



Munich Personal RePEc Archive

# **Exceptions to and the Fate of the Most – Favoured – Nation Treatment Obligation under the GATT and GATS**

Fotoh, Alexander Achia

12 September 2012

Online at <https://mpra.ub.uni-muenchen.de/41237/>

MPRA Paper No. 41237, posted 12 Sep 2012 04:31 UTC

# **Exceptions to and the Fate of the Most – Favoured – Nation Treatment Obligation under the GATT and GATS**

**By Alexander Fotoh<sup>1</sup>**

## **1. ABSTRACT**

The Most – Favoured – Nation (MFN) treatment obligation is provided in the WTO agreements and particularly the General Agreement on Tariffs and Trade (hereinafter referred as GATT) and the General Agreement on Trade in Services (hereinafter referred as GATS) for a purpose namely: to ensure equality in trade and services between WTO member states with a view to liberalize and multilateralize trade. But this purpose seems to have been defeated, alternatively improved by factors conflicting with the aforesaid purpose as well as other new emergence requiring consideration. This paper briefly examines concerns in this regard and settles on MFN retreat as a step-back development on MFN treatment obligation.

## **2. INTRODUCTION**

The Most – Favoured – Nation (MFN) treatment obligation under the GATT and the GATS constitute one of the founding principles of the WTO law against non – discrimination in trade and services respectively. Unlike the national treatment obligation which prohibits a country from discriminating against other countries, the MFN treatment obligation prohibits a country from discriminating between countries. In other words, the discrimination in national treatment relates to advantage given to domestic products against products from other countries, while in

---

<sup>1</sup> Alexander Fotoh holds a Bachelor of Laws LLB (Hons) from the University of Buea, Cameroon and a Master of Laws LL M (Mercantile law) from the University of Stellenbosch, South Africa.

MFN treatment, the discrimination relates to advantage given to products originating in or destined for any other country against that of other countries.

This paper seeks to look 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 writer will thereafter conclude, in light of the aforesaid, whether this recent retreat from MFN is something that represents a fundamental threat to the multilateral trading system or merely a natural evolutionary step on the path to greater trade. The subsequent paragraphs will examine seriatim the aforementioned issues in accordance with the relevant provisions under the GATT and GATS, the WTO rules and case law, and opinions of scholars and experts in trade law.

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<sup>2</sup>. The MFN principle of non – discrimination aims at ensuring trade liberalization —*a sine qua non* for multilateral 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. Both the GATT and the GATS contain a number of other provisions requiring MFN or MFN-like treatment: likewise other multilateral trade agreements, which this paper is not going to consider, but suffice to say, with regard to the importance of the MFN treatment, that they demonstrate the pervasive character of the MFN principle of non – discrimination. As it would become apparent from this paper, the MFN treatment obligation is in practice less prevalent than one would have expected of the ‘cornerstone of the GATT’ and

---

<sup>2</sup> Appellate Body Report, EC– Tariff Preferences, para. 101.

‘one of the pillars of the WTO trading system’<sup>3</sup>. To this we shall return, but first a cursory look at MFN treatment obligation applicable to trade in goods and services under GATT and GATS respectively.

### **3. MFN UNDER THE GATT AND GATS**

The focus in this section will be on the interpretation and scope of application of the relevant provisions of GATT and GATS, in particular, GATT Article 1:1 and GATS Article 11:1 which provide generally for MFN treatment obligation. GATT Article 1:1 frowns against measure(s) by a WTO member state in respect of products originating in, or destined for, any other country that does not accord “immediately” and “unconditionally” the same advantage to like products of other countries. GATS Article 11:1 is the equivalent of GATT Article 1:1 relating to trade in services. It follows from the above, as equally seen in the decision of the Appellate body in EC – Bananas 111 that the main purpose of the MFN treatment obligation is to ensure equality of opportunity to import from, or export to, all WTO Members.

The Panel in Canada – Autos, as well as the Appellate body (on appeal) interpreted Article 1:1 to cast a very wide net to cover not only de jure (in law) discrimination but also de facto (in fact) discrimination<sup>4</sup>. The merit of this decision is that measures which appear, on their face, to be ‘origin-neutral’ can give certain countries more opportunity to trade than others and can therefore, be in violation of the non – discrimination obligation of GATT Article I:1.

With such a wide scope of application allowed for GATT Article 1:1, the Appellate body further established, for the ease of interpretation, a consistency test to determine violation or not of the

---

<sup>3</sup> Appellate Body Report, EC– Tariff Preferences, para. 101

<sup>4</sup> Appellate body Report, Canada – Autos, para. 78.

MFN treatment obligation under GATT Article I:1. To constitute a violation of GATT Article 1:1 therefore the following must be considered:

- a) Whether the measure at issue confers a trade ‘advantage’ of the kind covered by GATT Article 1:1
- 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.

Problems of interpretation however exist, with regard to undefined words used, in applying the consistency test. There has been little debate on item (a) of the test as both the Panel and the Appellate body have recognized - demonstrated in the cases of Spain – Unroasted Coffee<sup>5</sup>, US – Certain EC Products<sup>6</sup> and EC - Poultry<sup>7</sup> that GATT Article I:1 cast a very wide net in respect of the meaning of the word ‘advantage’. Worthy of note is the fact that GATT Article I:1 also apply, albeit with certain conditions to the following: safeguard measures, anti – dumping duties and countervailing duties: it applies in principle to the Agreement on Civil Aircraft and the Agreement on Government Procurement. The “advantage” contemplated under GATT Article I:1 is not limited only to WTO Members but also to non – WTO Members, but this point is of little importance nowadays giving that trade between WTO Members comprises 95% of all world trade and all large economies (except Russia) are WTO Members.<sup>8</sup>

In the same vein, because the word “like products” as used in GATT Article 1:1 is not defined, problems exist in applying item (b) of the consistency test above, as both the Panel and the

---

<sup>5</sup> GATT Panel Report, Spain – Unroasted Coffee, para.4.3.

<sup>6</sup> Panel Report, US– Certain EC Products,para.6.54

<sup>7</sup> Appellate Body Report, EC– Poultry,para.99

<sup>8</sup> Peter Van Den Bosche “The Law and Policy of the World Trade Organisation” (2<sup>nd</sup> edition)

Appellate body have resorted to a case by case approach to determine the meaning of 'like products'. The view has been canvassed that it is only between 'like products' that the MFN treatment obligation applies and that discrimination within the meaning of GATT Article I:1 may occur<sup>9</sup>. To assist in this regard, the Appellate body in Canada – Aircraft provided as a guide the following questions to be considered:

- a) Which characteristics or qualities are important in assessing 'likenesses?
- b) To what degree or extent must products share qualities or characteristics in order to be 'like products'; and
- c) From whose perspective should 'likeness' be judged?<sup>10</sup>

The issue that is normally considered in applying the last item (c) of the consistency test above is the meaning of the words 'immediately and 'unconditionally', as used in GATT Article 1:1 which equally are not defined. The reasoning here is that advantage granted by a WTO Member to another WTO Member can not be subject to any condition for the others. This does not however suggest that all conditions are prohibited but rather reciprocity to the advantage being granted.

It should be noted that as equivalent, GATT Article 1:1 and GATS Article 11:1 share striking similarities<sup>11</sup> with regard to the scope of application and interpretation.

---

<sup>9</sup> Similar provisions in respect of like products under GATT 1994 include Articles II:2(a), III:2, III:4, VI:1, IX:1, XI:2(c), XIII:1, XVI:4 and XIX:1.

<sup>10</sup> Appellate Body Report, EC – Abestos, para.92

<sup>11</sup> Some differences however exist, in that, unlike the GATT 1994, the GATS under Article II:2 allows Members to schedule exemptions from the MFN treatment obligation.

#### 4. EXCEPTIONS TO MFN TREATMENT OBLIGATION

The relevance of the MFN treatment obligation has been emasculated, largely as a result of the need to protect other vital issues conflicting with trade liberalization such as societal values and interests and other new emergence. In this regard, exception provisions were inserted in both the GATT and the GATS that allow states, under certain conditions, to adopt measures that are otherwise WTO – inconsistent. Some of these exceptions are temporal while others are permanent.

The exceptions to MFN treatment are many but discussion herein will focus on the most important namely: the provisions of GATT Article XX and GATS Article XIV on the protection of vital issues such as societal values and interests; GATT Article XIX on economic emergency; GATT Article XXIV and GATS Article V on regional integration; and the economic development exception allowing for Special and Deferential (S&D) treatment provisions.

GATT Article XX and GATS Article XIV captioned “General Exceptions” are strikingly similar, save for some differences on the grounds contained in the paragraphs under the respective Articles. As it was found in the case of US – Gambling,<sup>12</sup> as well as subsequent decided cases, GATT Article XX constitutes the basis to interpret GATS Article XIV. The wordings of both Articles impose a two-tier test to determine whether a measure otherwise inconsistent with the GATT or the GATS can be justified<sup>13</sup>. The first test requires a provisional justification under any of the grounds contained in the paragraphs under the respective Articles, while the second test requires an examination of whether the provisionally justified measure meets the requirement of

---

<sup>12</sup> Appellate Body Report, US – Gambling, para.291

<sup>13</sup> Appellate Body Report, US – Gasoline, para 20 in respect of Article XX of the GATT 1994. See also Appellate Body Report, US – Gambling, para, 292 in respect of Article XIV of the GATS

the chapeau of the aforementioned Articles.<sup>14</sup> The said grounds on which the exception herein applies abound and for GATT Article XX, contains both economic and non – economic values under paragraphs (a) to (j). Some of the grounds include but not limited to the necessity to protect public morals, human, animal or plant life or health, the necessity to maintain order, and the necessity to comply with laws and regulations which are not inconsistent with the provisions of the GATT as well as the GATS.

Economic emergency justifies derogation from MFN treatment obligation. This is provided for under GATT Article XIX, which allows states to adopt measures otherwise WTO – inconsistent, where a surge in import causes or threaten to cause injury to domestic industry. In this regard, it is imperative, for the purpose of protecting domestic industry, that the Member state may adopt measures restricting import competition for a period, however temporary in order to allow the domestic industry time to adjust to the new economic realities. Such measures are called safeguard measures<sup>15</sup>. No safeguard measures exist for trade in services! Worthy of note is the fact that the application of these safeguard measures depend on ‘fair trade’ and not ‘unfair’ trade action as is the case with anti - dumping and countervailing measure<sup>16</sup>.

Similarly, regional integration through Regional Trade Agreements (RTAs) also justifies derogation from MFN treatment obligation. This is provided for under GATT Article XXIV and GATS Article V, which allow states to create free trade areas, customs unions, economic or monetary unions, or political unions which may cover different economic activities, such as trade, services, and foreign investment. Although the preferential treatment which is limited to

---

<sup>14</sup> Note that the most controversial cases in respect of Article XX of the GATT 1994 and Article XIV of the GATS have been on the chapeau and that the final decision by the Appellate Body in this regard is the task of finding the line of equilibrium.

<sup>15</sup> Note that there exist also an Agreement on Safeguard and also the transitional safeguard measure under China Accession Protocol.

<sup>16</sup> Appellate Body Report, Argentina – Footwear (EC), para.94



RTA Members, conflicts with the MFN principle of non - discrimination, it is allowed for reason that the measure is for the pursuit of regional integration in order to promote trade. It follows therefore that member states to RTA are not suppose to erect tariff barriers against other WTO Members more than what normally existed prior to the creation of the RTA. This practice constitutes the recent trend to the MFN treatment being steadily marginalized as will be seen below.

Lastly, economic development reason is also used to justify derogation from MFN treatment obligation. This exception to the MFN principle of non – discrimination allows various measures to be adopted in the interest of developing countries in order to facilitate their integration into the world trading system and to promote their economic development. This positive effort in favour of developing countries currently undertaken by the WTO takes many forms and is documented in almost all WTO agreements. The WTO law provisions to this effect are called special and differential (S&D) treatment provisions<sup>17</sup>. It should be noted that the S&D treatment provisions are not mandatory as such compliance in practice and success of the same is a subject of intense debate.

## **5. RECENT TREND TO MFN MARGINALIZATION**

Besides the exceptions discussed above allowing for derogation from MFN treatment obligation, a mark retreat from MFN treatment is seen in the emergence of Regional Trade Agreements (RTAs) which creates custom unions and free trade areas. The proliferation of RTAs in the early 1990s saw almost all WTO Member countries participating in one or the other RTAs save for Hong Kong, China; Japan; Macau and Mongolia.<sup>18</sup> The result of these RTAs is that other

---

<sup>17</sup> The preamble to the WTO Agreement is categorical on this issue of special preferences to developing countries

<sup>18</sup> Jo – Ann Crawford & Sam Laird, “Regional Trade Agreements and the WTO” CREDIT Research Paper No. 00/3

countries are excluded from the special treatment accorded to RTA Members – a trend which is inconsistent with the MFN principle of non – discrimination, yet allowed under the WTO law<sup>19</sup> because the WTO recognises the importance and believes economic integration and trade liberalization can better be achieved through regional economic integration.

The WTO Director General Pascal Lamy estimated, in a speech delivered on 17 January 2007 that over 200 RTAs existed and were likely to double by 2010<sup>20</sup>. Some of the efforts at regional integration include amongst other: the European communities, the North American Free Trade Agreement (NAFTA), the ASEAN (Association of South East Asian Nations) Free Trade Area (AFTA), the Common Market of the Eastern and Southern Africa (COMESA) just to name a few. It should be noted that some of these RTAs contain not only economic agenda but also political agenda, for example the European Communities which has succeeded to establish a union amongst members to prevent the re – occurrence of war.

This recent trend to liberalize and multilateralize trade via regional integration is a subject of intense debate, in particular whether it creates trade or diverts trade<sup>21</sup>. The solution so far has been to strike equilibrium between RTA benefits and the rights of other WTO Members to trade. It should be noted that the discussion has shift from cost and benefit to how regional trade agreements can serve to strengthen the multilateral trading system<sup>22</sup>.

## **6. CONCLUSION**

---

<sup>19</sup> Article XXIV of the GATT 1994 and Article V of the GATS

<sup>20</sup> See Pascal Lamy, Regional Agreements; the 'pepper' in multilateral 'curry', speech delivered at the confederation of Indian Industries, Bangalore, 17 January 2007, available at [www.wto.org/english/news\\_e/spp153\\_e.htm](http://www.wto.org/english/news_e/spp153_e.htm)

<sup>21</sup> The danger of regional trade agreements on multilateral trading system has been widely recognized by Guy de Jonquières as stated in his publication 'Global Trade: Outlook for Agreements Nears Moment of Truth', Financial Times, 24 January 2006.

<sup>22</sup> See P.Lamy, 'Proliferation of regional trade agreements "breeding concern"', Speech of the Director-General at the opening of the 2007 Conference on Multilateralizing Regionalism, Geneva, 10 September 2007.

From the foregoing, one is left to ponder over the fate of the MFN treatment obligation. Could the MFN treatment provisions now be seen as provisions in disuse? A guide to understanding this is provided in the Sutherland Report that shares light in that neither the WTO nor the GATT, alternatively, the GATT nor the GATS was ever an unrestrained free trade charter. It suggests that both were and are intended to provide a structured and functionally effective way to harness the value of open trade to principle and fairness, and that the rules provide checks and balances including mechanisms that reflect political realism as well as free trade doctrine.<sup>23</sup>

It can be deduced that the achievement of trade liberalization and multilateral trade depends not only on the achieved rules but also on socio-economic and political realism. The danger of the recent retreat from MFN treatment on the multilateral trading system has been recognised, but is not without more uncontrollable. The rules are not inelastic and are in any case interpreted so as not to defeat the purpose of trade liberalization and multilateral trade. Be that as it may, I am of the opinion that the recent retreat from MFN is a natural evolutionary step on the path to greater trade liberalization. As noted by the Director-General Pascal Lamy<sup>24</sup>, the point is not on the cost and benefits but how this retreat reinforces multilateral trade. This shows the pragmatic move of multilateralization. In my view, the recent retreat from MFN treatment should otherwise be seen as development around the law on MFN treatment obligation since development of the law also means responding to realities as they become apparent.

---

<sup>23</sup> Report by the Consultative Board to the Director-General Supachai Panitchpakdi, The Future of the WTO: Addressing Institutional Challenges in the New Millennium (the 'Sutherland Report') (WTO,2004), para.39.

<sup>24</sup> See P.Lamy, 'Proliferation of regional trade agreements "breeding concern"', Speech of the Director-General at the opening of the 2007 Conference on Multilateralizing Regionalism, Geneva, 10 September 2007.