

## *Chapter 1*

# MOST-FAVOURLED-NATION TREATMENT PRINCIPLE

## 1. OVERVIEW OF RULES

### *1) Background of the Rules*

“Most-Favoured-Nation” (“MFN”) treatment requires Members to accord the most favourable tariff and regulatory treatment given to the product of any one Member at the time of import or export of “like products” to all other Members. This is a founding principle of the WTO.

Under the MFN rule, if WTO Member A agrees in negotiations with country B, which need not be a WTO Member, to reduce the tariff on product X to five percent, this same “tariff rate” must also be extended to all other WTO Members. In other words, if a country provides favourable treatment to one country, it must provide the same favourable treatment to all Member countries. Therefore, the essence of MFN treatment is non-discriminatory treatment by providing the same conditions given to one Member to other Members. In the context of trade, it is a principle that prohibits different treatment given to the same products depending on the country of origin.

The concept of MFN has a long history. Prior to the GATT, an MFN clause was often included in bilateral trade agreements and, as such, contributed greatly to trade liberalization. However, in the 1930s, countries around the world took protectionist measures because of the impact of the world depression. Various systems to limit MFN treatment, including trade-restrictive measures by the British Commonwealth of Nations (commonly known as the sterling bloc) and the French franc bloc, etc. were introduced. It is generally believed that these limits divided the world economy into trade blocs and eventually led to World War II. Lessons were learned from this mistake and, in the wake of World War II, an unconditional MFN clause was included in the GATT on a multilateral basis, contributing to global trade stability. It was then succeeded by the WTO.

Considering this background, MFN treatment in particular must be recognized as a fundamental principle for sustaining the multilateral trading system. Regional integration and related exceptions must be uniformly administered so as not to undermine the MFN principle.

### *2) Legal Framework*

## **GATT PROVISIONS REGARDING THE MFN PRINCIPLE**

MFN treatment is provided for in GATT Articles I, III:7, V, and XVII.

### ***General Most-Favoured-Nation Treatment (GATT Article I:1)***

GATT Article I:1 requires WTO Members to extend MFN treatment to like products of other WTO Members with respect to tariffs, regulations on exports and imports, internal taxes and charges on imported products, and internal regulations. In other words, “like” products from all WTO Members must be accorded the same treatment as the most advantageous treatment accorded by a Member to the products of any one state or territory under the jurisdiction of that Member.

The meaning of “like products” raises an issue. There are only a few determinations in WTO dispute settlement cases, and determinations made in the former GATT era are used as precedents for interpretation<sup>1</sup>. According to the Panel on discriminatory tariff treatment of unroasted coffee by Spain (BISD 28S/102), like products are determined by the following three factors<sup>2</sup>: (1) physical characteristics of the products, (2) their end-users, and (3) tariff regimes of other Members. In this case, different tariff rates were established for four varieties of coffee beans, and the issue was whether or not these four varieties were “like products”. Based on the above-mentioned three factors, the Panel determined that the four varieties of coffee beans were “like products” because (1) most of these four varieties were sold in the form of blends, (2) consumers regarded these four varieties as a single product intended for drinking, and (3) the tariff regimes of many GATT contracting parties did not apply different tariff rates to these four varieties<sup>3</sup>. Therefore, the Panel concluded that establishing different tariff rates for certain varieties of unroasted coffee beans was in violation of the MFN treatment obligation.

In contrast, in the SPF (spruce, pine, fir) dimension lumber case, establishing different tariff rates on SPF in the tariff regime was claimed to accord discriminatory treatment between lumber from certain countries and lumber from other countries, but the panel recognized that each WTO Member could exercise considerable discretion as to tariff classifications and relied on the standards of each importing country in determining “like products” (Japan — Tariff on Imports of Spruce, Pine, Fir (SPF) Dimension Lumber Panel, BISD 36S/167).

Should an importing country extend differential treatment to “like products” of one exporting country over another - by setting different tariff rates - it would clearly violate GATT Article I:1. However, GATT Article I:1 violations can also occur when the discrimination against the product of another Member is less apparent, such as when an importing country accords differential treatment among products that are considered

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<sup>1</sup> Rudiger Wolfrum, Peter-Tobias Stoll, Holger P. Hestermeyer (ed.) “WTO - Trade in Goods” (Max Planck Commentaries on World Trade Law), describing the above-mentioned two cases; Peter Van den Bossche and Werner Zdouc “The Law and Policy of the World Trade Organization: Text, Cases and Materials”, describing only the Spain-Unroasted Coffee case.

<sup>2</sup> Panel Report, Spain — Unroasted Coffee (1981) (BISD 28S/102), Para 4.6.

<sup>3</sup> Ibid., Paras 4.7-8.

to be like products.

This is often defined as *de facto* discrimination. One such case involved Canada's automobile measures (DS139). In this case, Canada's system, which eliminated tariffs on imported automobiles from the United States under certain conditions, was at issue. The system was open to companies of other countries and could be used by meeting certain conditions. In actuality, however, the acceptance of new applications was suspended after the conclusion of the US-Canada FTA, making it practically available only to the US companies. The Panel and the Appellate Body both determined that the measures were *de facto* discrimination and concluded that they were in violation of GATT Article I:1.

***Non-Discriminatory Administration of Quantitative Regulation Relating to the Mixture, Processing or Use of Products (GATT Article III:7)***

GATT Article XIII:7 stipulates that no internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions shall be applied in such a manner as to allocate any such amount or proportion among external sources of supply. This paragraph provides for MFN treatment in the administration of quantitative restrictions relating to the mixture, processing or use of products, and supplements the disciplines under Article I.

***Non-Discriminatory Administration of Freedom of Transit (GATT Article V)***

GATT Article V stipulates that there shall be freedom of transit through the territory of each contracting party, via the routes most convenient for international transit, for traffic in transit to or from the territory of other contracting parties and that no distinction shall be made which is based on the flag of vessels, the place of origin, departure, entry, exit or destination, etc. This is MFN treatment in freedom of transit, and supplements GATT Article I.

***Non-Discriminatory Administration of Quantitative Restrictions (GATT Article XIII)***

In order to ensure fairness among countries in applying quantitative restrictions, GATT Article XIII stipulates that when imposing quantitative restrictions or tariff rate quotas on any product, they shall be imposed non-discriminatorily on like products of all countries, and that in applying import restrictions to any product, contracting parties shall aim at a distribution of trade in such product approaching as closely as possible the shares which the various contracting parties might be expected to obtain in the absence of such restrictions, based upon the proportions for a previous representative period, etc. This supplements GATT Article I.

The part that applies to quantitative restrictions and tariff rate quotas provides for non-discriminatory treatment, the essence of MFN treatment as described above. That is, it provides that no like product of any country shall be given exemptions from quantitative restrictions or tariff rate quotas.

However, GATT Article XIII, which states that contracting parties shall "aim at a distribution of trade in such product [subject to import restrictions and tariff rate quotas], approaching as closely as possible the shares which the various contracting parties might be expected to obtain in the absence of such restrictions", requires

attention. That is, beyond the application of import restrictions and tariff rate quotas, applying formally equal ratios for permitted import volumes may constitute a violation of GATT Article XIII. For example, the Panel on “United States — Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea” (DS202) determined that the imposition by the United States of import restrictions of 9,000 tons uniformly on line pipes from various exporting countries without taking into consideration the principle of the above-mentioned shares by country when implementing safeguard measures was in violation of GATT Article XIII. In this respect, this provision differs, for instance, from the MFN treatment obligation, which requires in essence the application of the same tariff rates/laws.

### ***State Trading Enterprises (GATT Article XVII)***

GATT Article XVII defines “State Trading Enterprises” as: 1) state enterprises established or maintained by a WTO Member; or 2) private enterprises granted exclusive or special privileges by WTO Members that make purchases or sales involving either imports or exports. By making use of their monopolistic status, such enterprises could operate against the principles of international trade by discriminating against an importing country or imposing quantitative restrictions, etc. GATT Article XVII requires WTO Members to act in accordance with the general principle of non-discriminatory treatment, including the MFN treatment obligation (Article XVII:1(a)), while at the same time it provides that they must act solely in accordance with commercial considerations (Article XVII:2(b)).

## **EXCEPTIONS TO THE GENERAL PRINCIPLE OF MFN TREATMENT**

GATT provides for exceptions with respect to the above-mentioned provisions concerning MFN treatment.

### ***Customs Unions/Free-Trade Areas (GATT Article XXIV)***

In order to strengthen economic relation between two countries, regional trade agreements are permitted for customs unions/free-trade areas under certain conditions. These agreements liberalize trade among countries within the regions, while maintaining trade barriers with countries outside the region or regions. They may also lead to results that are contrary to the MFN principle because countries inside and outside the region are treated differently. Thus, countries outside the region could be disadvantaged. However, completely prohibiting such agreements is considered too severe, and GATT allows them under strict conditions.

GATT Article XXIV provides that regional integration may be allowed as an exception to the MFN principle only if the following conditions are met: (1) tariffs and other barriers to trade must be eliminated with respect to substantially all trade within the region; and (2) the tariffs and other barriers to trade applied to outside countries must not be higher or more restrictive than they were prior to regional integration (*see* Chapter 16 “Regional Integration”, Part II).

### ***Enabling Clause***

The Generalized System of Preferences (GSP) program is a system that grants certain products originating in eligible developing countries preferential tariff treatment over those normally granted under MFN status. GSP is a special measure designed to help developing countries increase their export earnings and promote development.

GSP is defined in the GATT decision on “Generalized System of Preferences” of June 1971. Granting GSP preferences is allowed in GATT 1947 as a measure based on the 1979 GATT decision on “Differential and More Favourable Treatment, Reciprocity, and Fuller Participation of Developing Countries” or the so-called “Enabling Clause”.

GSP must have the following characteristics: (1) preferential tariffs may be applied not only to countries with special historical and political relationships (*see* “Other Exceptions”), but also to developing countries more generally (thus the system is described as “generalized”); (2) the beneficiaries are limited to developing countries; and (3) it is a benefit unilaterally granted by developed countries to developing countries. In addition, of GSP beneficiaries, the least developed countries (47 countries) are provided with further preferential treatment such as duty-free, etc. for items subject to special preferential treatment.

Regional trade agreements concluded between developing countries need not meet the requirements provided for in GATT Article XXIV because of the preferential treatment based on the Enabling Clause, and, regardless of the provisions of GATT Article I, contracting countries can provide developing countries with different and favourable treatment without providing the same to other contracting countries<sup>4</sup>.

### ***Non-Application of Multilateral Trade Agreements Between Particular Member States (WTO Agreement Article XIII)***

Article XIII of the Marrakesh Agreement Establishing the World Trade Organization (the “WTO Agreement”) provides that “[t]his Agreement and the Multilateral Trade Agreement in Annexes 1 and 2 shall not apply as between any Member and any other Member”, when any of the following two conditions are met: (a) at the time the WTO Agreement went into force, Article XXXV of GATT 1947<sup>(note)</sup> had been invoked earlier<sup>5</sup> and was effective as between original Members of the WTO which were Members of GATT 1947; or (b) between a Member and another Member which has newly acceded, the Member not consenting to the application has so notified the Ministerial Conference before the approval of the agreement on the terms of accession by the Ministerial Conference.

(Note) Although there is also a provision about non-application in GATT Article XXXV, it is recognized that WTO Article XIII prevails against GATT Article XXXV. This situation occurs because WTO Article XVI stipulates that “In the event of a conflict between a provision of this Agreement and a provision of any of the Multilateral Trade Agreements, the provision of this

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<sup>4</sup> Examples of regional trade agreements based on the Enabling Clause are described in WTO Analytical Index, Volume 1, PP383-388.

<sup>5</sup> GATT Article XXXV initially applied to Japan, but Japan officially joined the international trade system in the 1970s when the European countries abolished the measure invoking Article XXXV.

Agreement shall prevail to the extent of the conflict". In the case of non-application, benefits enjoyed by other Members are not provided to the country of non-application, which leads to results that are contrary to the MFN principle.

The WTO Agreement Article XIII provisions were created to deal with accession-related issues. Ideally, the MFN rule would be strictly applied so that when country B newly accedes to the Agreement, it is required to confer MFN status on all other Members, and they, in turn, are required to confer MFN status on country B. However, country A, which is already a Member of the WTO, may have reasons for not conferring all rights and obligations of the WTO on new Member B. Because the WTO only requires the consent of two-thirds of the existing membership for accession, it is conceivable that country A may, against its will, be forced to grant MFN status to country B. WTO Article XIII is a way to respect country A's concerns by preventing a WTO relationship from taking effect between countries A and B. Conversely, WTO Article XIII also provides a means for accession of country B, even when more than one-third of the membership, like country A, has reasons for not wanting a WTO relationship with country B (in which case they will object to the accession itself) by allowing for so-called non-application.

See the following table for examples of notifications of the non-application of the Agreements.

Country that notified non-application of the Agreements	Details
The United States	1995 Notified Romania of non-application of the Agreements (Repealed in February 1997) 1997 Notified Mongolia of non-application of the Agreements (Repealed in July 1999) Notified Kyrgyzstan of non-application of the Agreements (Repealed in September 2000) 2000 Notified Georgia of non-application of the Agreements (Repealed in January 2001) 2001 Notified Moldova of non-application of the Agreements (Repealed in 2013) 2003 Notified Armenia of non-application of the Agreements (Repealed in February 2005) 2007 Notified Viet Nam of non-application of the Agreements (Repealed in January 2007)
Turkey	2003 Notified Armenia of non-application of the Agreements
El Salvador	2001 Notified China of non-application of the Agreements

***Other Exceptions***

Other exceptions particular to MFN include GATT Article XXIV:3 regarding frontier traffic with adjacent countries, and Article I:2 regarding historical preferences that were in force at the signing of the GATT,<sup>67</sup>. General exceptions to the GATT that may be applied to the MFN treatment obligation include GATT Article XX regarding general exceptions for measures necessary to protect public morals, life and health, etc., and GATT Article XXI regarding security exceptions.

It is also possible to obtain a waiver from the MFN principle. Under WTO Article IX:3, countries may, with the agreement of other Members, waive their obligations under the agreement. Article IX:3 stipulates that exceptional circumstances, the terms and conditions governing the application of the waiver, and the date on which the waiver will be terminated shall be clearly stated. These waivers are also subject to annual review under Article IX:4<sup>8</sup>.

**MFN PROVISIONS OUTSIDE OF GATT 1994**

The idea of MFN treatment has been extended in agreements other than the GATT. Article 2.1 of the TBT Agreement provides the MFN treatment obligation with respect to technical regulations. The MFN provisions of Article 2.1 of the TBT Agreement are different from that of GATT Article I in wording, and there was a case in which the Appellate Body determined that they were interpreted differently (EC – Seal Products case). In this case, the Appellate Body concluded that while the MFN treatment obligation provided for in GATT Article I was determined solely based on whether or not the measure worsened the competitive conditions of imported like products regardless of the legitimacy of the objectives of the measure, violations of the MFN treatment obligation provided for in Article 2.1 of the TBT Agreement were determined after taking into consideration the objectives of the measure. The Appellate Body pointed out that this difference was due to the fact that in GATT the regulatory objectives were to be considered under Article XX (General Exceptions), but that general exception provisions similar to GATT Article XX did not exist in the TBT Agreement. Nevertheless, the objectives of the measure are indeed considered in both GATT and the TBT Agreement, and the determination of whether or not the measure is in violation of the obligation does not differ between these Agreements.

In addition, Article 2 of the SPS Agreement provides for the MFN treatment obligation with regard to sanitary and phytosanitary measures. Article 4 of the Agreement on Government Procurement (GPA) provides a non-discriminatory

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<sup>6</sup> See the WTO Secretariat Note (MTN.TNC/LD/W/1) issued in December 1992.

<sup>7</sup> These exceptions are not particular to the MFN treatment obligation, but there are exception provisions that can only be invoked under certain conditions. The provisions regarding anti-dumping and countervailing duties (GATT Article VI), exceptions to balances of international payments (GATT Article XVIII) (these are not exceptions to GATT Article I but to GATT Article XIII as described in (1)), governmental assistance to economic development (GATT Article XVIII:20), and suspension of the application based on nullification or impairment (GATT Article XXIII:2), etc. fall under such exception provisions.

<sup>8</sup> As of the end of September 2011, waivers applied in 31 cases (WTO Analytical Index, Volume 1, PP47).

treatment obligation for government procurement, and Article 3 of that Agreement provides for general exceptions to allow exemptions from the non-discriminatory treatment obligation.

For the trade in services and intellectual property rights sectors, Article II of the General Agreement on Trade in Services (GATS) provides for MFN treatment of services and service providers; Article 4 of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) contains the same requirements for the protection of intellectual property rights. The GATS provides exceptions where Members may waive their obligation to provide MFN treatment for specific measures in specific sectors by listing the measure in the Annex on Article II Exemptions. The TRIPS Agreement also provides for exemptions regarding measures based on existing treaties in the area of intellectual property. (*See* the relevant sections in Chapter 11 “Standards and Conformity Assessment Systems” for the TBT and SPS Agreements, Chapter 14 “Government Procurement” for the GPA, Chapter 12 “Trade in Services” for trade in services, and Chapter 13 “Protection Of Intellectual Property” for intellectual property rights.)

There are provisions, other than GATT, that provide for the conditions under which deviations from the MFN provisions are allowed. Such examples include the AD Agreement, the Agreement on Subsidies and Countervailing Measures (ASCM), the Agreement on Safeguards, the Agreement on Import Licensing Procedures, and WTO Accession Protocols, etc. (*See* the related sections in Chapter 6 “Anti-Dumping Measures” for the AD Agreement, Chapter 7 “Subsidies and Countervailing Measures” for the ASCM, and Chapter 8 “Safeguards” for the Agreement on Safeguards).

### ***3) Economic Aspects and Significance***

The significance of the MFN principle can be summarized by the following three points.

#### ***Increased Efficiency in the World Economy***

MFN treatment makes it possible for countries to import from the most efficient supplier, in accordance with the principle of comparative advantage. For example, if country B can supply product X at a lower price than country C, country A can increase its economic efficiency by importing it from country B. If, however, country A applies higher tariff rates to product X from country B than to product X from country C, country A may be forced to import product X from country C, even though country C is not as efficient a supplier. This distorts trade and reduces the welfare of country A and the economic efficiency of the entire world. However, under the MFN principle, country A must levy its tariffs equally with respect to countries B and C and therefore necessarily will import product X from country B because it is cheaper to do so. The most efficient result is thus attained.

#### ***Stabilization of the Multilateral Trading System***

The MFN rule requires that favourable treatment granted to one country be immediately and unconditionally granted to all other countries. Trade restrictions, too, must be applied equally. This increases the risk of trade restrictions becoming a

political issue, *i.e.*, it raises the costs and consequences of doing so, and therefore tends to support the liberalized *status quo*. By stabilizing the free trade system in this manner, MFN increases predictability and therefore increases trade and investment.

### ***Reduction of the Cost of Maintaining the Multilateral Trading System***

MFN reduces the cost of maintaining the multilateral trading system. The equal treatment demanded by the MFN principle tends to act as a force for unifying treatment at the most advantageous level (for trade that means the most liberal level). The establishment and maintenance of the MFN rule enables WTO Members to reduce their costs in monitoring the treatment given to them in comparison to the treatment given to third countries and in negotiating *vis-à-vis* disadvantageous treatment. In short, the MFN rule has the effect of reducing the cost of maintaining the free trade system.

In addition, as long as the MFN rule is honoured, imports from all WTO Members are treated equally, reducing the cost of determining an import's origin and improving economic efficiency.

## **2. MAJOR CASES**

The MFN principle is often invoked in GATT disputes as a basic principle of the GATT together with the national treatment principle. However, it is rare for MFN to be invoked on its own, and provisions regarding national treatment, quantitative restrictions, TRIMs, rules of origin, and technical barriers to trade are often cited in conjunction. Therefore, the number of precedents is small. In the following section, we discuss Canada's measures regarding automobiles, the EU's measures regarding bananas, the EC's generalized tariff preferences scheme, and the EU's measures prohibiting the importation and marketing of seal products, where MFN was a major issue.

### ***1) Canada – Measures Regarding Automobiles (DS139)***

Under the Agreement Concerning Automotive Products with the United States, which took effect in 1966 (the "Auto Pact"), the government of Canada accorded duty-free treatment to vehicles, provided that importers (the Big Three and others, hereinafter referred as "Auto Pact members") met certain conditions (*e.g.*, Canadian value-added — the required rates varied, but in general they were 60 percent or more). The system was implemented to provide tariff exemption to automobiles imported by any company that met the above conditions. However, the Free Trade Agreement (FTA) between the United States and Canada resulted in barring extension of the Auto Pact status to any new companies. This treatment continued after the North American Free Trade Agreement (NAFTA) took effect. What this essentially meant was that original Auto Pact member companies in Canada could import automobiles duty-free, provided they met the cited conditions, while non-members had to pay a 6.1 percent tariff (rate as of February 2000), despite the fact that all of these companies produced and offered like products and services.

The Ministry of Economy, Trade and Industry (METI) deemed this a priority trade policy issue and, in July 1998, requested bilateral consultations with Canada under WTO dispute settlement procedures. Japan requested the establishment of a panel in

November of that year, and in February 1999 a panel was established to review the Japanese complaint in conjunction with a similar EU complaint. The panel issued its report in February 2000, and the Appellate Body issued its report in May. Both reports upheld virtually all of Japan's arguments, finding that the measure: (1) violated GATT Article I:1 (MFN treatment); (2) violated GATT Article III:4 (national treatment); (3) violated the SCM Agreement; and (4) violated Article XVII of the GATS (national treatment). (However, the Appellate Body overturned the finding of the panel that the duty waiver violated Article II of the GATS (MFN treatment) and Article XVII (national treatment) of the GATS, stating that the panel based its ruling on a lack of sufficient evidence.)

## **2) EU – Measures Regarding Bananas (DS27)**

Under the Lomé Convention, the European Union maintains measures that provide preferential treatment to imports of bananas from countries in Africa, the Caribbean, and the Pacific (ACP) in the form of tariff quotas (*i.e.*, different tariffs are applied to set in-quota and out-of-quota amounts for the individual ACP countries). These measures have been before a panel twice under the GATT (*see* Chapter 16 “Regional Integration”).

After the conclusion of the Uruguay Round, the European Union created a new tariff quota regime for bananas. However, the United States, whose companies mainly deal in Latin American bananas, was dissatisfied with the new regime and argued that the licensing system provided preferential treatment to ACP bananas. The United States further argued that the preferential allocation of the quota to Latin American countries, who are parties to the “Framework Agreement on Bananas (BFA)” (especially Colombia and Costa Rica), was inconsistent with the WTO Agreement. After bilateral negotiations under GATT Article XXII between the European Union and the United States, as well as with some Latin American countries (Ecuador, Guatemala, Honduras, and Mexico), a panel was established in May 1996. Japan participated in the panel process as a third party.

In the report submitted in May 1997, the panel found that the EU's measures were inconsistent with the WTO agreements on the following points. The report of the Appellate Body generally upheld the main findings of the panel.

- (1) Allocating a portion of the quota regarding third-country and non-traditional ACP bananas to only operators who deal in the EU and traditional ACP bananas is inconsistent with Article I:1 (MFN) and Article III:4 (national treatment) of the GATT. The Lomé waiver does not waive the EU's obligations under Article I:1 with respect to licensing procedures applied to third-country and non-traditional ACP imports. The obligation under GATT Article I:1 was therefore still in force.
- (2) The above preferential allocation of the quota to operators who deal in traditional ACP bananas creates less favourable conditions of competition for like service suppliers from third countries, and is therefore inconsistent with the requirements of Article II (MFN treatment) and Article XVII (national treatment) of GATS.
- (3) Regarding the “BFA”, although it was not unreasonable for the EU to conclude at

the time the BFA was negotiated that Colombia and Costa Rica were the only Members that had a substantial interest in supplying the EU market, the EU's allocation of tariff quota shares is inconsistent with Article XIII:1 (non-discriminatory administration of quantitative restrictions). Regarding the relationship between the inclusion of the BFA tariff quota shares in the EU's tariff schedule and GATT Article XIII, the GATT Article XIII prevails over the EU's tariff schedule.

(For a broader discussion concerning the Lomé Conventions, *see* Chapter 16 "Regional Integration". For details on the dispute between the United States and the EU over the implementation of the recommendation by DSB, *see* Chapter 15 "Unilateral Measures".)

### ***3) EU– Differential provision of tariff preferences to developing countries (DS246)***

On December 10, 2001, the European Council announced Council Regulation No. 2501/2001 of generalized tariff preferences scheme covering the period from January 1, 2002 to December 31, 2004. The regulation consists of: (i) general arrangements; (ii) special incentive arrangements for the protection of labor rights; (iii) special incentive arrangements for the protection of the environment; (iv) special arrangements for least developed countries; and (v) special arrangements to combat drug production and trafficking (the "drug arrangement").

Among these arrangements, the general arrangements (i) are for developing countries in general, while the drug arrangement (v) is applicable only to the following twelve countries: Bolivia, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Pakistan, Panama, Peru, and Venezuela.

India argued that the Regulation is discriminatory since only twelve beneficiary countries are granted duty free access to the EC market, while all other developing countries are entitled only to the full applicable duties or duty reductions. In March 2002, India requested WTO dispute settlement consultations over the inconsistency of the Regulation with MFN and the Enabling Clause.

India requested the establishment of a panel in December 2002. The panel report was circulated to Member countries in December 2003. The panel found that the drug arrangement constituted a special treatment benefiting only some developing countries and, therefore, was inconsistent with GATT Article I. The panel further found that the measure's inconsistency with GATT could not be justified under the Enabling Clause, because not all developing countries equally received the special treatment, and such differential treatment was not based on special treatment for the least developed countries. Moreover, the panel found that the drug arrangement could not be justified under GATT Article XX(b), since it allows exceptions only for "necessary measures to protect life and health" and the drug arrangement was not intended as such.

The EU appealed the panel's findings to the Appellate Body in January 2004. The Appellate Body report was issued in April 2004, and subsequently adopted. The Appellate Body found that, in light of the object and purpose of the WTO Agreement

and the Enabling Clause, the Enabling Clause does not necessarily prohibit the granting of different special treatment to different GSP (Generalized System of Preferences) beneficiaries. However, the Appellate Body also found that identical treatment should be granted to all GSP beneficiaries who are at the same level of “development, financial and trade needs” that the treatment is expected to solve. The Appellate Body upheld for different reasons the panel’s findings that the EU violated its WTO obligations because the drug arrangement did not establish any criteria of grounds to differentiate the beneficiaries under the drug arrangement from other GSP beneficiaries and that, therefore, all similarly-situated GSP beneficiaries did not benefit from the drug arrangement.

***4) EC – Measures Prohibiting the Importation and Marketing of Seal Products (DS400, 401)***

*See* “Major Cases” 4) in Chapter 2, Part II.