

## **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.<sup>1</sup>

### **(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.<sup>2</sup>

### **(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.<sup>3</sup>

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<sup>1</sup> See Chapter 8 on Government Procurement.

<sup>2</sup> See Chapter 6 on Subsidies and Countervailing Measures.

<sup>3</sup> 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.