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Critical Analysis of World Trade Organisation's Most-Favored Nation (MFN) Treatment: Prospects, Challenges and Emerging Trends in the 21st Century

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1.0 Introduction

The paper focuses on the Most Favored Nation (MFN) Treatment within the context of regional integration and sustainable development in the 21st century. Its effect has evolved, since the Marrakesh Declaration when there was minimal active participation of developing states, to its adoption that has seen its benefits to a wider number of contracting under World Trade Agreements. However, there are emerging trends and case specific, regional scenarios that now renders it a not fit-for all purpose per se. Further, the premise of MFN and the participation of developing economies now depict major challenges, which may not have been either anticipated or considered in the very onset.

This paper critically analyses certain disparities and skewed aspects, some of which have pushed both developed and developing economies to react accordingly, to cushion themselves from the misgivings of MFN yet with ripple effects. This builds a case for reflection on salient gaps that the World Trade Agreements, the decision making and adjudicative organs need to timely address. Nevertheless, the paper highlights the rationale behind MFN treatment, while at the same time it pre-emptly controversial debates in the near future, on the bilateral Investment treaty provisions (in retrospect). This will not only restate the vision of multilateral trade, but also to achieve equitable and special interventions with respect to trade in goods, services and trade related intellectual property rights in the affected states.

The paper recommends the necessity for protection sovereignty of states, upholding of the wider fundamental freedoms and inalienable rights from

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violations by developed economies, consensus on rules of interpretation of BITs clauses, qualification of 'equal treatment' in the sui generis cases. This will inter alia ensure non-discrimination *in fact* and foster local economies to grow and alleviate the emerging notion of marginalization of World Trade operation and its conflict with sub regional economic integration.

2.0 What is the Most Favored Nation (MFN) Treatment?

The Most Favored Nation (MFN) treatment is defined as the situation in which a state promises, usually by treaty, to trade with a particular partner on the most favorable tariff terms available to other parties to bilateral treaty with respect to like goods or services¹. There might for example, be a policy in place of taxing the MFN nations imports at preferential rate². Where a bilateral treaty (BIT) is signed, a MFN clause is provided, setting our terms that prohibit the host state from treating an investor from the other signatory state less favorably than any other foreign investor or a domestic investor, especially eliminating discrimination between them³. As a consequence MFN has an effect of enabling an (foreign) investor take advantage of more favorable provision found in a BIT between the host state and other favour states⁴.

The operation of the MFN seeks to address through MFN clauses mischiefs of discrimination between states as well as against other countries, in the relevant markets involving dealings in goods, services and Intellectual property creations⁵.

¹ Henry Campbell Black, 'Black's Law Dictionary'.

² Ibid.

³ Turgut Aycan Özcan, 'Assessment of Most Favored Nation Clauses in Terms of Ejusdem Generis Principle and Its Impact over Some Bilateral Investment Treaties Executed by the Republic of Turkey in 1990s' (*Lexist*, 12 September 2018).

⁴ United Nations, 'Marrakesh Agreement Establishing the World Trade Organization [Hereinafter Marrakesh Agreement]'.

⁵ Patrick Anam, 'Most Favoured Nation Principle (MFN): Challenges and Opportunities' (23 July 2019).

It has been widely cited that MFN clauses are significant instrument of economic liberalization⁶. It removes entry barriers and distortions by guaranteeing foreign investors favorable treatments enjoyed by other domestic or foreign most favored customers or investors, owing from their economic or strategic influential negotiations with the countries where their investments take place⁷.

3.0 WTO Agreements on MFN Treatment

The MFN status came forth between states since 11th century, and developed as a modern concept around 18th century, as a bilateral arrangement, where one country would grant another the status of “most favored nation.” For instance, under the popular Jay Treaty of 1794, the United States accorded to Britain “most favored nation” trading status⁸.

In the aftermath of the Second World War resulted to establishment of the General Agreement on Tariffs and Trade (GATT)⁹. The GATT came into force into force in 1948 and has various rules covering different areas of international trade and these rules are supposed to be adhered to by the contracting states. The Marrakesh Agreement, World Trade Organization (WTO) Agreement, General Agreement on Tariffs and Trade (GATT),

⁶ Turgut Aycan Özcan (n 3).

⁷ Kimberly Amadeo, ‘Most Favored Nation Status: Pros and Cons’ (*The Balance*, 20 April 2022).

⁸ Jean Edward Smith and John Marshall, ‘Definer of a Nation’ (1998) 177 n The Treaty of Amity, Commerce, and Navigation, Between His Britannic Majesty and the United States of America, commonly known as the Jay Treaty. It was a treaty between the United States and Great Britain that averted war, resolved issues remaining since the Treaty of Paris of 1783 (which ended the American Revolutionary War), and facilitated ten years of peaceful trade between the United States and Britain in the midst of the French Revolutionary Wars, which began in 1792.

⁹ GATT 1994: General Agreement on Tariffs and Trade 1994, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1867 U.N.T.S. 187, 33 I.L.M. 1153 (1994).

General Agreement on Trade in Services (GATS)¹⁰ and Agreement on Trade Related Intellectual Property Rights (TRIPs Agreement)¹¹ are three main instruments that govern MFN operation with respect to goods, services and intellectual property items.

3.1 Marrakesh Agreement and World Trade Organization (WTO)

The origin of MFN Treatment and the National treatment are traced from the Marrakesh Declaration¹². Trade agreements and tariffs were negotiated under provisions of the General Agreement on Tariffs and Trade (GATT), which later established the World Trade Organization (WTO) in 1995 pursuant to the Marrakesh Agreement¹³.

The preamble of the WTO Agreement highlights ‘elimination of discriminatory treatment in international trade relations’ as one of main ways through which objectives of WTO may be attained. The organization aims inter alia to regulate international trade and boost relations between countries, through principles of most favored nation, national treatment¹⁴.

The MFN widely covers and prescribes nondiscrimination in international trade¹⁵, which among other principles hold the World Trade Organization together and fosters international relations¹⁶. Under MFN, there is a negative obligations under WTO Agreements on foreign states under and host countries not to discriminate against their trading partners. A special

¹⁰ GATS: General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, 1869 U.N.T.S. 183, 33 I.L.M. 1167 (1994).

¹¹ Agreement on Trade Related Intellectual Property Rights, including Trade in Counterfeit Goods, 1994.

¹² United Nations (n 4).

¹³ Turgut Aycan Özcan (n 3).

¹⁴ ‘Most-Favored-Nation Clause’

<https://corporatefinanceinstitute.com/resources/knowledge/economics/most-favored-nation-clause/> accessed 27 May 2022.

¹⁵ United Nations, ‘Most-Favored Nation Treatment : UNCTAD Series on Issues in International Investment Agreements II’ (United Nations 2010).

¹⁶ Patrick Anam (n 5).

favour enjoyed by the most favored nation goes to the rest of WTO Agreement members (unilaterally) subject to exemptions¹⁷.

3.2 General Agreement on Tariffs and Trade (GATT)

Most Favored Nation Treatment (MFN) is one of these rules and is covered under GATT 1994 Article 1¹⁸. GATT provides for unconditional, immediate equal treatment with respect to any advantage, favour, privilege or immunity granted by any contracting party to like products traded amongst the contracting parties. MFN is in covered under article 1 of GATT governing trade of goods, where paragraph 1 provides that¹⁹:-

[w]ith respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.

3.3 General Agreement on Trade in Services (GATs)

The GATS governing instrument on trade in services (as defined under article 1), protects the MFN in order of priority as one of the key obligations and disciplines principles, under Part II'. Further, article II of GATs provides that:

1. 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

¹⁷ 'Most-Favored-Nation Clause' (n 14).

¹⁸ Patrick Anam (n 5).

¹⁹ United Nations (n 15).

less favorable than that it accords to like services and service suppliers of any other country.

2. A Member may maintain a measure inconsistent with paragraph 1 provided that such a measure is listed in, and meets the conditions of, the Annex on Article II Exemptions.
3. The provisions of this Agreement shall not be so construed as to prevent any Member from conferring or according advantages to adjacent countries in order to facilitate exchanges limited to contiguous frontier zones of services that are both locally produced and consumed.

The GATs recognizes exceptions to the MFN principle under paragraph 2 of the article II above. It further construed that MFN applies to like services and like supplies which are accorded immediate, unconditional and equal treatment.

3.4 The Agreement on Trade Related Intellectual Property Rights (TRIPs)

The Agreement on Trade-Related Intellectual Property Rights (TRIPS)²⁰ is an agreement of international law between all WTO contracting states. It sets enforcement, dispute resolution mechanisms and minimum standards that regulate specific forms of intellectual property for the states. The principles of MFN on intellectual property items is governed by TRIPs under article IV, which provides that

[w]ith regard to the protection of intellectual property, any advantage, favour, privilege or immunity granted by a Member to the nationals of any other country shall be accorded immediately and unconditionally to the nationals of all other Members. Exempted from this obligation are any advantage, favour, privilege or immunity accorded by a Member:

²⁰ Agreement on Trade Related Intellectual Property Rights, including Trade in Counterfeit Goods, 1994.

- (a) deriving from international agreements on judicial assistance or law enforcement of a general nature and not particularly confined to the protection of intellectual property;
- (b) granted in accordance with the provisions of the Berne Convention (1971) or the Rome Convention authorizing that the treatment accorded be a function not of national treatment but of the treatment accorded in another country;
- (c) in respect of the rights of performers, producers of phonograms and broadcasting organizations not provided under this Agreement;
- (d) deriving from international agreements related to the protection of intellectual property which entered into force prior to the entry into force of the WTO Agreement, provided that such agreements are notified to the Council for TRIPS and do not constitute an arbitrary or unjustifiable discrimination against nationals of other Members

The provision secures MFN principles but expressly cites exemptions with respect to IPR items covered in conventions and international agreements that came into force, pre-WTO Agreement, and which are not discriminatory, arbitrary or unjustifiable against the national members²¹

4.0 Prospects of Most Favored Nation Treatment

The Most Favored Nation Treatment and status is distinguished from the NT, as the latter only applies one a product, service or item of IP that has already the market *ex port*. Accordingly, any imposed duties and import taxes are not in violation of National Treatment Status even where the domestic

²¹ Rudolf Adlung and Antonia Carzaniga, 'MFN Exemptions Under the General Agreement on Trade in Services: Grandfathers Striving for Immortality?' [2009] *Journal of International Economic Law*.

markets are exempted from such exactions²². Further, while the national treatment (NT) principle prohibits discrimination *against* other states, the MFN status prohibits discrimination *between* other contracting states with respect to *like products*²³. In addition, under MFN status, any advantage, favour, privilege or immunity granted by any contracting party to any product, service or IP work or item originating in or destined for any other country shall be accorded immediately and unconditionally²⁴.

In other words, the discrimination in national treatment relates to advantage given to domestic products against products from other countries, while in MFN treatment, the discrimination relates to advantage given to products originating in or destined for any other country against that of other countries. Therefore, as a general rule, a state lowers a trade barrier or opens up a market pursuant to a BIT, it has to do so for 'like products' unconditionally and with immediate effect with respect to goods, services and IP items, for all other WTO agreement contracting trading partners)²⁵.

5.0 Critical Analysis of Prospects and Challenges of the MFN Status

The MFN has come under scrutiny with respect to anti-trust laws regime; it is a type of vertical arrangement that would locally constitute a restrictive trade practice between suppliers and buyers. The Chicago school has seen potential noncompetition risks, especially where they are adopted under BIT or unilaterally by way of policy²⁶.

Further, questions have been raised on the efficiency rationale of MFN principle and whether it has shortcomings. This is in light of the emerging or subsisting peculiarities and circumstances of states. Does the principle favor all party states to WTO Agreement?

²² Patrick Anam (n 5).

²³ Ibid.

²⁴ United Nations (n 15).

²⁵ Turgut Aycan Özcan (n 3).

²⁶ Baker, Jonathan B. and Chevalier, Judith A, 'The Competitive Consequences of Most-Favored-Nation Provisions' (2013) 27 *Antitrust Magazine* <<https://ssrn.com/abstract=2251165>>.

5.1 Imperatives of MFN Treatment and Clauses

It has been justified as efficiency rationale; that mitigates holding up problems and counteracts incentives to delays in contracting, and reduce negotiation and transaction costs. Further, MFN Status operates as a substitute of specific of terms of engagement that would be required between trading partners for specific transactions of services, goods or IP items. This cures issues of delays, transaction and negotiation costs, as it guarantees contracting parties opportunity to enjoy the best price, based on most favored customer arrangements²⁷.

Those countries, acceding to the WTO Agreement enjoy and exercise monopolies of economic development, free trade, fairness, predictability and nondiscrimination based on principles of MFN and NT. The above have an overall effect of expansion of international markets, reduce export costs, enhance competitiveness. Advantage of equal treatment that is guaranteed to all WTO members and based on common grounds reached by the incumbent (MFC) hence guarantees permanent normal trade relations.

MFN principles cuts down red tape, differential tariffs and eliminates the need for customs authorities to calculated specific duties for each transaction among and between states, as they are “universal”. There is certainty and predictability and level play field, subject to exemptions.

Finally, MFN eliminates undesired trade protectionism and resultant complacency in domestic industries and fosters innovation. It hence boosts the market expansion and growing of smaller economies. Benefits of economies of large scale in turn lead to increase in export trade and economic growth and international relations²⁸.

²⁷ Ibid.

²⁸ Ibid.

5.2 Challenges facing the MFN Treatment

It is envisaged that MFN lowers costs on one side, while increases it on the other: as discussed in this paper, there is cost implication in monitoring, enforcement and litigating over matters linked to interpretation, exemptions and test of like products as well as claims of violation with respect to MFN clauses²⁹. The contracting states benefit from the efforts borne by most favored nations that contracted the BITs for like goods, services and IPRS, hence incur no costs in negotiating the same, without a general mechanisms or compensation or actual reciprocity other than unilateral agreement based on international relations and comity of states that is based on the WTO obligations³⁰.

Further, other nations have no incentives to push further beyond the exiting terms enjoyed with MFNS. While the contracting states including developing countries economically benefit from MFNS terms, they may have almost no opportunity to monitor and enforce compliance to MFN or its clauses hence makes no competitive sense³¹.

Economic viewpoints cites that classes of competitive collusive nature of MFNS; as it results to facilitatory coordination may raise sellers costs and enable players raise questions against rival undertakings on undertakings that make adjustments to fit in a competitive market. It has also potential exclusionary attribute where, rival and entrant investors may exit or face entry barriers, where foreign exports enjoy subsidies and sell at lower prices that host countries .

MFN clauses may enforce prohibitive effect on prices with respect to BIT that other states enjoy or operate under. Accordingly, where the prices and taxes are higher, it may lead undertakings in a relevant market to compete less as MFN clauses assist the incumbents to foreclose entry or expansion.

²⁹ Ibid.

³⁰ Patrick Anam (n 5).

³¹ Baker, Jonathan B. and Chevalier, Judith A (n 26).

There will therefore be claims over abuse of dominance or non-competitiveness of trade between states³².

Since all members are accustomed to same status and treatment for like goods, services, IP items, others may fall victim of unfair or restrictive practices. The new entrants and rival have no option but to adopt the terms already negotiated by incumbent. This may not reflect or be subject to deferential and unique circumstance of developing countries. Where such aspects are not addressed, through exemptions and drastic measures, the BITS may enforce and reinforce terms that result to disproportionate effect of high tariffs, entry barrier, lack of opportunity to negotiate or enforce MFN clauses or monitor compliance³³.

6.0 Salient Aspects of MFN and Emerging Trends

The discourses on MFN remain controversial one today, and has been a subject of claims and litigation in the global scape including in Africa³⁴. The disputes have inter alia involved the test for 'like products', the interpretation of the MFN clauses or their violations. What happens when aspects of international law and jus cogens are violated by a state that enjoys MFN Status? Or in the absence of an express agreement but unilateral declarations to be acceded by contracting states? Do they have a say to renegotiate the terms³⁵? Critical analysis African regional integration depicts challenges and opportunities³⁶, viz:-

6. 1 Question of the Test of 'like' products

The nature of MFN clauses is that they are unconditional, and general and extends privileges enjoyed by MFNs to other contracting state parties to WTO Agreement. In so doing, the status allows equal treatment in respect of import/export of "like products" such as uniform taxation regimes in imports, exports and international transfer of payments, without

³² Ibid.

³³ Ibid.

³⁴ Turgut Aycan Özcan (n 3).

³⁵ Baker, Jonathan B. and Chevalier, Judith A (n 26).

³⁶ Patrick Anam (n 5).

discrimination and or giving one party on advantage over the other with respect to 'like products' i.e. products with similar characteristics in *Japan -Taxes An Alcoholic Beverages*, vodka was considered to be like good to *Schochu*, on basis of unsophisticated market test and considered, taste, appearance and use. It was held that Japanese *Schochu* and U.S made whisky cognac and white spirits were like products³⁷. The exporters of spirits to japan complained that japan offered low tax to *Schochu* than whisky cognac and white spirits. The panel found japan in violation of article 3 (supra) of GATT by its inconsistent tax system, hereby considering both exported products from US and Japan *Schochu* as 'like products'³⁸

6.2 General Systems of Preference and exemptions

There are exemptions under GATT, GATs and TRIPs, where counties that under a treaty on a free trade area or customs may be allowed to apply differential (higher) tariffs at differential to that imposed on nonmembers, and contrary to MFN principles. Further, the developed countries may be unilateral agreements extend zero duty, quota free exports to develop preference.

There is more leeway exploited in the exemptions to most favored nation (MFN) obligation with respect to services under article II of GATS than in trade of goods under GATT. States had one-off opportunity upon entry to force of GATs in 1995 or WTO accession, to retain the departures from MFN treatment within 10 years. The MFN exemptions were subject to relatively soft disciplines only. Further, the departures from MFN treatment, were not subject to time constraints, including for Economic Integration Agreements and recognition measures related to standards, certificates and the like.

The question is how the patterns of current exemptions, to different groups affect the services negotiations. Scholars admit that non-availability of new exemptions, including for measures that had escaped members' attention

³⁷ Ibid.

³⁸ Ibid.

(especially developing countries) accession time to the agreements, could have raised propensity to and popularity of potential substitutes (including Regional Trade Agreement and Economic Integration Agreements). This may have also promoted an excessively broad interpretation of existing exemptions and discouraged governments from rescinding those that had served their initial purpose better. A more flexible approach might thus be warranted³⁹.

6.3 Plight of local industries

Where host countries grants to all WTO members states same treatment, it may be unable to protect local industries from cheaper goods imported from foreign countries. At the same time, undertakings that may not adjust to the exclusionary effect of margin squeeze and due to abuse of dominant position may choose to exist market for failure to compete.

Where a host state encourages subsidies policies in the domestic market, this may result to cheap exports and resultant distortion to foreign markets and unfair practice. Accordingly, exemptions are only allowable under strict conditions such that where MFN is not qualified, the host county fails to put in place subsidies to counter imbalance, and there may be a result into economic breakdown⁴⁰. In *US- Grass Guzzler case*; which concerns environmentally, friendly laws, panel determined that statutes that do not aim at protectionism are GATT compatible⁴¹. Exceptions help in playing safely nets, where through integration contracting parties such as developing/ poorest nations gross⁴².

6.4 Jus cogens (peremptory norms) and MFN Status

The MFN status does not after all guarantee permanent normal trade relations, neither does it only restrict to tariffs but goes beyond to relations, non-restrictive or protectionist environment and human rights obligations. It is emerging today that the principle is not permanent or absolute, as it may

³⁹ Rudolf Adlung and Antonia Carzaniga (n 21).

⁴⁰ Patrick Anam (n 5).

⁴¹ Ibid.

⁴² 'Most-Favored-Nation Clause' (n 14).

be qualified on justified grounds. Even in light of military actions against Ukraine in 2022, Russia remained member of the World Trade Organization. Biden administration suspended normal trade relations (MFN) with Russia apart April 2022⁴³. Later, the Trump administration begun imposing tariff on Chinese imports since 2018 on claims of unfair practices (intellectual theft). Unless members have statutes that allow abrogation of MFN, countries generally remain to enjoy MFN status. The Ukraine-Russia war has raised geopolitical debates where as a customary law rule, sovereignty, reciprocity, law of war and principle of international rules have led to many states isolating relations with Russia. US. Declared that Russia no longer have MFN status with respect to WTO BIT agreements. The war has resulted to ripple effect in oil crisis and foreign trade imbalances⁴⁴.

6.6 Principles of Construction of MFN clauses in BITs

There has been litigating over substantive MFN based BIT clauses which do not exist in the original BIT. This for examples are based on claims with respect to discrimination, fairness and security, full protection and equal treatment. According to Article 9 of the Draft Articles on Most Favored Nation Clause prepared by International Law Commission, *ejusdem generis* may be employed in construction of clauses. It expressly prescribes that when *Ejusdem Generis principle* is applied to MFN clauses existing in the BITs, the wording of each MFN may be imported from other BITs. The United Nations Conference on Trade and Development (UNCTAD)⁴⁵ on MFN concurs with the fact that “the *ejusdem generis* rule, is relevant to determine issues belonging to the same subject matter or category of subjects to which the MFN clause relates⁴⁶.

6.7 MFN Marginalization

There is increasing fear that the proliferation of regional trade agreements (RTAs) is continuing to cause marginalization of MFN status of countries that are non-members. The RTAs offer mutual benefits and preferential

⁴³ Kimberly Amadeo (n 7).

⁴⁴ Ibid.

⁴⁵ United Nations (n 15).

⁴⁶ Turgut Aycan Özcan (n 3).

treatments on customs, and economic zones that result to beneficial treatments among parties. The increase is expected to continue. The African Continent is not only realizing such RTAs but also working on a model AfRFTA that seeks to open even more benefits to members. The resultant effect is that other countries are excluded from these preferential treatment that are based on the RTAs as non-parties on basis of privity of the agreements, and enforcement between parties based on the laws of treaties. This in the end beats the purposes, where the excluded countries are share membership with the RTA members in the wider WTO Agreements regimes. This 'violates' the WTO non-discrimination principle enshrined in article 2 of GATs and article 1 for GATT and article 4 of the TRIPs respectively within the MFN clauses in other BITs. Yet the very states would want to enjoy equal treatment under MFN terms. This depicts hypocrisy and indifference⁴⁷.

7.0 Summary and Recommendations

The MFN and by extension, the National Treatment principle are important. However, it is emerging that MFN does not purely guarantee permanent normal trade relations in trade, services and IP rights under WTO regime. While WTO aims have achieved a balance and yielded benefits discussed in the paper including 'equal treatment', it is not obvious as a general rule. The MFN status is now a qualified one, owing to the exemptions and exceptional cases discussed above where litigation outcomes show unwillingness of adverse parties to comply.

Further, international law principle on grounds of violations of peremptory norms has made countries with that status defrocked of it. Further, the emergence of RTAs result to results to unequal field and undue advantage by countries that want to exploit both the gains coming from RTA terms as well as MFN clauses in BITs of most favored customers. While such exemptions and alternatives to permanent normal trade relations seem to offer remedies and lee-ways, they show that there are certain inadequacies

⁴⁷ Rudolf Adlung and Antonia Carzaniga (n 21).

found or not addressed under the WTO regimes. This constructively act as a source of its marginalization.

The WTO regime needs to be evaluated, not with respect to compliance with it by contracting state only, but in the context of its effectiveness of lack thereof. Given the creating of the regimes came before the liberalization and democratization of the third world in the 90s, it is been over three decades where regional integration and more awareness on international law and relations have depicted salient reforms both from national and regional level that may need to adjust to address what issues were not cured in the WTO agreement frameworks. Nonetheless, MFN principle has yielded benefits to less favored nations in international trade in merchandise, services and IPR protection as well as technology transfer.

The WTO and its partners should relook at the inadequacies and gaps in its framework without compromising violations of international rules and peremptory norms by its WTO treaty members against recognition of sovereignty as seen in Russia –Ukraine war case.

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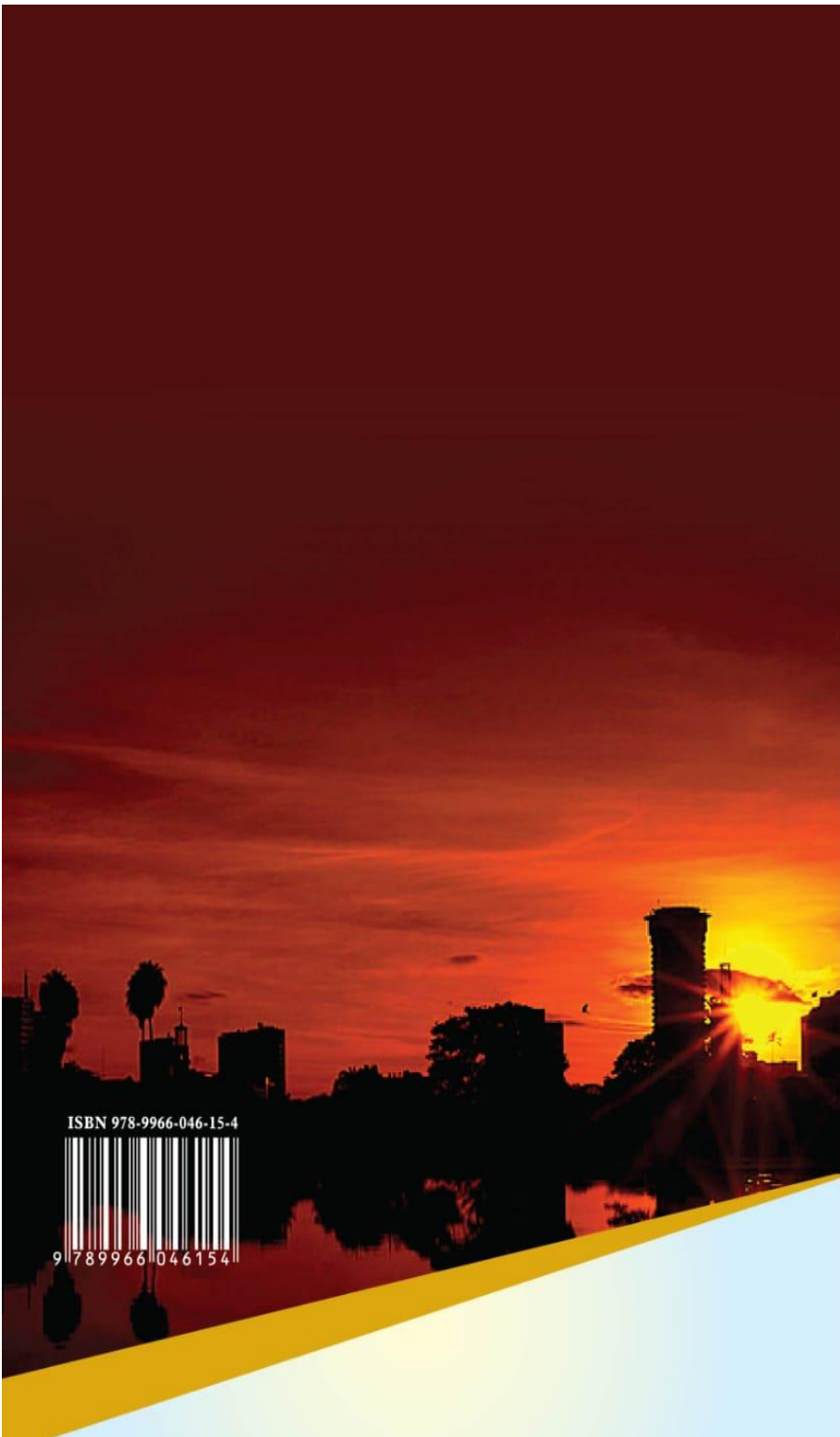
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