

THE MOST FAVOURED NATION PRINCIPLE - DECLINING EFFECTIVENESS IN THE WORLD TRADING SYSTEM

BY IJEOMA UCHEIBE

The Most-Favored-Nation clause MFN forbids Members to discriminate between trading partners. It is typically seen as one of the main features of the multilateral trading system, and appears in several of the agreements in the World Trade Organization. There is a widespread and strongly held belief among policy makers that there are strong economic rationales for the provision. The purpose of the paper is to talk about its importance in inclusion in international trade agreements, arguments for economic benefits and declining effectiveness of this principle in light of present day realities and change in world trade.

Keywords: Most-Favored-Nation , World Trade Organisation

INTRODUCTION

It is often been peddled around even though cliché that the world has become a global village thanks to technological advancement and also due to trading across borders which is an activity that has become a global phenomenon with its resultant effects. In view of these obvious developments, the need for regulations to govern these activities as it involved nations arose and one of the by products is the creation of the World Trade Organisation to cater to the administration of the various International Trade Instruments already in place before its coming into being. One of the aims of the WTO as enshrined in Art. I. and principles of the trading system is the creating of an international trading plain devoid of discrimination and this can be seen from two principles of the WTO;

1. The Most Favoured Nation principle (MFN) and;
2. National Treatment principle.

The Most Favoured Nation and National Treatment principle are well entrenched in the 3 major International trade instruments [General Agreement on Tarrifs and Trade (GATT), General Agreement on Trade in Services (GATS), Trade Related Aspects of Intellectual Property (TRIPS)] under the auspices of the World Trade Organisation.

In international economic relations and international politics, "**most favoured nation**" (MFN) is a status or level of treatment accorded by one [state](#) to another in [international trade](#). The term means the country which is the recipient of this treatment must, nominally, receive equal trade advantages as the "most favoured nation" by the country granting such treatment. (Trade advantages include low [tariffs](#) or high [import quotas](#).) In effect, a country that has been accorded MFN status may not be treated less advantageously than any other country with MFN status by the promising country. There is a debate in legal circles whether MFN clauses in [bilateral investment treaties](#) include only substantive rules or also procedural protections.

The members of the [World Trade Organization](#) (WTO) agree to accord MFN status to each other. Exceptions allow for preferential treatment of [developing countries](#), regional [free trade areas](#) and [customs unions](#). Together with the principle of [national treatment](#), MFN is one of the cornerstones of WTO [trade law](#). This principle also extends to foreign and domestic services, and to foreign and local trademarks, copyrights and patents.

This paper seeks to look at the philosophy of the non discrimination principle while considering its historical background and how it operates in principle under the three major international trade instruments. The paper concludes with a holistic study of its economic significance while weighing its effectiveness in the light of creation of other trading systems(MINTS, E7, BRICS) in light of existing realities in international trade and whether this recent retreat fromMFN is something that represents a fundamental threat to the multilateral trading system ormerely a natural evolutionary step on the path to greater trade.

HISTORICAL BACKGROUND TO THE MOST FAVOURED NATION (NON DISCRIMINATION) PRINCIPLE

Although the non-discriminationprinciple have come to particular prominence in the economic sphere, nothing about its operation restricts it to economic matters, and indeed its original development was predicated on a larger scope sociopolitically. In reality, the non-discriminatory principle fundamentally constitutes just a promise from one state to another that no third state will receive favorable treatment in some specific field and as a result of this, no conclusive birth date is likely to be ascertained. Such promises have, after all, likely been made for as long as states have entered into agreements with one another.

While the expression “most-favored nation” only became common in the seventeenth century, the rise of international commerce in the late medieval period saw states adopting non discriminatory principle as a means of ensuring that their traders would compete in foreign markets on at least equal terms with traders from third

states. However, a huge change occurred in the structure of these clauses in the seventeenth and eighteenth centuries, by which time the growth in global trade resulted in these clauses becoming a standard feature of almost all international economic agreements entered into by nations and corporations alike. In addition, they were now also usually both general and prospective, applying to any benefit given to any third state within a particular substantive field, usually tariffs, and to both already-existing benefits and those given in the future.

Today's concept of the most favoured nation status starts to appear in the 18th century, which is when the division of conditional and unconditional most favoured nation status also began. In the early days of [international trade](#), "most favoured nation" status was usually used on a dual-party, state-to-state basis. A nation could enter into a "most favoured nation" treaty with another nation. With the [Jay Treaty](#) in 1794, the US granted "most favoured nation" trading status to Britain. This tactical use of the clauses became most explicit in the treaty making activities of the United States in the nineteenth century. On its emergence into international commerce in the late eighteenth century, the United States had found itself in an international market heavily geared against it. As a producer of primarily agricultural products, the United States relied on exportation of such products to generate the income necessary to pay for the importation of manufactured products from Europe. However, European nations had erected large tariff barriers against the importation of agricultural products, and unless the United States could negotiate lower tariffs, its products could not compete in European markets. Negotiating lower tariffs was certainly possible, but if the United States agreed to include Non Discrimination clauses in its treaties, as had become standard by that time, each negotiated reduction would automatically be transferred to every other nation with which the United States had a Non Discrimination agreement. In effect, the United States would gain tariff reductions from just one country, while giving them away freely to every other European state.

The solution adopted by the United States was what came to be known as the *conditional* Non Discrimination clause. Prior to this time, Non Discrimination clauses were *unconditional* in their operation. The conditional clauses included within U.S. treaties, however, required that in order for the state benefiting from the clause to gain access to any more favorable treatment granted to a third state, it had to offer the United States a concession equivalent to that given by the third state. If no equivalent compensation was offered, no obligation to extend the more favorable treatment to the beneficiary arose. Since the United States was the ultimate judge of what constituted equivalent value, the conditional clause was effectively just an invitation to renegotiate the terms of the original treaty. The justification publicly offered by the United States for its insistence on the use of conditional clauses was that providing a benefit to a state via a Non Discrimination clause without securing equivalent compensation to that given by the original recipient of the benefit actually privileged the beneficiary of the clause. It therefore created precisely the inequality of treatment that the clauses were intended to eliminate. More realistically, of course, the true explanation for the United States' adoption of this policy is likely found in the power the policy gave it to decide for itself when it would and would not extend preferential treatment. Contrary to any understanding of the Non Discrimination clauses of this period as reflecting a commitment to nondiscrimination, European states had no objection in principle to conditional clauses. Indeed, although it was the United States that came to be identified with the use of the conditional clauses, it was in fact France that had initially proposed to the United States that a conditional clause be adopted for their 1778 treaty. Consequently, it is unsurprising that for a short period the conditional clause became the norm even within Europe. Nonetheless, in reality, the United States was the only state that truly benefited from conditional treatment, with the conditional clauses adopted by European states ultimately having the same substantive effect as unconditional clauses.

Because of the effect unconditional clauses have on conditional clauses, a state that has signed even a single unconditional clause will gain no benefit from negotiating conditional clauses. Only the fact that the United States was a new State entering into its

first round of treaties allowed it to successfully adopt conditional clauses, and only a continued insistence on this policy allowed them to remain effective.

As a result of such practices, by the end of the nineteenth century the non discrimination clause had largely fallen out of favor with States. Indeed, hostility to the clause was so strong in France that all its treaties containing Non Discrimination clauses were denounced, and a law was passed forbidding the French government from entering into any future treaties containing Non Discrimination clauses. But this hostility to the clause was relatively short lived, and the clause regained its popularity in the period between the two World Wars. Indeed, in 1923 even the United States came to endorse the unconditional non discriminatory clause. Notably, though, this was not because of a newfound appreciation of the benefits of multilateral nondiscrimination, but because the United States' continued use of conditional Non Discrimination clauses had become counterproductive in the face of the hostility of its trading partners. As a result, a practice of bilateral, prospective, general, and unconditional Non Discrimination clauses began and has remained the dominant approach to the present day.

Since 1947, MFN has been steadily weakened. The first blow came in 1958 with the inclusion of Article 24, permitting customs unions and free trade areas. This was followed by the US-Canada auto pact in 1965 and the Generalized System of Preferences in 1971. However, these were relatively minor exceptions compared to the experience since the mid-1970s. In the Tokyo Round (1973-79), industrialized countries began to complain of a "free rider" problem—smaller countries opting out of trade-barrier reductions, while continuing to benefit, through MFN, from the trade-barrier reductions of the large countries. The US Congress, in particular, mandated in the 1974 trade act that the US apply conditional MFN to the Tokyo Round. As a result, several codes were negotiated as "plurilateral" agreements, applying to only to GATT members that signed them. The Uruguay Round (1986-1994) side-stepped the free-rider problem by abolishing the GATT *per se* and requiring all countries to join a new agreement, the WTO, containing the GATT, GATS, TRIPs and TRIMs. Moreover, these new agreements contained numerous exceptions to MFN, notably in financial services and information technology. Also, the

number and scope of regional trade arrangements has exploded in the last decade. All of this raises the main question to be addressed in this paper: what could account for the strong large-country support for unconditional MFN in the early GATT years, and why has it apparently evaporated?

PRINCIPLES OF THE WORLD TRADE ORGANISATION TRADING SYSTEM

The WTO agreements are lengthy and complex because they are legal texts covering a wide range of activities. They deal with: agriculture, textiles and clothing, banking, telecommunications, government purchases, industrial standards and product safety, food sanitation regulations, intellectual property, and much more. But a number of simple, fundamental principles run throughout all of these documents. These principles are the foundation of the multilateral trading system. A closer look at these principles:

1. Trade without discrimination
 - a. Most-favoured-nation (MFN): treating other people equally

Under the WTO agreements, countries cannot normally discriminate between their trading partners. Grant someone a special favour (such as a lower customs duty rate for one of their products) and you have to do the same for all other WTO members. This principle is known as most-favoured-nation (MFN) treatment. It is so important that it is the first article of the General Agreement on Tariffs and Trade (GATT), which governs trade in goods. MFN is also a priority in the General Agreement on Trade in Services (GATS) (Article 2) and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) (Article 4). Together, those three agreements cover all three main areas of trade handled by the WTO.

Some exceptions are allowed. For example, countries can set up a free trade agreement that applies only to goods traded within the group – discriminating against goods from outside. Or they can give developing countries special access to their markets. Or a country can raise barriers against products that are considered to be traded unfairly from

specific countries. And in services, countries are allowed, in limited circumstances, to discriminate. But the agreements only permit these exceptions under strict conditions. In general, MFN means that every time a country lowers a trade barrier or opens up a market, it has to do so for the same goods or services from all its trading partners – whether rich or poor, weak or strong.

b. National treatment: Treating foreigners and locals equally

Imported and locally-produced goods should be treated equally – at least after the foreign goods have entered the market. The same should apply to foreign and domestic services, and to foreign and local trademarks, copyrights and patents. This principle of “national treatment” (giving others the same treatment as one’s own nationals) is also found in all the three main WTO agreements (Article 3 of GATT, Article 17 of GATS and Article 3 of TRIPS), although once again the principle is handled slightly differently in each of these.

National treatment only applies once a product, service or item of intellectual property has entered the market. Therefore, charging customs duty on an import is not a violation of national treatment even if locally-produced products are not charged an equivalent tax.

2. FREER TRADE

Lowering trade barriers is one of the most obvious means of encouraging trade. The barriers concerned include customs duties (or tariffs) and measures such as import bans or quotas that restrict quantities selectively. From time to time other issues such as red tape and exchange rate policies have also been discussed. Since GATT’s creation in 1947-48 there have been eight rounds of trade negotiations. A ninth round, under the Doha Development Agenda, is now underway. At first these focused on lowering tariffs (customs duties) on imported goods. As a result of the negotiations, by the mid-1990s industrial countries’ tariff rates on industrial goods had fallen steadily to less than 4%. But by the 1980s, the negotiations had expanded to cover non-tariff barriers on goods, and to

the new areas such as services and intellectual property. Opening markets can be beneficial, but it also requires adjustment. The WTO agreements allow countries to introduce changes gradually, through “progressive liberalization”. Developing countries are usually given longer to fulfil their obligations.

3. PREDICTABILITY: THROUGH BINDING AND TRANSPARENCY

Sometimes, promising not to raise a trade barrier can be as important as lowering one, because the promise gives businesses a clearer view of their future opportunities. With stability and predictability, investment is encouraged, jobs are created and consumers can fully enjoy the benefits of competition – choice and lower prices. The multilateral trading system is an attempt by governments to make the business environment stable and predictable.

In the WTO, when countries agree to open their markets for goods or services, they “bind” their commitments. For goods, these bindings amount to ceilings on customs tariff rates. Sometimes countries tax imports at rates that are lower than the bound rates. Frequently this is the case in developing countries. In developed countries the rates actually charged and the bound rates tend to be the same. A country can change its bindings, but only after negotiating with its trading partners, which could mean compensating them for loss of trade. One of the achievements of the Uruguay Round of multilateral trade talks was to increase the amount of trade under binding commitments. In agriculture, 100% of products now have bound tariffs. The result of all this: a substantially higher degree of market security for traders and investors. The system tries to improve predictability and stability in other ways as well. One way is to discourage the use of quotas and other measures used to set limits on quantities of imports – administering quotas can lead to more red-tape and accusations of unfair play. Another is to make countries’ trade rules as clear and public (“transparent”) as possible. Many WTO agreements require governments to disclose their policies and practices publicly within the country or by notifying the WTO. The regular surveillance of national trade

policies through the Trade Policy Review Mechanism provides a further means of encouraging transparency both domestically and at the multilateral level.

4. PROMOTING FAIR COMPETITION

The WTO is sometimes described as a “free trade” institution, but that is not entirely accurate. The system does allow tariffs and, in limited circumstances, other forms of protection. More accurately, it is a system of rules dedicated to open, fair and undistorted competition. The rules on non-discrimination – MFN and national treatment – are designed to secure fair conditions of trade. So too are those on dumping (exporting at below cost to gain market share) and subsidies. The issues are complex, and the rules try to establish what is fair or unfair, and how governments can respond, in particular by charging additional import duties calculated to compensate for damage caused by unfair trade. Many of the other WTO agreements aim to support fair competition: in agriculture, intellectual property, services, for example. The agreement on government procurement (a “plurilateral” agreement because it is signed by only a few WTO members) extends competition rules to purchases by thousands of government entities in many countries. And so on.

5. ENCOURAGING DEVELOPMENT AND ECONOMIC REFORM

The WTO system contributes to development. On the other hand, developing countries need flexibility in the time they take to implement the system’s agreements. And the agreements themselves inherit the earlier provisions of GATT that allow for special assistance and trade concessions for developing countries. Over three quarters of WTO members are developing countries and countries in transition to market economies. During the seven and a half years of the Uruguay Round, over 60 of these countries implemented trade liberalization programmes autonomously. At the same time, developing countries and transition economies were much more active and influential in the Uruguay Round negotiations than in any previous round, and they are even more so in the current Doha Development Agenda. At the end of the Uruguay Round, developing

countries were prepared to take on most of the obligations that are required of developed countries. But the agreements did give them transition periods to adjust to the more unfamiliar and, perhaps, difficult WTO provisions – particularly so for the poorest, “least-developed” countries. A ministerial decision adopted at the end of the round says better-off countries should accelerate implementing market access commitments on goods exported by the least-developed countries, and it seeks increased technical assistance for them. More recently, developed countries have started to allow duty-free and quota-free imports for almost all products from least-developed countries. On all of this, the WTO and its members are still going through a learning process. The current Doha Development Agenda includes developing countries’ concerns about the difficulties they face in implementing the Uruguay Round agreements.

APPLICATION OF THE MOST FAVOURED NATION (NON DISRIMINATION) PRINCIPLE UNDER INTERNATIONAL TRADE INSTRUMENTS

The Most – Favoured – Nation (MFN) treatment obligation under the General Agreement on Tariffs and Trades (GATT), General Agreement on Trade in Services (GATS) and Trade Related Aspects of Intellectual Property (TRIPS) constitute one of the founding principles of the WTO law against non – discrimination in trade and services respectively. This section will at the WTO rules on MFN as they apply in goods and services sectors, some of the traditional exceptions to MFN rules since the latter were enacted and the recent trend that led to the importance of MFN being steadily marginalized over the last two to three decades. The subsequent paragraphs will examine seriatim the aforementioned issues in accordance with the relevant provisions under the GATT, GATS, and the TRIPS.

To reiterate, the MFN treatment obligation is very important as it is the ‘cornerstone’ of GATT 1994 and one of the ‘pillars’ of the WTO trading system. It is provided for under GATT Article I:1 in respect of trade in goods, and GATS Article II:1 in respect of trade in services. It has become apparent that the MFN treatment obligation is in practice less prevalent than one would have expected of the ‘cornerstone of the GATT’ and ‘one of the pillars of the WTO trading system’.

MOST-FAVOURED-NATION TREATMENT UNDER THE GATT 1994

Article I of the GATT 1994, entitled *General Most-Favoured-Nation Treatment*, states in paragraph 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.

Article I: 1 of the GATT 1994 prohibits discrimination *between* like products originating in, or destined for, different countries. The principal purpose of the MFN treatment obligation is to ensure *equality of opportunity* to import from, or to export to, all WTO Members.

Article I: 1 of the GATT 1994 sets out a three-tier test of consistency. There are three questions which must be answered to determine whether there is a violation of the MFN treatment obligation of Article I: 1, namely:

- a. whether the measure at issue confers a trade advantage of the kind covered by Article I:1;
- b. whether the products concerned are like products; and
- c. whether the advantage at issue is granted immediately and unconditionally to all like products concerned.

A. A TRADE ADVANTAGE OF THE KIND COVERED BY ARTICLE I: 1

The MFN treatment obligation concerns any advantage granted by any Member with respect to customs duties, custom matters, other charges on imports and exports, internal taxes and internal regulation affecting the sale, distribution and use of products. The MFN treatment obligation not only concerns advantages granted to other WTO Members, but advantages granted to all other countries (including non-WTO Members). If a Member grants an advantage to a non-Member, Article I: 1 obliges the Member to grant that advantage also to all WTO Members.

In *Canada – Autos*, the Appellate Body usefully clarified the scope of Article I: 1 by ruling:

.....the words of Article I:1 refer not to some advantages granted "with respect to" the subjects that fall within the defined scope of the Article, but to "any advantage"; not to some products, but to "any product"; and not to like products from some other Members, but to like products originating in or destined for "all other" Members.

In other words, the MFN treatment obligation requires that *any* advantage granted by a Member to any product from or for another country be granted to *all* like products from or for *all other* Members.

B. LIKE PRODUCTS

Article I: 1 concerns any product originating in or destined for any other country and requires that an advantage granted to such product shall be accorded to the 'like product' originating in or destined for the territories of all other Members. It is only between 'like products' that the MFN treatment obligation applies and that discrimination is prohibited. Products that are not 'like' may be treated differently.

The concept of 'like products' is used not only in Article I:1 but also in Article II:2(a), III:2, III:4 VI:1(a), IX:1, XI:2(c), XIII:1, XVI:4 and XIX:1 of the GATT 1994. Nevertheless, the concept of 'like products' is not defined in the GATT 1994.

The meaning of the phrase 'like products' in Article I: 1 was addressed in a number of GATT working party and panel reports. In *Spain –Unroasted Coffee*, the Panel had to decide whether various types of unroasted coffee ('Colombian mild', 'other mild', 'unwashed Arabica', 'Robusta' and 'other') were 'like products' within the meaning of Article I:1. Spain did not apply customs duties on 'Colombia mild' and 'other mild'; while it imposed a 7 per cent customs duty on the other three types of unroasted coffee. Brazil, which exported mainly 'unwashed Arabica', claimed that the Spanish tariff regime was inconsistent with Article I: 1. In examining whether the various types of unroasted coffee were 'like products' to which the MFN treatment obligation applied, the Panel considered the characteristics of the products, their end-use, and the tariff regimes of other members; based on these considerations, the Panel concluded that unroasted, non decaffeinated coffee beans listed in the Spanish Customs Tariffs should be considered as "like products" within the meaning of Article I:1.

C. ADVANTAGE GRANTED 'IMMEDIATELY AND UNCONDITIONALLY'

Article I: 1 requires that any advantage granted by a WTO Member to imports from any country must be granted 'immediately and unconditionally' to imports from all other WTO Members. Once a WTO Member has granted an 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.

The granting of an advantage within the meaning of Article I: 1 may not be conditional on whether a Member has certain characteristics, has certain legislation or undertakes certain action. In the Belgium – Family Allowances case, a dispute of 1952, concerning a Belgian law providing for an exemption from a levy on products purchased from countries which had a system of family allowances similar to that of Belgium, the Panel held that the Belgian law at issue:

... introduced a discrimination between countries having a given system of family allowances and those which had a different system or no system at all, and made the granting of the exemption dependent on certain conditions. The Panel concluded that the advantage – the exemption from a levy was not granted 'unconditionally' and that the Belgian law was, therefore, inconsistent with the MFN treatment obligation of Article I: 1.

EXCEPTIONS TO THE MFN TREATMENT UNDER GATT

1. Regional Integration (GATT ARTICLE XXIV)

Regional integration through customs unions or free trade areas liberalizes trade among countries within the regions, while maintaining trade barriers with countries outside the region or regions. Regional integration therefore may lead to results that are contrary to the MFN principle because countries inside and outside the region are treated differently. Thus, countries outside the region could be disadvantaged. Nevertheless, GATT Article XXIV provides that regional integration may be allowed as an exception to the MFN rule only if the following conditions are met:

- a. tariffs and other barriers to trade must be eliminated with respect to substantially all trade within the region; and
- b. the tariffs and other barriers to trade applied to outside countries must not be higher or more restrictive than they were prior to regional integration.

2. Generalised System of Preferences

The Generalised System of Preferences (GSP) program is a system that grants certain products originating in eligible developing countries preferential tariff treatment over those normally granted under MFN status. GSP is a special measure designed to help developing countries increase their export earnings and promote development. It is a benefit unilaterally granted by developed countries to less developed countries. GSP is allowed in the GATT decision on "Generalized System of Preferences" of June 1971. To be permissible, GSP must have the following characteristics:

- a. preferential tariffs should be applied not only to countries with special historical and political relationships (e.g., the British Commonwealth), but also to developing countries more generally; and
- b. the beneficiaries are limited to developing countries.

3. Frontier Traffic Exception

Article XXIV: 3 of the GATT allows advantages to be accorded by any contracting party to adjacent countries in order to facilitate frontier traffic

4. Historical Preferences

Article I: 2 creates an exception regarding historical preferences that were in force at the signing of the GATT, such as the British Commonwealth.

5. Measures Necessary to Protect Public Health, Morals Life Etc

Article XX of the GATT allows contracting parties to make measures necessary to protect public morals, human, animal or plant life or health, etc.

6. Security Exceptions

Article XXI of the GATT allows a contracting party to go out of the principle on security grounds. It provides inter alia that a contracting party may refuse the disclosure of any information the disclosure of which it considers contrary to its essential security interests; a contracting party can also take actions which it considers necessary for the protection of its essential security interests

7. Non-Application of Multilateral Trade Agreements between Particular Member States under WTO Article XIII

The Marrakesh Agreement Establishing the World Trade Organization (the "WTO Agreement") provides that:

"this Agreement and the Multilateral Trade Agreement in Annexes 1 and 2 shall not apply as between any Member and any other Member", when any of the following two conditions are met: (a) at the time the WTO went into force, Article XXXV of GATT 1947 had been invoked earlier and was effective as between original Members of the WTO which were Members to GATT 1947or; (b) "between a Member and another Member which has acceded under Article XII(of the WTO agreement) only if the Member not consenting to the application has so notified the

Ministerial Conference before the approval of the agreement on the terms of accession by the Ministerial Conference."

In January 1995, the United States notified the General Council that it would not apply the Agreement and the Multilateral Trade Agreements in Annexes 1 and 2 to Romania. In February 1997 the United States withdrew its notification. In addition, the United States notified that it would not apply the above-mentioned agreements to three other new Members: Mongolia, the Kyrgyz Republic, and Georgia. The United States withdrew its notification for Mongolia in July 1999, for the Kyrgyz Republic in September 2000, and for Georgia in January 2001.

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

MOST FAVOURED NATION TREATMENT UNDER THE GATS

Article II: 1 of the General Agreement on Trade in Services provides:

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.

As is the case with the MFN treatment obligation under the GATT 1994, the principal purpose of the MFN treatment obligation of Article II: 1 of the GATS is to ensure *equality of opportunity, in casu*, for services and service suppliers from *all* WTO Members. The MFN treatment obligation of Article II: 1 of the GATS applies both to *de jure* and to *de facto* discrimination.

TEST OF CONSISTENCY WITH ARTICLE II: 1 OF THE GATS

Article II: 1 of the GATS sets out a four-tier test of consistency; these are whether:

- a. the measure is a measure covered by the GATS;
- b. the services or service suppliers concerned are like services or service suppliers;
- c. less favourable treatment is accorded to the services or service suppliers of a Member and;
- d. immediately and unconditionally.

Measures Covered by this Agreement

By virtue of article II: 1 of GATS, for a measure to be covered by GATS, it must be a measure by a member and such measure must affect trade in services. A 'measure by a Member' is a very broad concept. As stated in Article I: 3(a) of the GATS, a 'measure by a Member' is not limited to measures taken by the central government or central government authorities. Measures taken by regional or local governments and authorities are also 'a measure by a Member' within the meaning of Article I: 1 of the GATS. Measures taken by non-governmental bodies are 'a measure by a member' when these measures are taken in the exercise of powers delegated by governments or authorities. A 'measure by a Member' can be a law, regulation, rule, procedure, decision or administrative action, but can also take any other form. A 'measure by a Member' within the meaning of Article I: 1 can thus be a national parliamentary law as well as municipal decrees or rules adopted by professional bodies.

The concept of a 'measure affecting trade in services' has been clarified by the Appellate Body in *Canada - Autos*. The Appellate Body stated that two key issues must be examined to determine whether a measure is one 'affecting trade in services', namely: whether there is 'trade in services' in the sense of Article I: 2 and whether the measure in issue affects such trade in services within the meaning of Article I: 1. For a measure to affect trade in services the measure is not required to regulate or govern the trade i.e., the supply of services; a measure is covered by the GATS if it *affects* trade in services, even though the measure may regulate other matters. A measure affects trade in services when the measure bears upon the conditions of competition in supply of a service.

Like Services or Service Suppliers

Once it has been established that the measure at issue is covered by the GATS, the second element of the three-tier test of consistency concerning Article II: 1 comes into play, namely whether the "services" or "service suppliers" concerned are "like services" or "service suppliers". It is only between 'like services' or "service suppliers" that the MFN treatment obligation applies and that discrimination is prohibited. "Services" or "service suppliers" that are not "like" may be treated differently.

Treatment No Less Favourable

The third element of the test of consistency under Article II: 1 of the GATS concerns the treatment accorded to 'like services' or 'like service suppliers'. The treatment must not be less favourable than that which applies to "like services" or "like service suppliers"

Immediately and Unconditionally:

The treatment must be granted at once and without being qualified. It cannot be postponed or subject to the occurrence of certain events.

EXEMPTION FROM THE MFN TREATMENT UNDER GATS

Article II: 2 of the GATS provides:

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.

In principle, exemptions *should* not exceed a period of ten years thus by January 2005, all exemptions under Article II: 2 should have come to an end. In the meantime, all exemptions granted for a period of more than five years are reviewed after five years by the Council for Trade in Services. In such a review, the Council examines whether the conditions that created the need for the exemption still prevail and sets a date for any further review. In any case, the exemption terminates on the date provided for in the exemption. It is important to note that the exemption list may not identify Members that would *not* benefit from MFN; the exemption list may only identify members which would benefit from more market access than other members.

It should be noted that by virtue of paragraph II on the annex on article II exemption, any new exemption applied for after the date of entry into force of the WTO agreement, shall be dealt with under paragraph 3 of article IX of the WTO agreement. The GATS allows for exceptions where Members may waive their obligation to provide most-favoured-nation treatment for specific measures in specific fields by listing the measure in the Annex on Article II Exemptions.

MOST FAVOURED NATION TREATMENT UNDER TRIPS

The MFN principle requires each Member to treat nationals of all other Members on an equivalent basis in relation to intellectual property protection. As bilateral pressures mounted in the late 1980s to increase intellectual property right protection, Uruguay Round negotiators became

concerned that some countries were indeed granting Intellectual Property Right privileges to foreign nationals more extensive than the rights granted to their own nationals. This focused attention on incorporating an MFN principle in TRIPS, so that all Members would obtain an equivalent level of protection when more extensive protection was granted to foreigners.

Article 4 of the TRIPS provides:

With regard to the protection of intellectual property, any advantage, favour, privilege or immunity granted by a Member to the nationals of any other country shall be accorded immediately and unconditionally to the nationals of all other Members.....

For the purpose of Article 4, “protection” shall include matters affecting the availability, acquisition, scope, maintenance and enforcement of intellectual property rights as well as those matters affecting the use of intellectual property rights specifically addressed in the TRIPS.

EXCEPTIONS TO THE MFN TREATMENT UNDER TRIPS

The concluding paragraph of article 4 of the TRIPS provides:

..... Exempted from this obligation are any advantage, favour, privilege or immunity accorded by a Member:

(a) deriving from international agreements on judicial assistance or law enforcement of a general nature and not particularly confined to the protection of intellectual property;

(b) granted in accordance with the provisions of the Berne Convention (1971) or the Rome Convention authorizing that the treatment accorded be a function not of national treatment but of the treatment accorded in another country;

(c) in respect of the rights of performers, producers of phonograms and broadcasting organizations not provided under this Agreement;

(d) deriving from international agreements related to the protection of intellectual property which entered into force prior to the entry into force of the WTO Agreement, provided that such agreements are notified to the Council for TRIPS and do not constitute an arbitrary or unjustifiable discrimination against nationals of other Members.

Article 5 of the TRIPS provides that the obligations under Articles 4 do not apply to procedures provided in multilateral agreements concluded under the auspices of WIPO relating to the acquisition or maintenance of intellectual property rights; thus if there is any provision in the TRIPS relating to the non discrimination principle that is inconsistent with any of these multilateral agreements, the provisions of such multilateral agreement will prevail. However, the TRIPS Agreement can provide for exemptions regarding measures based on existing treaties in the area of intellectual property.

NATIONAL TREATMENT PRINCIPLE

NATIONAL TREATMENT UNDER THE GATT 1994

Article III of the GATT 1994, entitled states in relevant part:

- 1. The [Members] recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.*
- 2. The products of the 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 like domestic products. Moreover, no [Member] 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.*
- 4. The products of the territory of any [Member] imported into the territory of any other [Member] 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 of the GATT 1994 prohibits discrimination against imported products. Generally speaking, it prohibits Members from treating imported products less favourably than like domestic products once the imported product has entered the domestic market. In *Korea – Alcoholic Beverages*, the Appellate Body identified the objectives of Article III as avoiding protectionism, requiring equality of competitive conditions and protecting expectations of equal competitive relationships.

Test of Consistency with Article III: 2

The test of consistency under article III: 2 is examined under the first sentence and second sentence of the article.

First Sentence of Article III: 2

Article III: 2, first sentence, states:

The products of the 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 like domestic products.

This provision sets out a two-tier test of consistency. In *Canada – Periodicals*, the Appellate Body found that there are two questions which need to be answered to determine whether there is a violation of Article III:2 of the GATT 1994: (a) whether imported and domestic products are like products; and (b) whether the imported products are taxed in excess of the domestic products. If the answers to both questions are affirmative, there is a violation of Article III: 2 first sentence.

5.1.1.2 Second Sentence of Article III: 2

The second sentence of Article III: 2 states:

Moreover, no Member 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.

Furthermore, the *Ad Article III Note* provides with respect to Article III: 2:

A tax conforming to the requirements of the first sentence of paragraph 2 would be considered to be inconsistent with the provisions of the second sentence only in

cases where competition was involved between, on the one hand, the taxed product and, on the other hand, a directly competitive or substitutable product which was not similarly taxed

Flowing from the above stated provisions, three separate issues must be addressed to determine whether an internal tax measure is inconsistent with Article III: 2, second sentence. These three issues are whether:

- (1) the imported products and the domestic products are directly competitive or substitutable products which are in competition with each other;
- (2) the directly competitive or substitutable imported and domestic products are not similarly taxed; and
- (3) the dissimilar taxation of the directly competitive or substitutable imported and domestic products is applied so as to afford protection to domestic production.

However, before this test of consistency of internal taxation can be applied, it must be established that the measure at issue is an internal tax or other internal charge within the meaning of Article III: 2, second sentence.

Test of Consistency with Article III: 4

The national treatment obligation of Article III of the GATT 1994 does not only concern internal taxation dealt with in Article III: 2. Article III also concerns internal regulation and this was primarily dealt with in Article III: 4. Article III: 4 states in relevant part:

The products of the territory of any member imported into the territory of any other member 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.

This provision sets out a three-tier test for the consistency of internal regulation. In *Korea – Various Measures on Beef*, the Appellate Body stated that for a violation of Article III: 4 to be established, three elements must be satisfied:

1. that the imported and domestic products at issue are “like products”;
2. that the measure at issue is a “law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution, or use”;

3. and that the imported products are accorded “less favourable” treatment than that accorded to like domestic products.

NATIONAL TREATMENT UNDER THE GATS

Article XVII of the GATS, which is entitled ‘*National Treatment*’, states in paragraph 1:

In the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers.

Nature of the National Treatment Obligation of Article XVII of the GATS

The national treatment obligation of Article XVII of the GATS is different from the national treatment obligation of Article III of the GATT 1994. As discussed above, for trade in goods, the national treatment obligation has *general* application to all trade. On the contrary, the national treatment obligation for trade in services does not have such general application; it does not apply generally to all measures affecting trade in services. The national treatment obligation applies only to the extent that WTO Members have explicitly committed themselves to grant ‘national treatment’ in respect of specific service sectors.

Consistency with Article XVII of the GATS

In the sectors inscribed in its Schedule and subject to the conditions, qualifications and limitations set out therein, a Member must accord treatment no less favourable, to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, than that it accords to its own like services and service suppliers. This requires the examination of whether:

1. the measure at issue affects trade in services;
2. the foreign and domestic services or service suppliers are ‘like’ services or service suppliers; and
3. the foreign services or service suppliers are granted treatment no less favourable.

This three-tier test of consistency is in tandem with the earlier discussed tests for the most favoured nation principle.

EXCEPTIONS TO THE NATIONAL TREATMENT PRINCIPLES UNDER GATS

Article XIV of the GATS allows member states to take measures contrary to the agreement on grounds of public morals or public order, protection of human and plant life e.t.c. Furthermore, Article XV also allows states to deviate from the provisions of the agreement on security grounds.

NATIONAL TREATMENT UNDER TRIPS

The national treatment principle requires each WTO Member to treat nationals of other Members at least as well as it treats its own nationals in relation to the protection of intellectual property. Article 3(1) of TRIPS provides that Each Member shall accord to the nationals of other Members treatment no less favourable than that it accords to its own nationals with regard to the protection of intellectual property, subject to the exceptions already provided in, respectively, the Paris Convention (1967), the Berne Convention (1971), the Rome Convention or the Treaty on Intellectual Property in Respect of Integrated Circuits.

For the purpose of Article 3, “protection” shall include matters affecting the availability, acquisition, scope, maintenance and enforcement of intellectual property rights as well as those matters affecting the use of intellectual property rights specifically addressed in the TRIPS.

EXCEPTIONS TO THE NATIONAL TREATMENT PRINCIPLE UNDER TRIPS

Article 3(2) of the TRIPS permits member states to derogate from the national treatment principle in matters that relates to judicial and administrative procedures, including the designation of an address for service or the appointment of an agent within the jurisdiction of a Member, only where such exceptions are necessary to secure compliance with laws and regulations which are not inconsistent with the provisions of this Agreement and where such practices are not applied in a manner which would constitute a disguised restriction on trade.

As noted under the MFN principle, the national treatment provisions in the World Intellectual Property Organisation conventions are incorporated by reference in TRIPS. There are several relatively complex exceptions from national treatment in the various WIPO conventions, and these are largely incorporated in TRIPS, for example, under article 6 of the Berne Convention 1971, where any country outside the Union fails to protect in an adequate manner the works of authors who are nationals of one of the countries of the Union, the latter country may restrict the protection given to the works of authors who are, at the date of the first publication thereof, nationals of the other country and are not habitually resident in one of the countries of the Union.

ECONOMIC BENEFITS OF THE MOST FAVOURED NATION (NON DISCRIMINATION) PRINCIPLE

Increased Efficiency in the World Economy

Non discrimination principle makes it possible for countries to import from the most efficient supplier, in accordance with the principle of comparative advantage. For example, if country “B” can supply product “X” at a lower price than country “C”, country “A” can increase its economic efficiency by importing it from country “B”. If, however, country “A” applies higher tariff rates to product “X” from country “B” than to product “X” from country “C”, country “A” may be forced to import product “X” from country “C”, even though country “C” is not as efficient a supplier. This distorts trade and reduces the welfare of country “A” and the economic efficiency of the entire world. However, under the MFN principle, country “A” must levy its tariffs equally with respect to countries “B” and “C” and therefore necessarily will import product “X” from country “B” because it is cheaper to do so. The most efficient result is thus attained.

Stabilisation of the Multilateral Trading System

The Non discrimination principle requires that favourable treatment granted to one country be immediately and unconditionally granted to all other countries. Trade restrictions, too, must be applied equally. This increases the risk of trade restrictions becoming a political issue, *i.e.*, it raises the costs and consequences of doing so, and therefore tends to support the liberalized *status quo*. By stabilising the free trade system in this manner, the principle increases predictability and therefore increases trade and investment.

Reduction of the Cost of Maintaining the Multilateral Trading System

Non Discrimination principle reduces the cost of maintaining the multilateral trading system. The equal treatment demanded by the principle tends to act as a force for unifying treatment at the most advantageous level (for trade that means the most liberal level). The establishment and maintenance of the principle enables WTO Members to reduce their monitoring and negotiating costs *vis-à-vis* disadvantageous treatment. In short, the principle has the effect of reducing the cost of maintaining the free trade system. Also, imports from all WTO Members are treated equally, reducing the cost of determining an import’s origin and improving economic efficiency.

DECLINING EFFECTIVENESS OF THE MOST FAVOURED NATION PRINCIPLE

The principle that was once tenaciously held on to by Union members has progressively lost its importance in the last three decades. The United States and other industrialised countries were once strong proponents of the generalised, unconditional Non Discrimination principle as a fundamental principle of International trade but in light of today's realities that support has greatly diminished as countries routinely adopt policies that circumvent the principle. Over time, union members have come up with a steady stream of de jure and de facto exceptions to the Non Discrimination principle.

A critical look at the background of the principle reveals a very different use of the principle by states; the clauses were used tactically as a means of gaining advantage over competitors, rather than due to any idealistic commitment to nondiscrimination; For example, The United States jettisoned the conditional clause to endorse the unconditional non discrimination clause not because of a newfound appreciation of the benefits of multilateral nondiscrimination, but because the United States' continued use of conditional clauses had become counterproductive in the face of the hostility of its trading partners. Thus from the onset, the motive behind the principle has never been to achieve equilibrium between trading partners in international trade. The draftsmen of the GATT were not oblivious of this fact and this may have informed the various loopholes that have been left in the GATT as a getaway ticket from the stranglehold of the non discrimination principle. States have resorted to the loopholes contained in the various trade agreements as a means of reducing the effect of the principle.

Prominent among these loopholes is the provisions of article XXIV of GATT. Article XXIV of GATT allows Custom Unions and Free Trade Agreements as exceptions to the non discrimination principle. To say that this exception has been grossly abused is an understatement; lately, countries have used these exceptions to create preferential trade situations and play favourites through these agreements. Preferential trade situations have the effect of creating the "beggar thy neighbour policies" between nations by opening up the possibilities of playing favourites; when someone is the favourite, there are others who are not and this leads to bad political relations-the mischief that the MFN was designed to curb. It could be argued that the drafters of article XXIV foresaw a possibility of its abuse by stating that:

For the purposes of this Agreement:

(a) A customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that

(i) duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated with respect to substantially all the trade between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories, and,

(ii) subject to the provisions of paragraph 9, substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union;

(b) A free-trade area shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated on substantially all the trade between the constituent territories in products originating in such territories.

From 1948-94 there were 124 notifications to the WTO of distinct Preferential Trade Agreements by its members. Since 1995, there have been at least an additional 90. According to Gardener Patterson, a former deputy director of the WTO:

Of all the GATT articles, this is [article XXIV] one of the most abused, and those abuses are among the least noted. Unfortunately therefore, those framing any new area[Free Trade Area]need have little fear that they will be embarrassed by some GATT body finding them in violation of their international obligations and commitments and recommending that they abandon or alter what they are about to do.

Thus, article XXIV has unwittingly whittled down the effect of article I of GATT which made provision for non discrimination in trade relations.

Also, the Generalised system of preferences was in principle supposed to be applied to less developed countries generally and not LDCs that have special historical and political relationships with developed countries. This is however far from what is obtainable in practice

as developed countries tend to associate themselves with LDCs that have historical and political relationships with them.

CONCLUSION

At this juncture, it is safe to assume that the recent attitude of States has made the MFN principle a mirage and the effectiveness of the principle is gradually eroded by the creation of other multilateral trading systems like the MINT, E7, BRICS to mention a few. Also, the problem of free riding has betrayed the confidence the industrialised countries once reposed in the non discrimination principle. Eliminating the “free riding” problem has proved to be an onerous task and this has led to the creation of numerous Free Trade Agreements which were mostly made in flagrant abuse of the requirement of existing International Trade Instruments. The painful reality is that the WTO and other bodies which are suppose to ensure compliance with the provisions of these Trade Instruments has been a toothless bull dog in the face of the flagrant abuse of the principle by so-called developed nations in the organisation.

In light of this troubling developments, it is high time the WTO lived up to its responsibilities by putting effecting checks in place to ensure strict compliance. Alternatively, in the absence of a defacto application of the principle, it is suggested that the current dejure application of the principle is jettisoned for free multilateral trade agreement so as to give State parties a clear definition of the exact nature of the dealings between parties.

REFERENCES

1. Joanne Gowa & Raymond Hicks, *'The most-favored nation rule in principle and practice; Discrimination in the GATT'* Published online: 10 January 2012, Springer Science and Business Media, LLC 2011
2. Pinar Cebi & Rodney D. Ludema (Georgetown University), 'The Rise and Fall of the Most-Favored-Nation Clause' USITC December 2001.
3. Rodney D. Ludema & Anna Maria Maydat, 'Do Countries Free Ride on MFN?' Georgetown University and CEPR, June 2006
4. Michael J. Ferrantino and H. Keith Hall, 'The Direct Effects of Trade Liberalization on Foreign Direct Investment: A Partial Equilibrium Analysis', U.S. International Trade Commission Office of Economics
5. Nuno Limao, 'Are Preferential Trade Agreements with Non-trade Objectives a Stumbling Bloc for Multilateral Liberalisation?' University of Maryland June 2002
6. Denis Medvedev, 'Preferential Trade Agreements and Their Role in World Trade'.
7. Federico Ortino, 'The principle of non-discrimination and its exceptions in GATS: Selected Legal Issues'.
8. Jarrod Wong, 'The Application of Most-Favored-Nation Clauses to Dispute Resolution Provisions in Bilateral Investment Treaties'.
9. Marion Panizzon, 'Bilateral Migration Agreements and the Gats: Sharing Responsibility Versus Reciprocity'
10. Prabhash Ranjan, 'Bilateralism, MFN and TRIPS: Exploring Possibilities of Alternative Interpretation 13(4)', *International Trade Law and Regulation*, 67-78 (Sweet and Maxwell: London)

11. Julie A. Maupin, 'MFN-based jurisdiction in investor-state arbitration: is there any hope for a consistent approach?', Working Paper for the Centre for Trade and Economic Integration 26 October 2010.
12. Ryan Teksten, Professors Trachtman And Hudec, 'A Comparative Analysis Of GATS And GATT: A Trade In Services Departure From GATT's MFN Principle And The Effect On National Treatment And Market Access. ILO L240 Legal And Institutional Aspects Of International Trade August 26, 2010
13. Tony Cole, 'The Boundaries of Most Favored Nation Treatment In International Investment Law'.
14. Donald Mcrae, 'MFN in The GATT and WTO'.
15. McCloure, Mike, "[Most Favoured Nation Clauses - No favoured view on how they should be interpreted](#)". *Kluwer Arbitration Blog*. Retrieved 2014-09-19
16. [World Trade Organization. 1994. Regional Trade Agreements: Goods Rules](#)
17. Yi, Seong, Deong (2004). Commemorative Edition in Honour of Professor Paik, Choong-Hyun on his Retirement: Articles ; Most-Favoured Nation Treatment: Its Historical Developments and Concept. Vol. 11 No. 1
18. Bhagwati, Jagdish and Arvind Panagariya, "Preferential Trading Areas and Multilateralism: Strangers, Friends, or Foes?," in *The Economics of Preferential Trading Arrangements*, Jagdish Bhagwati and Arvind Panagariya (eds), 78, American Enterprise Institute, Washington, D.C., 1996.
19. [The World Trade Organisation website, Understanding the WTO-principles of the trading system.htm](#) Last retrieved 15th September, 2014.
20. Alexander AchiaFotoh, Exceptions To and the Fate of the Most Favoured Nation Treatment Obligation under the GATT and GATS, *Munich Personal RePEc Archive*, 12 September 2012, p. 2-3
21. Part II Chapter 1 Most-Favoured-Nation Treatment Principle, pp. 323-327, (searched the web for complete citation but couldn't locate the author of this paper as at submission of this seminar paper)

22.B, Foluso, ' Application of the MFN and NT under International Trade Instrument'
being a seminar paper presented in International Economic Law class, 2012/2013
Session.