# Why the most-favoured nation principle matters for business

In today's interconnected global economy, understanding the rules that govern international trade is essential for businesses of all sizes. One of the most fundamental yet frequently misunderstood concepts is the most-favoured nation (MFN) principle.

This document explains what MFN means in practical terms and why it matters for business operations (whether the business exports or not).

## What is the most-favoured nation (MFN) principle?

The MFN principle is a fundamental rule of the World Trade Organization (WTO) that ensures countries do not discriminate between their trading partners. If a WTO member grants favourable trading terms—like lower tariffs—to one country, it must extend the same benefits to all other WTO members. This promotes equality and fairness in international trade. Over 80% of global merchandise trade is conducted on MFN terms, underscoring its pivotal role in promoting stability and fairness in the global trading environment.

## Why does the MFN principle matter for businesses?

The MFN principle provides businesses with a stable and predictable trading environment. Businesses worldwide—from multinational enterprises to small- and medium-sized companies—rely on the consistent application of MFN treatment to maintain competitive access to global markets. This principle, together with the legal binding of stable levels of tariffs, directly impacts operational planning, investment decisions, and supply chain management across all sectors of the global economy.

**Example:** Imagine a small company exporting handcrafted furniture. Without MFN, it might face a 15% tariff in one market while its competitor from another country faces only 5% for similar products. The MFN obligation ensures that once the importing country gives that 5% rate to any one country, all other WTO members get the same benefit automatically (except where a 5% tariff is granted under a free trade agreement, see below). This predictability helps businesses price their products competitively and plan with confidence.

## How does the MFN principle benefit businesses that do not export?

Even businesses that operate solely within domestic markets benefit from the MFN principle. Access to a variety of imported goods and services at competitive prices allows companies to source quality inputs, machinery, and technology, enhancing their efficiency and competitiveness.

**Example:** Consider a local bakery that uses imported cocoa, vanilla, and specialised baking equipment. The MFN principle ensures these ingredients and tools are available at consistent and competitive prices because the same tariffs apply to imports from all WTO countries. If the country where the bakery is located suddenly raised tariffs on chocolate from just one supplier nation, the cost of ingredients would become unpredictable, making it harder to maintain stable prices for customers and likely forcing price increases. Ultimately, this may lead to disruption of supply if the supplier nation diverts its exports elsewhere.

## Can countries still negotiate special trade deals despite the MFN principle?

Yes, while WTO rules promote non-discrimination, they allow exceptions to the MFN obligation:

- **Free trade agreements (FTAs) and customs unions:** Countries can enter into FTAs and customs unions, granting each other preferential treatment for trade in goods and services. For instance, Canada's FTA with South Korea eliminates tariffs on many Canadian goods entering the Korean market, giving them an advantage over goods from countries without such an agreement. To benefit from the MFN exception, according to the WTO rulebook, FTAs and customs unions must meet certain conditions (e.g. parties to such agreements must eliminate tariffs and other restrictions of commerce on *substantially all trade* with an FTA or a customs union).
- **Developing country preferences:** Developed nations can offer reduced tariffs to products from developing countries to support their economic growth. For instance, a garment manufacturer in a developing nation might benefit from lower or zero tariffs when exporting to wealthier markets, helping create jobs and support economic development.

**Figure 1: The relationship between reciprocal and retaliatory tariffs and the most-favoured nation principle**

| Type of tariff | Simple explanation | MFN compatibility |
|---|---|---|
| **Reciprocal tariffs** | "We'll charge you what you charge us" approach where countries match each other's tariff levels | Violates MFN obligation if applied selectively to specific countries<br>Also, illegal if exceeding WTO bound rates (maximum tariff ceilings, which cannot be exceeded without compensating affected parties) |
| **Retaliatory tariffs** | Punitive tariffs imposed in response to another country's actions | MFN-compliant only when authorised through WTO dispute settlement or applied as temporary safeguards under strict WTO conditions |

Source: ICC (2025), Why the most-favoured nation principle matters for business

In practice, these categories often blur together. A country might impose tariffs that are both reciprocal (matching the same rates on the same products) and retaliatory (designed to punish the trading partner) simultaneously. What begins as reciprocal tariffs on one sector can expand into clearly retaliatory measures targeting politically sensitive industries. Governments frequently frame retaliatory actions as reciprocal measures to make them seem more reasonable, claiming to create a "level playing field" even when their primary intent is to inflict economic pressure.

## What happens when the MFN principle is ignored in favour of “reciprocal” tariffs?

When countries abandon the MFN principle in favour of reciprocal tariffs—where they unilaterally match the tariffs imposed by their trading partners—several harmful policy implications may emerge.

The application of unilateral tariff increases can have a chilling effect on foreign direct investment as companies grow hesitant to commit capital amid unpredictable trade conditions. Domestic industries simultaneously lose critical efficiency gains when forced to source inputs from less competitive suppliers, directly undermining their global competitiveness. Consumer prices may rise as tariff costs and higher production expenses contribute to inflation throughout the economy. The combined effect of reduced investment, higher costs, and market inefficiencies typically slows economic growth. Job markets face disruption as employment gains in protected sectors are outweighed by losses in export industries and sectors dependent on imported inputs.

The use of reciprocal tariffs also constitutes a fundamental violation of the core principles and obligations of the multilateral trading system. For example, if country A imposes a 25% tariff on steel from country B, and country B responds with the same tariff on steel from country A, both countries are creating conditions where they treat each other worse than their other trading partners. This selective application directly violates the MFN obligation, which requires that a trade advantage given to one country must be extended to all WTO members.

As these reciprocal measures multiply between different trading partners, the global trading system risks fragmenting into a complex web of bilateral arrangements with different rules for different countries. Companies inevitably then face mounting complexity in navigating varying tariff rates, supply chains get disrupted or broken, and the predictable trading environment that the MFN principle was designed to create is replaced by widespread market uncertainty.

## How do WTO-authorised retaliatory tariffs work within the MFN framework, and why are they considered a legitimate exception to the MFN principle?

Retaliatory tariffs, when properly authorised through the WTO dispute settlement system, represent a legitimate exception to the MFN principle. When a WTO panel determines that a country has violated its trade commitments and fails to bring its measures into compliance, the affected country may be authorised to suspend concessions or other obligations. This sanctioned retaliation allows the imposition of tariffs that would otherwise violate MFN obligations.

This exception exists as an enforcement mechanism to maintain the integrity of the overall system. Without this ability to retaliate under authorised circumstances, countries would have little recourse when faced with persistent violations by trading partners. Under WTO rules, retaliatory measures must be proportionate to the harm caused by the original violation.

Importantly, authorised retaliation does not apply on an MFN basis—it is directed exclusively against the violating country, allowing the affected member to impose costs only on the violator while intentionally sparing other WTO members. This targeted approach prevents a damaging chain reaction where multiple countries would be forced to withdraw their own concessions (i.e., trade benefits previously granted) in response.

By channelling retaliation through a rules-based process with multilateral oversight, the WTO preserves predictability and prevents uncontrolled escalation of trade disputes. This structured approach to retaliation actually reinforces the MFN system by providing consequences for violations while discouraging unauthorised unilateral actions that would more severely undermine the multilateral trading framework.

## How does the MFN principle impact consumers?

While the MFN principle is often discussed in terms of businesses, it also directly affects consumers. If the MFN principle is weakened, prices for everyday goods could rise as imported products face higher tariffs.

**For example:** A smartphone that contains components from multiple countries could become significantly more expensive if selective tariffs were applied to certain suppliers. Choice and availability of products could shrink as trade restrictions reduce competition. Economic instability could increase as disrupted trade flows impact jobs and industries that depend on global commerce.

In short, the MFN principle helps keep costs low and ensures a wide variety of products remain accessible to consumers.

## Does the MFN principle prevent trade imbalances?

No, the MFN principle focuses on equal treatment in trade policies but does not address the underlying causes of trade imbalances, such as differences in savings rates, investment flows, and economic structures. Trade balances are influenced by a complex mix of factors beyond tariff policies.

**For illustration:** Consider two countries with equal MFN tariffs. One may still export far more than it imports if it has comparative advantages like lower production costs, specialised expertise, or products that are in high demand. The MFN principle ensures the rules are fair, but other economic factors determine the actual trade flows.

## What are common misconceptions about the MFN principle?

- **“The MFN principle means best treatment”** → The MFN principle ensures **equal treatment**, regardless of the level at which the rate is set. Countries may impose tariffs but must apply them consistently to all WTO members (and those tariffs must not exceed the bound rates).
- **“The MFN principle removes all tariffs”** → No, the MFN principle simply ensures that **tariffs are applied fairly across all trading partners**. Individual countries can still maintain tariffs at their chosen levels.
- **“Countries can freely set tariffs outside the MFN principle”** → While countries can negotiate exceptions (such as FTAs), they cannot unilaterally impose selective tariffs without violating WTO rules. For instance, a country cannot arbitrarily charge a 5% tariff on televisions from one WTO member while charging 15% for identical televisions from another without a specific exception like an FTA.

## How has the MFN principle evolved over time?

The MFN principle has roots dating back to 17th century trade agreements, but became globally significant with the General Agreement on Tariffs and Trade (GATT) in 1947, the precursor to the WTO. Understanding this evolution helps businesses appreciate why the MFN principle remains central to international trade policy today, despite periodic challenges to multilateral trade frameworks.

## How do digital trade and services fit into the MFN principle?

While the MFN principle originated with merchandise trade, it equally applies to digital products and services under WTO agreements. For businesses in sectors like software development, consulting or e-commerce, the MFN principle ensures non-discriminatory treatment of digital services across borders. As digital trade grows, the MFN principle becomes increasingly important for maintaining open access to global digital markets.

## Bottom line

A rules-based global trading system with the MFN principle at its core provides the stability and predictability that businesses require for strategic planning, investment decisions, and day-to-day operations.

Without the MFN principle, businesses face increased complexity and compliance costs, unpredictable market access conditions, potential supply chain disruptions, barriers to competitive positioning, and heightened vulnerability to trade disputes. For small- and medium-sized enterprises, the preservation of the MFN principle may, in many cases, represent nothing less than the difference between viable participation in global trade and exclusion from international markets.

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