# THE EVOLUTION AND IMPACT OF MOST FAVOURED NATION (MFN) AND NATIONAL TREATMENT PRINCIPLES IN INTERNATIONAL TRADE LAW: A COMPARATIVE ANALYSIS OF THEIR APPLICATION IN WTO AGREEMENTS AND BILATERAL INVESTMENT TREATIES

Joseph T. Koottakkara, LLM, Christ (Deemed to be university) Lavasa, Pune

**ABSTRACT**

International trade and investment are inextricably linked in the world of international business. While trade has been governed multilaterally since 1947 under what is now the World Trade Organisation (WTO), foreign direct investment (FDI) is regulated by some 2600 bilateral investment treaties (BIT, s), which mushroomed in number during the 1980s and 1990s. The Most Favoured Nation and National Treatment principles, therefore, represent the fundamental principles of international trade law that oblige countries not to discriminate against trading partners while ensuring that foreign and domestic parties are accorded equal treatment.[1]

A closer look at the WTO reveals a web of numerous agreements and bilateral treaties. This paper traces the historical development of the MFN and National Treatment principles, highlighting their crucial role in the promotion of non-discrimination and the establishment of a rule-based multilateral trading system. Key WTO agreements will include in-depth study, namely General Agreement on Tariffs and Trade (GATT) 1994, the General Agreement on Trade in Services (GATS), and Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

Furthermore, the rising trend of PTAs among WTO Members and beyond has been gaining attention. As of the end of 2006, nearly 370 notifications of such agreements were registered under the relevant provisions of GATT/WTO.

[1] DiMascio, N. & Pauwelyn, J., Nondiscrimination in Trade and Investment Treaties: Worlds Apart or Two Sides of the Same Coin?, 102 CAMBRIDGE L.J. 48 (2008), https://www.jstor.org/stable/40007768.

This research undertakes a comparative analysis of the application and interpretation of MFN and National Treatment principles in various WTO disputes. In addition, it explores how these principles are incorporated into bilateral investment treaties and evaluate their influence on global trade dynamics.[2]

**Keywords:** MFN, NT, GATT, WTO, International Trade law

## INTRODUCTION

Most Favoured Nation (MFN) and National Treatment principles constitute the basics of international trade law and are considered as cornerstones to a fair and equal trade amongst nations. In this research the researcher aims at to trace the historical developments and legal frameworks associated with these principles that practically affect their considerations in World Trade Organization (WTO) agreements and Bilateral investment Treaties (BIT's).

The MFN principle would require a country to extend favourable trade terms granted to extend trade terms granted to one nation to all trading partners in the interests of non-discriminatory trade practices. It traces its roots back to centuries-old trade agreements and was later crystallised after the World War II in the General Agreements on Tariffs and Trade known as GATT that reflects the commitments to multilateralism and economic stability in world trade.

National Treatment Principle requires that once foreign goods, services, and investors have entered the domestic market, they must not be placed in a less favourable position than that which local counterparts enjoy, thereby ensuring a level playing field.

In this research the researcher will be conduct a comparative analysis of how the principles are expressed and applied in WTO agreements relative to BIT's. Through a careful review of key case studies and arbitral decisions effectiveness and challenges of the application of MFN and National Treatment shall be evaluated. This analysis is meant to not only depict legal niceties but also to assess the impact on international economic relations especially with regard to developing nations that are ever so often muddled by such complicated dynamics of trade.

The researcher hopes to contribute to the field of international trade law by highlighting these main tenets which ultimately mold and drive contemporary trade policies as well as global

[2] Ibid note 1

economic interactions[3].

## OBJECTIEVES

- To carry out a detailed analysis of the historical and legal developments regarding MFN and National Treatment principles.
- To understand how Most Favoured Nation (MFN) and National Treatment principles are applied in WTO Agreements.
- To carry out a comparative analysis of Most Favoured Nation (MFN) and National Treatment in Bilateral Investment Treaties (BITs).

## RESEARCH QUESTIONS

1) To what extent have MFN and National Treatment principles been effective in promoting non-discrimination and equality in international trade and investment?

2) How have recent developments in international trade law, such as the rise of regional trade agreements and investor-sate dispute settlement, impacted the application and interpretation of the MFN and National Treatment principles?

## 1. History of Most Favoured Nation (MFN) and National Treatment Principles

### 1.1 Origin

The MFN and National Treatment principles have very long historical antecedents in international trade law, tracing their origins back to early bilateral trade agreements. Common among many of these was the extension of the MFN provisions as a way of ensuring that concessions granted by a state to another were automatically extended to all trading partners. The purpose of this practice was the promotion of non-discrimination and equal treatment among nations, which translated to the common law principle of equality in relation of trade. More on these principles was stressed when developing the General Agreement on Tariffs and

[3] Ministry of Economic Trade and Industry, Report on the WTO: Chapter 2 - Trade Policies and Practices by Measure (Nov. 8, 2024), https://www.meti.go.jp/english/report/data/2015WTO/02_01.pdf.

trade (GATT) back in 1947, which incorporated unconditional most-favoured-nation (MFN) treatment, which meant a strong restatement of its role in multilateral trade relationships[4].

### 1.2 Codification in various international agreements

The MFN and National Treatment principles were codified very highly through key international agreements. The GATT codified the MFN treatment as a founding principle, which obliges any advantage given to one member to equally applied to all the other members by preventing discriminatory practices through various member countries. The aforementioned principle was subsequently reconfirmed within the framework of the World Trade Organisation (WTO), which broadened the scope of Most-Favoured- Nation (MFN) treatment to encompass not only goods but also services and intellectual property rights through several agreements, including the General Agreements on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

BITs equally represent those principles in the sphere of investment law because early versions of BITs were mainly characterized by Most-Favoured-Nation (MFN) clauses, while mainly characterised by Most-Favoured-Nation (MFN) clauses, while National Treatment provisions became prevalent in later agreement. Such a trend indicates a growing recognition of the need to provide fair level of competitive opportunities for foreign investors operating in host countries[5].

### 1.3 Contribution to the Establishment of the Principle of Non-Discrimination in Trade and Investment

MFN and National Treatment serves as critical mechanisms for establishing non-discrimination in international trade, investment and related activities. The MFN principle make sure that countries do not discriminate between their trading partners, they ensure that all members are treated equally in matters concerning tariffs and regulatory measures. National Treatment is a principle that complements this by mandating that once good from foreign market enters the domestic market, they must be treated no less favourably than their domestic

[4]United Nations Conference on Trade and Development (UNCTAD), Investment Policy Framework for Sustainable Development (2010), https://unctad.org/system/files/official-document/diaeia20101_en.pdf.
[5] Supra note 1 at page 2

counterparts. Both these principles together create a framework that promotes fairness and stability in global economic relations.[6]

### 1.4 Disparities between WTO and BIT definitions of MFN and National Treatment

MFN and National Treatment principles applied to WTO agreements have different meanings and applications. In the WTO context, MFN is applied equally to all member states regarding tariff rates and access to market. This is also applied to services. BITs have several provisions that make the treatment vary based on the nature of investments or sectors that are involved. Certain BITs have better rights under MFN clauses, this is in comparison to WTO agreements, where investors benefit from more favourable terms provided in treaties with third states[7].

### 1.5 Evolution

With the dynamic change in global trade and investment trends the MFN and National Treatment principles have acquired their own unique styles. The principles designed once to combat protectionism post-World War II has evolved and has become something capable of addressing challenges in regional trade agreements, globalization, and shifts in economic power. As international economic relationships started becoming more complex, application of these principles to WTO frameworks and BITs became subtle. An example to this is the development of special provisions for developing countries in the light of most favoured nation Treatment. This is done by accommodating diverse economic realities[8].

## 2 Effectiveness of MFN and National Treatment Principles in promoting non-discrimination

### 2.1 Case Studies

**WTO cases on MFN Principle**

*EC BANANA (DS27)*

This case was related to the import regime prevalent in European Communities regarding

[6] Supra note 3 at page 3
[7] Jus Mundi, Most-Favoured-Nation Treatment, https://jusmundi.com/en/document/publication/en-most-favoured-nation-treatment.
[8] Supra note 3 at page 3

'Banana'. In this case it was reported that the European communities discriminated against bananas originating from Latin American countries by preferring imports from their colonies in the Caribbean region. Ecuador, Guatemala, Honduras, and Mexico challenged this favourable treatment.

Findings: The WTO and the appellate body viewed that the EC's banana import regime violated the MFN principle under GATT Article I. The panel and the Appellate body found that the act in itself is a clear discrimination against other WTO members. The preferential treatment on the part of EC contravened the principle of non-discrimination. This case highlights the importance of MFN treatment in ensuring fairness between competing countries[9].

*US SHRIMP (DS58)*

The United States imposed a ban on the importation of shrimps from any country that does not employ turtle-excluder devices in the catching of shrimps. This was taken as a measure to protect endangered sea turtles.

Findings: The Appellate Body held that the measure taken by the U.S. breached the MFN principle as the latter discriminated against certain shrimp imports from certain countries. Further emphasis is placed that measures need to be applied equally across trading partners. This gave credence to the principle of MFN treatment in global trade practices[10].

**WTO cases on National Treatment Principle**

*Japan-Alcoholic Beverages II*

The law in conflict was the Japan's Liquor Tax Law, based on this law Japan imposed different tax rates on various alcoholic beverages mostly imported vodka at a higher rate than domestic shochu.

Findings: The Appellate body found that Japan breached GATT Article III:2 by taxation of

[9] World Trade Organization (WTO), DS27: European Communities — Regime for the Importation, Sale and Distribution of Bananas, https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds27_e.htm.
[10] World Trade Organization (WTO), DS58: United States — Import Prohibition of Certain Shrimp and Shrimp Products, https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds58_e.htm

Vodka more heavily than shochu. The body clarified that products were "like "under the first sentence of Article III:2 and established that tax treatment that results in discrimination against international products is a breach of national treatment obligations. It also confirmed the need of having an assurance that products were "directly competitive or substitutable", for which latter determination will constitute the basis for future national treatment principle under trade law interpretations[11]

### 2.2 Examination of Investor-State Dispute Results on MFN/National Treatment and BIT

BITs can be considered as one of the key instruments for the protection of foreign investors. There are case laws that justifies the same. There are a good number of arbitration cases that shows how these principles are invoked to protect the rights of investors against discrimination. Taking the example of CC/Devas V. India, the arbitral tribunal invoked the MFN clause to import benefits from another treaty that offered more favourable treatment. It also demonstrates how MFN can be extended to provide additional protection beyond the scope of the immediate provisions of a treaty. By taking this as an example its clearly visible, how BITs can offer effective redress mechanisms for instances of national treatment violations. Investors can make use of the MFN clauses to strengthen their legal position and available redress options[12].

### 2.3 MFN/ National Treatment's Ability to promote FDI in Host Countries

MFN and National Treatment principles are very important to attract Foreign Direct Investment (FDI) in host countries, they are stable and predictable and allows investors to commit capital as they are given the assurance that they would be treated fairly and equitably. All countries that adopt BIT frameworks attract more FDI as investors become less risk-averse on fears of discrimination or unfair treatment. The famous case US- Measures Affecting Alcoholic Beverages depicts how adherence to national treatment obligations can enhance market access for foreign investors, thereby promoting economic growth and development in host countries.

### 2.4 MFN clauses in BITs

The clauses of MFN within BITs extends benefits to investors and also impose restrictions on

[11] World Trade Organization (WTO), DS8: Japan — Taxes on Alcoholic Beverages, https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds8_e.htm.
[12] Oxford Academic. (n.d.). *ICSID review: Volume 37, Issues 1-2*. Retrieved November 11, 2024, from https://academic.oup.com/icsidreview/article/37/1-2/51/6528960?login=false

renegotiation of treaty terms that might have adverse effects on investor rights. These clauses enable investors to claim rights and protections that would more favourably be provided in other treaties compared to BIT. This dynamic nature is clearly illustrated in the case Rompetrol V. Romania, in this case tribunal recognized the applicability of MFN provisions in such a way that it could protect investors against regulatory actions by host state[13].

### 2.5 National treatment gives protection against discriminatory practices

National Treatment acts as a shield that protects foreign investors against discriminatory regulatory practices in host countries. This principle requires foreign investors to be treated like Domestic investors. In the case of Vodaphone V. India it was held that retrospective taxation measures violated the national treatment obligations, it was also emphasised that such measure disproportionately affected foreign investors compared to domestic entities. This judgement further underlines the protective function of national treatment not to be exposed to arbitrary or discriminatory measures that could undermine such investments[14].

### 2.6 Difficulties in balancing Host country Autonomy and Investor Protection

Even though MFN and National Treatment principles do confer definite advantages, investor protection is still weighed against host country sovereignty. Governments always feel pressure to regulate industries for public welfare or environmental protection, which thus conflict with their duties under BITs. This tension is clearly visible in the case Metal-Tech V. Uzbekistan where the tribunal ruled against Uzbekistan on allegations of corruption associated with an investment.

## 3 Impact of RTAs on MFN and National Treatment

Regional Trade Agreements have therefore seriously affected the international trade landscape on most matters relating to Most Favoured Nation (MFN) and National Treatment principles during the Worl Trade Organisation framework. This has been particularly important to note in this sense, that the core principles of non-discrimination of international trade will slowly be faded away since countries will be forced to undergo economic simulations compelling them

[13] Ministry of Economic Trade and Industry. (n.d.). *Reference materials on trade policies*. Retrieved November 12, 2024, from https://www.meti.go.jp/english/report/downloadfiles/2013WTO/03_05_reference_1.pdf
[14] Madhyam, India's Experience with Investment Treaty Disputes and Related Damages (Nov. 12, 2024), https://www.madhyam.org.in/indias-experience-with-investment-treaty-disputes-and-related-damages/.

to reach towards regionalism. The growth of RTAs, mega-regional agreements such as the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment partnership (TTIP), largely reflects a shift in focus away from the traditional multilateral to regional trade arrangements. The shift in attention towards regional arrangements in effect challenges the proper effectiveness of MFN and National Treatment standards within these agreements as contrasted with their application under WTO rules[15].

Most RTAs allow member states to give each other preferential treatment that is not passed on to third parties and thus exempt them from MFN obligations, this would expose the trading system to segmentation with higher barriers placed in front of non-member countries, effectively defeating the universal application MFN treatment. The WTO permits regional exceptions under Article XXIV of GATT to permit the formation of customs unions or free trade areas, but they must not raise new obstacles to trade for non-discrimination principle, as a country prioritizes regional commitments over worldwide commitment[16].

RTAs also act as "testing fields" for innovative methods of trade liberalization, sometimes pushing the envelope further of or deviating from traditional MFN norms. Many RTAs have dedicated provisions to increase or alter MFN treatment by setting up better conditions between member states, all the while maintaining a minimum of non-discrimination among member states. This often-given rise to what is known as "double MFN standards," whereby preferential treatment that exists within RTAs now resides now resides side by side with more traditional MFN obligations under WTO agreements[17].

Case studies regarding leading RTAs capture vividly the dynamics involved. The North American Free Trade Agreement (NAFTA), for example, added MFN clauses and national treatment provisions that practically improve market access for member countries but still had exceptions that could adversely affect non-members. The European Union's framework on internal markets best explains how regional integration can actually deepen economic relationships but still respect core non-discrimination principles through a set of rules on intra-community trade among member states.

[15]Słok-Wódkowska, M., From Most-Favoured to Least Favoured Nations: How RTAs Influenced the WTO MFN-Based Trade?, EUR. TRADE STUDY GROUP, https://www.etsg.org/ETSG2016/Papers/325.pdf.
[16] World Trade Organization (WTO), *Repertory of Reports and Awards: N1 — Non-Discrimination*, https://www.wto.org/english/tratop_e/dispu_e/repertory_e/n1_e.htm.
[17] Supra note 13 page 8

## 4 ISDS's Function in Interpreting National Treatment and MFN Clauses

The Investor-State Dispute settlement mechanism has evolved over time and transformed into a significant mechanism through which the principles of Most Favoured Nation (MFN) and National Treatment may be implemented within the framework of the Bilateral Investment Treaties. At its conception, ISDS was more in nature of a means of providing relief to investors against host states for violations of treaty obligations. However, its scope has greatly broadened since the landmark cases such as Maffezini V. Spain (2000), which was in fact the very first case wherein an ISDS tribunal applied MFN for bringing in favourable dispute resolution provisions from a third treaty. Such a case provided litigants with a legal justification to circumvent certain procedural barriers that defined the original BIT, such as resorting to more benevolent terms adopted in other treaties and reformulating the interpretation and application of MFN clauses in investment law[18].

Various important ISDS decisions have, in general have, in general shaped the meaning of MFN and National Treatment. An important landmark case would be Burlington Resources V. Ecuador whereby it is clear that the tribunal ruled that national treatment requires a foreign investor to receive no less favourable treatment than the treatment that a local investor receives in like circumstances. This judgement underscored the protective aspect of national treatment as a shield against discriminatory measures of regulation by host states, so that no arbitrary or unfavourable conditions should be imposed upon foreign investors without some rational necessity. Awards from ISDS have vast implications for the interpretation of treaties and also for the state's autonomy in policy-making processes, as tribunals ordinarily prefer the rights of investors to the regulatory powers of states. This creates strains between fostering regulatory autonomy in the name of public interest purposes and compliance with international obligations under BITs.[19]

### 4.1 Reforms

There have been several debates on the reform of investor-state Dispute Settlement Mechanism through various internal forums. Foremost among these are the UN commission on

[18] World Bank, Legal Authorities: RL-0133 (2011), https://icsid.worldbank.org/sites/default/files/parties_publications/C8394/Respondent's%20documents/RL%20-%20Legal%20Authorities/RL-0133-ENG%202011-00-00.pdf.
[19] Supra note 13 page 8

International Trade Law (UNCITRAL) and the International Centre for settlement of Investment Disputes (ICSID). UNCITRAL's working Group III has been actively discussing since 2017 some of the ongoing concerns over ISD, the need for reforms, and possible solutions to address these concerns. This has also involved comprehensive consultation with a variety of stakeholders-states, NGOs, and legal practitioners - that have voiced their perceptions about the efficiency and the equity of the ISDS system currently operational. Part of these efforts were the attention given by ICSID to the procedural reforms that would make the outcomes of the arbitration more coherent with and transparent for each other. All these reflect increased recognition that a dispute resolution system should be better positioned to provide robust and equitable recourse for the parties involved.[20]

### 4.2 Recommendation

There should be the need for a multifaceted approach in reformation to address the challenges that are posed by the principles of Most Favoured Nation and National Treatment on Investor-State Dispute Settlement. The need for clarification and consistency in the interpretation of such principles calls out from the ongoing discussion in forums like UNCITRAL and ICSID. One of the major recommendations would be clear definitions and guidelines for MFN and National Treatment clauses in future Bilateral Investment Treaties. Such definitions would demarcate ambiguity that would lead to inconsistent rulings by tribunals and increase predictability for investors and host states, which are important for a stable investment climate[21].

[20] Alvarez, J. E., ISDS Reform: The Long View, 36 ICSID REV. 253 (2021), https://arbitration-day.law.columbia.edu/sites/default/files/content/Reading%20Materials/Conversation%201/siab036.pdf.
[21] Taft Law. (n.d.). *Most-favored-nations scope in investor-state arbitration*. Retrieved November 13, 2024, from https://www.taftlaw.com/news-events/law-bulletins/most-favored-nations-scope-in-investor-state-arbitration/

## REFERENCES

1. DiMascio, N. & Pauwelyn, J., Nondiscrimination in Trade and Investment Treaties: Worlds Apart or Two Sides of the Same Coin?, 102 CAMBRIDGE L.J. 48 (2008), https://www.jstor.org/stable/40007768.

2. Ministry of Economic Trade and Industry, Report on the WTO: Chapter 2 - Trade Policies and Practices by Measure (Nov. 8, 2024), https://www.meti.go.jp/english/report/data/2015WTO/02_01.pdf.

3. United Nations Conference on Trade and Development (UNCTAD), Investment Policy Framework for Sustainable Development (2010), https://unctad.org/system/files/official-document/diaeia20101_en.pdf.

4. Jus Mundi, Most-Favoured-Nation Treatment, https://jusmundi.com/en/document/publication/en-most-favoured-nation-treatment.

5. Ministry of Economic Trade and Industry, Report on Japan's Trade Policies (Nov. 19, 2024), https://www.meti.go.jp/english/report/downloadfiles/gCT0212e.pdf.

6. World Trade Organization (WTO), DS27: European Communities — Regime for the Importation, Sale and Distribution of Bananas, https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds27_e.htm.

7. World Trade Organization (WTO), DS58: United States — Import Prohibition of Certain Shrimp and Shrimp Products, https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds58_e.html

8. World Trade Organization (WTO), DS8: Japan — Taxes on Alcoholic Beverages, https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds8_e.htm.

9. Madhyam, India's Experience with Investment Treaty Disputes and Related Damages (Nov. 12, 2024), https://www.madhyam.org.in/indias-experience-with-investment-treaty-disputes-and-related-damages/.

10. Słok-Wódkowska, M., From Most-Favoured to Least Favoured Nations: How RTAs

Influenced the WTO MFN-Based Trade?, EUR. TRADE STUDY GROUP, https://www.etsg.org/ETSG2016/Papers/325.pdf.

11. World Bank, Legal Authorities: RL-0133 (2011), https://icsid.worldbank.org/sites/default/files/parties_publications/C8394/Respondent's%20documents/RL%20-%20Legal%20Authorities/RL-0133-ENG%202011-00-00.pdf.

12. Alvarez, J. E., ISDS Reform: The Long View, 36 ICSID REV. 253 (2021), https://arbitration-day.law.columbia.edu/sites/default/files/content/Reading%20Materials/Conversation%201/siab036.pdf.

13. Taft Law, Most-Favored-Nations Scope in Investor-State Arbitration, https://www.taftlaw.com/news-events/law-bulletins/most-favored-nations-scope-in-investor-state-arbitration/.