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The most favoured nation
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trade law and the OECD
codes of liberalisation

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The Most Favoured Nation and Non-Discrimination Provisions in international trade law and the OECD Codes of Liberalisation

By

Andrea Marín Odio*

Increasing moves away from multilateralism have created a fragmented trade and investment scenario where economies progressively combine the application of restrictive unilateral actions with bilateral and regional preferences. The application of, and exceptions to, the non-discrimination provisions are a fundamental element of these trends.

This paper sheds light on the two types of non-discrimination provisions considered the founding stones of the multilateral system: the most favoured nation (MFN) clause - as developed under the GATT and GATS - and the non-discrimination clause among countries adhering to the OECD Codes of Liberalisation.

While not taking a position on the complex question of whether a multilateral, plurilateral or bilateral approach to trade and investment liberalisation should be pursued, the paper illustrates the OECD has upheld the non-discrimination obligation as one of its basic principles, dating back to its origins over 60 years ago.

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Abbreviations and acronyms

BIT	Bilateral Investment Treaty
CETA	EU-Canada Comprehensive Economic and Trade Agreement
CLCIO	Code of Liberalisation of Invisible Operations
CLCM	Code of Liberalisation of Capital Movements
CMIT	Committee on Capital Movements and Invisible Transactions
CPTPP	Comprehensive and Progressive Agreement for Trans-Pacific Partnership
CUSFTA	Canada-United States Free Trade Agreement
EEA	European Economic Area
EEC	European Economic Community
EFTA	European Free Trade Association
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GSP	Generalised System of Preferences
IC	Investment Committee
IIA	International Investment Agreement
IMF	International Monetary Fund
ISDS	Investor-State Dispute Settlement
MERCOSUR	Southern Common Market

MFN	Most-Favoured Nation
NAFTA	North American Free Trade Agreement
NT	National Treatment
OECD	Organisation for Economic Co-operation and Development
OEEC	Organisation for European Economic Cooperation
SSDS	State-State Dispute Settlement
UNCTAD	United Nations Conference on Trade and Development
UNISCAN	Anglo-Scandinavian Economic Committee
USMCA	United States-Mexico-Canada Agreement
WTO	World Trade Organization

Introduction

By the second half of the twentieth century, agreements concluding the global confrontation of the World Wars gave a main role to non-discrimination provisions in international trade and investment law, in a renewed effort towards building a multilateral framework of cooperation. In parallel, and prompted by economic circumstances and geopolitical considerations, regional integration schemes (in the form of bilateral and plurilateral agreements) developed as a way to grant additional preferences to selected treaty partners, without having to extend them to the rest of the world.

Since then efforts towards multilateralism have co-existed with preferential regional schemes, considered both a stepping-stone and a threat to the ultimate purpose of multilateral integration. Discussions on the interpretation, application and exceptions to the non-discrimination provisions in international trade and investment law are thus deeply linked with the debate on the preferred method of international cooperation and integration.

This paper contributes to this discussion by elucidating the concepts of the most-favoured nation (MFN) treatment and the non-discrimination clauses under international trade law and the OECD Codes of Liberalisation of Capital Movements and of Current Invisible Operations (hereinafter together referred to as “the Codes”), as well as their application and exceptions.

The non-discrimination principle often comprises two aspects: the MFN treatment obligation and the National Treatment (NT) obligation. The non-discrimination provision under Article 9 of the Codes is akin to the MFN obligation in other trade and investment instruments, whereas NT provisions are covered under the National Treatment instrument of the OECD Declaration on International Investment and Multinational Enterprises, albeit in a non-binding manner.

The non-discrimination principle protects the value of concessions granted by countries against future erosion through discrimination. In the absence of such provision a country might be reluctant to concede preferential access to foreign investment from negotiating parties fearing that they may grant a more favourable treatment to a third country thereby reducing relative benefits. This fear could lead to reducing the level of reciprocal concessions granted, or even frustrating any liberalisation process.

The application of this principle could, however, also bring unexpected consequences, such as the freezing of further expansion of concessions towards third parties, for fear of having to extend them via MFN to all; or, on the contrary, deepening trade and investment relations exclusively with third parties to avoid the application of a non-discrimination *inter partes* clause, such as the one in the Codes. Countries could also simply decide not to include, or to limit, MFN obligations in certain agreements, and give additional preferences only to their closest partners.

To mitigate the potential drawback of the non-discrimination provisions, different multilateral instruments allow some exceptions to the non-discrimination principle, provided certain conditions are met. As an example, Article 10 of the Codes allows Adherents forming part of a “*special customs or monetary system*” to apply additional measures of liberalisation to one another without extending them to other Adherents.

Currently, increasing moves away from multilateralism have brought about a fragmented world scenario, where trade and investment partners are progressively combining the

application of restrictive unilateral actions with bilateral and regional negotiations of preferences to selected partners.

While selective opening may help to reach agreements that would otherwise be impossible to achieve in the multilateral scenario, the continuing proliferation of International Investment Agreements (IIAs) has sparked a debate about coherence, compatibility and potential conflict between multilateral and regional approaches to trade and investment.

By November 2019, approximately 300 Free Trade Agreements (FTAs) and custom unions were in force. These correspond to 480 notifications from members of the World Trade Organisation (WTO). In addition, more than 2 300 Bilateral Investment Treaties (BITs) are in force. This spaghetti bowl of agreements can lead to a multiplication of regulations and associated increases in cost and administrative burden as well as the potential for countries to violate their non-discrimination obligations.

The OECD has been no stranger to the discussion of the discrimination issues caused by the proliferation of bilateral and plurilateral IIAs. Since 2005, the OECD Investment Committee has held ongoing discussions on the implication of preferential measures, taken unilaterally or in the context of the subscription of new IIAs, with the obligations of Adherents under the Codes.

The debate on the benefits and limitations of the non-discrimination principle stands at the core of the current policy discussions on the preferred model of international economic integration. This paper does not aim to take a position on the complex question of whether a multilateral, plurilateral or bilateral approach to trade and investment liberalisation should be pursued. It does illustrate however, how throughout the history of the Codes, both the Council and IC have upheld the non-discrimination obligation as one of the basic principles not only of the Codes but also in the broader OECD context (for example in the OECD Accession Roadmaps).

The paper proceeds as follows: **Section one** of this report explains the non-discrimination provision in the Codes and the traditional MFN provision, including definition, historical background and application. **Section two** expands on the exceptions to the traditional non-discrimination provision under the WTO and the non-discrimination provision under the Codes. **Section three** concludes.

1. Types of non-discrimination provisions: MFN and non-discrimination *inter partes*

This section presents an overview of the MFN and non-discrimination provisions, together with their historical background and applications and points to, where relevant, differences between the two provisions, which are not always well-understood.

Definitions

MFN provisions are core provisions in WTO agreements and are frequently found in bilateral, plurilateral or multilateral trade agreements. Through the inclusion of MFN clauses, parties typically agree that any concession or privilege granted by one contracting party to another contracting party should be not less favourable than the treatment extended to a third party in like circumstances, subject to defined exceptions (ILC, 1978). In investment treaties, MFN clauses provide for the not-less-favourable treatment for treaty-covered investors as compared to investors from other countries.

The initial objective of the MFN obligation has been to constrain countries from playing favouritisms among each other and, in this way, to avoid factionalisms (Trebilcock, 2015). As such, it has been considered as having a harmonising and levelling effect against discrimination (Ustor, 1968).

Although MFN provisions are common in international trade and investment agreements, the language in which they are expressed can differ significantly.

Early MFN clauses were mostly specific and retrospective. This meant they usually locked-in specific benefits already provided to a third party (backward-looking) and did not require extending any benefits granted to third parties in the future (Cole, 2012). Nowadays, MFN clauses in international trade and investment agreements are typically both backward- and forward-looking (covering preferential treatment already given to third states and future favourable treatment), or exclusively forward looking, for which their effect arises the instant more favourable treatment is provided to a third country (ILC, 1978).

For this initial analysis, this report will focus on the well-known MFN provisions under the WTO's General Agreement on Tariffs and Trade (GATT) and General Agreement on Trade in Services (GATS). Articles I of GATT and II of GATS embody the requirement for immediate and unconditional extension of benefits granted to any other country (whether a treaty party or not) to all treaty parties:

Article I of GATT:

“Article I: General Most-Favoured-Nation Treatment

1. With 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.**”* (Emphasis added).

Article II of GATS:

“Article II: Most-Favoured-Nation Treatment

*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 less favourable than that it accords to like services and service suppliers **of any other country**.”* (Emphasis added).

On several occasions, the WTO Appellate Body has described the MFN provision under GATT, as the “cornerstone of GATT” and as “one of the pillars of the WTO trading system.”¹

Similarly, the non-discrimination provision under the Codes calls for the extension to all Codes Adherents of benefits conceded to another Adherent. It differs from the MFN provision, however, in the sense that the obligation is limited to the extension of benefits granted to other Codes Adherents.

The non-discrimination obligation under the Codes is embodied in Article 9, which states that any benefit conferred to another member of the Codes (also known as Adherents to the Codes²) for the execution of transactions and transfers listed in Annex A of the Codes, must be extended to all members of the Codes:

“Article 9 Non-discrimination

*A Member shall not discriminate **as between other Members** in authorising the conclusion and execution of transactions and transfers which are listed in Annex A and which are subject to any degree of liberalisation.”* (Emphasis added).

Together with the obligation of progressive liberalisation and standstill, non-discrimination is considered as one of the core principles of the Codes, as well as of the OECD Accession Roadmaps (OECD, 2017). The lodging of discriminatory reservations is not permitted (OECD, 2019b).

According to Article 8 of the Codes, the non-discrimination rule applies independently of an Adherent’s degree of restrictiveness under the Codes.³ This means that even the most restrictive Adherent is still entitled to benefit from all liberalisation measures of other Adherents. There is no principle of reciprocity under the Codes. On the contrary, reciprocity and retaliation, for example in case of invocation of a derogation under Article 7, are not permitted.

Obligations under the Codes apply only among Codes Adherents. Third countries do not, in principle, benefit from the Codes’ obligation not to discriminate. However, under Article 1.d) of the Codes, Adherents have accepted to use their best endeavours to extend the benefits of liberalisation to all members of the International Monetary Fund (IMF).⁴

¹ Appellate Body Reports in: Canada – Certain Measures Affecting the Automotive Industry, WTO Doc. WT/DS139/AB/R (May 31, 2000); United States – Section 211 Omnibus Appropriations Act of 1998, WTO Doc. WT/DS176/AB/R (Jan. 2, 2002) and European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries, WTO Doc. WT/DS246/AB/R (Apr. 7, 2004).

² See Article 20.i) of the Code of Liberalisation of Capital Movements (CLCM).

³ Article 8 (Right to benefit from measures of liberalisation): “Any Member lodging a reservation under Article 2(b) or invoking the provisions of Article 7 shall, nevertheless, benefit from the measures of liberalisation taken by other Members, provided it has complied with the procedure laid down in Article 12 or Article 13 as the case may be.”

⁴ There has not been any study to assess whether Adherents have extended the same favourable treatment given under the Codes to other IMF members.

Historical background

Traditional MFN provisions

Although the first precedents of the contemporary notion of MFN clauses can be traced back all the way to the eleventh century (Ustor, 1968), it was not until the fifteenth century, with the codification of previous trade franchises, that the first examples of bilateral and reciprocal treaties appeared.

During the eighteenth and nineteenth centuries, MFN clauses became common features of many treaties, for example the friendship, commerce and navigation treaties, applying to a wide range of issues such as rights, privileges, immunities, duties, and prohibitions (UNCTAD, 2010).

In the twentieth century, the build-up of political tensions leading to the outbreak of the First World War made MFN clauses lose their appeal, since it was considered unnatural to treat close allies and more distant nations in the same fashion (Ustor, 1968).

Shortly after, the 1930s economic crisis spurred a proliferation of discriminatory measures with a protectionist aim, as trade blocs commenced applying a “beggar-thy-neighbour” trade strategy, raising import barriers and carving out preferential export markets in an effort to insulate from shrinking demand and growing unemployment (Krishna, Mansfield, and Mathis, 2012). This situation resulted in the collapse of international trade and contributed to the economic and political tensions that led to the Second World War (Van den Bossche, 2005).

Against this background, treaties concluding the global confrontation gave a preponderant role to MFN clauses, in a renewed effort towards multilateralism.⁵ The MFN principle was then considered vital to avoid falling back into hostile trade blocs and factionalisms that led to the previous wars. The decision to include an unconditional MFN principle as the first article of the 1947 GATT is a clear example of this sentiment.

There was, however, no clear consensus among countries regarding the complete elimination of preferential trade measures. Some pushed to maintain preferences to their colonies and close allies, and others advocated for acceleration of liberalisation through bilateral negotiation. A compromise was then reached in Article XXIV of the GATT, as an exception to the requirement of unilateral liberalisation. The outcome was a “multilateral-bilateral” hybrid, in which further concessions could be agreed in bilateral negotiations under certain conditions, as a stepping stone before multilateralising them in the future through the MFN provision (Irwin, Mavroidis, and Sykes, 2008).

In parallel, the MFN provision made its appearance in investment negotiations. An MFN clause was included in the first BIT ever concluded (Germany-Pakistan BIT of 1959) and was afterwards reproduced in subsequent IIAs, in an effort to guarantee a level playing field among foreign investors (UNCTAD, 2010; OECD, 2004). However, since MFN provisions in investment treaties apply to individual covered investors rather than to states, and mostly cover post-establishment treatment, its development differs to that of trade agreements (more details can be found in Box 1.1).

Since then, efforts towards multilateral liberalisation through the unilateral extension of preferences and multilateral trade negotiation have co-existed with regional efforts of integration. From the European Economic Community (EEC) and European Free Trade

⁵ The Paris peace treaties included MFN obligations to be complied with by Italy (Article 82) and Hungary (Article 33). Likewise, the Versailles Treaty (Articles 264-267), had imposed similar obligations on Germany.

Association (EFTA) of the late 1950s, passing through the 1990s MERCOSUR (Southern Common Market) and North American Free Trade Agreement (NAFTA) and the 2018 Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), among others, trade and investment preferences have been negotiated both at regional and multilateral level.

In recent years, progress through multilateral trade negotiation at WTO level has stagnated, raising new voices of criticism toward this model from both developed and developing economies. Critics cite different reasons such as a growing backlash against globalisation itself, free-trade capitalism and the proliferation of bilateral and plurilateral negotiations (Keating, 2015). The WTO strived to address these concerns through the 2001 Doha Development Agenda, originally expected to be concluded by 2005.

Nowadays, while some consider that bilateral/regional negotiations facilitate agreements and can spur a “domino effect” of faster multilateral cooperation, the continuing proliferation of IIAs and FTAs against inconclusive WTO negotiation has sparked a debate about the coherence, compatibility and potential conflict between multilateral and bilateral/regional approaches to trade and investment (Krishna, Mansfield, and Mathis, 2012).

Non-discrimination provision under the Codes

The Codes were born with the OECD in 1961, at a time when many OECD countries were still in the process of post-war economic recovery and fast catch-up, and the international movement of capital faced many barriers.

However, the origins of the Codes can be traced back to the predecessor of the OECD, the 1948 Organisation for European Economic Cooperation (OEEC).⁶ The OEEC emerged from the Marshall Plan and the Conference of Sixteen (Conference for European Economic Cooperation), which sought to establish a permanent organisation to continue work on a joint recovery programme and in particular to supervise the distribution of aid (OECD, 2019a).

The 1950 OEEC Code of Liberalisation focused mainly on trade and its “*invisible transactions*”. It included a framework for the elimination of trade quotas, as well as reforms aiming at international coordination of monetary policies, social and employment legislation, as well as capital and labour movements (Boyer, and Sallé, 1955).

The codification of capital account liberalisation and its principles, through the OEEC Code, was driven largely by the pursuit of European integration and the desire to establish a single market. Proof of this was the adoption of the OEEC framework, in late 1957, aimed at determining conditions for setting up a European Free Trade Area, in order to bring together the Common Market of the Six and the other OEEC members on a multilateral basis (OECD, 2019a).

The OEEC Code included a non-discrimination *inter partes* clause (Article 7). Initially, this principle was of difficult application, since European currencies were not transferable among themselves. With the establishment of the European Payments Union, which provided for such transferability, the pressure to discriminate for payments reasons

⁶ The OEEC originally had 18 participants: Austria, Belgium, Denmark, France, Greece, Iceland, Ireland, Italy, Luxembourg, Netherlands, Norway, Portugal, Sweden, Switzerland, Turkey, United Kingdom, and Western Germany (originally represented by both the combined American and British occupation zones (The Bizone) and the French occupation zone). The Anglo-American zone of the Free Territory of Trieste was also a participant in the OEEC until it returned to Italian sovereignty.

disappeared, and the non-discrimination rule was adopted as a basic principle of the Code (Boyer, and Sallé, 1955).

In 1961, with the creation of the OECD, all trade-related provisions were removed from the OEEC Code to become the current OECD Code of Liberalisation of Invisible Operations (CLCIO) and OECD Code of Liberalisation of Capital Movements (CLCM). The Codes became, respectively, Legal Decisions 0001 and 0002 of the newly-created Organisation. By virtue of being Decisions of the OECD Council, the Codes became legally binding on OECD Member governments. Although the OECD Codes are not a treaty in the sense of international law, they are an instrument which derives from a treaty.⁷

The principle of non-discrimination *inter partes* was maintained in both Codes (Article 9), as well as its role as a basic principle of the Codes.

Throughout the history of the Codes, Members have reiterated the importance of the effective and impartial application of the non-discrimination provision:

- During a major review of the CLCM in 1964, which provided for an exception to the principle of standstill for short-term operations,⁸ the non-discrimination principle for all operations (long- and short-term) was not only upheld, but also reinforced through a modification of Article 16.⁹
- In a 1978 review, Adherents reaffirmed that the non-discrimination principle “*in general is an important principle to the Organisation which must be followed as fully as possible*” [DAFFE/INV/72.23].¹⁰
- In 1986, the non-discrimination principle was reinforced through an agreement that reciprocity for inward direct investment and establishment is contrary to the obligations of the Codes; reciprocity, as one form of discrimination, may not be the subject of reservations under the Codes. In this context, a special Annex E to the CLCM was created to record reciprocity measures and practices outstanding at that time and subjected them to standstill, with a view to their eventual elimination (OECD, 2019b).
- The non-discrimination principle and corresponding provisions remained unchanged in the latest review of the Codes, finalised in May 2019.

Application of MFN and the Codes’ non-discrimination provision

MFN provisions

MFN provisions are present in both trade and investment agreements.

For the purposes of this paper, discussions will focus on the obligations enshrined in Article I of the GATT and Article II of the GATS, which reflect broad MFN obligations, and, where relevant, substantial case law and doctrine on MFN compliance can be easily found. In addition, a parallelism can be drawn between the Codes and WTO instruments, since both refer to multilateral agreements.

⁷ Article 5 of the Convention on the OECD provides that the Council may adopt legally binding Decisions.

⁸ By creating a new list B in Annex A.

⁹ The modification to Article 16 allowed Adherents to refer to the Organisation when they consider themselves prejudiced by the discriminatory effects of internal arrangements of other Members [C(64)13].

¹⁰ As quoted by the Report of the Committee on Capital Movements and Invisible Transactions (CMIT) Canada-United States Free Trade Agreement: issues for consideration [DAFFE/INV/88.23].

Since investment treaties differ in many ways from trade agreements and the Codes, the application of MFN in investment treaties will only be tangentially referred to. The MFN provisions in investment treaties apply differently (to individual covered investors rather than to states) and overwhelmingly apply only to post-establishment treatment, rather than to investment liberalisation (to note is that the Codes apply to both post and pre-establishment). They also typically provide for investor-state dispute settlement (ISDS) rather than state-state (SSDS), and much of their application and interpretation in cases has been associated with claimant efforts to treaty shop, raising issues of little relevance to date for the Codes.¹¹

The MFN provisions in IIAs that extend to liberalisation (and provide for covered investor claims) are, however, briefly addressed in Box 1.1. The bulk of the discussion herein focuses on non-discrimination provisions applicable to states in trade agreements in comparison with the non-discrimination provisions under the Codes.

Article I of the GATT enshrines the MFN obligation for trade in goods, while Article II of the GATS concerns trade in services. For goods, this obligation covers measures imposed on, or in connection with, both imports and exports. In relation to services, this obligation applies to measures affecting one of four modes of trade of services (as defined in Article I:2 of the GATS), namely: (i) cross border supply, (ii) consumption abroad by residents of other Members, (iii) supply by commercial presence in the territory of another Member, and (iv) presence of natural persons in the territory of another Member. The application of Article II of GATS to “Mode 3” supply of services is generally considered as the most direct multilateral commitment on investment, which may partially overlap with liberalisation arrangements made in investment treaties.

The MFN obligation under both GATT and GATS covers both *de jure* and *de facto* discrimination.¹² To that extent, MFN also forbids measures that appear origin-neutral, but in fact discriminate among products according to their origin. Additionally, it applies to measures adopted by central, regional or local governments or authorities, and to non-governmental bodies exercising powers delegated by governmental authorities.

Unlike the GATT, the GATS allowed, in principle, Members to exempt certain measures from the MFN obligation, which are listed in the Annex on Article II Exemptions. The majority of exemptions relate to maritime transport, communications, financial and business services (Van den Bossche, 2005). Exemptions were agreed for not more than ten years and subject to review after not more than five years, following the end of the Uruguay Round of Multilateral Trade Negotiations in 1995 or by the conclusion of extended negotiations on certain sectors for which the delayed submission of related exceptions was expressly authorised. Subsequently, requests for exemptions from Article II can only be granted under the waiver procedures of the Marrakesh Agreement (World Trade Organization, 2019a).

The application of the MFN provisions in the WTO means that all foreign producers and service providers seeking to enter the national market should have equal access, regardless

¹¹ See further development of the MFN principle in investment treaties at: OECD (2018). “4th Annual Conference on Investment Treaties Treaty shopping and tools for treaty reform”, available at <https://www.oecd.org/daf/inv/investment-policy/4th-Annual-Conference-on-Investment-Treaties-agenda.pdf>; and (OECD, 2004).

¹² See for example World Trade Organization (1997). Report of the Appellate Body. “European Communities – Regime for the importation, sale and distribution of bananas”. WT/DS27/AB/R, 9 September 1997; and World Trade Organization (2000a). Report of the Appellate Body. “Canada – Certain measures affecting the automotive industry”. WT/DS139/AB/R, WT/DS142/AB/R, 31 May 2000.

of origin. The MFN provision relates to equal treatment for like goods, services and service suppliers, even when what is or is not “like” can be difficult to establish.

Both in the GATT and in the GATS, the MFN obligation covers the advantages granted to any country, and not just to WTO Members. Subject to a number of exceptions (see Section 2.1), if a Member concedes an advantage to a third country, it must extend it immediately to all WTO Members.

Box 1.1. Pre-establishment MFN provisions in investment treaties ¹

A small but growing number of IIAs in force today contain MFN provisions that aim to foster market access by extending MFN treatment provisions to investors seeking to make investments, i.e. the pre-establishment phase of an investment. The first modern IIAs signed by the United States in the 1980s include pre-establishment MFN provisions (see, for example, [Senegal-United States BIT \(1983\)](#), Article 2(1), in which each contracting party guarantees that investments covered by the BIT may be “*established and acquired on terms and conditions that accord treatment no less favorable than the treatment it accords in like situations to investments of ... nationals or companies of any third country.*” (Emphasis added.)) These early US BITs were later followed notably by the NAFTA signed in 1992 between the United States, Canada and Mexico (Article 1103).

The 1994 GATS agreement represents one of the primary sources of multilateral liberalisation commitments on investment. Mode 3 of the GATS covers supply of trade in services by “commercial presence” in the territory of another WTO Member, which is in essence an investment activity. GATS provides for positive list liberalisation and MFN as described in the text, which may give rise to a partial overlap in service sectors between the GATS and IIAs containing pre-establishment MFN commitments. Several recent WTO disputes have involved alleged breaches of Article II of the GATS involving Mode 3 supply of services.²

More recently, Canada, Japan, the US and the European Union, among others, have included pre-establishment MFN provisions in some or all of their investment treaties and investment chapters of FTAs (for recent examples, see [EU-Canada CETA \(2016\)](#), Article 8.7; [CPTPP \(2018\)](#), Article 9.5; [USMCA \(2018\)](#), Article 14.5; [Japan-Argentina BIT \(2018\)](#), Articles 1(f) and 3; [EU-Japan EPA \(2018\)](#), Article 8.9; [Belgium/Luxembourg Model BIT \(2019\)](#), Article 6; [Australia-Indonesia CEPA \(2019\)](#), Article 14.5).

Pre-establishment MFN provisions in investment treaties generally contain exceptions. These can be in the form of negative lists for each party’s sectoral or other reservations. Alternatively, the treaty can set out positive lists identifying specific sectors to which MFN treatment extends. Few if any of the known investor claims filed under investment treaties have involved alleged breaches of pre-establishment MFN obligations.

1. This box was drafted by Baxter Roberts (DAF/INV)

2. See, for example, World Trade Organization (2018). Report of the Panel. “European Union and its Member States – Certain measures relating to the energy sector”. WT/DS476/R, 10 August 2018; World Trade Organisation (2015). Report of the Panel. “Argentina – Measures Relating to Trade in Goods and Services”. WT/DS453/R, 30 September 2015.

Non-discrimination provision under the Codes

Non-discrimination is one of the main principles of the Codes. It is enshrined in Article 9 and requires Adherents to grant the benefit of open markets to residents of all other Adherent countries alike, without discrimination. This obligation covers both pre-establishment and post-establishment.

Throughout the history of the Codes, both the Council and the IC have upheld the importance of this principle, reiterating that the non-discrimination provision must be applied impartially and as fully as possible, regardless of the country's own degree of liberalisation/restrictiveness under the Codes (OECD, 2019b).

The Codes do not permit the listing of reservations to the non-discrimination principle. Whenever Adherents lodge a reservation, irrespective of whether the reservation is a full or limited one – for example if authorisations are granted from time to time – the Adherent concerned must always grant such authorisations in a non-discriminatory fashion.

Adherent countries and those wishing to adhere to the Codes have agreed in the past to extend to all, unilaterally and unconditionally, preferential treatment given to other Adherents.

For example, in the case of the 1987 Canada-United States Free Trade Agreement (CUSFTA), the Council urged the Canadian authorities to normalise, at an early date, the situation with respect to their obligations under the Codes of Liberalisation [[C\(90\)38](#) and [C/M\(91\)19/PROV](#)]. As a result, Canada extended to all OECD Member countries the liberalisation measures adopted under the Agreement that offered more advantageous treatment to United States' investors in areas covered by the Codes.

Similarly, by application of Article 9 of the Codes, Mexico extended the benefits of the NAFTA to all OECD Members [[C\(98\)64](#)], and Chile extended the preferential treatment granted through FTAs in the area of insurance relating to goods in international trade and related brokerage services to all OECD Members [[C\(2009\)182/FINAL](#)].

The non-discrimination provision under the Codes has played a pivotal role during previous IC reviews of accession to the Organisation and now for non-Member adherence to the Codes.¹³

For example, as part of their accession processes to the Organisation, the Czech Republic [[C\(95\)188](#)], Hungary [[C\(96\)19](#)], Poland [[C\(2001\)243](#)], the Slovak Republic [[C\(2000\)114](#)] and Latvia [[C\(2016\)104/FINAL](#)] extended to all OECD Members any liberalisation measures taken under the association agreement with the European Union ("Europe Agreement") and committed to avoid discriminating among OECD countries in the event of recourse to the safeguards clause of that Agreement.

Furthermore, since reciprocity for inward direct investment and establishment are a form of discrimination contrary to the obligations of the Codes, which cannot be the subject of reservations, over the past 20 years discrimination based on reciprocity has been systematically eliminated at the request of the IC in all accession review processes.

Countries such as the Czech Republic [[C\(95\)188](#)], Chile [[C\(2009\)182/FINAL](#)], Israel [[C\(2010\)42/FINAL](#)], Slovenia [[C\(2010\)72/FINAL](#)], Estonia [[C\(2010\)62/FINAL](#)], Latvia [[C\(2016\)104/FINAL](#)], Lithuania [[C\(2018\)70/FINAL](#)], and Colombia [[C\(2018\)81/FINAL](#)] have all agreed to eliminate reciprocity requirements and extended to all Adherents the

¹³ On 19 May 2011, the Council decided to amend the Codes to make adherence by non-OECD countries possible [[C\(2011\)80](#)].

same liberalisation benefits, in accordance to Article 9 of the Codes. The application of this clause has impacted operations in areas such as radio and television broadcasting, acquisition of land, cross-border provision of transport services, professional services and establishment of insurance and banks.

In addition, Adherents such as Australia, Japan, Norway, Turkey and certain EU countries eliminated reciprocity requirements in financial services and corresponding entries in Annex E of the CLCM¹⁴, following a call by the Committee to set an example in a context where the Council's Accession Roadmaps explicitly require candidate countries not to apply reciprocity [\[C\(2009\)95\]](#).

Since 2005, the IC has held ongoing discussions on the implication of preferential measures, taken unilaterally or in the context of the subscription of new IIAs, with the obligations of Adherents under the Codes. Some Adherents have suggested considering the interaction between the MFN principle under the Codes and progressive liberalisation through the adoption of bilateral or regional FTAs, as well as further considerations on the potential exceptions to the non-discrimination principle under the Codes (OECD, 2017).

Notwithstanding the discussions of the IC, current obligations continue to apply until agreement is reached among all Adherents on any modification to their Code's obligations.

¹⁴ Annex E of the CLCM lists and "grandfathers" reciprocity conditions for FDI which were into force in 1986.

2. Exceptions to the MFN and non-discrimination provisions

Exceptions to the MFN provision

Under the WTO the two most relevant exceptions to the application of the MFN provisions concern: (i) concessions granted unilaterally to or among developing countries; and (ii) higher degrees of liberalisation within regional integration units (customs unions, FTAs, special economic zones, etc.) (Ustor, 1968).

The first exception (unilateral concessions for developing countries) is derived from the General Principle Eight of the Final Act of the United Nations Conference on Trade and Development, adopted in 1964: “*New preferential concessions, both tariff and non-tariff, should be made to developing countries as a whole and such preferences should not be extended to developed countries*” (United Nations, 1964).

In 1971, this exception was embodied into the Generalised System of Preferences (GSP) of GATT, with its corresponding “Enabling Clause”¹⁵.

The second exception (regional integration units) allows waiving the extension of unilateral concession in case of further liberalisation through customs unions, FTAs, special economic zones or other forms of regional integration. It is based on the assumption that close trading partners would grant each other deeper concessions and liberalisation since their already close relation would reduce the likelihood of one of them “free riding” that is, profiting from concessions made by the negotiating parties in multilateral settings, without granting any additional concessions on their own.

The WTO has codified this exception under Articles XXIV of the GATT for goods and Article V of the GATS for services, subject to the fulfilment of specific conditions, notification requirements and approval, as explained below.

The regional integration exception of the WTO

Since the MFN principle is considered one of the cornerstones of the trade system, exceptions to its application demand compliance with certain conditions under WTO rules, to ensure an optimal balance between the costs and benefits of breaching the non-discrimination principle (Schwartz, and Sykes, 1996).

Parties to a regional integration agreement must notify it to the WTO under Article XXIV.7 of the GATT for goods and Article V.7 of the GATS for services. The Committee on Regional Trade Agreements is responsible for reviewing whether the instrument complies with the required conditions of said Articles.

Nowadays, the agreed mechanisms to assess whether regional agreements or FTAs comply with WTO rules are harder to assess, since these rules correspond to a reality where treaty negotiation was motivated by the desire to avoid relatively high MFN tariffs. Today, this context has lost most of its relevance due to the fall in the average tariffs for goods and the new wave of deep FTAs, which involve more than just dismantling border barriers for commodities and focus increasingly on other domestic regulatory reforms needed for markets to perform competitively (OECD, 2014). Given that each FTA comes with a nearly

¹⁵ The Enabling Clause allows developed countries to grant additional preferences to developing countries, without the obligation to extend to all through the MFN principle.

unique regulatory framework, the proliferation of FTAs has increased the complexity of these assessments (Krishna, Mansfield, and Mathis, 2012).

The WTO Committee on Regional Trade Agreements considers FTAs falling under Article XXIV of the GATT and Article V of the GATS. As of today, there has been no finding as to the consistency of any notified agreement with WTO rules. Due to lack of consensus among WTO members, no assessment report has been completed (World Trade Organization, 2019b).

In December 2006, the Committee on Regional Trade Agreements provisionally enacted a Transparency Mechanism for Regional Trade Agreements. The mechanism provides specific guidelines on when a new FTA should be notified to the WTO and the related information and data to be provided (World Trade Organization, 2019c).

As part of the Doha Round, Members have sought to clarify and improve the disciplines and procedures under the WTO provisions applying to regional trade agreements (World Trade Organization, 2001). At the 2015 Nairobi Ministerial Conference, WTO members agreed to work towards the transformation of the current provisional Transparency Mechanism into a permanent mechanism. Members further agreed to discuss “*the systemic implications of [FTAs] for the multilateral trading system and their relationship with WTO rules*”. No conclusion has been reached to date, due to “*divergent reactions*” (World Trade Organization, 2019d).

Table 2.1. Notified exceptions to the MFN principle by type of agreement – WTO, 11/2019

	Enabling clause	GATS Art. V	GATT Art. XXIV (FTAs, CUs)	Grand total
Customs Union	7		11	18
Customs Union – Accession	2		10	12
Economic Integration Agreement		153		153
Economic Integration Agreement – Accession		7		7
Free Trade Agreement	17		239	256
Free Trade Agreement – Accession	1		3	4
Partial Scope Agreement	28			28
Partial Scope Agreement – Accession	2			2
Grand total	57	160	263	480

Note: Chart includes only agreements currently in force.

Source: World Trade Organization (2019) <http://rtais.wto.org/UI/publicsummarytable.aspx>

For trade in goods, Article XXIV of the GATT

Article XXIV of the GATT includes a series of conditions for the application of the regional integration exception to MFN. This Article has been subject to many interpretative questions throughout the years, however, its application remains intensely debated today (Schwartz, and Sykes, 1996).

The two main conditions for agreements to be accepted under the exception of Article XXIV are: (i) the agreement must cover substantially all trade; and (ii) liberalisation must be higher among parties, without worsening the conditions for other countries outside of the agreement.

The first condition of covering “substantially all” trade encourages the use of regional integration for the *creation* of trade, instead of *diversion* (Viner, 1950). To achieve the purpose of trade creation it is required that substantially all trade is liberalised by the

preferential arrangement; thus diminishing the incentives of striking a preferential deal that only favours inefficient, but politically powerful producers (Schwartz, and Sykes, 1996).

Some sustain that the legal application of the “substantially all” requirement has been loose, in particular since many current arrangements notified under the Article XXIV exception maintain an important number of trade barriers (Jackson, Davey, and Sykes, 2008). The fact that, typically, FTAs exclude certain “sensitive products”, which mainly fall within the agriculture and food sectors, supports this claim (Damuri, 2009).

For the second condition, the agreement must provide further liberalisation (of trade in goods) than that accorded to other parties. The assessment of this condition is made through a comparison of the weighted applied average tariff rates and customs duties collected before and after the conclusion of the agreement (World Trade Organisation, 1994). There is no system in place to assess the liberalisation of other measures, which might need to be reviewed individually. In that sense, assessing whether an FTA raises the level of barriers for non-participating countries is not a straightforward exercise (Van den Bossche, and Zdouc, 2012).

For trade in services, Article V of the GATS

As Article XXIV of the GATT for goods, Article V of the GATS requires the fulfilment of conditions for the application of the regional integration exception to MFN. These are that the agreements in question: (i) have substantial sectoral coverage; and (ii) provide for the absence or elimination of substantially all discrimination, through elimination of existing discriminatory measures and/or the prohibition of new or more discriminatory measures either at the entry into force of the agreement or on the basis of a reasonable time-frame.

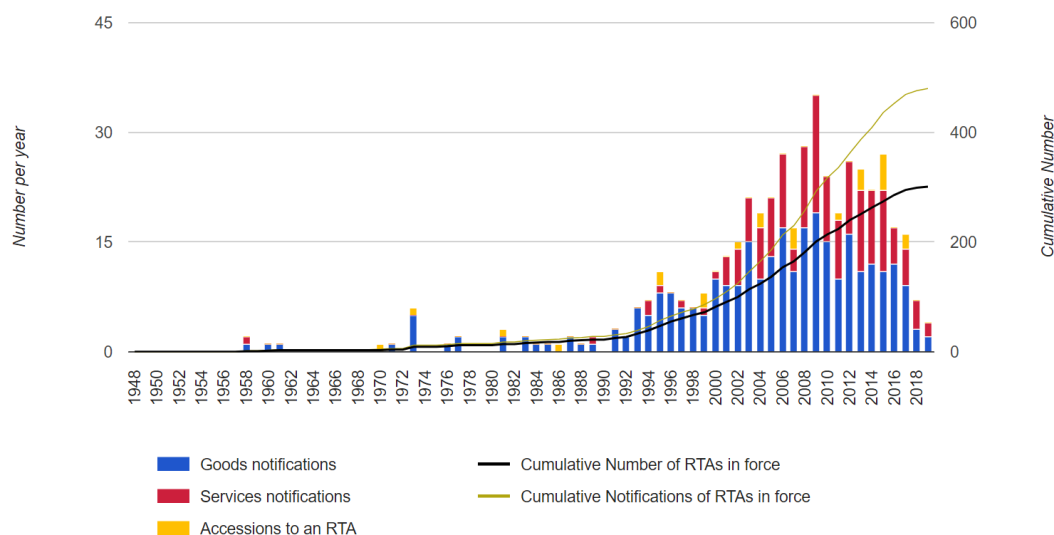
The first condition on substantial sectoral coverage implies the inclusion of all modes of supply and is understood in terms of number of sectors, volume of trade affected, and modes of supply. It derives from the purpose itself of Article V of the GATS, which is to allow for ambitious liberalisation at the regional level, while guarding from minor preferential arrangements undermining the MFN obligation. Exclusions shall be limited and no mode of supply can *a priori* be excluded (World Trade Organization, 2000a). This means that the agreement should also include liberalisation measures for investment (mode 3) and labour mobility (mode 4), excluding labour market integration agreements.

The second condition is for the agreement to provide for the absence of substantially all discrimination in the sense of Article XVII on National Treatment; this is, through the elimination of existing discriminatory measures and/or the prohibition of new ones. According to the WTO’s Appellate Body, the object and purpose of this provision is to eliminate all discrimination among services and service suppliers to all parties of an economic integration agreement, requiring preferential measures to be extended to service suppliers of all parties to the agreement (World Trade Organization, 2000b). Moreover, it requires parties to the agreement to abstain from raising the overall level of barriers to trade concerning the services and service suppliers of WTO Members outside the preferential agreement.

Some consider this second condition as an effective tool to multilateralise preferential liberalisation, in particular since its implementation in modern FTAs has translated in many instances into national regulatory changes (which tend to apply on an MFN-basis) in the areas of e-commerce, enhanced copyright protection, and pro-competitive practices (Lejarraga, 2014). Unfortunately, the complex nature of trade in services and the different

regulatory frameworks of countries hamper the exact evaluation of whether the overall level of barriers to trade has been effectively lowered (Van den Bossche, and Zdouc, 2012).

Figure 2.1. FTAs notified to the WTO (1948 – 2019)



Notes: FTAs appear referred as RTA (Regional Trade Agreement).

Source: WTO, Regional Trade Agreements Information System (RTA-IS), Extracted on 06/11/2019.

Exceptions to the non-discrimination provision in the Codes

The non-discrimination principle under the Codes admits only one exception, described in Article 10, according to which “*Members forming part of a special customs or monetary system may apply to one another, in addition to measures of liberalisation taken in accordance with the provisions of Article 2(a), other measures of liberalisation without extending them to other Members. Members forming part of such a system shall inform the Organisation of its membership and those of its provisions which have a bearing on this Code*”.

This exception seeks to promote a more rapid or wider liberalisation among selected Adherents, while preventing countries from raising new barriers to operations with the remaining Adherents.

At present, only the Belgium-Luxembourg Economic Union and the European Union have been recognised as special customs or monetary systems within the meaning of Article 10 (OECD, 2019b).

According to reiterated decisions by Council, new understandings of Article 10 can only be made by the IC (through delegated authority by the Council¹⁶), following an Adherent's invocation of an exception complying with the requirements set out on this Article.

In previous instances the Council has considered whether certain agreements, such as the US-Canada FTA or the EEA, could fall under the Article 10 exception, however it did not

¹⁶ In 2012, the Council delegated its own authority to take decisions concerning the Codes to the Investment Committee, in accordance with [\[C\(2012\)88/REV2\]](#).

reach a conclusion *ex officio*, since the parties to those treaties did not formally invoke the exception contained in Article 10 (see [\[C\(90\)38\]](#) and [\[C\(92\)218\]](#)).

Nevertheless, Council did clarify that any new measure falling under the understanding of Article 10 would have to be interpreted strictly, and require an examination by the Committee concluding that:

- The measure is taken in the framework of a "*special customs or monetary system*"; and that
- The measures giving rise to preferential treatment qualify as "*other measures of liberalisation*", in addition to those taken in accordance with the provisions of Article 2a). ([C\(90\)38](#), par. 45 and [C\(92\)218](#) par. 9 and 84)

“Special customs or monetary system”

The first element to consider for an exception to the non-discrimination provision in the Codes is whether the measures taken are within the framework of a special customs or monetary system.

This exception can be traced back to the 1950 OEEC Code (predecessor of the current Codes), where a reference to “*custom unions or analogous arrangements such as free trade areas*” was included, to allow for special exceptions for Members to “*strengthen their economic links by all methods which they may determine will further the objectives of the present Convention*”. This provision was further interpreted in 1949, 1958 and 1961, allowing countries to “*group themselves in special customs or monetary systems and grant additional advantages and assume additional liberalisation obligations among themselves*”. On this occasion, the Benelux customs union, the Anglo-Scandinavian Economic Committee (Uniscan)¹⁷, the European Economic Community and the European Free Trade Association (EFTA) were recognized as exceptions under the OEEC Code [\[DAFFE/INV/88.23\]](#).

When the OECD Codes were adopted in December 1961, the Council noted statements by the UK and by Denmark (on behalf of Denmark, Norway, Sweden and the UK) that Article 10 was understood to include the Sterling Area (which consisted of an informal group of countries that either pegged their currencies to the pound sterling or used the sterling) and the Uniscan.

The Belgium-Luxembourg Economic Union and the European Union have been recognised as special customs or monetary systems within the meaning of this provision. No further systems or areas have been invoked or recognised as falling within the purview of Article 10 of the OECD Codes.

It is noteworthy that the Codes, when adopted by the OECD Council, referred to *custom systems* and not to *customs unions*. The Committee on Capital Movements and Invisible Transactions (CMIT), predecessor of the IC, suggested that the original drafters of the Codes intended to provide Article 10 for “*customs arrangements falling short of a full customs union and thus possibly embracing the notion of free trade areas*”. This was suggested since it may not be relevant to the purposes of the Codes to insist on the

¹⁷ Association of an economic grouping between the Scandinavian countries participating in the OEEC with the United Kingdom and the Sterling area.

establishment of a common external tariff that would be necessary for the formation of a customs union [DAFFE/INV/88.23].

However, the required degree of integration between the members of a special system was not specified. CMIT called for a case-by-case assessment for those “*institutionalised and permanent arrangements between two or more Members aiming at achieving advanced liberalisation in their mutual economic relations through the abandon of existing customs or monetary barriers.*”

It was left for delegates to draw the line “*between such “systems” and merely limited individual arrangements on preferential treatment and/or reciprocity in certain fields which the codes intend to prevent*” [DAFFE/INV/88.23].

The CMIT provided criteria for the Committee to consider in case an Adherent invokes that a specific agreement falls under the understanding of Article 10 for “**special customs or monetary system**” [DAFFE/INV/88.23], which can be summarised through the following questions:

- Is it an institutionalised and permanent arrangement between two or more Adherents? (par. 59)
- Does it aim at achieving advanced liberalisation in their mutual economic relations through the abandon of existing customs or monetary barriers? (par. 59)
- Can the agreement be considered as “a system”? This is:
 - Is there a clear distinction between such “system” and a merely limited individual arrangement on preferential treatment and/or reciprocity? (par. 59)
 - Is there an acceptable level of abolition of restrictions (currently or planned)? (par. 62)
 - Are both parties eliminating restrictions to the same degree (par. 62)?
- Does the agreement establish a “special system” in the specific fields covered by the Codes (capital movements and invisible operations) or is it a “special system” for trade with only incidental implications for measures covered under the Codes? (par. 61)
- Would that part of the “special system” pertinent to the Codes extend to all or at least to the essential items included in Annex A of the Codes? (par. 61)

“Other measures of liberalisation”

The second element to consider for an exception to the non-discrimination provision in the Codes is whether the preferential treatment could be considered as “*other measures of liberalisation*”, in addition to measures of liberalisation taken in accordance with the provisions of Article 2.a).

This means that an Adherent that has lodged a reservation for a specific operation that affects all Adherents could grant partial or total additional liberalisation towards countries forming part of the same special customs or monetary system.

The purpose of this provision is to allow for more rapid or wider liberalisation among members of a special customs or monetary system, while preventing them from raising new barriers to operations with third countries.

According to previous interpretations by the CMIT, this additional liberalisation must not come at the expense of others or by ignoring previous obligations under the Codes [DAFFE/INV/88.23]. Consequently, new liberalisation measures may not result in “*deliberalisation*” for other Adherents, i.e. they must not involve the introduction of new restrictions on operations with third parties nor affect in any way liberalisation measures already taken in their respect.

In the past, the Committee created a non-exhaustive list of the main general principles of “**other measures of liberalisation**” [DAFFE/INV/88.23]:

- The liberalisation measures must be applied “to one another” i.e. among all members of the system;
- They must be applied “in accordance with the provisions of the system”, i.e. be taken in order to implement the special system;
- They must be taken with the intention of introducing more liberalisation among members of the system, as opposed to the intention to discriminate against third parties;
- The measures in question must be taken “in addition to measures of liberalisation taken in accordance with the provision of Article 2 a)”. Consequently, the measures may not result in *deliberalisation* for other Adherents, i.e. they must not involve the introduction of new restrictions on operations with third parties nor affect in any way liberalisation measures already taken in their respect.

3. Conclusion

This note expanded on the rationale, historical background and application of two different expressions of the long-established obligation in international trade and investment law of non-discrimination among states: the traditional MFN provision and the non-discrimination *inter partes* provision of Article 9 of the Codes.

Although often confused and referred to interchangeably, they serve a different scope and purpose. The traditional MFN provision seeks to extend to the parties of a treaty, unconditionally and unilaterally, any benefit conceded to any state, including third parties outside of the agreement; while the non-discrimination in the Codes constrains this same requirement exclusively to benefits granted among Codes Adherents.

Both of them, however, pursue the ultimate goal of abolishing discrimination in international relations, which has long been at the heart of the philosophy behind international law and the international governance system. The application of these provisions in international trade and investment has varied, fluctuating from periods of multilateral integration to those of high fragmentation. To cope with this divergence, exceptions to the MFN and non-discrimination provisions have been allowed, provided they serve the ultimate purpose of encouraging further liberalisation, albeit among a narrower set of economies.

With respect to the Codes, a historical analysis showed how, for almost 60 years and until recently, Adherents consistently abided to their obligations emanating from Article 9, by unilaterally extending liberalisation concessions in the areas of investment and financial services to all Codes Adherents, even if they originated from preferential agreements entered into with selected Adherents. In case these preferences were a result of concessions from a *special customs or monetary system*, an exception under Article 10 was invoked.

Discussions on the preferred model of integration must not overlook the origins and previous application of the fundamental principles of the multilateral system and its agreed exceptions. Understanding the reasons for a shift in countries' attitudes towards their non-discrimination obligations should include an assessment of whether the causes for non-compliance are endogenous (due to lack of clarity of the non-discrimination provisions) or exogenous (due to the increased international sentiment away from multilateralism and towards bilateral and regional liberalisation, combined with the application of restrictive unilateral actions).

This paper aims to contribute to this important discussion by clarifying and outlining the main aspects of the non-discrimination provisions in international trade law and under the OECD Codes, as well as their agreed exceptions.

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