Chapter 2
NATIONAL TREATMENT PRINCIPLE

1. OVERVIEW OF RULES

1) Background of the Rules

National treatment stands alongside MFN treatment as one of the central principles of the WTO Agreement. Under the national treatment rule, Members must not accord discriminatory treatment among imports and "like" domestic products (with the exception of the imposition of tariffs, which is a border measure). The GATS and the TRIPS Agreement have similar provisions. The rule prevents countries from imposing discriminatory measures on imports and from offsetting the effects of tariffs through non-tariff measures. An example of the latter could be a case in which Member A reduces the import tariff on product X from ten percent to five percent, but imposes a five percent domestic consumption tax on only imported product X, effectively offsetting the five percentage point tariff cut. The purpose of the national treatment rule is to eliminate "hidden" domestic barriers to trade by requiring WTO Members to accord imported products treatment no less favourable than that accorded to products of national origin. Adherence to this principle is important in order to maintain a balance of rights and obligations, and is essential for the maintenance of the multilateral trading system.

2) Legal Framework

GATT ARTICLE III

GATT Article III requires that WTO Members provide national treatment to all other Members. Article III:1 stipulates the general principle that Members must not apply internal taxes or other internal charges, laws, regulations and requirements affecting imported or domestic products in a manner that protects domestic production.

In relation to internal taxes or other internal charges, Article III:2 stipulates that WTO Members shall not apply standards higher than those imposed on domestic products between imported goods and "like" domestic goods, or between imported goods and "a directly competitive or substitutable product." With regard to internal regulations and laws, Article III:4 provides that Members shall accord imported products treatment no less favourable than that accorded to "like products" of national origin. In addition, in relation to quantitative restrictions, Article III:5 stipulates that no Member shall establish or maintain any internal quantitative regulation which requires, directly or indirectly, that any specified amount or proportion of any product which is

the subject of the regulation must be supplied from domestic sources.

In determining the similarity of "like products," GATT panel reports have relied on a number of criteria including the product's physical properties, the product's end uses, consumer tastes and habits, and tariff classification. WTO panels and the Appellate Body reports utilize the same criteria (Japan – Taxes on Alcoholic Beverages (WT/DS 8, WT/DS 10, WT/DS 11), etc.)[1].

First sentence of GATT Article III:2

In determining "like products" under the first sentence of Article III:2, the following four factors are considered: (1) the product's properties, nature and quality, (2) the product's end uses, (3) consumer tastes and habits, and (4) tariff classification. However, there was a case where tariff classification was only subordinately considered (Japan – Taxes on Alcoholic Beverages). It was concluded that imposing internal taxes and other internal charges on imported products higher, even slightly, than domestic "like products" was in violation of the first sentence (Japan – Taxes on Alcoholic Beverages)[2]. There were also cases where a violation of the first sentence was not claimed because being "like products" required high similarity (Korea, Republic of — Taxes on Alcoholic Beverages and Chile — Taxes on Alcoholic Beverages).

In addition, there was a case where, in determining the similarity, major emphasis was placed not only on the difference in physical properties, but also on whether they are in a competitive relationship in the market (Philippines — Taxes on Distilled Spirits). In this particular case, it was determined that alcoholic beverages (whiskey and brandy, etc.) with different ingredients were "like products" despite the use of different ingredients, because no significant difference was observed in their appearance and taste and they were in a competitive relationship. In contrast, there was a case where shochu and vodka were determined to be "like products" without directly referring to the competitive relationship (Japan – Taxes on Alcoholic Beverages). As described above, considering the existence of a competitive relationship within the same market in determining the competitive relationship significantly affects the determination of the similarity.

Second sentence of GATT Article III:2

The second sentence of Article III:2 determines the existence of violations of the national treatment obligation with respect to "a directly competitive or substitutable product" (competitive substitutability: when products are in a direct competitive relationship) (GATT Annex I: Notes and Supplementary Provisions, Ad Article III, Paragraph 2). In determining "a directly competitive or substitutable product", the similarities of the channels of distribution, etc., in addition to physical properties and uses, etc., are also considered (Korea, Republic of — Taxes on Alcoholic Beverages)[3]. To be recognized as violations of the second sentence, the existence of internal taxation

[1] WT/DS8/R para. 6. 21.
[2] WT/DS8/AB/R page 23.
[3] WT/DS75/AB/R paras. 108-109, 124.

under which products are not similarly taxed and the amount of differential taxation is not de minimis, as well as the fact that the measure is applied in a manner that protects domestic production and violates the principle of Article III:1, must be proven. The existence of such protectionist measures is determined not based on the subjective intentions of the countries concerned but based on the objective design, revealing structure and architecture (Japan – Taxes on Alcoholic Beverages)[4].

GATT Article III:4

Article III:4 addresses the difference in treatment between "like products" with respect to laws, regulations and requirements affecting internal sale, etc. According to precedent, the following four factors are considered, as with the first sentence of Article III:2, in determining "like products" under this clause: (1) the product's properties, nature and quality, (2) the product's end uses, (3) consumer tastes and habits, and (4) tariff classification (EC – Asbestos)[5]. In the determination of "like products" in the EC – Asbestos case, the Panel focused on the physical properties and uses, and determined that asbestos products and similar products (cellulose and glass fibres, etc.) were "like products". The Panel then concluded, based on the difference in treatment, that the measure was in violation of the national treatment obligation[6]. The Appellate Body, however, reversed the Panel's determination of "like products" because of the difference in the carcinogenic properties of asbestos and consumer tastes, and determined that the difference in treatment between asbestos products and similar products did not violate the national treatment obligation[7].

In addition, in the determination of violations of Article III:4, whether or not consider the regulatory objectives had been discussed in determining "treatment no less favourable" (EC — Measures Affecting Asbestos and Products Containing Asbestos, EC – Seal Products, etc.). In the EC — Asbestos case, the Appellate Body paid attention to the toxicity of asbestos and consumer tastes, considering the objectives of the measure in effect. In the EC – Seal Products case, in contrast, the Appellate Body clearly stated that the regulatory objectives of the measure should be considered in the context of GATT Article XX and they should not be considered under Article III:4. However, even after this determination was made, the way in which panels and the Appellate Body will resolve issues relating to claims by Members that the policy objectives of a measure should be considered in determining whether differences in treatment between domestic and imported "like products" constitute violations of the national treatment obligation has not been resolved. Therefore, attention needs to be paid to the developments in future cases.

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[4] According to precedent, emphasis is placed on the fact that taxes are imposed more heavily on imported products when compared to domestic products, but there was a case where a lack of rational connection between the objectives of the taxation measure and the tax rates was pointed out (WT/DS87/AB/R paras. 70-71).

[5] WT/DS135/R paras. 118-144. In precedential cases, however, "like products" under Article III:2 was deemed to be narrower than "directly competitive or substitutable products" (Japan – Taxes on Alcoholic Beverages), and the specific scope of "like products" may be deemed different between the second sentence of Article III:2 and Article III:4 even though the factors to be considered are the same.

[6] However, the Panel justified the import prohibition on asbestos products by invoking GATT XX(b).

[7] WT/DS135/AB/R paras.139-141.

As described above, different factors need to be considered for each paragraph in determining violations of GATT Article III.

EXCEPTIONS TO GATT ARTICLE III (NATIONAL TREATMENT PRINCIPLE)

Although national treatment is a basic principle under the GATT, the GATT provides for certain exceptions; the exceptions are outlined below.

Government Procurement

GATT Article III:8(a) permits governments to purchase domestic products for their own use preferentially, making government procurement an exception to the national treatment principle. This exception exists because many GATT contracting parties were unwilling to change the preferential treatment they gave to domestic products in government procurement[8]. Several contracting parties negotiated an agreement on government procurement in the Tokyo Round in which the national treatment principle was provided. It remained in the plurilateral Agreement on Government Procurement agreed upon in the Uruguay Round. However, WTO Members are under no obligation to join the Agreement on Government Procurement. In fact, it has mostly been developed countries that have joined the Agreement. Therefore, in the context of government procurement, the national treatment rule applies only among those who have acceded to the Agreement on Government Procurement. For others, the traditional exception is still in force. (*See* Chapter 14 "Government Procurement".)

Subsidies to Domestic Producers

GATT Article III:8(b) allows for the payment of subsidies exclusively to domestic producers as an exception to the national treatment principle. The reason for this exception is that subsidies are recognized to be an effective policy tool and are basically within the latitude of domestic policy authorities. However, to be within the exception provided by Article III:8(b) subsidies need to be granted directly to domestic producers, and, according to precedent, subsidies granted to consumers for purchasing domestic products and tax reduction measures are not within the scope of the exception. Furthermore, because subsidies may have a negative effect on trade, the Agreement on Subsidies and Countervailing Measures imposes strict disciplines on their use. (*See* Chapter 7 "Subsidies and Countervailing Measures".)

Exceptions for Members in the Early Stages of Development (GATT Article XVIII:C)

Members in the early stages of development can raise their standard of living by promoting the establishment of infant industries. This effort may require certain government support, and the goal of establishing the industry may not be realistically attainable within the confines of the GATT. In such cases, countries can invoke the provisions of GATT Article XVIII:C to notify WTO Members and initiate consultations. After consultations are completed and subject to certain restrictions, the developing

[8] *See* GATT Analytical Index, Volume 1, PP190-194.

country is then allowed to take measures that are inconsistent with GATT provisions, excluding Articles I, II and XIII. Unlike the trade restrictions for balance-of-payment reasons in GATT Article XVIII:B, the Article XVIII:C procedure allows both broader measures and violations of the national treatment obligations in order to promote domestic infant industries. In the case concerning Malaysia's import permit system for petrochemical products (DS1), Malaysia resorted to GATT Article XVIII:C as a reason to enforce import restrictions on polyethylene. Although Singapore filed a WTO case against Malaysia's practice, Singapore later withdrew its complaint. Thus, neither a panel nor the Appellant Body had an opportunity to rule on the case.

Other Exceptions to National Treatment

Exceptions peculiar to national treatment include the exception on screen quotas for cinematographic films under Article III:10 and Article IV. The provisions of GATT Article XX on general exceptions (*e.g.*, measures necessary to protect public morals, etc.), Article XXI on security exceptions and WTO Article IX on waivers also apply to the national treatment rule. (For further details, *see* Chapter 1 "Most-Favoured-Nation Treatment Principle").

NATIONAL TREATMENT RULES OUTSIDE OF GATT ARTICLE III

With the entry into force of the WTO agreements, the principle of national treatment was extended, although in a limited fashion, to agreements on goods, services and intellectual property. For instance, among the agreements on goods, Article 2.1 of the TBT Agreement addresses national treatment.

Article 2.1 of the TBT Agreement proves that "Members shall ensure that in respect of technical regulations, products imported from the territory of any Member shall be accorded treatment no less favourable than that accorded to like products of national origin". This provision is similar to the provision of GATT Article III:4 in wording, and it has been determined that when interpreting Article 2.1 of the TBT Agreement, the context of GATT Article III:4 needs to be considered (EC – Seal Products). Therefore, as with Article III:4, the determination of "like products" under this Article is based on the following four factors: (1) the product's properties, nature and quality, (2) the product's end uses, (3) consumer tastes and habits, and (4) tariff classification.

In the determination of "treatment no less favourable", the entirety of imported products subject to the determination were compared with domestic "like products" in the precedential cases[9]. The Appellate Body concluded that Article 2.1 of the TBT

[9] As mentioned in the body text, in the EC – Seal Products case, the Appellate Body determined that, unlike Article 2.1 of the TBT Agreement, the regulatory objectives were not considered under GATT Article III:4 because they were considered under GATT Article XX, which provided for general exceptions. Therefore, unlike Article 2.1 of the TBT Agreement under which the objectives of the measure are considered in determining the conformity, consideration of the objectives of the measure under GATT Article III are pushed back to the assessment of conformity under GATT Article XX. However, the objectives and the relationship between the objectives and the means were considered in the analysis of the consistency under GATT Article III in some precedential cases. It is extremely important to consider that which of these decision frameworks should be used depends on whether or not the policy

Agreement addressed whether or not the difference in treatment between imported products and domestic "like products" was based on a "legitimate regulatory distinction" (EC – Seal Products).

It also found that the provisions of Article 2.1 of the TBT Agreement and GATT Article III both related to the national treatment principle, and so the provisions to be applied would be decided according to the characteristics of the measure (EC – Seal Products)[10].

In addition, Article 5.1.1 of the TBT Agreement provides for Most-Favoured-Nation treatment together with national treatment with respect to assessments of conformity with technical regulations. GATS Article XVII provides national treatment for services and service providers and Article 3 of the TRIPS Agreement provides national treatment for the protection of intellectual property rights. The plurilateral Agreement on Government Procurement also contains a national treatment clause. (for more information, *see* Chapter 12 "Trade in Services", Chapter 13 "Protection of Intellectual Property", and Chapter 14 "Government Procurement".)

3) Economic Aspects and Significance

There is a tendency among importing countries to discriminatorily apply domestic taxes and regulations to protect national production, often under protectionist pressures from domestic producers. This distorts the conditions of competition between domestic and imported goods and leads to a reduction in economic welfare.

The national treatment principle does not, in principle, permit these sorts of policies that are designed to protect domestic products. GATT Article II does permit the use of tariffs as a means of protecting a domestic industry because tariffs have high degrees of transparency and predictability since they are published in tariff schedules and are subject to the obligation in GATT Article II not to exceed the tariff binding. On the other hand, domestic taxes and regulations are "hidden barriers to trade" that lack both transparency and predictability. Thus, they can have a large trade-distortive impact. The existence of GATT Article III generally impedes the adoption of policies and measures aimed at domestic protection, thus promoting trade liberalization.

In addition, regarding tariff concessions, GATT Article II recognizes that tariffs have been used as tools for domestic industrial protection. Consequently, it proves a course for achieving liberalization through gradual reductions. Even if tariff reductions were made as a result of trade negotiations, and if domestic taxes and regulations were to be applied in a discriminatory fashion to protect domestic industry simultaneously, then effective internal trade barriers would remain. The national treatment principle prohibits countries from using domestic taxes and regulations to offset the value of tariff concessions and is, therefore, a significant tool in promoting trade liberalization.

The national treatment principle, as well as the MFN principle, is often invoked in

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objectives can be allowed as exceptions solely under GATT Article XX (WT/DS400/AB/R paras. 5.127, 5.130).

[10] WT/DS400/AB/R paras. 5.118, 5.122.

WTO disputes. However, an argument regarding national treatment is rarely made on its own; instead, the national treatment principle is usually invoked in connection with other provisions regarding MFN, quantitative restrictions, TRIMs, and standards and conformity, etc.

2. MAJOR CASES

1) Japan – *Taxes on Alcoholic Beverages (DS8, 10, 11)*

The Panel report adopted on November 10, 1987 determined that Japan violated the national treatment principle provided for in GATT Article III. Japan responded to this by revising the Liquor Tax Act and abolishing the ad valorem duty system, the grading system, and the differential tax rate system based on the extracted component of fruit liquor. Japan also reduced the differences in the tax rates between distilled spirits. However, the EC pointed out that differences in the tax rates still remained between shochu and other distilled spirits, and consultations were held again in 1995.

In response to the Panel report, which determined Japan violated GATT Article III:2, Japan appealed to the Appellate Body and its report was issued in 1995. The Appellate Body partially amended the Panel report, but maintained its conclusions, and determined that shochu and vodka were “like products” and taxing the latter in excess of the former was in violation of the first sentence of GATT Article III:2. The Appellate Body also determined that shochu, whisky, brandy, rum, gin, genever (Dutch gin), and liqueurs are “directly competitive or substitutable products” and not taxing them “similarly” was in violation of the second sentence of the GATT Article III:2.

2) Korea — Measures Affecting Imports of Fresh, Chilled and Frozen Beef (DS161, 169)

In the Republic of Korea, imported beef can only be sold in specialized imported-beef shops, and large-scale distributors must provide a separate sales area for imported beef. In addition, the dual retail system, which requires stores selling imported beef to display a "Specialized Imported Beef Store" sign to distinguish them from domestic meat sellers, is in place. The United States, Canada and New Zealand claimed that the regulations were in violation of GATT Article III:4. The WTO Dispute Settlement Body established a panel to determine the legitimacy of the Republic of Korea’s imported beef measures and domestic retail system.

In relation to dual retail system, the Panel determined that any regulatory distinction that is based exclusively on criteria relating to the nationality or the origin of the products was incompatible with Article III:4. The Appellate Body, however, interpreted GATT Article III:4 only to require that no less favourable treatment be accorded to imported products than domestic products. According different treatment alone did not establish a violation of GATT Article III:4; for a violation of Article III:4 to be established, the imported products must be provided with less favourable conditions of competition than domestic products. The Appellate Body then found that imported beef was accorded less favourable treatment than domestic beef with respect to the conditions of competition in the Korean market, and concluded that the system was in violation of GATT Article III:4.

3) EU — Measures Affecting Asbestos and Products Containing Asbestos (DS135)

Based on the fact that asbestos is carcinogenic and harmful to the human body, France issued a ban on the import and distribution of asbestos and products containing asbestos in order to protect its consumers and workers. Canada filed a complaint in October 1998, claiming the measure was in violation of GATT Article III. The Panel determined that asbestos and similar products such as cellulose and glass fibres, etc. were "like products" under GATT Article III:4.

The Appellate Body interpreted the scope of "like products" under GATT Article III:4 to be not broader than the scope of "directly competitive or substitutable" under GATT Article III:2. The Appellate Body then mentioned that the carcinogenicity of asbestos was well established and determined that this fact affected "consumer tastes and habits", one of the four factors considered in determining whether or not the product were "like products". (The four factors are (1) the product's properties, nature and quality, (2) the product's end uses, (3) consumer tastes and habits, and (4) tariff classification). The Appellate Body found that because, if consumers were to choose between carcinogenic asbestos and similar products that are not carcinogenic, they would likely choose the latter, and therefore asbestos and products such as cellulose and glass fibres, etc. could not be deemed "like products". Therefore, there was no violation of GATT Article III:4.

4) EC – Measures Prohibiting the Importation and Marketing of Seal Products (DS400, 401)

The EU established a regulatory measure to prohibit the placing on the market of seal (refers to seal, sea lion, and walrus) products derived from commercial hunts. This measure included exceptions to allow the placing on the market of seal products resulting from hunts traditionally conducted by Inuit and other indigenous communities that contribute to their subsistence.

In 2009, Canada and Norway filed a complaint against the EU, claiming that the EU's regulatory measure set different conditions for applying exceptions between seal products from Canada and seal products from Greenland and was therefore in violation of the TBT Agreement. They also made a secondary claim that the measure was in violation of GATT Articles I and III.

The Appellate Body determined that the EU's regulatory measure did not constitute a technical regulation subject to the disciplines of the TBT Agreement and therefore the TBT Agreement did not apply to the measure. The Appellate Body therefore made its interpretations/determinations with respect to GATT Articles I and III. The Appellate Body stated that Article 2.1 of the TBT Agreement could not be interpreted in the same manner as the MFN principle of GATT Article I and the national treatment principle of GATT Article III:4. The Appellate Body also determined that all the WTO agreements must be interpreted consistently and pointed out that Article 2.1 of the TBT Agreement and GATT Articles I and III:4 needed to be interpreted in a consistent manner.

The Appellate Body then determined that the EU's regulatory measure detrimentally affected the conditions of competition for seal products from Canada and Norway when compared to domestic like products, and concluded that the measure was in violation of GATT Article III:4 because the EU did not accord "treatment no less favourable" under GATT Article III:4 to the latter. In this determination, the objectives of the measure were not considered and attention was paid only to whether or not the conditions of competition were worsened. The Appellate Body also determined that the EU's measure to prohibit the placing of seal products on the market was a measure necessary to protect public morals under GATT Article XX(a) in the light of increased concerns regarding animal welfare within the EU. However, the Appellate Body concluded that the EU's measure could not be justified under the chapeau of GATT Article XX because it accorded "arbitrary or unjustifiable" discriminatory treatment as proscribed by GATT Article XX.

5) Canada — Certain Measures Affecting the Renewable Energy Generation Sector (DS412, 426)

The FIT (Feed-in Tariff) program is a renewable energy electricity fixed-price purchase system operated by the Ontario Power Authority (OPA) in the Province of Ontario in Canada. This program offered renewable electricity generators standardized prices for a unit of electricity produced by them if they entered into a 20-year or 40-year contract with the OPA. However, prerequisites for wind and solar electricity generators to enter into the contract included a local content requirement of the use of "electricity generation equipment" sourced in Ontario. Japan requested consultations in 2011, claiming that the local content requirements under Canada's FIT program (and contracts under this program) were in violation of paragraph 1, Article 2 of the TRIMs Agreement, GATT Article III:4, and Articles 3.1(b) and 3.2 of the ASCM Agreement. Canada claimed that the measure at issue was not in violation of GATT III:4 because it was justifiable under GATT Article III:8(a).

Local content requirements violate the obligation under GATT Article III:4, but the obligation is exempted for measures provided for in GATT Article III:8(a). The Appellate Body therefore examined whether or not Canada's measure was a measures relating to government procurement provided for in GATT Article III:8(a). The Appellate Body pointed out that, in order to have the obligation exempted under GATT Article III:8(a), the product procured by the government and the foreign product must be in a competitive relationship. The Appellate Body then determined that they were not in a competitive relationship because the product procured by the provincial government was "electricity" produced by renewable energy electricity generation equipment and the foreign product accorded discriminatory treatment was "renewable energy electricity generation equipment". For this reason, the Appellate Body concluded that the discriminatory treatment against electricity generation equipment at issue did not fall within the scope of government procurement provided for in GATT Article III:8(a) (laws, regulations or requirements governing the procurement by governmental agencies of products for their own use) and therefore Canada violated GATT Article III:4.