Annex to Part One

ISSUES INVOLVED IN TRADE DISPUTES THAT HAVE ARISEN CONCERNING THE NATIONAL TREATMENT PROVISION OF THE WTO AGREEMENT

Globalization and liberalization are modifying the relative impact of trade measures. With the entry into force on 1 January 1995 of the Marrakesh Agreement Establishing the World Trade Organization (WTO), some are losing their importance as trade barriers and as instruments of trade policy. The Agreement on Agriculture and the Agreement on Safeguards, for example, make it virtually impossible to resort to quantitative restrictions and voluntary export restraints, in both agriculture and industry. On the other hand, the Agreement on Agriculture gives prominence to the tariff quota[1] as a liberalizing measure, but this, as discussed below, has given rise to a number of disputes concerning implementation. The liberalization of border measures and increased penetration of markets by investors have also served to focus attention on internal measures designed to protect domestic production, explaining to some extent the preoccupation of the WTO dispute settlement mechanism with issues relating to the national treatment principle.[2]

The strengthening of the GATT dispute settlement mechanism is one of the major achievements of the Uruguay Round.[3] Since the WTO Multilateral Trade Agreements (MTAs) entered into force on 1 January 1995, the number of disputes referred to the new dispute settlement mechanism has increased dramatically compared to the situation under the former GATT. As of 2 July 1997, the WTO Dispute Settlement Body had received 88 requests for consultations, involving 63 separate matters. Seven of the panels constituted have completed their work, and in five cases both the Panel Report and the report of the Appellate Body have been adopted. In almost half of these disputes, the question of conformity with the national treatment provisions of GATT article III has been at issue.

Article III aims at ensuring that the benefits of tariff concessions are not frustrated by measures of internal taxation and regulation which could be applied in a discriminatory fashion against imported products. Its disciplines include the following broad elements: (i) the imported product must not be subject to internal taxes or other internal charges in excess of those applied to "like domestic products"; (ii) the imported product must be accorded treatment no less favourable than that accorded to like domestic products in respect of rules and requirements affecting the sale, purchase, transportation, distribution or use of the product; (iii) regulations relating to the mixture, processing or use of products may not specify that a certain amount or proportion must come from domestic sources; and (iv) internal taxes or other internal charges or internal quantitative regulations may not be applied in a manner so as to afford protection to domestic production. While elements (i), (ii) and (iii) relate to the rate of taxes, regulations and the compulsory utilization of domestic products, respectively, element (iv) is about "the manner of application" of taxes, regulations, etc. Its purport is that even if the taxes or charges are applied at the same rate on the imported and like domestic products, the manner of application should not be such as to afford protection to domestic production. Thus, both *de jure*, and *de facto* discrimination is prohibited. Similarly, internal quantitative regulations, even other than those mentioned above, cannot be applied in a manner which affords protection to domestic production either of a particular

product or of directly competitive or substitutable products.

The observation that as tariff barriers to trade are reduced or eliminated, non-tariff measures become of greater importance has been repeated so often it has almost become a cliché. However, it is evident that globalization of production and trade liberalization have led to greater attention being paid to the effects of internal measures that discriminate against imports. Thus, it is no accident that the large number of complaints brought before the WTO Dispute Settlement Body have included allegations of contravention of the national treatment provision of GATT article III mainly through: (a) discriminatory internal taxes; (b) local content requirements; (c) allocation of tariff quotas among supplying countries; (d) measures relating to technical standards and the environment; (e) measures aiming at the preservation of cultural identity; (f) the limitation of access to distribution channels.

A. Discriminatory internal taxes

Some disputes have involved complaints over certain traditional forms of discrimination For example, in many countries domestic production of alcoholic beverages has benefited from a variety of protective measures, including fiscal privileges (such as taxes) and state trading. In the so-called "beer war" between the United States and Canada during 1990-1991, each country had filed a case against the other with respect to domestic (or internal) measures affecting the sales of certain imported alcoholic beverages in the other's market. The United States challenged Canada's monopoly of import and distribution by provincial liquor boards and restrictions on the size of the package in which imported beers could be sold. In the retaliatory complaint filed by Canada, the United States measures (both state and federal) on taxation and sale of alcoholic beverages were claimed to discriminate against imports.[4]

The Uruguay Round succeeded in achieving considerable trade liberalization in this sector, and exposed internal barriers that permitted the continuation of protection. For example, Japanese taxes on alcoholic beverages were recently challenged by the European Communities (EC), Canada and the United States on the alleged grounds that they discriminated against imports of vodka, whisky, cognac and white spirits by imposing substantially lower taxes on the domestic product *shochu*. They argued that *shochu* and the imported products were "like products".

The definition of the term "like product" has been the subject of dispute on many occasions. The general practice has been to interpret it on a case-by-case basis. But certain essential features have often been recognized as relevant in this context, e.g. the end-use of the product in a given market, the tastes and habits of consumers, and the properties, nature and quality of the product. Both the WTO Panel, in July 1996, and the Appellate Body, in October 1996, concluded that *shochu* and vodka were like products and that Japan, by taxing imported products in excess of like domestic products, was in violation of GATT article III:2, first sentence.

As noted above, the requirement of "no less favourable treatment" applies not only to the rate of a tax but also to the manner in which it is applied; and "domestic production" refers not only to like products but also to directly competitive or substitutable ones. What is a directly competitive or substitutable product has been the subject of intense consideration. Here again the practice has been to proceed case by case. For example, in the dispute on alcoholic beverages, it was concluded that *shochu* and other distilled spirits and liqueurs listed in HS tariff heading 2208, except for vodka, were "directly competitive or substitutable products", and that Japan, in the application of the Liquor Tax Law, did not tax imported and directly competitive or substitutable domestic products in the same way and afforded protection to domestic production in violation of article III:2, second sentence. It was the view of both the Panel and the Appellate Body that the term "directly competitive or substitutable product", in accordance with its ordinary meaning, should be interpreted more broadly than the term "like product".[5] The Euro-

pean Communities and the United States are similarly contesting taxes on alcoholic beverages by the Republic of Korea, and a similar case is being brought by several countries against Chile.

B. Local content requirements

The Agreement on Trade-Related Investment Measures (TRIMs), drawing upon earlier GATT panel decisions, prohibits investment measures which contravene GATT article III, notably local content requirements. It in effect codifies the finding in the complaint brought by the United States in 1984 against Canada's administration of the local content provisions of the Foreign Investment Review Act (FIRA).[6] The TRIMs Agreement has encouraged WTO members to challenge measures such as local content requirements which are prevalent in certain sectors, notably the automotive sector.

For example, complaints have recently been made by Japan, EC and the United States against Indonesia concerning its "National Car Programme". Under that programme, the Government designated "PT Timor Putra National" as the only "national car" manufacturing company eligible for exemption from customs duties and luxury taxes on condition that it achieved specified minimum local content ratios (20 per cent by the end of the first year of production, 40 per cent by the end of the second year and 60 per cent by the end of third year). Furthermore, the Government permits complete vehicles produced abroad by the Korean Kia Motors Corporation to be imported tariff-free as "national" cars so long as Indonesian workers participate in the foreign production of the vehicle and Korean Kia Motors Corporation counter-purchases from Indonesia parts worth 25 per cent of the value of the vehicles to be imported thereunder.

Complaints have also been filed by Japan, EC and the United States against Brazil concerning certain measures affecting trade and investment in the automotive sector. These measures require that companies must maintain a government-established ratio of net exports (by value) of certain goods, such as complete vehicles, to imported auto parts receiving duty preferences. They consider that the local content requirements in Brazil's automobile investment incentive measures constitute a prohibited TRIM, inconsistent with GATT article III:4.

C. Allocation of tariff quotas

Another area where it is perceived that breaches of the national treatment principle are being used to frustrate the liberalization achieved in the Uruguay Round is in the administration of the tariff quota system under the Agreement on Agriculture. For example, in the complaint filed by the United States against the Philippines concerning the latter's tariff quotas for pork and poultry, the United States considered that the implementation of these tariff quotas, in particular the delays in permitting access to these quantities and the licensing system used, appeared to be inconsistent with the relevant WTO provisions, including those under GATT article III. In the case of complaints by Ecuador, Guatemala, Honduras, Mexico and the United States against the European Communities in relation to the importation, sale and distribution of bananas, the WTO Panel found that the allocation to Category B[7] operators of 30 per cent of the licences allowing the importation of third-country and non-traditional ACP bananas at in-quota tariff rates was inconsistent

with the requirements of GATT article III:4. The ruling was based on the conclusion that the design, architecture and structure of the EC measure indicated that this measure was applied so as to afford protection to EC producers.[8] Despite the fact that its exports are negligible, the United States took a leading role to protect the interests of United States banana corporations operating in Central America. The Panel felt that under the Understanding on Rules and Procedures Governing the Settlement of Deputes, the United States had a right to advance the claims it had raised, even if it did not have actual trade or a potential export interest, since its internal market for bananas could be affected by the EC regime and by that regime's effect on world supplies and prices. The case also set a precedent for interpreting the legal meaning of the provisions in the General Agreement on Trade in Services (GATS) and its Schedule of Commitments, in particular with respect to those related to national treatment as provided for in article XVII of that Agreement.[9]

D. Technical standards

Many of the measures for which conformity with GATT article III is being challenged relate to those imposed for social and other non-economic reasons. The Agreement on Technical Barriers to Trade (TBT) was originally negotiated during the Uruguay Round with a view to ensuring that standards and technical regulations did not contravene the national treatment principle. It was recognized that the application of such standards and technical regulations required that foreign products meet domestic standards and be subject to conformity assessment procedures (e.g. testing) but that neither the technical regulations nor the related procedures should be applied so as to result in unnecessary restriction of trade. The Agreement on the Application of Sanitary and Phytosanitary Measures (SPS) applies the national treatment principle to the extent possible in the application of measures intended to protect human, animal and plant life and health.

The increased scope and application of measures aimed at environmental protection has also increased the possibilities of circumventing the national treatment principle by imposing more stringent conditions for foreign products. The first case resolved in the WTO dealt with a challenge by Venezuela and Brazil to environmental protection regulations in the United States relating to standards for gasoline, which they claimed allowed greater flexibility to domestic than to foreign refiners in conforming to special regulations for reformulated gasoline in major urban centres. The complaining countries were successful in demonstrating that the United States "Gasoline Rule" imposed more stringent criteria for foreign refiners. They argued that, by imposing less favourable standards for imported gasoline from certain countries than those applied to domestic products, the United States violated several provisions of the MTAs, including GATT article III.[10] They also claimed that the Gasoline Rule had nullified and impaired benefits under the non-violation provision of GATT article XXIII:1(b). The European Communities and Norway made submissions to the Panel as interested third parties, expressing concern that the gasoline rule could justify the fears of many countries about the use of purported environmental measures as disguised restrictions on international trade. Venezuela stressed that it was not seeking to avoid legitimate regulations for environmental protection, but merely wanted its gasoline to be subject to the same rules as gasoline produced in the United States.

Under GATT article III.4, the Panel found that imported and domestic gasoline were like products and that under the regulation imported gasoline was effectively prevented from benefiting from sales conditions as favourable as those afforded to domestic gasoline. It rejected the United States argument that the requirements of article III:4 were met because imported gasoline was treated similarly to gasoline from similarly situated domestic parties. Such an interpretation, it said, would be contrary to the ordinary meaning of article III:4, and would mean that imported and domestic goods could no longer be treated on the objective basis of

their likeness as products, but rather on the basis of a "highly subjective and variable treatment" according to extraneous factors. It would create great instability and uncertainty in the conditions of competition as between domestic and imported goods in a manner fundamentally inconsistent with the object and purposes of GATT article III. In its concluding remarks the Panel noted that it was not its task to examine generally the desirability or necessity of the environmental objectives of the United States' Clean Air Act or the Gasoline Rule; WTO members were free to set their own environmental objectives, but were bound to implement those objectives through measures consistent with the provisions of GATT 1994, notably on the relative treatment of domestic and imported products.

One of the notable characteristics of such disputes is the high degree of technical competence required to prepare evidence in support of a complaint. The cases under the Agreement on the Application of Sanitary and Phytosanitary Measures mentioned above have to be based on "scientific evidence" (e.g. that beef from hormone-fed cattle endangers human health); under the Agreement on Technical Barriers to Trade there is provision to call upon technical expert groups to assist panels in disputes. However, the need for such technical expertise is not confined to interpretations of these Agreements. For example, in order to successfully challenge the decision of the French Government to restrict the use of the term "coquille Saint-Jacques", Canada, Peru and Chile were required to demonstrate that molluscs harvested in the Pacific Ocean were in fact "like products". The complainants claimed that the French decision would reduce competitiveness of their exports of scallops in the French market as they would no longer be able to be sold as "coquilles Saint-Jacques" although there was no difference between their scallops and French scallops in terms of colour, size, texture, appearance and use.

E. Preservation of cultural identity

Other measures imposed for health, environmental, cultural and social reasons are currently being challenged. A dispute brought by the United States against Canada involves measures by the latter, motivated by considerations of cultural identity, imposing an 80 per cent tax on revenue from advertisements placed in the Canadian editions of periodicals sold both in Canada and abroad (the so-called "split-run" periodicals). The United States also complained about Canada's disallowing an income tax deduction to Canadian firms which advertise in "split-run" periodicals and applying favourable postage rates to its own periodicals

F. Distribution channels and related provisions of the General Agreement on Trade in Services

In the "Kodak/Fuji" case currently before the Dispute Settlement Body, the United States is challenging a series of Japanese laws, regulations, requirements and measures which it considers effectively exclude the firm Eastman Kodak from the Japanese market for consumer photographic film and photographic paper. According to the United States, these Japanese measures are "liberalization countermeasures"; they include measures to restructure the distribution system for photographic products, as well as the Premiums Law and the Large Stores Law and related measures aimed at preventing Kodak and other foreign firms from obtaining adequate access to the Japanese film dis-

tribution network and retail outlets.[11] The United States considers that these measures by Japan, including the measure to provide protection to the domestic production of consumer photographic film and paper, nullify or impair its benefits and violate GATT provisions within the meaning of GATT article III:1. It claims that they also conflict with GATT article III:4 since they affect the conditions of competition for the distribution, offering for sale and internal sale of consumer photographic film and paper in a manner which accords less favourable treatment to imported film and paper than to comparable products of national origin. The United States has also alleged that these measures nullify or impair its benefits (a "non-violation" claim) in as much as the Japanese Government's ineffective enforcement of its competition law was not foreseen when the concessions were negotiated on this product.

The United States has also filed a separate case under the GATS concerning Japan's measures affecting distribution services (not limited to the photographic film and paper sector referred to above) through the operation of the Large Stores Law, which regulates the floor space, business hours and holidays of supermarkets and department stores. In its view, the Large Stores Law has the effect of limiting the establishment, expansion and business operations of large stores in Japan by foreign investors and exporters. It further argues that by impeding the business operations of large stores, the Law reduces productivity in merchandise retailing, raises costs, discourages new domestic capital investment and ultimately limits the selection and quality of goods and services.

One of the driving forces of globalization has been the recognition by enterprises of the importance of obtaining access to domestic distribution systems, or of setting up their own distribution systems in the importing country. The major developed countries pressed for commitments in GATS for market access and national treatment in this sector. During the Uruguay Round, 35 countries made commitments related to distribution services, in particular with respect to wholesale and retail trade. It should be noted that while GATT article III deals only with goods, GATS article XVII contains a national treatment provision for service suppliers. National treatment, however, is not an obligation, as it is for trade in goods, but a concession that can be extended on a sectoral or subsectoral basis. In the Uruguay Round, countries were not prepared to accept that any enterprise or natural person which gained access to the domestic market would have the automatic right to engage in all activities on the same basis as domestic suppliers. The GATS differs from the GATT in the sense that market access and national treatment are both seen as negotiable. Accordingly, market access for services does not automatically imply national treatment, which is also subject to negotiation. Some countries considered that the two concepts should be merged into a single discipline. Such an approach was subsequently adopted for the basic NAFTA obligation on investment, in which the national treatment provision is broadened to subsume the market access concept, i.e. including the right of establishment. The national treatment provision in the draft OECD Multilateral Agreement on Investment virtually reproduces the equivalent NAFTA text.

* * * * *

With the significant reduction of tariffs and liberalization of non-tariff measures at the border, the discriminatory application of domestic taxes and regulations to protect national production, often reflecting protectionist pressures from domestic producers, has become more prominent as a barrier to trade. National treatment, as defined by GATT article III, alongside MFN treatment, is one of the central principles of the multilateral trading system. The main purpose of the national treatment rule is to eliminate or reduce "hidden" domestic barriers to trade and to increase transparency and predictability. In other words, GATT article III is designed to impede the adoption of policies and measures that have domestic protection as their purpose. As a result of the Uruguay Round, the idea of national treatment has been extended from trade in goods to trade in other areas, such as services, though in a limited manner. In this context, the intention to multilateralize the rules and disciplines relating to government procurement practices can be viewed as another step

towards strengthening the application of the national treatment rule. However, with increasing interactions between trade, investment and competition policies, an analysis is often drawn between the elimination and/or reduction of "hidden" domestic barriers to trade and the peeling away of the layers of an onion. As formal import restrictions have been removed, "embedded" barriers have come to light, such as domestic regulatory measures and inter-firm trading relationships. Thus, as the process of trade liberalization gathers momentum, the application and enforcement of competition policy at the national level assumes greater importance. ■

Notes

1 Under a tariff quota a fixed quantity of a given product may be imported at a special tariff rate; for quantities in excess of the quota the general, higher, tariff rate is applied.

2 Under this principle, WTO members are required to accord treatment to imported products no less favourable than that accorded to like domestic products (article III of GATT 1994).

3 See UNCTAD, *The Outcome of the Uruguay Round: An Initial Assessment. Supporting Papers to the Trade and Development Report, 1994* (United Nations publication, Sales No. E.94.II.D.28), chap. IX.

4 See GATT documents DS17/R and DS23/R reproduced in GATT, *Basic Instruments and Selected Documents, Supplement No. 39* (Geneva, Dec. 1993).

5 See the reports of the Panel and the Appellate Body in WTO document series WT/DS8, WT/DS10 and WT/DS11.

6 Under the Canadian FIRA, foreign investors are required to give preference to purchase of Canadian goods over imported goods and to meet certain export performance requirements. The GATT panel found that Canadian requirements were inconsistent with GATT article III:4, which stipulates that imported products shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of requirements affecting their internal sale, purchase, transportation, distribution or use.

7 Under the EC's operator category rules set out in article 19 of Council Regulation (EEC) 404/93 (as amended), import licences are distributed among three categories of operators, based on quantities marketed during the latest three-year period for which data are available. Category A refers to operators that have marketed third-country and/or non-traditional ACP bananas, who are given a 66.5 per cent allocation of import licences allowing imports at in-quota rates. Category B refers to operators that have marketed EC and/or traditional ACP bananas, given a 30 per cent quota allocation. Category C refers to operators who started marketing bananas other than EC and/or traditional ACP bananas in 1992 or thereafter ("newcomer category"), given a 3.5 per cent allocation.

8 See also the Report of the Appellate Body (WTO document WT/DS8/AB/R), p. 29.

9 See WTO documents in the series WT/DS27/R/... of 22 May 1997.

10 See the reports of the Panel and the Appellate Body in WTO document WT/DS2/9, 20 May 1996. Venezuela did not make any claim based on article 12 of the TBT Agreement (Special and Differential Treatment of Developing Country Members), rejecting the notion that it was seeking privileges for its own gasoline. Brazil stated that it, too, was not asking for a ruling under article 12, but wished to point out that the discriminatory treatment affecting its gasoline was particularly objectionable in the light of the provisions of that article.

11 See United States Trade Representative (USTR), *1997 National Trade Estimate Report on Foreign Trade Barriers* (Washington, D.C.), pp. 225-227.