PART I
CHAPTER 1 MOST-FAVoured-NATION TREATMENT PRINCIPLE

1. OVERVIEW OF RULES

(1) The Background of Rules: Most-Favoured-Nation (MFN) Treatment

“Most-Favoured-Nation (MFN) treatment,” which requires Members to accord the most favourable tariff and regulatory treatment given to the product of any one Member at the time of import or export of “like products” of all other Members, is one of the bedrock principles of the WTO. Under the MFN rule, should WTO Member A agree in negotiations with country B, which needs not be a WTO Member, to reduce the tariff on the same product X to five percent, this same “tariff rate” must also apply to all other WTO Members as well. In other words, if a country gives favourable treatment to one country regarding a particular issue, it must handle all Members equally regarding the same issue.

The idea of MFN treatment in and of itself has a long history. Prior to the GATT, an MFN clause was often included in bilateral trade agreements, and as such it contributed greatly to the liberalization of trade. However, in the 1930s, several measures that limited the functioning of the MFN principle were taken. It is said that these measures led to the division of the world economy into trade blocs. Having learned from this mistake, after World War II, the unconditional MFN clause was then included in the GATT, on a multilateral basis, and has contributed to the stability of trade around the world.

Against this background, the MFN principle in particular must be observed as a fundamental principle for sustaining the multilateral trading system. Regional integration and related exceptions need to be carefully administered so as not to undermine the MFN principle as a fundamental principle of the WTO.

2. Legal Framework

(i) GATT Practice Regarding MFN Treatment

MFN treatment is stipulated in GATT Articles I, XIII, and XVII.

(a) GATT Article I:1

GATT Article I:1 provides for WTO Members to accord MFN treatment to like products of other WTO Members regarding tariffs, regulations on exports and imports, internal taxes and charges, and internal regulations. In other words, “like” products from all WTO Members must be given the same treatment as the most advantageous treatment accorded the products of any state.

Should an importing country flagrantly accord differential treatment to “like products” of the exporting country, i.e. by setting different tariff rates, it would be clearly a violation of GATT Article I:1. However, Article I:1 violations can also occur even when there is no ostensible discrimination against the product of another Member, such as when an importing country accords differential treatment among products that are considered to be “like products,” which ultimately results in the de facto discrimination against products of specific Members. For instance, a country may apply a different tariff rate to a particular variety of
unroasted coffee, but if that variety and other varieties of coffee beans were considered to be “like products,” using criteria such as consumer tastes and end-use, the differential tariff may have an effect on imports from only specific countries. This may be considered in violation of the MFN rule.\(^1\) In contrast, the concept of like products was strictly interpreted in the SPF (spruce, pine, and fir) case involving Japan. The panel in that case recognized that each WTO Member might exercise considerable discretion as to tariff classifications and that the legality of such classifications would be established to the extent that it did not discriminate against the same products from different WTO Member.\(^2\)

(b) Non-Discriminatory Administration of Quantitative Restrictions

GATT Article XIII stipulates that quantitative restrictions or tariff quotas on any product must be administered in a non-discriminatory fashion regarding like products, and that in administering import restrictions and tariff quotas, WTO Members shall aim to allocate shares close to that which might be expected in their absence. Article XIII provides for MFN treatment in the administration of quantitative restrictions, and supplements the disciplines under Article I.

(c) States Trading Enterprises

“States Trading Enterprises” means state enterprises established or maintained by a WTO Member or private enterprises granted exclusive or special privileges by WTO Members, which make purchases or sales involving either imports or exports. By making use of their monopolistic status, such enterprises could operate against international trade through discrimination on the part of importing country and quantitative restrictions. GATT Article XXVII obliges WTO Members to act in accordance with the rules of non-discrimination, including the MFN rule.

(ii) Exceptions to the MFN Rule

The GATT provides for certain exceptions to the MFN rule described above.

(a) Regional Integration (GATT Article XXIV)

Regional integration liberalizes trade among countries within the region, while allowing trade barriers with countries outside the region. Regional integration therefore may lead to results that are contrary to the MFN principle because countries inside and outside the region are treated differently. This may have a negative effect on countries outside the region, and thus lead to results contrary to the liberalization of trade.

Therefore, GATT Article XXIV provides that regional integration may be allowed as an exception to the MFN rule only if the following conditions are met. First, tariffs and other barriers to trade must be eliminated with respect to substantially all trade within the region. Second, the tariffs and other barriers to trade applied to outside countries must not be higher or more restrictive than they were prior to establishment of regional integration.

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\(^1\) Spain - Tariff Treatment of Unroasted Coffee, BISD 28S/102.
Regional integration has a vast impact on the world economy today and is the subject of frequent debate in a variety of forums, including the WTO Committee on Regional Trade Agreements. (For details, see Chapter 15 on Regional Integration.)

(b) Generalized System of Preferences

The Generalized System of Preferences or “GSP” is a system that grants products originating in developing countries lower tariff rates than those normally enjoyed under MFN status as a special measure granted to developing countries in order to increase their export earnings and promote their development.

The GSP is defined in the Decision on “Generalized System of Preferences” of June 1971, and is a measure taken based on the Decision on “Differential and More Favourable Treatment, Reciprocity, and Fuller Participation of Developing Countries” or the “Enabling Clause.” The GSP has the following characteristics. First, preferential tariffs may be applied not only to countries with special historical and political relationships (i.e. the British Commonwealth), but to developing countries more generally (thus the system is described as “generalized”). Second, the beneficiaries are limited to developing countries. Third, it is a benefit unilaterally granted by developed countries to developing countries. As a related issue, concerning the expansion of market access for least developed-countries, see Chapter 4.

(c) Non-Application of Multilateral Trade Agreements between Particular Member States (WTO Article XIII)

The Marrakesh Agreement Establishing the World Trade Organization (the “WTO Agreement”) provides that “[t]his Agreement and the Multilateral Trade Agreement in Annexes 1 and 2 shall not apply as between any Member and any other Member,” when either of the following conditions are met: (a) at the time the WTO went into force, Article X XXV of GATT 1947 had been invoked earlier and was effective as between original Members of the WTO which were Members to GATT 1947 or; (b) between a Member and another Member which has acceded under Article XII only if the Member not consenting to the application has so notified the Ministerial Conference before the approval of the agreement on the terms of accession by the Ministerial Conference.

In the case of non-application, benefits enjoyed by other Members are not provided to the country of non-application, which leads to results that are contrary to the MFN principle.

These Article XIII provisions were created to deal with problems arising from accessions. Ideally, the MFN rule would be applied stringently so that when country B accedes to the Agreement, it is required to confer MFN status on all other Members, and they, in turn, are required to confer MFN status on country B. However, country A, which is already a Member of the WTO, may have reasons for not wanting to confer the rights and obligations of the WTO on new Member B. The WTO only requires the consent of two-thirds of the existing membership for accession, so it is conceivable that country A might, against its

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3 Decision of the Members of 28 November 1979, BISD 26S/203.
4 See (d) Other Exceptions.
5 Although there is also a provision about non-application in GATT Article XXXV, it is recognized that WTO Article XIII prevails against GATT Article XXXV. This situation occurs because WTO Article XVI stipulates that “[i]n the event of a conflict between a provision of this Agreement and a provision of any of the Multilateral Trade Agreements, the provision of this Agreement shall prevail to the extent of the conflict.”

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will, be forced to give MFN status to country B. WTO Article XIII is a way to respect country A’s wishes by preventing a WTO relationship from taking effect between countries A and B. On the other hand, WTO Article XIII provides a way for the accession of country B, even if more than a third of the membership, like country A, has reasons for not wanting a WTO relationship with country B (in which case they will object to the accession itself) by allowing for non-application.

In January 1995, the United States notified the General Council that it would not apply the Agreement and the Multilateral Trade Agreements in Annexes 1 and 2 to Romania, yet, in February 1997, the United States withdrew its invocation. In addition, the United States also notified that it would not apply the above-mentioned agreements to two other new Members: Mongolia and Kyrgyz Republic, but withdrew it for Mongolia in July 1999.

(d) Other Exceptions

Other exceptions peculiar to the MFN principle include Article XXIV:3 regarding frontier traffic with adjacent countries, and Article I:2 regarding historical preferences which were in force at the signing of the GATT, such as the British Commonwealth.

General exceptions to the GATT that may be applied to the MFN principle include Article XX regarding General Exceptions for measures necessary to protect public morals, life and health, etc., and Article XXI regarding security exceptions.

It is also possible to obtain a waiver to constitute an exception to the MFN principle. Under WTO Article IX:3, countries may, with the agreement of other Members, waive their obligations under the agreement. New waivers, however, can only be obtained for exceptional circumstances, and require the consent of three-quarters of the Members. It is stipulated that the exceptional circumstances, the terms and conditions governing the application of the waiver, and the date on which the waiver will be terminated shall be clearly stated, and that waivers are subject to annual review (Article IX:4).

(iii) MFN Provisions Outside of GATT 1994

The idea of MFN treatment has been extended to the areas of trade in services and intellectual property by the WTO Agreement, although with certain exemptions. Article II of the General Agreement on Trade in Services (GATS) provides for MFN treatment for services and service providers; Article 4 of the Agreement on Trade-Related Aspects of Intellectual Property Rights does the same for the protection of intellectual property rights. The GATS allows for exceptions where Members may waive their obligation to provide MFN treatment for specific measures in specific fields by listing the measure in the Annex on Article II Exemptions. The TRIPS Agreement also provides for exemptions regarding measures based on existing treaties in the area of intellectual property. (See Chapter 11 for Trade in Services; Chapter 12 for Intellectual Property Rights.)
(3) Economic Implications

The MFN rule has several positive economic implications, which are discussed below.

*Increased Efficiency in the World Economy*

MFN treatment makes it possible for countries to import from the most efficient supplier, in accordance with the principle of comparative advantage. For example, if country B can supply product X at a lower price than country C, country A can increase its economic efficiency by importing it from country B. If, however, country A applies higher tariff rates to product Xs from country B than to product Xs from country C, country A may end up importing product Xs from country C, even though country C is not as efficient a supplier. This distorts trade and, as a result, reduces the welfare of country A and the economic efficiency of the entire world. If, however, the MFN principle is applied between the three countries, then country A will apply its tariffs equally to all exporting countries and will therefore necessarily import product X from country B because it is cheaper to do so. The most efficient result is thus attained.

*Stabilization of the Multilateral Trading System*

The MFN rule requires that favourable treatment granted to one country be immediately and unconditionally granted to all other countries, while trade restrictions must also be applied equally to all. This increases the risk of the introduction of trade restrictions becoming a political issue, raises the costs of doing so and therefore tends to support the liberalized status quo. By stabilizing the free trade system in this manner MFN increases predictability and therefore increases trade and investment.

*Reduction of the Cost of Maintaining the Multilateral Trading System*

MFN reduces the cost of maintaining the multilateral trading system. The equal treatment demanded by the MFN principle tends to act as a force for unifying treatment at the most advantageous level (which in trade means the most liberal level). The establishment and maintenance of the MFN rule enables WTO Members to reduce their monitoring and negotiation costs - the cost of watching and comparing treatment received with that given to third countries - and of negotiating remedies to disadvantageous treatment. In short, the most-favoured-nation rule has the effect of reducing the cost of maintaining the free trade system.

Finally, as long as the MFN rule is honoured, imports from all WTO Members are treated equally, which reduces the cost of determining an import’s origin and therefore improves economic efficiency.

Thus the MFN rule is of fundamental importance in improving economic efficiency. However, we must also note that the MFN rule is often misused. The argument runs that bilateral negotiations not under the auspices of the WTO can be justified by the MFN principle, because any trade benefits that result from these negotiations will be applied equally to all other WTO members, even though they may be excluded from the negotiations. Bilateral negotiations are thus justified as a more time-saving and effective means to remove “unfair” trade measures. However, this does not take into account the fact that because bilateral negotiations lack transparency, there is a possibility that MFN treatment is not extended to countries not in the negotiation, and the fact that bilateral negotiations tend to
reflect the power relationship between the two countries. Even if the results of the negotiations are extended through the MFN principle, it must be noted that the end “result” of improved treatment in trade does not necessarily justify the means, that is the unfairness of procedure in bilateral negotiations. Continual vigilance is required to ensure that the most-favoured-nation rule is not abused in a result-oriented manner to undermine the basic importance of the dispute settlement process in the WTO.

2. PROBLEMS OF TRADE POLICIES AND MEASURES IN INDIVIDUAL COUNTRIES

The MFN principle is used often in GATT disputes as a basic principle of the GATT together with national treatment. However, in this case, it is rare for MFN to be invoked on its own, and articles regarding national treatment, quantitative restrictions, TRIMs, rules of origin, and standards and conformity assessment are often cited in conjunction (See Table 1-1). In this chapter, we take up the EU’s measures regarding bananas and Canada’s measures regarding automobiles where MFN is a major issue, and leave the detailed description of other specific cases to other chapters.

(1) Canada

Measures Regarding Automobiles

Under the “Auto Pact” (the Agreement Concerning Automotive Products with the United States that took effect in 1966), the Government of Canada accords duty-free treatment to vehicles, provided that importers (the Big Three and others, hereinafter referred as “Auto Pact members”) met certain conditions (Canadian value-added, whose required rates are various, but they are, in general, 60% or more, among others). The system had been administered so as to give tariff exemption to automobiles imported by any company as long as the companies met the above conditions, but the signing of the Free Trade Agreement (FTA) between the United States and Canada resulted in barring extension of the Auto Pact status to any new companies. This treatment continued after the North American Free Trade Agreement (NAFTA) took effect.

What this in essence means is that original Auto Pact member companies in Canada can import automobiles duty-free so long as they met the above conditions, while non-members must pay a 6.1 percent tariff (rate as January 1999), despite of the fact that all of these companies involved provide the same services: the importation and sale of automobiles.

By exempting only Auto Pact members from automobile tariffs, it is clear that there is discrimination between foreign companies, while it is not clear that there is any discrimination between imported products or suppliers of service in specific countries. However, the principle members of the original Auto Pact are the Big Three, so the end result is a system that offers preferential treatment to limited companies of, in fact, certain countries. This violates Article II of the GATS (MFN treatment). It is also, ultimately, in violation of Article I of the GATT (MFN treatment) because preference is given, in fact, only to imports from certain countries, and as a result, there is a bias vis-à-vis the countries producing products for duty-free import.

In addition, the requirement that certain Canadian value-added rates be met in order to qualify Auto Pact members for duty waivers violated GATT Article 3:4 (national treatment), as well as Article 2 of the TRIMs Agreement and Article 3:1(b) of the SCM Agreement (ban
on subsidies for preferential use of domestic over imported goods). Finally, this system is in violation of Article 3.1(a) of the SCM Agreement, because Canada attempts to maintain a certain ratio between the values of domestic production and domestic sales, which effectively serves as export promotion.

The Japanese Ministry of International Trade and Industry (MITI) designated the Canadian measure as a “priority area” of its trade policy for 1998 and 1999. In July 1998, Japan requested bilateral consultations under the WTO dispute settlement procedures. This consultation took place in August, but the outcome was not mutually satisfactory. In November, Japan requested the establishment of a panel. Since the European Union filed a separate complaint regarding the same matter, a single panel to hear complaints by both Members was established in February 1999. The panel met in June and July 1999, and on 11 February 2000 it circulated its final report, upholding virtually all of the Japanese claims. The panel did, however, find that Japan failed to sufficiently prove a violation of the ban on subsidies for preferential use of domestic products because there could conceivably be cases in which the Canadian value-added requirement was met entirely by labour costs. For the TRIMs claim, the panel declined to render a decision because it already found the same measure in violation of the national treatment rules. Canada appealed the panel decision on 2 March 2000, and we currently await the final report of the Appellate Body.

(2) EU

Measures Regarding Bananas

The European Union maintains measures that provide preferential treatment to countries of Africa, the Caribbean, and the Pacific (ACP) regarding tariff quotas (i.e. quota and tariff rate), under the Lomé Convention, and these measures involving bananas have been before a panel twice under the GATT (See Chapter 15 on Regional Integration).

After the conclusion of the Uruguay Round, the European Union put in place a new tariff quota regime for bananas. However, the United States, whose companies mainly deal in Latin American bananas, was unsatisfied with the new regime, and argued that the licensing system still provided preferential treatment to ACP bananas. The United States further argued that the preferential allocation of the quota to Latin American countries who are parties to the “Framework Agreement on Bananas (BFA)” (especially Colombia and Costa Rica) was inconsistent with the WTO Agreement. After bilateral negotiations under GATT Article XXII between the European Union on the one hand and the United States and some Latin American countries (Ecuador, Guatemala, Honduras, and Mexico) on the other, a panel was established in May 1996. Japan participated in the panel process as a third party.

In the panel report issued in May 1997, the EU’s measures were found inconsistent with the WTO agreements on the following points.

(i) Allocating a portion of the quota regarding third-country and non-traditional ACP bananas to only operators who deal in EU and traditional ACP bananas is inconsistent with Article I:1 (MFN) and Article III:4 (national treatment) of the GATT. The Lomé waiver does not waive the EU’s obligations under Article I:1 in respect of licensing procedures applied to third-country and non-traditional ACP imports.
(ii) The above preferential allocation of the quota to operators who deal in traditional ACP bananas creates less favourable conditions of competition for like service suppliers from third countries, and is therefore inconsistent with the requirements of Article XVII of GATS.

(ii) Regarding the “BFA”, although it was not unreasonable for the EU to conclude at the time the “BFA” was negotiated that Colombia and Costa Rica were the only Members that had a substantial interest in supplying the EU market, the EU’s allocation of tariff quota shares by agreement and by assignment to some Members not having a substantial interest in supplying bananas to the EU (including Nicaragua and Venezuela) but not to other Members (such as Guatemala) is inconsistent with Article XIII:1 (non-discriminatory administration of quantitative restrictions). Regarding the relationship between the inclusion of the BFA tariff quota shares in the EU’s tariff schedule and GATT Article XIII, the EU’s tariff schedule does not permit the EU to act inconsistently with the requirements of Article XIII.

The European Union appealed from this panel report, but the report of the Appellate Body basically upheld the main points of the panel report. At the Dispute Settlement Body meeting in September 1997, both the panel report and Appellate Body report were adopted, and the EU’s measures were found inconsistent with the WTO Agreements. In accordance with this decision, in July 1998, the European Union announced its plan to reform these measures. However, the complaining Members argued that the plan - which may still accord unfair preferential treatment to ACP countries – was in violation of the WTO Agreement. In October, the US announced that it would invoke sanctions against the EU based on Article 301 of its Trade Act of 1930, and initiated an investigation. The EU expressed its dissatisfaction with this treatment and fought the case at the DSB, but the sanctions were ultimately approved. (Concerning the Lomé Conventions, see Chapter 15, concerning implementation of recommendation by DSB, see Chapter 14.)

(2) United States

Measures Regarding Yellow-fin Tuna and Shrimp

The United States discriminates between like products on the basis of whether the country of origin has specific policies for yellow-fin tuna and sea turtles (See Chapter 3).
CHAPTER 2 NATIONAL TREATMENT PRINCIPLE

1. OVERVIEW OF RULES

(1) The Background of Rules: National Treatment Principle

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 appropriate treatment between 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. This rule prevents countries from taking discriminatory measures on imports on the one hand, and to prevent countries from offsetting the effects of tariffs through non-tariff measures. An example of the latter could be where Member A reduces the import tariff on product X from ten percent to five percent, only to impose a five percent domestic consumption tax only on 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 WTO Members through according imported products treatment no less favourable than that accorded to products of national origin. The adherence to this principle is important to maintain the balance of rights and obligations, and is essential for the maintenance of the multilateral trading system.

(2) Legal Framework

(i) 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 so as to afford protection to 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 tariff classifications, the product’s end uses in a given market, consumer tastes and habits, and the product’s properties, nature and quality. The same idea can be found in reports by WTO panels and the Appellate Body.

(ii) Exceptions to GATT Article III (National Treatment Rule)

Although national treatment is a basic principle under the GATT, the GATT provides for certain exceptions as follows.
(a) Government Procurement

GATT Article III:8(a) permits governments to purchase domestic products preferentially, making government procurement one of the exceptions 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 made government procurement an exception to the national treatment rule, the Agreement on Government Procurement resulting from the Uruguay Round mandates signatories to 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 between those who have acceded to the Agreement on Government Procurement, and for others, the traditional exception is still in force.6

(b) Domestic Subsidies

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 it is not in violation of other provisions in Article III and the Agreement on Subsidies and Countervailing Measures. The reason for this exception is that subsidies are recognized to be an effective policy tool, and is recognized to be 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 the use of subsidies.7

(c) GATT Article XVIII:C

Members in the early stages of development can raise their standard of living by promoting the establishment of infant industries, but this may require government support and the goal may not be realistically attainable with measures that conform to the GATT. In such cases, countries can use the provisions of GATT Article XVIII:C to notify WTO Members and initiate consultations. After consultations are completed and under certain restrictions, these countries are 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 border measures and violations of the national treatment obligations in order to promote domestic infant industries. In the case concerning Malaysia’s import permit system of 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 this Malaysian practice, Singapore then withdrew its complaints and therefore neither a panel nor the Appellant Body had an opportunity to rule on the case.8

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6 See Chapter 8 on Government Procurement.
7 See Chapter 6 on Subsidies and Countervailing Measures.
8 Malaysia – Prohibition of Imports of Polyethylene and Polypropylene (WT/DS1). This complaint had the distinction of being the first dispute under the new WTO dispute settlement system.
(d) Other Exceptions to National Treatment

Exceptions peculiar to national treatment include the exception on screen quotas of 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 detail, see the relevant sections of Chapter 1 (MFN Principle).

(iii) National Treatment Rules Outside of GATT Article III

With the entry into force of the WTO Agreement, the idea of national treatment has been extended, although in a limited fashion, to agreements on goods, services and intellectual property. Among the agreements on goods, for instance, 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 for more information on Trade in Services, Intellectual Property Rights, and Government Procurement.)

(3) Economic Implications

There is a tendency for importing countries to attempt to use discriminatory application of domestic taxes and regulations to protect national production, often as the result of 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 designed to protect domestic products. GATT Article II does permit the use of tariffs as a means of protecting domestic industry, but this is because tariffs have 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, which means that 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, and thus promotes trade liberalization.

In addition, regarding tariff concessions, GATT Article II recognizes tariffs as tools for domestic industrial protection, and having done so, sets a course for the achievement of liberalization through gradual reductions. Even if tariff reductions were made as a result of trade negotiations, 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.

2. PROBLEMS OF TRADE POLICIES AND MEASURES IN INDIVIDUAL COUNTRIES

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 conjunction with other provisions regarding
MFN, quantitative restrictions, TRIMs, and standards and conformity assessment (see Table 2-1). In this Chapter, we take up the United States’ Harbour Maintenance Tax and the Brazilian Automobile Policy, in which national treatment is a major issue. In principle we have left detailed descriptions of other cases to other chapters.

(1) United States

(i) Harbour Maintenance Tax (Harbour Services Fee)

Since 1987, in accordance with the Water Resources Development Act (1986 Public Law 99-662) and related amendments, the United States has operated a system that is designed to impose *ad valorem* taxes of 0.125 percent (0.04 percent until 1990) as to freight (imports and exports and parts of national freight) on persons who own the freight and use harbours within the territory of the United States.

Under this system, imported products are almost inevitably subject to the tax since it is collected at the point of importation, where relevant duties are charged. On the other hand, the tax burden on exports and national freight is comparatively light because ship-owners or exporters voluntarily pay the tax in these circumstances on a quarterly basis. With regard to national freight, exceptions to this system are allowed in the following three cases: (a) payment under ten thousand dollars per quarter, (b) traffic in Alaska, Hawaii and dependencies, and (c) landing of fish from ships, and some freights of Alaskan crude oil. Yet similar exceptions are not allowed for imported products. An annual limit of the above-mentioned *ad valorem* taxes that are to be granted to US military personnel is five hundred million dollars. It is reported that, as of October 1997, a surplus of 1.1 billion dollars has accumulated.

This new system instituted by the United States may be in violation of the WTO Agreement in the following three respects.

(a) GATT Article II (Schedules of Concessions): The system, which adopts the *ad valorem* taxes on import products, imposes a tax that is higher than that prescribed in the schedules of concessions;

(b) GATT Article III (National Treatment): Imported products are accorded less favourable treatment as explained above.

(c) GATT Article VIII (Fees and Formalities Connected with Importation and Exportation): The system is designed to levy charges that are heavier than fees for the maintenance of harbours.

In February 1998, the European Union requested consultations with the United States regarding this system pursuant to GATT Article XXII. Japan has participated in the consultations as a third party.

In October 1995, the US Court of International Trade ruled that the system violated the US Constitution prescribing the prohibition of direct taxation on export products. In June 1997, the Court of Appeals for the Federal Circuit, supporting this decision, ordered the prohibition of these taxes on the maintenance of harbours and the refund of collected taxes (about 1.1 billion dollars). In March 1998, the Supreme Court of the United States also
delivered a similar judgement regarding the unconstitutionality of the tax. In accordance with this decision, the US Government decided not to collect the tax from exporters or exports from 25 April 1998. However, the problems above have not been solved yet.

In May 1995, US Government submitted bill HR 1947 to introduce Harbour Services Fee, which substitute for Harbour Maintenance Tax. The fee will be reserved as Harbour Services Fee in order to expend for not only harbour maintenance but harbour development. However, this bill does not resolve problems of Harbour Maintenance Tax, such as exception measures for American domestic ships, and charges that are heavier than fees for the maintenance of harbours. In addition, there are criticisms that the bill has a character of “tax”, since this fee is charged irrespective of loading and actual substance of harbour services. Moreover, there is also criticism that the bill discriminates against container ships, which are usually foreign ships, and is in favour of non-container ships, which are usually American domestic ships, and imposes a fee about 25 times higher on the former. The bill was scheduled to apply from 1 October 1999, but the consideration of the bill has not been advanced yet.

Hence, we must closely observe the development with respect to this legislation and should make repeated requests to the United States to make the system compatible with the WTO agreements.

(ii) Merchant Shipping Act of 1920 (Jones Act)

This law specifies that only ships owned by US citizens, built in US shipyards, and run by US crews are permitted to engage in domestic passenger and cargo transport within the United States. The measure is conceivably a violation of Article III and XI of the GATT, but the United States has maintained its legality under the provisions concerning provisional application of GATT 1947. During this Uruguay Round negotiations, the United States successfully maintained the exemption of GATT provisions under Paragraph 3 of GATT 1994.

However, Paragraph 3 of GATT 1994 stipulates that the Ministerial Conference shall review this exemption not later than five years after the date of entry into force of the WTO Agreement and thereafter every two years for as long as the exemption is in force for the purpose of examining whether the conditions which created the need for the exemption still prevail.

The WTO General Council began its review in July of last year. The United States argued that the exemption continued to be necessary because there had been no change in domestic law. A large number of Members including Japan take the position that the Council should adopt a restrictive attitude when the exemption are renewed and should review in a strict manner, since the exemptions based on Paragraph 3 of the GATT 1994 are deviations from the basic principles of the GATT. The issue has not yet been resolved, and we will need to continue to monitor the US response (Concerning the maritime services, see Chapter 11 “Service Trade”).

(iii) Section 337 of the Tariff Act of 1930

Section 337 of the Tariff Act of 1930 law targets “unfair practices” by importers, through excluding imports by those importers from US imports, when US industry would have injury from those imports. The US International Trade Commission (ITC) establishes a
“target date” for final determination in each investigation within 45 days of the initiation of an investigation depending on how this law is administered, it could result in discriminatory treatment against imports. (See Chapter 12 “Protection of Intellectual Property”.)

(iv) Foreign Sales Corporations (FSC)

Tax exemptions regarding foreign sales corporations (FSCs) only cover products whose market value is over 50 percent domestic, in violation of the national treatment principle. (See Chapter 6 “Subsidies and Countervailing Measures”.)

(v) Corporate Average Fuel Economy (CAFE) Regulation

This measure requires that the average fuel economy for all models handled by an auto company remain above certain levels, but calculates domestic automobiles and imports as different groups. This is discrimination between like products according to whether they are domestic or foreign. (See Chapter 10 “Standards and Conformity Assessment Systems”.)

(2) India

Local Content Requirements for Automobiles

Local content requirements and import restrictions regarding parts that depend on meeting export performance targets are measures that are conditional upon priority use of domestic products over imports. (See Chapter 8 “Trade-Related Investment Measures”.)

<Box> Brazilian Automobile Policy

The Government of Brazil introduced measures regarding automobiles in the period between June 1995 and December 1995. Investment measures thought to be in violation of the GATT, the TRIMs Agreement, and the Agreement on Subsidies and Countervailing Measures among others were included.

Japan requested consultations with the Brazilian Government under Article XXII of the GATT. Brazil did not offer any specific improvements to its investment incentive measures in the informal and formal consultations that were held during 1996, but in August 21, 1996, it announced, as a unilateral measure, a Presidential Decree on tariff quotas that would give reduced tariff quotas to auto importers who did not enjoy the benefits of the investment incentive measures. Brazil implemented a similar measure in August 1997, September 1998, and September 1999.

Japan has repeatedly urged the government of Brazil to eliminate its investment-related measures as quickly as possible because of the consequent improvement in market access and relaxation of preferences for investing companies.

During consultations, the Government of Brazil indicated that the investment-related measures would be eliminated at the end of 1999, and indeed Brazil in fact eliminated them. Brazil should be praised for its positive attitude in bringing its domestic systems in line with the TRIMs Agreement and other WTO agreements and in fulfilling the promises it made in bilateral consultations.

20
CHAPTER 3 QUANTITATIVE RESTRICTIONS

1. OVERVIEW OF RULES

(1) Quantitative Restrictions

Article XI of the GATT generally prohibits quantitative restrictions on the importation or the exportation of any product, by stating “[n]o prohibitions or restrictions other than duties, taxes or other charges shall be instituted or maintained by any Member...” One reason for this prohibition is that quantitative restrictions are considered to have a greater protective effect than tariff measures and are more likely to distort free trade. When a trading partner uses tariffs to restrict imports, it is still possible to increase exports as long as foreign products become price competitive enough to overcome the barriers created by the tariff. When a trading partner uses quantitative restrictions, however, it is impossible to export in excess of the quota no matter how price competitive foreign products may be. Thus, quantitative restrictions are considered to have such a distortional effect on trade that their prohibition is one of the fundamental principles of the GATT.

However, the GATT provides exceptions to this fundamental principle. These exceptions permit the imposition of quantitative measures under limited conditions and only if they are taken on policy grounds justifiable under the GATT such as critical shortages of foodstuffs (Article XI:2) and balance of payment problems (Article XVIII:B). As long as these exceptions are invoked formally in accordance with GATT provisions, they cannot be criticized as unfair trade measures.

(2) Legal Framework

(i) GATT Provisions Regarding Quantitative Restrictions

Quantitative import and export restrictions against WTO Members are prohibited by Article XI:1 of the GATT. GATT provisions, however, provide some exceptions for quantitative restrictions applied on a limited or temporary basis. The following describes, in detail, quantitative restrictions explicitly provided for in the WTO Agreement.

(a) Exceptions Provided in GATT Article XI

- Export prohibitions or restrictions temporarily applied to prevent or relieve critical shortages of foodstuffs essential to the exporting WTO Members (Paragraph 2 (a));

- Import and export prohibitions or restrictions necessary to the application of standards or regulations for the classification, grading or marketing of commodities in international trade (Paragraph 2 (b)); and

- Import restrictions on any agricultural or fisheries product, necessary to the enforcement of governmental Measures which operate to restrict production of the domestic product or for certain other purposes (Paragraph 2 (c)).
(b) Exceptions Provided in Other Articles

<table>
<thead>
<tr>
<th>Exceptions for Non-Economic Reasons</th>
<th>- General exceptions for measures such as those necessary to protect public morals or protect human, animal or plant life or health (Article XX);</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>- Exceptions for security reasons (Article XXI).</td>
</tr>
<tr>
<td>Exceptions for Economic Reasons</td>
<td>- Restrictions to safeguard the balance of payments (Article XII regarding all WTO Members; Article XVIII:B regarding developing WTO Members in the early stages of economic development);</td>
</tr>
<tr>
<td></td>
<td>- Quantitative restrictions necessary to the development of a particular industry by a WTO Member in the early stages of economic development or in certain other situations (Article XVIII:C, D);</td>
</tr>
</tbody>
</table>
|                                      | - Quantitative restrictions necessary to prevent sudden increases in imports from causing serious injury to domestic producers or to relieve producers who have suffered such injury (Article XIX)
|                                      | - Quantitative restrictions imposed with the authorization of the Dispute Settlement Body as retaliatory measures in the event that the recommendations and rulings of a panel are not implemented within a reasonable period of time (Article XXIII:2); |
|                                      | - Quantitative restrictions imposed pursuant to a specific waiver of obligations granted in exceptional circumstances by the Ministerial Conference. |

(ii) Import Restrictions through Waiver of Obligations

Article XXV:5 of the original GATT (referred to as the “GATT 1947” in the WTO Agreement) permitted a waiver of obligations thereunder with the consent of the other contracting parties. When a waiver was obtained, then the contracting party was allowed to impose import restrictions.

Waivers granted under the GATT 1947 and still in effect when the WTO Agreement became effective could be extended under the WTO Agreement, provided, however, that necessary procedural steps were taken before 31 December 1996. Waivers are also allowed under the WTO Agreement when certain conditions are met as described in Chapter 1 on the MFN Principle.

(iii) Import Restrictions for Balance of Payments Purposes

Under Articles XII or XVIII:B of the GATT, a WTO Member may restrict imports in order to safeguard its balance-of-payments (“BOP”) if the International Monetary Fund (“IMF”) finds that such country is experiencing BOP difficulties (Article XV:2). When a country is designated to be an “IMF Article VIII country,” it is not generally allowed to institute foreign exchange restrictions. Members have rarely been found to be experiencing BOP difficulties.

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9 Quantitative restrictions imposed under the above-mentioned three exceptions should be applied, in principle, in a non-discriminatory manner (Article XIII).
10 See Chapter 1 for discussion of the conditions for waivers under the WTO Agreement.
Figure 3-1 shows recent developments in consultations made in the WTO Committee on Balance-of-Payments Restrictions. While Article XII can be invoked by all Members, Article XVIII:B can be invoked only by Members whose economy can only support low standards of living and is in the early stages of development.

**<Figure 3-1> Consultations in WTO Committee on Balance of Payments Restrictions under Article XII of the GATT**

<table>
<thead>
<tr>
<th>Country</th>
<th>Year of Resort</th>
<th>Most recent Consultation</th>
<th>Measures</th>
<th>Circumstance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Slovak Republic</td>
<td>1999</td>
<td>Sep. 1999</td>
<td>Import surcharge</td>
<td>The measure was introduced in June 1999. In the consultation held in September, the committee found Slovak in conformity with its obligations under Article XII of GATT 1994. The rate of the import surcharge will be gradually reduced, and the surcharge will be abolished in 2001.</td>
</tr>
<tr>
<td>Romania</td>
<td>1998</td>
<td>Feb. 1999</td>
<td>Import surcharge on Most items (the present rate is 4% as of March 1999)</td>
<td>The measure was introduced in October 1998. In the consultation held in February 1999, the committee found Romania in conformity with its obligations under Article XII of GATT 1994. The rate of import surcharge will be gradually reduced and abolished at the end of 2000.</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>1997</td>
<td>Jul. 1997</td>
<td>Import deposit</td>
<td>The import deposit was eliminated and Czech disinvoked Article XII in August 1997.</td>
</tr>
<tr>
<td>Hungary</td>
<td>1995</td>
<td>Sep. 1996</td>
<td>Import surcharge</td>
<td>The rate of import surcharge was gradually lowered and the scheme was eliminated in July 1997.</td>
</tr>
</tbody>
</table>

**Consultations in WTO Committee on Balance of Payments Restrictions under Article XVIII: B of the GATT**

<table>
<thead>
<tr>
<th>Country</th>
<th>Year of Resort</th>
<th>Most recent Consultation</th>
<th>Measures</th>
<th>Circumstance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bangladesh</td>
<td>1962</td>
<td>May. 1997</td>
<td>Import restrictions on Agricultural products</td>
<td>Bangladesh was deemed to have fulfilled its obligations under Article XVIII:B. The committee accepted the request from Bangladesh to adjourn its consultation until May 2000 on account of its economic crisis caused by flood.</td>
</tr>
<tr>
<td>Country</td>
<td>Year of Resort</td>
<td>Most recent Consultation</td>
<td>Measures</td>
<td>Circumstance</td>
</tr>
<tr>
<td>---------</td>
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<td>-------------------------</td>
<td>----------</td>
<td>--------------</td>
</tr>
<tr>
<td>India</td>
<td>1960</td>
<td>Jul. 1997</td>
<td>Import restrictions on More than 2700 Products at eight-digit Level under the HS Classification Including consumer Products, etc.</td>
<td>India proposed in May 1997 a three stage, nine-year phase-out schedule. In July, the United States, Canada, EU, Switzerland, Australia, and New Zealand requested Article XXII consultations. The United States has requested the establishment of a panel (For details see the column, in this chapter.)</td>
</tr>
<tr>
<td>Nigeria</td>
<td>1984</td>
<td>Feb. 1998</td>
<td>Import restrictions on Cereal, Vegetable oils, Wheat flour, Plastic Materials, Minerals, Etc.</td>
<td>Nigeria has proposed a plan to eliminate import restrictions by 2005, but in the last consultations held in February 1998, developed countries requested the immediate abolition of measures and the consultation was suspended.</td>
</tr>
<tr>
<td>Pakistan</td>
<td>1960</td>
<td>Jul. 1997</td>
<td>Import restrictions on Textile goods, etc.</td>
<td>During consultations, Pakistan was deemed to have met the requirements of Article XVIII:B, and it has notified the WTO of import restrictions under the balance-of-payments clause. The committee has requested Pakistan to provide a plan within a year to eliminate the restrictions.</td>
</tr>
<tr>
<td>Philippines</td>
<td>1980</td>
<td>Nov. 1995</td>
<td>Import restrictions on Motor vehicles and parts, Agricultural products, Petroleum products, etc.</td>
<td>The Philippines undertook to disinvoke Article XVIII: B though the liberalization of remaining restrictions by 31 December 1997. Restrictions on agricultural products were lifted in March 1996.</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>1971</td>
<td>Nov. 1995</td>
<td>Import restrictions on Agricultural products</td>
<td>Members questioned the balance of payments justification of remaining restrictions on eight food items and recommended not to have recourse to the provisions of Article XVIII:B. In September 1996, Sri Lanka notified the elimination of restrictions on four tariff lines. Sri Lanka notified the disinvokation of Article XVIII:B in May 1998.</td>
</tr>
<tr>
<td>Tunisia</td>
<td>1967</td>
<td>Jun. 1997</td>
<td>Import restrictions on Automobiles</td>
<td>Agreement was reached at a June 1997 meeting of the Committee on Balance-of-Payments restrictions on a plan to phase-out restrictions on automotive items, Tunisia’s only remaining restrictions, in four stages over three years, with full elimination by July 2000.</td>
</tr>
</tbody>
</table>
Under Articles XII and XVIII:B of the GATT, a Member may exceptionally restrict imports in order to safeguard its balance of payments (“BOP”). However, a lack of well-defined criteria with which to judge whether the country had met the conditions of these articles led to occasional abuse. To correct this, the WTO Agreement has attempted to clarify the conditions for invoking the BOP provisions as summarized below (see the Understanding on Balance-of-Payments Provisions of the General Agreement on Tariffs and Trade 1994 (the “Understanding”)). Among other requirements, countries invoking BOP safeguards must now specify products involved and a timetable for the elimination of measures. Nevertheless, even with the new Agreement, examples that may be considered misuse or abuse of the BOP provisions have already occurred.

On the other hand, the WTO Committee on Balance-of-Payments Restrictions has recently recommended on several occasions that Members invoking BOP provisions should phase out such measures.

< Outline of BOP Understanding >

| Conditions and Procedures | - Restrictive import measures adopted for BOP purposes may only be taken to control the general level of imports and may not exceed to the extent necessary to address the BOP difficulty (Paragraph 4 of the Understanding).  
- Members must announce time-schedules for removing restrictive import measures taken for BOP purposes (Paragraphs 1 and 9).  
- Wherever possible, price-based restrictions are to be preferred to quantitative restrictions, except in times of crisis (Paragraph 3).  
- Cumulative restrictions on the same product are prohibited (Paragraph 3). |
| Committee on Balance-of-Payments Restrictions | - A Member invoking restrictive import measures for BOP purposes shall enter into consultations with the Committee within four months of adopting such measures and consult in accordance with Article XII or XVIII as appropriate (Paragraph 6).  
- The Committee shall report on its consultations to the General Council (Paragraph 13). |

(iii) The Agreement on Agriculture

The Agreement on Agriculture created substantial, binding commitments in three areas: market access (tariffication), domestic supports (reduction in subsidies), and export competition. These commitments are to be implemented over a period of six years from 1995 to 2000. This was accomplished despite the following difficulties: (1) the United States had used price support policies to boost its grain production and exports making itself into “the world’s breadbasket;” (2) the European Union’s Common Agricultural Policy (“CAP”) had used price supports, import levies, and export subsidies, and consequently, transformed the European Union from one of the world’s largest importers of agricultural products to one of its largest exporters; and (3) competition for grain exports has been intensified as the shortages that existed through the mid-seventies turned to surpluses because of changes in the international supply-and-demand balance.
Below is the outline of the final agreement on market access in agriculture. When it takes full effect, countries will be expected to bring their quantitative restrictions on imports into conformity with the WTO Agreement. The integrated dispute settlement procedures of the WTO apply to consultations and dispute settlements under the Agreement on Agriculture.

< Outline of the Agreement on Agriculture >

| Tarification of Non-Tariff Barriers | All non-tariff barriers are to be converted to tariffs using tariff equivalents (tarification), (Article 4.2) and concessions are to be made. Tariffs after conversion are, in principle, to be equal to the difference between import prices and domestic wholesale prices. |
| Reduction in Ordinary Tariffs | Over a period of six years, ordinary tariffs, including tariff equivalents, are to be reduced by the minimum of 36 percent overall and the minimum of 15 percent for each tariff line. |
| Base Period | Domestic and foreign prices for the period 1986-1988 are to serve as indexes used in tariffication. |
| Standards for Establishing Minimum Access Opportunities | Current access opportunities will be maintained for tariffed products. If imports are negligible, a minimum access opportunity of 3 percent of domestic consumption will be provided in the first year, expanding to 5 percent by the end of the implementation period (Article 4.2 and Annex 5). |
| Special Safeguards | Additional tariffs may be imposed as special safeguard measures for tariffed items, as shown below (in the first case tariffs are hiked 30 percent; in the second case, due to a drop of 10-40 percent, tariffs may be hiked by 30 percent for the portion of the drop over 10 percent)(Article 5):

1. Tariffs may be increased by one-third if import volumes exceed the following trigger levels:
   a) where market access opportunities are 10 percent or less, the base trigger level shall be equal to 125 percent;
   b) where market access opportunities are greater than 10 percent but less than or equal to 30 percent or less, the base trigger level shall be equal to 110 percent;
   c) where market access opportunities are greater than 30 percent, the base trigger level shall be equal to 105 percent.
2. If import prices drop more than a certain percentage from the average prices for 1986-1988. |
| Rules on Export Prohibitions and Restrictions | Any Member instituting a new export prohibition or restriction on foodstuffs shall give due consideration to the effects thereof on the importing Member’s food security, notify the Committee on Agriculture, and consult with any other Member having a substantial interest. 11 |

11 Special exceptions (implementation waived for six years) to the tariffication rule are applied to agricultural products that meet several conditions including the three criteria below. The exceptions are conditional upon set increases in minimum access opportunities (improving those of 3 percent and 5 percent, to those of 4 percent and 8 percent). The three criteria for special exceptions are:
(1) imports during the base period (1986-1988) were less than 3 percent of domestic consumption;
(2) export subsidies are not provided, and
(3) effective production limits are in place.

When exceptions are ended during implementation, the annual rate of increase for minimum access is reduced beginning the next year (from 0.8% to 0.4%).
The WTO Committee on Trade and Environment (“CTE”) discussed the relationship between the WTO Agreement and trade measures pursuant to Multilateral Environmental Agreements (“MEAs”) as an issue related to quantitative restrictions.

The GATT generally bans trade restrictions, but allows those which fall under the general exceptions as described in Articles XX(b) (necessary to protect human, animal or plant life or health) and XX(g) (relating to the conservation of exhaustible natural resources), providing such measures are not applied in a manner which would constitute a means of unjustifiable discrimination or disguised restriction. Some GATT panel reports, however, have found that measures taken to protect human, animal or plant life or health, or exhaustible natural resources outside the jurisdiction of a regulatory country are not justified by Articles XX(b) or (g), or that measures taken so as to force other countries to change their policies are not justified by Articles XX(b) or (g) (see 2(1)(i)(a) of this chapter).

Further, some MEAs, such as the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and their Disposal, the Montreal Protocol on Substances that Deplete the Ozone Layer, and the Convention on International Trade in Endangered Species of Wild Fauna and Flora, authorize trade measures which are aimed at protection of the environment outside either member countries’ jurisdiction or the global environment, or which are taken so as to encourage changes in the environmental policy of non-signatories of MEAs. The finding of the past GATT panel reports would seem to indicate that such measures conflict with the WTO Agreement. The Committee has therefore been examining how the WTO compatibility of trade measures taken pursuant to MEAs can be clearly ensured.

One opinion voiced is that Article XX of the GATT (general exceptions) should be amended to be expressly permit exceptional treatment for measures taken for environmental protection. Opposing this is the view that allowing waivers on a case-by-case basis is adequate to address the issue. There has also been a proposal to formulate guidelines for the kind of trade measures pursuant to MEAs that would be considered consistent with the WTO Agreement.

In the CTE’s report to the Singapore Ministerial Conference in December 1996, the CTE noted that there may be cases in which trade measures pursuant to specifically agreed-upon provisions would be necessary to achieve the objectives of MEAs, but it offered no conclusions on how to ensure conformity. Discussions are still going on.

It is the majority’s opinion that unilateral measures for reasons of protecting the environment outside the jurisdiction of one’s own country should be strictly avoided when such measures are not based on MEAs.  

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12 On a related subject, see the discussion in Chapter 10 of the relationship between Eco-labelling schemes and the TBT Agreement, another major subject discussed in the CTE (See Chapter 10 Eco-labelling and TBT for a related discussion).
3) Economic Implications

Because quantitative import restrictions, including *de facto* restrictions and voluntary export restraints by exporting countries, protect particular domestic products from competition with foreign products having a high level of competitiveness, they may be beneficial in the short-term in protecting and increasing profits of the domestic industry producing competing products and maintaining stable employment in that industry. In order to create market access, foreign companies frequently respond to such restrictions by increasing their direct investment in import-restricting countries and by commencing production, which might create jobs and encourage technology transfer. Quantitative restrictions, however, distort the distribution of economic benefits between importing and exporting countries in favour of the producers in the importing country. The restrictions also harm consumers and downstream industries in the importing countries, which have to bear the economic cost of losing access to competitive imported products.

Quantitative restraints impose mid- and long-term costs that clearly outweigh the benefits of protecting domestic industries. For example, quantitative import restrictions may impede efforts of domestic producers to improve productivity or streamline operations in order to survive a tough business environment, depending on the operation of the quantitative restriction. Unless it is clarified that the restrictions are temporary, and appropriate measures are taken to ensure that protected producers acquire sufficient competitiveness, quantitative restrictions could harm the mid- or long- term development of the affected industry and the economic benefits of the country employing such restrictions. Without mid-term plans to eliminate restrictive measures, domestic producers will be unlikely to develop the ability to earn foreign currency through exports, which is the true indication of competitive strength.

The quantitative restrictions leave, at best, an import-substitute effect, and consumers and downstream industries in the importing country also suffer from higher prices and other disadvantages that are the immediate results of import restrictions. Therefore, such measures may cause a negative overall effect on the importing nation’s economy in the mid- or long term.

2. Problems of Trade Policies and Measures in Individual Countries

(1) United States

(a) Import Restrictions on Yellowfin Tuna

To reduce the incidental intake of dolphins by yellowfin tuna fisheries, the United States enacted the Marine Mammal Protection Act in 1972, which bans imports of yellowfin tuna and their processed products from Mexico and other countries where fishing methods result in the incidental intake of dolphins. To prevent circumvention, the United States also demands that similar import restrictions be adopted by third countries importing yellowfin tuna or their processed products from countries subjected to the above import restrictions and prohibits imports of yellowfin tuna and their products from countries which do not comply with this demand. Japan, the European Union, and others have been targeted by the US measures.

The United States contends that the above measures are designed to protect dolphins and are therefore measures “necessary to protect human, animal or plant life or health” (Article XX (b)) and measures “relating to the conservation of exhaustible natural resources”
(Article XX (g)). These measures are thus permissible under the GATT as exceptions to the
general prohibition of quantitative restrictions.

However, a panel established pursuant to the request of Mexico in February 1991 found
in September 1991 that the US measures violate the GATT. (Because Mexico sought
resolution through bilateral negotiations with the United States, the report was not adopted by
the GATT Council.) The panel report concluded that the US measures violate Article XI as
quantitative restrictions and that such restrictions are not justified by Article XX on the
grounds that: (1) the measures may not be a necessary and appropriate means of protecting
dolphins, and (2) allowing countries to apply conservation measures which protect objects
outside their territory and thus to unilaterally determine the necessity of the regulation and its
degree would jeopardize the rights of other countries.

In September 1992, a panel was established again at the behest of the European
Communities and the Netherlands (representing the Dutch Antilles). Its report, issued in May
1994, found US measures to be in violation of the GATT. The report noted that the United
States’ import prohibitions are designed to force policy changes in other countries and indeed
can only be effective if such changes are made. Since these prohibitions are not measures
necessary to protect the life and health of animals exempted by nor primarily aimed at the
conservation of exhaustible natural resources, the report concluded that the US measures are
contrary to Article XI:1, and are not covered by the exceptions in Articles XX:(b) or (g).

The report was submitted to the GATT Council for adoption in July 1994, but the
United States blocked adoption. In reaction to this deadlock situation, the United States and
the governments of countries concerned, such as Latin American countries, have agreed to the
Panama Declaration which adopts restrictive measures pursuant to the annual plan to regulate
the incidental intake of dolphins, as prepared in 1992. In response, the United States enacted
the International Dolphin Conservation Program Act (Public Law No. 105-42) in August 1997,
which would remove the embargo on yellowfin tuna with respect to imports from those
countries that participate in a dolphins conservation programme formulated under the law, if
an enforceable international agreement enters into force to implement the Panama Declaration.
The international agreement that has the legal binding force to carry this out, the International
Dolphin Preservation Agreement, was adopted in February 1998.

Although the United States is considering the lifting of the measures concerned, it
maintains them at present. Japan should continue to watch to ensure that the movement of the
United States closely as consistency with its obligations under the WTO Agreement.

(b) Import Restrictions on Shrimp and Shrimp Products

Under Section 609 of Public Law 101-162 of 1989, the United States began requiring
on 1 May 1991 that shrimp fishers provide a certificate showing that their governments have a
regulatory programme comparable to the United States to protect sea turtles from shrimpers’
 nets. Absent such a certificate, imports of shrimp are banned from countries that allow harvest
methods of shrimp which may be harmful to sea turtles.

The United States initially limited application of the law to fourteen countries in the
Caribbean and Gulf of Mexico region, requesting that these countries use the same kind of
turtle excluder devices as US shrimp trawlers. In accordance with the United States Court of
International Trade (“USCIT”) decision of December 1995 with regard to a lawsuit brought
by a US environmental non-governmental organization called “Earth Island Institute” in 1993, the United States began applying the law to countries all over the world, including Japan, beginning 1 May 1996. A subsequent USCIT ruling allows shrimp to be imported without a certificate if it is raised on fish farms (for more than 30 days), is harvested by methods that do not involve the use of engines, or is cold-water shrimp (from regions where sea turtles do not live). Otherwise, imports were banned without a certificate, regardless of whether excluder devices are used or not.

In response to this US measure, India, Malaysia, Pakistan, and Thailand requested consultations (the Philippines later joined as well), claiming the US measures violate Article XI and are not justified by any of other provisions including Article XX. The first round of consultations was held in November, with Japan participating as a third party. Further, at a DSB meeting held in January 1997, Thailand and Malaysia requested the establishment of a panel, but the United States disagreed. Thailand, Malaysia and Pakistan (India later joined as well) requested again, and the establishment of the panel was decided at the DSB meeting held in February 1997. Japan reserved its rights as a third party.

The panel report issued in May 1998 found that US measures regarding shrimp imports constituted “prohibitions or restrictions” under Article XI:1, and therefore violated Article XI. It also found that measures that attempted to influence the policies of other countries by threatening to undermine the multilateral trading system were not justified even under Article XX. The panel recommended the DSB to request the United States to bring the measures in question into conformity with its obligations under the WTO Agreement.

The United States appealed the decision in July 1998. The Appellate Body did reverse some of the panel’s findings in October, but it also found that the US measures were not justified under Article XX. In November 1998, the DSB adopted the report by the Appellate Body, which recommended that the DSB request the United States to bring its measures into conformity with its obligations under the WTO Agreement. There were some objections during the DSB meeting to the Appellate Body’s interpretation of Article XX, because it left room for the extraterritorial application of domestic measures, but the meeting adopted the report nonetheless. It is expected that the United States will modify its shrimp import regime so that the measures in question are consistent with its obligations under the WTO Agreement, and we will continue to watch to ensure that this is done.

(c) Export Restrictions on Logs

To conserve spotted owls’ habitat, the United States regulated the cutting of forests. This in turn, reduced the supply on the domestic logs market. In response, the United States imposed a permanent ban on exports of logs cut from federally owned forests and implemented export restrictions on logs cut from state-owned forests. From the beginning, the Forest Resource Conservation and Shortage Relief Act of 1990, which took effect in August 1990, regulated the export volume of state logs as follows:

A. States selling not more than 400 million board feet a year are permanently banned from exporting logs cut from state-owned forests.

B. States selling more than 400 million board feet a year are, without exception, banned from exporting three-quarters of all logs cut from state-owned forests.
The sole state satisfying the requirements stated in B above is the State of Washington, thus only 25 percent of the logs cut from its state-owned forests were allowed for export. Nevertheless, domestic lumber mills strongly requested to be allowed to maintain or even increase the supply of logs cut from state-owned forests in order to achieve job security and other objectives. In September 1992, the Secretary of Commerce published a notice that totally banned the export of logs cut from state-owned forests from October of that year until the end of 1993.

Further, the Forest Resource Conservation and Shortage Relief Act was amended in June 1993 to totally ban exports from states satisfying the conditions of B above until the end of 1995 and to ban exports from states selling more than the lesser of 400 million board feet or their annual sales in January 1996.

Nevertheless, the Balanced Budget Downpayment Act enacted in January 1996 and the later Omnibus Consolidated Rescissions and Appropriations Act of 1996 enacted in April extended the total ban until October 1996. In October 1996, the Omnibus Consolidated Appropriations Act of 1997 further extended the terms of the ban until October 1997, which was followed by the public notice of the Department of Commerce in November 1996 that formally extended it one year. Since the amendment of this act in November 1997, the export of logs from forests west of 100 degrees west longitude was permanently banned.

The United States contends that its measures are implemented to protect spotted owls and related forest resources and to relieve the resultant shortage of lumber. It reasoned that the restrictions are permissible “to protect human, animal, or plant life or health” (Article XX (b)) as well as to relieve a shortage of products consumed domestically (Article XI:2(a) and Article XX (j)), both of which exempt certain quantitative restrictions from their ban.

It is unlikely that the above measures are necessary or appropriate to protect the spotted owls’ habitat nor to relieve the shortage of products in the domestic market. Conservation of spotted owls should be accomplished by restrictions on the cutting of forests rather than export restrictions of logs. Although the Government imposes restrictions on log exports, it allows domestic sales of logs without any restriction and promotes exports of lumber. Thus, these restrictions should be characterized as quantitative restrictions implemented to protect domestic lumber mills, and as a violation of Article XI that cannot be justified by Article XX. Japan should continue to request that these measures should be brought into conformity with the WTO Agreement.

(d) **Helms-Burton Law (the “Cuban Liberty and Democratic Solidarity Act”)**

The US Cuban Liberty and Democratic Solidarity Act bans import of Cuban products and products with Cuban content from third countries. For further discussion, refer to the relevant discussion in Chapter 14.

(2) **Korea**

In an effort to reduce its trade deficit with Japan, Korea instituted in 1980 a source diversification system for specific imports, as amended by Article 25 of the Executive Order of Korea’s Foreign Trade Law of 1987. Article 14(2) of this law authorized the Minister of Trade, Industry and Energy to approve exports and imports of certain products designated in accordance with standards set forth in a presidential order for the purpose of balancing trade
with countries. Under this system, the approval of the Association of Foreign Trading Agents of Korea was required for imports of products exported by the country that had the largest trade surplus with Korea for the last five years (Notice of Ministry of Trade, Industry and Energy Proclamation on Import Source Diversification Article 2). This approval was not normally given, thereby functioning as a *de facto* import ban. This measure violated Article XI, which prohibits quantitative restrictions.

In 1994, the system covered 258 items. It has been gradually scaled back since then, and at the end of May 1999 the last of the items were removed from the list, and the system itself was abolished. We believe that the abolition of this system contributes toward the development of free trade, since it constitutes the elimination of a measure that was inconsistent with the WTO and was an impediment to trade between Japan and Korea.

(3) Indonesia

(a) Quantitative Import Restrictions

Indonesia has maintained an import ban and quantitative restrictions on a variety of items for the protection of domestic industries; for example, an import ban on automobiles and motorbikes, and import quotas on commercial vehicles. Recent deregulation has caused a year-by-year decrease in the number of covered items. Under the terms of the Minister of Commerce Ordinance No.133 (June 1996), however, Indonesia still places import restrictions on 197 items (HS 9-digit basis, 203 items at the previous proclamation).

It is welcomed that restrictions for the protection of domestic industry have been eased substantially since 1986 through the elimination or curtailment of central buying. However, prohibitive high tariff barriers remain on automobile imports, and further bans or restrictions on other residual items cannot be justified by the invocation of exceptions, such as the balance of payment provisions, and are therefore likely incompatible with Article XI.

Exclusive import rights to these products are given to sole agents designated by the Government of Indonesia and to a quasi-public corporation, PERSERO. The system is administered through central buying systems, and administrative guidance given to the above organizations.

In January 1998, Indonesia announced that it has agreed with IMF to abolish, by 2003, restrictions on imports of ships and the other restrictions except for those consistent with the GATT on health, safety, environment, and national security grounds.

(b) Export Restrictions on Logs and Lumber Products

In January 1998, the Government of Indonesia, under an IMF agreement, announced that it would be switching from a specific duty on the export of logs and lumber products (calculated according to volume) to an *ad valorem* (calculated according to price) and would reduce the duty to 10 percent in March. It was, however, late in implementing this measure, and in April reached a second agreement with the IMF that contained a specific schedule for reducing the export duty (to 30 percent by 22 April 1998, to 20 percent by the end of December 1998, to 15 percent by the end of December 1999, and to 10 percent by the end of December 2000) and also set export quotas for logs and lumber products, as well as additional export regulations.
Under these regulations, the *ad valorem* values are calculated based on standard export prices, which themselves are determined by the government according to methods that remain opaque. The setting of export quotas for logs and lumber products is also likely to be in violation of Article XI, which prohibits restrictions on product exports. Japan should request that these measures should be brought into conformity with the WTO Agreement.

(4) Thailand

Thailand imposes import restrictions under Article 5 and other provisions of the Export and Import Act of 1979. Restrictions are provided not only to protect national security, public order and morality, but also for the economic purpose of protecting domestic industries. Specific items are prescribed by Royal Decrees or Notifications of the Ministry of Commerce, with slight changes in the number of restricted items from year to year. The 1995 list of items requiring import licenses, prepared by the Ministry of Commerce, includes forty-three items (classification is not according to the HTS system but according to the Ministry classification). However, in line with the Uruguay Round Agreement, the cabinet approved an import liberalization policy for agricultural products on 20 December 1994, which has introduced a tariff quota system for twenty-three agricultural, forestry, and fishing products before the end of 1995, and import restrictions have accordingly been lifted at this time. Even still, restrictions remain in place for twenty items, including machinery, electrical equipment, and used automobiles, about 30 percent of which are for the protection of domestic industries. These measures taken for such purpose are likely to constitute violations of Article XI since they have not been justified under any exception such as the balance of payment provisions.

(5) Canada

(a) Export Restrictions on Logs

Since 1906, the Province of British Columbia has limited exports of logs and chips, except for surplus stockpiles, in order to protect domestic industries. In 1986, the Province banned exports of high-quality Douglas fir, spruce, and red cedar that do not have permission by the Provincial Secretary of Forestry regardless of whether or not they were in surplus. Quantitative restrictions designed to protect the domestic industry, it is highly likely that they violate Article XI. Although these measures are implemented by a provincial government not directly committed to obligations under the WTO Agreements, the Canadian Government must “take such reasonable measures as may be available to it to ensure observance of the provisions”, pursuant to Article XXIV:12. Japan should continue to request the Government of Canada to take reasonable measures to ensure the WTO consistency of these measures by the local government.

(b) US-Canada Soft Wood Lumber Pact

The United States argued before a GATT panel and the US-Canada Free Trade Agreement panel, that cheap logging fees for forests owned by Canadian provincial governments constitute a government subsidy which makes the price of coniferous products imported into the United States unreasonably low and damages the US industry, but lost both cases because of insufficient evidence. Unsatisfied with these results, the United States pursued the issue through bilateral negotiations, reaching a formal agreement in May 1996.
Under the agreement, the Canadian federal government will levy an export tax on lumber companies for any exports from British Columbia, Alberta, Ontario, or Quebec in excess of a set volume (14.7 billion board feet, or about 35 million cubic meters). The term of the agreement is for five years beginning 1 April 1996, during which US lumber producers agree that the government of the United States will take no trade-restrictive measures against Canada.

The measure will expire at the end of March 2001, and the United States and Canada have initiated discussion whether to renew the pact. Canada has been arguing for elimination, but the final outcome is still not clear. The United States is not adamant about extension, but it wants changes in provincial lumber sales methods and logging fees. Full-fledged bilateral negotiations are yet to get under way.

The purpose of this measure, however, is clearly to protect the United States lumber industry and as such it probably constitutes an export restriction that is prohibited under Article 11.1(b) of the Agreement on Safeguards.

(6) Malaysia

(a) Import Restrictions under the Customs Act

Under the terms of tariff orders and other provisions of Article 31 of the Customs Act of 1967, Malaysia restricts imports of four classes of products: 1) products subject to a total import ban (fifteen items including multicolour copy machines and weapons); 2) products which may be imported under certain conditions (thirty-eight items including magnetic video cassette tapes and complete vehicles), supposedly for the protection of a domestic industry; 3) products subject to temporary import restrictions in order to protect a domestic industry (fifteen items including cement and plastics raw material); and 4) products which are subject to conditions as to the manner of importation and procedures requiring quality and safety certifications from competent authorities in Malaysia or the exporting country (forty items including fertilizers and home electronic appliances). Such import restrictions may be in violation of Article XI since they cannot be justified under any GATT exception, such as restrictions necessary to safeguard the balance of payments.

(b) Export Restrictions on Logs

The Malaysian Government, with a view to increasing domestic timber processing in its territory, initiated an export ban on logs of ten species from the Malay Peninsula in 1972 and, since then, has strengthened the ban from time to time, culminating in the prohibition of exports of all logs except for small size wood in 1985. Since January 1993, similar bans on exports had been imposed on a temporary basis in the State of Sabah, which had its own forest industry policy. Sabah’s ban on exports changed to an annual export quota of two million cubic meters in November 1996 because the state’s finances had deteriorated and it needed the tax revenues that log exports generate. The export duty had been reduced to 15 percent as of the end of December 1999. The State of Sarawak also has been implementing export quotas so as to set aside a certain share of logs produced in its territory for domestic processing. These measures are highly likely to violate Article XI. Japan should continue to request that these measures be brought into conformity with the WTO Agreement.
Malaysian Export Promotion/Import Reduction Programme

1. Outline of Programme

   The Government of Malaysia announced in its October 1998 budget speech that it will take various measures, such as the increase of tariffs, as a part of an “Export Promotion/Import Reduction Programme” in response to the currency crisis in ASEAN countries. Set forth below are relevant points of the programme.

   (a) All imports of heavy machinery for the construction sector will require permission from the Ministry of International Trade and Industry. Permission will only be given if such machinery is not available domestically (as of 18 October 1997).

   (b) Tariffs will be significantly increased on such products as automobiles and automobile parts, construction material (paints, cement, steel materials, etc.), consumer durables (pottery, refrigerators, cleaners, microwave ovens, etc.), and heavy machinery (cranes, etc.) (as of 18 October 1997).

   
<table>
<thead>
<tr>
<th>Product</th>
<th>Tariff Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Automobiles</td>
<td>170% -&gt; 200%, 50% -&gt; 150%, 35% -&gt; 100%, etc.</td>
</tr>
<tr>
<td>Construction material</td>
<td>25% -&gt; 30%</td>
</tr>
<tr>
<td>Consumer durables</td>
<td>25% -&gt; 30%</td>
</tr>
</tbody>
</table>

   (c) Tariffs will be increased in practice by changing the calculation method regarding Licensed Manufacturing Warehouses and Free Industrial Zones (changing from either an input/component basis or a finished goods basis to only a finished goods basis) (as of 18 October 1997). However, the amendments to this measure, as enacted at the end of January 1998, and retroactively made effective as of 18 October 1997, have lessened the impact on enterprises.

   (d) For the manufacturing sector, companies exporting goods with domestic value-added at or above 30 percent or at or above 50 percent will be given, respectively, a 10 percent or 15 percent income tax exemption. In the agricultural sector and the service sector, such as health, education, and professional services, companies exporting will be given an income tax exemption of 10 percent of the increase in the export value (as of 1 January 1998).

   (e) Expenditure incurred on advertising local brands will be given a preferential tax deduction (as of 1 January 1998).

2. Assessment of the Above Measures

   (a) Regarding the import restrictions on heavy machinery for the construction sector, prohibiting imports of products that are produced domestically is an import restriction that may be in violation of Article XI.

   (b) and (c) If the tariff increases are within the bound rate, these measures are WTO-consistent, but there is still concern regarding negative effects on trade (for details, see Chapter 4 on Tariffs).
These measures are considered to be prohibited subsidies in violation of the Agreement on Subsidies and Countervailing Measures. They are further inconsistent with the standstill provision under the Agreement (for details, see Chapter 6 on Subsidies and Countervailing Measures).

These measures discriminate between foreign brands and local brands, and may well violate Article 3 of the TRIPS Agreement. They may also violate Article III since they provide preferential treatment to some domestic products (for details, see Chapter 12 on Intellectual Property).

< Box-3 > Import Restrictions by India for Balance of Payments (BOP) Reasons

1. India has been invoking Article XVIII balance of payment provisions to restrict a broad range of more than 3,300 items (mainly consumer goods) since 1960. The initial list had 2,714 items, but was gradually pared down to 1,429. There are several problems with these restrictions:

(1) Although trade restrictions taken for balance of payment reasons are supposed to be temporary measures, these restrictions have been in place since 1960.

(2) The restrictions cover an enormously broad range of items, most of which are consumer goods, which suggests that they are taken not for balance of payments reasons, but to achieve industrial policy objectives (according to paragraph 4 of Understanding on the Balance-of-Payments Provisions of the General Agreement on Tariffs and Trade 1994, restrictive import measures taken for balance of payments purposes may only be applied to control the general level of imports).

(3) The administration of licenses for the importation of restricted goods lacks transparency and the nature of the trade restrictions is unclear. In a complaint about these Indian restrictions, countries cited Article I (the rules and import licensing procedures shall be neutral in application and administered in a fair and equitable manner; EU), and Article III (prohibition of non-automatic import licensing procedures which shall have trade-restrictive and/or distortive effects on imports additional to those caused by the imposition of the restriction; United States, Canada, EU, Australia, New Zealand, Switzerland) of the Agreement on Import Licensing Procedures.

(4) There are a plethora of special licensing systems that give exporting companies priority access to import licenses. Not only are these systems used as if they were export subsidies, but special import licenses are in fact hard to use because there is often no one to resell them to.

2. The Committee on Balance-of-Payments Restrictions held a review of India’s import restrictions on 21 January 1997. At the review the IMF reported that India’s foreign currency reserves were not in a state that would justify quantitative restrictions nor was there any threat of a serious decline. It therefore recommended that quantitative restrictions be eliminated within a short period.
The Committee on Balance-of-Payments Restrictions subsequently invited the Government of India to present a plan for eliminating the measures taken for balance of payments reasons and decided to continue the discussion of a phase-out plan. A discussion of the phase-out plan was scheduled for June 1997. In May 1997, India proposed a three-stage and nine-year phase-out schedule. That plan was unsatisfactory to some developed countries. After that, these countries had negotiations with India, but did not reach agreement. United States, EU, Canada, Switzerland, Australia and New Zealand requested consultations in July 1997. Japan joined these consultations as a third party and in parallel, held bilateral negotiations with India. As a result, each country, except the United States, reached agreement on the phase-out plan with India. The phase-out plan, with which Japan agreed, is a three-stage six-year phase out schedule (the first stage-three years, the second stage-two years, the third stage-one year). The phase-out period of Japan’s interested items were shortened in comparison with that proposed in May 1997 by India (items which moved to the first stage: ITA products, electric products, watches, cosmetics, and some textile and clothing; the items which moved to the second stage: some cosmetic, and some automobiles, the remaining textile and clothing).

According to this agreement, India’s import restrictions under Article XVIII will be abolished (including the system of Special Import License under Article XVIII ), but regarding India’s export and import policy, some problems under the TRIMs Agreement remain (see Chapter 8 on Trade-Related Investment Measures).

The negotiations between India and the United States did not reach agreement and a panel was established by the DSB in November 1997. India argued that BOP measures could not be disputed in panel proceedings, but only in the Article XVIII:B review. The panel report (adopted April 1999) found in favour of the US, noting that panels did have authority to review BOP measures and determining India's BOP measures to be in contravention of the WTO Agreement. India appealed, but the report of the Appellate Body (adopted in August) supported the panel's findings. The Appellate Body did, however, propose to give India 15 months longer than usual to comply with the recommendations. The US opposed the compliance period, claiming it was too long. But in December 1999 the United States and India reached an agreement that would reduce the remaining 1,429 restricted items (December 1999) to 714 by 1 April, 2000 and eliminate all restricted items by 1 April, 2001. This agreement between the two governments will be applied equally to all other members, including Japan, under the MFN principle.

3. In October 1998, the EU requested consultations with India regarding import restrictions that India had put in place under Articles XX and XXI. The purpose of these consultations was to clarify the consistency with Articles XX and XXI of import restrictions concerning the EU priorities items on the import restrictions list submitted by India to the Committee on Balance-of-Payments Restrictions in 1997. Japan participated as a third party in the India-EU consultations held in December 1998.
CHAPTER 4  TARIFFS

1. **OVERVIEW OF RULES**

(1) **Background: Tariffs**

Tariffs are the most common kind of barrier to trade; indeed, one of the purposes of the WTO is to enable Member countries to negotiate mutual tariff reductions. Before we consider the legal framework that provides the discipline regarding tariffs, we must understand the definition of tariffs, their functions, and their component elements (rates, classifications, and valuations).

(a) **Definition of “Tariff”**

A tariff is a tax imposed on the import or export of goods.\(^{13}\) In general parlance, however, a tariff refers to “import duties” charged at the time goods are imported.\(^{14}\)

(b) **Functions of Tariffs**

Tariffs have three primary functions: to serve as a source of revenue, to protect domestic industries, and to remedy trade distortions (punitive function).

The revenue function comes from the fact that the income from tariffs provides governments with a source of funding. In the past, the revenue function was indeed one of the major reasons for applying tariffs, but economic development and the creation of systematic domestic tax codes have reduced its importance in the developed countries. For example, Japan generates about 90 billion yen in tariff revenue, but this is only 1.7 percent of total tax revenues (fiscal 1996). In some developing countries, however, revenue may still be an important tariff function.

Tariffs is also a policy tool to protect domestic industries by changing the conditions under which goods compete in such a way that competitive imports are placed at a disadvantage. In point of fact, a cursory examination of the tariff rates employed by different countries does seem to indicate that they reflect, to a considerable extent, the competitiveness of domestic industries. In some cases, “tariff quotas” are used to strike a balance between market access and the protection of domestic industry. Tariff quotas work by assigning low or no duties to imports up to a certain volume (primary duties) and then higher rates (secondary duties) to any imports that exceed that level.

The WTO bans in principle the use of quantitative restrictions as a means of protecting domestic industries, but does allow tariffs to be used for this purpose.\(^{15}\) The cost of protecting

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\(^{13}\) With regard to the scope of general MFN treatment, GATT Article I prescribes that MFN treatment includes “customs duties and charges of any kind imposed on or in connection with importation or exportation . . . .” and thus it deals with not only tariffs on importation but also those on exportation.

\(^{14}\) Article 3 of Japan’s Customs Tariff Law defines a tariff as “a tax based on the standard of assessment of prices or volume of imported goods,” explicitly limiting tariffs to import cargo.

\(^{15}\) GATT Article XI prescribes that “No prohibitions or restrictions other than duties, taxes or other charges, . . . shall be instituted or maintained by any Member”, and therefore it clearly bans quantitative restrictions while leaving the door open for tariffs.
domestic industry comes in the form of a general reduction in the protecting country’s
economic welfare and in the welfare of the world economy at large, but tariffs are still
considered to be more desirable than quantitative restrictions. (See Heading “(c) Tariff Rates”
below.)

Punitive tariffs may be used to remedy trade distortions resulting from measures
adopted by other countries. For example, the Antidumping Agreement allows countries to use
“antidumping-duties” to remedy proven cases of injurious dumping; similarly, the Subsidies
Agreement allows countries to impose countervailing duties when an exporting country
provides its manufacturers with subsidies that, while not specifically banned, nonetheless
damage the domestic industry of an importing country. (See Chapters 5 and 6 for further
discussion.)

(c) Tariff Rates

Obviously, one of the most important components in tariff measures is the rate at which
the tariff is imposed. As noted in the discussion of the three functions of tariffs, any
imposition of a tariff has the potential to reduce the welfare of the world economy as a whole.
Since 1947, the GATT has been the standard bearer in an on-going process of reducing tariff
levels. During tariff negotiations (known as “rounds,” the most recent of which was the
“Uruguay Round”), countries set ceilings on their tariff rates. This is known as the “bound
rate” and refers to the highest allowable rate, in contrast to the rate that is actually applied,
which is referred to as the “effective rate.” The GATT has been successful in encouraging
mutual reduction of these rates. Since the conclusion of the Uruguay Round, there have been
further efforts to reduce tariffs in specific sectors. For examples, the Information Technology
Agreement “ITA” successfully removed tariff barriers to information equipment and
technology, and the EVSL / ATL Initiative has been discussed in APEC.

The Uruguay Round resulted in a final average bound rate for industrial goods
(weighted average by trade volume) of 1.5 percent in Japan, 3.6 percent in the United States,
3.6 percent in the EU, and 4.8 percent in Canada. Japanese tariff rates are thus comparatively
low.

<Figure 4-1> Average Tariff Rates

<table>
<thead>
<tr>
<th>All products:</th>
<th>Japan</th>
<th>U.S</th>
<th>EC</th>
<th>Canada</th>
</tr>
</thead>
<tbody>
<tr>
<td>Simple average bound rate (1999)</td>
<td>4.8%</td>
<td>3.8%</td>
<td>7.2%</td>
<td>5.0%</td>
</tr>
<tr>
<td>Import-weighted average applied rate (1999)</td>
<td>1.5%</td>
<td>3.6%</td>
<td>3.6%</td>
<td>4.8%</td>
</tr>
</tbody>
</table>

Note: 1. The products coverage of the industrial sector covers all goods except for the products coverage of the
Agreement on Agriculture. The industrial sector covers forestry and fishery products.
2. Japanese figure on industrial products based on Ministry of International Trade and Industry Calculation
(excluding petroleum and forestry and fishery products). Japanese figure on the industrial sector including
forestry and fishery products is 1.7.
<Box-1> The Information Technology Agreement “ITA”

During the WTO Ministerial Meetings held in Singapore in December 1996, 29 countries and customs territories reached a basic agreement to eliminate tariffs on information technology products by 2000. Two conditions had to be met by 1 April 1997 in order for the agreement to take effect:

1. Notification of acceptance by countries that account for about 90 percent of the world’s trade in information technology.

2. An agreement among signatories on a “staging” schedule that will ultimately result in the elimination of tariffs.

A review meeting was held in March 1997, confirming that the conditions had been met and formally deciding that the ITA would take effect, and participating members started to reduce tariffs from June 1997.

The ITA covers semiconductors, semiconductor fabrication equipment, computers, telecommunications equipment, and other information technology products. In principle, it will eliminate all tariffs on these items by January 2000. However, some countries have been granted exceptions that will enable them to retain tariffs on some items after 2000.

As of December 1999, there were fifty-one countries and customs territories that had joined the ITA, accounting for a combined 93 percent of the world trade in information technology. The ITA will take on increasing importance in information technology industries.

A new initiative, commonly known as ITA II, is now in progress. The WTO is studying the potential for expanding the range of items covered and tackling non-tariff measures (for example, standards and certification), but as yet no agreement has been reached.

<Box-2> EVSL / ATL

EVSL stands for “Early Voluntary Sectoral Liberalization,” an initiative taken by APEC during the 1997 Ministerial Meeting in Vancouver. The program identifies fifteen sectors for liberalization by APEC members. This initiative includes tariffs, non-tariff measures, and economic and technical cooperation. APEC further divides these fifteen sectors into nine sectors for priority discussions and six other sectors.

Nine priority sectors (for tariffs, eight sectors because the telecomm sector is omitted):

- Environmental goods and services
- Energy sector
- Toys
- Gems and jewellery
- Medical equipment and instruments
- Chemicals
- Fish and fish products
- Forest products
- Telecommunications mutual recognition arrangement (MRA)

Six other sectors (for tariffs, five sectors because the automobile sector is omitted):

- Oilseeds and oilseed products
- Food sector
- Natural and synthetic rubber
- Fertilizers
- Civil
APEC members have initiated a WTO tariff process in the nine priority sectors, attempting, as stated in the Ministerial Declaration from the Kuala Lumpur meetings, to form a critical mass within the WTO so that agreement can be reached during 1999. This WTO process is called an ATL, or Accelerated Tariff Liberalization, in order to clarify that it is a tariff initiative. The September 1999 APEC Ministerial Meeting in Auckland agreed that the members would continue to work towards agreement on the ATL during 2000 if agreement could not be reached during 1999.

During the third WTO Ministerial Meeting, which was held in Seattle between November 30 and December 3, 1999, the United States, Canada, Australia, New Zealand and others argued for agreement on the ATL, but encountered strong opposition from the European Union, Brazil, India, and other non-APEC members. Japan's position is that the industrial tariffs should be negotiated comprehensively in the WTO next round, this ATL process therefore should not prejudice this position.

The Auckland Trade Ministers Declaration of June 1999 states that the remaining six sectors should be handled as part of the agricultural and industrial goods tariffs negotiations during the WTO next round.

**<Box-3> Expansion of market access for least developed-countries**

During the Lyon Summit of June 1996, Renato Ruggiero, then Director-General of the WTO, advocated a tariff waiver program for the least-developed countries. Subsequent summits have also advanced declarations calling for studies of potential ways to improve the least-developed countries’ access to markets.

During the Third WTO Ministerial Meeting, held in Seattle from November 30 to December 3, 1999, Japan and the EU proposed an initiative that would energize least developed countries exports, building on economic development and technical cooperation to ensure faithful implementation of the WTO agreement. This initiative consists of: 1) enhanced market access by extending and implementing tariff-free and quota-free treatment via their respective preferential system for essentially all products originating in least developed countries, and 2) enhanced technical cooperation through the WTO.

**d) Tariff Classifications**

Like tariff rates, tariff classifications represent one of the basic components of the tariff system. National tariffs are organized in the form of tables that consist of “tariff classification numbers” assigned to goods, and a corresponding tariff rate. The way in which an item is classified for tariff purposes will have an important and palpable effect on the duties charged. When classifications are applied in an arbitrary fashion, they can in effect nullify rate reductions.

The GATT contains no rules regarding tariff classifications. In the past, countries had their own individual systems. However, as trade expanded countries recognized the need for more uniform classifications, which resulted in the drafting in 1988 of the “Harmonized Commodity Description and Coding System” or “HS” system at Customs Co-operation Council (CCC; also known as the “World Customs Organization” or “WCO”). Today, most
countries use a harmonized system of six-digit tariff numbers.

(e) Valuation

The final component in tariffs is the valuation of goods for tariff purposes. When countries assign arbitrary values for tariff purposes, they render tariff rates meaningless. GATT Article VII and the “Agreement on Implementation of Article VII” (Customs Valuation Agreement) define international rules for valuation.\textsuperscript{16}

Under Article 20 of the Custom Valuation Agreement and so on, developing country Members may delay application of the this agreement for the particular period if other members approved. As of January 2000, some forty members have delayed implementation.

(2) Legal Framework

The WTO bans, in principle, all quantitative restrictions, but allows for the imposition of tariffs. It then attempts to reduce the barrier posed by tariffs in “tariff negotiations” among member countries, whereby they agree to “bind” themselves to maximum rates ("bound rates") for individual items (in principle following the tariff classification nomenclature) and negotiate for their progressive reduction.

(a) GATT Disciplines

GATT Article II obligates Member countries to apply tariff rates that are no higher than their bound rates. GATT Article XXVIII specifies that when Members wish to raise their bound rates or withdraw tariff concessions, they must negotiate and reach agreements with other Members with whom they had initially negotiated and enter into consultations with major supplying countries that have a substantial interest in any change in the bound rate.

(b) Disciplines on Tariff Classifications

Article 3.1 of the International Convention on the Harmonized Commodity Description and Coding System “HS Convention” stipulates that the signatories “shall not modify the scope of the sections, chapters, headings, or subheadings of the Harmonized System.” This is done in order to maintain uniform administration of the HS. The HS classifications are reviewed on a regular basis so as to keep pace with technological development. If, as a result of these reviews, the classification of a good changes in such a way as to raise its bound rate, countries must enter into negotiations under the terms of GATT Article XXVIII.

(c) The Importance of “Binding”

It should be obvious from the discussion so far that there are no problems in terms of WTO rules in setting high bound rates or in not agreeing to be bound at all. The WTO rules therefore allow countries to raise effective tariff rates within the scope of their bound rates, and to raise tariff rates at will for non-bound items. Regardless of whether it is permitted by

\textsuperscript{16} The Customs Valuation Agreement states that “the primary basis for customs value under this Agreement is “transaction value” as defined in Article 1...together with Article 8...adjustments.” This is an explicit affirmation that the price actually paid is to be used as the basis for customs valuation. Article 2 of the Agreement provides for the transaction prices of similar goods to be used in exceptional cases.
the rules, however, a sudden hike in tariff rates will obviously have a detrimental impact on trade.

Nevertheless, not binding tariff rates also runs against the sprit of the WTO, which is based on the idea of using “binding” to reduce tariffs. From this perspective, the importance of binding must be emphasized. As a result of the Uruguay Round, the percentage of industrial products subject to bound rates in Japan, the United States, the EU, and Canada (total value of imports subject to bound tariffs divided by total value of imports) is now about 100 percent. The percentage of other countries and regions is somewhat lower, or in some cases substantially lower: Korea (89 percent), Indonesia (92 percent), Thailand (70 percent), Malaysia (79 percent), Singapore (73 percent), and Hong Kong (23 percent).

(3) Economic Implications

This section analyses some of the basic economic issues associated with tariffs, specifically, why they are preferable to quantitative restrictions, and why it is desirable that they be reduced. This section then considers the importance of international tariff-reduction negotiations at the WTO.

(a) The Effect of Tariffs

The most basic effect that an import tariff has is to raise domestic prices in the country imposing the tariff. In “small countries” (defined for our purposes as countries that do not have an influence on international prices), the rise in domestic price is equivalent to the amount of the tariff. In “large countries” (those that have an impact on international prices), the price rises somewhat less than the amount of the tariff because part of the tariff is reflected in a reduction in international prices.

A tariff-induced price rise creates a gap between prices in the importing and exporting countries. This in turn causes supplies (production) to rise in the importing country, while demand (consumption) falls, which is the essence of the “industrial protection” function of tariffs. Obviously, a tariff also generates revenues for the government of the importing country (revenue function). Tariffs therefore benefit the government and producers of the importing country in the form of tax revenues at the expense of its consumers in the form of higher prices.

Because tariffs bring different benefits and costs to different groups, the net cost to the importing country is the “cost to consumers minus profits to producers minus government revenues.” This is equal to the sum of the “efficiency loss” caused by distortions to the pricing system and the “profits from improved terms of trade” brought by a reduction in international prices.

Therefore, for “small countries” which see no improvement in their terms of trade because their tariffs have no influence on international prices, the benefits from a tariff will necessarily be negative. However, for “large countries” that can expect an improvement in terms of trade because part of the tariff will lead to a reduction in international prices, the pros and cons are not so easily weighted. Economists sometimes refer to “optimal tariffs” that are

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17 In point of fact, it is difficult to gauge the net effect of tariffs in any strict sense because different people will assign different values to the same profits in absolute terms. We will therefore forgo further discussion here. We should note, however, that this point becomes important in real-world discussions, and thus we consider “weighted social welfare” later in this chapter.
low enough for the improvement in the terms of trade to exceed the costs, thereby maximizing economic welfare.

The degree of protection afforded by a tariff (the effective protection rate) is not equal to the tariff rate. The first reason for this is because of the potential influence from an improvement in the terms of trade. The second reason is that the effective protection rate will differ depending on which stage of the production process the tariff is applied (tariffs on parts or tariffs on finished goods).\(^\text{18}\) We must therefore point out that even a relatively low tariff rate can function adequately as a means of protecting domestic industry.

(b) The Effect of Quantitative Restrictions

Quantitative restrictions take many forms, the most common of which is import quotas. The effect of quotas is the same as that of import tariffs—reduction of amount of imported goods and higher domestic prices for those goods.

Quotas differ from tariffs because the importing country’s government gains no revenue from quotas while importers to whom the quotas are allocated obtain excessive profits (“rents”) from them. The cost of quotas to importing country governments is therefore higher than the cost of tariffs. Moreover, when there is a monopoly in the domestic market, and domestic demand is increasing due to economic growth, an import quota results in higher domestic prices than an import tariff that achieves the same import volume.

(c) Why Tariffs are Preferable to Quantitative Restrictions

As we have noted, the WTO Agreement bans in principle all quantitative restrictions while permitting tariffs to be used to protect domestic industries. One of the reasons for this is because it is easier to negotiate tariffs down than it is to negotiate a reduction in quantitative restrictions in all their many forms. Tariffs are also preferable from an economic standpoint because unlike quantitative restrictions, tariffs have a revenue generating function and less of a distorting effect on markets where monopolies exist. In addition, import quotas may not always be administered fairly. Finally, exporters can respond to tariffs by improving their efficiency.

(d) Justifications for Tariff Reductions

While the WTO Agreement permits tariffs as a means of industrial protection (unlike quantitative restrictions, which it bans outright), it also seeks to gradually reduce those tariffs through negotiations among Member countries. Below is a summary of the economic rationale for tariff reductions.

Reducing tariffs mitigates the “loss of efficiency” costs generated by the distortions to the price system that the tariff causes. Reducing the degree of market protection also expands the market, allowing producers in exporting countries to enjoy economies of scale and bringing benefits to the economy as a whole.

\(^{18}\) For an industry with an added-value rate of 25% (for example, purchases parts for $75 and assembles them into a finished good worth $100), a tariff of 25% on finished goods (resulting in a domestic price of $125) will increase the costs that can be tolerated by the industry from $25 to $50, which gives an effective protection rate of 100%.
There are also arguments against reducing tariffs. Large countries might argue that tariffs have certain benefits because they improve the terms of trade (the “optimal tariff” debate). Similarly, when there are domestic market failures, tariffs might be seen as a means of increasing welfare.

These rebuttals might themselves be challenged by questioning whether the hypothesis of “large countries” is reasonable and significant, by questioning whether the optimal results can achieve if other countries take retaliatory measures, or by questioning whether market failures can be measured.

(e) Income Redistribution and the Importance of International Negotiations

From an economic standpoint, it would seem reasonable to conclude that tariff reductions are basically beneficial in that they increase economic efficiency, and therefore tariff reductions are undisputably desirable for all countries other than “large countries” (in practical terms, the vast majority of countries), and for the world economy as a whole.

It is rare, however, for countries to completely eliminate their tariffs. In point of practice, countries often impose tariffs not for the purpose of increasing overall welfare from a purely economic standpoint, but for the purpose of redistributing income. As a result of lobbying by various interest groups, policy-makers assess marginal benefits differently depending on which group is benefiting.

When tariffs are imposed for such domestic reasons, domestic political interests often will outweigh “greater economic welfare” in the view of the government, making it more difficult to reduce tariffs. This domestic political reality is what makes international negotiations to reduce tariffs, the basic strategy of the WTO, so important. When international negotiations are conditional upon mutual benefits, governments are more likely to forego the marginal benefits that positively affect one sector to obtain the broader general welfare benefits that affect a group of sectors.

2. Problems of Trade Policies and Measures in Individual Countries

In this section we consider problems in the trade policies and measures of individual countries in light of the discussion above. We look both at measures that clearly violate the WTO and at measures that are within the scope of WTO rules but nonetheless have a detrimental impact on trade. Chief among the measures considered are high tariff rates and low bound rates. We also touch upon examples of voluntary reductions in effective tariff rates by individual countries when the evidence is clear and discussion is warranted.

We have already noted (see section 1(2)) that countries must go through the procedures outlined in GATT Article XXVIII and obtain approval for a hike in their bound rates before they are able to raise their tariffs to levels in excess of the current bound rate. Raising tariffs beyond the bound rate without going through these procedures constitutes a clear violation of GATT Article II. The WTO Councils and Disputes Settlement Mechanism addresses such violations. When changes in tariff classification result in what for all purposes is a tariff hike, the case must be referred to the Customs Co-operation Council (CCC; also known as the “World Customs Organization” or “WCO”) for a judgement on the reclassification.

High tariffs, low percentage of bound items, and tariff hikes (within bound rates) are not,
strictly speaking, “unfair trade policies and measures in violation of WTO rules,” but they nevertheless have a detrimental impact on trade when they are used too easily or too often. In light of the goal of the WTO, which is to promote free trade, these are actions that countries should remedy voluntarily.

It must be added that individual countries’ customs tariffs described below are bound rates. In some cases, applied rates have often become lower than the bound rates on an autonomous basis in accordance with national laws.

(1) European Union

Even after implementation of the Uruguay Round commitments, the EU tariff rate on some trucks remains as high at 22 percent, and the tariff level on some sectors such as home electric equipment (maximum 14 percent), textiles and textile products (maximum 12 percent) is higher than other developed countries.

(2) United States

(a) High tariff goods

After the implementation of the Uruguay Round there will be high US tariffs on some items such as, woolen fabrics (maximum 25 percent), glassware (maximum 38 percent), some ceramics (maximum 25 percent), and trucks (maximum 25 percent). Trucks, in particular, have very high tariffs as compared to passenger vehicles (2.5 percent).

(b) Method of calculating tariffs on clocks and wristwatches

The United States calculates tariffs on finished clocks and watches as the aggregate of the tariffs on their components. These calculations are complex, and trade procedures are thus onerous. For example, under the current rules, the tariff on a wrist watch is the total of the tariff on its 1) movement, 2) case, 3) strap, band or bracelet, and 4) battery. In other words, when a company exports a finished wrist watch to the United States, it must, by the nature of the product, classify it according to eight-digit HS headings, and then calculate and total the tariff for each component: the movement, case, band, and battery.

This method of calculating tariff rate is not a violation of WTO rules; it was enacted in accordance with concession table amendment procedures. Nonetheless, it places excessive burdens on traders. What is more, this "component price break down system" is unusual by international standards, and is based on the assumption that mechanical clocks and watches are the primary form of clocks and watches made. In actuality, they account for less than 2% of worldwide production today. Because of the disparities between the tariff system and the actual state of the industry, Japan has requested the United States in bilateral deregulation talks to switch to six-digit HS headings for watch imports, and to assign a flat tariff rate to the finished article instead of calculating tariffs for the individual components.
(3) Korea

After the implementation of the Uruguay Round, the internationally competitive textiles and textile products sector will have, on average, high tariffs (between 16.3 percent and 35 percent). In addition, there will be high tariffs on some items such as automobiles (maximum 80 percent), glass fibers (maximum 25 percent), copper products (maximum 13 percent), and aluminum products (maximum 13 percent). The bound rate for electrical equipment is 62.4 percent, and the binding rate for industrial goods as a whole is 86 percent.

Korea’s efforts to push forward liberalization, including dropping its 80 percent high-end bound rate for automobiles to a flat rate of eight percent in February 1999, is appreciated. However, taking into account its status in the current world trade system and its status as an OECD Member with a more developed economy than most other countries, further steps toward trade liberalization is expected.

(4) Australia

Tariffs on non-agricultural products remain at a high level after the implementation of the Uruguay Round. Items such as certain clothes (maximum 55 percent), automobiles (maximum 40 percent), electrical machinery (maximum 23 percent), and glass (maximum 23 percent) have high tariffs.

Australia began a unilateral program of phased-in tariff reductions in 1998, and effective rates will be either zero or 5 percent by 1 July 1996, excluding passenger cars, textiles, clothing, and footwear. As a result, with the implementation of the Uruguay Round offer, the average applied tariff rate will be 2.9 percent in 2001 according to the Government of Australia.

(5) Indonesia

The Uruguay Round improved Indonesia’s bound rate to 92 percent of its tariff items, a development that Japan welcomes. However, the bound tariff rates for the vast majority of items remain extraordinarily high, at levels of 30-40 percent. Effective tariff rates are also high, at an average of 27.8 percent for textiles and textile products, 30.6 percent for transportation equipment, and 26.1 percent for electric equipment.

In its “Individual Action Plan” for APEC, Indonesia made an explicit commitment to begin in 1995 to reduce effective tariffs currently less than 20 percent to less than 5 percent by 2000, and those currently in excess of 20 percent to no more than 20 percent by 1998 and to less than 10 percent by 2003.

(6) Canada

Canada’s average tariff rate on non-agricultural products will be 4.9 percent after the implementation of Uruguay Round commitments, a somewhat higher rate than those of Japan, the United States, and the EU. Tariffs on glass (maximum 15.7 percent) are an example of high tariffs.

In addition to its concession in the Uruguay Round, Canada’s APEC "Individual Action Plan" provides that Canada will phase in reductions in effective tariff rates on 714 items by 1999 and another 64 items by 2004.
(7) Thailand

After the implementation of the Uruguay Round commitment, the levels of tariffs in sectors such as transportation equipment (average 47.6 percent) and electronics (average 31.6 percent) are still high. Copper products (maximum 30 percent) and polyethylene (maximum 30 percent) also have high tariffs. Thailand has agreed to bind a relatively low percentage of its tariff goods. For example, only 15.7 percent of transportation equipment items is bound while only about 70 percent of industrial goods as a whole is bound.

(8) Malaysia

(a) High tariff goods, bound rates

The Uruguay Round resulted in an average bound rate (trade-weighted average) of 9.1 percent for imports of industrial goods into Malaysia. This is a low tariff rate for a developing country, and one that Japan welcomes. There are, however, some areas that are subject to high tariffs, for example, textile products (average 21.5 percent) and transportation equipment (average 22.6 percent). Other high-tariff items include electrical equipment and glass, which have maximum tariffs of 30 percent. We would also note that Malaysia’s bound rate covers only 79 percent of tariff items.

(b) Hiking the tariff on the steel plate

In April 1999, Malaysia hiked tariffs on the hot-rolled and cold-rolled steel plate from zero to twenty-five percent. Although this tariff hike does not necessarily violate WTO rules because these tariffs of these products are unbound, these tariff hikes have a clearly detrimental impact on trade.

Industrial tariffs negotiations in the next WTO round should be commenced with the object of improving coverage of bound products for each member. Such large tariff hikes on unbound items significantly hurt the predictability of smooth trade.

(9) Philippines

Even after implementation of its Uruguay Round commitments, the Philippines still has several high-tariff items, including textile products (maximum of 50 percent), watches and clocks (maximum of 50 percent), and electrical equipment (maximum of 50 percent). The percentage of bound items is only 66 percent of tariff lines.

We note, however, that the Philippines has been reforming its tariff structure since 1980 and has announced that it will enact a uniform effective tariff rate of 5 percent for all items except selected agricultural products by 2004.

(10) India

(a) High tariff goods, bound rates

Upon implementation of its Uruguay Round commitments, India will have uniform
tariff rates for virtually all bound items: high rates will be 40 percent; low rates, 25 percent. Almost all textiles are subject to 40 percent tariffs, which are high given India’s competitiveness and international standing in this sector. Likewise, the percentage of bound items is only 68 percent of tariff lines, which leaves substantial room for improvement.

(b) The Introduction of Special Additional Customs Duty

In August 1998, India introduced a new special additional customs duty (4 percent). Due to this additional duty, applied rates of some goods have exceeded the bound rates, which may violate GATT Article II. Thus Japan has participated as a third party in the consultations which were requested by the EU pursuant to based on GATT Article XXII.

India argues that the introduction of the special additional duty is aimed at providing a level playing-field to the domestic industry, which is compatible with WTO rules. It is still necessary to evaluate the facts related to this issue to see whether these new special additional duties violate the WTO rules or not. If they violate the WTO rules, we need to request India to take a remedial measure at an early stage. However, as of December 1999, India has not yet answered in writing the questionnaire presented by the EU during the first consultation in December 1998. We request India to cooperate to allow a smooth settlement of this case.

*Figure 4-2* Changes of Average Bound Tariff Rates (Non Agricultural Products)

<table>
<thead>
<tr>
<th></th>
<th>Japan</th>
<th>US</th>
<th>EU</th>
<th>Korea</th>
<th>Australia</th>
<th>Indonesia</th>
<th>Thailand</th>
<th>Canada</th>
<th>Malaysia</th>
<th>Philippines</th>
<th>India</th>
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<tr>
<td><strong>Average Bound Tariff Rate (%)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Pre UR</td>
<td>3.8</td>
<td>5.4</td>
<td>5.7</td>
<td>18.0</td>
<td>20.0</td>
<td>20.4</td>
<td>37.3</td>
<td>9.0</td>
<td>10.2</td>
<td>23.9</td>
<td>72.2</td>
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<tr>
<td>Post UR</td>
<td>1.5</td>
<td>3.5</td>
<td>3.6</td>
<td>8.3</td>
<td>13.2</td>
<td>36.9</td>
<td>28.0</td>
<td>4.8</td>
<td>9.1</td>
<td>24.6</td>
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<tr>
<td><strong>Scope of Bindings (%)</strong></td>
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<tr>
<td>Pre UR</td>
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<td>99</td>
<td>100</td>
<td>24</td>
<td>36</td>
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<td>12</td>
<td>100</td>
<td>2</td>
<td>9</td>
<td>9</td>
</tr>
<tr>
<td>Post UR</td>
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<td>100</td>
<td>100</td>
<td>89</td>
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<td>70</td>
<td>100</td>
<td>79</td>
<td>66</td>
<td>68</td>
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</tbody>
</table>

Notes:
1. Japanese figures based on Ministry of International Trade and Industry Calculation (excluding petroleum and forestry and fishery products). Average bound tariff rates are 1.7 percent in the industrial sectors including forestry and fishery products.
2. GATT Secretariat Calculations used for other countries (excluding petroleum).
3. Average bound tariff rates are trade-weighted average.
4. Scope of bindings rates are trade-weighted average.
5. "Pre UR" and "Post UR" refer to tariffs before and after implementation of Uruguay Round commitments.