

INTERNATIONAL AND REGIONAL TRADE LAW: THE LAW OF THE WORLD TRADE ORGANIZATION



J.H.H. Weiler
NYU School of Law

Sungjoon Cho
Chicago-Kent College of Law

Isabel Feichtner
Goethe University, Frankfurt

Julian Arato
Brooklyn Law School

Unit V: The Most-Favored Nation (MFN) Principle

The Law of World Trade Organization
Unit V: The Most-Favored Nation (MFN) Principle

Table of Contents

Supplementary Reading	2
I. Introduction	3
<i>1-1. Overview of Most-Favored-Nation (MFN) Treatment</i>	3
<i>1-2. Legal Texts: MFN Provisions in the WTO Agreements</i>	4
II. Case Law	6
<i>2-1. Spain—Coffee, Report of the Panel, 11 June 1981 (L/5135 - 28S/102)</i>	6
<i>2-2. Japan—Lumber, Report of the Panel, 19 July 1989 (L/6470 - 36S/167)</i>	14
III. Exceptions	22

Supplementary Reading

For a more complete overview over the WTO law on tariffs and customs and the most-favored nation principle we suggest the following reading:

Peter van den Bossche, The Law and Policy of the World Trade Organization, 2013, 315-348.

Raj Bhala, Modern GATT Law. A Treatise on the General Agreement on Tariffs and Trade, 2013, 252-303.

Michael J. Trebilcock et al., The Regulation of International Trade, 4th ed. 2013, 54-82.

John H. Jackson et al., Legal Problems of International Economic Relation, 6th ed. 2013, 503-534.

I. Introduction

1-1. Overview of Most-Favored-Nation (MFN) Treatment

Basic Concept

In essence, the MFN principle obliges a country to refrain from discriminating among its trading partners. A country subject to an MFN obligation must grant any trading partner treatment as favorable as that afforded any other nation, in like circumstances. In other words, the MFN obligation prohibits *horizontal* discrimination – a country may not discriminate among its trading partners. If Country A owes MFN treatment to nationals from Country B, it cannot treat them any worse than nationals from Countries C, D, or E, etc. Though simple enough in principle, the concept of MFN presents a number of difficult and controversial line-drawing problems – so much so that the scope of MFN treatment varies markedly across the many treaty regimes in which the concept can be found. As you read the MFN provisions in the GATT (Art. I) and GATS (Art. II), below, try to identify the key interpretive difficulties. Can you predict where the fault-lines will lie?

Origin of the Most-Favored-Nation (MFN) Principle

Excerpt from an OECD working paper on international investment

<http://www.oecd.org/dataoecd/21/37/33773085.pdf>

(footnotes omitted)

MFN treatment has been a central pillar of trade policy for centuries. It can be traced back to the twelfth century, although the phrase seems to have first appeared in the seventeenth century. MFN treaty clauses spread with the growth of commerce in the fifteenth and sixteenth centuries. The United States included an MFN clause in its first treaty, a 1778 treaty with France. In the 1800s and 1900s the MFN clause was included frequently in various treaties, particularly in the Friendship, Commerce, and Navigation treaties. MFN treatment was made one of the core obligations of commercial policy under the Havana Charter where Members were to undertake the obligation “to give due regard to the desirability of avoiding discrimination as between foreign investors”. The inclusion of MFN clauses became a general practice in the numerous bilateral, regional and multilateral investment-related agreements which were concluded after the Charter failed to come into force in 1950. Its importance for international economic relations is underscored by the fact that the MFN treatment provisions of the GATT (Article I General Most-Favoured-Nation Treatment) and the GATS (Article II Most-Favoured-Nation Treatment) provide that this obligation shall be accorded “immediately and unconditionally” (although in the case of the GATS, a member may maintain a measure inconsistent with this obligation provided that such measure is listed in, and meets the conditions of, the Annex on Article II Exemptions).

For a thorough history of the MFN clause up to the Second World War, including the work done by, or under the auspices of, the League of Nations, see the First Report of the ILC’s Special Rapporteur, Yearbook of the International Law Commission, 1969, Vol. II, p. 157 ff.

1-2. Legal Texts: MFN Provisions in the WTO Agreements

– General Agreement on Tariffs and Trade (GATT) 1994

Article I: General Most-Favoured-Nation Treatment

1. 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.

2. The provisions of paragraph 1 of this Article shall not require the elimination of any preferences in respect of import duties or charges which do not exceed the levels provided for in paragraph 4 of this Article and which fall within the following descriptions:

- (a) Preferences in force exclusively between two or more of the territories listed in Annex A, subject to the conditions set forth therein;
- (b) Preferences in force exclusively between two or more territories which on July 1, 1939, were connected by common sovereignty or relations of protection or suzerainty and which are listed in Annexes B, C and D, subject to the conditions set forth therein;
- (c) Preferences in force exclusively between the United States of America and the Republic of Cuba;
- (d) Preferences in force exclusively between neighbouring countries listed in Annexes E and F.

3. The provisions of paragraph 1 shall not apply to preferences between the countries formerly a part of the Ottoman Empire and detached from it on July 24, 1923, provided such preferences are approved under paragraph 5(1) of Article XXV which shall be applied in this respect in the light of paragraph 1 of Article XXIX.

(footnote original) 1 The authentic text erroneously reads “subparagraph 5 (a)”.

4. The margin of preference* on any product in respect of which a preference is permitted under paragraph 2 of this Article but is not specifically set forth as a maximum margin of preference in the appropriate Schedule annexed to this Agreement shall not exceed:

(a) in respect of duties or charges on any product described in such Schedule, the difference between the most-favoured-nation and preferential rates provided for therein; if no preferential rate is provided for, the preferential rate shall for the purposes of this paragraph be taken to be that in force on April 10, 1947, and, if no most-favoured-nation rate is provided for, the margin shall not exceed the difference between the most-favoured-nation and preferential rates existing on April 10, 1947;

(b) in respect of duties or charges on any product not described in the appropriate Schedule, the difference between the most-favoured-nation and preferential rates existing on April 10, 1947.

In the case of the contracting parties named in Annex G, the date of April 10, 1947, referred to in subparagraph (a) and (b) of this paragraph shall be replaced by the respective dates set forth in that Annex.

– **General Agreement on Trade in Services (GATS)**

Article II: Most-Favoured-Nation Treatment

1. With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country.
2. A Member may maintain a measure inconsistent with paragraph 1 provided that such a measure is listed in, and meets the conditions of, the Annex on Article II Exemptions.
3. The provisions of this Agreement shall not be so construed as to prevent any Member from conferring or according advantages to adjacent countries in order to facilitate exchanges limited to contiguous frontier zones of services that are both locally produced and consumed.

II. Case Law

The following two panel reports date from the 1980s and are among the relatively few pure MFN disputes. Compare the following two GATT panel reports and consider how to reconcile their legal rationales. Focus in particular on the expressly and implicitly applied criteria for determining likeness, and keep in mind the economic rationale for the MFN obligation.

2-1. Spain—Coffee, Report of the Panel, 11 June 1981 (L/5135 - 28S/102)

Start by trying to understand the market: what was Spain's rationale for introducing a differentiation in their tariff between mild and other coffees?

Litigation Exercise: if there had been an Appellate Body at the time Spanish Coffee was decided and you were Spain's legal counsel, how would you have phrased your appeal to show that "mild" coffee and "unwashed Arabica" are not like products?

SPAIN - TARIFF TREATMENT OF UNROASTED COFFEE

Report of the Panel adopted on 11 June 1981 (L/5135 - 28S/102)

I. INTRODUCTION

1.1 In a communication dated 13 September 1979 and circulated to contracting parties, Brazil informed that a new Spanish law had introduced certain modifications in the tariff treatment applied to imports of unroasted coffee, according to which imports into Spain of unroasted non-decaffeinated "unwashed Arabica" and Robusta coffees (tariff No. 09.01A) were now subject to a tariff treatment less favourable than that accorded to "mild" coffee. Prior to this new law there had been no differentiation in the tariff treatment applied by Spain to imports of unroasted coffee. As a main supplier of coffee to Spain, Brazil was concerned with the discriminatory character of the new tariff rates and had requested Article XXII:1 consultations with Spain (L/4832).

(...)

II. FACTUAL ASPECTS

2.1 The following is a brief description of factual aspects of the matter under dispute as the Panel understood them.

2.2 On 8 July 1979, the Spanish authorities enacted the Royal Decree No. 1764/79 (B.O.E. of 20 July) by which the tariff treatment and the sub-tariff classification applied to imports of unroasted, non-decaffeinated coffee (ex. CCCN 09.01) were modified and amended, effective by 1 March 1980. Imports of unroasted coffee, which prior to this last date entered Spain's customs territory under one and the same designation, was sub-divided into five tariff lines to which duty rates applied as follows:

Table 1

Spain's present tariff treatment for unroasted non-decaffeinated coffee beans

(Royal Decree 1764/79 - Tariff No. 09.01. A.1a)

Product description	Duty rate
1. Columbian mild	Free
2. Other mild	Free
3. Unwashed Arabica	7 percent ad. val.
4. Robusta	7 percent ad. val.
5. Other	7 percent ad. val.

2.3 Prior to the Royal Decree 1764/79, imports of unroasted coffee into Spain were subject to a customs duty of 25 per cent ad valorem, which was subsequently reduced to 22.5 per cent. In 1975, by Decree-Law 13/75 of 17 November of that year, Spain exempted imports of certain food products, including unroasted coffee, from customs duties when they were imported under the State-trading system.

2.4 Ever since Spain acceded to GATT, customs duties on raw coffee were never bound, and, therefore, not included in Schedule XLV of Spanish concessions in GATT.

2.5 On the same date, 8 July 1979, the Spanish authorities also published the Royal Decree 1765/79 which provided that as from 1 March 1980 imports of unroasted coffee would cease to be under State-trading and would begin to be marketed by private entities. Prior to that, imports of unroasted coffee into Spain were the monopoly of the Office of the General Commissioner for Supply and Transport (CAT) which also had exclusive responsibility for domestic supply.

2.6 Under the State-trading régime and intervention in the domestic market, the use of blends was prohibited in Spain and coffee was obligatorily marketed under the designations Superior, Regular and Popular, which largely corresponded to the types "mild", "unwashed Arabica", and Robusta, respectively. The CAT also maintained a system of maximum authorized prices for each of these types of coffee.

2.7 On 30 November 1979, a Ministerial Order (Ministry of Trade and Tourism) did away with the requirement to market coffee under the designations Superior, Regular and Popular. Confirming this removal of obligatory designations, the Resolution of the same Ministry's General Directorate of Domestic Trade, of 8 February 1980, indicated a single maximum price for the domestic sale of these products without distinction as to type.

2.8 This latter resolution having also been superseded, the Panel further understood that, at the present time, domestic coffee prices were free in the Spanish market.

2.9 Spain's imports of raw coffee clearly showed a rising trend over the period of 1967-1979 having increased two-fold by volume, and ten-fold by value.

Table 2
Spain's Imports of Raw Coffee
(Tariff No. 09.01.A.1 and Statistical No. 09.01.01)

Year	Metric tons	Million pts.	Main suppliers
1967	42,215	2,378	Colombia, <u>Brazil</u> , Mexico, Angola
1968	49,075	2,997	Colombia, <u>Brazil</u> , Angola, Mexico
1969	61,877	3,767	Colombia, <u>Brazil</u> , Angola, Mexico
1970	78,963	5,747	Colombia, <u>Brazil</u> , Angola, Uganda
1971	66,353	4,916	Colombia, <u>Brazil</u> , Angola, Mexico
1972	80,239	5,786	Colombia, <u>Brazil</u> , Angola, Equatorial Guinea
1973	73,464	5,789	<u>Brazil</u> , Colombia, Angola, Mexico
1974	84,898	7,215	Colombia, <u>Brazil</u> , Angola, Mexico
1975	75,788	6,325	Colombia, Angola, Ivory Coast, <u>Brazil</u>
1976	91,698	13,765	<u>Brazil</u> , Ivory Coast, Uganda, Colombia
1977	77,479	31,693	<u>Brazil</u> , Ivory Coast, Colombia, Uganda
1978	83,226	24,452	Colombia, <u>Brazil</u> , El Salvador, Ivory Coast
1979	99,621	22,291	Colombia, Uganda, <u>Brazil</u> , Ivory Coast

Source: Foreign Trade Statistics of Spain - General Directorate of Customs.

Note: The above figures cover only imports into the Peninsula and the Balearic Islands and exclude imports into Free Zones.

2.10 The increases in value and volume were not parallel, owing not only to international market fluctuations but also to differences in the composition of the Spanish imports, in terms of types of coffee. While varying, the main suppliers always included both Brazil and Colombia, although neither was always the principal supplier.

2.11 Spain's imports of unroasted coffee from Brazil were constituted of almost entirely "unwashed Arabica", and they evolved in most recent times as shown by Table 3.

Table 3
Spain's Imports of Raw Coffee (metric tons)

	1976	1977	1978	1979	March-September 1980
Total	91,698	77,749	83,226	99,621	74,668
[From] Brazil	40,672	24,946	18,137	18,573	21,004
% of total	44.35	32.08	21.69	18.64	28.13

III. MAIN ARGUMENTS

Article I:1

3.1 The representative of Brazil argued that by introducing a 7 per cent tariff rate on imports of unroasted, non-decaffeinated coffee of the "unwashed Arabica" and Robusta groups, while affording duty-free treatment to coffee of other groups, the new Spanish tariff régime was discriminatory against Brazil, which exports mainly "unwashed Arabica", but also Robusta coffee, and therefore was in violation of Article I:1 of the General Agreement, according to which:

"... any advantage, favour, privilege or immunity granted by any contracting party to any product originating in ... any other country shall be accorded immediately and unconditionally to the like product originating in ... the territories of all other contracting parties."

3.2 In this connection, he noted that, as did Spain herself under her previous tariff régime, no other contracting party discriminated in its customs tariff as between "types" or as among "groups" of coffee.

3.3 The representative of Spain, stressed that no contracting party was obliged to retain either its tariff structure, or its duties, applicable to the importation of products which have not been bound. He recalled that the Brussels nomenclature adopted by Spain did specify tariff headings but left it to each country to establish, if it is so wished, sub-headings within these headings. Accordingly, the Spanish authorities had the right to establish within a given heading the sub-divisions which were most suited to the characteristics of Spain's foreign trade, while respecting, as Spain has done on many occasions, the bound duties previously negotiated.¹ The classification criterion adopted was based on classifications made by international organizations, specifically the International Coffee Organization (ICO).

3.4 In order to ascertain the coverage of Article I:1 it was necessary, in the view of the Spanish representative, to consider two aspects in detail: (a) meaning of the term "like products", and (b) existence of any preference or pretermission in respect of a country as a consequence of the new structure of heading No. 09.01.A.1 of the Spanish tariff. The Spanish authorities continued to hold that, in their judgment, the provisions of the Royal Decree 1764/79 were fully compatible with the obligations assumed by Spain under the General Agreement, and in particular Article I:1 thereof. ... These authorities furnished photocopies of importing licences in Spain, issued after 1 March 1980, which evidenced that the new tariff classification was applied according to the nature of products, and completely independently of the country of origin. In particular, these licences evidenced that Brazilian "washed" coffee was imported into Spain free of duty.

"Like products"

3.5 Recalling that in some past GATT cases it had been suggested that "like products" were all the products falling within the same tariff heading, the representative of Spain did not agree with that opinion. In his view, this interpretation could lead to serious mistakes, given that products falling within one and the same tariff heading could be unlike and clearly different, as for example: (i) in the case of all the residual tariff headings ("other products not specified"), covering a large

number of heterogeneous products, and (ii) headings including homogeneous products where in many instances these were not "like products" (i.e. CCCN heading No. 15.07 including all kinds of vegetable oils; CCCN heading No. 22.05 including all wines, etc.).

3.6 The Spanish representative pointed out that qualitative differences did exist between various types of coffee considering both technico-agronomic, economic and commercial criteria. He argued that Robusta coffee bean was morphologically different from the Arabica coffee bean, having a different chemical composition and yielding a neutral beverage that was lacking in aroma and was richer in soluble solids than the beverage made from Arabica coffee.

3.7 Although both "mild" and "unwashed Arabica" coffees belonged to the group of Arabica, the Spanish representative further argued that differences in quality also existed between them, as a result of climatic and growing conditions as well as methods of cultivation and above all the preparation because aroma and taste, essential features in determining trade and consumption of these products, were completely different in "washed" and "unwashed" Arabica coffees. Different quotations in international trade and commodity markets were due to these factors.

3.8 As distinctive markets existed for the various types of unroasted coffee, the Spanish representative was of the view that such various types of coffee could not be regarded as "like products". This was particularly evident in the Spanish market where, for historical reasons, consumers' preference for the various types of coffee was well established, in contrast with other markets in which the use of blends was more generalized. When referring to the increasing market share of blends outside Spain, he argued that the existence of blends proved that the various types of coffee were not the same products.

3.9 For his part, the representative of Brazil argued that coffee was one single product and that, therefore, for the purpose of Article I:1 of the GATT, must be considered a "like product". He further argued that in the specific case of "mild" and "unwashed Arabica" coffees, both came from the same species of plant, and often from the same variety of tree. He also stated that, in such cases, the product could be extracted from the same individual tree, and the classification as "unwashed Arabica" or "mild" would depend exclusively on the treatment given to the berries.

3.10 He pointed out, therefore, that existing differences between "growths" or "groups" of coffee were essentially of an organoleptic nature (taste, aroma, body, etc.) resulting from geographical conditions and, principally, from the distinct methods of preparation of the beans.

3.11 He stated that the classification presently used by Spain for tariff purposes had been introduced by the International Coffee Organization in 1965/66, when the Council of the Organization decided to create groupings of coffee-producing countries as part of a system for the limited adjustment of export quotas in response to changes in an indicator price of "mild Arabicas", "unwashed Arabicas" and "Robustas". He further stated that the composition of each grouping depended upon political decisions taken yearly by the Council of the Organization, according to which each exporting country was placed in the group corresponding to the kind of coffee constituting the greater part of its production. He stressed that since 1972 these groupings had only served a statistical purpose.

3.12 He argued that, from the point of view of the consumer, virtually all coffee, either roasted or soluble, was sold today in the form of blends, combining in varying proportions coffee belonging to different groups. Moreover, in everyday language, the terms type, quality, and

growth were used interchangeably to indicate specific grades of coffee, for instance Colombian Mams, El Salvador Central Standard, Paraná 4, Angola Ambriz 2AA, etc. In his view, this was the only characterization really meaningful for trading purposes, since no roaster did buy a "Colombian mild" or "unwashed Arabica" as such, but rather well-known grades, priced according to the beverage they could provide.

3.13 He further stated that with respect to its end use, coffee was a well determined and one single product, generally intended for drinking as a beverage.

Differentiation made in the Spanish tariff

3.14 Explaining the economic reasons beyond the differentiation introduced in the Spanish tariff by the Royal Decree No. 1764/79, the representative of Spain said that the lower customs duty applicable to "mild" coffee imported into Spain reflected the Spanish Government's deep concern over the possible impact on prices of measures to return coffee to the private sector and afford greater trade liberalization. In this connection, he noted that coffee accounted for more than 2 per cent in the Spanish consumer price index. He also said that in the previous trade system of State-trading in which a nil tariff duty existed since 1975, nevertheless the difference between import prices and selling prices to roasters ("precios de cesión") in practice constituted an implicit tariff affecting all imports of coffee. This implicit tariff was higher than the tariff duties effectively applied since March 1980.

3.15 Having recalled that a very high proportion of "mild" coffee was consumed in the Spanish market, he noted that this very high proportion of "mild" in Spanish consumption had been maintained by keeping artificially low the retail price of "mild" coffee through the operation of the previously existing system of authorized prices.

3.16 In view of the foregoing, he indicated that his authorities had considered that the only way of reconciling consumers' preference for "mild" coffee and the transfer of the coffee trade to the private sector was to establish different rates of custom duty, with a zero duty on the most expensive coffee, i.e. "mild" coffee. In so doing, his authorities had not at any time given any thought to which countries were producing the different types of coffee. In fact, different types or groups of coffee were often grown in one and the same country and more than thirty countries were producing both Robusta and "unwashed Arabica".

3.17 Finally, the Spanish representative stressed the transitional character of the coffee import régime actually applied by his country. He said that his authorities ultimately aimed, in the shortest possible time, at introducing in respect of coffee a system of automatic licensing and free domestic trade.

3.18 Referring to the stated anti-inflation objective of the Spanish measures, the representative of Brazil was of the view that such argument was not relevant to the case under dispute, since, whatever the motivation to introduce the new tariff régime for unroasted coffee, such motivation did not exempt Spain from complying with the provisions of Article I:1 of the GATT.

(...)

IV. FINDINGS AND CONCLUSIONS

4.1 The Panel has carried out its consideration of the matter referred to it for examination in the light of its terms of reference and on the basis of various factual information which was available to it, and of arguments presented to it by the parties to the dispute.

4.2 The Panel considered that it was called upon to examine whether the Spanish tariff régime for unroasted coffee introduced by Spain through the Royal Decree 1764/79 (ref. paragraph 2.2) was consistent with Spanish obligations under the GATT, and more precisely whether it was in conformity with the most-favoured-nation provision of Article I:1.

4.3 Having noted that Spain had not bound under the GATT its tariff rate on unroasted coffee, the Panel pointed out that Article I:1 equally applied to bound and unbound tariff items.

4.4 The Panel found that there was no obligation under the GATT to follow any particular system for classifying goods, and that a contracting party had the right to introduce in its customs tariff new positions or sub-positions as appropriate.¹ The Panel considered, however, that, whatever the classification adopted, Article I:1 required that the same tariff treatment be applied to "like products".

4.5 The Panel, therefore, in accordance with its terms of reference, focused its examination on whether the various types of unroasted coffee listed in the Royal Decree 1764/79 should be regarded as "like products" within the meaning of Article I:1. Having reviewed how the concept of "like products" had been applied by the CONTRACTING PARTIES in previous cases involving, *inter alia*, a recourse to Article I:1² the Panel noted that neither the General Agreement nor the settlement of previous cases gave any definition of such concept.

4.6 The Panel examined all arguments that had been advanced during the proceedings for the justification of a different tariff treatment for various groups and types of unroasted coffee. It noted that these arguments mainly related to organoleptic differences resulting from geographical factors, cultivation methods, the processing of the beans, and the genetic factor. The Panel did not consider that such differences were sufficient reason to allow for a different tariff treatment. It pointed out that it was not unusual in the case of agricultural products that the taste and aroma of the end-product would differ because of one or several of the above-mentioned factors.

4.7 The Panel furthermore found relevant to its examination of the matter that unroasted coffee was mainly, if not exclusively, sold in the form of blends, combining various types of coffee, and that coffee in its end-use, was universally regarded as a well-defined and single product intended for drinking.

4.8 The Panel noted that no other contracting party applied its tariff régime in respect of unroasted, non-decaffeinated coffee in such a way that different types of coffee were subject to different tariff rates.

4.9 In the light of the foregoing, the Panel concluded that unroasted, non-decaffeinated coffee beans listed in the Spanish Customs Tariffs under CCCN 09.01 A.1a, as amended by the Royal Decree 1764/79, should be considered as "like products" within the meaning of Article I:1.

4.10 The Panel further noted that Brazil exported to Spain mainly "unwashed Arabica" and also

Robusta coffee which were both presently charged with higher duties than that applied to "mild" coffee. Since these were considered to be "like products", the Panel concluded that the tariff régime as presently applied by Spain was discriminatory vis-à-vis unroasted coffee originating in Brazil.

(...)

2-2. *Japan—Lumber, Report of the Panel, 19 July 1989 (L/6470 - 36S/167)*

Once again, start by analyzing the market. Who are the relevant players? Why is Canada complaining? And what was Japan's rationale for differentiating between the various forms of lumber?

Litigation Exercise – Spanish Coffee Redux: suppose once more that you are appealing Spanish Coffee. Does the decision in Japan—Lumber afford you any new tools for pleading your case? What, if anything, does Japan—Lumber reveal about how Spanish Coffee got it wrong?

CANADA/JAPAN: TARIFF ON IMPORTS OF SPRUCE, PINE, FIR (SPF) DIMENSION
LUMBER

Report of the Panel adopted on 19 July 1989 (L/6470 - 36S/167)

(...)

II. FACTUAL ASPECTS

A. Definition of, and Information relating to, "Dimension Lumber" (supplied by Canada - paragraphs 2.1 through 2.12)

2.1 Canada explained that while lumber was generally thought of as a raw material, or a semi-finished product, that is further manufactured to produce a wide range of goods, dimension lumber is different. It is a highly standardized, finished product that leaves the manufacturing plant in its final form. It is not further manufactured before being used in its intended end-use of platform-frame construction. Dimension lumber is a building product. As such, it is more akin to a steel girder used in construction than it is to other forms of lumber.

2.2 Dimension lumber is produced from a number of species of trees, the two most common groupings for this use being the SPF and Hemlock-Fir (Hem-Fir), although other species can be and are used. Trees of different species tend to grow in stands of mixed species, many of which have similar properties. It is usually not practical, nor necessary, to separate logs by individual species before manufacture, so species groups were developed to accommodate these mixed growths. All the species within a group are harvested, processed, graded and marketed together. An individual species cannot be classified in more than one species group.

2.3 The lumber industry in North America comprises thousands of sawmills. The most common product of virtually all of these mills is dimension lumber. In fact many of these mills are designed with the sole objective of producing the single product of dimension lumber which is completely interchangeable in construction and competes freely in the marketplace. The manufacturing and lumber grading systems are designed to ensure that the lumber is produced to the same sizes and grades, regardless of mill or species of lumber. It is not uncommon, nor is it a problem, to find dimension lumber of different species, from different mills, being used on the same job-site in North America and in Japan.

2.4 The definition of dimension lumber has been highly standardized in North America. The basic requirements are established by the Canadian Standards Association (Standard 0141-1970) and the US Department of Commerce National Bureau of Standards (Voluntary Product Standard PS 20-70). These standards are exactly the same in both countries in their application to dimension lumber.

(...)

2.7 ... [A]ccording to Canada, dimension lumber can be identified, and distinguished from all other forms of lumber through a combination of three elements: size, surfacing and appearance, and lumber grade. The assignment of a "dimension lumber"-type grade automatically defines the product as dimension lumber and distinguishes it from all other types. Dimension lumber that enters Japan is normally regraded, regardless of the North American grade that has been applied, to ensure conformity with the standards established by the Japanese Agricultural Standard for Structural Lumber for Wood Frame Construction, hereafter referred to as the JAS 600. A JAS stamp must be applied before the lumber can be used generally in Japan for platform-frame construction. The JAS 600 grades are unique to dimension lumber in Japan and distinguish it from all other types of imported and domestic lumber.

(...)

III. MAIN ARGUMENTS OF THE PARTIES

A. Canada's Case

3.1 Canada, in requesting Council to establish a Panel, explained, in document L/6315, (extract):

"The Government of Canada considers that the eight per cent tariff applied to imports of SPF dimension lumber [Japanese tariff number 4407.10.110] is not in conformity with the provision of Article I:1 of the General Agreement concerning the equal treatment of like products. It is Canada's view that dimension lumber made from SPF and dimension lumber made from other species of wood are like products under the meaning of Article I:1. The latter enter Japan with zero duty.

(...)

3.2 Canada stated that Article I:1 of the GATT imposes an obligation on contracting parties to provide equal tariff treatment, immediately and unconditionally, to "like-products", regardless of national origin. The Japanese duty treatment of SPF dimension lumber has had, and continued to have, a negative impact on Canadian exports. Canada had helped to create in Japan the platform-frame construction method, which is based on dimension lumber. However, Canada has become increasingly concerned with the discriminatory effect of the tariff on SPF dimension lumber which inhibits the ability of Canadian SFP suppliers to reap full benefit from the market which they have been largely responsible for creating.

(...)

Precedents relied upon by Canada

(...)

3.7 Canada considered that there was, in particular, a direct parallel between the Coffee Panel case and the case at hand. Both cases involved products with natural origins, subject to unbound tariffs. In both cases the products in question were exported by the complaining contracting party, as well as by other contracting parties. In both the Coffee Panel and the present case the product attracting the higher tariff rate was the one which constituted the larger share of exports of the complaining party. Additionally, in both cases the tariff sub-divisions which created the discrimination had been unilaterally determined by the importing contracting party. More specifically, the Coffee Panel had examined a case where Spain applied a higher tariff rate to imports of unwashed Arabica and Robusta coffees than it did to other groups of coffee. Brazil had complained that this constituted discrimination between "like products", in contravention of Spain's obligations under Article I:1 of the GATT.

3.8 Canada recalled that Spain had argued that the imposition of different tariffs to the various types of coffee was fully compatible with Spain's GATT obligations, since the tariff classification was applied according to the nature of the products and was independent of the country of origin. A very similar situation was found in the present case. Japan claimed that, since exports of a specific type of dimension lumber were treated the same for tariff purposes, regardless of country of origin, Article I:1 was not relevant. Canada noted in this connection that the Coffee Panel had ruled on products being exported from Brazil only, and had made no direct reference to the exports of third countries and, further, that the Panel's judgement was made on a product-, not on a country-basis. In Canada's view the results of the Coffee Panel confirmed that there is in GATT Article I:1 an obligation to provide equal tariff treatment to like products. Canada considered therefore that the conclusions of the Coffee Panel applied equally to the present case and that the same obligations apply to Japan, namely that Japan must not discriminate between "like products" in the application of duties. In Canada's view the focus of the SPF Dimension Lumber Panel should be on whether the products in question are like products within the meaning of Article I:1.

B. "Dimension Lumber" and Japanese Tariff Classification

(...)

3.10 Japan explained that in the Japanese Tariff "dimension lumber" is not separately identified, or referred to, as a customs- or statistical code-entity. While Japan saw no particular difficulty in recognizing that "dimension lumber", whether it be of SPF, hemlock, or any other coniferous species, might be a product manufactured by reliance on highly sophisticated technology, in its view, it remained a half-finished wood product, in no way different from planed lumber. Product attributes such as size, nominal measurements, strength evaluation, planing on four sides and stamps notwithstanding, Japan considered that "dimension lumber" was not truly distinguishable from planed lumber generally. While, admittedly, in North America "dimension lumber" might be produced to some extent without separating logs by individual tree species, this practice could not be considered to constitute a sufficient basis for giving all dimension lumber a universal status, or to qualify it for coverage under a single tariff line in the, not infrequent, cases where tariffs were

sub-categorized by species.

(...)

3.12 Japan explained that, "dimension lumber" was not a universal, clearly defined product and, as of now, there was not a single country, or market, which had established in its import tariff classification, or schedule, a specific item for dimension lumber; nor did the Harmonized System recognize, or identify, 'dimension lumber' as an independent item. In its written submission Japan had demonstrated that the range of sizes considered by Canada to be 'dimension lumber' had changed over time in North America, that the term was not understood in the same way in the trade-literature, that it was interpreted differently in North America, New Zealand and in Australia, that the interpretation in Japan was not the same and was, moreover, in evolution, even with reference to the JAS 600.

(...)

C. *Reasons for Specifications in Japanese Tariff*

3.21 Japan explained that tariff rates had been set for each item reflecting the item's special characteristics, including import-needs and the protection of related domestic industries. Thus, in 1962, when Japan was entering a phase of rapid economic growth, domestic resources of Japanese cedars - 16 - (sugi) and cypresses (hinoki) had largely been depleted as sources of building materials in the wake of postwar economic recovery. Since there existed a huge domestic demand for such lumber, lumber prices had soared. In that situation, Japan liberalized its forest-products-trade (which had been regulated since the end of World War II for foreign exchange control purposes) with the intention of promoting imports of lumber so as to meet domestic demand not satisfied by domestic resources. Japan decided to reduce import duties depending on the particular situation of each species and, consequently, introduced species distinctions, in its tariff schedule. Lumber of species in high demand, and for which no protection was felt to be required, mainly Douglas fir and hemlock (as substitutes, respectively, for "sugi" and "hinoki"), benefited from the introduction of a zero duty. Likewise, red cedar, considered to be a substitute for Japanese cedar as appearance lumber, was made duty-free. The previously generally applicable import duty rate of 15 per cent was reduced to 10 per cent for pine-, fir-, spruce-and larch-species lumber. A duty of 10 per cent for these species' lumber was retained because the relevant domestic industries were in need of protection and limited domestic demand reduced the need for imports. The duty reductions effected at that time were not the result of any negotiations, but constituted unilateral action by Japan, reflecting the domestic lumber supply and demand situation.

(...)

3.24 As Japan saw it, pine-fir-spruce, when compared with other species, were inferior in terms of lumber quality. The fir and spruce genera had insufficient decay resistance and pine lumber usually had large knots and its grain was not straight. When these lumber species were to be employed in building and other purposes their uses were limited.

3.25 Spruce-pine-fir (SPF) grow naturally, or are planted, in the northern parts of Japan, or in the long mountain range areas with low soil productivity. Due to the fact that these tree species are inferior in timber quality, and are moreover inconveniently located, the related forestry and wood-industries experienced low profitability and were in need of protection. Fostering other tree species, or implanting alternative industries, in the areas where SPF species were growing, was difficult. Compared to pine-fir-spruce, the situation and prospects for other coniferous species were markedly different. Among other coniferous trees the major species growing in Japan were "hinoki" (Japanese cypress, *Chamaecyparis obtusa*) and "sugi" (*Cryptomeria japonica*). Both of these were strongly in demand for house construction purposes. Major imported species of other coniferous trees were hemlock and Douglas-fir. These species had superior strength and other physical characteristics and were used as building-components requiring strength. Imports of such species were regarded as substitutes for sugi and hinoki. Domestic resources of sugi and hinoki were insufficient to meet a sustained high level of demand, with the result that the price level for such lumber was high and that the forestry and wood-industry activities related to sugi and hinoki enjoyed high profitability. To meet market-demand it was necessary to promote the importation of hemlock and Douglas-fir.

(...)

IV. FINDINGS

5.1 Under its terms of reference established by the Council the Panel had to examine a complaint by Canada that the application of a tariff duty of 8 per cent on imports of spruce-pine-fir (SPF) dimension lumber by Japan is not in conformity with the provisions of Article I:1 of the General Agreement and nullifies and impairs benefits accruing to Canada under the General Agreement, SPF dimension lumber being a "like product" as compared to other types of dimension lumber entering Japan with zero duty.

5.2 The Panel noted that Heading No. 4407.10 of the Japanese Tariff was defined in conformity with the International Convention on the Harmonized Commodity Description and Coding System of 14 June 1983 (hereinafter called the Harmonized System) as follows:

4407	"Wood sawn or chipped lengthwise, sliced or peeled, whether or not planed, sanded or finger-jointed, of a thickness exceeding 6 mm":
4407.10	"Coniferous"

5.3 The Panel further noted that the dispute before the Panel largely focused on the consistency with Article I:1 of the 8 per cent tariff imposed by Japan under sub-position 4407.10-110 of the Japanese Tariff:

4407.10-110	1. "Of <u>Pinus spp.</u> , <u>Abies spp.</u> (other than California red fir, grand fir, noble fir and pacific silver fir) or <u>Picea spp.</u> (other than Sitka spruce), not more than 160mm in thickness,
-------------	---

(1) planed or sanded."

5.4 According to Canada, Article I:1 required Japan to accord also to SPF dimension lumber the advantage of the zero tariff granted by Japan, under sub-position 4407.10-320 of its Tariff, to planed and sanded lumber of "other" coniferous trees, including the genera cedar and other Chamaecyparis, hemlock (Tsuga), and douglas-fir (Pseudotsuga), and five species excluded from sub-position No. 4407.10-110.

5.5 The Panel noted that the tariff classification for 4407.10-110 had been established autonomously by Japan, without negotiation.

5.6 The terms of Article I:1, as far as they are relevant to the issue, read as follows:

General Most-Favoured Nation Treatment

"With respect to customs duties ... imposed on ... imports ... any advantage ... granted by any contracting party to any product originating in ... any other country ... shall be accorded ... to the like product originating in ... all other contracting parties."

5.7 In view of analysing the factual situation submitted to it under its terms of reference, the Panel had first to consider the legal framework in which the Canadian complaint had been raised. In substance, Canada complains of the fact that Japan had arranged its tariff classification in such a way that a considerable part of Canadian exports of SPF 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 a zero-tariff duty. The Panel considered it impossible to appreciate fully the Canadian complaint if it had not in a preliminary way clarified the bearing of some principles of the GATT-system in relation to tariff structure and tariff classification.

5.8 The Panel noted in this respect that the General Agreement left wide discretion to the contracting parties in relation to the structure of national tariffs and the classification of goods in the framework of such structure (see the report of the Panel on Tariff Treatment of Unroasted Coffee, BISD 28S/102, at III, paragraph 4.4). The adoption of the Harmonized System, to which both Canada and Japan have adhered, had brought about a large measure of harmonization in the field of customs classification of goods, but this system did not entail any obligation as to the ultimate detail in the respective tariff classifications. Indeed, this nomenclature has been on purpose structured in such a way that it leaves room for further specifications.

5.9 The Panel was of the opinion that, under these conditions, a tariff classification going beyond the Harmonized System's structure is a legitimate means of adapting the tariff scheme to each contracting party's trade policy interests, comprising both its protection needs and its requirements for the purposes of tariff- and trade negotiations. It must however be borne in mind that such differentiations may lend themselves to abuse, insofar as they may serve to circumscribe tariff advantages in such a way that they are conducive to discrimination among like products originating in different contracting parties. A contracting party prejudiced by such action may request therefore that its own exports be treated as "like products" in spite of the fact that they might find themselves excluded by the differentiations retained in the importing country's tariff.

5.10 Tariff differentiation being basically a legitimate means of trade policy, a contracting party which claims to be prejudiced by such practice bears the burden of establishing that such tariff

arrangement has been diverted from its normal purpose so as to become a means of discrimination in international trade. Such complaints have to be examined in considering simultaneously the internal protection interest involved in a given tariff specification, as well as its actual or potential influence on the pattern of imports from different extraneous sources. The Canadian complaint and the defence of Japan will have to be viewed in the light of these requirements.

5.11 "Dimension lumber" as understood by Canada is defined by its presentation in a standard form of measurements, quality-grading and finishing. It appears from the information provided by Canada that this type of lumber is largely used in platform-house construction in Canada as well as in the United States and that it has found also widespread use in Japan, as is testified by the existence of a Japanese technical standard known under the name of "JAS 600".

5.12 Japan objected to this claim on different grounds. Japan explained that dimension lumber was only one particular type of lumber among many other possible presentations and that house-building is only one of the many possible uses of this particular kind of lumber. From the legal point of view, Japan contended that the concept of "dimension lumber" is not used either in any internationally accepted tariff classification, or in the Japanese tariff classification. In accordance with the Harmonized System, position No. 4407.10 embraces all types of coniferous wood "sawn or chipped lengthwise ... exceeding 6mm". Apart from the thickness and the grade of finishing, customs treatment of lumber according to the Japanese Tariff was determined exclusively on the basis of a distinction established between certain biological genera or species. Dimension lumber was therefore not identified as a particular category in the framework of the Japanese tariff classification.

5.13 The Panel considered that the tariffs referred to by the General Agreement are, quite evidently, those of the individual contracting parties. This was inherent in the system of the Agreement and appeared also in the current practice of tariff negotiations, the subject matter of which were the national tariffs of the individual contracting parties. It followed that, if a claim of likeness was raised by a contracting party in relation to the tariff treatment of its goods on importation by some other contracting party, such a claim should be based on the classification of the latter, i.e. the importing country's tariff.

5.14 The Panel noted in this respect that "dimension lumber" as defined by Canada was a concept extraneous to the Japanese Tariff. It was a standard applied by the Canadian industry which appeared to have some equivalent in the United States and in Japan itself, but it could not be considered for that reason alone as a category for tariff classification purposes, nor did it belong to any internationally accepted customs classification. The Panel concluded therefore that reliance by Canada on the concept of dimension lumber was not an appropriate basis for establishing "likeness" of products under Article I:1 of the General Agreement.

5.15 At the same time, the Panel felt unable to examine the Canadian complaint in a broader context, as Canada had declared expressly that the issue before the Panel should not be confused by broadening the scope of the Panel's examination beyond 'dimension lumber' to planed lumber generally. Canada's complaint was limited to the specific product known in North America, and also in Japan, as dimension lumber. Canada did not contend that different lumber species per se should be considered like products, regardless of the product-form they might take (see para. 3.15 above). Thus there appeared to be no basis for examining the issue raised by Canada in the general context of the Japanese tariff classification.

5.16 In these circumstances the Panel was not in a position to pursue further the questions

relating to the concept of "like products" in the framework of Article I:1 of the General Agreement.

V. CONCLUSIONS

6.1 In the light of the considerations set out in Section V above, the Panel could not establish that the tariff treatment of Canadian dimension lumber applied by Japan under its tariff number 4407.10-110 was inconsistent with Article I:1 of the General Agreement.

III. Exceptions

- **Regionalism** (*cf. UNIT II*)

GATT Art. XXIV and GATS Art. V

- **Enabling Clause and GSP**
(http://www.wto.org/english/tratop_e/devel_e/d2legl_e.htm)

The Enabling Clause, officially called the “Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries” was adopted under GATT in 1979 and enables developed members to give differential and more favorable treatment to developing countries.

The Enabling Clause is the WTO legal basis for the **Generalized System of Preferences (GSP)** and the **Global System of Trade Preferences (GSTP)**.

Under the Generalized System of Preferences, developed countries offer non-reciprocal preferential treatment (such as zero or low duties on imports) to products originating in developing countries. Preference-giving countries unilaterally determine which countries and which products are included in their schemes.

Under the Global System of Trade Preferences, developing countries which are members of the **Group of 77** (links to Group 77 website) exchange trade concessions among themselves. UNCTAD provides technical assistance to beneficiaries and conducts analyses of the various schemes.

The Enabling Clause is also the legal basis for **regional arrangements** among developing countries.

- **Waiver (Lomé Convention)**
(http://www.wto.org/english/tratop_e/devel_e/d2legl_e.htm#waivers)

Going beyond legal provisions stated explicitly in WTO agreements, actions in favor of developing countries may also be taken under “**waivers**” from the main WTO rules.

These waivers are granted by the General Council according to procedures set out in Article IX:3 of the Marrakesh Agreement Establishing the WTO. Recent examples of waivers include the EC/France Trading Arrangements with Morocco, the US — Caribbean Basin Economic Recovery Act (CBERA), the Canadian Tariff Treatment for Commonwealth Caribbean Countries (CARIBCAN), the US — Andean Trade Preference Act, and the ACP-EC Partnership Agreement (currently under consideration).