

THE MOST FAVORED NATION CLAUSE AND ITS POLITICS: IN RELATION TO INDIA AND PAKISTAN

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Abstract–

The partition of 1947 not only had political and social repercussions; it also significantly affected the economic relationship between both the countries. Trade between both these countries had come to a standstill. Thereafter, trade between the two nations has always been influenced by political factors. India and Pakistan are both members of WTO (World Trade Organization) and are signatories to GATT (General Agreement on Trade and Tariffs). Most Favored Nation (MFN) Principle is the central pillar of GATT is embedded under Article I of GATT. This principle is based on the age old concept of reciprocity and non- discrimination. In 1996 India granted MFN status to Pakistan thereby putting Pakistan on the same pedestal as the other countries with respect to trade quotient. But Pakistan has still not reciprocated this gesture. What are the various political factors playing a crucial role with respect to granting of the MFN status? What are the arguments put forth for not granting such status? What are the advantages that can be gained by granting MFN status? Can both these countries separate their political considerations and economic issues to fulfill their obligations under GATT? These are some of the key issues discussed in the paper.

Key Words – MFN, GATT, WTO, India, Pakistan

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“I sincerely hope that they (India) will be friendly and cordial. We have a great deal to do and think that we can be of use to each other and to the world.”

- Muhammad Ali Jinnah

In the nineteenth century industrialization had been taking hold in several countries; it generated an intensified search for foreign markets and sources of supply. Governments were faced with calls for lower tariff barriers on imported inputs and to negotiate reductions in tariffs protecting foreign markets. But in a nationalistic world of vying states – as it still is today – governments were not about to ease access to their markets in the absence of some quid pro quo.

The way forward has been found in the adoption of two instruments of policy – reciprocity and non discrimination- which had set off a wave of trade liberalization. These two ideas had enabled countries to surmount their innate distrust of each other and to engage in mutually beneficial and generalized reductions in tariff barriers. Neither of these ideas was a sudden intellectual invention; they had been long known to guide the human affairs. Their application to trade had been comparatively new and has done much to advance global trade liberalization.

Reciprocity– an age old concept

The signing of the Anglo- French Treaty of 1860 serves as the landmark that signaled the new era of trade relations. The immediate cause for signing the treaty had been a decision by the French government to follow Britain’s policy of trade liberalization that had been introduced following the repeal of the British Corn Laws in 1840. In undertaking to reduce tariffs on British manufacturers, the French government had sought some concession from Britain in order to win the support of its export tariffs in getting the lower tariffs passed through the Parliament.

Britain had already nailed the flag of free trade to its mast- and had firmly, but exceptionally, believed that others in their own interests should also reduce their tariffs unilaterally – it had accommodated the French political need. The European countries had anxiously sought comparable access to the French market; France had offered the same tariff rates that it had set for Britain. Therefore, the inclusion of such a most- favored nation (MFN) clause in commercial treaties had become common practice among the European states.

The New Era of the General Agreement on Tariffs and Trade (GATT)

During World War I the European powers formed many alliances, including trade alliances, and it was felt by that these alliances were a major cause of war. As a result, in the aftermath of the war, many countries recognized the important role equal treatment in trade relations could play in more peace and security generally.

It was discussed during the League of Nation economic and financial conferences in the 1920's and the 1930's. It was during this period that equal treatment was gaining a dominant approach. But it could not be materialized substantially due to the outbreak of World War II.

Following World War II, which ended in 1945, the United States had launched its grand design to establish an orderly multilateral framework for international monetary, financial, and trade relations. The idea of non-discrimination and reciprocity had become the central to global arrangements for trade.

This led to the birth of General Agreement on Tariffs and Trade, 1947. The primary objective of GATT, 1947 was to expand international trade by liberating trade so as to bring about all round economic prosperity. Including the inception round of GATT, eight rounds of negotiations were held. The final round at Uruguay was concluded on 15th April 1994 and 128 States signed its final Act at Marrakech, Morocco.

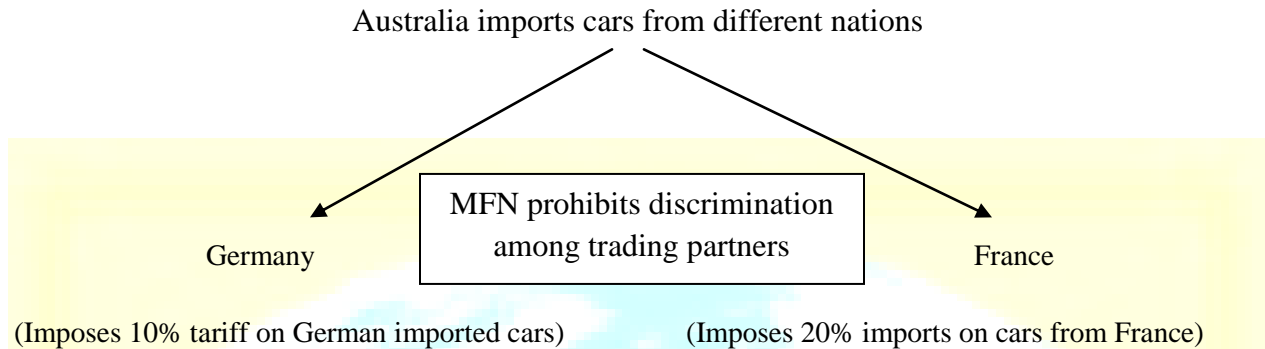
Most Favored- Nation – Central Pillar of GATT

The idea of MFN has been embedded in Article I of GATT. It is the cornerstone of both GATT, 1994 and the WTO. Even though the MFN treatment could be dated back to the 14th century, it was given the status of a highly lofty ideal and complexity in GATT, 1947. The techniques of interpretation from GATT 1947 up to 1994 have been varied and sometimes complex but the basic strand of MFN treatment continues to be the guiding principle determining the obligations of the contracting parties.

The MFN principle is one of the oldest and most important legal obligations in the area of international economic law. The MFN principle means that a country must treat other countries at least as well as it treats the 'most favored country'. 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.

Illustration –



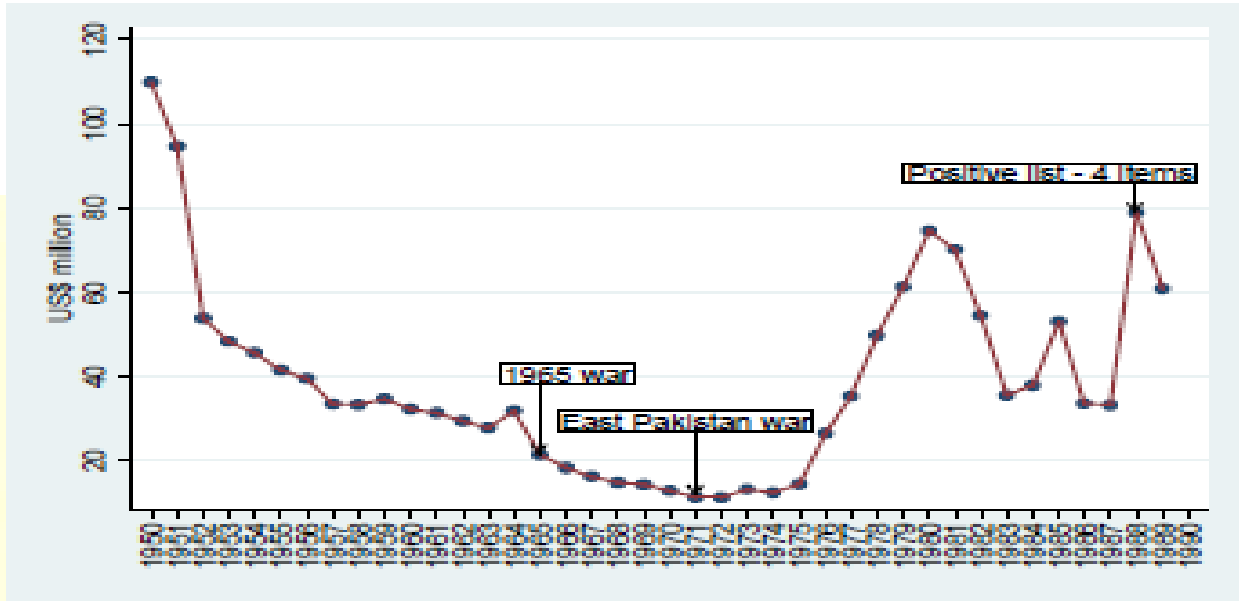
Thus, a key aspect of the principle is a prohibition on discrimination among trading partners. The result of a nation being beneficiary of an MFN clause is that the nation can comb all of the treaties and all of the actual treatment of the granting nation, to see if some obligation or real treatment is more favorable than that granted to it- in which case the beneficiary can argue that such better treatment is owed to it. India on the 8th July 1948 and Pakistan 30th July 1948 became signatories to GATT, thereby agreeing to bind themselves by various obligations laid under it.

India and Pakistan's Trade Relationship

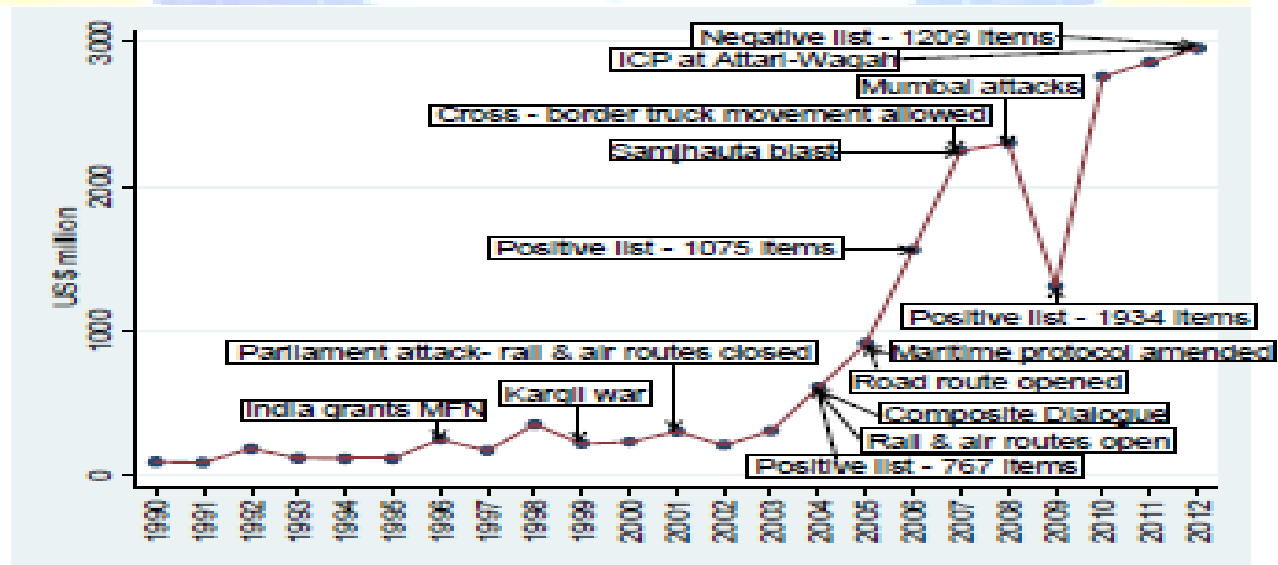
In 1947 when Pakistan separated from India and became a sovereign state, not only it did affect the political stability, it also had an adverse impact on its trade relationship. Trade between the two countries never had a smooth ride in the past. Bilateral trade always faced a series of bottlenecks, cascaded mostly by political tension and rivalry. After the 1965 war trade between them came to a standstill for almost nine years. Thereafter in the year 1974 there was a protocol to recommence trade on an agreed list of items. In 2001, India blocked its air and land routes due to the attack on Indian Parliament.(See Fig 2 for comparison of mode wise trade in the years 1995-96 and 2011-12). After 26/11 the trade quotient between them deteriorated to an awful extent. Again in 2013 due to the cross border firing incident trader was stopped completely, but it resumed within a few days. At present, the formal bilateral trade is USD 2.5 to 3 billion, while informal trade via third country i.e., Dubai is estimated to be at USD 10 million.

Figure 1 – Events influencing India- Pakistan Trade

1.1 From 1950 to 1990

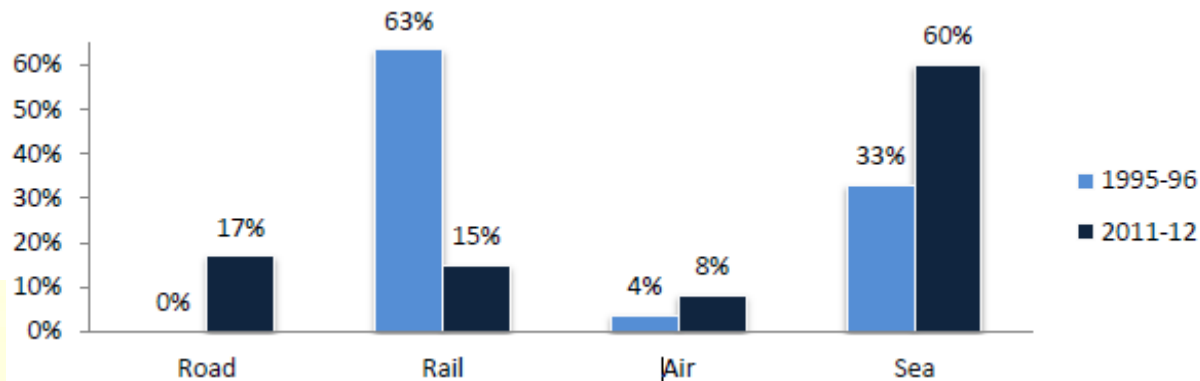


1.2 From 1990 to 2012



Source for both the figures - The World Bank Poverty Reduction and Economic Development Network Economic Policy and Debt Unit, Policy Research Paper

Figure 2 –Mode Wise Trade Total Trade between India and Pakistan



Source: Directorate General of Foreign Trade: Ministry of Commerce India

“Political” Side of MFN Policy

In 1996, India granted the MFN status to Pakistan and in doing so it has put Pakistan on the same pedestal as the other countries. Now, Pakistan is at par with the other countries and can avail the same opportunities in the trading regime with respect to India. Pakistan since the past nearly two decades has not granted India the MFN status. Pakistan, on the other hand, continued to allow imports of a limited number of items from India, collectively known as the positive list; although the number of items on the list has increased gradually (1,946 items). The grant of MFN was linked to the resolution on the Kashmir issue.

India and Pakistan are both members of SAARC (South Asian Association for Regional Cooperation) and both of them have also signed and ratified SAFTA (South Asian Free Trade Agreement) in 2004. Under SAFTA and under all other regional agreements under the WTO members must offer MFN treatment to each other, but in spite of this clause Pakistan did not accord India the MFN status and continued to trade on the positive list. In April 2011 talks commenced and a blueprint was drawn to promote bilateral trade “to build confidence, dispel misunderstandings and allay misapprehensions”. The most important aspect around which the talk revolved was Pakistan granting MFN status to India.

Sequencing and Time Line of Granting MFN to India

In November 2011 India and Pakistan issued a joint statement indicating the time line for full phasing of MFN status to India.

- First Phase - Pakistan would proceed from the positive list to a negative list specifying banned instead of the permitted items. In March 2012 Pakistan made the change and progressed towards a negative list with 1, 209 items.
- Second Phase – The negative list would be phased out; overall as well as for the road route on which trade takes place for only a fraction of items on positive list. Pakistan continued to restrict road-based trade by allowing only 137 items to be imported from India via road; while India took a number of steps to address Non Tariff Barriers (NTB's).
- Third Phase – In September 2012, both the countries agreed to intensify the special arrangements under SAFTA with India proposing concessions to Pakistan in exchange for Pakistan granting MFN status to India. India cut back its sensitive list to 614 items.

In July 2013 India agreed to bring the items under the Sensitive List to 100 items and Pakistan would reciprocate the same by granting MFN status to India and also phasing out of negative lists. On the 28th of August 2013 amidst the mounting the tension between India and Pakistan, the World Bank directed Pakistan to grant MFN status to India. On the 8th of September 2013 Pakistan assured the International Monetary Fund (IMF) that it shall grant the MFN status to India and shall also eliminate the negative trade list with New Delhi.

Latest Position - On the 26th January 2014 Pakistan has state that it is willing to grant the MFN status to India from next month provided India announces lower duties on 300 Pakistani items. Pakistan has said that it was unable to grant the status till date due to domestic factors but it has expressed its willingness to grant the status soon enough before India goes for the 2014 elections.

Advantages by granting MFN status

There are numerous arguments that can be stated in favor of granting MFN status to India. By providing MFN status Pakistan can access the Indian market without any reservations, and using the advantage of freight could market its goods at least in Northern India at highly competitive

rates. Raw materials could be cheaply imported from India instead of far off developed countries. Pakistan has normal trade with US, Canada, EU, Japan etc. on almost all items. If Pakistan can compete with these developed countries goods then it shall be easy to compete with the Indian goods.

The consumers can benefit from cheaper India products. Example: Glaxo Medicine cost Rs.7.20/- for 10 tablets in India whereas in Pakistan it costs Rs.80/- for 10 tablets. A similar comparison can be made between automobiles and various other identical products. All of them point towards the same thing: the entrepreneur in Pakistan faces less competition and this may affect the consumers and the government directly.

The argument given for not granting MFN status to India is that in doing so the Pakistani markets will be flooded with Indian commodities and the Pakistani domestic producers shall not be able to withstand such immense pressure. At this juncture, it needs to be reminded that under the WTO provisions Pakistan can take adequate measures to protect its local market from cheap imports. Article XIX of GATT provides that where, as a result of tariff reductions, a country finds that a product is being imported “in such increased quantities and under such conditions as to cause or threaten serious injury to domestic producers” it can impose safeguard measures to restrict such imports for temporary periods.

Conclusion

At present these ongoing efforts symbolize the hand of friendship both these countries want to extend towards each other. There is still a slight hitch in materializing the grant of MFN status as any small or major political or security mishap between these countries could bring these efforts to a standstill. The key challenge for both sides will be to find a way, and the political will, to insulate their progress on economic issues from the political and security challenges they will almost certainly face in the future.

Both the countries should adopt a positive outlook with respect to trade cooperation. Trade and politics should be separated from each other. If they are able to do so, the practical steps now underway could lead to transformational benefits for both countries and the entire South Asia region.

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