


Subject: **Law**

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Paper : **International Trade Law**

Module : **The Most favored Nation Treatment**



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DESCRIPTION OF MODULE

Items	Description of Module
Subject Name	Law
Paper Name	International Trade Law
Module Name/Title	Most Favoured Nation
Module Id	6
Pre-requisites	<ul style="list-style-type: none">• What is the MFN principle, its significance for developing countries?• Definition of like products,• Definition of non-discriminatory treatment.
Objectives	To understand the following: <ul style="list-style-type: none">• The principle of most favoured nation as the cornerstone of the GATT and its bearing on international trade policy regulation.• To understand the origins of this principle along with the scope of this provision as provided by virtue of Article I of the GATT, 1947; with respect to discrimination both <i>de jure</i> and <i>de facto</i>.
Keywords	GATT, most favoured nation treatment, like products, <i>de jure</i> discrimination, <i>de facto</i> discrimination.



E-TEXT

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TEXT

6.1. Introduction:

The principle of Most Favored Nation (popularly known as the MFN treatment) is a fundamental principle of trade ensuring non-discrimination between 'like' goods and services.

The clause on the Most Favored Treatment principle is in essence a misnomer. The clause relates to providing the same benefit and concession to one Member, in case benefits and concessions are provided to another Member. MFN hence calls for non-discrimination amongst Members inter-se; so for example, in case a country 'A' provides a tariff concession to a country 'B' by imposing a 10% duty on import of cars, 'A' is obligated to charge the same rate of 10% to the imports of cars by Country 'C'. In this sense, a nation is bound to treat every other nation as its favorite or most favored nation. Thus, with respect to the GATT, a Contracting Party is expected to treat every other Contracting Party as its favorite nation.

6.2. History of the MFN principle:



The origins of the MFN is said to be traced back to the World War – I with European trade alliances being one of the major reasons of the war due to their discriminatory practices. Countries hence realized the importance of the MFN clause and began to negotiate various bilateral and plurilateral agreements during the war. The birth of the League of Nations then saw the inclusion of an unconditional MFN clause to promote the principles of free trade. Trade liberalization saw countries taking advantage of the new international economic order by exporting products and services they had an expertise over, and consequently importing products and services they were not so good at; making countries mutually interdependent over one another. Given the change in circumstances, and the new economic scenario, equality of treatment to importers *inter se* became imperative with the drafting conferences on the GATT in London (1946) and Geneva (1947); making MFN treatment the cornerstone of the ITO Charter. With the failure of the (ITO) Charter, MFN treatment was successfully added in the form of Article I of the GATT to assure traders that they will be treated equally in the exports of ‘like’ products; and that any concession granted to one Member, shall unconditionally be granted to another.

With the conclusion of the Uruguay Round negotiations in 1994 at the Ministerial Conference in Marrakesh on 15th April, 1994, various Agreements were part of the new World Trade Organization as a new start to international trade law. Countries realized that there was more to trade in goods and due to new developments in technology and expertise in various services, countries began to export services like never before. With the mutual interdependence of Members, there was a need to assure trading partners that their services and service suppliers would be given the same treatment as that of like services and service suppliers of other Members. MFN treatment was hence not limited merely to trade in goods, but also to trade in services.

In matters of intellectual property, the Paris and Berne Convention did not consider it essential to include an MFN clause given the fact that the existence of the principle of national treatment made it imperative to provide benefits to nationals of other Members in case benefits were provided to nations of one Member. Discrimination would thus be justified only if nationals of another country were given more favorable treatment than nationals of its own country. The Agreement forming the TRIPS hence decided to include the MFN clause to address such scenarios.



The scope of MFN is hence largely the same in services and intellectual property: that being to ensure non-discrimination of 'like' goods. However, while the principle of national treatment calls for equal treatment of 'like' goods and services to imported products and domestic products; the MFN principle ensures that there is equality of treatments amongst imported goods and services inter-se.

6.3. Modes of discrimination

In order to obtain a thorough understanding of the principle of most-favored nation, it is vital to understand the forms of discrimination. Discrimination may either be *de jure* or *de facto*.

6.3.1. De jure discrimination

By *de jure* discrimination, we mean that discrimination that is spelt out by law. Hence, when foreign goods and services are not given the same treatment as domestic goods or services or that which is given to other Members; despite of being similar or like, it is a case of *de jure* discrimination. For example, there may be laws or regulations that have the impact of discriminating between goods and services that are like. Also, there may be an application of taxes in a different manner to domestic and imported goods, when in reality there is no real difference between the two.

6.3.2. De facto discrimination

De facto discrimination is discrimination that is not as explicit as *de jure* discrimination and is implicit in the type of measures used. For example, there may be a variable tax rate on beverages with high alcohol content than those with low alcohol content. There being no real discrimination apparent in such a measure, it will be regarded as *de facto* discrimination if, based on the market scenario, domestic beverages have a low alcohol content and imported beverages have a higher content.¹

Discrimination must hence operate so as to distort the 'conditions of competition' between goods and services that are like. Mere existence of different rule, does not lead us to the

¹ SIMON LESTER AND BRYAN MERCURIO WITH ARWEL DAVIES AND KARA LEITHNER WORLD TRADE LAW: TEXT MATERIAL AND COMMENTARY 277 (2d ed. 2008).



conclusion that like goods and services have been discriminated unless the ‘conditions of competition’ have been adversely impacted.

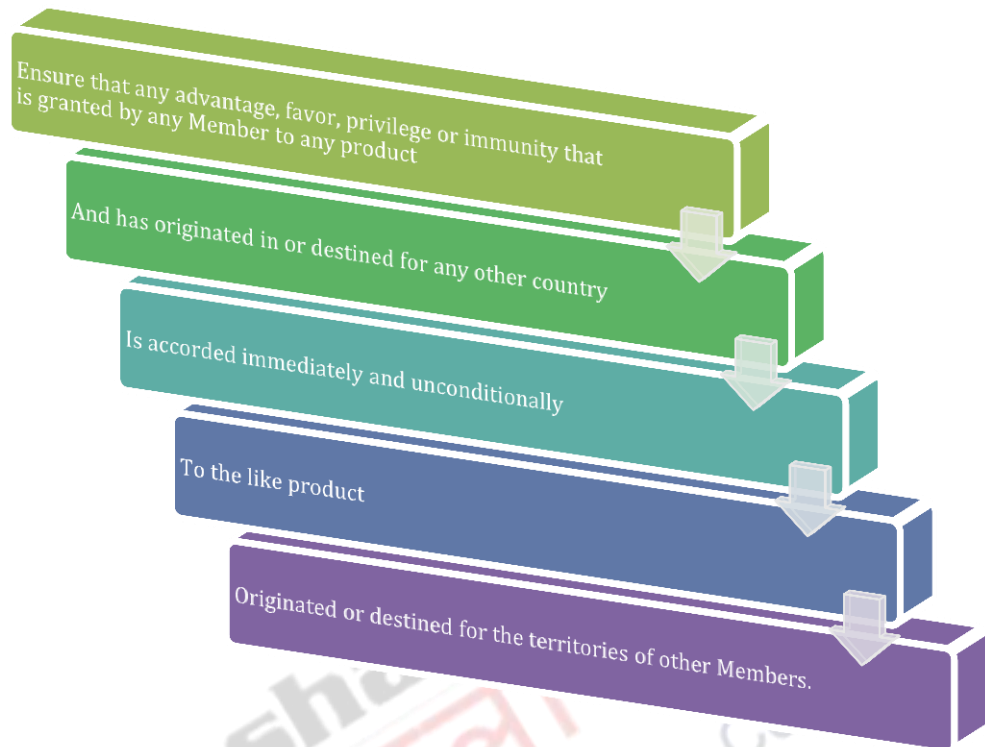
6.4. Most Favored Nation Obligations under the GATT, 1947:

Against this backdrop, Article I of the GATT, 1947 that invokes the principle of most-favored nation treatment prohibits discrimination that may be in the form of *de facto* and *de jure* discrimination, against the Contracting Parties *inter se*. It provides for non-discrimination amongst trading partners; and applies to every governmental measure in the form of customs duties and charges, the method of levying the same and the rules and formalities applicable in the importation and exportation of goods.

Article I of the GATT additionally calls for non-discrimination amongst Members *inter-se* in the importation of products that are ‘like’. Article I: 1 hence states that

“... any advantage, favor, privilege or immunity granted by any Member to any product originated in or destined for any other country shall be accorded immediately and unconditionally to the like product originated in or destined for the territories of other Members”

Having understood that any form of discrimination is prohibited by virtue of Article I of the GATT 1947, the MFN principle entails to:



6.4.1. Scope of the MFN principle under the GATT, 1947:

Like mentioned in the previous paragraphs, the MFN principle under the GATT prohibits discrimination that is either *de jure* or *de facto*. Hence, discrimination that is either in the form of explicit provisions of laws or regulations, or by means of a conduct is prohibited. The *Belgian Family Allowances* dispute comprehensively elucidates the scope of discrimination, and the phrase “any advantage, favor, privilege or immunity” for the purpose of understanding the nature and scope of discrimination prohibited by the MFN principle.

In this dispute, the measure at issue was whether Belgium had violated the MFN principle because of levying a charge on exports only due to the fact that such countries did not have a similar family allowance policy in place. As a result, countries like Denmark and Norway had to pay a charge on exports only by reason of not having a similar family allowance policy as that of Belgium. The question was whether Belgium was justified in imposing a special charge on the condition that exporting nations should also have a policy similar to that of Belgium. In this context, the Panel held that Belgium had Article I:1 of the GATT as a result of this measure. It elaborated that any advantage, etc. which was granted by one Contracting Party with respect to products originating or destined for any country must also be granted to all other countries. Hence, the Panel stated that such classifications made for certain products



must exclusively be based on the characteristics of the products themselves; as against being based on the characteristics of the country where they originate from.

6.4.2. Types of measures covered under Article I: 1:

The principle of most-favored nation under Article I: 1 of the GATT covers the following types of governmental measures:

- With respect to customs duties and charges of any kind (for example, transport or warehouse charges) which are requisite for free and fair trade; and such type of customs duty or charge must be imposed on or in applied in connection with the importation and exportation of products;
- The charge imposed on the internal transfer of payments for imports or exports. Hence, suppose a Member charges a different exchange rate or service charge on the importation or exportation of goods only for a particular WTO Member in a discriminatory manner, the measure is in violation of Article I: 1.
- The method of levying such duties and charges. This measure refers to the method used to calculate the duties and charges; and in turn refers to the application of *ad valorem* versus *specific duties*. Accordingly, if a WTO Member applies *ad valorem* duties on the (like) products imported or exported to some Members, while imposing specific duties on similar products; the same would be considered as a different method of levying duties and charges.
- Other rules and formalities in connection with importation and exportation: this means that rules and formalities with respect to importation and exportation of like products must be uniform for all Members so as to maintain a level playing field.
- Measures referred to in Article III: 4 of the GATT, 1947; with respect to all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use must also be uniform for like products from goods destined to or coming from another Member's territory.

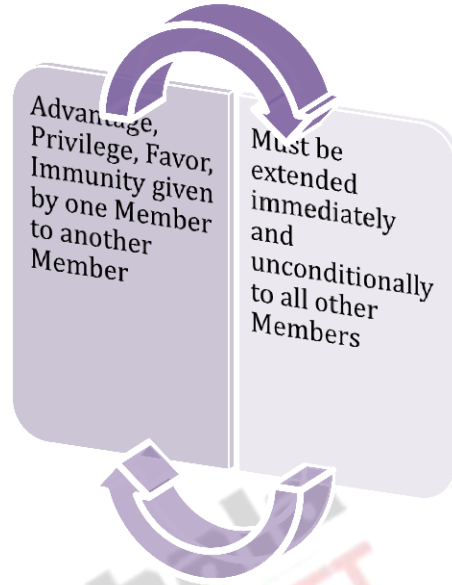


6.4.3. Conduct which is discriminatory by nature:

Against this backdrop, the scope of the MFN clause is application to **conduct** by means of a government imposed measure which is discriminatory. As a result of prohibiting any conduct which has a consequence of being discriminatory by nature, Article I: 1 covers even measures that are discriminatory on exports and imports. In other words, in the event a Contracting Party applies a measure by means of an advantage, favor, privilege or immunity on either the importation or the exportation of a product; and such measure is discriminatory, it would attract the scope of Article I:1 of the GATT, 1947. For instance, if India, a Contracting Party to the GATT, 1947 applies an additional customs duty on mangoes, but only if these mangoes are exported to the European Union (another Contracting Party to the GATT); because India aims at curbing the exportation of these mangoes in order to increase domestic consumption of the same, and because EU is the largest importer of mangoes. According to the provisions of the GATT, India's measure mentioned above is violative because it did not ban the export of mangoes on the whole, i.e. to every nation importing mangoes. On the contrary, India merely banned the fruit when the destination was E.U. In this respect, any advantage, etc. provided to one Contracting Party must be given unconditionally and immediately to all other Contracting Parties.



6.4.4. *Product must belong to a WTO Member:*



According to Article I:1, any advantage, etc. provided to any country, must be extended immediately and unconditionally to all the other WTO members. This has various implications.

- Firstly, the advantage, favor, etc. must be extended to any country. Thus, such country who receives the advantage, etc need not be a WTO Member; and may still receive the favorable treatment by another WTO Member.
- Secondly, such favorable treatment must be extended to all other WTO Members; and
- Thirdly, not only should such favorable treatment be extended to all other WTO Members, but must also be done immediately and unconditionally.



Hence, suppose Somalia which is not a Member of the WTO receives some form of favorable treatment, in the form of lesser customs duties on the export of cotton to India (8%); whereas South Africa, which is a Member is expected to pay 9% customs duties on the import of cotton to India, it is a violation of the principle of MFN. This is because every favorable treatment extended by India as a Member of the WTO to any other country (whether a Member or a non-Member) must be extended immediately and unconditionally to all other Members. In other words, India cannot impose a condition on South Africa stating that the former must export a certain percentage to receive the favorable treatment. Nor can India



assert that it would extend the favorable treatment to South Africa from a certain date onwards.

6.4.5. *Product must be a “like” product:*

In order to prove that the principle of MFN has been violated, the aggrieved party must first prove that the products are ‘like’. The jurisprudence of the concept of ‘likeness’ evolved in the case of Border Tax Adjustment wherein the Panel laid down the guidelines to determine ‘like’ goods by following four general criteria: a) the property, nature and quality of the products; b) the end uses of the product; c) consumer tastes and habits and d) tariff classification of the products. Hence, the physical properties, the extent to which the product may be perceived as serving the same end use, the extent to which consumers perceive and treat the products as an alternative and the international classification of the products for tariff purposes is what ought to be taken into account.²

The Japan-Alcoholic Beverages case is also known for its jurisprudence on the concept of “like products”³ The question before the Panel in this case was whether ‘vodka’ and the Japanese drink ‘sochu’ were alike. While Japan argued that the two shared no similarities, the Panel in its report (which was later upheld by the Appellate Body) stated that the two should be regarded as alike due to the fact that the two shared the same physical characteristics and even the same end-use. The differences in the same simply lie in the fact that the process of filtration is not the same. In elaboration, the Panel gave a comparison of other alcoholic beverages like ‘rum’ to sochu, stating that the two cannot be considered as ‘like’ products because of the difference in the ingredients, while ‘whiskey’ and ‘brandy’ had different appearances to that of ‘sochu’. At the same time, ‘gin’ ‘genever’ and ‘liqueurs’ contained certain additives. To this extent, vodka and sochu must be considered as like products given the fact that they are similar in appearances and even have identical end-uses. There

² Appellate Body Report, *European Communities – Measures affecting Asbestos and Asbestos containing products*, WT/DS145/AB/R, Para. 102 (March 12, 2001).

³ Appellate Body Report, *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R and WT/DS11/AB/R (Nov. 1, 1996).



were however, no clear guidelines as to the circumstances in which goods may be considered as ‘like.’

Hence, products that are ‘like’ must be treated equally, irrespective of their origin. Considerations in determining ‘like’ products are essentially the same in case of the MFN clause as well. Discrimination among ‘like’ goods arises when goods that are otherwise similar are discriminated by governmental measures. In *EC- Bananas*, the issues revolved around the banana’s import regime of the EC. The EC identified three types of bananas. The first were EC bananas: which were originating in the EC and received a duty free treatment. The second type was ACP bananas which originated in Africa, Caribbean and Pacific: which were known as traditional bananas (due to its traditional supply of bananas to the EC). ACP bananas also received duty free treatment, but were subject to a quota that specified the respective shares of 12 countries in the ACP. The third type was that of non-traditional bananas: wherein the bananas were imported by ACP countries (including the 12 countries mentioned above); but exceeded the shares allotted to these countries. The third type of bananas also involved imports from other nations; and required additional qualifications than that applicable to ACP countries. The Appellate Body noted that “the essence of the non discrimination obligations is that like products are treated equally, irrespective of their origin...” The Appellate Body further clarified that the obligation of non-discrimination may be waived in case of existence of Customs Unions or Free Trade Areas approved by Article XXIV of the GATT.⁴ ‘Like’ products are hence discriminated against when governmental measures either in the form of customs duties and charges, or the method of levying the same or the rules and regulations thereof so operate to discriminate between the two products rather than between two countries.

With reference to the MFN principle addressed in the GATT, the difference between the scope of discrimination in Article III (providing for the national treatment obligation) and Article I (providing for the MFN obligation) must be thoroughly understood. While both the national treatment and the most favored nation treatment make certain to eliminate measures that are both *de jure* and *de facto* discriminatory; the national treatment obligation is applicable to merely internal measures that are in the form of taxes, charges and governmental regulations. The National treatment clause is also invoked only when *imports* of ‘like’ products of a Member are not treated in the same manner as that of domestic ‘like’

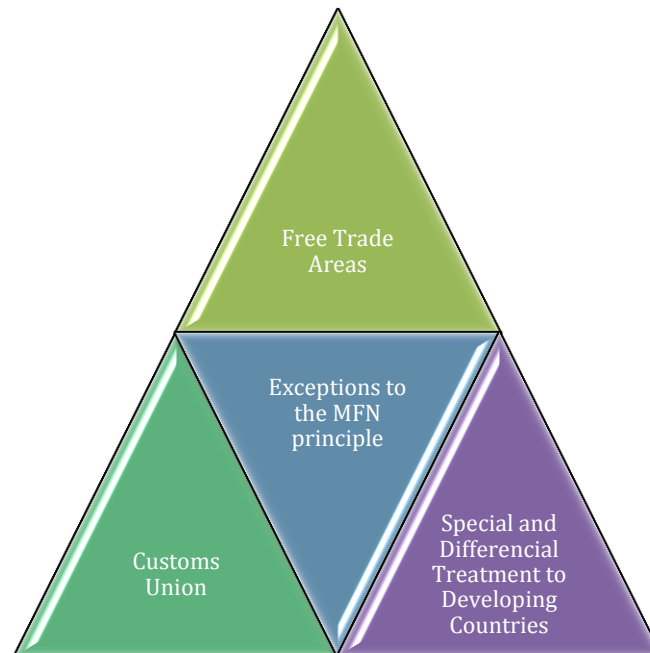
⁴Appellate Body Report, *European Communities - Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R (Sept. 9, 1997).



products. The MFN clause, on the other hand is broader a provision due to the fact that it covers all forms of government measures, including measures in the form of border measures.⁵ Secondly, the MFN principle is also broader in its application due to its application to both exports and imports⁶; making it the true cornerstone of GATT.

6.5. Exceptions to the MFN principle:

The MFN obligation is not sans exceptions. In addition to the general exceptions⁷ and the security exceptions⁸ to the obligations of GATT, the existence of customs union and free trade areas (FTA's) are also justification to measures that are otherwise GATT inconsistent.



1. *Customs Union*: A Customs Union is defined in Article XXIV: 8 (a) of the GATT, 1994 as “a substitution of a single customs territory for two or more customs territory so that duties and other restrictive regulations of commerce are eliminated w.r.t.

⁵ GATT, *supra* note 19, at 21 which clarifies that A - I: I is applicable 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..."

⁶*Id.*

⁷*Id.* A - XX.

⁸*Id.* A - XXI.



substantially all trade⁹ between the constituent territories of the union or at least w.r.t. substantially all trade in products originating in such territories.”¹⁰ Furthermore, the existence of customs union justifies a measure that is otherwise GATT inconsistent if the formation of that customs union were made to be impossible if the introduction of that measure was not permitted. At the same time, the existence of a customs union makes it obligatory for the members of the customs union to apply substantially the same duties and other regulations of commerce to each of the trade territories not included in the union.¹¹ In the application of substantially the same duties and other regulations of commerce, Article XXIV: 8(5) (a) (of the GATT) also imposes the obligation that such duty and other regulations are not higher or more trade restrictive than they were before the constitution of the customs union.

2. *Free Trade Area*: Measures inconsistent with the MFN obligation under the Article 1: 1 of the GATT is also permitted with the formation of a free trade area. A free trade area is defined under Article XXIV: 8 (b) as “a group of two or more customs territories in which duties and other regulative restrictions are eliminated¹² on substantially all trade between the constituent territories in products originating in such territories.” Hence, the measure is justified on the ground that the formation of the free trade area would be unattainable but for the existence of such a measure.

While the existence of a customs union makes it obligatory vide Article XXIV: 8(a) (ii) to apply substantially the same duties and regulations of commerce to territories not a part of the customs union (commonly known as ‘third party rights’); the same is not the case with free trade areas. Free trade areas, hence only establish a standard for *internal trade* between members of the free trade area. Trade territories not a part of the FTA are merely assured that the duties and other regulations of commerce are not higher or more restrictive than they were prior to the formation of the free trade area.

3. *Preferential Treatment to Developing Countries*: Next, countries may also be exempted from the MFN obligation with the aim to provide preferential treatment to

⁹ In the *Turkey – Textiles* case, the Appellate Body ruled that the phrase “*substantially all trade*” does not mean all trade; and is something considerably more than all trade; Appellate Body Report, *Turkey–Restrictions on Imports of Textile and Clothing Products*, WT/DS34/AB/R (Oct. 22, 1999).

¹⁰ It must be noted that as per Article XXIV: 8(a) of the GATT, regulative restrictions under Article XI, XII, XIII, XIV, XV and XX are still permitted notwithstanding the existence of a customs union.

¹¹ GATT, *supra* note 19, at 21. A - XXIV: 8(a) (ii).

¹² It must be noted that as per Article XXIV: 8(b) of the GATT, regulative restrictions under Article XI, XII, XIII, XIV, XV and XX are still permitted notwithstanding the existence of the free trade area; thereby making Article XXIV: 8 (b) similarly worded to Article XXIV: 8(a) of the GATT.



developing countries. The UNCTAD Special Committee on Preferences recognized as long as in the year 1970 that preferential treatment granted under the generalized scheme of preferences was a motivating factor for developing countries to increase their exports so as to promote industrialization and accelerate economic growth.¹³ Thereafter, the *Waiver Decision on the Generalized System of Preferences*¹⁴ was passed in the year 1971 to give effect to the *Agreed Conclusions*; which was eventually replaced as a result of the Tokyo Round Negotiations by the 1979 GATT Decision on Differential and More Favorable Treatment, Reciprocity and Fuller Participation of Developing Countries; commonly known as the '*Enabling Clause*'.¹⁵

The Enabling Clause authorizes Members to deviate from MFN obligations under Article 1: 1 of the GATT and accord differential and more favorable treatment to developing countries, without according the same to other Members. Preferential treatment may therefore be accorded in accordance with the Generalized System of Preferences by Members of developed countries to products originated in developing countries. The Appellate Body in *EC- Tariff Preferences* ruled that the Enabling Clause is enacted with a view to enhance the market access to products originating from developing countries beyond the access granted to like products originating from products of developed countries. The Enabling Clause, thereby persuades developing countries to accord 'differential and more favorable treatment' to developing countries; keeping in mind that the same is designed to facilitate and promote the trade for developing countries and not raise barriers or create undue difficulties for the trade of other Members; and that it does not constitute an impediment to the reduction or elimination of tariff and other restrictions to trade on an MFN basis. Lastly, the differential and more favorable treatment provided to developing countries under the Enabling Clause shall also be designed or modified as the case may be to respond positively to the development, financial and trade needs of the developing country.¹⁶

6.6. Summary:

¹³Para 1: 2 of the *Agreed Conclusions* of the UNCTAD Special Committee on Preferences, 1970.

¹⁴ The *Waiver Decision on the Generalized System of Preferences*, GATT document L/3545, June. 25 1971, BISD 18S/24. The *Waiver Decision* came into force to give effect to certain provisions in para. 1: 2 of the *Agreed Conclusions* of the UNCTAD's Special Committee on Preferences, 1970. These provisions in general permitted special treatment to developing nations to increase industrialization, improve export earnings and economic growth.

¹⁵The *Enabling Clause*, GATT Document L/4903, Nov. 28, 1979, BISD 26S/203.

¹⁶*Id.* para 4.



With this lesson we have therefore understood that Article 1:1 of the GATT would therefore require the analysis of four questions to verify the existence of non-discrimination, namely:

- Whether there is an advantage created by a measure?
- Whether the products affected by the measure 'like'?
- Whether the disputed measure is a type regulated by the MFN provision?
- Whether the advantage is not offered to all like products unconditionally?¹⁷

¹⁷RAJ BHALA, INTERNATIONAL TRADE LAW: THEORY AND PRACTICE 70 (2d ed. 2001).