المنهل ریسرچ جرنل
AL-MANHAL Research Journal
Publisher: Institute of Dialog and Research, Islamabad
E-ISSN 2708-2566 P-ISSN2708-8786
Vol.02, Issue 03 (July-September) 2022
HEC Category "Y"
https://almanhal.org.pk/ojs3303/index.php/journal/index

Title Detail

English:

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Citation:
Dr. Ikram Ullah. 2022. "Most Favoured Nation Principle and National Treatment Obligation and Their Efficacy in Elimination of the Discrimination". Al Manhal Research Journal 2 (2). https://almanhal.org.pk/ojs3303/index.php/journal/article/view/17.

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Most favoured nation principle and national treatment obligation and their efficacy in elimination of the discrimination

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ABSTRACT

In international trade, the non-discriminatory treatment by exporting countries to the products and services being imported from other countries is a matter of utmost significance. To this end WTO regime puts in place two principles i.e. most favoured nation principle and national treatment obligation. They have proved very effective to achieve the purpose for which they were enacted. In addition to the content of these provisions, the interpretations rendered over them also accumulated the benefit. This paper explains these obligations in the light of Panel Reports, Appellate Body Reports and Working Party Reports and demonstrates that they have effectively eradicated the discrimination in these subjects.

Key Terms: WTO, GATT, GATS, Most Favoured Nations, National Treatment, International Trade

Introduction

Trade ought to be liberalized for countries equally because discrimination policies beget political, social and economic crises at the international level. Some rules and regulations were direly required to regulate this liberalisation process and to eradicate the discriminatory policies so as to avoid the influence of the international key players in international trade and the negotiation process for the tariff, etc. The steps taken by WTO in this regard are of massive significance because it is the forum where every country can have access, where laws are constituted with negotiations on an almost equal pedestal and more importantly, it has its own dispute resolution mechanism. WTO codified two principles of non-discrimination namely The Most Favoured Nation and National Treatment Obligation. In simple terms, the Most Favoured Nation treatment obligation prohibits a

country from discriminating between countries; the National Treatment Obligation prohibits discrimination against other countries.[1] These two non-discrimination principles are articulated in Articles I, II, III of GATT 1994. These two obligations will be explained in the light of Panel Reports, Appellate Body Reports and Working Party Reports to demonstrate as to how they have effectively eradicated the discrimination in these subjects. In this regard, first MFN treatment obligation and then Nation Treatment Principle will be discussed.

Most Favoured Nation Principle:

MFN principle means that a country must treat other countries at least as well as it treats the "most favoured" country. For example, if Australia imposes a 10% tariff on German car imports, it cannot charge 20% on car imports from France or other trading partners but must give these others the 10% rate as well. Thus, a key concept of the principle is a prohibition on discriminating among trading partners.[2]

Scope and purpose of the Article I-1:

To interdict the discrimination among the like products originating in, or destined for, different countries, was the primary object of this provision[3] i.e. the like products should be treated equally, irrespective of their origin.[4] It is well settled that the principle entitled in Article I-1 is "a cornerstone of the GATT" and "one of the pillars of the WTO trading system". It states:

> "With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties."

To interpret this provision following matters are important to look at:

- Meaning of "any advantage, favour, privilege, immunity"
- How "accorded immediately and unconditionally" should be interpreted?
- Construction of "like products"

"Any advantage, favour, privilege, immunity"

The MFN treatment obligation, which has been discussed in many cases,[5] applies to "any advantage, favour, privilege, immunity granted by any contracting party to any product originating in or destined for any other country" with regard to[6]

- Custom duties
- Charges of any kind imposed on importation or exportation
- Charges of any kind imposed in connection with importation or exportation
- Charges imposed on the international transfer of payments for imports or exports
- Method of levying such duties and charges, such as the method of assessing the base value on which the duty or charge is levied
- All rules and formalities in connection with importation and exportation
- Laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of any conduct.

The above-narrated points can be summarised as the advantages granted by one member to any other country comes under the purview of MFN treatment obligation if they are related to:

- Custom duties, other charges on imports and exports and other custom matters;
- Internal taxes; and
- Internal regulations affecting the sale, distribution and use of products.

If an advantage has been ceded to a non-WTO member, that also comes under the scope of this obligation.[7] But WTO members cannot treat outsiders (non-WTO Members) better than they do insiders (WTO Members).[8] If a member grants any advantage to any other country (whether WTO Member or non-WTO member), it must extend that advantage to all members.[9]

Agreement on Safeguards finished the debate on whether the safeguard measure could be applied to some countries or to all countries, by manifestly saying that these measures will be applied on MFN basis i.e. without any discrimination among the supplying countries.[10] Article 5.2(b)

and Article 9.1 of the Agreement on Safeguards are the exceptions to this rule. Article 5.2(b)

> "A Member may depart from the provisions in subparagraph (a) provided that consultations under paragraph 3 of Article 12 are conducted under the auspices of the Committee on Safeguards provided for in paragraph 1 of Article 13 and that clear demonstration is provided to the Committee that (i) imports from certain Members have increased in disproportionate percentage in relation to the total increase of imports of the product concerned in the representative period, (ii) the reasons for the departure from the provisions in subparagraph (a) are justified, and (iii) the conditions of such departure are equitable to all suppliers of the product concerned. The duration of any such measure shall not be extended beyond the initial period under paragraph 1 of Article 7. The departure referred to above shall not be permitted in the case of threat of serious injury."

If any one of the requirements articulated in the above Article is there, the safeguards measures are allowed subject to the condition that they are taken in the form of quotas allocated among supplying countries. Article 9.1 narrates:

> "Safeguard measures shall not be applied against a product originating in a developing country Member as long as its share of imports of the product concerned in the importing Member does not exceed 3 per cent, provided that developing country Members with less than 3 per cent import share collectively account for not more than 9 per cent of total imports of the product concerned."

So, under Article 9.1 of the Agreement on Safeguards, safeguard measures shall not be applied against a product originating in a developing country member as long as its imports do not exceed the individual and collective thresholds in that provision.[11] Anti-dumping duties and countervailing duties are, in principle, within the scope of Article I:1. The facts relating to anti-dumping duties and countervailing measures may be different from countries, but if the facts are same, then the anti-dumping and countervailing measures should be applied without any discrimination.[12]

"Like product"

The advantage granted by a member country to any product will be accorded unconditionally to like product originating in or destined for the other territories of all members. The interpretation of the like product is the main issue. In addition to Article I:1, the term like product is also found in Article of GATT 1994, namely, II:2(a), III:2, III:4, VI:1(a)(b), XI:2(c), XIII:1, XIX1. The term "like commodity" is there in Article VI:7 and the term "like merchandise" has been used in Article VII:2 of GATT 1994.

The term “like product” has also been used in Safeguard Agreement, Anti-dumping Agreement, and SCM Agreement.

With regard to the interpretation of the term "... like or similar products ...", which occurs some sixteen times throughout the General Agreement, a considerable discussion had taken place in the past, both in GATT and in other bodies, but no further improvement of the term had been achieved. The Working Party concluded that problems arising from the interpretation of the term should be examined on a case-by-case basis. This would allow a fair assessment in each case of the different elements that constitute a "similar" product. Some criteria were suggested for determining, on a case-by-case basis, whether a product is "similar": the product's end-uses in a given market; consumers' tastes and habits, which change from country to country; the product's properties, nature and quality. It was observed, however, that the term "... like or similar products ..." caused some uncertainty and that it would be desirable to improve on it; however, no improved term was arrived at.[13]

In Spain-Coffee, the panel found that differences result from geographical factors, cultivation methods, the processing of beans and genetic factors. The panel said that these differences were insufficient to allow for different tariff treatments and coffee in its end use was universally regarded as well as defined as a single product intended for drinking. The panel also noted that no other WTO member applied its tariff regime in respect of unroasted, non-decaffeinated coffee in such a way that different types of coffee were subject to different tariff rates. So all types are like product in spite of their different tariff classification and different physical appearance.[14] The other case, in which the of like products were discussed, was the Japan-SPF Lumber case,[15] where appellant, Canada, complained of the fact that Japan has arranged its tariff classification in such a way that a considerable part of Canadian exports of SFP dimension lumber to Japan was submitted to a customs duty of 8 per cent, whereas other comparable types of dimension lumber enjoy the advantage of zero-tariff duty. The panel said that protection of trade would be considered to be legitimate if gained through tariff classification because tariff differentiation is basically a legitimate trade policy because members enjoy considerable freedom to formulate the structure of their national tariffs and classification of goods in the framework of such structure. So, the burden will be on the importing

member to establish that such tariff arrangement has been diverted from its normal purpose so as to become a means of discrimination in international trade. Furthermore, it was also obligatory for Canada to allege Japan's custom classification on the basis of internally accepted custom classification, which Canada did not. So, the decision of the panel for Japan's tariff classification was in the favour of Japan stating that because both the lumbers are not like products, zero tariff on some lumber and 8 per cent tariff on others was not a violation of Article I:1 of GATT.[16]

"Unconditionally and immediately":

In obligation put by MFN Obligation on WTO members to extend that advantage unconditionally and immediately, the term unconditionally caused much confusion. Whereas there seems no need for any interpretation for the term immediately but term unconditionally has raised many disputes.[17] Once a member has granted any advantage to imports from a country, it cannot make the granting of that advantage to imports of other WTO members conditional upon those other WTO members "giving something in return" or "paying" for the advantage.[18]

In Indonesia- Autos, the findings of penal with regard to "unconditionally and immediately" are as following:

> "under the February 1996 car programme the granting of customs duty benefits to parts and components is conditional to their being used in the assembly in Indonesia of a National Car. The granting of tax benefits is conditional and limited to the only Pioneer Company producing National Cars. And there is also a third condition for these benefits: the meeting of certain local content targets. Indeed under all these car programmes, customs duty and tax benefits are conditional on achieving a certain local content value for the finished car. The existence of these conditions is inconsistent with the provisions of Article I:1 which provides that tax and customs duty advantages accorded to products of one Member (here on Korean products) be accorded to imported like products from other Members "immediately and unconditionally".[19]

In **Canada-Autos**, the same issue was narrated in the following way:

> "The measure maintained by Canada accords the import duty exemption to certain motor vehicles entering Canada from certain countries. These privileged motor vehicles are imported by a limited number of designated manufacturers who are required to meet certain performance conditions. In practice, this measure does not accord the same import duty exemption immediately and unconditionally to like motor vehicles of all other Members, as required under Article I:1 of the GATT 1994.

> The advantage of the import duty exemption is accorded to some motor vehicles originating in certain countries without being accorded to like motor vehicles from all other Members. Accordingly, we find that this measure is not consistent with Canada's obligations under Article I:1 of the GATT 1994".[20]

National treatment obligation:

National Treatment Obligation requires a WTO member to treat foreign products, services and service suppliers not less favourably than it treats "like" domestic products, services, and service suppliers. Where National Treatment Principle applies, foreign products, once they have crossed the border and entered the domestic market, should not be subject to less favourable taxation and regulation than "like" domestic products.[21]

Article II:2, first sentence, of the GATT 1994:

Article III:2 first sentence of GATT 1994 states:

> "The products of territory of any [member imported into the territory of any other member shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to the like domestic products."

In brief, the two-tier test of consistency of internal taxation with Article III:2, first sentences, requires the examination of:

- Whether the imported and domestic products are like products; and
- Whether the imported products are taxed in excess of other domestic products.[22]

'Internal taxes…in excess of…'

Article III:2, is applicable to "internal taxes or other internal charges of any kind" which are imposed "directly or indirectly" on the products. By interpreting "applied directly or indirectly" internal tax as the taxes "applied on or in connection with products" value added tax, sales tax and excise duties are considered to be examples of internal tax, while income tax and import duties are not covered by this provision. It has been suggested that the tax applied "indirectly" is a tax applied, not on a product as such, but on the processing of the products.[23] The direct taxes are applied on products and not the producers.[24]

First sentence also states that the internal taxes on imported products should not be applied in excess to like domestic products. The first sentence is not conditional on a "trade effect test" nor is it qualified by a deminimus standard.[25] So, if the tax burden differential between the

imported and domestic products is de minimus, with respect to either its quantity or with regard to time span, in both the cases, it is not a defence. The panel held the imposition of tax for 30 days to be inconsistent with first sentence of Article III:2.[26] Due to the inflexibility in the first sentence of Article III:2, its interpretation confirms the absolute equality of taxation between imported products and domestic products. The fact that unequal taxation has no effect is not a defence. The sentence does not "protect expectations on export volumes; it protects expectations on the competitive relationship between imported and domestic products.

"Like products…"

Article III: 2 first sentence says that "like products" shall not be "subject, directly or indirectly, to internal taxes or other internal charges". Determining the "like product" is a very spiny job in WTO adjudications[27] because GATT does not render any guidance to the criteria for the determination of this term. So the reliance to know about this term is all on the reports of panels, appellate bodies and working committees.[28] The Report of Working Party on Border Tax Adjustment, in 1970 set some criteria to determine the likeliness in products:

> "With regard to the interpretation of the term "... like or similar products ...", which occurs some sixteen times throughout the General Agreement, it was recalled that considerable discussion had taken place in the past, both in GATT and in other bodies, but that no further improvement of the term had been achieved. The Working Party concluded that problems arising from the interpretation of the term should be examined on a case-by-case basis. This would allow a fair assessment in each case of the different elements that constitute a "similar" product. Some criteria were suggested for determining, on a case-by-case basis, whether a product is "similar": the product's end-uses in a given market; consumers' tastes and habits, which change from country to country; the product's properties, nature and quality. It was observed, however, that the term "... like or similar products ..." caused some uncertainty and that it would be desirable to improve on it; however, no improved term was arrived at.[29]

So, it was suggested that the term should be interpreted on the case by case bases. The criteria to determine the likeliness are: (i) the product's end use in a given market, (ii) consumers' tastes and habits, and (iii) the product's properties, nature and quality. In Appellate Body Report, Japan — Taxes on Alcoholic Beverages, Appellate Body expressly agreed with the

Working Party Report on Border Tax Adjustments. The Appellate Body stated this concept should be interpreted narrowly because of the existence of the concept of "directly competitive or substitutable products" used in the second sentence of Article III: 2.[30]

Article III:2, second sentence, of the GATT 1994

Article III:2, second sentence, states:

> "Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1"

Here the following things should be observed before calling for the application of this provision

- Whether the imported and domestic products are directly competitive or substitutable
- Whether these products are not similarly taxed; and
- Whether the dissimilar taxation is applied so as to afford protection to domestic production.[31]

'Internal tax…'

The legal and factual interpretation of the term "internal tax or other internal charges" for the first sentence of Article III:2 and second sentence of Article III:2 is the same.[32]

'Directly competitive or substitutive products'

Different panel and appellate body reports[33] expressed the standard of "directly competitive or substantive" that may be summarised as, "directly competitive or substantive" standard is somewhat broader than the "likeness" standard because the "like" products are the subsets of directly competitive and substitutable products. "Directly competitive or substantive products" are considered to be interchangeable, that is they offer "alternative ways of satisfying a particular need or taste. Different factors were considered to analyse whether or not the products are competitive and substitutable. Competition in the market including the elasticity of substitution between the products was considered. Similarly, in another case, physical characteristics, common end use, tariff classification, the nature of the compared products and the competitive conditions in the relevant market were considered for this purpose. To

examine, whether the products are 'directly competitive or substitutable', the products should be compared in groups.[34]

'Not similarly taxed'

If imported products and domestic products, both are not similarly taxed, this would amount to a contravention of the second sentence of Article III: 2. Even if there is a minimal tax differential, the tax imposed on the products is concluded to be a violation of Article III:2, first sentence, but under Article III:2 second sentence, the tax differential should be more than de minimus to establish the tax imposed to be inconsistent with National Treatment Obligation.[35]

'So as afford protection to domestic production'

The internal taxes should not be applied "so as to afford protection to domestic production" is the last requirement of Article III:2, second sentence. This requirement and requirement of "not similarly taxed" should not be mixed up and both of them should be distinguished from each other.[36] To determine whether the tax is imposed "so as to afford protection to domestic production", the Appellate Body in Chile-Alcohol relied on an analysis of the 'objective' purpose of the measure, as revealed by its 'design', 'architecture' and 'structure'.[37]

'Laws, regulations and requirements…' under Article III:4

Article III:4 states in the relevant part:

> "The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use."

Article III:4 concerns "all laws, regulations and requirements affecting their internal sale" which affect the "sale, purchase, transportation, distribution or use" of products. A certain degree of formal government involvement is essentially required before a government action can be challenged under Article III:4. Broadly speaking, this article includes all the measures that may modify the conditions of competition and measures present in Article III:4 are applicable to measures across the borders and the measures in isolated cases only. The private action which has a very

close relation with the action of government, the government action must be held responsible for that private action.[38] The basic criterion to determine a violation of the national treatment obligation under Article:4 is the "no less favourable" treatment standard which is interpreted to require "effective equality of opportunities for imported products" compared to like domestic products. This can not be balancing less favourable treatment for imports in some instances and more favourable treatment in others. But it does allow more favourable treatment for imports.[39]

Conclusion

To conclude with, two non-discrimination principles formulated by WTO are serving better by taking steps in the direction of eradication of non-discrimination. The law on this subject is being purified with the passage of time as new disputes occur and are decided by Panels and Appellate Bodies which give an authoritative interpretation to GATT provisions. Even better can be hoped in future for WTO law on non-discrimination and about the situation of trade because with decontamination of flaws in laws and their equal enforcement against all the countries create the best hopes for the future, despite the fact some unfair behaviour with developing countries have also been observed. But, the toil endeavoured by developing countries signifies that they will certainly have the status to be behaved fairly and equally.

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