Chapter 3

GENERAL MOST FAVOURABLE NATION TREATMENT

The most favoured nation clause is the cornerstone of the General Agreement. The clause does not guarantee any special privileges to the contracting party as suggested by the wording of the clause. Nor does it imply an equalisation of the conditions of competition i.e. offsetting the differences in the comparative costs of production between the contracting parties. It aims only at treating the goods from a contracting party on an equal footing i.e. absence of discrimination.

It is of vital importance to every state that its trade in foreign markets should not receive a treatment inferior to that received by any other state. Every state wants that any concession or guarantee accorded to other states should be extended to it so that its commerce is not at a competitive disadvantage in foreign markets. This leads to the emergence of the most favoured nation clause. The purpose of this instrument is to prevent the establishment of preferences in favour of and the discrimination against any state. The General Agreement contains the clause in its most comprehensive form:

with respect to customs duties and charge 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 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. (1)

After the breakdown of the free and multilateral trade in the thirties, more and more countries started resorting to bilateral agreements for finding markets for their exports. Bilateral agreements, however, involve a number of disadvantages. These divert trade into artificial and uneconomic channels. These discriminate against third countries and thereby injure their economies. This, often, leads to the embitterment of international relations. Discrimination is, often, injurious not only to third countries but also to the countries practising it. Bilateral treaties are generally for a short period because both parties want to keep their hands free to adjust their commercial policy according to changed circumstances. This creates instability and uncertainty and thereby further restricts trade. Bilateral agreements often lead to an exploitation of the weaker party by the stronger party because the terms of the agreement are determined by mutual bargaining and are not based on any objective principles.

Most favoured nation clause is a useful instrument of avoiding or mitigating the unpleasant consequences of bilateral agreements. The stronger party will have less incentive to exact unreasonable terms from the weaker party if it knows that these terms will be generalised to all other countries competing with it in the market of the weaker party. It will not like to incur the displeasure of the weaker party by exacting unreasonable terms from it if it knows that it will have to share the benefits flowing from the agreement with several other countries. The operation of

(1) Article 1, 1.
the clause will avoid discrimination and thereby the evil consequences generally associated with it. Most favoured nation clause ensures that the goods will be imported from the country with the lowest cost of production. In case of a bilateral agreement, the cost of production in the country which is enabled to export with the help of certain concessions might be comparatively higher.

The generalisation to all countries of any concession granted to one country under the most favoured nation clause may be 1) conditional or unconditional, 2) limited (restricted) or unlimited (unrestricted), 3) reciprocal (bilateral) or non-reciprocal (unilateral). Under the conditional most favoured nation clause, each of the contracting parties agrees to extend to the other party any concession granted to a third country only in return for a compensation equivalent to the price paid by the third country for obtaining the concession. If the concession is granted gratuitously to the third party, it will be extended to the contracting party without any compensation. Under the unconditional most favoured nation clause, each contracting party agrees to extend immediately and without compensation any concession granted to a third party. The privilege of the conditional most favoured nation clause is that the contracting party will not be deprived of the concession if it is prepared to pay the price for it. Under the limited most favoured nation clause, the agreement is limited to certain specified matters, countries and goods. In case of unlimited most favoured nation clause, the agreement applies to every favour, privilege or immunity. The agreement is reciprocal if both the parties promise to extend to each other any concession granted to a third country.
Under this kind of agreement each party has a right as well as an obligation. The agreement is non-reciprocal if one party undertakes to extend to the other party any concession it grants to a third party without the other party undertaking any such obligation. This kind of one-sided treaties are, sometimes, concluded between the strong and the weak countries or the victor and the defeated countries. Under the Treaty of Versailles, Germany undertook to give unilateral most favoured nation treatment to the Allies for five years.

The General Agreement contains the most favoured nation clause in its unconditional, unlimited and reciprocal form. This form of the clause completely eliminates discrimination. Other forms of the clause mentioned above contain some element of discrimination.

**Conditional Vs. Unconditional Most Favoured Nation Clause**

Conditional most favoured nation clause is more equitable than the unconditional one because the concession granted to a third party is extended to the contracting party only at a cost equivalent to that paid by the third country. If country A gives a concession to country B in exchange for an equivalent concession, it will be inequitable if the same is extended to another country C under the unconditional clause without obtaining any thing in exchange. If the objective is to mete equal treatment to all countries, it can best be achieved by the conditional most favoured nation clause. The treatment to different countries under the unconditional M.F.N. clause, however, is not so unequal as it seems apparently. If a country
extends certain benefits to other contracting parties without charging any price, it also receives concessions from them through the most favoured nation clause without paying any price. If all the countries exchange concessions in good faith, the benefits received and given through the most favoured nation clause are likely to counterbalance, at least roughly, and thus very little or no inequity may be involved.

It is very difficult to determine what constitutes an equivalent concession. There exists no objective measure of the benefit flowing from a particular concession. In the absence of such a measure, a country which does not want to extend the concession, granted to a third party, to the contracting party can refuse any amount of compensation as inadequate for the extension of the concession. In fact, the conditional most favoured nation clause is nothing more than an obligation to enter into a negotiation with the contracting party.

Conditional most favoured nation clause involves a tremendous waste of time and effort of the administrative machinery because the conclusion of a new treaty necessitates the re-bargaining of all the concessions exchanged before. It complicates the conclusion of treaties and thereby restricts the world trade.

Conditional most favoured nation clause fails in completely eliminating discrimination in international trade.

It confers no significant rights and obligations on any contracting party because every concession has got to be bought at a price determined by mutual bargaining.
A country having conditional as well as unconditional treaties is always at a disadvantage as compared with the country having only the former type of treaties. Suppose, for instance, that country A has a conditional treaty with country B and unconditional treaty with country C. Further country A exchanges a concession of an equivalent value with country D. It will have to extend the concession given to D to C without any compensation under the unconditional most favoured nation agreement. If it is extended to C without charging any price, country B can also claim it without any compensation. Thus the conditional treaty with one country becomes an unconditional one if the country has also unconditional treaty with some other country.

Unconditional most favoured nation clause, on the other hand, might prove a great obstacle in the way of a substantial reduction in tariffs. If a country can enjoy all tariff concessions exchanged between any two countries by virtue of the most favoured nation clause, it may not have much incentive to make reciprocal reductions in its own tariffs. If many countries are interested in getting the duty reduced on a particular product exported to a particular country, each will tend to wait till it gets the concession through the most favoured nation clause instead of obtaining it by giving a reciprocal concession. This policy of wait and see if followed by many countries will obstruct the reduction of tariffs. A country may be willing to offer substantial tariff concessions to another country from whom it expects an equivalent benefit, but the fact that these concessions will have to be extended to all contracting parties
from whom there is no guarantee of an equal benefit may discourage reduction of tariffs. Another way in which the most favoured nation clause obstructs the reduction of tariffs is mentioned by Professor Haberler:

It often happens that A withholds certain concessions in its negotiations with B, C and D because it must reserve them for its negotiations with E; hence tariffs in B, C and D will be reduced less than otherwise they might be. Then possibly no agreement is reached with E, and therefore A does not make the further reduction in its duties which it was prepared to concede. (2)

The benefit of a concession granted to a country is reduced if it is extended to other countries. This will make the country less eager to seek the concession. Sometimes the main benefit might be appropriated by a third country who obtains the concession through the most favoured nation clause free of any cost. Such cases, however, are exceptional. Generally, the major benefit is reaped by the country which exchanges the concession directly; others get only the secondary benefit.

It is, however, doubtful if a country can get all the needed concessions indirectly through the most favoured nation clause. Generally, there will be certain concessions which are more important to this country than to others. It will have to give concessions in exchange for these because no other country is likely to negotiate for these. Parasitic tendencies can be discouraged by making it a principle that every country should negotiate on products which are of primary interest to it.

Negotiations in GATT for the reduction of tariffs are conducted

on the principle of 'chief supplier.' If there are more than one country with a major interest in the concession on a particular commodity, the commodity might be broken into different varieties and each country negotiate for the variety in which it has a major interest. This increases the number of products for negotiation and thereby the scope for the reduction of tariffs. If the commodity cannot be broken down into sub-classifications, the negotiation should be conducted by the country which has the least scope for negotiation i.e., which is a major supplier of the least number of products. An alternative will be to split up the concession. One country might negotiate for a part of the concession, leaving the remaining concession to be negotiated by another. Further, the country which gets the concession indirectly through the most favoured nation clause is in an unfavourable position. It does not receive assurance for the continuation of the concession. If the parties directly exchanging the concessions terminate the agreement, the country obtaining the concessions through most favoured nation clause will be deprived of these. Moreover, the belief that the countries will tend to be parasitic is based on the assumption that any reduction in a country's tariffs is harmful for it and consequently involves a cost. Often the reduction in tariffs by a country on its imports from another country might be beneficial for the importing country, too. In such cases, the country will not try to obtain all concessions indirectly through the most favoured nation clause. It will be ready to directly exchange concessions. While evaluating the effect of the unconditional most favoured nation clause on the reduction of tariffs, the indirect reduction in tariffs through the most
favoured nation clause, a part of which might not have occurred in the absence of the clause, should also be taken into account.

**Treatment of Non-bargaining Countries**

Countries with very low tariffs should be accorded most favoured nation treatment even if these do not exchange concessions directly. What should be done of the high-tariff countries which do not exchange concessions directly. The General Agreement provides no remedy for such countries. Professor Haberler suggests a remedy for such countries. (3) If the withholding of the most favoured nation treatment can induce these countries to negotiate, then the remedy is either to denounce the most favoured nation treaty with these or to accord the most favoured nation treatment on the condition that they should be ready, whenever possible, to exchange concessions directly on reasonable terms. This condition, however, may not succeed in eliminating the whole adverse effect of the clause on the reduction of tariffs because the country may exchange directly only the minimum concessions which are essential to make it qualify for the most favoured nation treatment from other countries whereas in the absence of the unconditional clause, it might have exchanged many more concessions. If the country is in such a strong position that the withholding of the most favoured nation treatment will not induce it to negotiate, there is no alternative but to concede her unconditional most favoured nation treatment. This course does not involve any injury to the importing country. It is rather beneficial as the country is

assured that it will import from the lowest-cost source whereas, in the absence of this, it might import from a country whose cost of production is comparatively higher but is enabled to favourably compete with the lower-cost country simply because it gets a concession which is not accorded to the lower-cost country.

The remedy suggested by Professor Haberler is more expedient than just. According unconditional treatment to countries in a strong position and withholding the same from countries in a weak position involves discrimination which is contrary to the fundamental principles of GATT.

Exceptions to the Most Favoured Nation Clause

Perfect equality of treatment is an ideal which is very difficult to achieve in actual practice. If it is not possible to achieve complete equality of treatment, there is no reason for being discouraged. Efforts should be made to achieve as much equality as is possible. Treaties, often, provide a number of exceptions to the most favoured nation clause. The General Agreement exempts the following preferences from the purview of the most favoured nation clause:

1) those in force exclusively between two or more of the territories listed in Annex A, subject to the conditions set forth therein; (4)

2) those in force exclusively between two or more territories which on 1 July 1939 were connected by common sovereignty or relations of protection or suzerainty and which are listed in Annexes B, C and D, subject to the conditions set forth therein; (5)

(4) Article 1, 2a.
(5) Article 1, 2c.
3) those in force exclusively between the United States of America and the Republic of China; (6)

4) those in force exclusively between neighbouring countries listed in Annexes F and F; (7)

5) those between the countries formerly a part of the Ottoman Empire and detached from it on 24 July 1923, provided such preferences are approved under sub-paragraph 5(a) of the Article XXV, which shall be applied in this respect in the light of paragraph 1 of Article XXIX. (8)

Paragraph 3(a) of the Article XXIV permits the contracting parties to accord advantages to their adjacent countries in order to facilitate frontier traffic. National boundaries are generally arbitrary. Restriction of the long established trade between the frontier areas is likely to cause great hardships to the inhabitants of the frontier areas if they are prevented from trading with their neighbours on one side when the people living in the interior trade with their neighbours on both sides. Commercial treaties, therefore, generally, exclude frontiers as an exception to the general provisions. The General Agreement does not specify the width of the frontier zone. In fact, it is very difficult to decide it. Care should be taken that it is wide enough to avoid any inconvenience to the inhabitants of the frontier areas. Though the width of the frontier zone varies in various treaties, yet some degree of uniformity has been achieved through constant practice. In sixty-five treaties an area of fifteen kilometres is stated as being within the

(6) Article 1, 2b.

(7) Article 1, 2d.

(8) Article 1, 3.
ambit of the clause. (9)

The above mentioned regional preferences are based on special ethnic, historical, political, cultural and economic ties existing between these regions. Most of these preferences, however, are a result of the imperialistic designs of the powerful countries. Powerful countries want these preferences to maintain their influence on the small and backward countries in their orbit by making these dependent for their exports and imports mainly upon themselves. Some of the regional preferences are a direct exploitation of the weaker countries. Whenever there is a move to abolish these, it is strongly opposed by the vested interests. In addition to the above exceptions, a number of countries have been granted waivers to deviate from the most favoured nation clause and some countries have deviated from the clause violating the provisions of the General Agreement. Some such cases are stated below.

The European Coal and Steel Community - The General Agreement permits the formation of free trade areas and customs unions. It does not contain any provisions for the formation of unions limited to specified sectors of trade. To form the Coal and Steel Community, therefore, the governments of Belgium, Luxemburg, the Netherlands, France, Germany and Italy were required to obtain a waiver from the provisions of the paragraph 1 of Article I. The Contracting Parties considered the request of the constituent parties for a waiver at the Seventh Session and found that the objectives of the Community were broadly consistent

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with those of the General Agreement. (10) The six governments put forward the view that closer integration between their economies resulting from the removal of barriers to the free movement of coal and steel products within their territories would benefit other contracting parties to the General Agreement by increasing the supply of coal and steel products and by providing increased markets for commodities used by the coal and steel industry and for other products. The Community undertook to take account of the interests of third countries both as consumers and as suppliers of coal and steel products, to promote the development of international trade, and to ensure that its producers charge equitable prices in markets outside the Community. The members assured that the harmonised tariffs and restrictions on the import of coal and steel products from outside contracting parties shall be less restrictive than the existing ones. The Community will avoid unreasonable restrictions on exports to third countries. Keeping in view the provisions of the Treaty and Convention and specific undertakings by the High Authority and the constituent governments, the Contracting Parties granted a waiver, in November 1952, authorising the six governments to abolish within the Community import and export duties and quantitative restrictions on the products covered by the Treaty. During the transitional period, the governments of the constituent countries were required to submit an annual report to the Contracting Parties regarding the measures taken by them towards

(10) GATT, Basic Instruments and Selected Documents, First Supplement (Geneva, 1953) 17-22 and 85-93.
the full application of the treaty. The annual reviews in respect of the European Coal and Steel Community have indicated considerable concern on the part of the developing countries in regard to the prices fixed by the export cartel for steel created by Community members, while other industrial countries were more concerned with the impact of those arrangements on their own exports.

Waiver for the continued application by Italy of special customs treatment to certain products of Libya. Italy was accorded special treatment to certain products of Libya both before the Second World War and, with certain modifications, since war. Termination of such special treatment would have resulted into serious economic difficulties for Libya. Italy, therefore, requested for a waiver of the provisions of Article I, paragraph 1 under the provisions of Article XXV, 5(a), to continue special treatment to the imports from Libya. The Contracting Parties granted the waiver until 30 September 1952. (11) Afterwards the period of the waiver was extended several times.

Waiver in respect of the trust territory of the Pacific Islands. The Government of the United States requested under Article XXV, 5(a) for a waiver of the provisions of Article I, paragraph 1 to accord preferential treatment to the Marshall, Caroline and Marianas Islands (other than Guam). In 1947, these islands were placed under the trusteeship of the United States. Before that these were held by Japan under mandate and there existed preferential arrangements between these and Japan. Owing to the nature and small volume of the production and trade

(11) GATT. Basic Instruments and Selected Documents (Geneva, 1952) II, 10-11.
involved and the underlying economic factors affecting such production and trade, it was considered that the preferential arrangements were not likely to cause substantial injury to the trade of any contracting party. On 8 September 1948, the Contracting Parties decided to grant the requested waiver to the United States. (12) In case, owing to changed circumstances, the permitted preferences result or threaten to result in substantial injury to the competitive trade of any contracting party, the Contracting Parties, upon the request of the affected contracting party, shall review the decision in the light of all relevant circumstances.

Belgian Family Allowances. The Norwegian and Danish Governments lodged a complaint against the Government of Belgium regarding the levy of a charge on foreign goods purchased by public bodies and originating in countries whose system of family allowances did not meet specified requirements. Several contracting parties obtained exemption from this levy. The complainants claimed equal treatment. A panel was appointed to examine the issue. After hearing the concerned parties and examining the legal provisions for the collection of the charge, the panel concluded that, in view of the legal issues involved, it was difficult to recommend a definite ruling, but they reported that the legislation appeared to be inconsistent with the most favoured nation provisions and was difficult to reconcile with the spirit of the Agreement. (13) On the proposal of the Panel,

(12) GATT, n. 10, 17-22 and 84-93.
(13) Ibid., 59-62.
the Contracting Parties recommended the Belgian Government to remove the discrimination. (14) The discriminatory tax was terminated on 6 March 1954. (15)

**Italian Discrimination Against Imported Agricultural Machinery.** The United Kingdom lodged a complaint against Italy regarding the discriminatory treatment to imported agricultural machinery. Italy was providing credit facilities for the purchase of agricultural machinery of Italian, but not foreign, origin. The Contracting Parties, at the suggestions of the panel, recommended that Italy eliminate discrimination by providing similar credit facilities for the purchase of imported agricultural machinery. (16) Bilateral consultations were held between the United Kingdom and Italy and the agreement reached along the lines of the panel's suggestions. (17)

The margin of preference permitted by Article 1, 2, but not specifically set forth as a maximum of margins of preference in the appropriate schedule, should not exceed, in respect of the duties on the items mentioned in the schedule, the difference between the most favoured nation rates and the preferential rates. Regarding charges on products not described in the appropriate schedule, these should not exceed the difference between the most favoured nation rates and preferential rates existing on 10 April

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(15) GATT, Basic Instruments and Selected Documents, Seventh Supplement (Geneva, 1957) 68.

(16) Ibid., 23 and 60-8.

1947. (18) The term 'margin of preference' means the absolute difference between the most favoured nation rate of duty and the preferential rate of duty for the like product, and not the proportionate relation between those rates. (19)

Preferential arrangements deprive the consumers of their freedom to buy in the cheapest market. Similarly, producers in the non-participating countries are deprived of the rewards of their efficiency. (20) In GATT negotiations some preferences have been eliminated and certain others reduced. Further, expansion of the preferential arrangements which existed in 1947 has been checked. Some countries, of course, have been granted waivers to increase the existing margin of preference and to create new preferences. Some such cases are stated below.

Waiver to the United Kingdom in connection with items not bound in Schedule XIX and traditionally admitted free of duty from countries of the Commonwealth. The General Agreement permits certain preferential arrangements subject to the condition that the existing margin of preference shall not be increased. This was a great hindrance in the way of the United Kingdom's traditional policy of permitting the import of most of the products from Commonwealth countries free of any duty. This prevented the United Kingdom from exercising its right, which it enjoys under the GATT along with other contracting parties, of raising duties on unbound items because unless the duties are

(18) Article 1, 4.
(19) Ad. Article 1, paragraph 4.
levied on Commonwealth products, too, new preferences will be established which is contrary to GATT provisions. To overcome this difficulty, the United Kingdom requested the Contracting Parties for a waiver from the provisions of paragraph 4(b) of Article I permitting it to increase unbound rates of duty without imposing corresponding duties on imports from Commonwealth countries. (21) It assured that in seeking this waiver, it has no intention of according any substantial additional advantage to Commonwealth goods in the United Kingdom market over goods from other contracting parties. It was difficult for the United Kingdom to obtain a modification of the legislation for imposing duties on imports from Commonwealth countries. It was said that the United Kingdom Government had no intention of effecting any substantial or comprehensive upward revision of its tariffs and certain adjustments in tariffs would facilitate the elimination of quantitative restrictions being imposed on several products. The Government of the United Kingdom declared that it was desirous of contributing to the objectives of the GATT through arrangements aiming at a reduction of trade barriers and the requested facilities, if granted, would not stand in its way of co-operating with the Contracting Parties in their programme of obtaining further reductions in tariffs. It explained to the Contracting Parties that it proposed to increase the most favoured nation rates only on unbound items in which the Commonwealth countries had little interest and, therefore, the increase in the margin of preference would only be apparent and not real and would not divert trade from other contracting

parties to Commonwealth. Keeping in view the above mentioned assurances, the Contracting Parties granted the requested waiver to the United Kingdom. To safeguard against the misuse of the waiver, the Contracting Parties laid down a detailed procedure for action under the waiver and specifically mentioned that in granting the waiver they had no intention of impairing the provisions contained in Article I.

**Australian treatment of products of Papua - New Guinea.**

The Government of Australia requested for a waiver to accord preferential treatment to the imports of primary products from its Trust Territory of Papua - New Guinea. Such preferential treatment was necessary for the development of the Territory of Papua - New Guinea. The Government of Australia assured that the waiver would be availed of in such a manner as does not cause material injury to the competitive trade of any contracting party and would not be utilised for the protection of domestic production in Australia. On 24 October 1953, the Contracting Parties decided under Article XXV, 5(a) to waive the provisions of paragraphs 1 and 4(b) of Article 1 to the necessary extent to enable Australia to accord preferential treatment to the imports of primary products from Papua - New Guinea. (22) Before taking action under the waiver, the Government of Australia was required to inform the Contracting Parties of the proposed action and to consult with any contracting party which considered that such action would threaten substantial injury to its competitive trade or

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would afford considerable protection to the domestic production of Australia. In case no agreement was reached as a result of consultations, the matter might be considered by the Contracting Parties. The Government of Australia could go ahead with the proposed action if it was determined by the Contracting Parties that there existed no threat. The Government of Australia was to submit annual reports to the Contracting Parties on the measures taken and the effect of the same on the trade of Papua - New Guinea and on imports into Australia of the concerned products from all sources. In case, owing to changed circumstances, the permitted preferences result or threaten to result in substantial injury to the competitive trade of any contracting party, the Contracting Parties, upon the request of the affected contracting party, shall review the decision in the light of all relevant circumstances.

Special problems of dependent overseas territories of the United Kingdom. The Government of the United Kingdom requested for certain facilities to assist her in promoting the economic development and social well-being of her dependent overseas territories. She assured that such facilities will be used in a way which safeguards the interests of the other contracting parties. On 5 March 1955, the Contracting Parties decided, subject to certain conditions, to grant a waiver to the United Kingdom from the provisions of Article 1 permitting her to accord preferential treatment to imports from the dependent overseas territories outside the limits permitted by the provisions of paragraph 4 of Article 1. (23)

Main Obstacles to the Operation of the Most Favoured Nation Clause

Quantitative Restrictions. Most favoured nation clause was developed mainly during the period 1860-1914 when, barring a few exceptions, tariffs were the only barrier to free trade. The clause has found it difficult to cope with the quantitative restrictions.

The most favoured nation clause is practically inapplicable to quotas and quantitative restrictions in general. For there is no accepted or plausible principle of quota allocation which could be called non-discriminatory and consistent with the most favoured nation principle. (24)

Quantitative restrictions have diminished the importance of tariffs and thereby the importance of the clause even in its own sphere.

Refinement of Tariff Classification. Taking an undue advantage of the difficulties involved in defining a commodity, many countries have tried to evade the extension of concessions to third parties under the most favoured nation clause by introducing minute refinements in the classification of tariffs. Similarly, the difficulties involved in the determination of the nationality or the country of origin of the products have been misused to evade the obligations imposed by the most favoured nation clause.

Barter Agreements. Barter agreements involve the exchange of goods for goods. The importation of goods under the barter

agreements discriminates against the other exporters of similar goods.

In short, recent changes in the technique of commercial policy have drastically decreased the effectiveness of the most favoured nation clause in establishing equal treatment for all countries.

Convertibility and stability of currencies and expanding trade are very important for the successful working of the clause. Past experience shows that the clause became popular during periods of economic stability and expanding trade but was denounced by more and more countries during periods of economic instability and declining world trade. When the world trade is expanding, no country wants more than an access to the world markets on equal terms. In order to obtain equal treatment, each country has to give equal treatment to other countries. As soon as a decline in world trade starts, countries are not satisfied with equal treatment. They seek special concessions for their exports to appropriate as large a share as possible of the declining world markets. Reservation of home market for domestic producers is considered to be more important than the stimulation of exports. There arise the balance of payments difficulties. These lead to the emergence of quantitative restrictions, dumping, bounties etc. which reduce the effectiveness of the most favoured nation clause.

**Most Favoured Nation Clause and Underdeveloped Countries**

However, valid the most favoured nation principle may be in regulating trade relations among equals, it is not an
appropriate concept for trade between countries of vastly unequal economic strength. Some years ago an Indian delegation to GATT remarked "equality of treatment is equitable only between equals." The underdeveloped countries have pleaded for an amendment of the most favoured nation principle so as to permit industrialised countries to grant special treatment to less developed countries and to permit less developed countries to grant special most favoured nation treatment amongst themselves. The acceptance, by the Ministerial Meeting of GATT in May 1963 and subsequently in the New Chapter in GATT adopted in November 1964, of non-reciprocal tariff concessions to developing countries was a valuable first step in recognising the need for special encouragement to the trade of these countries. Adoption of the principle of preferential treatment for the trade of developing countries is the logical next step.

Preferences to the exports of developing countries are an important way of promoting GATT's basic objective, that is, expansion of world trade. If the underdeveloped countries are not able to export more, they will have to resort to a policy of import substitution in order to achieve an equilibrium in their balance of payments. Under a preferential system, if they can export more, they would be in a position to import more and relax import substitution policy; this would lead to an expansion in world trade.

Preferential treatment for the exports of developing countries would help the industries of the developing countries to overcome the difficulties they experience in export markets because of their high cost of production. It is a temporary
measure which, by opening up large markets to the industries of developing countries, would enable them to lower their costs and thus compete in the world market without the need for continuous preferences.

The case is thus a logical extension of the infant industry argument ... if infant industries need protection in the domestic market, because of high costs, they obviously need protection all the more in foreign markets, whether developed or developing, in the form of preferential treatment. (25)

Preferential treatment for underdeveloped countries would open broader markets for exports of manufactures and thereby provide an additional stimulus to the industrial growth of the less developed countries. It would encourage industrial enterprises in advanced countries to invest in manufacturing activity in the less developed countries with a view to taking benefit of preferences for increasing their trade. Care should, of course, be taken that the grant of preferences is strictly governed by detailed rules of origin for determination of nationality of a product based on either proportionate value or a list of processes on particular base materials done in less developed countries; otherwise the new industries may function as mere assembly plants and not take the form of full manufacturing units.

The introduction of a new system of preferences would involve a number of complicated problems. The first question is as to which countries should grant preferences. The developing countries would expect all the advanced countries to grant preferences. The scheme can be effectively implemented only if all

the advanced countries agree to grant preferences. But it can be enforced if a group of countries accounting for not less than a certain proportion of present imports from developing countries agree to participate.

The imports in the centrally planned countries are regulated primarily not by tariffs but by the administrative decisions of the state trading agencies. Such countries should give special treatment to imports from developing countries in their foreign trade plans and direct their state trading agencies to act accordingly. The implementation of such policies as of policies adopted by the private enterprise economies, could be evaluated in the light of actual performance.

The second and more complicated problem is that of selecting the countries which are to benefit from the preferences. There is no single criterion for identifying such countries. Consideration has to be given to a number of factors like the per capita income, the share of agriculture and industry in total employment and output, the impact of primary export sector on the growth of the economy etc. A vast majority of the cases is clear-cut but the problem of identification arises in border-line cases at the top of the per capita income range. The problem is not so important from the standpoint of the advanced countries because imports of manufactured goods from the developing countries, however defined, is not likely to materially affect their economies. The problem is a little serious from the point of view of the developing countries because some of them may fear that they will not be able to benefit from preferences if they have to compete with some of the more advanced members of the
developing group. One way out will be to accord preferences to all developing countries as defined in Article XVIII of the GATT and these may be permitted to run till such countries reach the stage of self-sustained growth.

The third problem relates to the selection of preferences. The advanced countries would prefer to grant preferences on a selective basis because they would like to exclude products which would have material effects on the domestic economy. There may also be the consideration to direct the attention of the developing countries towards industries offering substantial growth potential and the prospect of viability within a reasonable period of time without the need for continuing preferential treatment.

The system of selective preferences, however, has several disadvantages. Firstly, the experience of GATT and other bodies has shown that a system of selective negotiations, product by product, gives rise to a number of difficulties. Secondly, industries which fear foreign competition would have a tendency to adopt a severely defensive attitude and seek to maintain status quo. Thirdly, if the preferences to be granted by all developed countries are to be standard in terms of commodity coverage, the ultimate list of products qualifying for preferences would be the lowest common denominator of all national lists because any industry considered vulnerable in one country would be excluded from the general list of all countries. Fourthly, if the preferential treatment is to be restricted to only semi-finished and finished manufactures, there would arise the difficulty of defining the scope of these products, requiring
expert study and recommendations. Expert study would also be required of the problem of defining the origin of products manufactured and semi-manufactured from imported materials and components.

In view of the reasons stated above, a better and simpler approach would be the concession of linear cuts, as preferences, affecting groups of products or full categories where exports of less developed countries are possible but lagging. Of course, if difficulties arose in respect of some products, they can be excluded by mutual consultations; it would be easier to negotiate a list of exceptions to a general concession. The linear approach should not prevent, however, the concession of preferences on individual items of particular significance to the trade of less developed countries and where an export capacity is already in existence.

The concessions, depending on the product or list of products affected, could be made without time limitation or for a certain period, say five or ten years, after which they would be subject to review. During review, the interested parties would study the effect of preferences granted, determine whether the margin had been sufficient to permit establishment or development of production and the overall effect on the international trade flows. It could be determined then whether to continue them as before, whether to increase the margin, or to take other measures.

In granting preferences to underdeveloped countries, some countries may encounter constitutional problems. The United
States, for instance, under its present constitution, can assume only most favoured nations obligations and granting of preferences would require constitutional amendment.

So far we were discussing the first aspect of the problem of preferences i.e. grant of preferences by advanced countries to the undeveloped countries. Let us now turn to the other aspect of the problem i.e. the permission to underdeveloped countries to grant special most favoured nation treatment among themselves. Under the present rules of GATT, different countries can exchange preferences only by constituting a customs union or free trade area. In this regard, the Havana Charter was more liberal but unluckily the relevant provisions (Article 15) were not incorporated in the General Agreement. Generally speaking, the advanced countries do not favour the exchange of preferences between developing countries fearing that this may adversely affect their exports to the developing countries. Probably, it was this fear which led to the dropping from GATT of provisions in the Havana Charter permitting a system of preferences justified by the need for economic development. (26)

Each country has engaged in this (import) (27) substitution process in isolation. If, in order to lighten the difficulties they encounter in this process, they carry out substitution jointly in a grouping of developing countries, their imports from the rest of the world will not decrease in volume on that account; they will merely undergo a change in composition. Their volume depends, in the last analysis, upon the attitude of the industrial countries, not on unilateral decisions on the part of the developing countries. . . . if industrial

(26) Ibid., 39.
(27) Word within parenthesis added.
countries buy more from the developing countries, their sales to them will grow correspondingly, but, if the latter buy more from the former, their sales of primary commodities will not thereby increase. (28)

The groupings of developing countries are imperative on a number of counts: "to make import substitution policy more rational and economical through specialisation and the division of labour; to remedy gradually the former distortion deriving from the policy of import substitution in watertight compartments; to promote industrial competition among member countries through the lowering and ultimate removal of tariffs; and to counteract the trend towards excessive agricultural protectionism in some of the developing countries." (29)

E. W. White, Executive Secretary to the Contracting Parties to the General Agreement holds the view that the exchange of preferences among the developing countries is not difficult even under the existing provisions of the General Agreement. He states that the question of preferences among the developing countries "is - so far as the GATT is concerned - rather like pushing at an open door. It was carefully considered in the course of the review of General Agreement in 1955, when it was conceded that the waiver provisions of the General Agreement could be invoked in favour of systems of regional preferences of this type. The waiver provisions depend upon obtaining an approving vote of two-thirds of the contracting parties which in effect means, in present circumstances, that, provided the developing countries


(29) Ibid., 39.
themselves were agreed on the desirability of such arrangements, the GATT presents no real obstacle to them, because at the present moment more than two-thirds of the contracting parties are developing countries. I think, therefore, that one cannot argue that the most favoured nation principle, as incorporated in the General Agreement, accompanied as it is by the waiver provisions of Article XXV, is a significant obstacle to valid regional arrangements which commend themselves at least to most of the developing countries." (30)

(30) Statement made by E.W. White, Executive Secretary, GATT, at the Plenary Meeting of the Conference on 8 April 1964, Directorate of Commercial Publicity, United Nations Conference on Trade and Development (New Delhi, 1964) 52.