Chapter 2

NATIONAL TREATMENT PRINCIPLE

1. OVERVIEW OF RULES

National treatment (GATT Article III) 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 determining the similarity of "like products," GATT panel reports have relied on a number of criteria including the product's end uses in a given market, consumer tastes and habits, the product's properties, nature and quality, and tariff classification. WTO panels and the Appellate Body reports utilize the same criteria. [1]

EXCEPTIONS TO GATT ARTICLE III (NATIONAL TREATMENT RULE)

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 preferentially, making government procurement one exception to the national treatment rule. This exception is permitted because WTO Members recognize the role of government procurement in national policy. For example, there may be a security need to develop and purchase products domestically, or government procurement may, as is often the case, be used as a policy tool to promote smaller business, local industry or advanced technologies.

While the GATT recognizes government procurement as an exception to the national treatment rule, the Agreement on Government Procurement, resulting from the Uruguay Round, mandates that signatories offer national treatment in their government procurement. 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. [2] For others, the traditional exception is still in force.

---

1 Japan – Taxes on Alcoholic Beverages (WT/DS 8, WT/DS 10, WT/DS 11)

2 *See* Chapter 8 on 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 rule, under the condition that the subsidy does not violate other provisions of Article III and of the Agreement on Subsidies and Countervailing Measures. 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, because subsidies may have a negative effect on trade, the Agreement on Subsidies and Countervailing Measures imposes strict disciplines on their use.[3]

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 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, 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.[4]

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, Article XXI on security exceptions and WTO Article IX on waivers also apply to the national treatment rule. For further details, *see* the relevant sections of Chapter 1 (MFN Principle).

---

[3] *See* Chapter 6 on subsidies and countervailing measures.

[4] Malaysia – Prohibition of Imports of Polyethylene and Polypropylene (WT/DS1). This complaint had the distinction of being the first dispute brought under the new WTO dispute settlement system.

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 5.1.1 of the TBT Agreement also addresses national treatment. 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. (*See* the relevant chapters of Part I for more information on Trade in Services, Intellectual Property Rights, and 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 rule 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 certain high degrees of transparency and predictability since they are published and committed to in tariff schedules. 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 rule 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.

4. MAJOR CASES

National treatment provisions, as well as the MFN clause, are often invoked in WTO disputes. However, an argument on 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 technical barriers to trade. In this section, we discuss the US-Import Restriction on Gasoline, France's (EU) Ban on the Import and Distribution of Asbestos and Products Containing Asbestos, China-Value-Added Tax on Semiconductors, and Restriction on the Selling of both Imported and Domestic Automobiles where national treatment was a major issue.

US-Import Restriction on Gasoline

Based on the US Clean Air Act (hereinafter referred to as "Clean Air Act") of 1990, the United States Environmental Protection Agency (EPA) implemented a Regulation on Standards for Reformulated and conventional Gasoline in December 1993.

The Clean Air Act divides the United States into polluted and non-polluted areas, permitting the sales of conventional type gasoline in a non-polluted area, while requiring that the environmental pollution rate remain below the 1990 level.

To be specific, refiners who had gasoline sales as of 1990 were allowed to use the gasoline sold at that time as its standard (individual standard), while those refiners and importers who did not have gasoline sales as of 1990 were subject to a unified standard defined by the US Government.

Under this regulation, EPA applied individual standards to domestic entrepreneurs, and requested importers (foreign refiners) and others to: (i) apply individual standards if they imported 75% or more of gasoline refined in a foreign country as of 1990; and (ii) otherwise apply the unified standard. Moreover, importers subject to (i), above, were requested to submit applications within a designated period; no importers submitted applications. As a result, no importers were subject to item (i), but instead to item (ii) and had to request the unified standard.

In regards to the above measure, Brazil and Venezuela requested WTO consultations in accordance with GATT Article XXII in January 1995, claiming that the measure violated GATT Article I and Article III, as well as TBT Agreement Article 2. The Panel was established in April 1995; the final report was issued in January 1996. The Panel Report determined that the US measure was in violation of GATT Article III:4 (the Panel did not consider Article I and Article III:1). The Panel next considered whether the measure was justifiable under GATT Article XX. The Panel determined that: "The measure did not come under GATT Article XX (d) and (g). Although the policy objective was written within the scope of Article XX (b), the measure failed to fulfill the "necessity" requirement of that Article and, thus, the Article was not applicable."

The U.S. appealed the Panel's finding in February 1996 and the Appellate Body Report was circulated in May 1996. The Appellate Body did not agree with the Panel's decision with respect to Article XX (g) and determined that the measure fell within Article XX (g) ("measure for the conservation of exhaustible natural resources") but did not fulfill the requirements set out in the chapeau of Article XX, and thus was not justified under Article XX.

France's (EU) Ban on the Import and Distribution of Asbestos and Products Containing Asbestos

France issued a ban on the import and distribution of asbestos and products containing asbestos in order to protect its consumers and workers. Canada requested a panel regarding this measure in October 1998. In September 2000, although the WTO panel found France (EU) in violation of GATT Article III:4 because of discriminatory treatment of like domestic and foreign products, it ultimately concluded that the discriminatory treatment was justified under GATT Article XX:(b) (general exceptions for the purpose of protecting the life and health of people, animals, etc.). In March 2001 the Appellate Body found that asbestos and building materials containing asbestos were not like products and thus, reversed the panel's decision on this issue. The Appellate Body, however, upheld the panel's decision concerning GATT Article XX:(b).

China-Value-added Tax on Semiconductors

The Chinese Government confirmed that, upon its accession to the WTO, it would conform its measures, including taxation and surcharges, with WTO rules.

With respect to the value-added tax on semiconductors, domestic semiconductor manufacturers received a refund of the tax on their domestically made semiconductors under State Council Notification No. 18 ("Several Policies for Encouraging the Development of the Software and Integrated Circuit Industry").

Refunding the value-added tax on domestically made semiconductors can be interpreted as imposing a higher tax on imported semiconductors than on domestic semiconductors. Thus, it could be a violation of GATT Article III:2 (national treatment). On the other hand, GATT Article III:8(b) allows the application of subsidies (producer subsidies) for domestic producers only, as an exception to the national treatment principle. If the actual tax refund based on State Council Notification No. 18 was construed as a *de facto* tax deduction, the tax refund could not be viewed as a producer subsidy under GATT Article III:8(b) and may be a measure not conforming to the exception clause of GATT Article III:2.

Japan and the United States are equally concerned over the above measures. On March 18, 2004, the United States invoked WTO Dispute Settlement procedures and requested consultations with China. On April 27, the US held bilateral consultations

with China; Japan, the EU and Mexico participated as third parties. After additional unofficial consultations between the United States and China, an agreement was reached on July 14. The agreement provided that China would not qualify new companies for the value-added tax redemption system, that the system would be completely abolished by April 1, 2005, and that the public announcement of this agreement would be published by November 1, 2004. China made the announcement on September 21, 2004.

In addition to abolishing the value-added tax system, China's announcement included language to implement a government subsidy program for research, development and human resource cultivation in the semiconductor industry. Concerned about the consistency of such a program with the Agreement on Subsidies, Japan raised the issue during the TRM for China in the Committee on Subsidies in November 2004 and the Japan-China Economic Partnership Meeting in April 2005. China responded that the program was still being planned and that its implementation would be consistent with the WTO agreements.

Japan appreciates that, as a result of WTO consultations, China abolished the value-added tax redemption system for domestically manufactured semiconductors. However, Japan will continue to monitor closely the consistency of the government subsidy program for research and development to ensure that it is implemented in accordance with the Agreement on Subsidies.

Restriction on the Selling of both Imported and Domestic Automobiles

Regarding the sale of automobiles in China, a draft "Automobile Industry Development Policy" of June 2003 included provisions that ban the sale of imported cars at domestic car dealers and the sale of domestic cars at imported car dealers.

If dual distribution (sale of both domestic and imported cars) is prohibited, many dealers may choose to sell only domestic cars. This means that imported cars may in effect get adverse treatment and may not be accorded national treatment, a violation of GATT Article III:4.

During the Japan-China Economic Partnership Meeting held in June and December 2004, China explained that it "would not prohibit dual distribution."

There are no provisions that prohibit the dual distribution of domestic and imported cars in the "Automobile Industry Development Policy" published by the State Development and Reform Committee on May 21, 2004, in the "Measures for the Administration of Automobile Brand Sale" published by the Ministry of Commerce on February 21, 2005, or in the "Automobile Trade Policy" published by the Ministry of Commerce on August 10, 2005.

The Measures for the Administration was put into force on April 1, 2005, and pursuant to Article 38, the State Administration for Industry and Commerce published the list of automobile dealers that had completed the procedures set out in the Measures

on November 21, 2005. No substantial problems have occurred.