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LUCKNOW

CERTIFICATE

This is to certify that the thesis entitled "**STUDY OF MFN STATUS IN WTO**" submitted by **Himanshu Jatav** to the Babu Banarasi Das University, School of Legal Studies , BBD University, Uttar Pradesh, India for the award of the degree of, LL. M,(Corporate and Commercial Law) is a bona fide record of Dissertation work carried out by him under our supervision. The contents of the thesis, in full or in parts, have not been submitted to any other institute or university for the award of any degree or diploma.

DECLARATION

I hereby declare that this LL.M Dissertation. entitled **"STUDY OF MFN STATUS IN WTO"** was carried out by me for the degree of LLM in Corporate and Commercial Law , under the guidance and supervision of **Ms. Trishla Singh**,, Babu Banarsi Das University of Uttar Pradesh, India.

The interpretations put forth are based on my reading and understanding of the original texts and they are not published anywhere in the form of books, monographs or articles. The other books, articles and websites, which I have made use of are acknowledged at the respective place in the text.

For the present thesis, which I am submitting to the University, no degree or diploma or distinction has been conferred on me before, either in this or in any other University.

Place…….. (Mr. Himanshu jatav)

Date: ……..

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(…….)

List of Abbreviation

1. WTO	–	World Trade Organization
2. GCC	–	Gulf Cooperation Council
3. GATT	–	General Agreement on Trade and Tariff
4. GATS	–	General Agreement on Trade and Services
5. DSB	–	Dispute Settlement Body
6. TRIPS	–	Trade–Related Aspects of Intellectual Property
7. TPRM	–	Trade Policy Reviews
8. MFN	–	Most–Favoured–Nation
9. UAE	–	United Arab Emirates
10. FDI	–	Foreign Direct Investment
11. FTA	–	Free Trade Agreement
12. GDP	–	Gross Domestic Product
13. EU	–	European Union
14. UN	–	United Nation
15. FTA	–	Free Trade Area
16. CU	–	Custom Union
17. CET	–	Common External Tariff
18. MU	–	Monetary Union
19. OECD	–	Organization for Economic Co–operation and Development
20. WB	–	World Bank
21. MFA	–	Multi-fiber Arrangement
22. IB	–	International Business
23. TNC	–	Transnational Corporations
24. OIC	–	Organization of Islamic Cooperation
25. ASEAN	–	Association of Southeast Asian Nations

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CHAPTER 1

INTRODUCTION

The most-favoured-nation principle is omnipresent in contemporary international economic relations[1]. It has long been considered "the corner-stone of all modern commercial treaties and is a central principle in the General Agreement on Tariffs and Trade (GATT), the General Agreement on Trade in Services (GATS) and the Agreement on Trade-Related Aspects on International Property Rights (TRIPs). Accordingly, the Appellate Body described the principle as 'a cornerstone of the GATT and one of the pillars of the WTO trading system[2]'. The desirability of conducting international trade on the basis of most-favoured-nation treatment has been pointed out ever since, inter alia in the 1974 Charter of Economic Rights and Duties of States and the 1975 Final Act of the Helsinki Conference on Security and Cooperation in Europe. During the second half of the twentieth century, it has become a "core element of international investment agreements"6 and was included in almost all of the now more than 3000 bilateral investment treaties (BITs) and regional and multilateral investment treaties. It is the object of mostfavoured-nation clauses to avoid discrimination and establish equal competitive opportunities. Since there is no obligation of economic non-discrimination in customary international law, such obligation only exists when a treaty creates it. Lacking a treaty, nations have the sovereign right to discriminate against foreign nations in economic affairs.

In contrast to the multilateral GATT, where one MFN clause is applicable to all member States, international investment law presents a variety of differently worded MFN clauses embedded in different treaties. The large number of treaties also leads to variations with regard to the standards of protection accorded to investors from different home countries. The provisions in bilateral investment treaties are not uniform both concerning the substantive protection of investors and investors possibilities to settle disputes with the host State. More favourable treatment granted to third-State investors can therefore not only

[1] The clause is however not limited to the field of international economic law, but can also be found in non-economic conventions, such as the Convention relating to the status of refugees (see Articles 13, 15.
[2] Appellate Body Report, Canada-Autos, 31 May 2000, WT/DS139/AB/R, WT/DS142/AB/R, para. 69

derive from unilateral measures taken by a State, but also from agreements concluded with a third State[3]. This means that investors may invoke more favourable provisions from bilateral investment treaties concluded with a third State if their home States have concluded a bilateral investment treaty including a most-favoured-nation clause with the investor's home State.

This possibility has given rise to the question about the scope of the various MFN clauses. The question arises as regards the applicability of the clause to substantive treaty standards, but it has gained particular significance as regards its application to dispute settlement provisions. By now a significant number of investment cases has dealt with the application of MFN clauses to procedural or jurisdictional dispute settlement provisions. The decisions are however highly contradictory. Views range from the application of MFN clauses to all dispute settlement provisions over a distinction between procedural and jurisdictional dispute settlement provisions to a complete negation of applicability. The issue is still by no means settled. In regard of the great amount of conflicting decisions, it is the objective of the thesis to seek to contribute to a greater coherence in the approaches adopted in the view of this question. The finding of a coherent approach is of vital importance in order to work against the fragmentation of international law and to increase the legitimacy of international investment law, which is necessarily threatened by the unpredictability deriving from conflicting decisions[4]. At the same time, it is essential to give States enough room to pursue self-determined public policies given that invest- ments may be beneficial or detrimental to the host States economy, environment or development.

Against this background, Part I of the thesis deals with the basic principles governing most-favoured-nation clauses, including an elucidation of the notion (A). and functions (B.) and an examination of the impact most-favoured-nation clauses have in trade and investment law (C.). It is argued that most-favoured-nation clauses in investment law potentially have a stronger impact on the regulatory autonomy of the host State than in trade law, a finding which becomes particularly relevant when ascertaining the comparators relevant for the determination of like circumstances. Part II deals with the historical development of most-

[3] Nolde, La clause de la nation la plus favorisée et les tariffs préférentiels, p. 48; Sacerdoti, Bilateral Treaties and Multilateral Instruments on Investment Protection, p. 350
[4] See Schill, Internationales Investitionsschutzrecht und Vergleichendes Öffentliches Recht, p. 255.

favoured-nation clauses. Part III contains an overview of mostfavoured-nation clauses in various agreements. A survey of most-favoured-nation clauses necessarily constitutes a limited selection. It is the aim of Part III to examine the language of some most-favoured-nation clauses in order to demonstrate that arbitral tribunals may come to different results depending on the wording of the relevant clause. Part IV deals with the application of most-favoured-nation clauses to substantive provisions by examining and systematising existing case law. Investment tribunals have homogenously accepted application of most-favoured-nation clauses to substantive treatment standards. They have so far dealt with the invocation of an allegedly more favourable fair and equitable treatment standard, with the invalidation of a non-precluded measures clause and the obligation to grant necessary permits. The thesis then turns towards further substantive treatment standards which have not yet been relevant in investment cases, but which might be invoked by means of a most-favoured-nation clause in the future. It concludes that application of the most-favoured-nation standard to substantive provisions may have a far-reaching impact on the substantive treatment owed to an investor. Part V discusses the application of most-favoured-nation clauses to the conditions ratione temporis, ratione materiae and ratione personae. It is demonstrated that these conditions cannot be circumvented via a most-favoured-nation clause, given that they restrict the scope and applicability of the entire treaty, including the most-favoured-nation clause. Part VI deals with the application of most-favoured-nation clauses to dispute settlement provisions. In the view of several tribunals that have distinguished between the application of MFN clauses to jurisdictional and procedural provisions, Part VI.A. sets forth the distinction between jurisdictional and admissibility-related provisions, while recognizing that this distinction does not entail the non-mandatory nature of admissibility-related provisions. Part VI.B contains the arguments relating to the application of most-favoured-nation clauses to procedural dispute settlement provisions. In this respect, the interpretation of MFN clauses according to the Vienna Convention is of paramount importance. It is argued in Part VI.B.I. that depending on the wording of each clause, this interpretation generally suggests application of MFN clauses to procedural and jurisdictional dispute settlement provisions. Part VI.B.II and III. examines domestic case law and ICJ jurisprudence, which does not offer unequivocal guidance on the issue. As a further argument to affirm application of MFN clauses to jurisdictional provisions in addition to procedural provisions, Part VI.C.

stresses the importance of consent both to substantive and jurisdictional provisions and rejects the restrictive interpretation of jurisdictional clauses. Part VI.D. contains an overview of rulings by investment tribunals. While Part VI.D.I. deals with rulings concerning the circumvention of procedural requirements, and more specifically with the requirement of submitting a dispute to domestic courts for a certain period of time before commencing arbitration, Part VI.D.II examines cases dealing with the importation of jurisdictional provisions. The cases are assessed against the background of the argumentation in Parts VI.B and C. After an overview of further potential fields of application to dispute settlement matters, it is concluded that the outcome of the cases affirming an MFN clause's application to dispute settlement provisions should be endorsed, while the reasoning is sometimes subject to critique. Part VII deals with the question whether it should be possible to invoke by means of a most-favoured-nation clause beneficial provisions without having to import at the same time disadvantageous provisions that may have been inserted in the basic treaty as a balance or trade-off for the relevant beneficial provisions. This would involve the possibility to create a combination of beneficial treaty provisions that the host State never intended to guarantee to investors from any State. It is argued that cherry picking is the natural effect of MFN clauses, which implies that only beneficial provisions must be imported. However, as a limiting principle .

to this approach, some features of a BIT which are closely related only allow conjoint incorporation. Part VIII deals with the concept of like circumstances, which is the prerequisite for a comparison whether there is in fact less favourable treatment. First the thesis gives an outline of the concept of like products and like services in trade law. These concepts can however not be easily transferred to the investment context. Then the comparators relevant to the determination of like circumstances in investment law are identified, taking into account that the like circumstances analysis in investment law should give more room to the consideration of regulatory objectives of the host State than the corresponding concepts in trade law. Part VIII is followed by the Final Conclusion.

Basic Principles

A. Notion and Substance of the Most-Favoured-Nation Clause

I. Definition

The most-favoured-nation clause is a treaty provision which obliges a State (the granting/conceding State) to extend to another State (the beneficiary State) or to persons or things in a certain relationship with that State all the benefits which it accords to third States (favoured States) or to persons or things in the same relationship in an agreed sphere of relations[5]. In the field of investment law, the standard obliges host states to treat investors from one foreign country no less favourably than investors from any other foreign country. The rights enjoyed under the most-favoured-nation standard are thus not absolute, but dependent on the rights granted by the promisor to third States or persons or things in a determined relationship with that State. As a contingent standard, its content is ascertained by reference and dependent on an exterior set of rules. Thus, the mostfavoured-nation standard has been described as a shell with variable – and continuously varying – contents. To determine the field of application for the most-favoured-nation clause, reference is often made to the ejusdem generis principle, which stipulates that rights are acquired only in respect of matters which are specified in the clause or implied from its subject-matter[6].

With regard to the scope of the prohibition of discrimination, the difference in treatment may be specifically provided for in a law or regulation of the host state or may be the consequence of a measure ostensibly non-discriminatory, but resulting in different treatment in fact. De jure discrimination involves a law or regulation that openly links a difference in treatment to the origin of investors or investments. The term de facto discrimination refers to regulatory measures which are formally origin-neutral and do not explicitly distinguish between various investors but which impose an illegitimate burden on a certain category of investors while sparing others, thus modifying the conditions of competition. With regard to Article I:1

[5] Ustor, Most-Favoured-Nation clause, p. 468. See also the definition in the ILC Draft Articles, at p. 21, which states that the most-favoured-nation clause guarantees treatment accorded by the granting State to the beneficiary State, or to persons or things in a determined relationship with that State, not less favourable than treatment extended by the granting State to a third State or to persons or things in the same relationship with that third State.

[6] See below Part VI B.I.2.

GATT, the WTO Appellate Body ruled that Article I:1 GATT does not only cover de jure discrimination, but also de facto discrimination and thus also measures which, on their face, do not depend on the origin of the relevant product[7]. The Appellate Body in EC-Bananas found that the same was true for the most-favourednation obligation of the GATS in Article II:1. Similarly, under the non-discrimination standards of investment treaties, both direct and formal de jure discrimination and indirect de facto discrimination are prohibited.

Scope of the Study

The conventional debate on multilateralism versus regiomilism ·· has changed considerably over the time. With the ever expanding nature and scope of modem RTAs, the issues involved, its depth and inclusiveness also changed. The tension between the multilateral and regional ethos continues to create new and interesting debates in the academic circle. The recent shift of focus of the major trading economies from multilateralism to regionalism has further intensified the debate. Several volumes of literature have been produced on the above subject. Till recently the regionalism was considered as more or less contained within the legal and political framework of the GATT!WTO. With the standstill in WTO negotiations, countries are eagerly pushing RTAs and it is interesting to note that trading blocs are emerging with vigour. In their efforts to liberalize trade, countries go much beyond the WTO framework to create rules and disciplines in new areas and sectors often not governed by WTO. Thus multilateralism and regionalism have created two parallel legal regimes operating in the same plane. The legal complexities involved in the coexistence of these legal regimes are high, given the fact that countries are members to one or more RTAs at the same time when they are members of WTO. These complexities give rise to regulatory confusions and other inherent and inevitable conflicts.

The present study exammes the existing legal framework for RTAs under the GATTIWTO and its weakness in exerting the disciplines. In this attempt, the study explores the historical evolution of the disciplines and the subsequent legislative developments in the GATT/WTO. The important GATTIWTO cases are also discussed for an understanding on the emerging jurisprudence on the subject. The study also examines some of the policy issues associated

[7] Appellate Body Report, Canada-Autos, 31 May 2000, WT/DS139/AB/R, WT/DS142/AB/R, para. 78; EC-Bananas, WT/DS27/AB/R, para. 234.

with modem RT As and its implications. In this regard, the study is limited and focused on some of the policy issues surfacing in RTAs. The attempt is to identify the legal and policy challenges raised by RTAs and its larger impact on the multilateral trading system. The study also covers the Indian approach and practice to RT As. However, the study is focused and has not addressed all the legal issues related to RT As. The constitutional as well as the jurisdictional issues could be themes for in depth studies. The present study in its legal examination has limited itself to issues associated with the legal text of the discipline, its interpretation and practice. In the policy front, the present study has identified two major areas- TRIPS and GATS- to test the hypothesis of'WTO-Plus' --------- - - --· ---~----------~--~ in the RTAs and hence the examination is limited to these two broad areas. The issues are critically looked upon from a developing country perspective and have placed some suggestions towards the conclusion.

Research Questions

1. Whether the Regional Trade Agreements supplement the multilateral trade liberalization or weaken it?
2. What kind of a comprehensive legal discipline could ensure co-existence and minimize conflicts between the multilateralism and regionalism?
3. What implications, if any, the present surge of regionalism will have on the existing legal framework of multilateral trading system?
4. Whether this surge of RTAs benefits and takes into account concerns of developing countries?

Hypotheses

1. The existing multilateral legal framework that incorporates provisions relating to RTAs as embodied primarily within World Trade Organization (WTO) requires new formulations and interpretations to validate the scope, applicability and legality of increasing number ofRTAs.
2. The existing discipliiles and procedures under WTO applying to RT As require substantial clarification and strengthening.

Research Methodology

The Study is done on the basis of the available primary sources including the relevant legal texts of the WTO Agreement and the Covered Agreements, other multilateral/bilateral trade agreements, GATT /WTO documents, GATT /WTO Dispute Settlement Reports, relevant documents/briefs prepared by the Member States to the WTO and the policy papers published by the Government of India. The secondary sources include books, articles, institutional working papers, discussion papers and relevant Internet sources. The Study initially applies the historical method to understand the development of disciplines governing regional trade agreements through the legal texts, various documents and other available secondary sources. Also, it adopts comparative and analytical methods to study the features of multilateralism and regionalism and to examine the recent trends in modem RTAs. In view of limited literature on Indian approach to Regionalism, an attempt has been made to discuss and take views from authoritative sources including concerned Ministry officials.

Objective

The main objective of the WTO is to provide full competitive opportunity of trade among the contracting parties. Its trading system is founded on certain basic principles. The principle of Non-Discrimination requires that all trading partners shall be granted the Most Favoured Nation (MFN) clause. Under the National Treatment, there should be commitment to treat foreign producers and sellers the same as domestic firms. The other fundamental principles are promotion of free trade, predictability and stability to the trading system, promotion of fair competition and special concern for developing countries. It deals in three ways with the special needs of the developing countries. The WTO agreements contain special provisions on developing countries. The committee on Trade and Development keep watch over the special aspects of the WTO agreements related to developing countries and the WTO secretariat provides technical assistance for developing countries.

This chapter discusses the basic principles and agreements of WTO. The WTO agreements are a set of rules, which have to be followed by governments in enacting their policies and practices in the areas of international trade in goods and services and intellectual property rights. There are provisions for transparency of actions. Members have opportunity to consult

among themselves.2 The WTO agreement is described as a “Mini-Charter”. It is strictly institutional and procedural in character. It incorporates some 29 individual texts. These are spread over three compartments, viz., goods, services and intellectual property rights. The three corresponding agreements are, (a) General Agreement on Tariffs and Trade (GATT), (b) General Agreement on Trade in services (GATS), and (c) The Agreement on Trade Related Aspects of Intellectual Property Rights

CHAPTER 2

HISTORICAL OVERVIEW

Origins of the Most-Favoured-Nation Clause

The most-favoured-nation principle has been part of international economic relations for centuries. The origins of the principle can be traced back to the eleventh century[8]. In mediaeval times it was mostly Mediterranean, especially Italian towns that engaged in international commerce. Mediaeval merchants first concluded contracts with foreign sovereigns assuring them the right to trade in these countries and to assure them and their commodities the necessary protection. They also aspired to obtain monopolies and exclusive privileges on the foreign markets in these contracts[9]. In the fifteenth century, particularly Portuguese, Spanish and Dutch traders began to compete for foreign markets. This was also the time when modern absolute States emerged which used their power to assure for their nationals the right to trade in foreign countries. Contracts between individual merchants and a State were therefore increasingly replaced by treaties concluded between States. With the expansion of commerce and competition, the merchants realised that they could not secure monopolies any more. It was therefore vital for them to at least establish equal opportunities with their competitors.

The first commercial treaties usually contained unilateral grants of most-favoured-nation treatment. The treatment standard was for example granted to French and Spanish cities by the Arab princes of western Africa, ensuring the same treatment as that granted to citizens of Venice and other Italian towns; by the Byzantine Emperors to Venice to ensure treatment equal to that granted to Genoans and Pisans; by the French princes of the Kingdom of Jerusalem to several trading cities of the Mediterranean; and within the Holy Roman Empire[10]. These promises related to the personal rights of and jurisdictional favours for the merchants rather than to concessions in respect of customs duties. Probably the first example of the clause can be found in the treaty between the Holy Roman Emperor Henry III and the

[8] Nolde, La clause de la nation la plus favorisée et les tariffs préférentiels, p. 26.
[9] Martens, Traité de droit international, vol. II, pp. 299-300.
[10] Ustor, History of the most-favoured-nation clause, p. 159.

town of Mantua of 1055. In this treaty, the Emperor granted to the merchants of the town of Mantua to enjoy all privileges including customs privileges that were obtained by any other town.

Since the fifteenth century the clause also appeared in the bilateral form. In the Treaty between Henry V of England and the Duke of Burgundy and Count of Flanders of 1417, the Duke of Burgundy granted to subjects of the English King the same right of free navi- gation as that granted to nationals of certain other States and vice versa. Although in that treaty both treaty parties granted each other most-favoured-nation treatment, the reciprocal favours were limited to concessions granted to subjects from specifically enumerated nations. This indicates that the idea of equality underlying the most-favourednation clause was not yet entirely developed.

By the end of the fifteenth century the restriction to certain nationalities was lifted, and the same advantages were granted to merchants as those accorded to merchants of any third State. One can cite as examples of this modern type of treaty the commercial treaty between England and Britanny of 1486130 and the Anglo-Danish treaty of 1490. Since both commercial activities and navigation increased since the fifteenth century, both aspects were the basic field of application for the clause. Another evolution of the clause was its increasing application not only to advantages accorded in the past, but also to treatment accorded to third States in the future. These two development lines marked the beginning of the modern type of the most-favoured-nation clause, whose application was neither limited to advantages granted to certain states only nor to past advantages. It was towards the close of the seventeenth century that the term “most-favoured-nation” emerged.

The use of the clause became common practice in the period of mercantilism, which formed the basis of economic policy in almost all European states between 1650 and 1750. Mercantilism was inter alia marked by the encouragement of export and the thought that the economic system was a zero-sum game, where a gain by one party required a loss by another[11]. It was therefore considered vital by all States to obtain exclusive privileges or, if that was impossible, at least to prevent other States from obtaining privileges that were not

[11] For details see Tilly, Geschichte der Wirtschaftspolitik, pp. 8 et seq.

accorded to them.135 With the rapid expansion of commerce and the increased frequency of commercial treaties, this could most conveniently be ensured by the use of most-favoured-nation clauses, which were a suitable means to avoid a permanent revision of treaties.

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Since European States tended to impose very differing tariffs on goods depending on their origin, an explicit reference to most-favoured-nation treatment in regard of tariffary treatment was not included in treaties until the seventeenth and eighteenth century, when most-favoured-nation treatment was first granted with regard to tariffary treatment. Early examples were the 1642 treaty between Portugal and Great Britain and the 1713 Treaty of Utrecht between France and Great Britain.

A broad field of application of the clause, albeit in a unilateral form, was opened with the capitulation agreements concluded by European powers with certain non-European States since the sixteenth century[12]. Such clauses typically benefited European powers without giving reciprocal benefits to their non-European counterparts. For example, the 1740 capitulation between France and the Ottoman Empire stated that the privileges and honours accorded to the other European nations should also be accorded to the subjects of the Emperor of France. The abandonment of the unilateral type of the clause can be explained with its incompatibility with the sovereign equality of states.

[12] Capitulations can be defined as the sum of rights, privileges and immunities that enabled foreigners in certain countries, such as Morocco or the Ottoman Empire, to almost entirely avoid actions of the administration, of the fiscus and the jurisdiction of domestic tribunals, see Carabiber, Capitulations dans l'Empire Ottoman et au Maroc, in: de Lapradelle/ Niboyet (eds), Répertoire de droit international, vol III, p. 39, para. 1

"The Most Christian King and the United States engage mutually not to grant any particular favour to other nations, in respect of commerce and navigation, which shall not immediately become common to the other Party, who shall enjoy the same favour, freely, if the concession was freely made, or on allowing the same compensation, if the compensation was conditional[13].

The basis for the conditional form of the clause was the idea of material reciprocity; if a State extended to a state benefits that it had only granted to a third state against compensation, it should also be afforded some compensation by the beneficiary state. Under the conditional form, it was argued, all are treated equally since they can obtain the same advantages under the same conditions. This view was succinctly voiced in the statement by the American Secretary of State John Sherman who wrote.

But the allowance of the same privileges to a nation which makes no compensation, that have been conceded to another nation for an adequate compensation, instead of maintaining destroys that equality which 'the most-favored-nation' clause was intended to secure. It concedes for nothing to one friendly nation what the other gets only for a price. It would thus become the source of international inequality and provoke international hostility.

Even when a commercial treaty concluded by the United States contained the clause in its general form, with no explicit reference to conditional application, the United States insisted that it should be interpreted as though it explicitly required reciprocity. It was until the beginning of the twentieth century that the United States typically resorted to a conditional form of most-favoured-nation treatment[14]. In Latin America and Europe as well, coming along with an era of protectionism, the conditional form of the clause became dominant between 1830 and 1860. Only Switzerland and Great Britain stuck to the inconditional form of the clause.

[13] Cited by Ustor, History of the most-favoured-nation clause, p. 161.
[14] Ustor, History of the most-favoured-nation clause, p. 161; Nolde, La clause de la nation la plus favorisée et les tariffs préférentiels, pp. 29-31.

I. Liberalisation and the 1860 Chevalier-Cobden Treaty

The era of protectionism was followed by a period marked by a surge of liberal economic perceptions. It was recognized that the unconditional most-favoured-nation clause can help spread liberalisation faster than the conditional clause, given that any concession is generalized to apply to beneficiaries automatically. The disadvantage of the conditional conception is that since countries rarely make concessions freely, the beneficiary regularly has to give some kind of compensation equivalent to the compensation offered by the favoured country. As the mere promise that the terms of any deal would be equally available to any country benefiting from an MFN clause, the conditional clause does not fulfil the functions of a most-favoured-nation clause to eliminate discrimination and promote equality since egality is tied to reciprocal concessions. Moreover, it is hardly possible to say what amounts to a reciprocal compensation of the same or equal value, for a concession which is valuable when made by one state may be of less value or even valueless if made by another. The clause in its conditional form thus also loses its effects of unification and simplification. Moreover, it bears disadvantages for countries with a liberal commercial policy, since these countries are less favourably situated for negotiating than those which possess heavier restrictions. In the course of liberalisation, the conditional most-favoured-nation clause was therefore largely abandoned in favour of unconditional most-favoured-nation treatment. This development was initiated by the ChevalierCobden Treaty concluded between France and Great Britain in 1860, which is named after the main British negotiator Richard Cobden, an advocate of free trade, and Michel Chevalier, who was the economic adviser to Napoleon III. 153 In this treaty Great Britain and France substantially reduced their tariffs, abolished import prohibitions and granted each other the status of the most favoured nation on an unconditional basis. In the 1800s and 1900s, the unconditional form of the clause gradually became the cornerstone of commercial treaties in all of Europe and almost all countries and was often included in Friendship, Commerce and Navigation treaties.

IV. The First World War and the Post-War Period

During the First World War, economic nationalism spread among almost all countries, which led to a widespread abrogation of treaties containing the most-favoured-nation

clause. The destruction of the economy by the war led to trade restrictions, widespread discrimination and a temporary overall decline of the clause[15]. In 1918, France, Italy, Romania, Spain and Greece abrogated all treaties of commerce containing a mostfavoured-nation clause[16]. The Allied countries agreed at their Economic Conference in 1916 that enemy nations should be subjected to "systematic discrimination in economic matters'. The insertion of unilateral clauses to the detriment of the defeated countries was typical for the peace treaties. However, with the resumption of economic relations after the war and growing dissatisfaction with protectionism, commercial treaties based on the principle of most-favoured-nation treatment became again more and more common.

V. Attempts of Codification Under the Auspices of the League of Nations

Already during the war, there were perceptions recognising the dangers for peace involved in tariff discriminations and economic hostilities. Woodrow Wilson attempted in the third of his Fourteen Points to obtain general acceptance of the principle of "equality of trade conditions'. This Third Point was the basis for Article 23 (e) of the Covenant of the League of Nations, granting "equitable treatment for the commerce of all Members of the League". However, Wilson's proposal was watered down in the Covenant, equal treatment being granted only subject to international conventions and the "special necessities of the regions devastated during the war.

After the entry into force of the Covenant, a series of International Economic Conferences was initiated under the auspices of the League of Nations in order to reorganize the world economy. One such conference took place in Genoa in 1922. This conference established as a goal the use of most-favoured-nation clauses, however, temporary difficulties in the application of the clause were recognised and its general application was not explicitly recommended. The report of the Economic Commission provided-

> 'The Conference recalls the principle of the equitable treatment of commerce set out in article 23 of the Convenant of the League of Nations, and earnestly recommends

[15] Ito, La clause de la Nation la plus favorisée, p. 35; Nolde, La clause de la nation la plus favorisée et les tariffs préférentiels, p. 91; Rousseau, Principes Géneraux, p. 467; Virally, Le principe de réciprocité, p. 74
[16] Ito, La clause de la Nation la plus favorisée, p. 90

that commercial relations should be resumed upon the basis of commercial treaties, resting on the one hand upon the system of reciprocity adapted to special circumstances, and containing on the other hand, so far as possible, the mostfavoured-nation clause[17].

(2) While recognizing that each State must judge in what cases and to what extent this fundamental guarantee should be embodied in any particular treaty, the conference strongly recommends that the scope and form of the most-favoured-nation clause should be of the widest and most liberal character and that it should not be weakened or narrowed either by express provisions or by interpretation[18].

After that conference, the Economic Committee of the League of Nations followed the task of carrying out the commercial policy advocated by the International Economic Conference of 1927. In particular, it thoroughly examined the general principles governing most-favoured-nation treatment and drafted a model clause. This clause was focused exclusively on customs matters. It contained a promise of unconditional and unrestricted most-favoured-nation treatment in all matters concerning customs duties, subsidiary duties and the rules, formalities and charges imposed in connexion with the clearing of goods through the customs. The efforts of the World Economic Conference however ended without result due to the onset of the depression in 1929.

The Committee of Experts for the Progressive Codification of International Law operating under the auspices of the League of Nations also dealt with the effects of the mostfavoured-nation clause. It stated in its report.

'Bearing in mind that any favour which a State may grant as a public right may be claimed under an unlimited most-favoured-nation clause, it would be idle to attempt a list of subjects which are or may be subject to most-favoured-nation treatment'[19].

[17] Report of the Third Economic Commission of the Genoa Conference, Chapter 1, Article 9, quoted by Ustor, History of the most-favoured-nation clause, p. 168.
[18] League of Nations, The World Economic Conference, Document C.356.M.129.1927.II (C.E.I.46) (1927), quoted by Ustor, History of the most-favoured-nation clause, p. 169.
[19] Publications of the League of Nations, 1927.V.10 (C.205.M.79.1927.V), p. 6.

Emphasizing the need for Contracting Parties to formulate the clause in such a way as to leave no doubt to their intention, the report concluded that it was not necessary to endeavour to frame a general convention to establish the principal means of determining and interpreting the effects of the most-favoured-nation clause in treaties[20]. The efforts of the Committee of Experts therefore did not lead to a codification concerning the effects of the clause.

Neither did the World Monetary and Economic Conference which took place in London in 1933 and which particularly dealt with possible exceptions to the most-favoured-nation clause lead to substantial progress due to widespread disagreement between the participating parties.

VI. Codification Efforts by the Institut de Droit International

The Institut de Droit International adopted a resolution concerning the effects of the most-favoured-nation clause in matters of commerce and navigation in 1936. The resolution established that the clause should unless otherwise stated be unconditional para.1. Its effects should be limited by the duration of the third party treaty, para. 3. The resolution focused on equal treatment as regards customs duties and the rules, formalities and charges that are applied to customs clearance operations (para. 4). It provided for several exceptions to most-favoured-nation treatment, inter alia concerning treatment granted to adjacent states and treatment resulting from a customs union (para. 7). Disputes concerning the interpretation and the application of the clause should be settled by courts or by arbitration (para. 10). In 1969 the Institut de Droit International issued another brief resolution on the most-favoured-nation clause in multilateral conventions, which emphasized the need for preferential treatment for developing countries and recognized regional agreements as exception to most-favoured-nation treatment.

VII. Codification Efforts by the International Law Commission

Codification efforts gained new momentum when in 1978 the ILC submitted thirty draft articles on most-favoured-nation clauses to the General Assembly. Those articles deal,

[20] Publications of the League of Nations, 1927.V.10 (C.205.M.79.1927.V), p. 14.

inter alia, with the definition of the clause, rules for interpretation, its structure and effects and the distinction between the conditional and the unconditional approach. With regard to the determination of its scope, the articles endorsed the ejusdem generis princi- ple. Namely, Article 9 (1) of the Draft Articles clarified that "the beneficiary State acquires, for itself or for the benefit of persons or things in a determined relationship with it, only those rights which fall within the limits of the subject-matter of the clause. The General Assembly gave consideration to the topic at its forty-sixth session in 1991 and decided to "bring the draft articles on most-favoured-nations clauses to the attention of Member States and interested intergovernmental organizations for their consideration in such cases and to the extent as they deem appropriate, without, however, transforming them into a binding instrument.

VIII. Integration of Most-Favoured-Nation Treatment in WTO Agreements

During the world economic crisis which started in 1929 and World War II, States again resorted to discriminatory policies. In the aftermath of the war, multiple attempts were made to restore the economic order and to create instruments for the liberalisation and multilateralisation of trade. One outcome was the formation of the General Agreement on Tariffs and Trade (GATT) in 1947. The most-favoured-nation standard played a central remedial role in the international efforts to establish a system of guarantees against trade discrimination, which was considered one of the causes of both world wars. 173 In the GATT framework, the principle of most-favoured-nation treatment, which was traditionally used in bilateral trade agreements, was multilateralised, which put an end to policies based on bilateral reciprocity and established a general principle of non-discrimination.

The general and unconditional most-favoured-nation clause was established in GATT Article 1. It is applicable to customs duties, methods of levying such duties, rules and formalities in connection with importation and exportation, and matters referred to in, i.e. internal taxes and regulatory laws. Apart from Article I1, the GATT con- tains various other subject-specific non-discrimination clauses. Moreover, several other multilateral trade agreements covering trade in goods contain special most-favourednation clauses.

Various exceptions are applicable to the most-favoured-nation principle, inter alia general public policy exceptions (Article XX), exceptions as regards emergency action (Article

XIX), security interests (Article XXI), national interests (Article XXIII), and customs unions and free trade areas (Article XXIV:4-10). Moreover, there are numerous provisions in WTO agreements that permit to grant more favourable treatment to be given to developing countries. Of particular importance in the context of development is the so-called "Enabling Clause", which was decided by the Contracting States in 1979 in the course of the Tokyo Round and which allows developed countries to accord preferential treatment to developing countries in departure from the most-favoured-nation clause.

A most-favoured-nation clause is also included in Art. II:1 of the GATS, and repetitions of the principle can be found in other provisions of the GATS. GATS Article II:1 is structured similarly to GATT Article I:1, however, deviant from the unconditional mostfavoured-nation principle, GATS Article II:2 permits members to maintain measures that are inconsistent with the most-favoured-nation principle provided that such measures are listed in the Annex on Article II Exemptions. Furthermore, the GATS provides a catalogue of general exceptions in Article XIV and of security exceptions in Article XIV bis, which are virtually identical with GATT Articles XX and XXI, and an exception concerning regional integration in Article V, which is analogous to GATT Article XXIV.

The TRIPS Agreement deals with the protection of the intellectual property of foreign companies and individuals investing in, producing and trading intellectual propertyintensive goods and services. Since the protection of intellectual property is an important factor for the creation of a legal environment that is attractive to foreign investors, the agreement constitutes an important source of investment protection. Article 4 TRIPS sets out the principle of unconditional most-favoured-nation treatment in the field of intellectual property rights. It follows from the clause that unilateral practices, bilateral agreements affording greater protection ("TRIPS-plus") or the improvement of registration procedures have to be extended to all Members.180 The most-favoured-nation clause of TRIPS is linked with standards provided in bilateral investment treaties insofar as these treaties define investment as encompassing intellectual property rights. If a WTO member grants more favourable treatment in a BIT with regard to intellectual property rights, this standard can be extended to other WTO Members by means of Article 4 TRIPS.

Article 4 TRIPS also lists various exceptions to most-favoured-nation treatment. Despite proposals by the (former) European Communities181 and the United States182 to incorporate an exception for regional agreements as an equivalent to GATT Article XXIV and GATS Article V, such exception was not included in the final TRIPS agreement. Thus, if a regional agreement provides for more privileges than the TRIPS Agreement, these privileges can be imported via the most-favoured-nation clause of the TRIPS Agreement.

IX. The Use of Most-Favoured-Nation Clauses in Investment Treaties

The first bilateral investment treaty, which was concluded in 1959 between the Federal Republic of Germany and Pakistan, did not contain a general most favoured nation clause, but only a specific one concerning most-favored-nation treatment in cause of war and a general prohibition of discriminatory treatment. A general most-favoured-nation clause was however included in subsequent treaties. While the 1960 Germany-Malaysia BIT and the 1961 Germany-Greece BIT[21] grant most-favoured-nation treatment only 'unless specific stipulations made in the document of admission provide otherwise thus leaving governments the possibility to decide on the validity of the standard as regards every individual investment, the following BITs provided for unreserved most-favourednation treatment. Most-favoured-nation clauses have since been continuously included in virtually all investment treaties.

[21] See Articles 1 II and 2 of the BIT.

CHAPTER 3

REVIEW OF LITERATURE

The literature on regionalism and multilateralism is vast and several volumes have appeared with almost all conceivable issues being discussed from several perspectives; economic theory; domestic and international political economy; systematic aspects, including legal aspects; and empirical evidence. The available literature focuses broadly on the issues discussed below.

The desirability of RT As is a central question debated in the literature on the impact ofRT As on multilateral trading system even more than fifty years back. The debate is still on in the trade circles since the Canadian economist and scholar Jacob Viner came out with an authoritative work, 'The Customs union Issue' in 1950 in which he provided a more or less definitive analysis of the trading bloc issue. The pertinent question in the debate is, to what extent regionalism promotes or erodes trade liberalization. Since then, scholars have expressed divergent views regarding the impact of regionalism on the multilateral trading system. The debate has grown through various theoretical and empirical arguments producing various terms now familiar in the academic circle like trade diverting, trade creating, stumbling bloc, building bloc, etc. Scholars who argue that the regionalism can complement multilateral trading system build their argument on the logic that as RTAs are formed with a view of further lowering the tariffs, it directly or indirectly promotes trade liberalization. On the other hand, scholars who are critic of regionalism base their argument on the logic that as being an exception to MFN principle which is the comer stone of multilateral trade liberalization, regionalism hampers the multilateral trade liberalization. Several arguments have been put forward as to why regionalism can complement and hamper multilateral trading system.

Over all, it is possible to distinguish two schools of thought as to the dynamic impact of discriminatory liberalization: one school highlights 'discrimination' and provides a pessimistic prognosis on the effects of regionalism on multilateral liberalization (Bhagwati 1999; De Melo and Panagariya 1992), thus suggesting that regionalism represents a threat to the development of a global economy. Proponents of this view stress (i) the risks that RTAs

may promote trade diversion rather than trade creation, thus reinforcing vested interests to maintain preference margins and raising concerns against multilateral liberalization on the ground of preference erosion; (ii) that RTAs may provide bargaining tool to exchange preferential market access with concessions on non-tariff issues (such as standards), thus reducing the enthusiasm of MFN liberalization; (iii) that the proliferation ofRTAs may crowd out negotiating resources necessary to achieve further multilateral liberalization; (iv) that the competing RTAs may lock-in incomparable regulatory structures and standards; (v) the fact that RTAs, by creating alternative legal systems and dispute settlement mechanisms, may weaken the enforcement system of the discipline of the multilateral trading system; (vi) that the proliferation of a maze of different regulatory systems undermines the principles of transparency and predictability of the WTO.

The other school highlights 'liberalization' and predicts a benign effect of regionalism on multilateralism (Summers 1991; Krugman 1993; Lawrence 1991), reaching the conclusion that regionalism can serve as a catalyst for further liberalization.

Proponents of this view have highlighted that: (i) the proliferation and expansion of RTAs de facto erode existing preferences, thus reducing the opposition to multilateral liberalization; (ii) RTAs act as laboratories of international co-operation, whereby co-operation can be tested among small number of ~ore being extended multilaterally. This helps to build up the political consensus for further liberalization and may make multilateral liberalization politically viable and (iii) the network of overlapping RTAs including trade diverting RTAs may act as a positive force for the multilateral system by generating the need of rationalizing the system.

Bhagwati (2001) who is the originator of several felicitous phrases in this area of literature has contributed substantially to the debate on the desirability of regionalism in the backdrop of multilateralism. In an earlier work ~he qu~tion whether trade blocs, that is, PT As regional and others are 'stumbling' or 'building' towards free trade for all. Bhagwati's wo~rovides a wide understanding on the conceptual framework of regionalism an~out some of the core concerns and potential conflicts in this area. These conc~s-Jd issues evolved in his work provide much food for thought for scholars working in this area. Though the work is one of the earliest enriched literature appeared, still its relevance is unabated.

Thus theoretical literature has provided contrasting answers to the question ofwhether RTAs are building blocs or stumbling blocs to the multilateral trading system.

The other studies on conceptual framework of regionalism like Viet De Do and William Watson (2006) who address regionalism with an economic perspective concludes that although results are mixed, the proliferation of RT As does not yet seem to have created a world trading system do~atedby trade diversion. They also .--- raise the question that if member-nations could summon the will to restrict RT As in any meaningful way, would they not also have the political will to provide the multilateral liberalization that would make such an action necessary. Michealak and Gibb (1997) consider that the classical economic analysis of trading blocs is inconclusive and regionalism cannot be understood in economic terms alone. Regionalism and multilateralism represent competing, but not mutually exclusive, principles. underpinning economic integration and trade in global economy. Trading blocs will surely plan an increasingly significant role in shaping the new form of international governance. Ethier (1998) who outlines the emergence of New Regionalism holds that new regionalism reflects the success of multilateralism and not its failure.

De Melo (2007) discusses regionalism from the standpoint of developing countries arguing that it is multilateralism which protect best the interest of developing countries. He asserts the importance of partner choice in trade agreements and suggests that North-South agreements are beneficial for developing countries than South-South RTAs. Pascal Lamy (2002), writing from an EU perspective expresses the view that multilateralism and regionalism are not mutually exclusive, but are complementary instruments to manage the complexities of an inter-dependent world. He states that EU favours the model of 'deep integration' and concludes with the assessment that EU has a policy of 'multilateralism frrst' but will continue to be an active player in regional trade policy. Among several case studies of regional integrations within the debate, Paul J Davidson (2005) examines the role played by international legal framework in regulating the formation of RT As/ FT As in the Asia Pacific region and the contribution that RT As/FT As are making to broaden the international legal framework with an emphasis to the role of APEC.

There are several studies on the concept of regionalism and the GATTIWTO linkages. Lorand Bartels and Fedrico Ortino's (2006) work on Regional Trade Agreements and the

WTO Legal System in the cont~xt of the great proliferation of a wide variety of agreements which pose considerable concern to the multilateral trading system is a classic work on the subject. According to them, many of these agreements can perform useful functions in a world that is hobbled by difficult 'constitutional' problems of making timely decisions so as to ke~ abreast of rapid paced economic developments frequently described as 'glo balisation'. There are some advantages for the RT As, partly because with a limited number of members decisions often can be made more easily, more efficiently and in a timely manner. On the other hand, other concerns like the possibility of ~ RTAs developing protectionist measures which discriminate against ~ non-member can be significant. The work analyses various issues like framework issues, constitutional issues, WTO-plus and dispute settlement issues involved in these agreements as against multilateral trading system in considerable detail, however it fails to give a definite solution for many of the issues raised.

One of the most significant observations is from Jackson (1997) who gtves a comprehensive evaluation of Regionalism and GATT through a legal analysis of GATT Article XXIV and its regional clauses. It indicates that the legal criteria for permissible regional arrangement remained ambiguous and the reconciliation between the political and economic motives of regional integration is largely ignored. The arguments and consultations on regionalism would positively influence the arrangements to soften its impact on multilateral trade. A thorough review of regional arrangements with out cutting on its form or nature, before providing it as a departure from the MFN and other obligations is suggested. With the trend towards freer trade on the rise, it is suspected that the over all debate on preferential arrangements is reducing. The literature is limited to a detailed purview of Article XXIV and excludes the more recent issues on proliferation ofFT As.

Chimni (2004) argues that the significance and role of present day International Institutions, political economic and social has passed through different stages of renewal and that a novel approach in the light of contemporary developments is the need of the time. In analyzing the WTO, he argues that, countries are required to shed their sovereign economic space in this multilateral forum. He expresses the concern that, while the developing countries are also required to do so, there is no substantial special and differential treatment given for them

which runs against the spirit of WTO. This argument goes well with the case of modem RT As, which tend to treat its partners at par.

Srinivasan (1999) observes that the enabling clause in effect exempted developing countries from many GATT obligations and allowed them to engage in preferential trade among themselves as well as to receive preferential treatments by developed countries. In this context he observes that far from helping developing countries integrate with the world economy, these departures from MFN in fact slowed such integration. Further he examines the logical inconsistency in the Article XXIV and its implementation. He makes it abundantly clear that the procedures laid down in Article XXIV to examine the consistency of FT As with WTO have not worked. He also critically examines the concept of 'open regionalism.'

Mathis (2002) makes a detailed examination of Article XXIV right from the evolution and focuses on the many aspects of the provision. He attempts to enlist and analyse the internal trade requirement for meeting the criteria laid down in Article XXIV, and delves into the jurisprudence on the interpretation of Article XXIV emerging under the GATT Working Party as well as the WTO Panel and Appellate Body decisions. Though an effective examination of the legal provision under Article XXIV, the wider spectrum of issues to be addressed in the debate surrounding regionalism is lacking.

Zakir Hafez (2003) offers another comprehensive review ofRTAs and GATT Article XXIV while discussing the historical background of the Article, types of RT As permitted and the legal requirements for its formation. He examines the special criteria for RT As among developing countries under Part IV of GATT on Trade and Development and explores the disciplining of RTAs under the GATT/WTO. His observation of a weak discipline and negligible jurisprudential development in regulation of RTAs concludes with strong remarks on the need for improving the existing discipline and considers the responsibility of CONTRCTING PARTIES or WTO members to ensure proper discipline for RTAs under the GATT/WTO.

Sungjoon Cho (2001) makes a detailed and comprehensive analysis of various dimensions of regionalism. He examines the origins of trade regionalism through various theoretical lenses.

Further he discusses the absence oflegal discipline of trade regionalism under the GATT 1947 system and explores how it was finally achieved under the WTO framework in legislative as well as judicial terms. He suggests a potential solution to this problem by describing a new paradigm consisting of converging trade blocs as structure and jus gentium of international trade aJ!.fied operational norm.

Daniel Yuichi Kono (2002) also examines the question whether free trade agreements (FT As) help or hinder multilateral liberalization. He observes that there is no consensus_9!1-th.50mpac_U~fET~~4~U!!_l!_ltilateral trading system. He argues that given the diversity among FT As and their members the universalistic arguments on its effect on multilateral trading system is tenuous. He places his arguments on two hypotheses that FT As are building blocks for members whose intra-FTA and extraFT A comparative advantages converge and FT As are stumbling blocks for members whose intra-FTA and extra-FTA comparative advantages diverge. His analysis however draws facts and figures from European Free Trade Association which is limited in analyzing the impact of FTAs. Matsushita (2004) observes that spread of FT As may undermine the basis for the multilateral trading system and it would be the task for members of WTO to ensure that WTO disciplines are effectively applied to prevent FT As from being too exclusive and discriminatory in relation to outside parties. He concludes that many of the legal problems surrounding the relationship between the WTO rules and FTAs are still unresolved. According to him, there should be a way in which the multilateral trading system represented by WTO and the FT As can co-exist and complement each other. However, he fails to suggest how to achieve the same.

On the other end, Valentine Zahrnt (2005) observes that enhancement of the effectiveness of the WTO negotiations by regionalism are not sufficiently appreciated. He argues that regionalism extends the zone of agreement in WTO negotiations, helps reducing and managing the complexity of WTO negotiations and curbs the risks of participation in the WTO. Also, Hung Lin (2003) favours regional integration as a catalyst for multilateral trade liberalization with a positive impact in providing solutions for developmental problems and role in conflict prevention. At the same time, he cautions that regionalism in the absence of strong multilateral system may generate protectionist pressures.

Further, the GATT law and practice and the WTO Yearbook for various years provide volumes of information on the interest and practice of state parties on this subject. The WTO analytical index provides the existing and emerging case law as well as the legal jurisprudence on the subject.

Apart from the conventional debates on the topic, scholars have written extensively on other dimensions of the study. A study by Prabhash Ranjan and Aparna Sivpuri (2005) focuses on the implications of Regional and Bilateral Trade Agreements with respect to Bio-Diversity. The paper exposes the inherent contradictions between UPOV and --- Convention on Biological Diversity (CBD) and thus shows how the signing of RT As and BT As between developed and developing countries is . converting CBD in to a dead treaty for the latter. The scholars argue for the need to bring UPOV in conformity with CBD so that RTAs and BTAs would not be able to render CBD ineffective. Bryan Mercurio (2006) skull out various TRIPS-Plus provisions negotiated and included in many US RTAs and gives an illustrative study of its impact on the pharmaceutical sector and public health as an attempt by the US to push TRIPS-Plus at multilateral level. However the possible legal incompatibility arising out of different parameters at multilateral and regional levels is overlooked by the author. The issues under multilateral and regional service liberalizations are sketched in the study by Krajewski (2006) who also examines the disciplines on domestic regulation, government procurement, subsidies and emergency safeguard measures under selected regional arrangements to arrive at some lessons for negotiating in the GATS context. Antonio Rivas (2006) illustrates the FTA Rules of Origin as another issue determining the flow of trade and hence the necessity to ensure strict interpretation of Article XXIV to minimize the trade-diverting effects of origin rules. In the abundant literature on non-conventional issues arising m contemporary RT As, however, a comprehensive study to identify the areas of conflicts existing and likely to arise in the two parallel legal regimes, is seriously lacking.

From a perusal of the above-mentioned literature it is to be understood that various scholars have written on the subject matter of regionalism and multilateralism and that ample secondary sources including books, articles and discussion papers are available. Though they have dealt with the various aspects and implications of the subject, a concrete study has not been done from an Indian perspective. At a time when RTAs are mushrooming rampantly in

the global trade and in view of the increased role these RTAs play .in t~e global economy ~uch a study on the le0 approach towards regiOnalism seems to be pertment.

CHAPTER 4

Fundamental of Most Favored Nation

The fundamental principle regulating trade patterns under the General Agreement on Tariffs and Trade (GATT) and its successor the World Trade Organization (WTO) is the principle of unconditional non-discrimination enunciated in Article I General Most Favoured Nation Treatment (MFN). As a rule basic to the whole edifice ofthe international trading system, it requires that if one signatory state grants to another country "more favourable treatment," it must immediately and unconditionally give the same treatment to the imports from all other signatories. However, the high sounding ideal of MFN found a number of exceptions within the GATT itself Most of the exceptions were allowed out of certain compulsions at the negotiating stage and under the presumption as well as understanding that recourse to these exceptions shall not be so frequent and consequential so as to undermine the principle of MFN. The important GATT exception to MFN is found in the provisions for customs union and free trade areas under Article XXIV of the GATT. In the beginning itself the GATT 'grand fathered' a number of preferential trade systems which were in existence at the time. The multilateral framework also envisages within itself the exemptions for Regional Trading Agreements'[22] (RTAs). Countries are required to meet certain preconditions laid down by the GATTIWTO while forming the RTAs.

There are different forms oftrade arrangements which fall within the ambit ofRTAs. Though broadly classified as Free Trade Areas and Customs Unions in the legal text, there also exists trading arrangements with much higher economic integration[23]. In fact, regional economic integration has many names, shapes and forms, each with different implications and nuances. The depth and breadth of RTAs vary from one agreement to another. Classification of regional trade agreements and arrangements can be based on the nature (legality) of the agreement as well as on the range of integration of the agreements. Regional economic

[22] In this study, the tenn Regional Trade Agreements {RTAs) is generally used which also includes Customs Unions (CUs), Free Trade Agreements (FTAs), Preferential Trade Agreements (PTAs), Interim Agreements leading to CUs or FTAs and other Economic Integration Agreements (EIAs) in relevant contexts.
[23] Economic Unions like the European Union (EU), Common Market like MERCOSUR are examples.

integration under various agreements occurs on a variety oflevels ranging from loose cooperative arrangements to tightly structured agreements. They differ in their degree of institutionalization as well as integration. While it is difficult to categorise regional trade organizations or arrangements, some generally accepted classifications have been developed (Winters 1996).

> Free Trade Areas (FTAs) are regional trade arrangements which have substantially eliminated internal barriers between members for all or groups of goods, while member countries maintain individual external trade barriers and commercial policies towards non-member countries.
>
> Customs Unions (CUs) share the same characteristics as FTAs, with the addition of a common external commercial and trade policy. This means that all imports entering the customs union are subject to the same barriers to trade regardless of the country of entry. A customs union also has a central administrative body to aid in policy coordination, facilitate communication and oversee operations.
>
> Common Markets (CMs) incorporate the features of a CU plus the free movement of labour and capital. The harmonization of taxation and many domestic regulations must be undertaken to prevent the creation of false trade flows to ensure 'a level playing field' for businesses across all member countries.
>
> Economic Unions requrre, in addition to the features incorporated into a common market, the complete harmonization of government spending and procurement as well as the coordination of the operation of central banks (WTO 1995a).

Various regional trade arrangements are often interchangeably referred to as RTAs, FT As or PT As by various scholars irrespective of their nature or characteristics.

Strictly speaking, these terminologies do not bear any rational difference in the content and character of the trading arrangements[24].

[24] A reference may be made to Article 2 (use of terms) of the Vienna Convention on Law of the Treaties (11 UNTS 331 (1969)) which provides that an international agreement concluded between States in written form and governed by international law, irrespective of its particular designation, is a treaty.

Irrespective ofthe nomenclature, there has been a surge in the number ofRTAs. It is said that one of the most significant developments in the world economy since the Bretton Woods Conference in 1944 has been the emergence of a number of regional trade agreements. Preferential treatment in trade and such arrangements existed among nations even well before this. Today almost all the Members ofthe WTO are party or going to be party to one or more RTAs[25]. Over the years, the RT As have graduated to continental trading blocs. The EU, NAFTA and the Asian trade bloc (ASEAN etc.) occupy an increasingly prominent role in the creation of continental trade blocs and cast serious doubts on the robustness of the concept of multilateralism. According to a number of economists and political scientists'[26] commitment to the multilateral framework underpinning globalization is weakening (Michalak and Gibbs 1997: 264). Krueger (1995) has observed that even after the successful conclusion of the Uruguay Round and new provisions contained in the WTO, the trading blocs are capable of dividing world markets into exclusive and potentially hostile camps through unilateral protectionist trade policies (Michalak and Gibbs 1997: 264).

With the powerful re-emergence and unprecedented proliferation of RTAs towards the end of the 20th century, attempts were made to study the impact of regionalism in trade. This opened the wide room of debate on the effects of regionalism on multilateralism. The debate is polarized. On one side, an influential group of economists and political scientists argued that regional trading blocs, by the very fact of their existence, threaten the spirit of multilateral trade liberalization. On the other side are those who argue that the regional trade blocs contribute to the freeing of world trade. There are scholars who hold yet another view that impact of RT As on the multilateral trading system depends on the nature and characteristics of each individual RT A.

Case for Regionalism

It is interesting to note that there is hardly any hypothesis out rightly rejecting either regionalism or multilateralism. One of the major debates in this regard is, to what extent regionalism promotes or erodes multilateralism. The concept of trade creation' and 'trade

[25] As per the latest reports, Mongolia, who is the only WTO Member not party to any PTA, is currently studying the feasibility of a PTA with Japan and other states (Baccini et al. 2011).
[26] See, Preeg 1989; Belous and Hartley 1990; Bhagwati 1990, 1991, 1993; Schott 1990.

diversion,' the argument enunciated by the Canadian economist and scholar Jacob Viner'[27] more than sixty years back, finds a universal acceptance among the scholars of international trade. Viner (1950) provided a more or less definitive analysis of the trading bloc issue. In precise words, according to Viner, a preferential trading arrangement promoted 'trade creation' when a country's more expensive domestic production is replaced by cheaper products from a participating country. Greater domestic consumption generated additional trade and welfare in the process. Conversely, 'trade diversion' occurred when imports of inexpensively manufactured goods from non member countries were replaced by more expensive imports from participating countries. The resulting increase in intra regional trade took place at the direct expense of imports from outside the bloc; hence trade diversion reduced or, at best did not increase global welfare in this scenario. To put in other words, regional trade bloc promoted global trade liberalization when it promoted trade creation, and hindered global trade liberalization when it created trade diversion. With the emergence and re-emergence of regionalism in the sixties and, later in the eighties, the debate has grown more complex. Jackson (1993 121) took a double sided view and approach in analyzing the impact of regionalism on global trade liberalization. According to him, trading blocs can actually promote global free trade if the MFN principle is applied.

Scholars have observed that regional trade arrangements can serve as stepping stones for building political support and strengthening the will for negotiating free trade worldwide. Summers (1991) and Krugman (1993) observed that trading blocs merely formalize the already existing trade practice of geographical proximate countries or in other words "natural partners" that are expected and bound to trade with each other more than with distant or "unnatural" partners. In other words, countries that trade with each other in larger volume than with other nations are "natural" trading partners and hence that PT As among them are likely to be welfare enhancing. A related assertion is that regional PT As are likely to improve welfare by minimizing transport costs (Krugman 1991; Krugman 1991a).

It is observed by some scholars that a universalistic approach towards all kind of regional groupings is not desirable. In his classic work on the Charter of International Trade

[27] Jacob Viner (1892-1970) in his 1950 book "The Customs Union Issue" introduces the distinction between the trade creating and the trade diverting effects of customs unions.

Organization, Wilcox (1949) noted logical inconsistency in using the same yardstick for all kind of regional trade arrangements. He emphasized the difference between the impact of a Customs Union and a Preferential Trading Arrangement in multilateral trade liberalization (Wilcox 1949: 70). He explained the view in favour of customs union as follows.

> A customs union creates a wider trading area, removes obstacles to competition, makes possible a more economic allocation of resources, and thus operates to increase production and raises planes of living. A preferential system on the other hand, retains internal barriers, obstructs economy in production, and restrains the growth of income and demand. It is set up for the purpose of conferring a privilege on producers within the system and imposing a handicap on external competitors. A customs union is conducive to the expansion of trade on a basis of multilateralism and non discrimination; a preferential system is not (Wilcox 1949).

The thrust of Wilcox's argument favouring customs union was out of the belief that any expansion of area within which all trade is free ofbarriers is desirable in the sense of improving welfare of one or more of its members while hurting no other country, as long as barriers to trade in the countries outside the area are not raised (Srinivasan 1999: 331).

Summers (1991) took a positive outlook towards regionalism. He explained his view by stating that "economist should maintain a strong but rebutable, presumption in favor of all liberal reductions in trade barriers, whether they are multi-, uni-, bi-, tri-, plurilateral. Global liberalization may be the best, but regional liberalization is very likely to be good" (Srinivasan 1999: 336). In this context, Barfield (1996) observed that, "Summers and other proponents of regionalism base their case on a belief that total trade creation will out weigh trade diversion in most cases, that the multilateral process is too slow to produce substantial progress toward further trade liberalization, and that regional free trade arrangements will allow some nations to speed up liberalization and ultimately produce a self-reinforcing process toward more open markets."

Winters (1996), referred to many scholars who argued that the creation of the European Economic Community (EEC), that is, regionalism, led directly to the Dillon and Kennedy Rounds of multilateral trade negotiation. It is also argued by some, though denied by others,

that the Seattle APEC Summit in November 1993 was perceived by the EU as a threat by the United States to go the route of regionalism and prompted the EU for a compromise in the Uruguay Round negotiations to be successfully concluded in December 1993. But Winters (1996) concluded after an analysis of the empirical evidence that "regrettably it seems as ambiguous as the theory, at least (so) far as the issues of current policy are concerned." Thus, neither theory nor evidence provides a robust regionalism and multilateralism. A similar view is shared by Bagwell and Staiger (1996) by observing that "our analysis suggests that the consequences of regional arrangements for multilateral tariff cooperation need not be clear cut: effects exist under which regional agreements complement multilateral liberalization efforts, and effects also exist under which regional agreements undermine the multilateral liberalization process.

One of the widely received arguments in favour of RTAs is their experimental or laboratory effect vis-a-vis multilateral trade liberalization (Jackson 1993; Cho 2001: 432). As on date, the WTO has 153 members is 0 which indicates that negotiation processes will be slow and cumbersome especially when it comes to new areas such as services, information technology):government procurement, investment, etc. In this context negotiation among a smaller number of regional participants is likely to produce better results, that too in less time. II Furthermore, once agreements are adopted and implemented at a regional level, the experience and lessons gained through trial and error will serve as a knowledge base (Bergsten 1997: 545, 548). This knowledge base, in turn will serve as a valuable foundation on which subsequent multilateral agreements can be built. From an internal point of view, a process such as this often serves to educate government officials, helping them to adapt to new practices of trade liberalization and enabling them to move on to a multilaterally binding track. From an external point of view, RTAs can "ratchet up" multilateral liberalization process by creating an incentive for other regions or countries to emulate successful initiatives (Bergsten 1997: 548). In summing up the above arguments, it is worth quoting Jackson (1993: 121) that 'RTAs tend to provide test laboratories for the multilateral trading system,.' ln.support of this view it can be found that most countries involved in RTAs are also active and committed participants in the WTO (Sampson 1996: 17). Some scholars observed that in long term, intra-regional trade becomes relatively less significant vis-a-vis inter regional trade (Cho 2001: 433). Others offered detailed evidence regarding the success

of _regional agreements for global trade liberalization: contributions from NAFT A and the EU to the WTO (Zahmt 2005: 684-86). Some scholars emphasized that RT As ---· often "lock in" previous liberalization records or reforms in a manner that prevents subsequent backsliding. In this context, a plausible argument for NAFT A was that it locked in Mexican reforms so that future political authority in Mexico could not reverse them (Frankel1997). While scholars favouring RTAs argued this as a positive aspect of regionalism, some others termed it as hegemony of major economic powers such as United States to use the formation of RTAs to extract far superior terms in negotiations with less - ·powerful participants; empirical confirmation of this 'hegemonic strategy' could be found in trade talks on intellectual property rights between the United States and Mexico (Bhagwati 1999: 309).

Favoring the trend of Regionalism, Zahmt (2005) argued that 'deep integration can better and faster be attained on a regional level with smaller and more homogeneous membership. He further argued that deep regional integration can be contributory for the effective functioning of the WTO.' In support of this view, he observed that regionalism extends the agreement in WTO negotiations. It offered a way to cope with the complexity of WTO negotiations as it reduces the number of participants and fewer policy proposals which are conducive for a deeper integration. Further, overlapping free trade areas which created webs of free-trade agreements reduce the risk of participating in WTO (Zahrnt 2005: 695-696).

Rejecting all the views favouring regionalism, Bhagwati, 'perhaps the most out spoken critic of regionalism:..(Mi~_halak an_Q_Q!h.~ 1997: 269) argues that the recent proliferation of trading blo~ signals the breakdown of multilateralism. at~e"a§it as the frrst best options (Bhagwati 1993). 12 Even rejecting the new concept of 'open regionalism' 13 he found that

(t)he popular argument that free trade agreements at least where led by the United States, will be of the "open regionalism" variety so that, with steadily increasing members, we shall arrive at full multilateralism is naive for several reasons. Free Trade agreements are as hard as multilateral trade treaties to negotiate Taking the case of speed of negotiations, Bhagwati points out that, after a decade,

Going a step further it is stated that

> free trade arrangements seriously damage the multilateral trade liberalization process by facilitating the capture of it by extraneous demands that aim, not to reduce but to increase trade barriers (as when market access is sought to be denied on grounds such as "eco dumping" and "social dumping") (Srinivasan 1998).

Bhagwati observes that the current rise and proliferation of regionalism is likely to endure and gain strength. He finds reason for the same in the changed attitude of key players EU and especially the United States towards Article XXIV of GATT. It is argued that there is a major shift in the balance of force towards regionalism[28]. So far, this observation is proved correct in the wake of American urge to enter into more regional arrangements around the globe (Bhagwati 1991: 72). In the context of changed policy and strategy of US towards regionalism, it is pointed out that, regionalism would be America's new wepan if GATT/WTO were not amended and bent to American demands for reconstitution and reform and bent to American demands fo _reconstitution-and reform, and combined with actual resort to regional arrangements, it will produce the negative perception that regionalism is anti ethical to the GATT and that proliferation of Article XXIV sanctioned free trade areas is somehow the nemesis of the GATTIWTO (Bhagwati 1991: 74).

The advocates of regionalism do not agree that there exists the possibility of regionalism becoming a protectionist tool and could develop into a welfare diminishing entity. Thus, both the proponents and detractors of regionalism would agree that if you must live with regionalism then, if put in Bhagwati's words, ' it is best to contain it and shape it in a way so that it becomes maximally useful and minimally damaging and consonant with the objective of arriving at multilateral free trade for all.

Encompassing Regionalism within Multilateralism

For the opponents of regionalism, the reason for opposing is it potential for trade diversion. It is the discriminative capacity of the R T As which leads to trade diversion. If multilateralism and trade liberalization are to be fostered, the principle of nondiscrimination should be

[28] He observes that, this shift has taken place in the context of a growing perception in the American Congress that the GATT is inadequate and the "regional card should be played" as a threat to those who will not move fast enough to change the GATT to suit America's desires and interests. Since the process of change at the GATT is necessarily going to be slower than American impatience would dictate, the regional card is likely to be played again and again reinforcing the American shift in policy (Bhagwati 1991: 72).

adhered to and trade diversion minimized. Though the Article XXIV which regulates regionalism is intended to avoid or minimize discrimination, the inherent weakness and ambiguities'[29] allows the regional trade arrangements to practice discrimination and hence, trade diversion takes place. The discrimination occurring need not be explicit or proactive: 'as is evident to trade economists, maintaining external tariffs unchanged (that is, not raised) is not the same as eliminating trade diversion' (Bhagwati 1994: 156). Hence, the lower the external barrier, the less is the scope of trade diversion. On this hypothesis, one suggestion is that regional trade arrangements shall be required to lower external barriers simultaneously on a pro rata basis as a price to be paid for the gains from internal liberalization. If this principle is enshrined in the WTO, it would go a long way to strengthening the multilateral system and ensuring the global building block' role of regional trading arrangements. Alternatives suggested for accomplishing this goal is the outright banning of FT As and allowing only CUs. The CUs could be forced to make the lowest tariff of any of its members on any individual good the common external tariff Put in other words, all tariffs would have to be reduced to the lowest common denominator amongst the members with higher rates. As these tariffs become the 'bound' tariffs, this would ensure that a substantial degree of liberalization would occur vis-a-vis non-members (Yeung et al. 1999).

Non-tariff barriers also have a greater potential of being used in a discriminatory fashion. Article XXIV or the present mechanisms in place is no way adequate to stem the use of non-tariff barriers. Effective controls, surveillance and regulations by the WTO regarding the non-tariff barriers are of utmost importance in ensuring nondiscrimination in regionalism. The WTO's provisions banning voluntary export restraints and strengthening rules regarding the use of contingent protection are viewed as initial steps in this direction. However, countries make use of the ambiguities in~ the GATT legal text to continue ~ith the practice. It could be said that an overall strengthening of the WTO regarding discrimination and protection, including Article XXIV, is required to deal with the new challenges of regionalism.

The concept of a partnership between regionalism and multilateralism enjoys growing support amongst trade economists from both sides of the debate. The belief that regionalism

[29] See detailed discussions in Chapter III.

is an effective supplement to the WTO and multilateralism evolve from the perception that any reductions in barriers to trade, be they through, the multi-, tri-, bi- or plurilateral negotiations should be presumed favourable. According to Drysdale and Garnaut (1994: 42)

> The argument for regional economic cooperation identifies the value of regional arrangements which serve collective ends but not at the price of discrimination in commercial policy. It does not follow that multilateral collective action to secure the regime for economic exchange is the only feasible or efficient route to closer economic integration. Regional economic cooperation, within a framework of multilateral economic relations, offers the potential for joint provisions of a stronger trade regime- a trade regime which also raises confidence in the international economic specialization and promotes closer world economic integration.

These principles more or less point to the concept of open regionalism. The assumption is that regionalism does not necessarily preclude support for and maintenance of the multilateral trading regime. A regional arrangement could be formed as it is 'nested' into the overall multilateral system, so long as the region maintains and promotes practices of non-discrimination and openness with external parties. Such regional arrangements could be viewed as building block for multilateralism It is also noted that regional trade arrangements, on their own, have had little effect on liberalizing their external trade. The multilateral system provides a mechanism for wide-ranging reciprocity, while regionalism provides a supplementary regional reciprocity. Both are mutually beneficial and complementary. Often one may be more effective in certain areas than the other. Together, they are effective across a broader spectrum of trade-enhancing activities (Yeung et al. 1999).

In sum, classical economic analysis as well as the trade theory is ambiguous about the outcome of regionalism. Under certain favourable circumstances regionalism is found complementary to the global free trade while in some unfavorable circumstances regionalism complicate and damage the multilateral trade liberalization process. The traditional debate on the subject was focused on the question of whether the RTAs supplement or supplant multilateral trade liberalization. Various economists have analyzed the economic theory of RTAs 16 and offered divergent opinions on the economic efficiency of RTAs. The consensus so far reached among the scholars is that the RTAs can have both trade creating and trade

diverting effects. However, the legal challenges that RTAs present have not received the same attention as the economic challenges in empirical and theoretical scholarship. This is precisely because of the misconception that the issue of RTAs is rather economical and political rather than legal, so the best way to address the issue is through economical as well as political analysis.

Legal and Policy Challenges

Over the time, the nature and scope of RTAs have undergone tremendous change and modem RT As have attained a very different and distinctive face in their formation and operation. The coverage and depth of preferential treatment varies. from one RT A to another. Modem RT As are not that ~-- exclusively linking the most developed economies, but goes well beyond the tariff cutting exercises. They provide for preferential regulatory framework for mutual services trade. The modem sophisticated RTAs go beyond traditional trade policy mechanisms to include regional rules on investment, competition, environment, labour and many other WTO-Plus standards[30]. The proliferation of RTAs, especially as their scope broaden to include policy areas not regulated multilaterally, increase the risk of inconsistencies in the rules and procedures among RTAs themselves and between RTAs and the multilateral framework. The possibility of such inconsistencies is high, given the fact that countries are members to one or more RTAs, at the same time when they are members to WTO. This is likely to give rise to regulatory compulsions, distortion of regional markets and other implementation problems. It is in this context that the legal examination of the relevant provisions regulating the formation and operation of RTAs in the multilateral trading system assumes importance.

First and foremost, the principles and rules pertaining to regional integration and preferential trade agreements is of paramount importance for any one who attempts a legal study on the topic. They shape the conditions, requirements and limitations for such agreements on the basis of the GATT and the GATS. Members of the WTO negotiating and concluding RT As are obliged to comply with a number of principles and rules of the multilateral system. Since preferential agreements by definition restrict the application of MFN, the WTO rules only

[30] For detailed discussion see Chapter VI.

exceptionally allow for sectoral, bilateral or regional arrangements. The WTO law provides the framework within which Members may conclude preferential arrangements between themselves and with third countries. In the field of goods, the provisions for RTAs are set forth in Article XXIV of the GATT and the Understanding on the Interpretation of Article XXIV GATT. In the field of services, a largely parallel provision contained in Article V of GATS and Article V his GATS allows for Regional Integration Agreements. The Enabling Clause also contains provisions for forming preferential arrangements between developing countries. The above provisions seek to balance multilateralism and the needs of the RTAs by setting out a number of conditions which these agreements are required to meet.

The legal question here is how to effectively exert these disciplines on RT As while recognizing the existence of a large number of R T As. The challenge for Members of the WTO is to ensure that these WTO disciplines are effectively applied to prevent R T As from being too exclusive and discriminatory in relation to outside partners. From a legal perspective, a coherent body of disciplines, its effective implementation and strict compliance would ensure that exception provisions are not abused or misused. The relative inefficiency of legal disciplines governing RT As has already found its place in the existing legal scholarship. The WTO has also recognized the need to strengthenthese disciplines governing RTAs. During the Uruguay Round, the soon-to-be WTO Members attempted to strengthen the disciplines in GATT Article XXIV. They rendered explicitly RT As subject to the WTO dispute settlement system. The WTO Panels and Appellate Body have already addressed some legal issues arising under GATT Article XXIV and RTAs·, though in limited·scope. The WTO has also initiated various steps in its attempt to deal with the challenge of regionalism. The Understanding on the Interpretation of Article XXIV ofthe GATT 1994 sought to clarify the criteria and procedures for the assessment of new or enlarged agreements and to improve the transparency of notified agreements. The WTO also established the Committee on Regional Trade Agreements (CRT A) to assess and examine the compliance of the various regional trade agreements with the relevant WTO rules and to consider the implications for the multilateral trading system. Faced with clear difficulties in the surveillance function of the WTO and concerned with the increasing number of RT As, the WTO Members agreed on negotiations aimed at "clarifying and improving disciplines and procedures under the existing WTO provisions applying to regional trade agreements."

The negotiations are progressing in two tracks, viz., "substantive" issues and holding consultations on procedural issues related to the transparency of the RTAs. As a first outcome, the WTO's General Council established a new WTO Transparency Mechanism for all RT As on a provisional basis which could be reviewed and replaced wit a permanent mechanism later. Still, the WTO cannot claim RTAs are now strictly disciplined. The present study largely focuses on the inherent weakness of legal disciplines governing RT As and its impact on the multilateral trading system.

Apart from addressing the above referred legal issues, the study also looks into the policy concerns raised by modem RT As. The various WTO-Plus commitments and disciplines appearing in the RT As are raising concerns especially for the developing world. The bilateral and regional setting oftrade standards, norms and disciplines fails to take into consideration the various developmental aspects and flexibilities for the developing countries. Including trade regimes that are not governed multilaterally, increases the possibility of conflicts of interest and approach. The legal challenge posed by these policy matters could not be overlooked. The present study looks into this modern trend in various RT As in selected areas as a case study, and their impact for the developing countries and the multilateral trading system at large.

All these points to the fact that, if left unregulated, the proliferation of bilateral and regional agreements may cause erosion of the WTO disciplines which could, in effect, .. -~ -- ·--------- ------- weaken the multilateral ~ trading system. But given the fact that a large number of RTAs do exist and continue to increase in their numbers and broaden their scope and ambit, the WTO needs to co-exist with them. The challenge here is how to minimize the conflict, and complement the co-existence of these two trade regimes. This -:---~ requires a new legal paradigm capable of effectively regulating RTAs well within the multilateral framework. An effective legal regime and its proper compliance will be capable of minimizing the conflict and maximizing the complementarity between the WTO and RTAs which is required for a robust multilateral trading system capable of addressing the regional aspirations of its Members.

CHAPTER - 5

Relationship between Most-Favoured-Nation Treatment and the Pacta Tertiis Principle

The relationship between treaties and third parties is defined by the principle of customary international law pacta tertiis nec nocent nec prosunt. According to this principle, which is codified in Article 34 of the Vienna Convention on the Law of Treaties (VCLT), treaties generally only have an effect between the parties to the treaty; for States not party to a treaty, the treaty is res inter alios acta. The underlying principle of the pacta tertiis rule is the principle that no rights or duties can be conferred on a third State without its consent, which is the result of the sovereign equality of States.

Before the ICJ judgment in the Anglo-American Oil Co. case, part of legal doctrine took the view that most-favoured-nation treatment in connection with the beneficiary thirdparty treaty was an exception to the pacta tertiis rule in that it lay in the nature of mostfavoured-nation treatment that treaties concluded between two States had an effect on all States that were not party to the treaty but had agreed on most-favoured-nation treatment with one of the parties. 21 It was argued that the legal obligations of the granting State towards the beneficiary State derived from the third-party treaty and not from the treaty stipulating the most-favoured-nation clause. The same view was held by the United Kingdom as Claimant in the Anglo-Iranian Oil Company Case. The ICJ had concluded from the Iranian Declaration made under Article 36 (2) of the ICJ Statute that Iran had accepted the jurisdiction of the ICJ only with regard to disputes relating to treaties ratified subsequent to the aforementioned Declaration. While Iran and the United Kingdom had agreed upon most-favoured-nation treatment in treaties concluded before the crucial date, the third-party treaties that the United Kingdom intended to invoke by virtue of the mostfavoured-nation clause were ratified subsequent to the Declaration[31]. In order to establish the Court's jurisdiction, the Government of the United

[31] The Treaty mainly relied upon was a Treaty of Friendship, Establishment and Commerce between Iran and Denmark, signed on 20 February 1934, which provided in Article IV that "The nationals of each of the High Contracting Parties shall, in the territory of the other, be received and treated, as regards their persons and property, in accordance with the principles and practice of ordinary international law. They shall enjoy therein the most constant protection of the laws and authorities of the territory for their persons, property, rights and interests. (See Anglo-Iranian Oil Company Case, ICJ Judgment of 22 July 1952, p. 108.) Additionally, the

Kingdom argued that the decisive treaties to which the dispute related were the third-party treaties invoked by means of the most-favoured-nation clause. Since the dispute concerned the new substance of the treaty deriving from the rights accorded in the third-party treaties and these rights had become part and parcel of the most-favoured-nation clause only after the ratification of the Declaration, the ICJ had jurisdiction.

The ICJ rejected the argumentation that the most-favoured-nation clause represented an exception to the relative effect of treaties stipulated by the pacta tertiis rule. It held that the third-party treaty itself did not create a legal relation between Iran and the United Kingdom. The beneficiary state did not derive rights and benefits from the third-party treaty, but was entitled to claim these rights only by virtue of the most-favoured-nation clause. Therefore the treaty containing the most-favoured-nation clause was to be considered the basic treaty that established the legal connection between the beneficiary State and the third state. The Court's argument basically was that the scope of the benefits that the United Kingdom could require was determined by the third-party treaty. Howev- er, the title on which the United Kingdom could base her claim could only be derived from the treaty stipulating the most-favoured-nation clause. The assumption made by the Claimant and in the dissenting opinions that the most-favoured-nation clause itself had no substance was therefore based on a confusion of the concrete content of the right, which is indeed only contained in the third-party treaty, and the entitlement to enjoy that treatment, which is stipulated by the clause. There is thus no legal relation between the beneficiary State and the third State, but only material equal treatment[32].

This view was confirmed by the ICJ in the Case concerning the rights of United States nationals in Morocco, where again the substance of the most-favoured-nation clause was controversial. The Claimant sought to profit from consular provisions in third-party treaties

Claimant relied on a treaty between Iran and Switzerland of April 25th, 1934 and a treaty between Iran and Turkey of March 14th, 1937.

[32] In addition, it is very doubtful whether the United Kingdom's interpretation was in line with the intention of Iran since it is unlikely that its consent under article 36 II of the ICJ Statute covered disputes about subsequent treaties with third States. For details see the individual opinion of Judge McNair, AngloIranian Oil Company Case, ICJ Reports, pp. 116 et seq

that the third States had already waived[33]. The question was whether the reference to the treatment accorded to third States could still be relevant in cases where the treatment was no longer accorded to these States. According to the United States, the mostfavoured-nation clause had a consolidating effect in Moroccan treaties by leading to a permanent incorporation of rights even after the abrogation of treaty provisions from which these rights had been derived. Inversely, the ICJ held that the beneficiary enjoyed rights only as long as the promisor actually granted these rights to third states, corroborating the finding established in the Anglo-Iranian Oil Case that the benefits accorded to the beneficiary State on the basis of the third-party treaty did not form the clause's legal substance and remained apart from the title. Thus, when the reference disappeared, the operation of the clause ceased in this effect (cessante causa cessat effectus).

This interpretation is also reflected in Article 8 § 1 of the ILC-Draft Articles on mostfavoured-nation clauses which confirms that the basic act acte règle is the agreement between the granting State and the beneficiary State. The third-party treaty is only an element which gives effect to the most-favoured-nation clause acte condition.

Neither could a renouncement of the distinction between the entitlement to mostfavoured-nation treatment and the actual content of the right be justified in the light of Article 36 (1) VCLT, which deals with rights emerging from a treaty for third States and provides that:-

> 'A right arises for a third State from a provision of a treaty if the parties to the treaty intend the provision to accord that right either to the third State, or to a group of States to which it belongs, or to all States, and the third State assents thereto. Its assent shall be presumed so long as the contrary is not indicated, unless the treaty otherwise provides.'

[33] The US based its claim on the most favoured nation clause stipulated in Art. 17 of Madrid of 1880 and relied on treaty rights granted to Great Britain in 1856 and to Spain in 1861, which these States had however renounced in 1937 and 1914 respectively. The US argued that given that the most-favoured-nation clause had been concluded with a Muslim State and that there was a common legal policy of European and American States towards Muslim States based on stability, the clause had the effect of incorporating the beneficiary provisions permanently in the treaty containing it. The Court rejected this argument of incorporation with a reference to the aim of the most-favoured-nation clause to ensure equality among States (Case concerning the rights of nationals of the United States of America in Morocco, Judgment of 27 August 1952 (ICJ Reports, pp. 192, 204).

Both the cases of Article 36 (1) VCLT and of the most-favoured-nation clause concern a State which is favoured by a clause of a treaty to which it is not a party. However, the legal bases for this right differ. In the case of Article 36, the basis of the right is the treaty conferring it and the intention of the parties to that effect. It is thus only when the parties have an intention to grant a legal right to a third State that such right arises from a treaty provision. Such intention can however not be presumed. As the PCIJ held in the Case concerning certain German interests in Polish Upper Silesia,

'A treaty only creates law as between the States which are parties to it; in case of doubt, no rights can be deduced from it in favour of third States[34].'

In the case of a State enjoying a benefit from a treaty on the basis of the most-favourednation clause, the parties to that treaty may sometimes be aware of such an effect, but they do not have such intent.

Summing up, the legal foundation of that benefit is the agreement to grant most-favourednation treatment but not the third-party treaty providing for better treatment.41 Mostfavoured-nation treatment is therefore not an exception to the pacta tertiis rule.

Functions of the Most-Favoured-Nation Principle

MFN clauses combine several legal, political and economic functions. First, it is an essential function of MFN clauses to effect a general equalisation of the legal conditions of competition and thus protect the individual rights of investors. Second, they serve to multilateralise benefits and thus contribute to a liberalisation of the investment area. Moreover, due to the insertion of MFN clauses, treaties can easily be adapted to changing legal circumstances without the need to formally amend legal provisions. And finally, (unconditional) MFN clauses uphold formal reciprocity, granting both treaty parties the right to MFN treatment.

[34] e from the provision. 39 Case concerning certain German interests in Polish Upper Silesia, Judgment of 25 May 1926, p. 29. In the Case of the free zones of Upper Savoy and the district of Gex, pp. 147, 148, the Court ruled that It cannot be lightly presumed that stipulations favourable to a third State have been adopted with the object of creating an actual right in its favour. This rule was also confirmed by international arbitral tribunals, e.g. in the case of Ungarische Erdgas A.G. v. Rumanian State, Annual Digest of Public International Law Cases 5 1929 -1930, 383, 386.

II. Non-Discrimination and Establishment of Equal Competitive Opportunities

As the ICJ stated in the US Nationals in Morocco case, the object of the most-favourednation clause is to

'establish and to maintain at all times fundamental equality without discrimination among all of the countries concerned'.

The essential function of the clause is to guard against present or future discrimination and to guarantee equality among the relevant States or actors[35]. In the investment field, it sets limits upon host countries with regard to their present and future investment policies by prohibiting them from favouring investors of one foreign nation over those of another foreign nation.

The most-favoured-nation clause is at once a political and an economic instrument. On the political plane, the avoidance of discrimination helps to suppress international tensions among States since the more special advantages are created, the more disputes can be expected. 45 As regards the economic function of MFN treatment, both States and private investors seek an assurance that they do not fall into a position of competitive disadvantage on the world market. The object of granting unconditional most-favoured-nation treatment is to enable the beneficiary to automatically acquire the rights granted by the promisor to any third State or actor. In the context of the WTO, the Appellate Body has numerously stated that the goal of non-discrimination obligations was to provide effective equality of competitive opportunities – either between national and foreign competitors in the case of national treatment or between foreign states in the case of most-favourednation treatment.46 In the context of trade, the Appellate Body stated in Canada-Autos.

The object and purpose of the most-favoured-nation obligation is to prohibit discrimination among like products originating in or destined for different countries. The prohibition of discrimination in Article I:1 also serves as an incentive for concessions, negotiated reciprocally, to be extended to all other Members on an MFN basis[36].

[35] Vignes, La clause de la nation la plus favorisée et ses problèmes contemporains, p. 214; Visser, La clause de "la nation la plus favorisée" dans les traités de commerce, p. 78; Nolde, La clause de la nation la plus favorisée et les tariffs préférentiels, p. 5 Schwarzenberger.

[36] Appellate Body Report, Canada-Autos, 31 May 2000, WT/DS139/AB/R, WT/DS142/AB/R para. 84. In Canada - Autos, the Appellate Body reviewed the Panel's finding that the Canadian import duty exemptions granted to motor vehicles originating in certain countries were inconsistent with Article i.

In the context of investment law, the purpose of the most-favoured-nation clause is to give investors a guarantee against certain forms of discrimination by host countries, and establish equality of competitive opportunities between investors from different foreign countries. The aim of including most-favoured-nation clauses in bilateral investment treaties is to harmonise the conditions applicable to investors and investments irrespective of their nationality, to ensure uniformity and equality and to thereby create a level playing field for business participants and allow them to compete on an equal footing. Thus, the value of negotiated bilateral trade concessions will not be eliminated by a later and more favourable trade concession to a third country. This has the effect of stabilising investors' expectations since they are reassured that they will not be denied the benefits of their home State's bargain if a third country achieves more favourable conditions.

In world trade law, while one side of the economic rationale for the most-favoured-nation clause is the protection of competitive opportunities, the other is the avoidance of trade distortion. The economic background for this rationale is the theory of comparative advantage that was developed by David Ricardo[37] and was at the time of its development a renunciation of the then dominant doctrine of mercantilism. The theory of comparative advantage offers a rationale for the welfare-enhancing effect of international trade and, more specifically, of the most-favoured-nation principle. The basis for the theory is the perception that all countries (or rather private economic actors) are endowed with different abilities and opportunities for the production of certain commodities. It is for the common benefit if every actor specializes in the production of those commodities for which it is specifically adapted due to its geographical conditions, climate and other advantages. A country has a comparative advantage in the production of a good if it can produce it at a lower opportunity cost than another country. The opportunity cost of a product is defined as the amount of another product that must be given up in order to produce more of the first good. Therefore a country has a comparative advantage in the production of a certain good relative to another country if it must give up less of a second good to produce another unit of the first good than the amount of the secod good that the other country would have to give up to produce

[37] Ricardo, On the Principles of Political Economy and Taxation, Chapter VII. See also Trebilcock/ Howse, The Regulation of International Trade, pp. 3, 4; Sykes, Comparative Advantage, JIEL 1 (1998) 49- 82.

another unit of the first good[38]. International trade thus enables countries to exchange these commodities with foreign commodities that could only be produced at higher cost in the home country. These trade relations are advantageous for the participating States, even if one country can produce all products at lower cost than other countries, i.e. has an absolute advantage in the production of all goods. Even in that case it is beneficial for the State to concentrate on the production of those goods in which it has the greatest absolute advantages, compared to its other commodities, and exchange them against those goods in whose production it has the least ab- solute advantage. Summing up, the theory of comparative advantage says that States should specialize in the production of commodities in which they have the greatest comparative advantage and import such goods that they can only produce with a comparative disadvantage. This way, due to international trade, States can benefit from specialization and division of labour on the international plane.

If however discriminatory tariffs are imposed these may enable relatively high-cost producers in the States that benefit from lower tariffs to outcompete lower-cost producers in the States subject to higher tariffs. Discrimination will induce a shift of resources towards relatively less efficient producers who are favoured and away from more efficient producers who are disfavoured. This phenomenon, known as "trade diversion", creates losses that do not occur when all suppliers are subject to the same tariffs. It is the economic function of the MFN principle to ensure that more efficient producers have equal access to markets as less efficient producers and thus to guarantee the most efficient allocation of resources. This way a country's imports will be supplied by the most efficient international supplier. The prevention of trade diversion lowers the costs of production and services, increases consumer choices and promotes world economic growth. Usually therefore, a non-discriminatory policy enhances global welfare by ensuring that imports are supplied by the countries that can produce them most cheaply, at least given otherwise equal circumstances. The aim to exchange trading opportunities not only to assure benefits for individual exporters, but rather to enable free and efficient trade policies and prevent trade diversion shows that trade law focuses on the improvement of the overall welfare of nations, economic efficiency and trade liberalization.56 In contrast, BITs are concluded for the protection of individual foreign

[38] Trebilcock/ Howse, The Regulation of International Trade, p. 3; Mankiw/Taylor, Grundzüge der Volkswirtschaftslehre, p. 69.

investments that are usually already present in the host countries. Non-discrimination in investment law originates and remains embedded in the idea of individual fairness[39]. Investors' competitive opportunities are therefore protected not for the enhancement of economic efficiency and overall welfare, but for the protection of individual rights. According to DiMascio/Pauwelyn. the traditional investment regime is about fairness grounded in customary rules on treatment of aliens, not efficiency. It is about protection, not liberalization, and about individual rights, not state-to-state exchanges of market opportunities.

The Most-Favoured-Nation Clause in Various Agreements

Due to the large number of investment agreements and the different formulations of the most-favoured-nation principle in various bilateral and multilateral agreements, there is not one single most-favoured-nation clause. It is the aim of this part to examine the language of some most-favoured-nation clauses in order to demonstrate that arbitral tribunals may come to different results depending on the wording of the relevant clause. The following analysis will be based on GATS, the North American Free Trade Agreement, the Energy Charter Treaty, the ASEAN Framework Agreement, the Colonia and the Buenos Aires Protocols of MERCOSUR, and the Draft Multilateral Agreement on Investment as multilateral instruments, and on the model BITs of Germany and the United States as models for bilateral instruments. Although model BITs per se have no legal relevance, it is useful to examine them instead of single BITs since many capital-exporting States negotiate investment treaties on the basis of a model treaty. Although treaties may deviate from these model BITs, model BITs are an object of imitation or at least an important source of inspiration for a large number of BITs. This makes it possible to make general statements about a considerable number of investment treaties without evaluating every single treaty text.

The GATS is a set of multilateral rules governing international trade in services. Article I GATS defines trade in services as the supply of a service through four possible modes of supply, one of which is the supply of a service 'by a service supplier of one Member, through

[39] DiMascio/Pauwelyn, Nondiscrimination in Trade and Investment Treaties, p. 70

commercial presence in the territory of any other Member[40]. Article XXVIII (d) GATS defines commercial presence as, any type of business or professional establishment, including through (i) the constitution, acquisition or maintenance of a juridical person; or (ii) the creation or maintenance of a branch or a representative office, within the territory of a Member for the purpose of supplying a service'. The presence on the market of foreign juridical persons, branches or representative offices through local 'commercial presence' is thus protected as a form of trade in services within the meaning of Article I GATS. Given that a foreign affiliate is usually established as a result of capital flows taking the form of foreign direct investment,190 the GATS can be considered a multilateral agreement on foreign investment which is however limited to the service sector and does not refer explicitly to investors but to juridical persons. Moreover, the enterprise-based definition of commercial presence in the GATS is narrower than the asset-based definition of investment usually encountered in bilateral and multilateral investment treaties. Whereas investment treaties define investment using an asset-based approach which covers a wide range of direct and portfolio investment[41] the narrower definition adopted in the GATS suggests that the term commercial presence covers foreign direct investment, but does not cover bonds, portfolio investments or other categories of assets typically protected by investment treaties. The protection that GATS affords to investors is further limited by the fact that commitments are binding solely in sectors and modes of supply listed in the Members' schedules. In addition to the supply of services through commercial presence, the supply of services "by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member, is relevant in the context of investment protection since commitments of Members concerning that mode of supply provide entry privileges to intra-company transferees and key personnel that are essential to the establishment and operation of a commercial presence.

The most-favoured-nation principle is a general obligation under the GATS. It is constitutive for this agreement to differentiate between general obligations and specific commitments. With regard to the latter, Members have chosen to adopt a positive list or bottom-up approach, which means that specific commitments are only valid if WTO Members have

[40] GATS Article I:2 (c)
[41] See Part V II

specifically committed a particular service sector to these obligations. The most important specific commitments are market access and national treatment. Through the schedules of specific commitments for market access and national treatment, states can also control the establishment of foreign investors. In contrast, the most-favourednation principle is a general obligation and thus applies to all measures in all sectors, unless a Member explicitly exempts a certain measure from its scope. This approach is referred to as negative list or top-down approach and is a result of the Uruguay Round, where it became clear that liberalization could only take place subject to temporary MFN exceptions[42].

The most-favoured-nation provision in Article II:1 GATS provides:

With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country.

While Article I:1 GATT enlists certain fields of application of the clause, Article II:1 GATS applies to "any measure covered by this Agreement, which is equivalent to all measures affecting trade in services.197 Since trade in services covers commercial presence by a service supplier, basically any measure affecting the competitive opportunities of foreign investors can be a measure affecting trade in services and thus a measure covered by the most-favoured-nation standard of the GATS. The most-favoured-nation standard in the GATS prohibits discrimination between services and service suppliers. The background is that many regulations in the services sector, such as qualification requirements, are not coupled with the service, but with the service supplier. Like Article I:1 GATT, Article II GATS prohibits de jure as well as de facto discrimination in order not to frustrate the basic purpose of the GATS,199 namely to ensure equality of competitive opportunities. Article II GATS is not necessarily applicable in the pre-establishment phase since juridical persons only have a right to establish a commercial presence if the respective Member has made a specific commitment for market access in the relevant sector. If however the respective

[42] WTO, Guide to the Uruguay Round Agreements, pp. 165-166.

Member has entered into such a specific commitment the most-favoured-nation clause also covers the pre-establishment phase.

Exceptions from the most-favoured-nation standard are either of a general and permanent or of a self-selected nature[43]. There are permanent exceptions inter alia permitting the accordance of advantages to adjacent countries (Article II:3), the membership in economic integration agreements (Article V), labour markets integration agreements (Article V bis), government procurement (Art. XIII), and measures necessary to protect public morals or maintain public order, to protect human, animal or plant life or health, to secure compliance with certain laws and regulations and to maintain security (Articles XIV and XIV bis).201 In addition to these permanent derogations to the application of the mostfavoured-nation clause, GATS Article II:2 together with the Annex on Article II Exemptions provide for the possibility to derogate from most-favoured-nation treatment by list- ing self-selected exemptions.202 Although the GATS was adopted with the intention of progressive liberalization and exemptions were thus supposed to be temporary203 , the overwhelming majority of exemptions is characterised by the Member States as unlimited.204 The broad possibility to make exemptions to the MFN obligation can be seen in the light of the broadness of the scope of the GATS, which covers any measure of a member country affecting trade in services. The possibility to submit exemptions and the resulting limited scope of the most-favoured-nation clause reveals that Members were not willing to completely eliminate discrimination in services trade and considered the submission of exemptions necessary due to the potentially broad reach of the most-favourednation standard in the normally heavily regulated services sector. One reason why members list exemptions is their aim to ensure that certain treatment only has to be granted on the basis of reciprocity[44]. Without the possibility to submit exemptions, unconditional most-favoured-nation treatment would allow competitors located in countries with relatively restrictive policies to benefit from their sheltered markets while enjoying a free ride in less restrictive export markets. Exempted measures must have been specified in a list of MFN exemptions submitted by the end of the Uruguay Round of Multilateral Trade Negotiations or by the

[43] For details see Wang, Yi, Most-Favoured-Nation Treatment under the General Agreement on Trade in Services – And Its Application in Financial Services, pp. 91-124.
[44] OECD, Working Paper of the Trade Committee, Trade in Services: Roadmap to GATS MFN exemptions (2001), TD/TC/WP(2001)25/FINAL, 3

conclusion of extended negotiations on certain sectors for which the delayed submission of related exceptions was expressly authorized. Subsequently, no new exemptions can be granted except under the conditions of the waiver procedures of the WTO Agreement[45]. A study by the OECD counted 424 exemptions listed by 79 WTO members (counting the then European Communities as one).208 Exemptions have been used to a large extent in order to uphold discriminating measures particularly in the sectors of audiovisual services, air, maritime and road transport services and financial services.209 Another important category of MFN exemptions relates to international agreements.210 These exemptions must often be applied horizontally, which means that they affect all sectors. Since the GATS covers foreign investment in services, the relationship between the GATS and other international investment agreements is of potentially far-reaching effect. Especially, the most-favoured-nation clause of the GATS could be used to extend to all Members of the WTO higher treatment standards which are provided in investment agreements, such as expropriation standards, investor-state dispute resolution provisions, or market access and national treatment standards in cases where Members have not made specific commitments under the GATS. In the multilateral context of most-favoured-nation relations in the GATS, which has a wide membership, the number of potentially beneficiary parties may be immense. As a result, several WTO members have taken exemptions from the most-favoured-nation requirement of the GATS with respect to bilateral investment treaties. This is consistent with the GATS' focus, which is not on investment protection per se in the same way as in the context of bilateral investment treaties.212 A number of exemptions even make specific reference to the dispute settlement procedures in BITs, excluding the application of the most-favoured-nation clause in the GATS to dispute settlement provisions in BITs. This way Members make sure that there is no direct recourse to arbitration for GATS violations.

B. North American Free Trade Agreement (NAFTA)

The North American Free Trade Agreement, which entered into force on 1 January 1994, is an agreement between the governments of the United States, Canada and Mexico concluded with the intention to implement a free trade area. It contains in its Chapter 11 substantive obligations and dispute settlement provisions for the protection of investments. NAFTA

[45] Para. 2 of the Annex on Article II Exemptions refers to Article IX:3 of the WTO Agreement

Chapter 11 submits all economic sectors to its substantive commitments unless they are specifically exempted by the submission of a negative list of non-conforming measures. Among its substantive obligations is the requirement to grant most-favourednation treatment to both investors and their investments. NAFTA Article 1103 provides:

(1) Each Party shall accord to investors of another Party treatment no less favourable than that it accords, in like circumstances, to investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments. (2) Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

In contrast to GATS, the clause enumerates certain fields of application for the MFN principle. As can be derived from the references to establishment and acquisition, the clause covers both the post- and the pre-establishment phase, which separates the agreement from most other multilateral agreements like for example the Energy Charter Treaty, and from most bilateral investment treaties. Contrary to the GATS, the NAFTA adopts a negative-list approach as regards market access, which means that the obligation to grant market access is only restricted if the State has specifically made exceptions for certain areas.

The investment provisions including most-favoured-nation treatment are subject to a number of reservations and exceptions set out in Article 1108 and the schedules established in Annexes I-IV. According to Article 1108 (1), the most-favoured-nation standard does not apply to existing non-conforming measures that are maintained by the Parties in the schedules in Annex I. This standstill agreement is intended to avoid relapses into greater protectionism. Article 1108 (3) provides that certain substantive obligations including the most-favoured-nation standard do not apply to measures that a Party adopts with respect to sectors set out in Annex II. This Annex contains exceptions with respect to specific sectors in which Parties may maintain or adopt measures that are inconsistent with the enumerated obligations. Article 1108 (6) specifically deals with the mostfavoured-nation requirement, which according to this norm does not apply to treatment with respect to sectors set out in the

Parties' schedules to Annex IV. The Annex IV schedules of Canada, Mexico and the United States are identical and exempt treatment accorded under all bilateral or multilateral international agreements which were in force or signed prior to the date of entry into force of the NAFTA. Further, they exempt treatment accorded under agreements concerning aviation, fisheries, maritime matters, telecommunications transport networks and telecommunications transport services. Neither does the most-favoured-nation obligation apply to current or future foreign aid programmes to promote economic development. Apart from the annexes, Article 1108 (7) provides that the most-favoured-nation standard does not apply to procurement by a Party or a State enterprise or subsidies or grants provided by a Party or a State enterprise.

C. U.S. Model BIT

The U.S. model bilateral investment treaty of 2012 contains a most-favoured-nation clause that is almost identical with that of the NAFTA. It provides in Article 4.

(2) Each Party shall accord to investments of the other Party treatment no less favorable than that it accords, in like circumstances, to investments in its territory of investors of any non-party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

In contrast to early U.S. Model BITs, the most-favoured-nation obligation is now uncoupled from the national treatment obligation. It now contains not only a reference to investments, but also an obligation to treat investors on a most-favoured-nation basis. The reference to "like situations" has been changed into "like circumstances", which does not however entail a change of the meaning217. Moreover, the list of covered activities is now exhaustive. It is less detailed than in early model treaties; yet the definition of "investment" contained in Article 1 of the 2012 model BIT covers all activities that were additionally mentioned in the most-favoured-nation clause in prior model BITs. The mostfavoured-nation obligation in the U.S. model BIT does not apply to government procurement and to subsidies or grants provided by a Party (Article 14 (5)). Most United States bilateral investment treaties adopt a negative-list approach for market access, which means that the obligation to grant market access is only restricted if the State has specifically made exceptions for the respective

sector. Moreover, the most-favoured-nation clause of the U.S. model BIT refers to the establishment and acquisition of investments. Thus, like NAFTA's most-favoured-nation clause, the most-favoured-nation obligation in the U.S. model BIT is also applicable in the pre-entry phase.

D. 2008 German Model BIT

The general most-favoured-nation clause in Article 3 of the German Model BIT provides:

(1) Neither Contracting State shall in its territory subject investments owned or controlled by investors of the other Contracting State to treatment less favourable than it accords to investments of its own investors or to investments of investors of any third State.

(2) Neither Contracting State shall in its territory subject investors of the other Contracting State, as regards their activity in connection with investments, to treatment less favourable than it accords to its own investors or to investors of any third State. The following shall, in particular, be deemed treatment less favourable within the meaning of this Article:

The provision provides that less favourable treatment is given in certain enumerated cases, however, the list is not exhaustive. The clause only covers the post-establishment phase and is thus not applicable to the market access of an enterprise. This can be inferred from the formulation of Article 2 (1) of the German model BIT, which obliges the Contracting States to admit investments in accordance with their legislation. One can follow from this provision that the BIT does not prohibit restrictions to the admission of an investment if they are provided in the national legal system. Moreover, the most-favourednation clause of the German model BIT refers to investments "in [the Contracting States'] territory", thus indicating that most-favoured-nation treatment shall only be applied to investments that have already been established within the jurisdiction of the respective host State. The lack of a right to market access is in conformity with the rights protected in most bilateral investment treaties except those of the United States and Canada, which usually do not grant a right to establish a foreign investment in a certain country, but only comprehend the protection of enterprises that are already operating on the market. Accordingly, the predominant part of

bilateral investment treaties grants most-favourednation treatment only with respect to the phase following the establishment of the enterprise.

Article 3 (3) of the model BIT provides for an exception from the duty to accord mostfavoured-nation treatment with regard to privileges granted due to membership in a customs or economic union, a common market or a free trade area or a State's association with such union. This norm is particularly relevant as regards Germany's membership in the European Union. Article 3 (4) provides that most-favoured-nation treatment shall not relate to favours granted to third states on account of an agreement concerning the payment of taxes, especially double taxation agreements. Article 3 (2) third sentence clarifies that measures that are taken for reasons of public security and order are not classified as less favourable treatment.

Application of the Most-Favoured-Nation Clause to Substantive Treaty Standards

In accordance with their economic rationale to establish equal conditions of competition among investors from different home countries, MFN clauses extend more favourable substantive rights that host States offer to investors of third country nationals to those investors benefitting from the MFN clause. These substantive rights encompass on the one hand unilateral State measures, policies or legislation and on the other substantive treatment standards agreed upon in third-party treaties on a bilateral or multilateral basis. BITs typically contain several substantive treatment standards, most prominently a provision regulating expropriation, an obligation to accord fair and equitable treatment and the prohibition of discrimination.The use of MFN clauses to import more favourable substantive provisions from third-country BITs has continuously been endorsed by investment tribunals. Although BITs concluded by one State are often based on a model BIT and therefore do not differ to a great extent, there are instances where treaties are not completely alike due to the possibility of a change in policy or different negotiating positions. This is even more so with regard to BITs concluded by mainly capital-importing countries since these States conclude treaties on the basis of different model BITs, depending on the treaty partner. The differences in the substantive provisions of treaties open up a field of application for MFN clauses.

This chapter contains an overview of the case law of investment tribunals dealing with the applicability of MFN clauses to substantive treaty provisions. It demonstrates that tribunals have uniformly affirmed the application of MFN clauses to such provisions. This outcome is endorsed by the wording and the functions of MFN clauses. Moreover, the chapter gives an overview of substantive treaty standards which may also potentially be incorporated by MFN clauses, thus illustrating a considerable potential of harmonization of substantive investment protection on the highest possible level.

A. Jurisprudence by Investment Arbitration Tribunals

I. Invocation of a more Favourable Fair and Equitable Treatment Clause

1. Introduction to the Fair and Equitable Treatment Standard

The obligation of host countries to accord fair and equitable treatment is a widespread principle in investment treaties. Tribunals have identified numerous elements encompassed in the fair and equitable treatment standard including transparency the protection of legitimate expectations stability and predictability of the legal and business environment procedural propriety and due process requirements prohibiting inter alia denial of justice, arbitrariness good faith and freedom from coercion and harassment.

Discussion on the fair and equitable treatment standard has mainly focused on whether the treatment required should be measured against the customary international law minimum standard or whether the standard is an autonomous self-contained concept. Depending on whether one accepts that certain fair and equitable treatment clauses may contain elements going beyond what is required by the customary international law minimum standard there may or may not be room for the invocation of more favourable fair and equitable treatment clauses in conjunction with MFN clauses. The possibility to construe the fair and equitable treatment standard as going beyond the international minimum standard of treatment depends on the formulation of the standard which differs in particular with regard to the inclusion or non-inclusion of a reference to international law, and in case there is such a reference with regard to the relationship between the fair and equitable treatment clause and international law as expressed in the wording of the clause. For disputes arising under NAFTA, the issue whether the fair and equitable treatment standard is independent from the minimum standard

of customary international law has been resolved in the binding interpretation of the Free Trade Commission (FTC)250 of July 21, 2001. The note clarified that the fair and equitable treatment standard of NAFTA did not go beyond the international minimum standard rejecting the interpretation given by the Pope & Talbot Tribunal, which had interpreted the clause as covering a fairness requirement going beyond the international law minimum standard.

While the interpretation of the FTC is binding on the NAFTA Contracting Parties, it is not necessarily valid for other investment treaties. Moreover, there are two features in which NAFTA Article 1105 deviates from most other investment treaties. First its heading is not "Fair and Equitable Treatment" but "Minimum Standard of Treatment", which explicitly refers to the minimum standard of customary international law, and second it requires to accord to investments treatment "in accordance with international law, including fair and equitable treatment", which suggests that the fair and equitable treatment standard is a subsidiary element of customary international law.253 In reaction to the Pope & Talbot case and the FTC's Note on Interpretation, several recent BITs have adopted a more precise approach to the fair and equitable treatment standard, explicitly linking the fair and equitable treatment standard to the minimum standard which is part of customary international law. 254 In contrast, the majority of fair and equitable treatment clauses does not make reference to the minimum standard of international law[46]. In that case, the content of the standard leaves room for autonomous interpretation, leaving the possibility to pro- hibit administrative measures that would not necessarily be illegal under customary international law.

Whether fair and equitable treatment clauses which do not make reference to international law can be interpreted autonomously, i.e. independently from the international minimum standard, is highly disputed. While some affirm the possibility and thus an opportunity to apply the principle of most-favoured-nation treatment to import more favourable fair and equitable treatment clauses,257 other tribunals have rejected the inclusion of fairness requirements beyond the international minimum standard despite variations in the

[46] Coe, Fair and equitable treatment under NAFTA's investment chapter, p. 18.

language[47]. Under the narrower interpretation of the fair and equitable treatment standard, there is no room for application of the MFN principle .

Comparable to the fair and equitable treatment standard, the full protection and security standard, which is a common standard in bilateral investment treaties and dates back to Treaties of Friendship, Commerce and Navigation, raises the question whether it only provides an obligation for the host state to comply with the customary international law minimum standard, or whether it imposes an obligation going beyond the minimum standard. Some BITs expressly provide that full protection and security shall be enjoyed in a manner consistent with international law. A number of BITs combine the full protection and security standard with the fair and equitable treatment standard, which suggests that both expressions contemplate compatible standards of treatment. The full protection and security standard has been interpreted by the tribunal in AAPL v. Sri Lanka as adopting the customary international law standard[48] according to which State responsibility generally arises when a State has failed to apply due diligence in the protection of foreigners against violation of their rights and interests, as opposed to creating strict liability, under which States are under an absolute obligation to guarantee that no damages will be suffered263 . Yet the tribunal left open the possibility that the full protection and security standard could refer to a standard higher than the international law minimum standard.

2. Case Law

a. Pope & Talbot, Inc. v. Canada

In Pope & Talbot v. Canada, the issue of the scope of NAFTA's MFN clause became relevant within the Tribunal's determination whether there was a violation of the fair and equitable treatment clause of the agreement. The Tribunal rejected the Canadian ap- proach

[47] ADF v. U.S., Award, 9 January 2003, ICSID Case No. ARB(AF)/00/1, para. 194; Rumeli v. Kazakhstan, Award, 29 July 2008, ICSID Case No. ARB/05/16, para. 611; Azurix v. Argentina, Award, 14 July 2006, ICSID Case No. ARB/01/12, para. 361; CMS v. Argentina, Award, 12 May 2005, ICSID Case No. ARB/01/8, para. 284. See also Orakhelashvili, The normative basis of "fair and equitable treatment", p. 105.

[48] AAPL v. Sri Lanka, Award, 27 June 1990, ICSID Case No. ARB/87/3, paras 48-53. See also ELSI case, Judgment of 20 July 1989, ICJ reports 1989, para. 108 (referring however to a "constant protection and security" standard, which emphasizes rather the absence of change in the level of protection rather than the extent of protection). See also Dolzer/ Stevens, Bilateral Investment Treaties, p. 61; Park, NAFTA Chapter 11, in: Kaufmann-Kohler/ Stucki (eds), Investment Treaties and Arbitration, p. 19; Vasciannie, Bilateral Investment Treaties and Civil Strife, p. 342

according to which the fair and equitable treatment standard did not go beyond traditional customary international law principles but adopted an additive approach, interpreting the clause so as to cover certain fairness requirements in addition to the international law minimum standard.In order to support its view, the Tribunal cited NAFTA's MFN clause, arguing that in light of the fact that certain BITs concluded by the parties to NAFTA included in their fair and equitable treatment clauses fairness elements going beyond the international law minimum standard [49] a right under NAFTA to object to laws, regulations and administrative measures which would be more limited than that of thirdstate nationals that have concluded an investment treaty with a NAFTA party would lead to a violation of the most-favoured-nation standard.268 Assuming that NAFTA investors could only claim a violation of NAFTA's fair and equitable treatment standard in the case of an "egregious" violation, they could simply claim a violation of the most-favourednation standard, which would lead to the absurd result that what was denied under Article 1105 could be claimed under Article 1103. The decision was in the end based on the tribunal's finding that the host State's conduct had already violated the more restrictive interpretation of fair and equitable treatment[50]. However, the Tribunal's argumentation indicates that the arbitrators took for granted the applicability of the MFN clause to the fair and equitable treatment standard.

b. ADF Group Inc. v. United States[51]

In this case, the Claimant contended that it could invoke by virtue of NAFTA's MFN clause fair and equitable treatment clauses from third-party BITs that allegedly contained a more favourable fair and equitable treatment standard. The Claimant originally claimed a violation of the national treatment and the fair and equitable treatment and full protection and security standards. However, when the NAFTA Free Trade Commission issued its narrow interpretation of Article 1105, stating that the fair and equitable treatment standard only prohibits treatment that is not in accordance with customary international law, the Claimant focused on the most-favoured-nation standard. The investor relied on Article II (3) of the

[49] The Tribunal cited as an example the fair and equitable treatment clause of the 1987 United States Model BIT which provided in Art. II.2 that "Investment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than that required by international law."

[50] Pope and Talbot Inc. v. Canada, Award in Respect of Damages, 31 May 2002, para. 66.

[51]

United States-Albania BIT, which allegedly incorporated a fair and equitable treatment standard going beyond the customary international law minimum standard. The Tribunal dismissed the claim for three reasons. First it held that the investor had not persuasively shown the existence of an autonomous fair and equitable treatment standard independent and distinct from customary international law. Second, even if there was such a standard, the investor had not shown that it had been breached. And lastly, according to NAFTA Article 1108 (7) (a) the case did not fall under the mostfavoured-nation standard since the case involved government procurement. The tribu- nal did however not express any doubts as regards the general applicability of the mostfavoured-nation clause to fair and equitable treatment standards in BITs which offer different levels of protection.

c. Rumeli Telekom A.S. v. Republic of Kazakhstan

In this case, the Tribunal held Kazakhstan liable for a violation of the fair and equitable treatment standard, basing its finding on the MFN clause of the basic treaty in conjunction with the fair and equitable treatment clause that it incorporated from the UK-Kazakhstan BIT.275 This importation of the fair and equitable treatment clause was not disputed by the parties, even though the BIT between Turkey and Kazakhstan did not at all contain such a standard. The Tribunal thus acquiesced application of the MFN clause to treatment standards to all forms of substantive benefits as long as they are connected with investment protection.

3. Assessment

These cases show that tribunals have accepted the applicability of most-favoured-nation clauses to fair and equitable treatment clauses. While the Rumeli case dealt with the incorporation of a fair and equitable treatment clause where the basic BIT did not contain such clause at all, the Pope and Talbot and ADF cases concerned the invocation of allegedly more favourable MFN standards. The Tribunal in Rumeli Telekom A.S. v. Republic of Kazakhstan based its decision on the operation of the MFN clause in the relevant BIT. It held that Kazakhstan was bound by the fair and equitable treatment clause from a thirdparty BIT, which it incorporated through the MFN clause. Both the Pope and Talbot and the ADF Tribunals did not finally base their decision on the application of the clause.

Moreover, it seems questionable whether there is in fact a fair and equitable treatment standard going beyond what is required by customary international law.

The Pope and Talbot and ADF cases also bring to the fore the issue of applicability of the most-favoured-nation principle to a certain treaty provision where the State parties have given a clear and detailed expression of their intention about the scope of that provision. In the Pope & Talbot and the ADF cases, the notes on interpretation of the Free Trade Commission give a clear indication of the parties' intention to exclude from the NAFTA's fair and equitable treatment standard the protection of standards going beyond the customary international law minimum standard. However, the FTC interpretation only states that the breach of a standard going beyond the customary international law minimum standard does not constitute a violation of NAFTA's fair and equitable treatment standard. It does however not express an intention to limit the scope of the most-favourednation clause so as to exclude its application to a more favourable fair and equitable treatment clause. The decisions thus underline that the fact that specific provisions embody a specific party intention does not exclude the operation of the most-favoured-nation clause. 276 This result is not changed by the fact that a certain provision is subject to interpretation by the Contracting parties subsequent to the ratification of the treaty. It can be said of all provisions in an investment treaty that they are the expression of a certain party intention, and it is the function of a most-favoured-nation clause to eliminate specifically negotiated provisions that are discriminatory towards certain investors. Therefore investors protected by NAFTA can rely on more favourable fair and equitable treatment standards in third-party investment treaties in spite of the FTC interpretation. In case the parties to the NAFTA want to evade this result, they would have to issue a note on interpretation concerning NAFTA's MFN clause, or to assure not to grant a more favourable standard to other treaty partners, for example by agreeing on notes of interpretation concerning the relevant fair and equitable treatment clauses with these treaty partners as well.

II. Invalidation of a Non-Precluded Measures Clause

Non-precluded measures provisions exempt measures adopted for the specified permissible objectives in exceptional circumstances from some or all obligations under the BIT.277 Such objectives include security interests, international peace and security, public order, public

health and public morality. Precluding the applicability of the specified obligations of the BIT to acts that fall within its scope, a non-precluded measures clause provides States with a legal mechanism to regulate and control the risk of investment tribunals reviewing core State policies in exceptional circumstances and times of crisis. In case of lack of such legal mechanism in a treaty, States only have the option to refer to the necessity exception recognized under customary international law which is subject to conditions not necessarily congruent with those established in a necessity clause included in a treaty. Apart from the varying conditions for the applicability of either an emergency clause or the customary international law necessity principle, the consequences as regards the payment of compensation are different. If emergency clauses such as Article XI of the United States-Argentina BIT, which as a primary rule of responsibility exclude the applicability of substantive provisions of a BIT, are applicable, there is no violation of the treaty and therefore no right to compensation. In contrast, in case of necessity under customary international law, compensation is at least not excluded. Thus, the existence of a non-precluded measures clause in a BIT can create less favourable conditions for the investor.

Invocation of a More Favourable National Treatment Standard

The application of a most-favoured-nation clause to the national treatment standard is another option of potentially far-reaching impact of MFN treatment, given that the denial of national treatment leaves a possibility for States to protect domestic infant industries and entrepreneurship and can therefore be regarded as a key interest in its investment policy. National treatment standards differ as to the levels of protection granted. Some BITs do not include a national treatment clause at all or merely include a best-efforts obligation. There are more than fifty BITs which do not include a national treatment clause,304 including most Chinese BITs from the 1980s and 1990s,[52] the treaties between Germany and Bulgaria306 and Germany and Russia.[53] The ASEAN investment agreement (1987) provides that the Contracting parties may negotiate to accord national treatment to investors of the other party respectively; it does not contain a binding national treatment obligation.308 Other BITs only guarantee that the host state shall accord national treatment "in accordance with the

[52] Xiao, Das neue deutsch-chinesische Investitionsschutzabkommen, p. 448. See, e.g., the 1985 China-Kuwait BIT, the 1986 China-Switzerland BIT and the 1994 China-Egypt BIT.
[53] Germany–USSR BIT of 13 June 1989

stipulations of its laws and regulations or provide for a national treatment obligation "to the extent possible'[54] which means that the Contracting States are only under a best-efforts obligation. Such restrictions were typical for earlier Chinese BITs. Moreover, some BITs only refer to national treatment in the post-establishmentphase, and others extend national treatment also to the pre-establishment phase.

In case a third-party BIT contains a broader national treatment standard than the basic treaty, that standard may, unless explicitly exempted, be incorporated in the basic treaty via the relevant MFN clause. The relevance of this possibility becomes apparent especially as regards the new generation of Chinese BITs, which in contrast to earlier BITs abstain from restrictions on the national treatment standard such as the treaties concluded by China with Germany and the Netherlands. This finding is corroborated by the fact that treaties concluded prior to the mid-seventies often contain a reciprocity clause according to which a contracting party grants national treatment only to the extent that the other party provides national treatment as well. This clause was included in order to exclude free riders who could otherwise have claimed national treatment via MFN clauses. The ASEAN investment agreement (1987) even explicitly provides that nothing herein shall entitle any other party to claim national treatment under the mostfavoured-nation principle.

An allegedly more favourable national treatment standard was invoked by the Claimant in Occidental v. Ecuador. The U.S. investor argued that it could benefit from the national treatment provisions in several of Ecuador's third-party BITs, which allegedly contained a broader national treatment obligation since they did not explicitly limit national treatment to "like situations". Ultimately, the Tribunal refrained from discussing the argument because it agreed with the investor's argument that the "in like situations" requirement could not be interpreted in a narrow sense by addressing only the industry sector in which the investor's activities were undertaken and that there was therefore already a violation of the national treatment obligation under the basic BIT.

II. Extension of Market Access

[54] Congyan, Outward Foreign Direct Investment Protection, p. 637

Most countries refrain from granting foreign nationals and companies an unrestricted right to invest in their economies. They merely require that host States admit foreign investment in accordance with their national legislation. This allows States to preserve initial screening mechanisms and even discriminatory legislation affecting the establishment of foreign investment. Such screening procedures regulating market access leave the possibility not to admit those types of investments that are considered welfare-reducing and deleterious to domestic economy. The main purpose of restricting the admission of investment in certain industries is to promote indigenous capacities, or to specifically attract those foreign investors that are particularly conducive to the upgrading of the domestic economy and the deepening of the country's technological infrastructure.

Under another approach which aims at liberalizing market access and is mostly pursued in BITs concluded by Canada and the United States, the Contracting States grant investors certain rights of entry, which may however be subject to reservations. To grant those rights of entry, investors are endowed with national and most-favoured-nation treatment also with respect to the pre-establishment phase so as to ensure market access for foreign investors on terms equal to those enjoyed by domestic and other foreign investors. Depending on whether they conclude a BIT with the United States or Canada or with another country, treaty partners are therefore usually confronted with different model clauses, with some leaving the establishment phase under the control of the laws of the host state, and others additionally liberalizing the pre-entry phase. In comparison with investors from European states, investors from the United States thus enjoy more favourable treat ment as to the opening of the market. However, in case the admission or establishment is not an enumerated field of application of a particular MFN clause, the clause is not applicable to market access. MFN clauses are only applicable to investments or investors, therefore in case no investment has yet been established, the clause is not pertinent. Some clauses are even more explicit, referring to investments within [the state's] jurisdiction[55] or investments in [the state's] territory which have already been admitted in accordance with domestic law.

Sometimes an intermediate approach is pursued, which does not grant investors a right to entry, but the right to most-favoured-nation treatment in the pre-entry phase. This approach

[55] See, e.g., Article 3 (1) of the German Model BIT

was taken in Article 2 of the BIT between Japan and Bangladesh.324 Given that Japan has also concluded BITs providing for most-favoured-nation and for national treatment in the pre-entry phase[56] Bangladeshi investors in Japan are also entitled to national treatment in the pre-entry phase on account of the most-favoured-nation clause in Article 2 (2) of the Bangladesh-Japan BIT[57].

III. Invalidation of Performance Requirements

There is also the possibility for investors to circumvent performance requirements by virtue of MFN clauses in case more favourable treatment is granted to a third party. Performance requirements are stipulations, imposed by host countries on investors, requiring hem to meet certain goals with regard to their operation in the host country. They are instruments implemented with the aim of influencing the investor's behaviour and the character, costs and benefits of the investment. Host States use them in order to enhance the development benefits of foreign direct investment, for example to generate employment, increase the demand for local products, or stimulate exports[58]. They are adopted in order to deal with concerns related to the political and economic consequences of the presence of transnational corporations, notably in order to strengthen the industrial basis of the country, to generate employment opportunities and export, to promote technological progress and various non-economic objectives, such as political independence and distribution of political power. Such measures aim at the direct or indirect control of the investment by the host State; moreover they have the effect that a smaller part of benefits will be repatriated abroad and promote the emergence of a local entrepreneurial class. Examples are requirements to establish a joint venture with domestic participation or requirements for a minimum level of domestic equity participation, employment and training requirements, export requirements, research and development requirements and requirements to transfer technology, production processes or other proprietary knowledge. Other performance requirements are implemented with regard to environmental or social goals; for example, Chilean investment legislation provides since 1997 that projects susceptible to having an impact on the environment must be subjected to an environmental impact assessment. An increasing number of BITs contains prohibitions of

[56] See e.g. Article 2 (1) and (2) of the Japan-Korea BIT
[57] UNCTAD, Bilateral Investment Treaties 1995-2006, p. 26.
[58] UNCTAD, Bilateral Investment Treaties in the Mid-1990s, p. 81.

performance requirements which in contrast to those in the TRIMs Agreement are not restricted to trade in goods and often go beyond the obligations assumed in the con- text of that agreement[59]. In case the basic treaty contains the obligation to observe performance requirements which are not included in or prohibited by a third-party BIT, the investor can invoke the absence of performance requirements by means of the MFN clause in the basic BIT.

III. Invocation of More Favourable Applicable Law Provisions

Another possible field of application for the most-favoured-nation principle is the choice by the parties to the investment treaty of the law which shall be applicable to the substance of the investment dispute.335 The ICSID Convention grants autonomy to the parties in choosing the law that ought to be applied to solve their dispute, providing in Article 42 (1) first sentence

The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties.

Apart from national legislation and direct agreements between the parties, choice of law clauses can be included in investment treaties. In many cases, the choice of law clause provides for the settlement of the dispute in accordance with the provisions of the investment treaty itself in conjunction with the "applicable rules of international law. The application of rules of international law may have a major impact on the result of the arbitration, for example as regards the amount of interests to be paid by the Respondent in case an expropriation has occurred. The choice of law clause may also include a refer- ence to agreements relating to the particular investment and to the law of the host State. Other treaties do not refer to the law of the host State.

However, the majority of investment treaties does not contain a choice of law clause.341 For that case, the ICSID Convention provides in Article 42 (1) second sentence:

[59] UNCTAD, Bilateral Investment Treaties 1995-2006, p. 65. See for example Article 8 of the 1995 US-Uruguay BIT; Article 1106 (1) NAFTA; Article 9 (1) of the 2002 Japan-Korea BIT

"In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute and such rules of international law as may be applicable."

Application of Most-Favoured-Nation Clauses to conditions ratione materiae, ratione temporis and ratione personae

Investment tribunals have so far only dealt with a condition ratione temporis. In this respect, the Tecmed tribunal has come to the conclusion that the relevant most-favourednation clause was not applicable. Although the outcome of the ruling must be endorsed, the reasoning of the tribunal is flawed.

A. Extension of the Application of a Treaty Ratione Temporis

I. Introduction into the Application of Treaties Ratione Temporis

All BITs are applicable to investments established after their entry into force, but they differ as to the question of application to investments already existing at the time of their entry into force. It is however more common for BITs to protect both future investments and investments already established at the date of entry into force of the BIT, which is either laid down in a special provision or can be derived from the definition of investment in the treaty. In contrast, BITs which are only applicable to future investment are rare. However, the fact that treaties apply to investments already existing at the time of their entry into force does not mean that they may be applied retroactively. The general rule for the application of a treaty ratione temporis is layed down in Article 28 of the Vienna Convention on the Law of Treaties, which provides

Unless a different intention appears from the treaty or is otherwise established, its provisions do not bind a party in relation to any act or fact which took place or any situation which ceased to exist before the date of the entry into force of the treaty with respect to that party.

One can derive from this provision that the scope of treaties ratione temporis generally does not encompass the retrospective application of treaty provisions. This principle precludes the possibility of litigation arising out of situations or facts dating from a period when a State could not have foreseen that the circumstances might give rise to legal

proceedings. However, the prohibition of retrospective application of treaties is rebuttable and subject to the disposition of the parties. In accordance with the Vienna Convention, BITs generally do not have retroactive effect, which means that the rights and obligations derived from a BIT apply only after the treaty has entered into force and with respect to acts or facts occurring thereafter. The fact that a treaty may be applicable to investments already existing at the time of its entry into force, but may not be applied retroactively can be explained by the fact that the dispute has to be distinguished from the facts or situations which have led to the dispute. Thus, if the competence of a tribunal is excluded for disputes that occurred prior to a certain date, the tribunal is competent as soon as the dis- pute arises after that date, no matter whether the facts or the situation which provoked the dispute occurred before or after that date[60].

II. Case Law

In Tecmed v. Mexico, the arbitral tribunal denied the extension of its jurisdiction ratione temporis by operation of the relevant MFN clause. The Claimant was a Spanish company which had acquired a landfill of hazardous industrial waste from a Mexican municipal agency in a public auction. While the municipal agency had operated the landfill on the basis of an unlimited authorisation, Tecmed was only granted temporary one year-licenses by the competent Mexican agency. In November 1998, this agency denied the renewal of the license for the operation of the landfill. As a consequence, the company brought a claim for alleged violations by Mexico of the provisions in the Spanish-Mexican investment treaty concerning expropriation, fair and equitable treatment and full protection and security. They argued that the issue of a temporary instead of an unlimited license violated the investment treaty since the landfill had been acquired in the public auction together with the unlimited license on the basis of which the municipal agency had operated it. Regarding the jurisdiction ratione temporis of the Tribunal, the Respondent argued that while covering investments that existed prior to the entry into force of the treaty356, the bilateral investment treaty did not apply to the conduct of the Respondent in the public auction, which predated the entry into force of the treaty. The

[60] Santulli, Droit du contentieux international, para. 306; In the Interhandel Case (Switzerland v. United States), Preliminary Objections, Judgment of 21 March 1959, ICJ Reports 1959, p. 22, the ICJ stated that "the facts and situations which have led to a dispute must not be confused with the dispute itself"

Tribunal agreed, pointing out that the substantive obligations were drafted as projected into the future357 and that the general rule of Article 28 VCLT was the preclusion of retrospective application of a treaty.358 The Claimant therefore sought to extend the applicability of the investment treaty ratione temporis to the time when the investment treaty had not yet entered into force.

Relying on the Maffezini decision and a provision in the Austria-Mexico bilateral investment treaty which allegedly allowed the retrospective application of certain treaty provisions the investor argued that the temporal scope of application of the SpainMexico BIT could be extended by operation of its MFN clause.

The tribunal did not examine the wording of the most-favoured-nation standard and refused to consider whether investors were granted further protection under the Austria Mexico treaty, but made a determination of principle to deny the standard's applicability, holding that the present case dealt with the temporal applicability of substantive provisions of the investment treaty and could therefore be distinguished from the situation in Maffezini, which involved dispute settlement questions. The tribunal considered the application of a treaty ratione temporis and the access of an investor to a substantive protection regime to be within the core of matters that had to be regarded as specifically negotiated party agreements. There was therefore a presumption that agreements concerning the temporal applicability of a treaty were a decisive factor for the acceptance by the parties of the treaty. Since the party would presumably not have entered the Agreement in the absence of such provisions, such provisions fell outside the scope of the most-favourednation clause. In the words of the tribunal matters relating to the application over time of the Agreement, which involve more the time dimension of application of its substantive provisions rather than matters of procedure or jurisdiction, due to their significance and importance, go to the core of matters that must be deemed to be specifically negotiated by the Contracting Parties. These are determining factors for their acceptance of the Agreement, as they are directly linked to the identification of the substantive protection regime applicable to the foreign investor and, particularly, to the general (national or international) legal context within which such regime operates, as well as to the access of the foreign investor to the substantive provisions of such regime.

Their application cannot therefore be impaired by the principle contained in the most favored nation clause.

III. Assessment

The tribunal did not generally put into question the applicability of the most-favourednation clause to substantive or dispute settlement questions. Instead it held that application of the most-favoured-nation clause is precluded when the respective provisions are "part of the essential core of negotiations" and must be deemed to be "specifically negotiated", and when the Parties would presumably not have entered into the treaty without the respective provisions.364 Thus, the tribunal distinguished Tecmed from Maffezini v. Spain, arguing that the lack of possibility to apply the BIT retroactively was a determining factor for the parties' acceptance of the agreement.365 In addition to the assumption established in Maffezini that provisions envisaged as fundamental conditions for the acceptance of the treaty by the parties could not be overcome by means of the most-favoured-nation clause, the tribunal introduced the notion of core of matters that must be deemed to be specifically negotiated, which was developed further in the Plama case.

This reasoning suggests that parties can specifically negotiate benefits without having to grant them to third States. Moreover, the tribunal's argumentation that certain matters have to be deemed to be specifically negotiated indicates that the investor bears the burden of proof to prove the contrary[61]. However, this would be contrary to the very purpose of most-favoured-nation clauses to eliminate discrimination. As discussed above[62], it is inappropriate to limit the scope of the MFN clause due to the specificity of BIT provisions since it is exactly the purpose of the MFN clause to do away with specifically negotiated provisions in order to further non-discrimination. Applying this principle would make MFN clauses virtually redundant since all provisions in BITs are the outcome of negotiations. Moreover, the specific negotiation of provisions does not necessarily imply that it was the parties' intention to exempt the respective provisions

[61] This is underlined by the tribunal's argument that "it should therefore be presumed that they would not have entered into the Agreement in the absence of such provisions" (para. 74).
[62] See Part VI B.I.3.e.

from change by means of the most-favoured-nation clause and does not give any information about the scope of that clause. It is the object of MFN clauses to eliminate discrimination stemming from specifically negotiated provisions. Moreover, the introduction of two different types of treaty clauses – one which consists of specifically negotiated provisions and one which consists of provisions which were not specifically negotiated – would suggest that treaty provisions possess different degrees of validity. However, all treaty provisions are based on the consensus of the contracting State parties and have an equally binding force.

The outcome of the reasoning has to be endorsed, however, for different reasons. The analysis of the Tribunal dealing with the question whether the treaty is applicable ratione temporis is, as the Tribunal points out, actually not a question of jurisdiction or admissibility, but concerns the question whether the claim can be founded on the text of the treaty at all. The question whether a treaty is applicable temporally does not involve a situation of a possibly well-founded right which can however not be implemented for lack of jurisdiction, but involves the question whether there is actually a right which can be founded on the treaty.370 Since the treaty cannot be applied to State conduct which took place before its entry into force, neither can the most-favoured-nation clause be applied retroac-

tively. It was therefore not possible to base the claim on the standard with regard to acts that took place before the entry into force of the treaty. When the treaty is not applicable ratione temporis, neither is the MFN clause included in that treaty applicable. Hence, the clause cannot be invoked to extend the application of a treaty ratione temporis.

B. Extension of Jurisdiction Ratione Materiae and Ratione Personae

For the condition ratione materiae to be fulfilled, the dispute must concern an investment. According to Article 25 (1) ICSID Convention, ICSID tribunals only have jurisdiction to arbitrate legal disputes “arising directly out of an investment”. The drafters of the ICSID

Convention refrained from including a definition of the term "investment" due to "the essential requirement of consent by the parties" in the relevant investment agreements[63].

They apply to "every kind of investment" or "every kind of asset" invested in the host country. Other BITs have included certain limitations on the scope of investments covered. A number of BITs adopt a closed-list definition of "investment", which means that they include an ample but finite list of assets to be covered by the treaty. An example for such a closed-list approach is NAFTA Article 1139. Some treaties explicitly exclude certain categories of investments, such as portfolio investment. Portfolio investment is usually characterised as "a movement of money for the purpose of buying shares in a company formed or functioning in another country. The distinguishing element is that in portfolio investment, the investor is typically not interested in exercising influence on the economic activity of the enterprise, but in gains achieved through shareholding. Due to its short-term nature and volatility there is a special need to regulate portfolio investment in countries with unstable financial markets. In contrast, foreign direct investment is defined as "the category of international investment that reflects the objective of a resident entity in one economy obtaining a lasting interest in an enterprise resident in another economy. It is characterized by the influence of the investor on the economic activity of the enterprise and by a certain duration. For example, the German Model BIT does not contain any restriction to investments. However, the BIT with China restricts the term of investments to those investments "made for the purpose of establishing lasting economic relations in connection with an enterprise, especially those which allow to exercise effective influence on its management. This formulation explicitly excludes portfolio investment. Even when no such explicit exclusion takes place in an investment treaty, the broad definitions of investment do not necessarily encompass portfolio and other investments in addition to direct investment.

The condition ratione personae is fulfilled when the dispute exists between the host State and an investor. Regarding the definition of who is an investor under the BIT, the essential criterion is its nationality, as can be derived from Article 25 (2) of the ICSID

[63] Report of the Executive Directors on the Convention on the Setlement of Investment Disputes between States and Nationals of other States, para. 27.

Convention.379 The exact criteria for establishing the nationality of an individual investor or of a corporation are not laid down in the ICSID Convention, but can be derived from the various BITs.380 According to the majority of BITs, whether a particular individual has the nationality of a particular state depends on the national legislation of that state[64]. As a variation of this standard, some BITs combine the standard requirement with that of residence in the territory of the state concerned. BITs concluded with former socialist states used to exclude natural persons from the scope of the BIT and covered only economic organisations of the Contracting States.383 However, the transition from socialist economies to market economies is reflected in more recent BITs with such countries.384 With regard to corporations, one criterion to establish corporate nationality refers to incorporation.385 Other BITs refer to the siège social. These two criteria do not allow a piercing of the corporate veil since they do not require examining the nationality of the controlling shareholders.387 Other treaties establish the control of the company by nationals of the contracting state as the decisive element. There are also BITs which combine several criteria.

Even if third-country BITs provide for a broader scope of application ratione personae or ratione materiae, the most-favoured-nation clause cannot be used to invoke a broader definition of investment or investor since it offers most-favoured-nation treatment only to investments and investors covered by the basic treaty. For the same reason, the requirement of acceptance or certification of the asset cannot be overridden if it is a precondition for the existence of the investment.

Application of Most-Favoured-Nation Clauses to Dispute Settlement Provisions

This Part deals with the applicability of most-favoured-nation clauses to dispute settlement provisions. It first outlines the distinction between procedural and jurisdictional dispute settlement provisions. It follows in Part B an examination of the arguments that can be brought forward in favour or against the application of MFN clauses to dispute settlement provisions. The thesis does not undertake to find a

[64] Dolzer/Stevens, Bilateral Investment Treaties, p. 31.

conclusion which may seem wisest in the view of potential treaty shopping or cherry picking by means of MFN clauses. It rather engages in the interpretation of MFN clauses and argues that according to the principles of the Vienna Convention, Tribunals should not differentiate between the application of MFN clauses to admissibility and jurisdictional requirements. Rather, the possibility to achieve uniformity by means of applying most-favoured-nation clauses should be affirmed both as regards the importation of procedural and jurisdictional provisions. Part C contains an overview and assessment of the jurisprudence of arbitral tribunals regarding the importation of dispute settlement provisions.

A. Distinction between Procedural and Jurisdictional Provisions

The jurisprudence of arbitral Tribunals concerning the importation of dispute settlement provisions through the MFN clause is heterogeneous. The interpretation of MFN clauses particularly differs with regard to its applicability to admissibility and to jurisdictional questions. Several Tribunals particularly in the earlier cases following the Maffezini case have distinguished between procedural and jurisdictional dispute settlement provisions, affirming the application of MFN clauses to procedural provisions and rejecting its application to jurisdictional provisions Indeed a distinction can be made between jurisdictional and admissibility requirements. The concept of jurisdiction refers to "the power vested in a court by law to adjudicate upon, determine and dispose of a matter" upon which its decision is sought[65]. As stated by the ICTY, jurisdiction

is basically – as is visible from the Latin origin of the word itself, jurisdictio – a legal power to state the law' (dire le droit) within this ambit, in an authoritative and final matter.

Objections to the jurisdiction of a tribunal strike at the authority of a court or tribunal to hear and determine the dispute involved. If successful, they stop all proceedings in the case, since they strike at the competence of the tribunal to give rulings as to the merits or admissibility of the claim.394 In contrast, the non-fulfilment of procedural provisions is not an obstacle to jurisdiction, but can be a bar to the admissibility of a claim.

[65] Rosenne, The Law of Treaties, vol. II, p. 524; Amerasinghe, Jurisdiction of International Tribunals, p. 52.

In the practice of the PCIJ and the ICJ, the two conceptions of jurisdiction and admissibility have never been clearly defined. Nevertheless, the ICJ has recognized that objections to jurisdiction form a category distinct from objections to admissibility.396 The criterion by which issues of jurisdiction and admissibility can be distinguished is whether the success of the preliminary objection negates consent to the forum, i.e. whether the objecting party is targeting at the tribunal or at the claim[66]. An objection to the admissibility of a claim involves a challenge to the validity of a claim distinct from issues as to jurisdiction or merits. It does not question the existence of the tribunal's power but challenges the right of the applicant to invoke it in the circumstances of the case.398 Non-admissibility means that the court or tribunal cannot hear a case now, but could do so in the future. Once the defect is cured, the application may be successfully brought before the tribunal at a later date[67]. On the other hand, when a tribunal has no jurisdiction in a dispute, the defect cannot be cured in relation to that particular dispute as framed and presented to the tribunal.

The distinction between jurisdictional and procedural provisions also becomes apparent as regards the possibility to annul a ruling under the ICSID Convention. Annulment within the context of the ICSID system is the primary avenue the Convention provides to challenge an award. The possibility to annul an award is limited to five specific grounds. According to Article 52 (1) (b) of the ICSID Convention, an award can be annulled if the tribunal has manifestly exceeded its powers. A manifest excess of powers will be found inter alia where an ICSID tribunal adjudicates a case without having jurisdiction. In contrast, disputes as to the correct application of procedural provisions are not subject to annulment.

Procedural and jurisdictional dispute settlement provisions thus present different obstacles to the determination of a claim. While the criterion of jurisdiction determines the limits of the power of the tribunal as defined by the consent of the parties, admissibility conditions determine the possibility of the tribunal to exercise given jurisdictional power. This does however not mean that jurisdictional provisions are

[66] Paulsson, Jurisdiction and Admissibility, p. 616.
[67] Amerasinghe, Jurisdiction of International Tribunals, p. 243.

mandatory, while admissibility criteria are permissive and may therefore be neglected. The effect of non-compliance is a lack of jurisdiction in one case and non-admissibility in the other. Thus, compliance is required both as regards jurisdictional and admissibility requirements listed in a BIT.

B. Arguments Relating to the Application of Most-Favoured-Nation Clauses to Procedural Dispute Settlement Provisions

This Chapter highlights the role of dispute settlement in BITs and demonstrates that this role combined with the function of MFN clauses to establish equal competitive opportunities argues in favour of applying MFN clauses to procedural provisions. It follows an interpretation of MFN clauses according to the Vienna Convention on the Law of Treaties, which leads to the same result. Next, the chapter gives an overview of domestic and ICJ jurisprudence dealing with MFN clauses.

I. Interpretation of Most-Favoured-Nation Clauses According to the Vienna Convention Bilateral investment treaties are subject to the rules of interpretation codified in the Vienna Convention on the Law of Treaties. The principal rule for treaty interpretation is framed in Article 31 (1) VCLT, which states:

A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

Article 31 (1) names as primary means of interpretation the plain meaning, the context and the object and purpose of the treaty. There is no hierarchical structure between the means of interpretation mentioned in that article, the interpretation of treaties by applying the methods of interpretation enumerated in Article 31 (1) being intended to be a "single combined operation"401. Yet Article 31 (1) establishes as the basis of interpretation the ordinary meaning rule, which means that the starting point for treaty interpretation is the determination of the meaning of the treaty text[68]. Notably, it is not possible to give an interpretation valid for all existing most-favoured-nation clauses, rather it is necessary to

[68] Yearbook of the International Law Commission 1966, vol. II, p. 220, Herdegen, Interpretation in International Law, Law, in: Wolfrum, Rüdiger (ed.), Max Planck Encyclopedia of Public International Law, para. 11.

interpret each clause separately. Nevertheless, it is possible to make some general statements which are valid for the majority of clauses.

1. The Wording of Most-Favoured-Nation Clauses

Concerning their relationship to dispute settlement provisions, MFN clauses can be divided into three major groups. There is one category of clauses that explicitly excludes dispute settlement from their scope. The 2006 Canada-Peru BIT provides in Annex B.4 that most-favoured-nation treatment shall not encompass dispute resolution mechanisms, providing that:

For greater clarity, treatment 'with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments' referred to in paragraphs 1 and 2 of Article 4 does not encompass dispute resolution mechanisms that are provided for in international treaties or trade agreements.

In addition, the MFN clause is situated in Section B of the Canada-Peru BIT titled "Substantive Obligations" and thus clearly separated from Section C, which deals with dispute settlement. Another example is the interpretative statement on the scope of application of the MFN clause in the final draft text of the Central America Free Trade Agreement (CAFTA-DR), which expressly provides that international dispute resolution procedures shall not be encompassed by the clause. The parties to the CAFTA-DR, referring explicitly to the Maffezini case, included a footnote providing that the MFN clause included in the investment chapter did not encompass international dispute resolution mechanisms.

A similar footnote was included by the negotiators of the draft Free Trade Agreement of the Americas (FTAA)[69].

A second category of clauses explicitly extends its scope to dispute settlement provisions. In that respect, two approaches can be distinguished. According to one approach, the implementation of rights is explicitly enumerated as a field of application

[69] Third Draft FTAA Agreement, November 21, 2003, note 13.

of the clause. This approach has been chosen in the 2001 Austria-Saudi Arabia BIT, which provides in Article 3 (3):

> Each Contracting Party shall accord the investors of the other Contracting Party in connection with the management, operations, maintenance, use, enjoyment or disposal of investments or with the means to assure their rights to such investments like transfers or indemnifications or with any other activity associated with this in its territory, treatment not less favourable than the treatment it accords to its investors or to the investors of a third State, whichever is more favourable[70].

An alternative model is to explicitly make reference to those articles in the BIT to which most-favoured-nation treatment shall apply, thus also referring to the dispute settlement provisions of the BIT. This approach has been chosen in the 1991 UK Model BIT, the MFN clause of which provides:

(1) "Neither Contracting Party shall in its territory subject investments or returns of nationals or companies of the other contracting Party to treatment less favourable than that which it accords to investments or returns of its own nationals or companies or to investments or returns of nationals or companies of any third State.

(2) Neither Contracting Party shall in its territory subject nationals or companies of the other Contracting Party, as regards their management, maintenance, use, enjoyment or disposal of their investments, to treatment less favourable than that which it accords to its own nationals or companies or to nationals or companies of any third State.

(3) For the avoidance of doubt it is confirmed that the treatment provided for in paragraphs (1) and (2) above shall apply to the provisions of Articles 1 to 11 of this Agreement[71].

The peculiarity which distinguishes this model clause from others is its paragraph 3, according to which the MFN clause is applicable to Articles 1 to 11 of the BIT. These Articles include definitions, substantive treatment standards and provisions on State-State and investor-State dispute settlement. The Articles to which the MFN clause cannot be

[70] Emphasis added by the author.
[71] Article 3 of the United Kingdom Model BIT. For further examples see Article 3 of the UK-Albania BIT, Article 3 of the UK-Venezuela BIT, Art. 3 of the Ethiopia-UK BIT and Article 3 of the ArmeniaEgypt BIT.

applied (Articles 12 to 14) are the final treaty provisions concerning the treaty's territorial extension, its entry into force, duration and termination. This formulation clarifies the scope of the clause in a way which leaves no doubt that it shall be applicable to substantive as well as procedural treatment standards as guaranteed in Articles 1 to 11. The enumeration of fields of application in paragraph 2 can therefore not serve as a restriction of the clause's scope.

It has been argued that one can infer from paragraph 3 by an argumentum e contrario that in case such a clause is not inserted in a BIT, the clause cannot be applied to dispute settlement provisions.407 Yet the formulation "for the avoidance of doubt" implies that the United Kingdom did not necessarily believe that it was departing from a general rule but only inserted paragraph 3 to ensure a correct interpretation.

CHAPTER 6

MOST FAVOURED NATION (THE INTERNATIONAL SCENARIO)

This chapter deals with international organizations including the WTO (formerly called the GATT), UNCTAD, These organizations have become increasingly important in the present-day world, where international trade is becoming increasingly important.

(General Agreement on Tariffs and Trade)GATT

The beginnings of GATT now succeeded by the WTO (World Trading Organisation) were with the Bretton Woods Conference of 1948. From the end of the Second World War to 1974, there were over twenty-two years of progressive liberalization of trade. After 1974, the economic climate worsened. There were currency crises, oil crises, debt crises, recession and high unemployment. The crises provided a cause for demands for protectionism. It is reportedly attempts to avoid the pain of unemployment which is the main cause of today's protectionism in the industrial countries.

Since 1st January, 1948, open trade, enabling enterprises to expand to sell their goods and services around the world, operated within the framework of a set of rules. This has been laid down in the articles and codes of the GATT. GATT is a multilateral treaty among the member countries that lays down agreed rules for conducting international trade. It started as a contractual arrangement regulating trade policies, and was first entered into by twenty-three countries in 1947. India was a Contracting member of GATT.[72] The Agreement contains four Parts, comprising of 38 Articles. Apart from laying out basic principles (such as non-discrimination and national treatment) it also addresses some special problems (such as free-trade areas, balance of payments, export subsidies) and procedures for consultation and dispute settlement.

The basic objective of GATT is to liberalise world trade[73]. The most fundamental principle of GATT is nondiscrimination between between the Contracting Parries. GATT contains rules relating to tariffs, quantitative restrictions, trade measures for balance-of-

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payments purposes, export subsidies, anti-dumping and countervaioing duties, customs valuation, state trading, etc. Special provisions have been made for developing countries. GATT also provides a forum for dispute settlement among member countries.[74]

Prior to the seventies, GATT had organised six Rounds of trade negotiations. These were as below : -

1947	**(Geneva)**	**1st Round**
1949	**(Amn) France**	**2nd Round**
1951	**(Torquay, England)**	**3rd Round**
1956	**Geneva ..**	**4th Round**
1960-61	**(Geneva, Dillon Round)**	**5th Round**
1963-67	**(Geneva, Kennedy Round)**	**6th Round**

After the first round at Geneva in 1947, GATT's next several rounds focussed on product-by-product negotiation of tariff bindings by the developed countries. As a result of these negotiations the tariff rates on thousands of items were reduced or bound against increase. An attempt was made to accelerate liberalisation in the Dillon Round (1959-61). There was a more radical across-the-board approach in the Kennedy Round (1963-67) which achieved approximately 35% cut in tariffs.

GATT is founded on the basis of certain obligations. These are as follows :

TRADE WITHOUT DISCRIMINATION Most Favoured Nation (MFN) Treatment

The main provision establishing the rule of nondiscrimination is known as the Most-Favoured Nation(MFN)[75] clause. Under this provision, a country granting an advantage to one Non-GATT party (Most FavouredNation) must grant the same advantage to another member country. This covers all matters connected with imports or exports including

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customs duties, changes and regulations affecting internal sale, purchase, distribution and the use of imported products. Thus to each member country, the best treatment accorded to any trading partner has to be given. The extension of the concession or favour has to be The exceptions to the above facility are those dealing with regional trading arrangements (customs union and free trade area) and the balar.ce-of-payments restrictions (of the developing countries).

A Protection through Tariffs

GATT is designed mainly as a tariff agreement, and contains elaborate provisions with regard to tariff concession. These are in the form of commitments (or bindings) on the ceiling of the levels of tariff to be applied on specific items of products imported from other members.

A Stable Basis of Trade Tariffs Negotiations and Renegotiations :

While the first five rounds followed the process of product-by-product negotiations, the sixth round adopted a linear approach on industrial products. The tariffs were to be cut by fifty per cent, allowing exceptions for good reasons. Reciprocity was central to the framework for reduction of tariffs. During rounds of negotiations for reduction of tariffs, each country is expected to meet equivalent concessions.

Consultation

A basic principle of GATT is that member countries should consult one another in the matter of trade and trade problems. They can call on GATT for settlement in cases where member countries feel aggrieved. The GATT councils set up panels of independent experts to examine the trade disputes between members. Those on the panels are experts from different countries, who have no vesgted interests. The panel is generally interested in making mutual and amicabble settlements between the two parties.

National Treatment on internal taxation and regulation :

GATT prohibits differential application on imported and domestic products of internal taxes and laws, regulations and requirements affecting internal sale. The obligation applies equally

to all products, irrespective of whether it is covered by a tariff concession or not. GATT bans quantitative restrictions on both imports and experts. More than twenty five years of progressive liberalisation of trade, from 1948 to 1976, saw considerable growth in world prosperity. However with the beginning of the crises referred to earlier, countries started resorting tc protectionism. The first victim was trade in textiles, followed by trade in footwear, leather goods, steel, ship building, cars and consumer electronics.

Instead of tariffs, NTBs (Non Tariff Barriers) have been resorted to. These include foreign exchange licensing, special taxes on imports, import licensing and quotas, and health and safety regulations which are a constraint on intra-developing country trade.

United Nations Conference on Trade and Development(UNCTAD)

The second international organisation which is significant from India's point of view UNCTAD is a body of the United Nations. Although most of the developing countries^ were joining the GATT, they were not completely comfortable as they felt that they did not always get a good deal and that the developed countries tended zo ensure that their interests were taken care of. UNCTAD was established in 1964 on the demand of the developing countries to enable them to have a forum to discuss the problems relating to trade matters and to their economic development. Presently also, UNCTAD is the only body where developing, developed as well as centrally planned economies are memoers.

(i) Prevailing upon the developed countries into progressing, reducing and eliminating trade barriers and other restrictions which impede trade with developing countries. In effect, it has been working on getting preferential terms of trade for the products of developing countries while the.- are exported to developed countries.

{ii) Formation of principles and policies in international trade and other related fields covering all aspects of development, including trade, transport, finance and technology.

Member-countries of UNCTAD meet as often as is necessary, but a meeting is a must once in four years. The Trade and Development Board is a permanent organisation of the UNCTAD which exercises administrative controls of the conference. There are four subsidiary organisations :

(1) The Committee on Commodities;

(2) The Committee on Manufacturers;

(3) The Committee on Shipping;

(4) The Committee on Invisibles and Financing.

The activities of UNCTAD cover a wide area which includes trade in commodities, trade in manufactures, invisibles and financing related to trade, transfer of technology, shipping and economic cooperation among developing countries. So far nine conferences have been held. UNCTAD VII was held in Geneva in 1987, while UNCTADVIII wwas held in Cartegena in 1992. UNCTAD IX was held in 1996 in Midrand, South Africa.

UNCTAD has a number of achievements to its credit. In 1974, the Convention on a Code of Conduct for Liner Conferences was adopted. This seeks to promote an equitable balance of interests between shippers and ship-owners in developing countries. Agreement was reached on a Common Fund in June 1980. The Common Fund is the key element of the Integrated Programme and is intended to assist in the financing of buffer stocking, and of the other measures, such as research and development, market promotion, etc., under international commodity arrangements.

(Generalised System of Preferences)GSP

GSP is one of the principal achievements of UNCTAD in the 1964 Geneva Conference. It is a system which allows preferential tariff rates i.e. less or very much reduced tariff rates in' favour of certain products of developing countries to be exported to developed countries. It was agreed that in order to promote the exports of manufactures from developing countries to developed nations, special tariff concessions should be allowed by the developed countries on such items of imports from developing countries. Under the GSP, developing countries have been allowed to compete on preferential basis. As imports of such items from other developed countries are subject to normal rules of duties, exports of developing countries would be more competitive.

For example-Suppose the U.S. imposes import duty on handtools at 15% under GSP then the imports of handtools from India to US will not be subject to the customs duty, while handtools imported from Japan, will be charged customs duty at 15%. Indian handtools will be cheaper than that of Japan, an industrially advanced country. Thus, Indian products can compete easily. The problem areas include agricultural exports, manufactured goods (textiles, leather products and petroleum products), non-durable products. These areas are outside the GSP. Consequently trade in these areas is untouched by the GSP.

UNCTAD's Vllth Session took place in Geneva in 1987. 141 countries attended the meeting. The main emphasis of the Conference was on the revitalisation, development and growth of international trade, through multi-lateral cooperation, assessment of relevant economic trends and global structural change. Appropriate formulation of policies and measures including key issues in the interrelated areas of resources for development including financial and related monetary problems of the least developed countries were also discussed.

The Conference adopted by consensus the "Final Act", which contains a common assessment of the world economic situation and the agreement on policies. These included (i) resources for development (ii) commodities (iii) international trade and (iv) problems of the least developed countries. The Trade and Development Board was expected to follow up issues in the Uruguay Round of particular concern to the developing countries. Liberalization of textile trade and clothing was sought.

UNCTAD VIII was convened at Cartagena, in February 1992. During the conference it was agreed that UNCTAD needed to be revitalised by reforming its machinery and working methods and by strengthening its capabilities in addressing the economic and development problems of all countries, particularly developing countries. Sustainable development was emphasized and UNCTAD decided to participate in the Conference on the Environment at Rio de Janeiro. The target of 0.7% of the GNP of developmental countries as Overseas Development Assistance, was also reaffirmed and the need for concessional finance to support structural adjustment recognised. On international trade, market access for textiles of developing countries was urged even at the cost of structural adjustment in developed countries.

Voluntary Export Restrictions,(VERs)

Since the 1970s, several quantitative restrictions have returned in several new forms. The industrialised countries have violated GATT, when they pay subsidies or set VERs (Voluntary Export Restraints). The Multi-Fibre Agreement, though it is a separate instrument, is administered by the GATT. Yet it is clearly inconsistent with the GATT principles. It would be relevant to spend some time on the Multi-Fibre Agreement here.

The Multi-fibre Arrangement (MFA)

This has been an important Arrangenent6 regarding International Trade in Textiles. The MFA. (Multi-fibre Arrangenent) was a worldwide system of managed trade in textiles and clothing. In 1935, the USA despite high tariffs of 40% to 60% negotiated the first voluntary export quota on Japanese textile exports. In 1961, under GATT the Short Term Cotton Textile Arrangement was negotiated at the behest of USA. This was replaced in October 1962 by the Long Term Arrangement regarding International Trade in Cotton Textiles (LTA), which controlled cotton textile exports for the next ten years. Though a multilateral document, importing countries were allowed to negotiate quotas on a country-bycountry basis. In some cases, they could impose unilateral quotas without penalty.

In 1974, the LTA was replaced by the MFA I, (1974-77). The MFA included synthetic fibres. During the pre-1974 period, the productivity in the textile secror had increased resulting in increasing unemployment in the industrial countries. The Newer Industrialised Countries (NIC's) (the Asian countries) were progressively gaining more market share). The Textile Surveillance Body was established by the GATT to supervise the implementation of the Agreement and to arbitrate disputes arising from it. In the case of MFA I, the USA was willing to make concessions on quantitative restrictions and to accept a fairly liberal MFA.

MFA-II, 1978-81

MFA-II reflected the strong protectionist sentiments of the EC. In particular the UK and France, which experienced a 21% increase in textile imports from 1973 to 1977, supported a more restrictive MFA in 1977. More restrictive quotas were allowed, while bilateral arrangements were worked cut with all its ma;or suppliers, thereby reducing the imports.

MFA-III (1982-86

MFA-III maintained the earlier restrictions and added more constraints. The USA itself negotiated 41 bilateral agreements with its major suppliers.

MFA IV (1986-91)

This was signed in July 1986, and included silk, line, ramie and jute in the arrangement - basically all the natural fibres.

In general over the years, the developing countries have found that the tariffs on industrial products have been falling faster than on products of interest zo developing countries. Several non-tariff barriers have also come up. This is one reason why the developing countries have evinced increasing interest in the rounds of discussions in the eighties. This can be seer, from Table 7.1.

The Tokyo Round (1973-79) negotiations

These multilateral trade negotiations have been a landmark in the history of GATT. 99 countries participated in the negotiations which concluded in 1979. This was the first time that various non-tariff measures such as subsidies and countervailing measures, technical barriers to trade, customs valuation, import licensing procedures and the revision of the 1967 GATT anti-dumping code took place. The salient features were as below :

Tariff Measures

The participating countries agreed to cut tariffs on thousands of industrial and agricultural products. The full implementation of the Tokyo Round cuts were expected to mean that tariffs on manufactures would be around 6.0% in the European Community, 5.4% in Japan and 49% in the United States.

NON-TARIFF MEASURES

Non-tariff measures were the significant features of the Tokyo Round negotiations. Governments here began to negotiate new or improved rules on non-tariff barriers. Under

theTokyo Round in 1979, all the agreements provided for mutual consultation and dispute settlement. The negotiations resulted in the following non-tariff measures.

(i) Subsidies

In the case of subsidies, the signatories committed not to use subsidies against the interest of any other signatory. They were also to ensure that countervailing measures did not unjustifiably impede the international trade. These measures could be applied only if the domestic industry requested the Government that the subsidised imports were causing material injury or threatening such injury.

(ii) Standards Code

The Agreement on Technical Barriers to Trade (the Standards Code) contained a number of provisions which aimed at dealing with the special problems which the developing countries encounter in this area. One of the major problems is the question of dissemination of information. The Agreement provides for notifications to be made through the GATT Secretariat and for each country to establish an enquiry point from which interested readers could get information on standards, technical regulations and certification systems.

Although countries are expected to adopt the technical regulation international standards, the Agreement authorised the Committee on Technical Barriers to Trade to grant, specific, time-limited exceptions in whole or in part from the obligations under the Agreement. Preferential tariffs were introduced by the developed countries in 1971, in the form of Generalised System of Preferences through the mechanism of a waiver from the MFN obligation for most developing countries. This was not a satisfactory solution. These barriers commit signatories to ensure that no Government or body should create unnecessary obstacles to international trade.

Import Licensing

The Agreement on Import Licensing Procedures laid down that the import licensing procedures should be used in a fair and neutral way. The agreement aims at ensuring that the procedures do not in themselves act as restrictions on exports. The signatory Governments are committed to adopting simple licensing procedures and to administer them fairly.

(iv) The Agreement on Government Procurement

Government procurement aimed at securing greater international competition in the bidding for Government procurement contracts. The Agreement contained provisions on special and differential treatment for developing, countries. It is designed so that the parties to the Agreement take into account the development, financial and trade needs of developing countries, in particular the least developed countries. These countries are in need of safeguarding their balance of payments position, promoting the establishment or development of indigenous .industries, supporting industrial units and encouraging their economic development.

The Agreement contained detailed rules regarding the invitation and award of Government contracts. The provisions were designed to reduce regulations, and to make procedures and practices relating to Government procurement more transparent. This is to ensure that the home countries do not protect domestic products or suppliers. This would also ensure that they do not discriminate against foreign suppliers or products. The provision was meant to apply to individual Government contracts worth more than about US $ 1,70,000. It was voluntary and India did not participate in this.

(v) Customs valuation

This sets a fair, uniform and rental system for the valuation of goods for customs purposes. Ii prohibits the signatory Governments from the use of arbitrary or fictitious customs values. The code provides a precise revised set of valuation rules.

THE URUGUAY ROUND

There has been a great amount of discussion and debate regarding the Uruguay Round of multilateral trade Q negotiations and the Dunkel drait.

The Uruguay Round derives its name from the fact that the Negotiations were launched at a special session of the Contracting Parties held in Punta del Esta, Uruguay in September 1986. The negotiations were held at the level of ministers of the respective countries. The

Ministerial Declaration in Punta del Esta in Uruguary, agreed that the negotiations would be completed in 3 years. Instead in reality they took 7 1/2 years. The Marrakesh Declaration was eventually signed on 15th April 1994.

About 110 countries are members of the GATT, accounting for ninety per cent of World Trade. The seemingly democratic structure of GATT conceals the power relations which determine the course of negotiations. A'lot of the bargaining takes place behind the scenes - between the three powerful trading partners - the 'JS, EC and Japan, during the meetings of the Group of Seven (G-7) industrial countries.

In the Uruguay Round, a Trade Negotiations Committee (TNC) was set up to monitor the overall negotiations. The TNC . had two Chairmen, one at the official level and the other at the ministerial level. Due to opposition from developing countries like Brazil and India, a Group for Services was separately established, which also reported to the TNC.

Market access (Tariffs)

The Dunkel Text itself did not stipulate the extent to which individual countries were to reduce tariffs. However as in the past, countries exchanged concessions on tariffs. In the past, India had benefitced greatly from the reduction of tariffs on industrial products, by almost all the major trading countries.

Normal tariff levels for industrial products in many developed /'developing countries are in the region of 5% to 25%. India, in line with the direction of the existing economic policy, offered reduction of tariffs in respect of industrial raw materials, intermediates and capital goods (with a few exceptions) from the then existing levels to a current level not exceeding 40%. Where existing customs duty was less than 40%, the offer was to bind the tariff at 25%.The reduction would be implemented in a graduated manner over a period of six years. These negotiations did not pose a problem, since India already planned to follow the recommendations of the Chelliah Committee of gradually reducing the tariffs. It is therefore part of the economic reform plans proposed by the Indian government. Tariff reduction was to be carried out in 6 annual instalments from Januaryl, 1996, with the exception of textiles where reduction will be oveer 10 years. Tariff reductions by other countries will also help our exports.

TEXTILES

A major achievement of the Round has been that a timetable has been set for phasing out the Multi-Fibre Arrangement (MFA) . Under this quotas v/hich have been imposed by the USA and the E.C. on imports of textiles and garments would be phased out, in 10 years. The Agreement is backloaded in the sense that most of the liberalisation would occur only at the end of the transition period. However, integration of the Textile agrement in GATT itself has been an achievement. There will be very little The agreement envisages complete phasing out of the Multi-Fibre Agreement (MFA) in 10 years. This transition period is divided into three stages of three, four and three years. On 1.1.1995, each Member was expected to integrate products which account for not less than 16% of the total volume of the Members 1990 imports of the products covered by the agreement. The products which are integrated would cover items from each of the following groups: tops and yarns, fabrics, made-up textile products and clothing.

Onl.1.1999 products which accounted for not less than 17% of the total volume of the Members' 1990 imports would be integrated. On 1.1.2002 the extent would be not less than 18% of the volume of the Members' 1990 products. On 1.1.2005, all restrictions under the Agreement would be terminated.

During the process of integration, the growth rates on quotas on non-integrated sectors would be increased by 16%, 25% and 27% in the three stages. These growth rates refer not to growth in the quotas per se, but an acceleration in the existing quota rates.

India has a traditional comparative advantage in the textiles sector. Due to its overall competitiveness in this sector, India stands to gain substantially from the Agreement. However it has generally been felt that the transitional period of ten years is too long. The Agreement is back-loaded and importing countries may not be able to complete the integration at the end. In order to oversee the implementation of the Agreement, a Textiles Monitoring Body (TMB) will be set up and existing restrictions have to be notified to the TMB

AGRICULTURE

This has been a very protected sector both for the developed and developing countries. This is a very important sector for our country. Even in the GATT Round, the deadlock on agriclutural subsidies between the U.S.A. and E.C. was responsible for the failure in reaching the earlier deadline of end-1990.

(i) Market Access

There are specific national commitments for countries to open up their markets to imports through tariff reductions. The stipulation is that protection against imports must be reduced, but for developing countries, the reduction must be 24% over 10 years. This, however would not apply if quantative restrictions have to be maintained for balance of payments reasons. Similarly the stipulation of minimum access of 3 to 5% of domestic consumption is not necessary, if the quota restrictions exist for BOP reasons.

(ii)Subsidies

The Agreement provides for clubbing of product and non-product subsidies, which will allow the flexibility to operate subsidies under the permissible ceiling of 10% of the value of agricultural production. The Agreement utilizes an index known as the "Aggregate Measurement of Support (AMS)". This seeks to provide an overall measure of the subsidies valued as a share of production. While domestic and trade policies include customs duties, quotas, domestic price support, export enhancement and price stabilisation policies, farm subsidies could include inputs like fertilizers, power, credit, irrigation or direct "payments" to them.

The "total AMS" is the sum of all domestic support provided in favour of agricultural producers, calculated as the sum of all product specific and non-product specific aggregate measurements of support. The product-specific and non-product specific domestic support, as measured by the AMS, would have to be reduced, if they exceeded the figure of 5%. For developing countries the percentage is higher than 10%.

In the case of almost all the products, the productspecific subsidies are well below the threshold level of 10%. Certain support policies such as research, pest and disease control

etc. are all exempted from thi-s. The subsidies in India which get covered are fertilizer subsidy, electricity subsidy, water rate subsidy, credit subsidy and seed subsidy. As pointed cut, India is not required to reduce its subsidy.

The Ministry of Commerce's calculation is as follows:9 For the base-period, 1986-89, the total value of agricultural production was Rs 1,13,000 crores;

Ten percent of this was Rs 11,300 crores;

The average annual non-product - specific subsidy was therefore Rs 5,300crores

(iii)Export Subsidies

A number of export subsidy practices have been listed for reduction commitments. Outlays and quantities have to be reduced from 24% to 21%. Developing countries have been exempted from some subsidy cuts. The only major export subsidy that we have for agricultural products is Section 80 HHC of the Income Tax Act. But this subsidy is non attracted by the reduction commitments for export subsidies.

(iv)The Public Distribution System

The agreement on agriculture is not concerned with consumer subsidies. The Text explicitly provides now that there will be no obligation to alter our PDS in any way.

(v)Traditional Tights of Farmers

It has been confirmed in the Text that farmers' rights can be protected through a proper national (suigeneris) legislation. The use of protected seeds for sowing or traditional exchange will be in order.

TRADE RELATED INVESTMENT MEASURES (TRIMs)

This Agreement, after the negotiations, did not impose any obligation relating to controls on foreign direct investment or ceilings on foreign equity holding. Developing countries facing balance of payments, are exempt from the need to remove stipulations which are prohibited under the agreement, like export commitments.

However, no requirements of local content could be applied. India has already in the context of the reform measures dispensed with the "Phased Manufacturing Programme", which imposed local content obligations on foreign enterprises. There was earlier a condition that the indigenous content in the manufacture should gradually increase.

Dispute Settlement

The Uruguay Round Agreement sought to improve the process of resolution of disputes among countries relating to international trade. This process has been improved by making the dispute settlement rules more time-bound, automatic and judicial in nature.

W.T.O is expected to provide a forum for negotiations among member countries relating to multilateral trade relations. It would monitor trade policies of countries and to ensure that they are in line with GATT principles. The W.T.O. would also act as a Dispute Settlement Body.

Services

The previous GATT rounds confined themselves only to liberalization of trade in goods. The industrialised countries however, kept exerting pressure that trade in services should also be liberalised. This pressure is due to their feeling that while they are competitive in areas of services such as banking, insurance etc., they are unable to take advantage of this due to several barriers. Consequently developing countries like India and Brazil had to agree with great reluctance to the inclusion of trade in services in the Uruguay Round. This was done during the course of a different set of negotiations from that for goods.

The draft agreement on trade in services deals with two basic principles sought to be applied to all the services. These are the Most Favoured Nation principle and transparency. The MFN principle implies that each country will give equal treatment to other countries which are signatories to the agreement. Transparency requires every country to promptly publish all relevant lav/s, regulations, administrative guidelines ar.d other decisions, rulings or measures of general application pertaining to the area of services.

In respect of market access, countries are free to negotiate the specific services which they wish to seek or to provide market access. There is no general obligation to liberalise every service sector.

There have been apprehensions that India would be forced to open up banking, insurance and basic telecommunication services. There are also security implications in the basic telecom sector. The provisions for mobility of personnel to other countries is not adequate. The progressive liberalisation of services envisaged in the Uruguay Round does conflict with national policy. Negotiations have been held on financial services and telecommunications. The concerned Ministries are in the process of issuing guidelines for the various areas.

Since India has an advantage in skilled labour services, there is considerable potential in this area, specially in fields like software, construction, consultancy and medical services. This could however be achieved only through negotiations.

GATT RULES

The Agreement on Anti-Dumping provides that at least 50% of the domestic industry should be consulted and that 25% of domestic industry must support it before the AntiDumping investigation can be initiated. If the margin on dumping is less than 2% no investigation can be taken up. IE dumped imports from a particular country are less than 3% of the total imports and if the total share of countries with imports of under 3% is below 7% then also no anti-dumping investigation can be taken up.

The concerns in respect of India were :

(1) whether this would affect the farmer's right to retain a part of his crop for use as seed in subsequent crops. It has been assured that there would be no problem in respect of this.

(2) whether the drug prices in India would shoot up because of product patents in the pharmaceutical sector. The viewpoint of some is, that the prices of drugs could shoot up. The alternative view is that only new drugs will be covered by patents in the future. By the time a new drug goes through all the clinical trials and is successful, it would mean the passage of

another 5-6 years. Consequently at any point of time the ratio of drugs covered by patents would not be small.

The positive point is that a strong intellectual property protection system enhances the prospects of agreements between Indian and foreign firms, particularly in - technology intensive sectors.

REGIONAL TRADING BLOCS AND OPPORTUNITIES FOR INDIA

There have been rapid changes in the international economic environment in the late 80's and the early 90's.At the corporate level, there is an increasing bid for globalisation, but at the level of countries, regionalism is continuously on the increase. This was the evolution of new regional blocs and the strengthening of the existing regional blocs. These were based on the success story of the European Community (established in 1957) and its movement towards the emergence of a single economic market by the end of 1992. On the other hand, the conclusion of the Uruguay Round of talks togk a very long time i.e. from 1986 to 1994. The major regional blocs, which are significant and have emerged in the course of the last few years are the European Commission (EC), North American Free Trade Area(NAFTA), Association of South East Asian Nations(ASEAN), Gulf Cooperation Council (GCC) and South Asian Association for Regional Cooperation (SAARC)

The first impact of the trading blocs is to set up local regional barriers to the movement of trade. This is because each bloc establishes its own system of preferences. The growth of these blocs also provides a challenge. There is a view that trade within the blocs, is often an additionality, and does not necessarily affect trade to other countries. However, India will have to make an effort to enter these markets in order to derive benefit.

SINGAPORE MINISTERIAL CONFERENCE

The First Minsterial Conference of the World Trade Organisation was held at Singapore from 9-13 December 1996. This Conference was held in compliance with Article IV of the Marrakesh Agreement establishing the W.T.O. This stipulates that the Ministerial Conference would meet at least once in every two years. There are presently 128 members of

the W.T.O. in addition to 34 Governments and 49 international organisations having observer status.

Apart from the implementation of the existing agreements, it was expected to discuss further liberalisation and the new future work programme. In the area of implementation, a major concern related to the proper implementation of the Agreement on Textiles and Clothing (ATC). The Ministerial Declaration also mentioned its commitment to the implementation of the ATC and to respect the time-frames established in the various WTO Agreements.

An area of liberalisation proposed was on Information Technology Agreement. India maintained that subject to the interests of domestic producers being adequately safeguarded, India could consider joining the programme of phased tariff reductions. At the same time, India urged that the rules for the movement of skilled persons working in the sector should also be liberalised. Cue to paucity of time to negotiate, India did not join the Agreement which was initialled by 13 countries at Singapore.

Major Focus

However, the major focus of the discussions at Singapore related to the future work program.me of the W.T.O. which included new issues. These new issues included

1. Investment

2. Competition Policy

3. Core Labour Standards

4. Transparency in Government procurement

5. Trade facilitation.

Investment

This was a significant issue. Around early 1995, the Organisation of Economic Development (OECD), which represents 20 developed countries agreed to hold negotiations for drawing up a Multilateral Agreement on investments. Some of these countries contemplated that this

issue could be taken up in the WTO, instead of in the OECD.Thrs work has been taken up since. At Singapore however, Japan and Canada and a few other developed countries followed up their proposal of starting an educative process to look at all issues connected with investment, considering a trade and investment linkage.

India has resisted any attempt to establish such a linkage between trade and investment. It has maintained that no single investment framework can meet the specific requirements of countries, which are at different stages of development. Further it is for each individual country to decide as tc what should be its policy regime for attracting foreign direct investment.

As a result of India's stand, the Conference only mentioned that five years after the coming into force of the WTO Agreement, i.e. in 2000, there would be consideration of whether the Agreement needed to be complemented with the provisions on the investment policy and the competition policy. The SMC agreed to establish a. Working Group to examine the relationship between trade and investment. It also agreed to establish a Working Group to study issues relating to the interaction between trade and competition policy, including anti-competitive practices, in order to identify any areas that may merit further consideration in the WTO framework. These groups would draw upon each other's workif necessaryand also draw upon and be without prejudice to the work in UNCTAD and other appropriate intergovernmental fora. It was also decided that future negotiations, if any, regarding multilateral disciplines in these areas will take place only after explicit consensus decision is taken among WTO members regarding such negotiations.

Core Labour Standards

This was an important and sensitive issue. While renewing the commitment to /core Labour Standards, the SMC observed that International Labour Organisation is the competent body to deal with these standards.The SMC affirmed the WTO support for the ILO,but rejected the use of labour standars for protectionist purposes. It was ageed that the comparative advantage of countries, particularly low-wage developing countries, must ir. no way be put into question.

Transparency in Government Procurement

The SMC agreed to establish a Working Group tc conduxct a study on transparency in Government practices. These would also take into account national policies, and elements for inclusion in an appropriate agreement.

Trade Facilitation

The SMC directed the Council for Trade in Goods to undertake exploratory and analytical work.

India's stand at the SMC generated a lot of debate in Parliament, which happened to be in session when the Conference took place. There was an uproar from the Opposition parties, that India had not put up adequate resistance on investment and labour standards to the 1 P pressure of the developed countries. The Commerce Minister had mentioned that, " It was at India's specific insistence that strict conditionalities were included bringing the entire examination under the existing WTO provisions and clearly stipulating that no negotiations could automatically be initiated in these areas without the explicit consensus of WTO Members.

In respect of the Patents Act, the draft Bill for the amending the Act lapsed with the life of the last Lok Sabha drawing to a close. Earlier, the Act had been amended by an Ordinance, but the Ordinance providing for Exclusive Marketing Rights, and Mail-Box facility could not be replaced. Presently Government has been continuing a process of discussions between all the parties. As the compliance of the pipeline protection requirement could not be fulfilled, the U.S.A. has sought to move the W.T.O through the Dispute Settlement Mechanism, regarding the non-fulfilment of the obligation. A panel has been constituted to go into the case.

In conclusion, the international environment is fast changing. It is becoming increasingly difficult for a country to avoid the impact of events occurring in the world. The only way open, is to be aware of the reality of the situation, and to equip the country to cope with international pressures.

CONCLUSIONS AND SUGGESTIONS

The dispute settlement system of the WTO is considered as a central element in providing security and predictability to the multilateral trading system. The Members recognize that it serves to preserve the rights and obligations of Members under the covered agreements, and to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law. Recommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements. The recommendations or rulings made by the WTO DSB shall be aimed at achieving a satisfactory settlement of the matter in accordance with the rights and obligations under this Understanding and under the covered agreements.

In my view, it's fruitful that before bringing a case, a Member shall exercise its judgement as to whether action under these procedures would be productive. The aim of the dispute settlement mechanism is to secure a positive solution to a dispute. A solution mutually acceptable to the parties to a dispute and consistent with the covered agreements which is clearly to be preferred." In the absence of a mutually agreed solution, the first objective of the dispute settlement mechanism is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements.

The WTO dispute settlement system is one of the most comprehensive in international dispute resolution; in fact the resort to political reality today indicates that there is still need to reinforce the enforcement mechanism and remedy of the weak points in this system. Therefore, it necessitates providing more collective implementation machineries.

Dispute Settlement Body (DSB) is the General Council, the supreme decision-making body of the WTO in the absence of the Ministerial Conference, which convenes to discharge the responsibilities provided for in the Dispute Settlement Understanding (DSU). The (DSB) developed working practices on order to handle practical matters such as submissions of notifications and circulation of dispute settlement documents at times when legal deadlines might fall on a WTO nonworking day. However, it is important to note that the DSB's main

role is to provide a framework to enable WTO members to express their views and to provide their comments on the legal interpretation reasoning of panel and the Appellate Body.

The Dispute Settlement Body (DSB) is composed of all the WTO Members. It provides a strong institutional mechanism for the parties to the dispute to resolve their trade differences.

The DSB is responsible for the application of the DSU; in other words, it oversees the entire dispute settlement procedure. It has the authority to set up panels, adopt panel and Appellate Body Reports, monitor the application of recommendations and authorize retaliatory measures when a Member fails to comply with rulings.

The DSB provides a strong institutional mechanism for the parties to the dispute to resolve their trade differences. The role of the DSB is vital at various stages of the process. In area such as implementation, there is need for that role of DSB could even be strengthened.

The WTO Dispute Settlement System aims to provide sufficient methods to settle the disputes brought before it. Hence, the system aims to secure a positive solution to disputes. A solution mutually acceptable to the parties to dispute and consistent with the covered agreement is clearly to be preferred. So, the preferred objective of the DSU is for the Members concerned to settle the dispute between them in a manner that is consistent with the WTO agreements.

The consultation stage is considered as compulsory requirement and important stage to settle trade disputes. The great importance of consultation stage for settlement of dispute because it enables the dispute parties to understand better the factual situation and legal claims in respect of the dispute; such understanding may allow them to resolve the matter without future proceeding.

Consultations help in increasing mutual information of the problem and understanding of the significance of challenging claims. It permits members to clarify the fact of dispute, to dispel confUsions and misapprehension to arrive at mutually satisfactory solution. The consultation can serve as an informal pre-trial tool to discovery mechanism.

Moreover, the alternative means to settle disputes as stated by Art.5 of the DSU as: good office, conciliation and mediation, so the DSU emphasizes on offer all efforts before resorting to further action under this Understanding, Members should attempt to obtain satisfactory adjustment of the matter voluntarily, if the parties of dispute agree to undertake it. These methods are taken as non-official methods to settle dispute among WTO's Members. The flexibility of these procedures through they are requested at any time by any party to a dispute also terminated at any time as stated by Art.5:3 of the DSU.

Many proposals have been made on consultations, ranging from rather programmatic calls for strengthening the consultative process to suggestions for specific modifications. The different proposals fi-om different Members are provided in the suggestions sections.

In general it is advantageous when the panel proceedings are to be codified and making provisions permanent which would increase and enhance the efficiency of panel. The panel is considered as one of the most important stages for considerations of cases before it; that is clear through DSU Articles. It started fi-om Article 6 establishment of panel up to Article 16 adoption of panel reports with various sections under each Article. Thus, it is the major stage of dispute settlement process. The panel processes considered under the WTO's DSU has unique features such as limited timeframe in order to perform its functions, formulation of panel and other procedures up to issuance of their reports.

The Panel stage is called upon to make an objective assessment of the matter before it^, including an objective assessment of the facts of the case. WTO panels enjoy a broad margin of freedom of choice in the collection and appreciation of the evidence.

The impartiality of panels and their independence has been in the schedule of DSU reform. The improving of the independence of panelist is to create a class of law assistants who should assist in the judicial panels that are not regular to WTO officialdom.

The Appellate Body was the major change in the new system called WTO 1995 comparative with old system GATT1947; it was estabhshed in 1995 under Article 17 of the Understanding on Rules and Procedures Governing the Settlement of Disputes .

The most important accomplishment introduced by the Uruguay Round negotiators is to ensure that the WTO dispute settlement process receives wide acceptance of appellate review.

The Appellate Body Process is the most visible institutional innovation in the WTO dispute settlement system. No such institution existed in the GATT system and does not exist in any other international legal context. The importance of Appellate Body Process aims to protect the interest of WTO Members by ensuring that the automatic dispute settlement system doesn't produce unsound decisions that could upset the balance of rights and obligations under the WTO agreements.

• Implementation of Rules and Recommendations

The credibility of the dispute settlement machinery of the WTO depends to a large extent on the prompt implementation of the rules and recommendations of the Dispute Settlement Body. The WTO's dispute settlement understanding (DSU) arguably is the most significant achievement of the Uruguay Round; its provisions concerning adoption and implementation of reports arguably are the most significant parts of the DSU.

The GATT 1947, when they seek adoption and implementation of report, a consensus in favour of a report was required for its adoption. Dissatisfied party could block consensus and prevent adoption of report. But in the DSU, reports are adopted unless there is other means that "negative consensus" not to do so.

For the effective implementations, the dispute settlement system, the Dispute Settlement Body keeps implementation process under their surveillance, furthermore, the DSU emphasis on the implementation processes shall be on "prompt compliance" to make sure effective and actual implementations that will benefit all WTO's Members.

The developing countries have difficulty realizing the benefit of the WTO dispute settlement system. They therefore rarely invoked such provisions in the DSU and the judicial organs have been hesitant to apply them. The elementary objective should therefore be put to developing countries in the position to effectively protect their rights. DSU is a system in which essentially same procedures apply to all parties. So, the Special and Differential

Treatment in the field of WTO dispute settlement should for these reasons take mainly treatment in the field of entrance of legal expertise in order to enhance their presence and active participations in WTO dispute settlement system.

Suggestions

The Dispute Settlement Understanding that entered into force in 1995 has undergone several review efforts since 1998. The most important effort so far has been undertaken under the Doha mandate in 2002 and 2003. Suggestions on virtually all provisions of the DSU have been received, including suggestions on each stage of the process and on most horizontal issues. So far, all attempts to review and reform the system have failed as members were unable to reach consensus on a package of modifications

The question of reform of the WTO dispute settlement system is very important to the WTO Members. The issue of strengthening the implementation and enforcement of Dispute Settlement Body recommendations and rulings directly affect the level of enforcement pressures which would be applied to governments in violation of WTO obligations.

There are different streams of thought on the methods and nature of the DSU reforms relating to implementation and enforcement of DSB rulings and recommendations. Some view desire to preserve and strengthen the existing system, through development and expansion of the current system. And others view their opinions in proposing change of the whole system and starting an alternative system of implementation and enforcement

Suggestion for Reforming Consultations

There is a proposal on reforms in the DSU which includes a proposal by a number of countries to reduce the number of days from 60 to 30. The recommendation adds 30 days to post-panel procedures, perceived to be a more complex stage requiring more time to be dedicated by parties, without having to increase the total number of days for the dispute settlement process.

The argument posited is that it is possible to reduce the number of days for consultations without affecting the intent of this phase for parties to reach a mutually agreed solution since

they are free to extend their consultations beyond the 60 day period, provided it is mutually agreed.

So strengthening of the consultations stage is expected to be more effective, through support participation of third parties in consultation stage through clarify of the Article 4.11 on who are the third parties, and eliminating the option to deny third parties by invoking consultations procedures under Article XXIII thus making the acceptance of third parties automatic, besides to resolve of third parties to be strictly based on substantial trade interest, and in specifying a general criteria for valuation of whether a such claim of interest is well-founded.

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