MOST FAVOURED NATION TREATMENT AND ITS EXCEPTIONS: A LEGAL ANALYSIS

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ABSTRACT

The Most Favoured Nation (MFN) principle lies at the centre of the law of international trade and forms the basis of the World Trade Organization (WTO). As a vehicle for promoting the equity, transparency, and stability of global trade, the rule has increasingly been subjected to increasing assault by numerous exceptions that have been perfected to prioritize domestic interests, regional affiliations, and development agendas.

This article provides a comprehensive legal analysis of MFN provisions within the frameworks of the General Agreement on Tariffs and Trade (GATT)[1] (General Agreement on Tariffs and Trade (GATT 1947), 2025) regimes and the General Agreement on Trade in Services (GATS)[2] (General Agreement on Trade in Services (GATS), 2025) and considers major derogations, including Regional Trade Agreements (RTAs), developing country preferences and national security exceptions. Basing its analysis on WTO case law, academic writing, and treaty provisions,the study considers the consistency and broader policy iss ues of the exceptions. The research ends with some proposals to try to come up with a more realistic and balanced approach to the goals of liberalization of trade and appropriate role of regulatory flexibility in the world trading system.

Keywords: Most Favoured Nation Principle, World Trade Organization, General Agreement on Tariffs and Trade (GATT), General Agreement on Trade in Services (GATS), Regional Trade Agreements (RTAs).

[1] General Agreement on Tariffs and Trade art. I, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194.
[2] General Agreement on Trade in Services (GATS) - General Agreement on Trade in Services art. II, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, 1869 U.N.T.S. 183, 33 I.L.M. 44.

Introduction

The MFN clause remains an integral part of the WTO legal framework, and also reflects the basic principles of equality, predictability, and multilateralism in international trading relations. Under an MFN obligation that requires any privilege, favour or benefit granted by a WTO member to another to be extended unconditionally and simultaneously to all other WTO members, the MFN obligation promotes equality and predictability in the trading system. It is a fundamental assurance against discriminatory trade and fragmentation, in support of transparency and mutual trust in the multilateral order. Nonetheless, the legitimacy and efficacy of the MFN standard have been increasingly challenged by an expanding list of approved exceptions and special arrangements that, while intended to make room for accommodating domestic policy interests and development needs, have diluted the doctrine's global application. They encompass Regional Trade Agreements (RTAs), the Generalized System of Preferences (GSP)[3] (Differential and More Favourable Treatment Reciprocity and Fuller Participation of Developing Countries, 2025), and derogations based on national security. Though granted according to WTO standards, these carve-outs become a source of fuel for growing normative incoherence in the system. The proliferation of RTAs, especially, has given rise to regulatory overkill with incoherent rules of origin and one another's different regimes, thereby making compliance difficult and undermining cohesiveness of WTO disciplines. The fresh invocation of national security exceptions under Article XXI of the GATT[4] in politically sensitive circumstances more frequently than not has also given rise to concerns about their potential abuse. These trends give rise to serious doubts as to whether such measures are truly based on national defense requirements or rather represent instruments for avoiding MFN obligations. Though the WTO dispute settlement system has touched upon some of these complexities, as in the Russia – Traffic in Transit case, the current stalemate regarding the Appellate Body has created a serious lacuna in the legal oversight mechanism, destabilizing predictability, and the uniform application of trade norms.[5]

To preserve the credibility and usefulness of the MFN rule, member states need to be more restrained and predictable in applying exceptions. This calls for setting clear, transparent

[3] Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries (Enabling Clause), Nov. 28, 1979, GATT Doc. L/4903, 26th Supp. BISD 203 (1980).
[4] General Agreement on Tariffs and Trade art. XXI, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194.
[5] Panel Report, Russia – Measures Concerning Traffic in Transit, WTO Doc. WT/DS512/R (adopted Apr. 5, 2019).

criteria for derogation, grounded in objective justification and supported by procedural checks. The development of the dispute settlement machinery and the promotion of institutional reforms would also ensure the use of such exceptions in accordance with the principles of the rule of law and the general goal of fair and cooperative international trade governance.

Literature review –

Its economic and legal consequences have been widely debated in trade law scholarship. (Bhagwati, 2008) is severe in his criticism of PTAs for undermining the multilateral trading system and refers to them as "termites in the trading system." Van den Bossche and Zdouc (2021) (Zdouc, 2021) provide a comprehensive treatment of WTO law with a focus on how MFN treatment has evolved alongside international trade jurisprudence. Several WTO case law disputes such as EC Tariff Preferences and Canada Autos have unravelled the complexities of interpreting MFN and its relationship with country-specific national policies and regional trade interests. MFN's importance is acknowledged in the literature, coupled with an emphasis on the need for its balanced use to account for development needs and geopolitical necessity.

DOCTRINAL EXAMINATION OF MFN TREATMENT AND ITS EXCEPTIONS –

Legal Framework of MFN Treatment

The Most Favoured Nation (MFN) principle is a cornerstone of the multilateral trading system, playing a crucial role in fostering non-discriminatory practices and equality among nations. Enshrined in Article I of the General Agreement on Tariffs and Trade (GATT)[6], 1994 and Article II of the General Agreement on Trade in Services (GATS), 1995, the MFN clause mandates that any advantage, Favor, privilege, or immunity granted by a WTO member to the products or services of one country must be extended to like products or services of all other WTO members, immediately and unconditionally. This implies that if a nation lowers tariffs or simplifies trade restrictions on one of its trading partners, it is obligated under law to extend the same treatment to all WTO members, no exceptions.

The main purpose of the MFN principle is to promote transparency, equity, and predictability in international trade by preventing nations from indulging in discriminatory or preferential

[6] General Agreement on Tariffs and Trade art. I, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194. General Agreement on Trade in Services art. II, Apr. 15, 1994, 1869 U.N.T.S. 183.

treatment that can affect market competition. Through evening out the balance, MFN fosters economic efficiency, enhances market access to all traders, and welcomes long-term stability of trading relations. It reduces the likelihood of bilateral favouritism or the development of closed trade blocs that could exclude weaker economies or tear apart the international trading order.

But while the MFN principle appears to necessitate strict uniformity, it is not an absolute or rigid requirement. In recognition of the dynamic and heterogeneous nature of global trade, WTO agreements permit a range of exceptions and carve-outs to meet specific policy needs, strategic interests, and developmental disparities among member states.[7] Such exceptions are enshrined in the law so that states can pursue legitimate objectives such as national security, environmental protection, and social welfare, even if such measures may be discriminatory against trade. Of particular note, such exceptions include concessions for Regional Trade Agreements (RTAs), special and differential treatment for developing countries, and measures justified on grounds of public morals or essential security.[8]

While such flexibilities allow for essential policy space, they also raise an element of complexity and subjectivity that may be abused. Accordingly, disputes have emerged on the abuse of MFN exceptions and resulting uncertainty and fragmentation of the interpretation and application of trade rules.

Key Exceptions to MFN Treatment

a. Regional Trade Agreements (RTAs)

One of the strongest exceptions to MFN treatment is in the formation of Regional Trade Agreements (RTAs) and customs unions. Article XXIV of GATT and Article V of GATS allow the WTO members to establish FTAs or customs unions that accord preferential treatment[9] to only the participating members. The best examples are the European Union (EU), the United States-Mexico-Canada Agreement (USMCA), and ASEAN. These pacts are intended to support greater economic integration and cooperation between regional partners. They also

[7] World Trade Organization, Most-Favoured-Nation Treatment, https://www.wto.org/english/tratop_e/serv_e/cbt_course_e/c1s6p1_e.htm, Accessed on 24 th April, 2025.
[8] World Trade Organization, Understanding the WTO: Principles of the Trading System, https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm (last visited April 27, 2025).
[9] Article XXIV of the General Agreement on Tariffs and Trade (GATT 1947)- https://www.wto.org/english/tratop_e/region_e/region_art24_e.htm, Accessed on 26 th April, 2025.

form selective liberalization frameworks, but with the issue of fragmentation and divergence from multilateralism on a global level.

b. Preferential Treatment for Developing Countries

Another major derogation from MFN is made possible by the Enabling Clause of 1979, permitting developed nations to grant non-reciprocal trade preferences to least developed countries and developing countries (LDCs). Programs like the Generalized System of Preferences (GSP) grant developing and LDCs lower tariff rates and superior market access to these countries to promote their development and integration in the international trade system. While the logic behind such programs is to encourage equity and development in the Global South, the eligibility criteria and discretionary character of such preferences have sometimes created doubts regarding their fairness and consistency.[10]

c. National Security and Public Policy Exceptions

Articles XX and XXI of GATT recognize the right of WTO members to deviate from their MFN obligations for legitimate public policy and national security concerns. Article XXI[11] allows for measures deemed necessary to protect a country's essential security interests, particularly in times of war or political crisis. Alternatively, Article XX[12] delineates exceptions to measures taken in order to safeguard human, animal, or plant life; save exhaustible natural resources; and maintain public morals, among others. Although such provisions give states the leeway to maintain national interests, their wide and, at times, ambiguous language have sometimes precipitated controversy regarding the possibility of misuse.

WTO Dispute Settlement and MFN Exceptions

WTO Dispute Settlement Mechanism (DSM) has served to define the extent and operation of Most-Favoured-Nation (MFN) obligations under the GATT and GATS regimes. Through a series of pivotal disputes, the Appellate Body and Panels have issued binding statements that

[10] Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries (Enabling Clause), Decision of 28 Nov. 1979, L/4903, GATT B.I.S.D. (26th Supp.) at 203 (1980), https://www.wto.org/english/docs_e/legal_e/enabling1979_e.htm.World Trade Organization

[11] World Trade Organization, Analytical Index: GATT 1994 – Article XXI (Security Exceptions), https://www.wto.org/english/res_e/publications_e/ai17_e/gatt1994_art21_jur.pdf (last visited April 29, 2025).

[12] World Trade Organization, Analytical Index: GATT 1994 – Article XX (General Exceptions), https://www.wto.org/english/res_e/booksp_e/gatt_ai_e/art20_e.pdf (last visited April 29, 2025).

explain how and when MFN treatment is to be granted, or may legally be denied between WTO Members.

One such milestone cases on this account is the EC Tariff Preferences (WT/DS246) case. The dispute involved a complaint by India that the European Communities had levied its Generalized System of Preferences (GSP), and its additional trading benefits to a specified group of developing nations against meeting certain "drug-related" and "sustainable development" requirements. The Appellate Body decided that although the Enabling Clause authorizes differential treatment in favour of developing nations, the said preferences must be established on objective and transparent grounds, and be offered to all like situations developing nations without discrimination. The ruling was important since it highlighted the fact that even in the application of exceptions to MFN, the same could not be used arbitrarily or discriminately.

Another interesting case is Canada Autos (WT/DS139 & WT/DS142)[13], where Japan and the European Communities complained against Canadian regulations that accorded preferential import terms only to automobile producers who invested in Canada. The WTO Panel held that this scheme violated Canada's MFN commitments under GATT, since the preferential treatment was not given to all WTO Members equally. The panel reaffirmed that MFN treatment must be accorded equal treatment of "like products" from every Member state and that investment incentives granting preferential access or privileges to specific states constitute an unreasonable discriminatory regime.

Collectively, the cases underscore the significance of precision, non-arbitrariness, and procedural fairness in implementing MFN exceptions. They also reiterate that WTO Members may not utilize exceptions under the Enabling Clause, Article XX, or otherwise as a backdoor to impose disguised protectionism or engage in politically motivated economic discrimination. The jurisprudence demonstrates how the DSM not only promotes compliance but also enhances the rule-based character of the multilateral trading system by enforcing members' MFN obligations.

[13] Canada—Certain Measures Affecting the Automotive Industry, WTO Docs. WT/DS139/R, WT/DS142/R (adopted June 19, 2000), https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds139_e.htm

Challenges and criticisms –

While exceptions to the Most-Favoured-Nation (MFN) treatment add much-needed flexibility to the trading system of the world, they are not free from considerable controversy and criticism. One of the main concerns stems from the proliferation of Regional Trade Agreements (RTAs), such as Free Trade Agreements (FTAs) and Customs Unions. Although authorized under Article XXIV of the GATT and Article V of the GATS, the accelerated surge in these preference arrangements has contributed to what is commonly known among economists and law scholars as the "spaghetti bowl" phenomenon.[14] The above metaphor best illustrates the messy, overlapping, and frequently conflicting system of trade treaties that has materialized each having its own cluster of rules, standards, and tariff obligations. Consequently, companies experience more complexity and higher transaction costs, and policymakers have to contend with a fractured regulatory regime that is contrary to the ease and non-discrimination enshrined in the MFN ideal.

This fragmentation makes compliance more difficult and also erodes the integral authority of the multilateral trading system. The WTO, created as a main pillar of trade governance in the world, has the potential to be pushed onto the periphery as bilateral and regional arrangements lead in both law enforcement and political salience. Additionally, developing nations, that depend on MFN-based equivalence to gain entrance into large markets, tend to be left behind in such RTAs, more deeply entrenching asymmetries in global trading order.

Another dimension of concern lies in the use and potential misuse of national security exceptions, particularly under Article XXI of GATT. This exception has recently been utilized in contentious settings, most significantly in trade wars and rising geo-political tensions, like the tariffs imposed by the United States invoking national security in its clashes with China, the European Union, and others. Though national security is a legitimate sovereign interest, its expansive and self - judging wording risks abuse as states will employ it as a handy cloak for using protectionist policies.

This undermines the predictability and credibility of the WTO framework, and raises questions about whether such exceptions can be effectively reviewed or limited within the existing

[14] Straining the Spaghetti Bowl: Re-Evaluating the Regulation of Preferential Rules of Origin in the WTO, 25 J. Int'l Econ. L. 25 (2022).

dispute settlement architecture.

Conclusion –

The Most-Favoured-Nation (MFN) principle remains a cornerstone of the World Trade Organization's legal framework, embodying the foundational values of non-discrimination, fairness, and multilateral cooperation in international trade. By requiring WTO Members to extend any trade advantage offered to one Member equally to all others, the MFN obligation helps level the playing field, particularly for smaller and developing economies that may lack the leverage to negotiate bilateral or regional preferences. It creates an atmosphere of predictability and mutual trust that is essential for businesses and governments that trade across borders.

However, in the contemporary trade environment, the effectiveness and universality of the MFN principle are increasingly under strain, largely due to a growing array of exceptions and carve-outs. These include regional trade agreements (RTAs), developing country generalized system of preferences (GSPs), and national security exceptions, all of which are accepted in WTO law. Though these flexibilities are intended for legitimate policy purposes such as supporting regional integration, supporting sustainable development, or defending strategic interests they also make it challenging to enforce trade rules uniformly, and in some cases leave the window open for protectionism and geopolitics manipulation.

Here, it is crucial that these exceptions should not become tools of disguised trade discrimination. The validity of the WTO system is based on the transparency of legal norms, the openness of the criteria under which exceptions are being granted, and the efficacy of enforcement mechanisms. For example, situations such as EC Tariff Preferences and Canada – Autos have demonstrated the importance of the WTO dispute settlement process in identifying the acceptable limits of exceptions and reminding Members of restraint. Watchfulness has to continue to prevent the thin line between flexibility and uniformity from being breached.

This research concludes that although MFN exceptions are both inevitable and necessary in a changing global environment, their application needs to be closely regulated. There is an urgent need for increased transparency, objective criteria, and predictable jurisprudence to assist Members in invoking exceptions responsibly. Reinforcing institutional machinery for monitoring and review, together with a reaffirmed political commitment to multilateralism, will

be crucial to maintaining the legitimacy, functionality, and integrity of the rules-based international trading system.

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