

**The World Trading  
System**

Law and Policy of  
International Economic  
Relations

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### 6.1 Most-Favored-Nation Obligation and Its Politics

There are two important principles of "nondiscrimination" in GATT and most international trade policies. The first is that of the "most-favored-nation" (MFN) principle, expressed in Article I of GATT and in a number of bilateral and other treaties. Despite some confusion derived from the phrase "most-favored," which seems to imply a specially *favorable* treatment, the concept is one of equal treatment, but to that *other* party which is most favored. In the GATT the MFN obligation calls for each contracting party to grant to every other contracting party the most favorable treatment which it grants to any country with respect to imports and exports of products.

The second obligation of nondiscrimination — that of "national treatment" — is the obligation to treat foreign goods equally to domestic goods, once the foreign goods have cleared customs and become part of the internal commerce. In this chapter we deal with MFN, and defer until a later chapter the national-treatment subject.<sup>1</sup>

The MFN obligation has a long history which is easily traced back to the twelfth century,<sup>2</sup> although the phrase seems to have first appeared in the seventeenth century. Growth of commerce during the fifteenth and sixteenth centuries seemed to be a major cause of MFN-type treaty clauses, as European nations competed with each other to develop networks of trading relationships. The United States included an MFN clause (albeit "conditional") in its first treaty, a 1778 treaty with France.<sup>3</sup> It has sometimes been speculated that early MFN clauses were "shorthand" means of including series of trade obligations in new treaties, without laboriously writing out those obligations.<sup>4</sup> In later centuries, the MFN clause, either conditional or unconditional, was frequently included in a variety of treaties, and particularly in the various Friendship, Commerce, and Navigation (FCN) treaties.<sup>5</sup>

One question which has sometimes been debated is whether there is any sort of MFN or economic nondiscrimination obligation independent of a treaty clause, under customary international law. While the issue is disputed, the prevailing view of scholars is that such an obligation exists only when a treaty clause creates it. Lacking a treaty, nations presumably have the sovereign right to discriminate against foreign nations in economic affairs as much as they wish. It may be that the "national treatment" obligation differs in this respect, however.<sup>6</sup>

What are the policy arguments which underpin the MFN principle? We now turn to an examination of some of those arguments, as well as to some arguments against the MFN idea.

Sometimes MFN is equated with the concept of "multilateralism," but it must be recognized that the two concepts can be distinguished. Multilateralism is an approach to international trade and other relations which recognizes and values the interaction of a number, often a large number, of nation states. It recognizes the dangers of organizing relations with foreign nations on bilateral grounds, dealing with them one-by-one. MFN, on the other hand, is a standard of equal treatment of foreign nations.

Many of the policies favoring MFN also favor multilateralism. It is, of course, possible to have multilateral approaches that do not depend on MFN; but the reverse seems relatively unlikely, although not impossible (for example, MFN clauses can be contained in bilateral agreements).

There are at least two groups of arguments that buttress the policy of MFN. First, there are some arguments that we may loosely call "economic." Second, there are a group of political or "not-so-economic" arguments.

With respect to the first category, several economic policy arguments in favor of MFN can be stated. To begin with, nondiscrimination can have the salutary effect of minimizing distortions of the "market" principles that motivate many arguments in favor of liberal trade. When governments apply trade restrictions uniformly without regard for the origin of goods, the market system of goods allocation and production will have maximum effect. Lamb meat will not be shipped halfway around the world when nearby markets could just as easily absorb it.

A second economic argument is that MFN often causes a generalization of liberalizing trade policies, so that overall more trade liberalization occurs (the multiplier effect of the MFN clause).

Third, MFN concepts stress general rules applicable to all participating nations, which can minimize the costs of rule formation (such as the

difficulty of negotiating a multitude of bilateral agreements). Some theoretical arguments incidental to the "prisoner's dilemma" suggest that an optimum approach to avoid mutually destructive actions is to enter into an agreement that effectively restrains attempts by any party to engage in "exploitative" behavior. When many parties are involved (such as ninety-six or more member nations of GATT), a generalized rule seems the best approach. In addition, of course, attention must be given to making the rule effective.

Finally, MFN helps minimize transaction costs, since customs officials at the border may not need to ascertain the "origin of goods" to carry out their tasks with respect to goods controlled by MFN.

Turning to the second group of arguments, the "political" side of MFN policies, we first can note that, without MFN, governments may be tempted to form particular discriminatory international groupings. These special groupings can cause rancor, misunderstanding and disputes, because those countries which are "left out" resent their exclusion. Thus MFN can serve the functions of lessening tensions among nations and of inhibiting temptations for short-term *ad hoc* government policies which could be tension-creating in a world already too tense.

It must be recognized, however, that there are certain counterarguments, and that certain categories of nations take a position on some of the MFN policies that acts contrary to a full implementation of MFN obligations. During recent decades this has been particularly true of the developing countries,<sup>7</sup> who have argued that the GATT world trade system operates in such a manner as to inhibit the economic development of many societies who have a weaker economic status in the world. In the view of these countries, "preferences" should be arranged to compensate for the operation of this system, and generally for charitable reasons to assist the poorer nations to develop faster. Obviously, these arguments have merit. However, the risk is always that these arguments will be used to rationalize preferential systems that do not have the intended function of promoting economic development, but rather are used to assist national governments in certain short-term nationalistic political objectives not materially related to overall economic development. In addition, the experience of the Generalized System of Preferences in the GATT System, during the last fifteen years or so, is that for a number of different reasons each of the preference-granting national entities (the industrialized countries) succumbs often to the temptation to use the preference systems as part of the "bar-gaining chips" of diplomacy.

A second set of counterarguments stresses the risk of a unilateral unconditional MFN approach. These are the "foot-dragger" and "free-rider" arguments. To negotiate a general rule applicable to all nations in a system that stresses unanimity and consensus often means that a hold-out nation can prevent agreement or cause its provisions to be reduced to the least common denominator. This can greatly inhibit needed improvement in substantive or procedural rules.<sup>8</sup>

On the other hand, for like-minded nations to go ahead with reforms and agreements without the "foot dragger," but to grant (as unconditional MFN requires) all the benefits of the new approach to the non-agreeing parties, gives the latter unreciprocated benefits without any of the obligations. This furnishes an incentive to nations to stay out of the agreement. It was this which led the United States to require nations to accept the Subsidies Code obligations as a condition to receiving beneficial United States treatment in countervailing duty cases (as specified in the Code).<sup>9</sup>

## 6.2 The Meaning of MFN

### Introduction

What does MFN treatment mean? Essentially, it is an obligation to treat activities of a particular foreign country or its citizens at least as favorably as it treats the activities of any other country. For example, if nation A has granted MFN treatment to B, and then grants a low tariff to C on imports from C to A, nation A is obligated to accord the same low-tariff treatment also to B and its citizens. The result of a nation being a beneficiary of an MFN clause is that that nation can comb all the treaties and all of the actual treatment of the granting nation, to see if some obligation or real treatment is more favorable than that granted to it, in which case the beneficiary can argue that such better treatment is owed to it.<sup>10</sup>

The subjects to which MFN applies depend on the treaty clause. The GATT clause (Article I), for example, applies to trade in goods—both imports and exports. However, it does not apply to the "right of establishment" (often found in FCN treaties, which often apply MFN to it), nor to "services" trade (e.g., banking, insurance, etc.).<sup>11</sup> Nevertheless, the GATT language is quite broad, and covers a lot of territory.

MFN clauses can be "conditional" or "unconditional," and in recent decades yet another MFN concept has arisen, which I will call "code-conditional."

### Conditional and Unconditional MFN; Code Conditionality

Under conditional MFN, when country A grants a privilege to country C while owing MFN to country B, then country A must grant the equivalent privilege to B—but only after B has given A some reciprocal privilege to “pay for it.”

Under unconditional MFN, in the case above A must grant the equivalent privilege to country B, without receiving anything in return from B. The United States pursued a “conditional MFN” policy prior to World War I, although many other major nations had by that time moved to an unconditional approach. The United States changed to an unconditional policy in 1923.<sup>12</sup>

Several arguments are often voiced in preference of the unconditional approach over the conditional. In the first place, it is very difficult to negotiate for reciprocal concessions from a third-party beneficiary of benefits. When A grants to C a privilege, and B knows that MFN obligations require that privilege to go to B also, albeit after “payment,” there is not a very strong incentive for B to be forthcoming in a bargaining process with A. Such negotiations can generate more rancor and trouble than they are worth. Second, unconditional MFN can help spread trade liberalization faster, since any concession by a particular country is generalized to apply very broadly.<sup>13</sup> The GATT MFN clause is clearly unconditional.

A different type of MFN concept has arisen in connection with various “codes,” or side agreements on trade matters, negotiated in the Tokyo Round. In some of these codes, certain code members have taken the position that the benefits of code treatment will only be granted to other nations who have become members of the code (or at least reciprocate with code treatment). Thus, if A, B, and C belong to a code which calls for an “injury” test requirement before countervailing duties may be applied to imports, A could argue that it need not give such a test to the imports from X, who is not a code member.<sup>14</sup> Sometimes this has been called “conditional MFN,” but in fact it is not the same as the traditional “conditional MFN” concept, since it does not require a particular negotiation of reciprocal benefits. Instead, the code itself defines the nature of the “reciprocity” which is owed in order to receive the advantage of this type of MFN. The advantage of “code conditionality” is that it creates an incentive for other nations to join a code and submit to its discipline. If a general (e.g., GATT) MFN obligation required all code nations to grant the favorable code treatment to nations who did

not become code members, there would be substantially less incentive for such nations to join. They could take a "free-rider" approach, and claim the benefits without having to incur the discipline of code membership.

### Applying the Clause

It is not always easy to determine the way the MFN obligation applies. First, in the GATT and many other agreements, the language of the obligation speaks of MFN treatment for "like products." So the question often arises as to what "like products" are.<sup>15</sup> This question relates frequently to the question of classifications for tariff purposes which I described in chapter 5. When country A wishes to differentiate its treatment of countries B and C, regarding tariffs on radios, for example, one way to do this is to analyze the imports from B and from C to see if there are distinguishing characteristics. If it is discovered that B ships FM radios, while C ships AM radios, then A will be tempted to charge a higher tariff on FM radios, if it intends to favor C or disfavor B. As I noted in section 5.3, this is one of the reasons for narrower classifications within tariff schedules.

A 1952 GATT dispute case reveals an important consideration in the process of applying MFN clauses.<sup>16</sup> Norway and Denmark complained that a Belgian law levied charges on imported goods which differed according to the nature of family allowances in the exporting country. Although the language of the report in this case was not very clear, the report did conclude that Article I of GATT had not been fulfilled. The case can be interpreted to support the proposition that while treatment can differ if the *characteristics of goods* themselves are different, differences in treatment of imports cannot be based on differences in characteristics of the *exporting country* which do not result in differences in the goods themselves. On the other hand, as chapter 5 noted, a 1982 GATT panel found in favor of Brazil that Spain had not lived up to GATT MFN obligations when it subdivided its customs classification of coffee into sub-parts and applied a much higher duty on those types of coffee imported from Brazil. The panel stated that the coffees were so nearly the same that they were "like products," and that this must be treated nondiscriminatorily even though there were no tariffs binding by Spain on the product.<sup>17</sup>



### 6.3 Exceptions to MFN and Potential for Bilateralism

#### The Variety of Exceptions

Despite the policies and legal obligations which support MFN, it is widely recognized that there are substantial departures from MFN in international trade practice. Indeed, it has been estimated that more than 25 percent of all world trade moves under some form of discriminatory regime which is a departure from MFN principles.<sup>18</sup>

Some of these departures were anticipated by the original draftsmen of the MFN clauses, such as the MFN clause in GATT. For example, it has been recognized for centuries that although a tariff may be established on an MFN basis, classifications of tariff items can to some extent operate effectively to discriminate between the goods of various countries (as I noted in the previous section).<sup>19</sup>

In addition, when the GATT was drafted there were a number of preferential systems in existence, most prominently the Commonwealth Preference System. The GATT recognized that some of those preferential systems could continue as something like "grandfather exceptions" to the GATT, with the assumption that in due time the effect of those preferences would decline. Thus, annexes to GATT explicitly provide for such exceptional treatment from MFN.<sup>20</sup>

Other exceptions include some which are discussed elsewhere in this book, such as the problem of Article XIX (escape clause),<sup>21</sup> questions which have arisen in the context of the Tokyo Round codes,<sup>22</sup> and the opportunity for nations to "opt out" of a GATT relationship pursuant to Article XXXV of GATT.<sup>23</sup> It should be noted that if the GATT authorizes a responding action under the disputes provision, Article XXIII, such action need not be taken on an MFN basis.<sup>24</sup>

Furthermore, waivers sometimes authorize departures from MFN. Two important examples of this are the United States-Canada Automotive Products Agreement, (allowing a free trade area for automotive products),<sup>25</sup> and the United States preferences granted to the Caribbean Basin.<sup>26</sup> The Generalized System of Preferences (GSP) program to favor trade of less developed countries operated under the benefit of a waiver from GATT MFN from 1971 to 1981.<sup>27</sup> Presently it is presumed to be authorized by the Tokyo Round Understanding, called the "enabling clause" but officially entitled the understanding on "Differential and More Favorable Treatment, Reciprocity, and Fuller Participation of Developing Countries."<sup>28</sup>

The GATT Article XX "general exceptions"<sup>29</sup> can allow departures from MFN, but there is in that article another "soft" MFN obligation.<sup>30</sup>

Quantitative restrictions often pose an important conceptual challenge to the MFN principle. If a licensing system is used which is based on a "global quota," open to all equally on a first-come, first-served basis, or on a system of auctioning licenses to the highest bidder, then MFN seems realized. But, as is often the case, when quotas or licenses are allocated on a geographical or enterprise basis, even if they are related to historical trading patterns, then to some extent MFN is not completely fulfilled, since different countries or enterprises will have different types of fixed rights. GATT Article XIII establishes a "quasi" MFN principle for many such cases, which primarily relies on historical patterns.

In a similar context, the explosion of use of export-restraint arrangements in world trade provides one of the most significant recent challenges to the MFN principle of GATT. In the widespread use of so-called "voluntary restraint agreements," or "orderly market arrangements," the typical application is on a bilateral basis, and often provides *de facto* discrimination. Thus, countries that have proved most successful in rapidly expanding their exports of particular products become the targets of importing country governments' pressures to adopt export restraints of one form or another. In this context Japanese automobile restraints on the United States market immediately come to mind.<sup>31</sup>

Finally, this brief inventory of some of the discriminatory or non-MFN activities within the current world trading system is not complete without noting the real difficulty of this problem for nonmarket economies. When the enterprises doing the trading—either in imports or exports—are doing so not according to market principles but according to government commands, it is very hard to police any notion of MFN nondiscrimination. A government can always argue that it is not discriminating, and can often conceal the noneconomic motivations which have led it to command differential orders for imports or treatment for exports. In this connection, the problem of reconciling the forms of economic organization of nonmarket economies with the particular obligations of GATT which were designed for market economies is not unique.<sup>32</sup> This problem comes up in a number of different types of obligations of the GATT.<sup>33</sup> A similar group of problems arises in the context of so-called "countertrade."

## Customs Unions and Free Trade Areas

One of the most prominent and difficult problems engendering exceptions to MFN and GATT is that of Article XXIV, which provides an exception for customs unions (CU), free trade areas (FTA), and interim agreements leading to either. This article has furnished a very large loophole for a wide variety of preferential agreements.<sup>34</sup>

GATT Article XXIV is based partly on the historical precedent of special regimes of frontier traffic between adjacent countries, but also on the policy that total world welfare can be enhanced by regimes of trade which totally eliminate restrictions on trade among several countries. This is sort of an "all-or-nothing" idea, which is prepared to tolerate some of the disadvantages of preferential treatment of trade in exchange for substantial liberalization of trade among several nations. It recognizes the "free-rider" or "foot-dragger" disadvantages of MFN, allowing particular departures from MFN to facilitate trade liberalization if such liberalization goes far enough to provide substantial advantages to the world. This article is also designed to allow such departures from the MFN principle for the purpose of trade *creation*, while discouraging regimes leading to trade *diversion*.

For these reasons, the GATT exceptions for customs unions and free trade areas provide several significant limitations on the exception.<sup>35</sup> First, the MFN departures are in theory allowed only for CUs or FTAs which are defined to require liberalization on "substantially all" the trade involved. Second, regarding CUs, the GATT article requires that the common tariff arrangements of the preferential group, toward third-country "external" trade, be not "on the whole" more restrictive than the "general incidence of" duties and regulations before the CU was formed. These are, however, difficult legal concepts to apply, and have caused much controversy in the GATT. In addition, the GATT exception allows an "interim agreement" — one which leads to a CU or FTA within a reasonable time — to depart from MFN. This has opened a loophole of considerable size, since almost any type of preferential agreement can be claimed to fall within the exception for "interim agreement," and "reasonable time" is exceedingly imprecise.<sup>36</sup>

Indeed, despite notification of five dozen or more Article XXIV-type arrangements, some of which provide very loose preferences as "interim agreements" and no set date for completion of the FTA, there is no formal record of GATT "disapproval" of such arrangements.<sup>37</sup>

## 6.4 Rules of Product Origin

The customs laws of many nations require identification of the country of origin for imported goods. If true MFN were followed for all goods and all origins, then presumably there would be no need for such rules.<sup>38</sup> In fact, however, there is considerable differentiation of treatment of imports, depending on their origin. For example, if six countries who are GATT members form a customs union so as to free all trade among them from tariffs, then at least three levels of tariffs may apply to goods imported into one of the six: the GATT bound-tariff level for GATT members who are not in the customs union; tariff-free treatment for customs union goods; and tariffs on goods from other countries who are not GATT members. Thus, when widgets are imported, it may be necessary to determine from which of the three groups of countries the goods originated. In some cases there may be more than three categories, when other special preferential areas exist.<sup>39</sup>

In addition to the problem just mentioned, there is also the "transshipment" question. Let us say the countries A, B, and C belong to GATT, but country X does not. Suppose X ships tires to B, which then ships them to C, where C plans to charge a tariff of 12 percent. If C's tariff binding on tires is 10 percent, and C actually charges 8 percent on tires from A, can B claim benefits from either the GATT binding (10 percent maximum) or GATT's MFN clause for its tire shipment to C? The answer is no, because the products are not products of B. They are products of X, and the GATT obligations apply only to the *products* of GATT members.

Now imagine that X produces plastic pellets which are shipped to B. In B these are melted and extruded into combs. Can B ship the combs to C and claim GATT benefits? The key question is whether the products are those of B. Merely transshipping, or even merely repackaging X products, would probably not obtain for B the GATT treatment for the combs. But when substantial processing occurs, then B can claim the goods are now B's product. But how much processing is necessary?

GATT does not offer a single definitive answer to this question. Instead, each country, within the bounds of reasonableness, has the sovereign right to define its "rules of origin," which will govern the determinations of its customs officials about the "origin" of goods presented for import. Indeed, the same country may have several different "rules of origin" depending on the purpose of the regulation which governs the particular imports. However, there is a multilateral convention covering rules of origin. The Kyoto Convention<sup>40</sup> (concluded under

the auspices of the Customs Cooperation Council in 1974) contains, in Annex D:2, certain rules for the determination of origin. The EC adopted the convention's rules in 1977. However, the U.S. only partially ratified the convention in 1983,<sup>41</sup> and did not accept the provisions on rules of origin.

The U.S.–Canadian FTA contains a measure regarding rules of origin, and this has already proven somewhat controversial.<sup>42</sup>

Two fundamental approaches to this problem have been widely used. One approach is a "substantial transformation" principle, by which a product becomes attributed to the most recent exporting country only if within that country there has been a "substantial transformation" of the input goods obtained from another country. One test, sometimes mentioned, is whether the goods have been changed sufficiently to cause them to be listed under a different heading in the tariff classification. The problem with this approach is that different parts of the tariff classification have different levels of detail, and somewhat arbitrary results can occur.<sup>43</sup>

A second approach is a "value-added," or percentage-value, approach. Under this principle, goods are attributed to the last country of export if that country has added a certain percentage of value to those goods. For example, the U.S. rule-of-origin law governing goods imported to the U.S. under the Generalized System of Preferences (GSP) rules is that the goods must in general contain 35 percent of their value in materials or processes originating in beneficiary developing countries.<sup>44</sup>

Occasionally, rules of origin generate complaints from exporting countries when such rules are deemed to unfairly restrict imports from the complainant. For example, the United States became quite upset about standards for rules of origin in some free-trade agreements between the EC and other European countries (former EFTA partners). Allegedly, the rule required 95 percent of the value of goods to be attributed to the free trade partner,<sup>45</sup> thus reducing the opportunity for the U.S. to sell parts or partly completed products to EC countries in competition with favored third-country goods.

## 6.5 The Tokyo Round Agreements and MFN

For reasons noted in earlier parts of this chapter,<sup>46</sup> there is a rational policy reason to require "code conditionality" for the application of benefits of a "side agreement" regarding particular trade principles

such as antidumping, countervailing duties, or government procurement. None of the Tokyo Round codes actually requires "code conditionality"; that is, none of the codes prevents signatories from extending the benefits of trade treatment required under the code to GATT member nations who have not signed the code. Nevertheless, discussions during the Tokyo Round negotiations (1973-1979) noted the advantages of providing an incentive for nations to enter the disciplines of the codes, and limiting the benefits of the codes to signatories was observed to be a major incentive.

Still, GATT has a broad MFN obligation, and this can be deemed to require at least some of the code benefits to apply to all GATT members. For example, if fourteen GATT members sign a side agreement (or "code") which limits certain trade-restrictive practices in antidumping duty procedures, GATT members who did not sign the side agreement can claim that such beneficial treatment should be accorded their exports to the code signatories, because of the GATT MFN clause. Indeed, a GATT ruling in 1968 stated with regard to the 1967 Antidumping Code that GATT nations were entitled to beneficial treatment under the Code even if they had not signed the Code.<sup>47</sup>

The same issue has come up with regard to the Tokyo Round agreements. Anticipating this problem somewhat, the GATT Contracting Parties at the end of the Tokyo Round in 1979 adopted a decision which noted "that existing rights and benefits under the GATT of contracting parties not being parties to these Agreements, including those derived from Article I, are not affected by these Agreements."<sup>48</sup> This language, of course, leaves somewhat open the question as to when the MFN obligation specifically applies to the benefits under a Tokyo Round agreement.

The United States, when it implemented the Tokyo Round codes through its Trade Agreements Act of 1979,<sup>49</sup> did not extend the code treatment of three agreements to all other GATT parties. These three exceptions to MFN application by the U.S. of the codes were:

1. The Subsidies-Countervailing Duty Code
2. The Government Procurement Code
3. The Technical "Standards" Code

In each of these three cases, the U.S. statute required nations to themselves apply the code provisions before being entitled to code treatment by the United States. Thus, the question arises whether this approach violates U.S. obligations under Article I of GATT.

With respect to the second and third agreements listed above, there are significant arguments why MFN is not required. Government procurement is excepted from GATT Article III (national treatment) by explicit clauses in paragraph 8 of Article III. Article III treatment is incorporated by reference into GATT Article I, and so it has been argued and apparently accepted by tacit consent and practice that the GATT MFN obligation does not apply to government procurement.<sup>50</sup>

The Standards Code is essentially a set of procedures. Its substantive rule merely restates the principle of national treatment found in GATT Article III. Thus it can be argued that MFN does not apply to the mere offer of certain consultation procedures to foreign nations.<sup>51</sup>

The tough question has to do with the Countervailing Duty Code, and particularly with the code requirement that importing nations extend an "injury test"<sup>52</sup> so that imports found to be subsidized will not be subject to countervailing duties unless they are found also to be "injuring" the competing industry of the importing country. Although there are some arguments to the contrary, this particular code benefit appears to be the type of treatment of imports contemplated by the MFN language of GATT. Thus, when the United States denies the injury test to subsidized imports from countries who do not apply the code discipline, it arguably violates GATT Article I.

A definitive solution to this problem has not yet been formulated. In a complaint brought in GATT in 1981, India raised this issue after the United States refused an injury test for certain industrial fasteners imported from India. A GATT panel was appointed,<sup>53</sup> but before the panel got into the substance of the case, the United States and India came to a settlement agreement, which seemed to satisfy India.

## 6.6 MFN, Bilateralism, and Possible Trends: Some Conclusions

During the last decade, United States policymakers have been seriously tempted to use bilateral approaches to trade relations.

One of the earliest post-1945 departures from MFN by the United States was its exclusion of communist countries from such treatment in 1951.<sup>54</sup> During the 1960s, however, the United States began a series of moves that related to its more traditional trading partners, with the development and 1965 implementation of the U.S.-Canada Automotive Products Agreement.<sup>55</sup> The United States obtained a GATT waiver from its MFN obligations for this agreement, and there was at least some comment at the time that the agreement and waiver efforts helped

undermine United States advocacy of MFN and multilateralism in connection with other GATT exercises such as GSP.<sup>56</sup>

Despite the various U.S. reservations and hesitations about GATT and some of its rules (chronicled in other chapters),<sup>57</sup> in general the United States has been a strong supporter both of the principles of multilateralism and of nondiscrimination as embodied in the unconditional MFN clause of GATT. These were pillars of United States policy during the drafting and formative years of the GATT. Through the 1960s, for example, the United States continued to express skepticism and hostility toward the proposal of developing countries to carve out an exception to MFN so as to allow a "generalized system of preferences" to provide particularly favorable conditions of trade for developing country exports. The United States was the last major industrialized country to implement the GSP policy, which had been called for by the international and multilateral institutions, including the GATT.<sup>58</sup>

Likewise, although the United States had tolerated and perhaps even favored the formation of the European Economic Community, partly for broad strategic reasons the United States found itself well into the 1970s increasingly skeptical about the benefits and directions of that and other regional trade groups in international trade. The United States particularly viewed the series of agreements between the European Community and about four dozen developing countries in the world, the so-called "Lomé Conventions" and their predecessors, as departing from MFN principles of GATT. The Congress specified certain conditions regarding this convention in its 1974 legislation, refusing to extend GSP benefits to developing countries who afforded preferential treatment to developed countries (so-called "reverse preferences").<sup>59</sup>

In the Tokyo Round (1973–1979), the United States also took some steps that departed from unconditional MFN. The Congress mandated in the 1974 Trade Act that the United States try to offset the "free-rider" problem, at least of industrial countries, by withholding MFN treatment from certain countries if they did not provide reciprocal advantages in the results of a negotiation. In addition, as we have seen, the United States has refused to give unconditional MFN status to all GATT members in connection with the obligations of three of the Tokyo Round codes.<sup>60</sup> Clearly, however, the United States was again concerned about the "free-rider" problem, and the need to provide an incentive for countries to enter into the discipline of the codes.

More recently, one of the most visible and acrimonious trade relationships has become that of the United States and Japan. The United States



has essentially dealt with this on a bilateral level, rarely going to a multilateral forum, possibly partly because it has distrusted the effectiveness of that forum. At the end of the Tokyo Round, the United States entered into bilateral negotiations with Japan for additional and special concessions under the Government Procurement Code, for purchases by the Japanese telephone company, NTT.<sup>61</sup> Subsequently, United States and Japan bilateral meetings have occurred frequently, and certain institutional mechanisms have been set up to try to ameliorate their problems.<sup>62</sup> Europe also has had similar difficulties with Japan. Yet there does not seem to be an inclination on the part of either the United States or Europe, or for that matter Japan, to focus these troubled bilateral relationships in the multilateral forum of GATT, although some specific cases and representations have been made in GATT about the "Japan problem."<sup>63</sup>

From the beginning of the Reagan administration in 1981, statements by the United States Trade Representative and his deputies hinted at a willingness of the administration to consider the potential of bilateral actions, at least where multilateral activities seemed ineffective. For example, in November 1985, Ambassador Yeutter said:

We simply cannot afford to have a handful of nations with less than 5 percent of world trade dictating the international trading destiny of nations which conduct 95 percent or more of international commerce in this world. . . .

We would still like to go the GATT route with a new round. . . . That is the preferred course of action; but if those discussions bog down in Geneva two weeks from now to where it becomes evident that a new GATT round is not likely to occur, or simply could not occur with those issues included, then we would prefer to pass on a GATT round. In our judgment, this is not a negotiable issue. Services, in particular, must be in the Round or we are just not going to have a new GATT round from the U.S. standpoint; and we will have to confront those issues in a different way — plurilaterally or multilaterally.<sup>64</sup>

President Reagan reiterated this tough stance of the U.S. Administration:

To reduce the impediments to free markets, we will accelerate our efforts to launch a new GATT negotiating round with our trading partners, and we hope that the GATT members will see fit to reduce barriers for trade in agricultural products, services, technologies, investments and in mature industries. We will seek effective dispute-settlement techniques in these areas. But if these negotiations are not initiated or if insignificant progress is made, I am instructing our trade negotiators to explore regional and bilateral agreements with other nations.<sup>65</sup>

More recently, additional statements by high administration officials have hinted at a growing impatience on the part of the United States with multilateral approaches.<sup>66</sup> Congressional efforts to promote reciprocity also seemed to tilt away from multilateralism towards bilateralism in many respects.<sup>67</sup>

Even when ostensibly carrying out an MFN policy, sometimes an examination "beneath the skin" detects a strong bilateral effect. For example, in the escape clause case on motorcycles, the quotas that were actually implemented seem to affect Japan, but very few other countries.<sup>68</sup> Likewise, during the massive group of antidumping and countervailing-duty cases on steel brought in 1982, the United States found it convenient to negotiate extensively with the EC. In many ways, the EC and the United States bypassed the GATT in working out their conflicts in the context of that series of cases.<sup>69</sup>

In 1983, the United States proposed and subsequently implemented a preference for Caribbean basin nations.<sup>70</sup> Some suggested that this may have represented a major watershed in United States policy, although it was not particularly noticed to be such at the time. Later, a bilateral free trade area was negotiated and implemented with Israel.<sup>71</sup> Subsequently, a free trade agreement between the United States and Canada was completed.<sup>72</sup> Other such possibilities have been mentioned, such as Mexico (or more broadly, a North American FTA), Japan or ASEAN countries, although there seems to be considerable resistance to those possibilities.<sup>73</sup>

In sum, the inconsistent history of U.S. policy makes it difficult to forecast its future, but there are ample situations which have occurred, particularly during the last decade, that suggest the possibility that the United States has gradually moved away from its earlier adamant support of MFN and multilateralism, toward a more "pragmatic" (some might say "*ad hoc*") approach, of dealing with trading partners on a bilateral basis, and of "rewarding friends."