non-discrimination obligation on a case-by-case basis. At the same time, the treaty should spell out the factors which the adjudicating bodies need to take into consideration under an overall weighing and balancing test. This article suggests an approach along the following lines:

First, the treaty should specifically spell out that all forms of de jure discrimination are considered a prima facie violation of the non-discrimination obligation and thus create a presumption of illegality. The respondent may only justify the measure by showing (i) that it has no impact on the competitive relationship or (ii) that it protects an important public interest and that there is a strong nexus between the measure and its objective as well as between the measure and the respondent’s territory.

Second, prima facie violation of the non-discrimination obligation may also be established in case the complainant is able to produce direct evidence proving the protectionist intent on behalf of the respondent. Measures specifically designed to protect certain domestic market participants would not be justifiable. However, as a complainant will hardly ever be able to produce such evidence, this intent based standard of non-discrimination would be likely to remain theoretical.

Third, with regard to measures not formally differentiating on the basis of origin, the treaty should explicitly state that such measures are subject to an analysis of their protectionist effect in the market place. The following criteria need to be taken into consideration for the assessment of the measure’s protectionist effect:

− Competitive relationship between disadvantaged foreign market participants and domestic market participants;

− Qualitative effect of the measure (i.e. extent of the additional burden or the competitive disadvantage imposed by the measure);

− Quantitative effect of the measure (i.e. ratio of negative competitive impact between domestic and foreign market participants);

− Supply substitutability (i.e. costs and time for foreign market participants to escape the negative competitive impact of the measure);

− Regulatory purpose of the measure, taking into account

  (i) the relative importance of the public interest sought to be protected;
(ii) the nexus between the measure and its objective;

(iii) the nexus between the measure and the regulatory country’s territory.

The adjudicating bodies need to conduct a weighing and balancing test on the basis of these factors in order to determine whether a measure amounts overall to unlawful de facto discrimination. For instance, a clear violation of the non-discrimination obligation would occur in case (i) a measure affects only or predominantly imported market participants (quantitative effect) (ii) and constitutes a high negative impact on the competitive opportunities (qualitative effect) (iii) in a narrowly defined relevant market consisting of products, services or investments with high demand substitutability (competitive relationship); moreover (iv) foreign participants are unable to substitute their good or service with another one not subject to the trade restrictive measure (supply substitutability) and, finally, (v) the measure does not pursue a legitimate policy objective (regulatory purpose).

In practice it would be very rarely the case that all factors clearly show that the measure under scrutiny either violates or complies with a non-discrimination obligation. Hence, under the factor-based approach it would still be difficult to accurately predict whether a given trade restrictive measure violates a certain non-discrimination obligation. However, the main advantage of the here proposed approach is that at least there would be significant legal security with regard to the applicable legal test and, to a certain degree, the legal standard of non-discrimination obligations. Due to the clarity of the legal test, it would be much easier for the parties in a dispute to make their case by bringing forward the pertinent arguments. At the same time such a factor based-test for non-discrimination is sufficiently flexible to allow adjudicating bodies to consider the framework and purpose of the agreement in which the obligation is found. Most importantly, the arbitral tribunals could set the appropriate standard in light of the fact that trade agreements aim to protect competitive opportunities and equal conditions of competition, whereas investment protection agreements are designed to protect the value of a specific investment.

Finally, it is important to point out that the main risk of the factor-based approach for non-discrimination is that the analysis will focus much more on the regulatory purpose and necessity than on the issues of differential treatment and comparability. In fact, if a measure does not pursue a legitimate policy objective or if the respondent fails to demonstrate a nexus between an alleged objective and the measure, it may be difficult for the adjudicating bodies to come to an overall finding that the measure complies with the non-discrimination obligation. Hence, arbitral tribunals must pay attention not to overemphasize the possible absence of a legitimate purpose in comparison to the elements of ‘likeness’ and ‘less favourable treatment’.