12 August 1994

UNITED STATES - MEASURES AFFECTING THE IMPORTATION, INTERNAL SALE AND USE OF TOBACCO

Report of the Panel adopted by the Council on 4 October 1994
(DS44/R)

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I. INTRODUCTION

1. On 7 September 1993, Argentina, Brazil, Chile, Colombia, El Salvador, Guatemala, Thailand, Venezuela and Zimbabwe requested the United States to hold consultations, pursuant to Article XXIII:1 of the General Agreement, on the amendments to the "Tobacco Program" in the U.S. Omnibus Budget Reconciliation Act of 1993 ("the 1993 Budget Act") (DS44/1 and DS44/2). On 22 and 30 September 1993, respectively, Canada and the European Community ("EC") also requested consultations pursuant to Article XXIII:1 with respect to the same matter (DS44/4 and DS44/3, respectively). Consultations were held on 4 October 1993 but did not result in a mutually satisfactory solution of the matter. At the Council meeting of 17 December 1993, Brazil, Chile, Colombia, El Salvador, Guatemala, Thailand and Zimbabwe requested tha4.48 616.08 Tm/F8 11 a(satisfactory) TjET1 0 0 1 296.64 616.08 TBT1 0 0 1 159.12

II. FACTUAL ASPECTS

General

6. On 10 August 1993, the United States enacted the 1993 Budget Act[1] which included the Agricultural Reconciliation Act of 1993 containing, in Section 1106, the four measures concerning tobacco challenged in this dispute: a Domestic Marketing Assessment ("DMA"); a Budget Deficit Assessment ("BDA"); a No Net Cost Assessment ("NNCA"); and an Inspection Fee provision ("Inspection Fee") (described below).[2] The U.S. tobacco programme had for many

Domestic Marketing Assessment (Section 1106(a))

8. Beginning after the end of 1994, the 1993 Budget Act required that designated "Domestic Manufacturers of Cigarettes", *i.e.* those manufacturers that individually contren355em(Manufacturers) TjETB(6turer

's use of domestic tobacco was less than 75 per cent of its total tobacco use per year, it had to pay to the CCC a non-refundable marketing assessment and make supplementary purchases from the burley and flue-cured tobacco area marketing associations up to the amount of the shortfall, which could be used in the following year. The requirement applied equally to cigarettes that were exported. The assessment per pound was equivalent to the difference between: (1) the average of domestic burley and flue-cured tobacco market prices during the preceding calendar year; and (2) the average market prices for imported unmanufactured tobacco during the preceding calendar year. Penalties were due from Domestic Manufacturers of Cigarettes which failed to pay an outstanding assessment, or which did not make the purchases from the area marketing associations.

Budget Deficit Assessment (Section 1106(b)(1))

9. The U.S. Congress enacted a series of Budget Deficit Assessments ("BDA") in Section 1105 of the Omnibus Budget Reconciliation Act of 1990 ("1990 Budget Act").[4] Domestic tobacco[5], as well as other domestic commodities such as dairy and peanuts, were subject to these assessments. The 1990 Budget Act established the BDA for tobacco by tobacco type, so that, for example, the BDA for burley was different from that for flue-cured tobacco. However, the formula was the same for all types: one per cent of the average support value established by law. For private sales, the 1990 Budget Act provided that one half would be paid by the producer, and the other half by the purchaser. For loan tobacco, the buyer of inventory tobacco paid the purchaser BDA. For the 1993 crop year, the price support level for *burley tobacco* was $1.683 per pound.[6] The total domestic BDA, therefore, was $.0168 per pound (1 per cent), divided between producers and purchasers, each paying $.008415 per pound. The domestic support level for *flue-cured tobacco* was $1.577 per pound, so that the total BDA was $.01577 per pound (1 per cent), with the producer and purchaser each paying $.007885 per pound (half of the total). The 1993 Budget Act, Section 1106(b)(1), effective for each of the 1994 through 1998 crops of tobacco, subjected all imported unmanufactured tobacco to the BDA, the assessment calculated as half the BDA paid on domestic burley (0.5 per cent of the domestic support rate) plus half of the BDA paid on domestic flue-cured (0.5 per cent of the domestic support rate), with the full one per cent payable by the importer *(i.e.* a total of $.0163 cents). Penalties for non-payment of BDAs applied equally to imported and domestic tobacco.[7] The BDAs for both domestic and imported tobacco were remitted to the CCC and were non-refundable.

[4]Pub. L. No. 101-508.

[5]7 U.S.C. 1445.

[6]58 C.F.R. 68018 (December 23, 1993).

[7]7 U.S.C. 1445.

No Net Cost Assessment (Section 1106((b)(2))

10. For crops prior to the 1982 crop year, all net losses at the time of the final accounting for a crop year's inventory were absorbed by the CCC. In 1982, a No Net Cost Assessment ("NNCA") was introduced[8] to make the domestic price support programme for tobacco independent of government funding. As a result of the 1982 reforms, the Secretary of Agriculture was required to compute the

III. MAIN ARGUMENTS

General

12. **Argentina, Brazil, Canada, Chile, Colombia, El Salvador, Guatemala, Thailand and**

processed or used".[16] Following the logic of the United States in that case, its current law restricting the use of imported tobacco in cigarettes was inconsistent with Article III:5. In addition to the above, in the proposed rules to implement the DMA, this statutory provision was referred to as a "domestic content requirement" no less than 13 times, including in a definition of the 75/25 ratio. In the same proposed rules, the DMA was specifically referred to as the "domestic content marketing assessment". Finally, an analysis by the USDA referred to the DMA as providing "for a minimum domestic content".

15. The **United States** considered that the burden of establishing an inconsistency with the General Agreement rested on the complainants, noting that the DMA provisions did not require that a product **sold** in the United States contain any particular mix of tobacco. Nor did the DMA limit imports of products. According to the United States, its

17. The complainants submitted that even if this panel adopted a narrow reading of Article III:5, first sentence, the second sentence was a broad requirement that the quantitative regulations not be contrary to the general principles of Article III:1. The DMA's minimum domestic content requirement was, according to the complainants, contrary to the principles of Article III:1. That Article required that domestic mixing and use provisions "not be applied to imported or domestic products so as to afford protection to domestic production". The minimum domestic use requirements of the United States, however, violated this principle since they permitted unlimited use of domestic tobacco without penalty, while providing substantial penalties for use of imported tobacco above the 25 per cent ceiling. Also, they required a manufacturer exceeding the 25 per cent ceiling to purchase specified quantities of domestic tobacco.

18. In addition, **Canada** submitted that, according to the USDA, 41 per cent of tobacco used to manufacture cigarettes in the United States in 1992[19] had been provided from foreign sources. With the passage of the 1993 Budget Act, this figure would have to decrease to 25 per cent annually while the use of domestic tobacco would rise from 59 per cent to 75 per cent, thus benefitting domestic production at the expense of imported tobacco. Imported tobacco had been defined in the proposed regulations to include Oriental tobacco. In 1992[20], U.S. cigarette manufacturers had used 14 per cent Oriental tobacco and, according to Canada, this was likely to continue, given long-established consumer preferences. Since the 1993 Budget Act limited imported tobacco to 25 per cent of all tobacco used to manufacture cigarettes in the United States, only 11 per cent was left for other types of tobacco. The law thus disadvantaged exporters of flue-cured and burley tobaccos. Flue-cured tobacco leaf accounted for virtually all Canadian tobacco leaf exports to the United States. Canada also exported a significant quantity of tobacco refuse to the United States. With 14 per cent of the 25 per cent limit on imported tobacco expected to be taken by Oriental tobacco, the access of Canadian tobacco to the U.S. market would be severely restricted. Canada further submitted that the DMA undermined the competitive relationship between imported and domestic tobacco, contrary to a fundamental component of the national treatment obligation of Article III:2. The law had eliminated the price competitiveness of imports in the U.S. market by requiring domestic manufacturers of cigarettes to use 75 per cent U.S. grown tobacco, regardless of the price relationship between imported and domestic tobacco. No matter what the price of foreign tobacco, foreign producers would be unable to improve their competitive position vis-à-vis domestic tobacco producers.

requirement of the United States was inconsistent with the requirements of Article III:4 since it discriminated between domestic and imported products after the imports had entered the customs territory of the United States. Section 1106(a) of the 1993 Budget Act created an incentive not to import any tobacco other than what was essential for flavour requirements. The United States had itself, in the past, argued that other countries' domestic content restrictions on cigarettes were inconsistent with the General Agreement. It had explicitly accepted the proposition that charges imposed by a government on the use of imported tobacco in the manufacture of cigarettes violated the General Agreement. A similar situation existed here. As described in paragraph 16 above, domestic manufacturers were subject to substantial penalties if they used more than 25 per cent imported tobacco in their products. This was discriminatory treatment which could not be justified under Article III:4.

20. **Argentina, Brazil, Chile, Colombia, El Salvador, Guatemala, Thailand and Zimbabwe** submitted that the U.S. domestic content requirement (i.e. Section 1106(a) of the 1993 Budget Act) was also inconsistent with the prohibition in paragraph 2 of Article III, first sentence, against discriminatory internal taxes or charges since it imposed an "internal charge" in the form of monetary penalties and domestic purchase requirements when a manufacturer used more than 25 per cent imported tobacco in its cigarettes.

price support level for those tobacco crops for which price support was available. This assessment was divided equally between producers and purchasers of such tobacco. The 1993 Budget Act extended the assessment to imports of unmanufactured tobacco, regardless of type, the calculation of

of the General Agreement. Since the BDA was "directly levied" on similar domestic tobacco, it was therefore eligible for border adjustment under the criteria described in a report of a GATT working party on border tax adjustments in 1970[29]. The United States explained, as concerned the exclusion from the assessment of certain types of domestic tobacco referred to in paragraph 22 above, that this reflected, in contrast to flue-cured and burley tobaccos, that those types of tobacco did not participate in the price support programme. However, 98 per cent of US-grown tobacco was currently covered by support and control programmes. Although the actual BDA differed depending on the kind of tobacco invstly

taxes which were directly applied to domestic products could also be applied at the border to imports. The purpose of border tax adjustments was to ensure equal conditions of competition with respect to taxation.

28. **Argentina, Brazil, Canada, Chile, Colombia, El Salvador, Guatemala, Thailand and Zimbabwe** responded that although the BDA might indeed be *eligible* for border tax adjustments as claimed by the United States, any such border tax adjustments had nonetheless to conform to the national treatment provisions of Article III:2. That provision specified that any such tax had to be levied on imports at the same or a lower rate than that levied on the like domestic product, and that no such border tax adjustment should provide protection to the domestic industry in violation of Article III:1. However, the BDA levied on certain types of imported tobacco was *higher* than that levied on the like domestic product.

29. The complainants submitted that the United States was in breach of its Article III:2 obligations regardless of whether the Panel considered that the "like domestic product" was flue cured tobacco or all kinds of unmanufactured tobacco. The "like domestic products" could be either (i) flue-cured tobacco, or (ii) all kinds of unmanufactured tobacco. Whichever comparison was used, the United States was, in the opinion of the complainants, in breach of Article III:2. If the Panel considered that U.S. flue-cured tobacco was the "like domestic product" to imported flue-cured tobacco, then the BDA was inconsistent with Article III:2 since it was applied at a higher rate on imported than on domestic flue-cured tobacco. Moreover, the application of the BDA to imports afforded protection to domestic production. If the Panel concluded that the appropriate comparison between imported and "like domestic products" was all unmanufactured tobacco rather than just flue-cured tobacco, the BDA still violated Article III:2. The complainants noted that the BDA was imposed on every pound of tobacco imported into the United States, regardless of type, while certain varieties of US-grown tobacco paid *no* BDA of any kind. A number of other US-grown tobaccos were assessed a BDA in an amount that was less than that assessed on imports. According to the complainants, this constituted discriminatory taxation, contrary to Article III:2.

30. The **United States** explained that flue-cured, light air-cured burley, Maryland and Turkish (oriental) tobaccos were distinct types which imparted distinct flavour characteristics to the American blend cigarette. Each type was valued differently by the manufacturers for its individual qualities. The three main leaf components were flue-cured, burley and Turkish, the proportional use of which had varied very little over the years. Burley tobacco had certain burning characteristics which distinguished it from other tobacco. Flue-cured tobacco had a lightness of taste that made it different from the heavier oriental tobaccos. Maryland tobacco also had a mild taste and distinct burning characteristics, but was considered a distinct type by manufacturers; a manufacturer's switch from burley to Maryland would definitely change the character of the cigarettes produced. Cigarette tobaccos, as a group, tended to have different markets in general from cigar tobaccos.

No Net Cost Assessment (Section 1106(b)(2))

31. **Argentina, Brazil, Canada, Chile, Colombia, El Salvador, Guatemala, Thailand and Zimbabwe** submitted that the NNCA[37] was an internal tax or charge on imported tobacco that exceeded the internal charge on comparable domestic tobacco. Iinitely

to the same type of tobacco grown in the United States. However, while the rate used for imported burley and flue-cured tobacco was the same as the rate applied to the same type of domestic tobacco, the *net charge* to imported tobacco was greater than the charge for the same type of domestic tobacco. Domestic burley and flue-cured tobacco were subject to price support programmes in which the producer was offered a minimum price for his tobacco. These programmes were not available to the importer of these tobaccos. The value of the tobacco at the appropriate support price was "loaned" to the producer by the producer-owned cooperative if the farmer could not obtain that price at auction. The cooperative retained the tobacco as "collateral". The 1993 Budget Act levied an identical NNCA on each pound of imported tobacco, for which importers (and imported tobacco) received no benefits at all. Indeed, the proceeds of the NNCA on imported tobacco were used to fund the costs of the domestic price support programme. Since the price support programme provided benefits only to domestic tobacco, the NNCA operated as a true "tax" on imported tobacco, and as a payment (fee) for services for domestic products.

32. **Argentina, Brazil, Canada, Chile, Colombia, El Salvador, Guatemala, Thailand and Zimbabwe** submitted that by giving the proceeds of the NNCA on imports directly to the cooperatives, the law benefited and protected domestic production. It indirectly reduced the cost of the price

explained that the NNCA was such a direct tax assessed on the marketing of *all* tobacco grown in the United States subject to the price support programme.

34. The United States rejected the claim that benefits received by domestic tobacco growers through the tobacco programme amounted to a tax remission of the NNCA. The provision of a loan to a farmer was a transaction entirely separated from the farmer's payment of the NNCA in that year or subsequent years. Producers who grew price support tobacco had a choice at marketing time. They could sell the tobacco to a private buyer, or they could place the tobacco for a price support loan with the appropriate area marketing association. (About one quarter of the tobacco crop currently went under loan and was placed with an association.) In either case, the tobacco was assessed the producer portion of the NNCA. If the tobacco was sold to a private buyer, that buyer was liable to pay the purchaser NNCAs at the same time as well. For the farmer, the loan received from the CCC was not a loan in the normal sense but was rather as though the farmer had sold the tobacco to

between the market price and the support price lowered the effective NNCA imposed on participating domestic tobacco. Consequently, the net or actual NNCA imposed on imported burley or flue cured tobacco was higher than the assessment on domestic burley or flue cured tobacco, in violation of Article III:2. Given this inconsistency between the NNCA and Article III, the NNCA could not be considered to be a valid border adjustment.

38. The **United States** submitted that paragraph 8(b) of Article III further supported the view that any indirect benefit ultimately received by U.S. tobacco farmers in the form of a more sustainable price support programme could not make the border tax adjustment inconsistent with Article III:2. Thus, Article III:8(b) supplemented the general principle that the purpose of the tax was irrelevant in the analysis of a border tax adjustment, by specifically providing that the use of tax revenues to grant domestic subsidies was permissible where taxes were equally applied. The non-recourse loans given by the CCC to U.S. tobacco farmers from government funds did not make the application of the same taxes to foreign imports inconsistent with Article III.

39. **Argentina, Brazil, Chile, Colombia, El Salvador, Guatemala, Thailand and Zimbabwe** were of the view that Article III:8(b) had nothing to do with the case at issue here. Paragraph 8(b) provided only that Article III should not "prevent the payment of subsidies" exclusively to domestic producers. In this case, however, the complainants raised no arguments that would in any way prevent payments of subsidies to anyone. They simply objected to being required to help pay for benefits available only to U.S. domestic producers. Further, the complainants argued that they did not question the right of the United States to develop a programme to pay farmers higher-than-market prices. Nor did they question in any way the right of the United States to transfer the costs of these subsidies to tobacco farmers and domestic purchasers, through the imposition of an NNCA. What the complainants did object to was the imposition of levies on imports that received no benefits from the tobacco price support programme. Article III:8(b) by its own terms permitted subsidies to continue only so long as the internal taxes which financed them were applied "consistently with the provisions of this Article". If the provisions of the tobacco price support programme were consistent with Article III:8(b), they were consistent only so long as they did not impose a burden on imports that was greater than the burden on domestic tobacco, and only so long as they did not afford protection to domestic tobacco. In this case, the NNCA imposed a greater burden on imports than on domestic tobacco, because domestic tobacco received a benefit for the assessment it was charged whereas imported tobacco did not. Thus, the assessment was not only discriminatory, it afforded protection to domestic tobacco, in violation of both sentences of Article III:2. Finally, the complainants disputed that the loan programme to support tobacco prices was a "government purchase" since the domestic producers had the option to sell their tobacco to private purchasers or place it "under loan" with the producer-owned area marketing associations. These cooperatives then took title to the tobacco. Therefore, the second part of Article III:8(b) was not applicable in the case of the U.S. tobacco support programme.

40. **Canada** submitted, in addition, that the receipt of the support price by domestic producers was a tax remission of the NNCA otherwise payable, not a subsidy to which Article III:8(b) applied. Canada argued that unlike subsidies that were disbursed from general revenues, often in respect of persons and products unrelated to the source of the funds, moneys collected under the NNCA and disbursed from this account were administered separately from general revenues. Under the new law, taxes were collected and supported

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payable

Beverages[40] which considered the drafting history of Article III:8(b), noting that the Havana Reports stated:

> "This sub-paragraph [III:8(b)] was redrafted in order to make it clear that nothing in Article [III] could be construed to sanction the exemption of domestic products from internal taxes imposed on like imported products or the remission of such taxes."

In Canada's opinion, the drafting history thus made clear that tax remissions were specifically excluded from

the requirement of Section 1106(c) be consistent with the General Agreement. The complainants were of the view that if a provision had not yet gone into effect, it did not mean that it could not

this provision to require also that these fees "be comparable to fees and charges fixed and collected for services provided in connection with tobacco produced in the United States". In

IV. INTERESTED THIRD CONTRACTING PARTIES

Either the BDA conformed with Article III:2, and its actual impact on imports was of no relevance for a violation case, or it did not, in which case its limited effect on the price of the end-product was also not relevant, as Article III:2, first sentence, obliged contracting parties to establish certain competitive conditions for imported products in relation to domestic products, not to protect

the costs of such services, and one pursuant to which these fees should be comparable to fees and charges fixed and collected for services provided in connection with tobacco produced in the United States. Inspection fees for imported tobacco were currently lower than for domestic tobacco and one could reasonably assume that they were fixed at least at the level of the cost of services. One could consequently deduce that if they were raised to the level of fees on domestic tobacco, they would no longer be commensurate with the actual costs of the services. In other words, one could assume, on the basis of the above, that Section 1106(c) required the U.S. authorities to take actions inconsistent with the General Agreement. Under GATT practice with respect to mandatory legislation, an argument to the effect that the fee had not been increased yet was irrelevant, as was clearly stated by the panel on

shall otherwise apply internal quantitative regulations in a manner contrary to the principles set forth in paragraph 1".

The Panel then recalled the complainants' claim that the DMA was inconsistent with both the first and second sentences of this provision.

67. As to the applicability of Article III:5, first sentence, to the DMA, the Panel considered that it first had to determine whether the United States had established an "internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions … ". The Panel noted the following in this respect:

(a) First, the DMA was established by an Act of the U.S. Congress, Section 1106(a) of the 1993 Budget Act, and was implemented through regulations of USDA. The effective date for the DMA was 1 January 1994. It thus constituted a *regulation* within the meaning of Article III:5.

(b) Second, the Panel noted that the opening sentence of the DMA legislative provision, Section 1106(a) of the 1993 Budget Act, stated:

> "CERTIFICATION. A *domestic manufacturer* of cigarettes *shall certify* to the Secretary, for each calendar year, the percentage of the quantity of tobacco used by the manufacturer to produce cigarettes during the year that is produced in the United States". *(emphasis added)*

The DMA was thus an *internal* regulation imposed on domestic manufacturers of cigarettes.

(c) Third, the Panel noted that the second sub-paragraph of the DMA legislative provision stated:

> "PENALTIES. In General. Subject to subsection (f) [exception for crop losses due to natural disasters], a *domestic manufacturer of cigarettes that has failed,* as determined by the Secretary after notice and opportunity for a hearing, to *use in the manufacture of cigarettes* during a calendar year a *quantity of tobacco grown in the United States that is at least 75 percent of the total quantity of tobacco used* by the manufacturer or to comply with subsection (a) [certification requirement], *shall be subject to* the requirements of subsections (c), (d) and (e) [*penalties* in the form of a nonrefundable marketing assessment and a required purchase of additional quantities of domestic burley and flue-cured tobacco]". *(emphasis added)*

The DMA was thus a *quantitative* regulation in that it set a minimum *specified proportion* of 75 per cent for the use of U.S. tobacco in manufacturing cigarettes.

(d) Fourth, the DMA was an internal quantitative regulation relating to the *use* of a product, in that it *required the use* of U.S. domestically grown tobacco.

The Panel thus found that the DMA was an "internal quantitative regulation relating to the … use of products in specified amounts or proportions … ", within the meaning of the first part of the first sentence of Article III:5.

Article III:2

73. The Panel next turned its consideration to the claim by the complainants that the penalty provisions

> "Each domestic manufacturer of cigarettes who *fails to comply* with the requirements of this section *shall pay* a domestic marketing assessment and *shall purchase* loan

'être in the absence of the underlying domestic content requirement. The above factors suggested to the Panel that it would not be appropriate to analyze the penalty provisions separately from the underlying domestic content requirement.

81. The Panel further noted that prior panel decisions also supported the view that the additional marketing assessment and purchase requirements should be treated as enforcement measures, and not be analyzed separately as internal charges. The Panel recalled that one such panel, in examining a regulation according to which buyers of vegetable proteins had the possibility of providing a security as an alternative to the required purchase of a certain quantity of skimmed milk powder, had determined that the security deposit was not a fiscal measure because, *inter alia*,

> "the revenue from the security deposit accrued to EEC budgetary authorities only when the buyer of vegetable proteins had not fulfilled the purchase obligation. The Panel therefore considered that the security deposit, including any associated cost, was only an enforcement mechanism for the purchase requirement and, as such, should be examined with the purchase obligation".[66]

[63]59 Federal Register 1493, 1497 (11 January 1994).

[64]59 Federal Register 1493, 1495 (11 January 1994).

[65]59 Federal Register 1493, 1495 (11 January 1994).

[66]Report of the panel on EEC - Measures on Animal Feed Proteins, adopted on 14 March 1978, BISD 25S/49, 64. See also report of the panel on EEC - Programme of Minimum Import Prices, Licences and Surety Deposits for Certain Processed Fruits and Vegetables, adopted on 18 October 1978, BISD 25S/68, 98.

In a similar vein, another more recent panel had first examined the underlying m ng systems for the internal distribution of imported and domestic beer), and co ry to examine certain enforcement measures (charges on beer containers).[67] The der that there were any elements in the case before it which would justify a differe that adopted in these earlier cases.

Reconci49rketing

82. In view of the Panel's analysis in paragraphs 75 - 81 above, the Panel at the evidence did not support the complainants' claim that the DMA's penalty provis eparate taxes or charges within the meaning of Article III:2.

Budget Deficit Assessment ("BDA")

83. The Panel noted that the issues in dispute with respect to the BDA arose essentially from the following facts. Pursuant to the Agricultural Act of 1949, and later amendments thereto in the Omnibus Budget Reconciliation Act of 1990, the United States had imposed a series of nonrefundable marketing assessments, known as budget deficit assessments, on various domestically produced agricultural commodities, including tobacco. Pursuant to the 1949 Act and the 1990 amendments, the BDA was imposed on all domestic tobacco for which price support was available. The BDA differed by tobacco type, so that, for example, the BDA for burley was different from that

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domestic and imported tobacco had to be remitted to the CCC and were non-refundable. Penalties for non-payment of BDAs applied equally to imported and domestic tobacco.

86. The Panel recalled the claim of the complainants that the BDA was inconsistent with Article III:2, first sentence, because the legislation mandated calculation of the BDA in such a way that it would always be higher on some types of imported tobacco than on like domestic tobacco. The Panel further recalled the complainants' s claim that the BDA was also inconsistent with Article III:2, second sentence, because imported flue-cured tobacco was not similarly taxed to domestic flue-cured tobacco in that purchasers of domestic flue-cured tobacco paid an assessment based on government price support for that type of tobacco whereas importers had to pay an assessment based on the average of the sum of assessments on domestic burley and flue-cured tobacco, thus extending protection to domestic production. The Panel then recalled the defense of the United States that the BDA was simply a border tax adjustment, that the method of calculating the BDA for imports (averaging the BDA charges for domestic burley and flue-cured tobacco to arrive at a single BDA charge for imports) was reasonable, and that in any case the discriminatory impact of the BDA was so small as to be of no commercial consequence.

87. The Panel noted that Article III:2 provides as follows:

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

Panel also noted that the sec cle III:2, when read on with Article III:1, ns that "internal taxes or oth " … "should not be mported or domestic ucts so as to afford prote roduction". In ad Panel noted that the pretative Note Ad Article her:

> "A tax conforming to th e first sentence of paragraph 2 would be considered to F8 11 Tf(would) Tj 3T1 0 0 1 281.52 369.8would) TjET1ul250f3a1 0 0 4.64

directly

As the evidence indicated, a number of domestic tobacco types, *e.g.* Maryland tobacco, were not subject at the present time to any such assessment. The Panel thus was of the view that the BDA, as currently applied, provided less favourable treatment to imported tobacco than to like domestic tobacco.

91. The Panel next considered the claim of the complainants that the differing formulas mandated by the U.S. legislation for calculating the BDA on imported tobacco on the one hand, and the domestic BDA on domestic tobacco on the other, were such that the BDA would always be higher on some types of imported tobacco than on like domestic tobacco. In examining this claim, the Panel considered that it should focus attention on the differing calculation bases for the BDA and the significance these might have for the treatment of imported and domestic tobacco.

92. The Panel recalled that the BDA, applicable to all domestic tobacco for which price support was available, was calculated at the rate of one per cent of the average price support level for each such tobacco type in the previous crop year. The Panel then recalled that the BDA on all types of imported tobacco was calculated as the average of the BDA on domestic burley and domestic flue-cured tobacco.

93. The Panel further noted that the application of these two different statutorily prescribed formulas to tobacco in the current year, at least in the case of flue-cured tobacco, resulted in an internal ta7(the) TjETBT1

97. The Panel thus considered that the system for calculation of the BDA on imported tobacco itself, not just the manner in which it was currently applied, was inconsistent with Article III:2 because it carried with it the risk of discriminatory treatment of imports in respect of internal taxes.

98. The Panel recalled the U.S. defense that even if the BDA was higher on imported flue-cured tobacco than on like domestic tobacco, the method of calculation of the BDA for imports - averaging the BDA on domestic burley and flue-cured tobacco - was a reasonable method and should not be subject to challenge before this Panel. However, the Panel could not see how such a method of calculation could be termed "reasonable" in the context of the General Agreement if it mandated and inevitably resulted in discriminatory treatment of imported tobacco in respect of internal taxes. The Panel recalled in this regard that a prior GATT panel had ruled

other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1", *i.e.* "so as to afford protection to domestic production". However, in the present case, because the Panel had already determined that the BDA was inconsistent with Article III:2, first

to imported burley and flue-cured tobacco was not in excess of - indeed was

of products, not of producers.[79] In the Panel's view, so long as the tax burden on the imported product was no greater than that on the like domestic product there could be no violation of Article III:2, first sentence, even where there was a differing liability for the payment of that tax. The Panel noted that this conclusion was supported by prior panel decisions.[80]

111. The Panel then considered the complainants' claim that the NNCA was inconsistent with Article III:2, second sentence, because the NNCAs charged on imported tobacco reduced the cost of the price support programme to the domestic tobacco producer, without providing any benefit to imported tobacco. The Panel did not consider that it needed to examine this claim in view of the fact that Article III:8(b), which explicitly recognizes that subsidies to domestic producers are not subject to the national treatment rules of Article III, applies to all provisions of Article III, including that of Article III:2, second sentence.

112. In view of the analysis in paragraphs 106 - 111 above, the Panel rejected the complainants' claims of inconsistency of the NNCA with Article III:2, first and second sentence. In addition, the Panel concurred with the United States that the NNCAs on imported burley and flue-cured tobacco were permissible border tax adjustments consistent with Article III:2.

113. The Panel accordingly **concluded** that the NNCA was not inconsistent with Article III:2, first or second sentence.

Fees for Inspecting Imported Tobacco

114. The Panel noted that the issues in dispute with respect to fees for inspecting imported tobacco arose essentially from the following facts. All tobacco sold in the United States, whether domestic or imported, was subjected by law to inspection. Each individual lot of domestic tobacco was required to be inspected for grade and quality at the warehouse, whereas imported tobacco was required to be inspected for grade and quality, on the basis of samples, at the point of entry into the United States. Pursuant to the Tobacco Inspection Act of 1935, as amended by the Tobacco Adjustment Act of 1983, the Secretary of USDA was required to fix by regulation and collect from the importer of tobacco, fees and charges for inspection "which shall, as nearly as practicable, cover the costs of such services, including the administrative and supervisory costs customarily included by the 1 0 0 1 285.84 343.92 Tm/F8TBT1

116. The Panel noted that the text of Article VIII:1(a) provides as follows:

> "All fees and charges of whatever character (other than import and export duties and other taxes within the purview of Article III) imposed by contracting parties on or in connection with importation or exportation shall

121. The Panel considered that if USDA had the discretion to lower its fees for inspection of domestic tobacco to a level *comparable* to the cost of services rendered for inspection of imported tobacco or to otherwise determine that the fees for inspecting imported and domestic tobacco were *comparable,* such action would permit the U.S. Government to avoid inconsistency with Article VIII:1(a).

122. On this point, the Panel recalled the complainants' argument that Section 1106(c) required inspection fees to be imposed commensurate with something other than the *cost* of inspecting tobacco, and was therefore inconsistent with Article VIII:1(a). The complainants considered that the term "comparable to" as used in Section 1106(c) meant "*the same as*". Thus, in the view of the complainants, if the cost of

VI. CONCLUSIONS AND RECOMMENDATIONS

125. On the basis of the findings set out above, the Panel **concludes** that:

(a) the Domestic Marketing Assessment (Section 1106(a) of the 1993 Budget Act) was an internal quantitative regulation inconsistent with Article III:5; in light of this conclusion, the Panel did not consider it necessary to examine the consistency of the Domestic Marketing Assessment with Articles III:2 and III:4;

(b) the Budget Deficit Assessment (Section 1106(b)(1) of the 1993 Budget Act) was an internal tax or charge inconsistent with Article III:2;

(c) the No Net Cost Assessment (Section 1106(2)(b) of the 1993 Budget Act) was not inconsistent with Article III:2; and

(d) the evidence did not demonstrate that Section 1106(c) of the 1993 Budget Act, Fees for Inspecting Imported Tobacco, mandated action inconsistent with Article VIII:1(a).

126. The Panel **recommends** that the CONTRACTING PARTIES request the United States to bring its inconsistent measures into conformity with its obligations under the General Agreement.

ANNEX

SECTION 320C OF THE AGRICULTURAL ADJUSTMENT
ACT OF 1938, AS AMENDED
(DOMESTIC MARKETING ASSESSMENT)

SEC. 320C. [1314i] DOMESTIC MARKETING ASSESSMENT.[85]

(a) CERTIFICATION. - A domestic manufacturer of cigarettes shall certify to the Secretary, for each calendar year, the percentage of the quantity of tobacco used by the manufacturer to produce cigarettes during the year that is produced in the United States.

(b) PENALTIES.-

(1) IN GENERAL. - Subject to subsection (f), a domestic manufacturer of cigarettes that has failed, as determined by the Secretary after notice and opportunity for a hearing, to use in the manufacture of cigarettes during a calendar year a quantity of tobacco grown in the United States that is at least 75 per cent of the total quantity of tobacco used by the manufacturer, or to comply with subsection (a), shall be subject to the requirements of subsections (c), (d) and (e).

(2) FAILURE TO CERTIFY.- For purposes of this section, if a manufacturer fails to comply with subsection (a), the manufacturer shall be presumed to have used only imported tobacco in the manufacture of cigarettes produced by the manufacturer.

(3) REPORTS AND RECORDS.-

(A) IN GENERAL.- The Secretary shall require manufacturers of domestic cigarettes to make such reports and maintain such records as are necessary to carry out this section. If the reports and records are insufficient, the Secretary may request other persons to provide supplemental information.

(B) EXAMINATIONS. - For the purpose of ascertaining the correctness of any report or record required under this section, or of obtaining further information required under this section, the Secretary and the Office of Inspector General may examine such records, books, and other materials as the Secretary has reason to believe may be relevant. In the case of a manufacturer of domestic cigarettes, the Secretary may charge a fee to the manufacturer to cover the reasonable costs of any such examination.

(C) PENALTIES.- Any person who fails to provide information required under this paragraph or who provides false information under this paragraph shall be subject to section 1001 of title 18, United States Code.

(D) CONFIDENTIALITY.- Section 320A(c) shall apply to information submitted by manufacturers of domestic cigarettes and other

(c) DOMESTIC MARKETING ASSESSMENT.-

(1) IN GENERAL.- A domestic manufacturer of cigarettes described in subsection (b) shall remit to the Commodity Credit Corporation a nonrefundable marketing assessment in accordance with this subsection.

(2) AMOUNT.- The amount of an assessment imposed on a manufacturer under this subsection shall be determined by multiplying-

(A) the quantity by which the quantity of imported tobacco used by the manufacturer to produce cigarettes during a preceding calendar year exceeds 25 per cent of the quantity of all tobacco used by the manufacturer to produce cigarettes during the preceding calendar year; by

(B) the difference between -

(i) ½ of the sum of -

(I)

(4) NONCOMPLIANCE.- If a manufacturer fails to purchase from the inventories of the producer-owned co-operative marketing association the quantity of Burley tobacco required under this subsection, the manufacturer shall be subject to a penalty of 75 per cent of the average market price (calculated to the nearest whole cent) for Burley tobacco for the immediately preceding year on the quantity of tobacco as to which the failure occurs

(5) PURCHASE REQUIREMENTS.- Tobacco purchased by a manufacturer under this subsection shall not be included in determining the quantity of tobacco purchased by the manufacturer under section 320B.

(e) PURCHASE OF FLUE-CURED TOBACCO.-

(1) IN GENERAL.- A domestic manufacturer of cigarettes described in subsection (b) shall purchase from the inventories of the producer-owned co-operative marketing association for Flue-cured tobacco described in section 320B(a)(2), at the applicable list price published by the association, the quantity of tobacco described in paragraph (2).

(2) QUANTITY.- Subject to paragraph (3), the quantity of Flue-cured tobacco required to be purchased by a manufacturer during a calendar year under this subsection shall equal ½ of the quantity of imported tobacco used by the manufacturer to produce cigarettes during the preceding calendar year that exceeds 25 per cent of the quantity of all tobacco used by the manufacturer to

EXCERPTS FROM SECTIONS 106A AND 106B OF THE
AGRICULTURAL ACT OF 1949, AS AMENDED
(NO NET COST ASSESSMENTS APPLIED TO IMPORTS)

SECTION 106A

(c) Each association shall establish within the association a Fund. The Fund shall be comprised of amounts contributed by producer-members or paid by or on behalf of purchasers[87] and importers[88] as provided in subsection (d).

(d)[89] The Secretary shall -

(1)[90] require-

(A)

(iii)[94] each importer of Flue-cured or Burley tobacco shall pay to the appropriate association, for deposit in the Fund of the association, an assessment, in an amount that is equal to the product obtained by multiplying -

(I) the number of pounds of tobacco that is imported by the importer; by

(II) the sum of the amount of per pound producer contributions and purchaser assessments that are payable by domestic producers and purchasers of Flue-cured and Burley tobacco under clauses (i) and (ii); and

(B) that, upon making a contribution under subparagraph (A)-

(i) in the case of quota tobacco marketed other than by consignment to an association for a price support

(A) from the person who acquired the

of any price support loan made by the Corporation to the association under such agreements for 1982 and subsequent crops of tobacco, or for both purposes;[106]

(6)[107]; and

(7) [108] effective for the 1986 and subsequent crops of quota tobacco, provide, in loan agreements between the Corporation and an association, that if the Secretary determines that the amount in the Fund or the net gains

tobacco for the immediately preceding year on the quantity of tobacco as to which the failure occurs.

(C)[111] The Secretary may reduce any such marketing penalty in such amount as the Secretary determines equitable in any case in which the Secretary determines that the failure was unintentional or without knowledge on the part of the person concerned.

(D)[112] Any penalty provided for under this paragraph shall be assessed by the Secretary after notice and opportunity for a hearing.

(2)(A) Any person against whom

of the kind of tobacco involved whose farm is within such association's area shall, as a condition of eligibility for price support, agree, with respect to all of such kind of tobacco marketed by the producer from the farm, to pay to the Corporation, for deposit in such association's Account, marketing assessments as determined under paragraph (2)

(B)[120]

(C)[121] The amount of the assessment

necessary for the purposes of this section, then the Secretary, in consultation with such association, may suspend the payment and collection of marketing assessments under this section upon terms and condi5assessments

(B) The Secretary shall promptly file in such court a certified copy of the record on which the penalty is based.

(3) The district courts of the United States shall have jurisdiction to review and enforce any penalty imposed under this subsection.

(4) An amount equivalent to any penalty collected by the Secretary under this subsection shall be transmitted by the Secretary to the Corporation, for deposit in the Account of the appropriate association.

(5) The remedies provided in this subsection shall be in addition to, and not exclusive of, other remedies that may be available.

(e) Tobacco pesticide residues; certification; etc., requirement. Notwithstanding any other provision of law:

(1)(A) All flue-cured or burley tobacco offered for importation into the United States shall be accompanied by a certification by the importer, in such form as the Secretary of Agriculture shall prescribe, that the tobacco does not contain any prohibited residue of any pesticide that has been cancelled, suspended, revoked, or otherwise prohibited under the Federal Insecticide, Fungicide and Rodenticide Act (7 U.S.C. 135 et seq.)[7 USCS §§ 135 et seq.]. Any flue-cured or burley tobacco that is not accompanied by such certification shall be inspected by the Secretary at the point of entry to determine whether that tobacco meets the pesticide residue requirements. Subsection (d) of this section shall apply with respect to fees and charges imposed to cover the costs of such inspection.

(B) Any tobacco that is determined by the Secretary not to meet the pesticide residue requirements shall not be permitted entry into the United States.

(C) The customs fraud provisions under Section 592 of the Tariff Act of 1930, as amended (19 U.S.C. 1592), and criminal fraud provisions under Section 1001 of

to ascertain the identity of any and all such end users, including requesting such information from purchasers of such imported tobacco. Domestic purchasers of imported tobacco shall be required to supply any relevant information to the Department of Agriculture upon demand under this subsection.

(2) The Secretary shall provide to the Senate Committee on Agriculture, Nutrition, and Forestry, and the House Committee on Agriculture, on or before 1 April 1986, a report on the implementation of this authority to identify each end user and purchaser of imported tobacco. Such a report shall identify the end users and purchasers of imported tobacco and the quantity, in pounds, brought by such end user or purchaser, as well as all steps taken by the Department of Agriculture to ascertain such identities. The Secretary shall provide an additional report, beginning 15 November 1986, and annual reports thereafter on the implementation of this authority.

(3) As used in this subsection, the term "end user of imported tobacco" means -

(A) a domestic manufacturer of cigarettes or other tobacco products;

(B) an entity that m

m

note), in subsection (a)(2), substituted "Chapter 24 of the Harmonized Tariff Schedule of the United